



Epeus | project advisors
& specialists

Planning for Project Success

Conflicts of Interest

Dealing with Conflicts of Interest in Turnkey Solutions

Cost control is a key to project success. Yet, a threat to cost control that often goes unrecognised has become prevalent in the oil and gas industry – a key supplier’s conflict of interest. This type of conflict exists whenever a supplier advises on project strategy and could benefit by that very advice by supplying other types of goods or services at other stages of the project.

When a key supplier has a conflict of interest, the project owner’s costs are likely to increase on the project with no corresponding benefit. Accordingly, even aside from moral or ethical issues, an effective cost control requires

1. Elimination of conflicts of interest and
2. Mitigation of conflicts that are unavoidable.

Supplier conflicts of interest can and have developed in a number of ways. This article focuses on the types of conflicts that arise from “turnkey solutions”. These can range from advice given by a project consulting firm that is part of a larger integrated construction company to the situation where an outside project execution

manager makes recommendations for resources needed to complete project execution, which happen to include his or her friends from past projects. Although the incentives are different, both situations can result in the project owner’s loss of opportunity to secure the best available resources and ultimately in bearing unnecessary costs for the project.

The Contractor as Manager

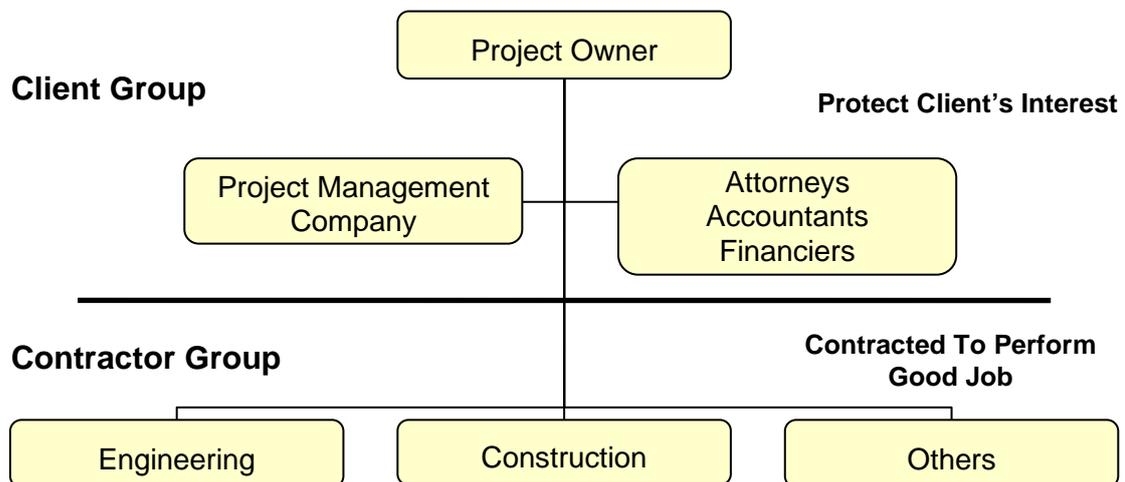
Many traditional engineering and construction firms in recent years have announced moves into “project management”. This means that the same company providing project management services will likely provide some combination of design engineering, fabrication, and construction services on the same project. Rather than protecting the client’s interest, the project management arm in such a venture will likely protect first its own corporate interests.

A project owner should expect its project management company to protect the project owner’s interests, much as its attorneys, accountants, and bankers. The ideal relationship is shown in the figure below:



Planning for Project Success

Conflicts of Interest



This structure, however, is not the expectation for the contractor group. The contractual standard for a contractor is generally to perform “in a good and workmanlike manner,” or some similar rubric, not as a fiduciary of the project owner’s interest. When a company in the contractor group takes on the role of a project management company, the real world distinctions are confused, often with results that are not beneficial to the project owner.

The Vertically-Integrated EPC Contractor

In recent years, some contracting firms have also sought to provide turnkey solutions for their clients’ oil and gas industry projects by, among other things, acquiring independent boutique consultancies. Project owners, however, may have previously come to rely on the expertise and

advice of these formerly independent consultancies, and their integration into EPC contractors raises real conflict of interest issues.

For example, in the case of an independent consulting firm whose business is to assist project owners in the planning stages of a project, the incentive is to find the best resources for project execution based on the client’s cost, schedule, and quality parameters. This kind of recommendation enhances the likelihood of overall project success and repeat business for the independent consultancy.

If that same consultancy is acquired by an EPC contractor, however, the incentives change. The acquiring party typically expects “synergies” from such an acquisition, which among other things include enhanced profits throughout the organisation. Advance-



Epeus | project advisors
& specialists

Planning for Project Success

Conflicts of Interest

ment opportunities or even continued employment for personnel of the formerly independent firm depends upon delivering what is expected by the acquiring company.

A project owner would likely not approve a similar relationship among its attorneys, investment bankers, and auditors or, if in insolvency, its administrators. Yet presumably, the EPC firms have acquired formerly independent consulting firms at least partially because of client expressions of interest in a “total solution”. The only possible conclusions are (1) the owners have considered the conflict issues and are dealing with them in ways discussed below in this paper, or (2) the owners have not considered the issues and are open to a substantial risk of abuse of trust by the contractor.

The abuse of trust can include a recommendation of sister companies for the execution work, as well as project “oversight” that entails reviewing the work of those companies. Uncovering any such abuse is difficult at best after the fact, since an unscrupulous company can take advantage and even alter records of work done and project audits.

The Manpower Agency

A similar issue comes up when the project owner retains an outside project manager from an agency that

also provides personnel for other project execution positions. This practice has been around longer than the integrated EPC contractor and has been used often. The owners, however, may or may not have recognised the potential for conflicts.

A statistic that is often cited is that 6 out of 10 projects fail. Whether actually true or not and regardless of the parameters on which the project may have “failed,” many of the failed projects have been managed by an outside project manager who hires his or her friends to fill various jobs on the project execution. When the project owner accepts these recommendations on a wholesale basis, it has apparently given little or no thought as to whether it will obtain the best available resources for project success.

How To Deal with Potential Conflicts

A conflict of interest can therefore arise from any situation in which close advisors to the project owner organisation are in a position to recommend using related corporate entities or resources on other aspects of a project.

Obviously, the best solution from the project owner’s viewpoint would be to eliminate completely potential conflict situations. In rare instances, however, a conflict is unavoidable because of



Epeus | project advisors
& specialists

Planning for Project Success

Conflicts of Interest

the nature of the goods or services offered. Even when the conflict is avoidable, resistance to a complete ban can come from both inside and outside the organisation: “This is the way we have always done business” or “Joe’s my mate, he’d never do THAT”.

Conflicts of interest are not unique to projects in the oil and gas industry. For example, the potential for conflicts of interest exist in large accounting firms that both advise and audit companies, the hotel management industry, and doctor ownership of medical clinics, to name a few. Project owners in the oil and gas industry can learn lessons for dealing with the potential conflicts of interest from these other industry situations.

Dealing with potential conflicts of interest by contract is only part of the solution. A simple paragraph in a contract that prohibits conflicts will do almost nothing to prevent recommendations, which when viewed later, could be seen as a conflict situation.

On the other hand, one company has gone so far as to publish its standard contract in which a company that provides services on one part of project is prohibited along with its corporate affiliates from providing services not only on any other part of the same project but also or for any other project for the owner for a specified period. While such a

provision may be seen as extreme, it demonstrates the degree of determination of some project owners to control costs.

Some less intense measures would seem to suffice in most situations. The first step in dealing with potential conflicts is to instil a culture of zero-tolerance of avoidable conflicts of interest. Some organisations have conveyed this to their personnel and contractor, but many have not. This is a long-term process and includes development of written policies, as well as an intake and ongoing training program.

The second step is to identify potential conflicts. The project owner should ask any advisor on project strategy to identify in writing its corporate affiliates and the products and services offered by those affiliates. Then the project owner can make an informed evaluation of the recommendations made by the advisor or consultant as to whether a conflict exists.

Conclusion

As it turns out, therefore, solving one problem – the desire for turnkey solutions – leads to other serious issues. In the end, the only effective substitute for strong in-house management of outside contractors is retention of a truly independent firm whose personnel recognise the



Èpeus | project advisors
& specialists

Planning for Project Success

Conflicts of Interest

necessity for independent judgment and that pledges to such oversight to a project owner.

Èpeus is dedicated solely to protecting its client's interests. Èpeus professionals have consulted on a number of projects and maintain a knowledge base of lessons learned of the things that have gone well and that have not gone as well on a project. These lessons include not only ones learned during execution, but during all phases of a project, from definition through planning, approval, execution, and commissioning.

On the other hand, Èpeus does not offer anything but project advisory and assurance services. We do not offer FEED or other engineering services

and do not offer actual construction personnel on project execution. We are therefore in a unique position to offer our clients unbiased and independent advice on contracting and project strategy in the definition and planning stages of a project, as well as during execution and commissioning.

For instance, during execution, Èpeus can at the client's direction either manage the project or audit the execution of a project carried out by another company against the project parameters set during the definition and planning stages.

Visit our [website](#) for more information about Èpeus and how we can help you achieve project success.