



EUROPEAN
INTERNATIONAL
CONTRACTORS

Annual Report 2004-2005

- **Financing**
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Greeting

"At a time when terrorism may appear as a threat to our international activities, we European contractors must proudly recall our specific contribution to bridge the gap between poor and rich countries and outline the peace-keeping character of our work. Indeed we know the relevance of sharing our construction technology, our contracting experience and our life vision with less developed areas by building infrastructure and providing basic services to the people. Even though our internal European market, which is currently growing strongly towards the East, appears increasingly safe and attractive, it remains our common responsibility to contribute to the international efforts to achieve the Millennium Development Goals aimed at ensuring a peaceful and sustainable development.

Over the past years, our organisation has become globally acknowledged for its technical publications dealing with financial, contractual and procurement issues. These high-quality documents reflect the European contractors' view on sustainable contracting. But in order to be eventually successful with our lobbying, they must be coupled with an increased effort to convince the political decision-makers in the European Union, the Multilateral Development Banks and all other relevant International Organisations that infrastructure is a key driver for economic growth and development. More international funds for reliable infrastructure are the only solution to fight effectively global poverty."

President Gian Alfonso Borromeo

Rome, 20th September 2005

ORGANISATION

European International Contractors (EIC) is registered as a legally independent association under German law in Berlin, Germany, and has as its members construction industry federations from 16 European countries, which are directly or indirectly affiliated to the European Construction Industry Federation (FIEC).

In accordance with a Protocol signed between both federations in 1984, and reaffirmed in 2002, EIC and FIEC carry out complementary tasks. Whilst FIEC represents the European construction industry in the area of

the European harmonisation and integration process, the work of EIC aims primarily at improving the operating conditions for the European construction industry on the international level. For this purpose, EIC maintains close relations with all international and other organisations whose policy is of relevance for the international construction business. For this purpose, EIC maintains close relations with all international and other organisations whose policy is of relevance for the international construction business.

In 2005, the Members of the EIC Board are the following:

Gian Alfonso Borromeo	(Astaldi)	Italy	President
Johan Beerlandt	(Besix)	Belgium	Vice-President
Per Nielsen	(NCC)	Sweden	Treasurer
Alcibiades López Cerón	(FCC)	Spain	
Ebbe Malte Iversen	(Per Aarsleff)	Denmark	
Gerrit Witzel	(Strukton Groep)	The Netherlands	
Lefty Panayiotou	(Costain)	United Kingdom	
Michel Démarre	(Colas)	France	
Norbert Hoffmann	(Bilfinger Berger)	Germany	

President Gian Alfonso Borromeo represents EIC as Vice-President on the FIEC Steering Committee. The EIC Secretariat in Berlin is managed by Frank Kehlenbach (Director) and Hasso von Pogrell (Assistant Director).

TASKS AND OBJECTIVES

EIC has the objectives

- to represent and promote the interests of the European construction industry in all matters relating to the international construction business;
- to foster the exchange of views with international and other relevant organisations in order to improve the political, financial, economic and legal environment for European international contractors; and
- to offer European contractors a unique forum for the exchange of experience in all matters relating to the international construction business.

International contracting has always involved additional risks for those European construction companies working abroad. At the beginning of the 21st century, the international construction business, including construction-related services and operation via subsidiaries and associates, poses a multitude of both challenges and opportunities. Within the broad range of operating conditions influencing the work of European international contractors abroad, the following framework conditions have been identified as priority issues for the EIC activities:

I. INTERNATIONAL FINANCING OF INFRASTRUCTURE PROJECTS

By promoting the PPP concept, EIC helps to build institutional capacity and understanding for the interaction between economic infrastructure and development, and advocates a diversification of the construction market.

Infrastructure needs are huge on a global scale and we observe funding difficulties world-wide for new construction, rehabilitation and maintenance. Whilst construction demand exceeds available funds also in much of the industrialised world and in many emerging markets, the governments in the developing world face a particular challenge in providing its people with access to quality infrastructure services. Current estimates of the World Bank point to financing needs of about 7% of GDP for all developing countries and as much as 9% of low-income countries' GDP. In Central and Eastern Europe, this figure on average is estimated at around 5% at least. By comparing the past actual investment and maintenance rates to the projected global requirements of some 465 billion US\$ over the years 2005-2010, the vast financing gap and thus the need to potentially double or triple actual financing for infrastructure becomes obvious.

At the same time, Official Development Assistance (ODA) is only beginning to recover from all time low levels. In 2003, ODA totalled almost 70 billion US\$ of which, however, less than 20% were disbursed for economic infrastructure. Admittedly, the Multilateral Development Banks (MDBs) and International Financing Institutions (IFIs), and in particular the World Bank, are revamping their infrastructure business again. And EIC may well claim to have been one of the unceasing voices to call for an "Infrastructure Action Plan" long before this new World Bank initiative was adopted and implemented. Given, however, the continuous chasm between the infrastructure needs and the conventional financial resources, both from international aid funds and national budgets, a new balance has to be found between public and private sector roles for infrastructure financing and services provision.

Current experience in many countries shows that by means of Public-Private Partnerships (PPP), the scope

for private investment in infrastructure can be enlarged by leveraging the mobilisation of additional private capital per unit of available public sector resources. Whilst the PPP concept has flourished over the past years mainly in sectors that generate adequate cash flows, such as telecom, ports, airports and natural gas pipelines, the right blend between public and private funding has yet to be determined for transport infrastructure projects, where the social acceptance of user fees is either missing or its level is not adequate to guarantee the necessary return on investment.

With the aim of providing the public sector as well as MDBs and IFIs with a user-friendly consultation document for the efficient preparation and implementation of privately developed infrastructure projects, EIC published in April 2003 the "*EIC White Book on BOT / PPP*", reflecting the broad expertise of its member companies acting as investors and concessionaires in view to the political, financial, economic and legal requirements for successful BOT/PPP models. Doing this effort, EIC developed 21 "Key recommendations" in order to improve the project environment, the project preparation, the tendering procedures, the linking of the various types and sources of financing as well as the distribution of risks between the parties involved.

As a follow-up measure, EIC participated in 2004 in the DG INTERNAL MARKET survey in connection with the Commission's "EU Green Paper on Public-Private Partnerships". We drafted a EIC Position Paper based on the recommendations of the "EIC White Book" which was submitted jointly with the FIEC Position Paper to the Commission. Concerning the procurement aspect, EIC highlighted that PPPs cannot be regulated in exactly the same way as conventional construction projects. Despite the cautious undertone of its statement, EIC generally supports the idea that the European Commission has a role to play in further improving the legal framework for PPPs in the Union. The role of the Commission should be, however, "catalytic" rather than that of a European regulator.

Other presentations of the "EIC White Book" in 2004 included the World Bank's "Regional PPP Forum in Central and Eastern Europe" in February in Prague and an OECD Workshop on "Synergies between Official Development Assistance and Foreign Direct Investment" in March in Paris. Most recently, EIC presented the "EIC White Book" at the "10th International Business Forum 2005" in New York which brought together some 150 business people from all over the world with government representatives, development practitioners and spokespeople of civil society groups in order to discuss business-driven solutions for Sustainable Development. In 2005, this Forum was a pre-conference running up to the 2005 U.N. World Summit at the headquarters in New York.

Notwithstanding the progress made in Europe and world-wide on advocating the PPP concept to the public sector, EIC still observes many prejudices and misconceptions against the PPP concept. Whilst the "EIC White Book" covers the technical aspects of PPP, we are currently drafting a political supplement which shall provide the answers to the most "*Frequently Asked Questions in PPP*". The purpose of this paper is to explain to politicians and public officials as well as to the MDBs and IFIs that PPPs can in fact provide significant added value over the results that can be obtained from conventional forms of procurement. EIC thereby endeavours to respond to certain fears and doubts of the general public and to refute some misconceptions of the PPP philosophy.

II. INTERNATIONAL TENDER PROCEDURES AND STANDARD FORMS OF CONTRACT

EIC constantly monitors the latest trends in International Competitive Bidding and Conditions of Contract in order to inform its member companies and to ensure that the respective sample documents provide for a level playing-field.

Since the publications of the FIDIC "New Red, Yellow and Silver Books" back in 1999, EIC has published *three "EIC Contractors' Guides"* to this new suite of standard contract forms. The EIC Guides are rather critical of the general tendency in the 1999 FIDIC "New Books" to burden more construction risks than in the past on the contractor. All EIC Guides have been published in the world's leading construction law magazine and are marketed and distributed not only through EIC's website, but also through FIDIC's electronic Bookshop. This is due to the fact that FIDIC itself considers the EIC Guides as a "useful checklist" to be studied when entering into a large construction project.

In 2003, FIDIC was approached by the MDBs which, under the leadership of the World Bank, are in the process of elaborating Master Procurement Documents to be used for issuing harmonised bidding documents for construction projects for which they are providing finance. At the World Bank's request, FIDIC gave its permission under a licensing agreement to incorporate a modified version of the 1999 FIDIC "New Red Book" as the standard form of contract of these harmonised procurement documents.

EIC was invited by FIDIC as a so-called "friendly reviewer" to review the amended version which was, at the outset, to become the 2nd Edition of the FIDIC "New Red Book". EIC was initially surprised about the early update of the 1999 Edition, as the 4th Edition of the former FIDIC "Red Book" (1987) is still very much in use

in Asia, Africa and Latin America. Initially, we had hoped to find at least some of the concerns which had been voiced publicly in the "Contractor's Guide to the New Red Book" to be addressed in the harmonised draft version. Quite reverse, however, upon scrutinising the "amended" version in detail, EIC realised that the modifications, in balance, swung to the other extreme and would increase the risk to contractors even further than the 1999 Edition. From an international contractor's perspective, the amended clauses dealing with the definition of "Unforeseeable", the Engineer's Authorities, the Performance Security and the Evaluation all represented a move in the wrong direction. Moreover, EIC was concerned about the increased usage of subjective terms which, in practice, lead to frictions between the parties and thus eventually to more disputes.

In the light of this worrying development, EIC drafted within a short period of time an *"EIC Position Paper on the 2nd Edition of the FIDIC "New Red Book"*. Eventually, the EIC comments contributed to a revised FIDIC policy, since FIDIC decided in April 2005 to abstain from publishing a 2nd Edition of the "New Red Book". However, FIDIC continued the collaboration with the World Bank on a harmonised version of the New Red Book. As a consequence, the so-called "MDB Harmonised Edition" was published as part of the World Bank's and the Asian Development Bank's new Standard Bidding Documents for Works in May and in August 2005. Thereupon, EIC submitted its comments under the umbrella of CICA directly to the World Bank's Procurement Department in order to bring its concerns on a higher political level. Many of the comments of both EIC and CICA were accepted in July 2005 by World Bank management staff and are now transmitted for internal discussions between the World Bank and FIDIC as well as the other MDBs and IFIs. Notwithstanding this provisional success story, drafting work on an *"EIC Contractor's Guide to the MDB Harmonised Edition of the FIDIC New Red Book"* is already underway and due to be finalised in late 2005.

Notwithstanding EIC's constant lobbying for fair international contract conditions, it has to be recognised that, as a matter of fact, European international contractors have almost ceased from bidding for infrastructure projects financed by the international donor agencies. With the aim of contributing the experience of European international contractors to the political discussion in the international development community, EIC drafted in November 2004 a new publication entitled *"EIC Blue Book on Sustainable Procurement"*. This publication, which has already been received with great interest from the MDBs and IFIs as well as the European Commission, points to the major shortcomings in the traditional procurement system and concludes that "Sustainable Procurement" cannot be based solely on the lowest construction cost, but must take into consideration in some form the operation and maintenance

cost over the project's entire life cycle. In EIC's opinion, the quality criterion, which is already a factor in the selection of consultants and services, needs to be adapted also to civil works by way of introduction of a holistic and quality-orientated project management process which is supervised by the MDBs and the European Commission over the projects entire value chain.

The EIC Position has been explained to the European Commission and the Parliament and it has been largely adopted by Europe's industry voice, UNICE. EIC is currently in contact with both the World Bank and the European Commission in order to jointly evaluate if and how quality-related aspects of construction can be integrated into their procurement systems.

III. INTERNATIONAL ARBITRATION AND ALTERNATIVE DISPUTE RESOLUTION MECHANISMS

EIC promotes the application of ADR mechanisms and International Arbitration as the preferred way of solving disputes in international construction contracts.

Another main priority for EIC in connection with tender and contract conditions is the promotion of International Arbitration and Alternative Dispute Resolution (ADR) mechanisms, such as Dispute Review and Adjudication Boards (DRB and DAB). For a number of years, internationally there were two satisfactory standard dispute settlement mechanisms available, one since 1995 in connection with World Bank projects and the another one related to projects governed by the 1999 FIDIC "New Books".

In September 2004, a third set of Dispute Board Rules was published by the International Chamber of Commerce in Paris (ICC). EIC scrutinised the various drafts in detail and voiced in *several EIC Position Papers* concerns about several provisions of the draft Rules. The most important difference of opinion between EIC and the ICC arose with the new concept of a "Combined Dispute Board" that deviates significantly from the Dispute Board arrangements introduced by the World Bank and FIDIC. In fact, it imposes more risks on both parties in terms of foreseeability of time and cost and of the final outcome, since it offers an intermediate approach between a binding DAB decision and a non-binding DRB recommendation. The final decision as to which of those alternatives will be used shall be with the Combined Dispute Board.

From the outset, EIC has warned that such a procedure is not in the best interest of the parties, since it is vital for the conduct of the Dispute Board procedure that the parties know already from the beginning whether they will obtain a non-binding Recommendation or a binding

Decision at the end of the dispute resolution process. This is particularly relevant for countries or parties which have only a limited tradition to follow Recommendations of neutral bodies. EIC has *reiterated its opposition at various international construction law conferences* and most recently in April 2005 at the Joint ICC/FIDIC Conference on "International construction contracts and dispute resolution" in Cairo. It will repeat this effort at an International Conference on Arbitration in November 2005 in Dubai. However, at the same time, EIC reaffirms that the construction industry, especially on the international level, has a special need for such alternative dispute resolution mechanisms in order to resolve construction project disputes quickly, at best promptly on the site.

IV. EXPORT CREDIT INSURANCE

EIC calls for a reasonable interpretation of the relevant multilateral agreements in order not to aggravate the competitiveness of European international contractors vis-à-vis its competitors from non-OECD countries.

Some 15 % of the projects classified in 2002 in Category A of the OECD's Recommendation on "Common Approaches on Environment and Officially Supported Export Credits", i.e. "projects with the potential to have significant adverse environmental impacts", were concentrated in the construction industry. Against this background, EIC is concerned about any additional administrative burden involved in the screening provisions stemming from the latest OECD recommendation.

In December 2003, the OECD member countries adopted an update of the "Common Approaches on Environment" to which *EIC responded with a very critical Position Paper* arguing that, given that most involvement of the export credit agencies is limited to the provision of insurance against political and commercial risks, their power to mitigate environmental, social and cultural risks is almost negligible. The same goes for the applicant itself, as the traditional construction activity is, basically, carrying out instructions on the basis of the requirements and technical criteria drawn up by clients and their consulting engineers. Thus, the ability of contractors to influence environmental aspects of construction works is constrained by the design and tender documents elaborated by third parties and, in addition, by the national legislation in force in a third country.

EIC continues to monitor the development in the OECD as a Member of BIAC, the Business and Advisory Committee to the OECD. In this function, EIC forms an important counterweight to other non-business stakeholders within the regular OECD consultations on export credit insurance.

V. ELIMINATION OF MARKET ACCESS BARRIERS IN INTERNATIONAL CONSTRUCTION

EIC co-operates with the European Commission on the task of identifying crucial market access barriers in key international markets and on trying to eliminate them.

In 2001, China agreed under its WTO accession treaty to open its market to trade and services, which gave cause for high expectations, also in the construction sector. However, since the issuance of new regulations for the construction sector by China's Ministries of Construction and of Commerce in September 2002, European international contractors are faced with new market entry barriers. Whilst the granting of the possibility for foreign construction companies to establish wholly foreign-owned enterprises (WFOE) in China was a step in the right direction, a number of provisions of the new Chinese qualification system imposed constraints that are excessive and not in line with China's GATS obligations (e.g. residency requirements, limitations on the number of foreign engineers, capital requirements). Most importantly, the new regulations eliminated the "foreign contractor" status that had been in place for many years and even before WTO accession, and under which licenses to foreign companies were awarded on a project basis. In sum, the initial Chinese grading system introduced for both WFOEs and Sino-foreign Joint Ventures was designed to de facto closing the market to most foreign contractors, since it excluded experience, assets and qualification gathered outside the Chinese market.

In an attempt to avert the most severe impact resulting from Decree 113, EIC intensified its **co-operation with the European Commission's DG TRADE** and was successful in putting off the entry into effect of the new qualification system until 01st April 2004. By maintaining pressure on the Chinese government, EIC, in collaboration with the European Commission, the European Chamber of Commerce in China and other international bodies, was able to partly convince the Chinese authorities that certain requirements of the new legislation had to be relaxed. On 06 September 2004, the Chinese Ministries of Construction and Commerce jointly promulgated a circular for the purpose "of encouraging large-scale international contractors to establish FICEs [Foreign Invested Construction Enterprises] in China". The main amendments foresee that, first, the off-shore project experience obtained by the foreign shareholders would be taken into account in evaluating its track record and, second, that registered foreign contractors would be allowed to employ foreign service providers as long as such foreign service providers possess the equivalent experience and skill sets required for Chinese technical/management personnel.

VI. RELATIONS WITH THE WORLD BANK

EIC makes use of the periodic meetings with the World Bank and other MDBs and IFIs under the umbrella of CICA as a good platform to channel the EIC Positions and concerns on the international construction practice to the international donor agencies.

In the most recent meeting on 01 and 02 December 2004, the conference discussion picked up on the topics of the November 2002 Meeting ranging from the harmonisation of the Master Procurement Documents over Performance-based Procurement and Public-Private Partnerships to Ethics Management issues. Most of the CICA presentations were inspired by European international contractors. For instance, EIC presented at this occasion the new "EIC Blue Book on Sustainable Procurement" and its critical position on the draft "MDB Edition of the FIDIC New Red Book". Moreover, EIC recalled its earlier observation that the anti-corruption policy initiated by World Bank President Wolfensohn would probably fail if it were not to address the public side of unethical behaviour. Instead of shifting all the blame unilaterally to the industry's camp, EIC proposes to introduce a Joint Code of Ethics which has to be applied by all parties to the contract, i.e. borrower/employer, engineer, contractor and subcontractors.

On 17 May 2005, EIC President Borromeo met in Berlin with the World Bank's Director of Procurement Operations Policy, Mr. Armando R. Araujo, for a discussion on the Bank's pending proposal entitled "Increasing Use of Country Systems in Procurement". Mr. Araujo clarified that an increased use of country systems in procurement had to be understood as a harmonisation of concepts rather than as a standardisation of wording. The Bank believes that if certain key clients can be convinced to use domestic procurement rules equivalent to those prescribed by the World Bank, that this might be a good incentive for other countries of the region to follow-up. However, the envisaged pilot programme will most probably not involve International Competitive Bidding for major civil works, but will rather be applied in the procurement of goods and services in the social sectors. EIC submitted its respective **Position Paper on "Country Procurement Systems"** not only to the World Bank senior management, but also to the European Executive Directors for information in order to sensitise them for its perspective.

EIC GENERAL ASSEMBLIES

The spring 2004 Generally Assembly took place for the first time in the country of EIC's "youngest" Member Federation, Turkey. EIC followed-up on the latest developments in its General Assembly that took place on 15 April 2004 in Istanbul, Turkey. The Workshop focused on the issue of **"Environmental and Social Standards in**

Export Credit Insurance and Project Finance". At the conference, experts from the Turkish Government, from private and multilateral financial institutions as well as representatives from industry associations and contractors themselves analysed the impact of the new standards on acquiring international finance for infrastructure projects in the developing world. Whilst EIC agrees with and supports the introduction of higher social and environmental standards on a global level, it calls upon all relevant European decision-makers to be vigilant that these new "soft rules" do not have a one-sided negative impact on the competitiveness of the European construction industry vis-à-vis its non-OECD competitors.

The autumn 2004 meeting of the EIC General Assembly took place on 01 October 2004 in Copenhagen, Denmark. The theme of the Workshop was **"EU Financing for Infrastructure Projects in Developing Countries"**. In the presence of the then EU Commissioner for Development, Poul Nielson, representatives from EIC and the European Commission discussed how transport infrastructure projects financed under EU surveillance could be organised in a more efficient manner.

In the General Assembly held on 22 April 2005 in Paris, France, EIC followed-up on the Copenhagen discussions and organised a Workshop on **"The Global**

Infrastructure Market – Which Role for European International Contractors?". With a record attendance of more than 80 participants, the meeting witnessed an informative exchange of opinions between representatives of the World Bank and the European Commission on the one hand and senior management executives on the other hand about the key drivers for change in the international construction business. It was concluded that, with all the technical publications in hand, EIC should continue to act as a political factor in order to shape the international rules for the international construction business of its membership.

The 2005 autumn General Assembly will take place on 07 October 2005 in Helsinki, Finland, and will examine **"The Future European Development Policy"** as well as the opportunities for European international contractors in **"The Transport Infrastructure Market in Russia"**. High-level representatives from the European Commission and national governments, including the Russian Ministry of Transport, will brief EIC member companies on the latest developments in these areas.

The 2006 General Assemblies are scheduled to take place in Basle, Switzerland, and in Valencia, Spain.

Note: More information on passages in bold italics can be downloaded from the EIC website (<http://www.eicontractors.de>)

MEMBER FEDERATIONS



Vereinigung Industrieller
Bauunternehmungen Österreichs - VIBÖ
E-Mail: office@viboe.at



Confédération Construction
E-Mail: info@confederationconstruction.be
Internet:
http://www.confederationconstruction.be



Dansk Byggeri
(Danish Construction Association)
Eksportsektionen
(Danish Contractors Working Abroad)
E-Mail: htu@danskbyggeri.dk
Internet: http://www.danskbyggeri.dk



Rakennusteollisuus RT ry
E-Mail:
markku.aaltonen@rakennusteollisuus.fi
Internet: http://www.rakennusteollisuus.fi



Syndicat des Entrepreneurs
Français Internationaux - SEFI
E-Mail: sefi@sefrance.fr
Internet: http://www.sefrance.fr



Hauptverband der Deutschen
Bauindustrie e.V.
E-Mail: Frank.Kehlenbach@bauindustrie.de
Internet: http://www.bauindustrie.de



Association Panhellénique des
Ingénieurs Diplômés
Entrepreneurs de Travaux Publics
E-Mail: info@pedmede.gr
Internet: http://www.pedmede.gr

Associazione Nazionale
Construttori Edili - ANCE
E-Mail: info@ance.it
Internet: http://www.ance.it
Associazione Imprese Generali - AGI
E-Mail: agiroma@tin.it



Samtök iðnaðarins
(Federation of Icelandic Industries)
E-Mail: mottaka@si.is
Internet: http://www.si.is



Netherlands Association of International
Contractors - NABU
E-Mail: nabu@nabu.nl
Internet: http://www.nabu.nl



Associação de Empresas de
Construção e Obras Públicas
E-Mail: aecops@aecops.pt
Internet: http://www.aecops.pt



Asociación de Empresas Constructoras
de Ambito Nacional - SEOPAN
Grupo Exportador
E-Mail: grupoexport@seopan.es
Internet: http://www.seopan.es



Sveriges Byggindustrier
E-Mail: bo.antoni@bygg.org
Internet: http://www.bygg.org



Schweizerischer Baumeisterverband
E-Mail: info@schweizer-baumeister.ch
Internet: http://www.baumeister.ch



Turkish Contractors Association - TCA
E-Mail: tgunay@tmb.org.tr
Internet: http://www.tmb.org.tr



bccb
E-Mail: rn@bccb.org.uk
Internet: http://www.bccb.org.uk



Secretariat:

- Frank Kehlenbach (Director)
- Hasso von Pogrell (Assistant Director)
- Vera Stark (Secretary)

Address:

- Kurfürstenstrasse 129
- D-10785 Berlin
- TEL +49 30 2 12 86-244
- FAX +49 30 2 12 86-285
- eicontractors@compuserve.com
- www.eicontractors.de