



EUROPEAN  
INTERNATIONAL  
CONTRACTORS

**EIC Blue Book**  
on  
**Sustainable Procurement**

**THE EIC BLUE BOOK**

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**on**  
**Sustainable Procurement**

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Kurfürstenstrasse 129

D – 10785 Berlin, Germany

Phone: ++493021286244

Fax: ++493021286285

E-mail: [eicontractors@compuserve.com](mailto:eicontractors@compuserve.com)

Web: [www.eicontractors.de](http://www.eicontractors.de)

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## FOREWORD

Throughout the 20<sup>th</sup> century, infrastructure facilities and services in the transport, energy, water and sewerage sectors provided by European international contractors have made significant contributions to the economic and social development of more than 150 countries in all continents. They have not only contributed to employment, income and taxation in the host countries, but generally enhanced the European image abroad. Through constant co-operation with local partners, suppliers and subcontractors, the transfer of technology and know-how and the training of local people, these companies have helped to create a climate for cross-cultural understanding as well as a potential for economic growth and thus made a contribution to what is nowadays labelled “sustainable development”. It is fair to say that **internationalisation and globalisation have a long tradition in the European construction industry** and, at the beginning of the 21<sup>st</sup> century, European international contractors, despite difficulties within the global business environment, **are still committed to this tradition**.

For a number of years, however, **many European international contractors have actually ceased bidding for international infrastructure projects in developing and transition countries financed by international donor agencies**, such as the Multilateral Development Banks (MDBs) and Bilateral Donor Organisations (BDOs)\*. This has not gone unnoticed by some donors who have questioned the limited interest of European companies in their multilateral infrastructure tenders. Whilst some observers assert that European construction companies are not prepared to enter into international competitive bidding any longer because of a lack of competitiveness, such conjecture is both simplistic and misconceived since a number of complex reasons underlie the poor appetite of European companies for multilateral infrastructure tenders. In hindsight, the drivers for the strategy change can be traced back to several complementary trends, which started in the 1990’s and continue today.

One important factor that emerged **in the last decade of the 20<sup>th</sup> century is the fundamental shift of MDB funding away from the infrastructure sector** to the social sectors and to structural adjustment lending programmes. During the 1990’s, the focus of MDBs switched from capital assets to so called “soft” projects, such as policy advice and institutional capacity-building, which, in reality, signified a sharp decline in multilateral infrastructure lending. Instead of funding new national road networks, mostly rehabilitation works or rural roads were financed in some instances several times, and instead of large dams, donors preferred to fund the erection of smaller barrages.

This policy shift was justified in a number of ways: one was the notion that governments of developing and transition countries had only limited capacity to implement large infrastructure investments and little or no experience of operating and maintaining new assets once built; also governments in some developing countries

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\* In order to avoid lengthy repetitions, the use of the term Multilateral Development Bank(s) or MDB(s), which also comprise the European development institutions (European Commission, EIB, EBRD), shall equally refer to the Bilateral Donor Organisation(s) or BDO(s), unless otherwise stated.

had embarked on the privatisation of public assets and sought private participation in infrastructure investments in preference to multilateral lending, a trend that boomed in the mid-1990's but collapsed in the wake of the Asian crisis in the late 1990's. At the other end of the spectrum, some commentators questioned the significance of a modern infrastructure network developing economic growth and alleviating poverty in the light of the inadequacies in the economies of some developing and transition countries. Last, but not least, by the end of last century MDBs had adopted rigid environmental and social safeguard policies. As a consequence MDBs were prevented from financing infrastructure projects where their clients were not yet ready to share their vision of sustainable development. These policy changes in the funding of infrastructure projects by international donors effectively prevented many European international contractors from maintaining a permanent presence in developing countries, especially in those countries where aid funds were the major source of infrastructure financing.

Also **during the 1990's the international construction business that did not depend on MDB funding changed significantly**, particularly in the so-called emerging markets in Eastern Asia as well as Central and Eastern Europe. Following the economic upswing of these regions with the era of globalisation, market focus shifted away from the traditional construction export markets in Africa and parts of Latin America. Yet, the rapid development of domestic contractors intensified the competition and caused European international contractors to adopt new strategies, mainly the establishment of local subsidiaries, as a preferred way of doing business, rather than continuing the traditional export business of posting expatriate staff abroad. In this way, European companies clearly gave preference to countries offering investment-friendly conditions (such as political and economic stability as well as fair procurement and contract management practices) in preference to those countries with extensive bureaucracy and an inefficient business environment. The strong development of the construction sector in Central and Eastern Europe over the last decade clearly demonstrates that European international contractors have neither disregarded international contracting nor do they fear competition, provided it is organised in a reasonable, fair and transparent manner. However, in these times of particular focus on **“shareholder value”**, it is inevitable that market pressures will force European international contractors to withdraw from regions with a weak business and investment climate. This drift away from participation in this market will continue unless the project and contract management practices of Contracting Authorities and international donors improve.

Finally, with the new concept of “Public-Private Partnerships” gaining ever more attention and acceptance across the globe, **the leading European international contractors have developed their construction core business “upstream” and “downstream” and have integrated new elements of financing, development, design and operation into their supply chain**. Regrettably, until a short while ago, these innovative options of financing and procuring infrastructure services seemed to have gone almost unnoticed by the MDBs. After fifty years of experience in financing infrastructure projects, which was certainly not always satisfactory, MDBs were, until recently, reluctant to reconsider their procurement policies and appear reluctant to critically examine the value added by the conventional design-bid-build method of procurement. Preference still seems to be based on the “lowest evaluated tenderer”. Nevertheless, a high-quality, environmentally-friendly, socially responsible and transparent, “sustainable” finished product is expected.

EIC observes that the MDBs are conducting somewhat contradictory policies which will inevitably introduce tensions between conflicting goals. If the international donor community wishes to achieve the U.N. Millennium Development Goals by the year 2015, a change of paradigm is needed in the procurement policy, too.

**In a nutshell: for sustainable development to be achieved, “sustainable procurement” is indispensable in both theory and practice.**

The procurement process supervised by MDBs should inspire the participating tenderers to make optimal use of their experience, technological and financial capabilities and creativity to provide solutions which optimise the balance between technical and financial considerations. Against this background, we have prepared our “**EIC Blue Book on Sustainable Procurement**” which examines the current procurement philosophy and practice of MDBs and evaluates this philosophy and practice against the fundamental considerations that are generally guiding their procurement transactions:

1. The need for **economy and efficiency** in the implementation of the project, including the procurement of goods and works involved;
2. The interest in giving all eligible bidders the **same information and equal opportunity** to compete in providing goods and works financed by the MDB;
3. The interest in encouraging the **development of domestic contracting and manufacturing industries** in the borrowing country; and
4. The importance of **transparency** in the procurement process.

## EXECUTIVE SUMMARY

According to a recent World Bank analysis concerning the infrastructure needs for the years from 2000 – 2010, the annual funding needs for infrastructure facilities in the developing world amount to around 465 billion US\$ of which 50% would be needed for new construction and the other 50% for maintenance and rehabilitation. Similar estimates show that meeting this challenge of increasing access to quality infrastructure services will require sizeable investments in the range of about 7% of GDP for all developing countries for both new investment and maintenance expenditures. Hence, creating capacity and incentives for ongoing maintenance of capital investments is a huge challenge across all infrastructure sectors.

In the past, however, the focus of tender procedures under MDB supervision has been placed solely on the lowest construction cost of an infrastructure facility rather than the optimisation of the project's life-cycle costs. Inevitably, this practice has led to some frustration of donor efforts, with investment in capital works failing to produce satisfactory and sustained service levels. Rather, this practice has in fact tended to subsidise inefficient public utilities not connected to the existing networks. EIC is aware of such shortcomings and fully shares the vision of the international development community that MDB funded spending for infrastructure – whether provided in form of a grant, a loan or a guarantee, and whether these funds are collected directly from the taxpayer or through the issuance of debt securities based on the MDBs' subscribed capital (which is guaranteed by the taxpayer) – in fact reaches the poorer parts of the populations, that the services this money finances, respond to their needs and preferences, that these services are delivered efficiently and that public funds are used in a way that leverages private financing of service delivery. This holistic approach is particularly relevant for transport infrastructure, due to both the magnitude of the initial investment and the strategic importance for the economic development of developing and transition countries. EIC observes that if MDBs wish to achieve the U.N. Millennium Development Goals by the year 2015, a change of paradigm is needed in their procurement policy, too.

### Traditional Tender Process

In case of the *traditional tender process*, MDBs should place particular importance on the pre-qualification stage, the quality of the tender documents, the fairness of the Conditions of Contract and the adequacy of tender securities. Particular attention should be paid to the following:

1. The selection process should commence with a **standardised pre-qualification procedure** aiming to establish a limited number of experienced and qualified bidders that demonstrably intend to submit competitive tenders and have the proven capability to live up to the MDBs' policy goals on environmental sustainability and social accountability;
2. In order to overcome notorious under-funding for the preparatory project stage and to **improve the quality of the tender documents**, EIC recommends that the Contracting Authority takes full responsibility for the quality and sufficiency of studies, specifications, drawings, etc. prepared by its consulting

engineer(s) before it invites tenders, and sufficient funding is allowed by MDBs for this purpose;

3. It is of paramount importance that the procurement guidelines irrevocably obligate the Contracting Authority **not to deviate in the Conditions of Contract from a fair balance of risk**, either through the prescription of general principles or through the mandatory use of a standard contract form which also ensures the enforcement of dispute settlement decisions through a **Dispute Board** and/or **International Arbitration**.
4. The Standard Bidding Documents of MDBs should contain provisions for the use of **either a Demand Guarantee or a Contract Bond** as may be appropriate to the project.

Although the traditional method of project procurement may be a reliable form of procurement, it is certainly not the only viable form of procurement. In fact, there are **inherent disadvantages associated with the design-bid-build method of contracting**: a big challenge are the many interfaces in a traditional design-bid-build project which requires all parties to adopt complex management procedures and these procedures serve to increase costs with little added value. Furthermore, under conventional procurement arrangements, the knowledge and skills of contractors play no role at all in the design stage, although early involvement of such skills can significantly contribute to the efficiency of the entire process. The traditional method of procurement does not provide a mechanism to draw on the private sector's capabilities to maintain and operate the facility.

### Innovative Forms of Procurement

Therefore, it is one of the most firmly held beliefs of EIC that much benefit would accrue to Contracting Authorities and MDBs if *innovative forms of procurement* are more frequently adopted. Private sector practice shows that alternative approaches can be implemented without any trade-off on efficiency, competition and transparency – quite the opposite:

1. The first option for the Contracting Authority is to reserve more room for **quality-based selection of tenders** within the traditional procurement process. Apart from upgrading the procedures on pre-qualification, tender documentation, conditions of contract and securities, Contracting Authorities could foster the submission of reasoned tenders by adopting various selection criteria, such as basing the award on **the Economically Most Advantageous Tender (EMAT)** rather than the lowest price, inviting **Alternative Proposals** in appropriate cases and carefully applying a **Two-envelope system**.
2. The second option for the Contracting Authority is to make better use of the tenderers' skills in the design phase by procuring a **"turnkey" or "design-build" project**. Under such a procurement scheme the Contracting Authority notifies the tenderers of the basic project parameters in its Employer's Requirements and divides the selection procedure into a two-stage process where a certain degree of flexibility for discussions with tenderers is permitted in order to integrate their ideas and concerns.

3. The third option for the Contracting Authority is to use a form of contract that rewards the contractor for achieving a specified level of performance in terms of “outputs” rather than focusing on inputs. This arrangement may resemble a “design-build” or “turnkey” project, but the Contracting Authority can extend this principle and fully delegate the delivery of a service to a private third-party provider under long-term contracts that comprise planning, construction, rehabilitation, maintenance and operation. As a general rule, any defect – whether in the design or construction or operation phase – falling within the scope of the works under such **Performance-Based Procurement** will be the responsibility of the contractor.
4. The fourth option for the Contracting Authority is to use a variant of the so-called **Public-Private Partnership (PPP) model** and to “outsource” the delivery of a public service to the private sector. It has to be borne in mind that there is not yet an overarching definition for PPP and that the term describes more generally a wider range of arrangements where the public sector and the private sector enter into a formal agreement in order to draw on private resources – either financial, commercial or technical – in providing infrastructure works and/or delivering public services. PPP models are most common in the infrastructure sector, both social and economic, but equally can be applied to public buildings. The common feature is that these projects comprise a substantial initial capital expenditure for construction and/or rehabilitation and they attract maintenance and operation costs after completion of the construction phase, for which no government up-front borrowing is required. These costs are refinanced over the project’s life-cycle either through “user” or “unitary” payments made by the state. PPPs involving a donor-funded grant element, such as the EU Structural or Cohesion funds or even MDB-funded schemes such as Output-Based Aid, would also be a facet of PPP with the payments, at least partly, disbursed from Official Development Assistance funds rather than the state budget or the users, but similarly paid over the duration of the private sector service delivery. Conversely, short term management contracts with little or no capital expenditure are not addressed in this document.

In conclusion, it can be stated that in order to achieve better value for money on projects financed under MDB supervision, MDBs should review and optimise their current procurement regime. EIC submits that “**Sustainable Procurement**” starts with an efficient pre-qualification of applicants, followed by a tender process based on high-quality documents and balanced contract conditions. The period that follows the submission of bids, and which runs until the contract becomes effective, is not only the part of the procurement process that is least prescriptive but is also the most under-utilised. It is the period when the contractor’s offer must be rigorously tested to ensure that it is completely compliant with the requirements of the Contracting Authority. Such requirements must be technically robust, clear and unambiguous. Finally, to ensure the highest quality for the lowest price (i.e. the most sustainable project solution), MDBs should more often apply innovative tender procedures that allow qualified bidders to bring their expertise to the competition.

## BACKGROUND



### 1.1 ABOUT EIC

European International Contractors (EIC) was founded as a legally independent federation in 1984 and its membership is made up of construction industry trade associations from fifteen European countries. EIC's objective is to represent the interests of the European construction industry in all questions relating to international construction activities. In that context, the primary goal is to improve the legal and economic and financial framework for the international construction market. To achieve this, EIC maintains contact with all European, international and multilateral organisations and associations whose activities are relevant to international construction activities. Europe's international construction companies are currently active in all corners of the globe and in all types of infrastructure development procured by every possible process imaginable. In the year 2003, the total volume of international turnover outside Europe carried out by EIC member companies amounted to € 50 billion.

### 1.2 POLITICAL SETTING

Globally, the gap is steadily widening between the demand for infrastructure facilities and the resources available for financing these types of investments from public budgets. This is in particular, but not exclusively, true for the developing and transition countries. Nevertheless, over the past decade EIC has observed a **reluctance to make substantial funds available for economic infrastructure facilities**. This has resulted in a sharp decline of infrastructure investment lending through the MDBs. This may, at least partly, come from the past experience that donor efforts have sometimes led to frustration, with investment in capital works failing to produce satisfactory and sustained service levels. Rather these efforts have in fact subsidised inefficient public utilities not connected to the existing networks.

EIC is also aware of such shortcomings of the traditional procurement procedure and fully shares the vision of the international development community that MDB funded spending for infrastructure – whether provided in form of a grant, a loan or a guarantee, and whether collected from the taxpayer or through the issue of debt securities based on the MDB's subscribed capital (which is guaranteed by the taxpayer) – in fact reaches the poorer parts of the populations, that the services this money finances, respond to their needs and preferences, that these services are delivered efficiently and that public funds are used in a way that averages private financing of service delivery.



According to a recent World Bank analysis\* concerning the infrastructure needs **for the years from 2000 – 2010, the annual funding need for infrastructure facilities in the developing world amounts to around 465 billion US\$** of which 50% would be needed for new construction and the other 50% for maintenance and rehabilitation. The World Bank more recently added that meeting the challenge of increasing access to quality infrastructure services will require investments in the range of about 7% of GDP for all developing countries for both new investment and maintenance expenditures.\*\*

With its “*Infrastructure Action Plan*” approved in July 2003 the World Bank signalled a reinvigorated commitment to infrastructure development. It now appears that there is once again a strong recognition in the entire international development community of the key role that infrastructure plays in achieving the U. N. Millennium Development Goals, either directly for the well-being of mankind as in the case of modern energy and safe water and sanitation, or indirectly as a precondition for creating macroeconomic wealth as in the case of energy and a reliable transport network. **It has also been acknowledged that it is not sufficient to build these types of infrastructure facilities but that the real challenge is to maintain, rehabilitate and operate them and to adapt them to the user’s changing needs.**

**This holistic approach is particularly relevant for transport infrastructure** (road and railroad network, ports and airports), due to both the magnitude of the initial investment and the strategic importance for a country’s economic progress. When establishing the priorities for infrastructure financing across all sectors, the international development community must bear in mind that the investment in transport infrastructure makes a direct contribution to the alleviation of poverty by increasing mobility and by reducing transport costs, which in turn makes goods consumed by developing and transition communities more affordable and their products more competitive. Investment in transport infrastructure also makes an indirect contribution to the alleviation of poverty by providing better access to markets, services, jobs and isolated communities. Economic analysis proves that, apart from technical know-how and competitive labour costs, a well-functioning transport infrastructure network is a prerequisite for economic development and growth and thus poverty reduction. In other words: it is indispensable that these tangible and intangible assets are available to the developing world in order to enable it to become an active player – rather than a passive observer – in international trade and commerce.

The international development community meanwhile has realised that, on current trends, it is unlikely to meet most of the Millennium Development Goals by the year 2015. The “*Global Monitoring Report 2004*”, published in April 2004, pointed out that all partners for development must scale up action, significantly and swiftly, and enter into a more dynamic partnership. **The report also says that in-**

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\* “Investing in Infrastructure: What is Needed from 2000 to 2010?” – World Bank Policy Research Working Paper 3102, July 2003, by *Marianne Fay* and *Tito Heyes*.

\*\* “Strengthening the Foundations for Growth and Private Sector Development: Investment Climate and Infrastructure Development”, September 17, 2004, World Bank staff paper for the Joint Ministerial Committee of the Boards of Governors of the Bank and the Fund on the Transfer of Real Resources to Developing Countries.

**frastructure spending will need to rise by 3.5 – 5% of GDP in low-income countries and by 2.5 – 4% of GDP in low-middle-income countries.** Against this background, observers are calling for a dynamic relationship between development partners, i.e. developed and developing countries, MDBs and NGOs, and, last but not least, the infrastructure industry.

### 1.3 PURPOSE OF THE POSITION PAPER

With this paper EIC wishes to contribute the experience of its member companies to the ongoing important strategy discussion in order to analyse whether the **traditional tender process** when used for donor-financed infrastructure investments is best practice to procure infrastructure works and services in a sustainable manner.

Conventionally, procurement of internationally financed construction works has taken place according to a standard pattern. The “Borrower” or “Client” or “Contracting Authority”<sup>\*</sup> engages a consulting engineer to develop comprehensive specifications and documentation to be included in the invitation to tender. The bidders then review the documentation and submit their proposed price. In the past, the focus of the traditional tender procedure was much more on the lowest construction cost of an infrastructure facility rather than on the optimisation of the project’s life-cycle costs. Although there are, in theory, no apparent objections to the traditional approach, it is also true that inherent problems have often been encountered, such as:

- A tendency toward unreasonable tenders and therefore expensive risk allocation, often due to insufficient funding for consulting services (leading to poor preliminary studies) and/or excessive time between preliminary studies and work implementation (leading to obsolete tender documents);
- The inability of the Contracting Authority to explore with the tenderers options for innovation, added efficiency and value engineering;
- The need for early investment of significant resources by the Contracting Authority.

European international contractors recall numerous occasions where the Contracting Authority has placed substantial demands on tenderers in an effort to maintain negotiating power and obtain a tender compliant with its requirements. By selecting the most compliant tenderer, the Contracting Authority often obtained an illusory benefit, and engaged in an adversarial relationship with the tenderer, as the same tenderer tried to compensate for financial imbalance caused by his initial aggressive tender. Evidently, the aims of the Contracting Authority for a high quality of the works and, at the same time, for the lowest price of the contract are

<sup>\*</sup> MDBs and BDOs are using different terminology as to the procuring entity. For the sake of simplicity, this EIC Paper only speaks of the “Contracting Authority” which also stands interchangeably for the terms “Borrower” or “Client” or “Employer”, etc.



mutually exclusive, particularly in large and complex projects. EIC observes that, despite the many commendable practical procurement guidelines issued by the MDBs, **there are still obvious gaps between the – in theory fair, transparent and efficient – tender procedures and their imperfect implementation in practice.**

Given the early state of discussion within the international development community on best procurement practice, traditional tendering is likely to prevail in a number of cases, especially for smaller and medium-size projects, e.g. when participation of local contractors is promoted. However, even in this case, a number of improvements to the current design and procurement practices should be considered by the MDBs for the sake of efficiency and transparency. The European Court of Auditors has recently investigated European Commission spending on infrastructure works in the ACP countries and has come to the conclusion that both the European Union and the ACP countries must improve the supervision of the implementation of works contracts financed by the European Development Fund and, in particular, must reduce the extent of divergences that were found between contractual expectations and their actual implementation.\* In this context, this EIC Blue Book will make the case for **“Sustainable Procurement”**.

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\* European Court of Auditors, Special Report 8/2003 (OJEU C 181).



## ROLE OF THE PARTIES

It is a long tradition that infrastructure projects financed from MDB loans are procured as design-bid-build projects through International Competitive Bidding (ICB). The Contracting Authority usually employs a consulting engineer to carry out the design and then prepare the tendering documents. The consulting engineer designs and defines (in the form of drawings, specifications and other documents) the Works, whilst the contractor is engaged to do the work of construction in strict accordance with the design and documents prepared by the consulting engineer. The tender dossier is distributed to all interested, and usually pre-qualified, bidding companies, who will then prepare their tenders. Tenders are all received at the same time, and all based on precisely the same tendering documents and information. The received tenders are then checked for compliance with the tendering requirements, and evaluated by the Contracting Authority or by his consulting engineer. No negotiations with any of the tenderers are permitted, although limited clarifications may sometimes be allowed. Non-complying tenders are rejected, and the contract is invariably awarded to the Contractor offering the “lowest evaluated tender”, i. e. lowest construction price.\*

### 2.1 INTERNATIONAL FINANCIER

Given some rather discouraging outcomes of MDB financed infrastructure projects in the past, one cannot help but think that mediocre results could be improved if MDBs reconsidered the basic principles of financing, procuring and executing a project in order to gain best value for their money. Traditionally, the MDBs have implemented the general rule that the responsibility for the implementation of a given project, and, therefore, the award and administration of contracts under such project, rests solely with the Contracting Authority. Often the immediate and compelling needs in a developing country, its government's challenge to allocate the available funds in meeting those needs and the political instability that sometimes applies to such governments in general pose a threat to the continued flow of funds towards an initiated project. Typically, bidders will assess the likelihood of these issues causing increased cost and/or jeopardising the programme and they will usually make appropriate allowances in their tenders.

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\* For the purpose of this document, the words “bid” and “tender”, and the words “bidder” and “tenderer” shall respectively have the same meanings.



## EIC recommendation

In the past, technical staff of MDBs have played an active and conducive role in the management and follow-up of MDB-financed infrastructure projects. This is no longer the case, probably due to the limited human and financial resources of the MDBs. EIC considers that fulfilment of the requirements of a fair, transparent and efficient tender process can only be achieved if the MDBs again assume an increased role in the evaluation process in the form of **a comprehensive project control mechanism**. As part of their development policy, MDBs should not leave the entire responsibility of the tender procedure with the Contracting Authority, but share some of the burden by closely reviewing the essential steps of both the procurement decision and the project execution. This could be introduced by obliging the consulting engineer or employer's representative (as the case may be) to report to the MDBs all events of non-compliance of tenders. During the execution phase any material default in relation to the construction contract and any proposed variations to such contract should also be monitored. Such procedures would begin at the pre-qualification stage and end only after the final settlement of any disputes.

MDBs should **check the quality of the feasibility studies** before the Contracting Authority proceeds with the project. MDBs should also become actively involved in the implementation of **variations** and extensions of Loan Agreements/Grants. A "dispute free" project is likely if contractors may only carry out variations when additional funds are available. Active involvement of MDBs would also be helpful in the event of sanctions against the government of the Contracting Authority.

In addition, despite the fact that MDBs are not a party to the contract, MDBs' procurement rules should provide for the possibility of **payments directly to the contractor** in the event of default of the Contracting Authority or **assignment of certain rights of the Loan Agreement** to the contractor by naming the contractor as an intended third party beneficiary in such Loan Agreement. Such an option would demonstrate the MDB's commitment to the project and would put it in a better position to control the execution of the project in its own interests should a major default occur. It would also mitigate the perceived risk of non-payment by the Contracting Authority to the contractor.

In case of **decentralised procedures**, the supervising role of the MDBs is of even greater importance. Tenderers should be informed at the outset of the project about responsible decision-makers in the MDBs, i.e. whether they are to be found in the field or at the headquarters. Transparent reporting procedures are imperative should tenderers wish to inform MDBs about certain shortcomings during the tender process or if the successful contractor enters into a dispute with the Contracting Authority.

EIC would welcome MDBs adapting their Standard Bidding Documents to the most modern types of procurement strategies, including **"turnkey"** and **"design-build"** schemes, **Performance-Based Procurement** and **Public-Private Partnerships**. Such an addition could help to initiate a drastic change of attitudes in those parts of the world where the roles of the parties are still traditional and sometimes, regrettably, adversarial. EIC considers that MDBs should take the lead in establishing **mutual trust and confidence between contracting parties** and to eliminate the us vs. them attitudes in favour of the "we" approach.



## 2.2 CONTRACTING AUTHORITY

As the principal decision-maker on the allocation of costs and risks, responsibilities and liabilities, the Contracting Authority plays a crucial role and much of the project's outcome depends on how well the role is performed by the Contracting Authority. This is particularly true in the early phase of a project when it has to allocate sufficient budget to establish comprehensive data and information required for a successful tender process. If the Contracting Authority does not have the required management skills in-house to undertake a monitoring role, it ought to recruit professional consultants in connection with the design, engineering and supervision of the construction project. Under the traditional design-bid-build method, any ambiguity or failure to define the role of the Contracting Authority may result in delays, contractor's claims, need for additional funding and, ultimately, frustration.

### EIC recommendation

The Contracting Authority has the basic responsibility to prepare the tender with due care. EIC asks that it **shares all relevant data and information at its disposal with all tenderers**, in order to ensure a level playing-field in the competition. Thus, the Contracting Authority must be obligated to ensure that the tender documents for construction contracts comprise, at least, the following information:

- Relevant technical information, including geo-technical conditions;
- Duration of design and construction phase;
- The nature and quantity of the Work to be carried out;
- Survey information for a quality check
- Construction specifications, standards and norms;
- Environmental impact assessment;
- Security and environmental standards and norms;

If the Contracting Authority issues tender documents for design-build or even an EPC type of contract, then the first item on the above list should be an **exhaustive statement of its requirements** (Employer's Requirements) setting out the purpose for which the project is intended.

All this requires of course, as pointed out before, an **adequate budget** to engage professional consulting engineers who then, to the best of their ability, compile the aforementioned data and information.

Contracting Authorities should **exempt** the contractors in accordance with the national legislation from **obtaining clearance** through customs, obtaining import and export licences and from compliance with port regulations, storage and transport regulations, etc. Any such clearance or exemption should not be subject to a review by any other national authority. If clearance remains the respon-



sibility of the contractor, Contracting Authorities should render whatever assistance they can in connection with the such clearances and exemptions.

Last but not least, the Contracting Authority shall **make payments** due under the contract **without any delays or inappropriate deductions**.

## 2.3 CONSULTING ENGINEER

Since the Contracting Authority in developing and transition countries may not be familiar with the multiplicity of technical, commercial and legal considerations involved in a large infrastructure project, typically it will commission one or more consulting engineers for the preparation and administration of the tender procedure as well as the supervision of the execution of the project. In traditional contracts, the consulting engineer exercises a dual role, balancing its powers between acting as the Contracting Authority's agent for designing and supervising the execution of the works and as the neutral decision-maker in terms of costs, approvals and variations. For many years now, this ambiguity has introduced inherent conflicts between the engineer's alignment with its client and its duty to decide on contract matters in an unbiased manner. These dual roles potentially cause difficulties for both the Contracting Authority and the contractor and, ultimately, the financier.

### EIC recommendation

Whether a consulting engineer is appointed by the MDB directly or by the Contracting Authority, it is of paramount importance that consultants be chosen which are capable of producing reliable tender documents, including **precise and state-of-the-art specifications and drawings**, which are in turn the basis for the successful execution of an infrastructure project, as they define the scope and the technical requirements of the project. This must include the entire staff or any authorised assistant engaged on the project. Again, this requires an adequate budget for the preparation phase. Any ambiguities in the final tender documents will unavoidably lead to serious problems for project execution in later stages. In our experience, the root of many problems in projects is sub-standard documents which result from under-funding in the tender preparation.

**Comprehensive data and information** must be provided in sufficient detail to enable the tenderers to assess accurately the nature and the scope of the works, all in conjunction with the specifications and the bill of quantities. The quality of materials and the standards of workmanship to be provided by the contractor must be clearly described. A serious question is whether or not the ability of consulting engineers to exonerate themselves or to limit their contractual liability should be curbed.

It has also been argued that added value might be gained by **splitting the roles** and thus the authority of the engineer in the stages pre and post-project award. Thus the Contracting Authority could select one engineer to design the project and to administer the tender phase, and another engineer to supervise project execution and to administer the contract. There are pros and cons to both alternatives. Whilst a separate control-engineer might be impartial between the designer and the contractor if problems arise during the performance which could be due



to the negligence or error of either party, a combination of the design and control functions in a single person would allow the designer to check whether his design ideas are properly applied in practice. EIC has no preference for either option, provided that sufficient quality standards are observed at all times.

EIC calls, instead, on the MDBs to provide for a **Dispute Board**, in the contract conditions. Such board should be appointed at the commencement of the contract and should be **empowered to make a binding decision** in the event of any difference in opinion between the consulting engineer and the contractor in connection with the design and implementation of the project.

## 2.4 CONTRACTOR

The role of European contractors in international contracting has evolved significantly over the past decades. Whereas in the early days of international construction, business was procured mostly by contractors submitting competitive bids in the traditional manner, nowadays design-build and turnkey contracts have become much more commonplace, particularly in Performance-Based Procurement and PPP models, with the contractor being responsible not only for the design and the construction of the project but in some cases also for the performance and even the financing of the facility. In some sectors of the industry or parts of the globe, partnering and alliancing are also well established alternative approaches. It is a concept designed to promote positive attitudes among the participants and to engender an environment of mutual trust, commitment and open communication between owner, contractor, designer, subcontractors and suppliers.

Conversely, procurement practice of the MDBs has not evolved at the same pace and thus many European international contractors are increasingly reluctant to enter into the competition for MDB financed projects, not out of fear of competition, but in the awareness that their **added value: high quality products, efficiently designed and built and within a proposed budget and within the required time-frame, cannot be realised in a competition simply to obtain the lowest price.**



## KEY ISSUES IN THE TRADITIONAL TENDER PROCESS

Despite the many practical guides and policy guidelines issued by the MDBs for the procurement of major works, there is an obvious gap between the tender regulations, which are in theory fair, transparent and efficient, and the implementation of the conventional tender procedures in procurement practice. All too often, bidders complain about unclear tender provisions and/or irregularities during the tender process, even when the project is financed and executed under the procurement rules of prominent international financing institutions. Against this background, EIC wishes to make some basic recommendations with regard to the implementation of the traditional tender process, as currently applied by the MDBs. The recommendations are set out in four categories as follows:

- PRE-QUALIFICATION
- QUALITY OF TENDERING DOCUMENTS
- CONDITIONS OF CONTRACT
- TENDER SECURITIES

### 3.1 PRE-QUALIFICATION

European international contractors have observed that **certain aspects of the pre-qualification (PQ) process are unnecessarily complicated, costly and time-consuming**. For instance:

- Despite the harmonisation efforts of MDBs, invitations to tender and the relevant documentation required by the various MDBs indicate a remarkably low degree of co-ordination. Hence, the contractor is unable to prepare standard PQ documentation but must produce new or slightly modified documents for each project.
- Pre-qualification questionnaires often contain requirements for unnecessary formalities which, unless required by the substantive law of the contract, could easily be eliminated, such as:
  - annual statements with the *auditors' original signatures* for each PQ and each tender;
  - bank references with the *bank's original signature* for each PQ and each tender;
  - translations by a *certified translator*, sometimes bearing his signature and attested by a notary;



- *powers of attorney* attested by a notary and by an apostille (which means that the contractor's chief representatives must go to see the notary for each offer and each PQ application);
  - *statements of origin* or even *certificates of origin* for the equipment intended to be used in the project;
  - *certifications from a notary*, even though the notary system is not widely used in many countries which makes it difficult to obtain such notary attestations.
- Invitations to tender often contain **requirements derived from common law** ("sworn statement", "solemn statement", "affidavit") which do not exist either in civil law systems generally or specifically in the country making the invitation and nor do they have any legal implication whatsoever. Accordingly, sometimes it is impossible to comply with these requirements.
  - More and more invitations to tender contain requirements which put **excessive burden** on the PQ applicant:
    - bank statement on the availability of a *credit line specifically for the project*, which costs money and blocks the overall credit line and which does not make sense in a PQ where the tenders for the project are expected more than half a year later;
    - contractors' statement that the *personnel* and the *equipment* listed is *intended exclusively for the project*, which makes it difficult, if not impossible, to tender for several lots at the same time with the expectation that only one lot will be awarded to the contractor and which does not make sense in a PQ where the tenders for the project are expected more than half a year later;
    - the requirement that all or half the *equipment* to be used in the project *must be owned* by the contractor as opposed to leased or acquired under a hire-purchase agreement or under other financing arrangements;
  - The **Eligibility Statement** required in the text often is not identical to the Eligibility Statement provided in the Forms.
  - **Non-relevant information** that normally is not readily available to the contractor often must be submitted. The relevance of information *concerning "the applicant's history of non-performing contracts" or "pending claims or litigation as related to company assets"* is not readily understood. Furthermore, the prospective bidder is normally not informed as to how such information will be used by the Contracting Authority in the PQ process which leads to the suspicion that the evaluation process will be subjective.
  - **Late answers to questions:** often the answers to questions of the applicants are so late that it is impracticable for the tenderer to react.

## EIC recommendation

EIC recommends that the pre-qualification criteria be objective and expressed and published clearly in the tender notice. They should be applied equally to all prospective tenderers. From the EIC viewpoint, it should be sufficient to submit:

- photocopies of documents such as commercial registers, annual statements, bank references etc.;
- simple translations instead of certified ones;
- powers of attorney signed by the contractor;
- a statement that all the equipment to be used in the project will have its origin in eligible countries.
- if originals, certificates and attested signatures are considered an absolute must, it should be sufficient to require them to be provided only by the successful tender (or alternatively from a limited number of short-listed bidders) at the end of the bid evaluation procedure.

As stated before elsewhere\*, the terms for bidder pre-qualification should be established in order to demonstrate that the bidder (1) possesses the necessary professional and technical qualifications; (2) maintains the necessary financial, human and equipment resources; and (3) is capable and sufficiently reliable to complete the project within the time limits and to deliver the quality of work required by the owner. Of emerging importance is the ability to manage the highly complex financial aspects of new projects as are required by the increasingly popular Public-Private Partnership (PPP) schemes on which new works are based.

If MDBs wish to promote environmental and social aspects which shall be strictly observed in the execution of works financed by them, pre-qualification documents and tender evaluation should also address any relevant information, such as the applicant's track-record on health and safety issues as well as its environmental accountability, etc.

In conclusion, **the Contracting Authority should use the pre-qualification process as an opportunity to raise the standard of the competition by setting out the minimum requirements to be met in terms of the tenderers' technical ability, financial position, capacity and experience.** By introducing an intense and comprehensive screening of the candidates' general performance capacities, the Contracting Authority can establish a limited number of experienced and qualified bidders that have the intention on submitting competitive tenders, thereby focusing, not limiting, the competition. **MDBs in turn should closely monitor the pre-qualification process and along with the Contracting Authority insist that only those tenderers that can demonstrate their ability to satisfy MDBs policy goals on environmental and social sustainability may proceed.**

\* EIC commented in 2002 and 2003 on the Master Pre-qualification Documents of the IFIs and MDBs as well as on the revision of the World Bank Procurement Guidelines. The documents can be downloaded from our website: <http://www.eicontractors.de/seiten/communication/position.php>.



### 3.2 QUALITY OF TENDER DOCUMENTS

EIC estimates that Contracting Authorities inviting international tenders spend, on average, approximately 3% of the total project capital cost in the preparation of the tender design and the bidding documents. Such expenditure is, of course, a function of the nature of the project, but it would appear that it may be insufficient to perform state-of-the-art feasibility studies. EIC notes that the quality of tender documents has severely diminished in recent years. If tender documents are inadequately prepared, the project will invariably suffer.

Reliable tender documents, including precise and state-of-the-art specifications and drawings, are the basis for the successful execution of any infrastructure project, as they define the scope and the technical requirements of the project. The quality of materials and the standards of workmanship to be provided by the contractor must be clearly described. Details must be included of samples to be provided and tests to be carried out by the contractor during the course of the contract. The drawings must contain sufficient detail to enable the bidders to assess accurately, in conjunction with the specifications and the bill of quantities, the nature and the scope of the works.

#### EIC recommendation

In order to overcome notorious under-funding for the preparatory project stage, EIC recommends that the **Contracting Authority take full responsibility for the quality and sufficiency of studies, specifications, drawings, etc. prepared by the selected consulting engineer** before tenders are invited. In order to influence the Contracting Authority in that direction, MDBs should insist that the relevant terms of the construction contract ensure that the Contracting Authority assumes responsibility for and the risk arising out of the studies, specifications and drawings that comprise the tender documents.

In case of “turnkey” or “EPC” types of projects procured in a single-stage procedure, the tender stage assumes an even greater importance. It is imperative that the **Contracting Authority be obliged to provide a clear and sufficient description of the Employer’s Requirements (and take responsibility for it)** in order to provide a reliable level playing-field for all tenderers. Otherwise, tenderers are forced into some kind of “gamble situation” where each of them has to develop its own design based on insufficient data and mere assumptions, facing the risk that the contract will be finally awarded by the Contracting Authority to a (cheaper) competitor which will construct the works on the basis of somebody else’s design.

In order to avoid such kind of distortions of competition, EIC recommends that MDBs be prepared to **instruct reviews of any reservations or observations made by bidders in respect of the tender documents** before the Contracting Authority is authorised to accept the successful bid. It is recommended that **MDBs should, in common with private financiers, retain a separate consultant to advise the MDB.**

### 3.3 CONDITIONS OF CONTRACT

In the same way that precise technical specifications and drawings are necessary to define the scope and quality of the works, the Conditions of Contract set out the contractual framework under which the works are to be executed. Best international practice reveals that, in order to complete a project within the required time and budget, it is essential that each phase of its execution be formulated with precision and that the balance of risks and responsibilities be clearly defined. The 4<sup>th</sup> edition FIDIC Conditions of Contract for Civil Engineering Works, which was published in 1987 and is known as the “Red Book”, continues to be used widely on the international stage and, due to the equitable balance of risk between the contractor and the employer contained in those terms, has contributed greatly to the successful completion of a very large number of infrastructure projects across the globe. This FIDIC standard form of contract was modified in 1996 with the publication of a supplement introducing the Dispute Adjudication Board as the instrument for the resolution of disputes between the contracting parties as they arise during the period of execution of the Works.

Regrettably, nowadays it is common practice for some Contracting Authorities to shift the balance risk allocation toward the Contractor by imposing Special Condition. Such practice inevitably leads to lengthy disputes between the Contracting Authority and the contractor during the execution period of the Contract.

#### EIC recommendation

EIC strongly maintains that MDBs should only use construction contracts with **a balanced allocation of risk** in key items, such as design, physical obstructions, amount of work to be done as well as for the amounts and duration of contract securities, the certification procedure and the terms of payment.

Where MDBs prescribe the use of standard conditions of contract through the MDBs’ Standard Bidding Documents, as for instance the FIDIC standard contract documents, it is of paramount importance that the **procurement guidelines oblige the Contracting Authority not to deviate from the General Conditions**, as they provide, to a large extent, a fair balance of risk.\*

With the aim of creating an even-handed construction contract based on the FIDIC 1999 standard contract forms, **EIC has published a series of “EIC Contractor’s Guides to the FIDIC 1999 New Books”**.\*\* These Guides highlight the potential risks and pitfalls of each of the new FIDIC standard forms and they are considered both by FIDIC and the international construction lawyers’ community as a useful checklist to all parties before undertaking an international con-

\* In the case of the FIDIC 1999 Conditions of Contract for EPC/Turnkey Projects (“Silver Book”), it has been pointed out in the Introductory Note that this standard contract form actually departs from the traditional approach of a balanced risk sharing and, therefore, the “Silver Book” is not suitable in many circumstances.

\*\* On FIDIC standard forms of contract, EIC has published three “Contractor’s Guides to the FIDIC *New Books*” in order to highlight the most important risks and pitfalls of these documents. The EIC Guides provide a useful checklist for contractors and other parties to the contract before entering into a contractual agreement.



struction project. As the World Bank has recently drafted its own version of the FIDIC 1999 “Conditions of Contract for Construction”, it is submitted that the EIC Guide to the FIDIC 1999 “New Red Book” be annexed as a **supplementary document to the new MDBs’ Standard Bidding Documents for the Procurement of Works**.

In addition, the Conditions of Contract should contain terms that make the use of **binding Dispute Boards** and of **International Arbitration** mandatory on the parties. They are well-suited tools for the Contracting Authority and the Contractor to avoid litigation. If prescribed by the MDBs in their Standard Bidding Documents and the appropriate standard contract form, both mechanisms will contribute to a reduction in contingencies in the contract price for the uncertain effect that local dispute resolution may have where it is not up to the highest standards set for such procedures. In the case of international arbitration, such resolution by international arbitration should not be subject to any further approval by any of the Contracting Authority’s state authorities.

However, the problem remains that many developing companies still have not ratified the **New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards (1958)** or, even if they have, they often do not recognise such awards. Hence, either party may contest an award. EIC proposes that the Loan Agreements on the part of the recipient countries stipulate that the country will surrender to such awards being final and irrevocable. Even so, there may still be cases where local legislation overrules and opens up the award. In these cases, MDBs should be prepared to intervene vis-à-vis the recipient country.

The **Particular Conditions** should only be employed to regulate the project and the country specifics and should not be used to re-allocate the risks, which is sometimes the case. Hence, EIC asks the MDBs to develop and agree finally on **standard country-specific Particular Conditions** in order to avoid open-ended possibilities for deviation from the General Conditions. MDBs should prescribe in their Loan Agreements that the Particular Conditions may not deviate from the allocation of risks as set out in the General Conditions. MDBs should not approve bidding documents which contain such deviation and, as a consequence, Contracting Authorities may not disqualify a tenderer who has based a given qualification on such a prohibited deviation by the Contracting Authority.

Ultimately, the **Appendix to Tender** as defined by the FIDIC Conditions should be completed in accordance with **international standards** and should not place an excessive burden on the contractor for items such as Liquidated Damages, Performance Bonds, and the like.

### 3.4 TENDER SECURITIES

There is a standard requirement in international construction contracts to guarantee private and public sector clients the completion of a project within budget and on schedule. Typically, an unconditional guarantee issued by a bank (generally in the amount of about 10% of the Contract Price) is used to satisfy an international client's demand for collateral security. This practice is recommended also by the MDBs. Most Contracting Authorities prefer to work with the banking system because they consider it to be simple, well known and enforceable. Guarantors underline that it is a generally accepted commercial practice world-wide, which reinforces their image as efficient and serious institutions. Beneficiaries are provided with a quick access to money, without the obligation to prove fault.

Conversely, the use of Contract Bonds issued by surety companies as contract guarantees is not usual practice in international contracting. Under the surety bond system the guarantor not only underwrites financial aspects of the contract guarantee, but provides an assurance to the Employer that the Contractor's obligations under the construction contract will be fulfilled (i.e. the Works will be completed). Surety bonds may be issued to satisfy all of the Contractor's guarantee obligations under the contract, performance, advances and retention release mechanisms. Principal advantages for the contractor under this system are that: (1) the bond does not affect the credit facility of the contractor, (2) the contractor is protected against unfair demands, and (3) disputes are often avoided because the surety is involved in the development of the project. This form of guarantee is also attractive to the institutions financing the project since the reliability of its investment is guaranteed by the assurance that the project will be completed.

The International Chamber of Commerce (ICC) has issued Uniform Rules both for Demand Guarantees and Contract Bonds. The Rules have been ratified by member states and provide protection for the principals and the guarantors against the improper use of these financial instruments.

#### EIC recommendation

EIC recommends that **MDB's Standard Bidding Documents contain provisions for the use of either the Demand Guarantee or the Contract Bond as may be appropriate to the project.** Alternatives also can contribute to lower end cost as the contracted price has to accommodate such costs. It is suggested to use guarantees issued by surety companies, as they are in general cheaper to procure and thus also an advantage for the Contracting Authority. Ultimately, the reference to the ICC Uniform Rules in the text of the Guarantee or Bond should be mandatory for the Parties.



## MODERNISATION OF THE TENDER PROCESS

The traditional method of project procurement (design-bid-build) whereby the party undertaking the design and the party constructing the works in accordance with that design are two completely different parties, may be a reliable form of procurement but it is most certainly not the only viable form of procurement. However, there are **various potential disadvantages associated with the design-bid-build method of contracting**:

1. One significant issue is the **many interfaces in a traditional design-bid-build project** which forces all parties to adopt complex management procedures and these procedures serve to increase costs with little added value.
2. Furthermore, the **knowledge and skills of contractors play no role at all in the design stage** although early involvement of such expertise can significantly contribute to the efficiency of the entire process.
3. The **traditional method does not provide a mechanism to draw on the private sector's capabilities to maintain and operate** infrastructure facilities.
4. Last but not least, the conventional procurement method has an **unfortunate bias towards solely the lowest tender**. It would be nice to think that the Contracting Authority will duly appreciate the merits of a reasoned tender, but experience shows that, even if it is sufficiently sophisticated and diligent, it will have its own responsibilities towards superior officials, financiers and auditors, who may not appreciate the difference between a reasoned tender versus a low price tag.

In the private sector, design-build and turnkey contracts have become much more commonplace over the past years, with the contractor being responsible not only for the design and the management of the project, but in some cases for the performance of the facility. This type of contract demands its own special procedures and processes. The traditional procurement process, however, from contractor selection through to contract award, is inadequate for turnkey work and has not evolved in line with contract forms.

It is one of the most firmly held beliefs of EIC that **much benefit would accrue to Contracting Authorities and MDBs if they more often apply innovative schemes for efficient procurement**. Private sector practice shows that alternative approaches can be implemented without any trade-off on efficiency, competition and transparency – quite the opposite.

1. The *first option* for the Contracting Authority is to reserve more room for **Quality-based Selection of tenders** within the traditional procurement process. Apart from upgrading the procedures in accordance with Chapter 3 on pre-qualification, tender documentation, conditions of contract and securities, Contracting Authorities could foster the submission of reasoned tenders by various criteria, such as basing



the award on the **Economically Most Advantageous Tender (EMAT)** rather than the lowest price, inviting **Alternative Proposals** in appropriate cases and carefully applying a **Two-envelope system**.

2. The *second option* for the Contracting Authority is to make better use of the tenderers' skills in the design phase by procuring a **“turnkey” or “design-build” project**. Under such a procurement scheme the Contracting Authority notifies the tenderers of the basic project parameters in its Employer's Requirements and divides the selection proceedings into a **Two-stage tendering** where it provides for a certain degree of flexibility for discussions with tenderers in order to integrate their ideas and concerns.
3. The *third option* for the Contracting Authority is to use a procurement model under which it specifies and pays for the expected performance in terms of outputs rather than focusing on and paying for inputs. Whilst in its moderate form, the arrangement resembles a “design-build” or “turnkey” project, in its most extreme form, the Contracting Authority fully delegates the delivery of a service to a private third-party provider under long-term contracts that comprise planning, construction, rehabilitation, maintenance and operation. As a general rule, any defect – whether in the design or the construction or operation phase – falling within the scope of the works under so-called **Performance-Based Procurement** – will be the responsibility of the contractor. In this way, most of the traditional construction risks are transferred from the employer to the contractor.
4. The *fourth option* for the Contracting Authority is to use the **Public-Private Partnership (PPP) model** and to outsource the delivery of a public service to the private sector and to utilise, at least partly, private investment for the realisation of the project. It has to be borne in mind, though, that there is not yet an overarching definition for PPP and that the term describes more generally a wider range of arrangements where the public sector and the private sector enter into a formal contractual agreement in order to draw on private resources – either financial, commercial or technical – in providing and/or delivering public services. PPP models are most common in the infrastructure sector, both social and economic, but can be applied equally to building works used for public purposes. The common feature is that all these projects comprise a substantial initial capital expenditure for construction and/or rehabilitation and they incur maintenance and operation costs after completion of the construction phase, for which no government up-front borrowing is needed but which are refinanced over the project's life-cycle either through “user” or “unitary” payments by the state. PPPs involving a donor-funded grant element, such as the EU Structural or Cohesion funds or even MDB-funded schemes such as Output-Based Aid, would also be a facet of PPP with the payments, at least partly, disbursed from Official Development Assistance rather than the state budget or the users, but similarly paid out over the duration of the private sector service delivery. Conversely, short term management contracts with little or no capital expenditure are not addressed in this document.\*

\* EIC has published in 2003 the „EIC White Book on BOT / PPP” in order to make publicly available the experience of member companies in implementing these complex projects.

## 4.1 QUALITY-BASED SELECTION

Whereas the MDBs' Procurement Guidelines for *Consultants* explicitly prescribe the evaluation of the consultant tenders in two separate stages – first the quality and then the cost – the general rule for the evaluation of the contractor tenders is the “lowest evaluated cost”. When bidding under such system, bidders have the option of either submitting an aggressive bid with a very low price and the wish to renegotiate any unreasonable risks incurred later, or to submit a reasonable bid which duly prices all the risks contained in the tender documentation. Usually, if one of the bidders uses an aggressive approach seeking re-negotiation later, a reasonably priced bid may not appear to be competitive. This leaves the reasonable bidder with a disadvantage and the more aggressive bidder with an opportunity to renegotiate in search of a deal that works. Against this background, the Contracting Authority should consider the introduction of quality aspects into the conventional tender procedure, such as broadening the scope of the award criteria from financial only to technical and environmental elements (EMAT), asking tenderers to submit Alternative Proposals with their tenders or evaluating the financial aspect only once the technical merits of the tender have been assessed.

### 4.1.1 ECONOMICALLY MOST ADVANTAGEOUS TENDER vs. LOWEST EVALUATED TENDER

In the case of large and/or complex infrastructure works, the costs involved in running the infrastructure facility over its lifetime often far exceed the initial costs of construction. Since higher up-front investment can ultimately lead to lower maintenance and operation costs, there should be a genuine interest of Contracting Authorities as well as the multilateral lenders in procuring assets which take account of both capital costs and running and maintenance costs.

Improved value engineering would also help to achieve another important goal of the international development community, i.e. a better protection of the environment. In recent years, MDBs have implemented comprehensive environmental and social safeguard policies which have to be observed and implemented during project execution. However, in practice the “lowest price” tender will not necessarily produce the optimal technical solution and leaves no financial means to provide for any environmental costs.

Whilst it would be desirable for the Contracting Authority to appreciate the merits of the reasoned bid in the sense of the “Economically Most Advantageous Tender” (i.e. the bid which embodies the most beneficial combination of technical performance, cost-effectiveness, flexibility, environmental impact, investment in the local community, social responsibility, etc.) in reality, it will usually rely solely on the “lowest price”, since it has its own responsibilities toward public officials who may not understand fully the difference between the “lowest price” and the “Economically Most Advantageous Tender”. Therefore, how the Contracting Authority can sufficiently take into account the quality aspect of the tender should be examined.



## EIC recommendation

The European Court of Justice recently decided that the “lowest price” is recognised as being an “objective criteria”, but the selection of a single award criterion deprives the Contracting Authority of the ability to take into account the nature and specific features of each contract, to choose the most appropriate criteria for free competition and therefore to make sure that the best tender is selected. It concluded that a framework law on public works procurement, which for the open and restricted procedures imposes the sole “lowest price” as mandatory award criteria, runs counter to Community law. \*

**To overcome the “lowest price syndrome” in MDB funded projects, EIC recommends that MDBs strongly encourage Contracting Authorities to award the project on the basis of the “Economically Most Advantageous Tender” (EMAT).** With the help of consulting engineers, the Contracting Authorities should determine in advance the necessary economic and quality criteria depending on the nature of the works, as defined in the technical specifications, and the value for money of each tender can be measured accordingly.

Manifestly, such practice presupposes that the MDBs’ Standard Bidding Documents require that the evaluation of the tenders also takes into account the **projected operating and maintenance costs over the entire project life-cycle**. Thus, costs for selected life-cycle cost criteria for each year of the design life of the facility should be requested from – and guaranteed by – bidders and then incorporated into the award mechanism in the same way as the tender price. The “Economically Most Advantageous Tender” should be established by applying appropriate weightings to quality, price and life cycle costs in accordance with the mechanism laid out in the tender dossier.

However, if tenders are invited on the basis of various criteria other than price (e.g. quality, performance specifications, design requirements, time for completion, life-cycle costs, etc.) the evaluation of such tenders can become much more complex, if not subjective. Therefore, the interpretation of public procurement rules should respect its primary objective, which is economical in nature, and at the same time integrating life-cycle and environmental criteria, without, however, replacing the primary objectives of procurement.

The steps to be taken by the Contracting Authority normally cover five stages:

- 1. Choice of the award criteria in addition to price;**
- 2. Weighting of the criteria;**
- 3. Assessment of the tenders in the light of each criteria;**
- 4. Rejection of abnormally low tenders;**
- 5. Final ranking of the tenders.**

\* ECJ Case C-247/02, “*Sintesi SpA vs. Autorità per la Vigilanza sui Lavori Pubblici*”

### 4.1.2 ALTERNATIVE PROPOSALS

Alternative proposals are tenders that the tenderer believes satisfy the Contracting Authority's needs, but do not specifically comply with the requirements set out in the tender documentation. It may involve a technical innovation or some other change in approach which will reduce the costs or improve the performance of the project. In some cases, the Contracting Authority may want to require tenderers to submit a compliant bid in addition to any variant bid or it may wish to restrict the extent to which a bid may be varied from a compliant bid, by specifying those elements of the bid which are fixed or otherwise not subject to variation.

#### EIC recommendation

EIC recommends that contractors should have the **option to propose technical alternatives without being disqualified**. The Contracting Authority in fact should encourage tenderers to submit alternative proposals based on performance criteria as a powerful source for innovation, thereby selecting bidders on the basis of best value for money. A prospective tenderer may have the knowledge to offer a solution to the construction of the project that is different from the solution described in the tender documents. The practical solution is to invite tenderers to present alternative proposals, provided that such tenders reduce costs (where appropriate, taking into account life-cycle costs), shorten the construction period or allow better implementation of the project. To ensure comparability, it is generally stated in the instructions to bidders that no alternative bid will be considered unless the bidder also submits an unmodified bid in accordance with the tender documents. If an alternative technical solution reduces costs, these savings should be shared in an equitable manner.

### 4.1.3 TWO-ENVELOPE SYSTEM

In order to avoid the risk of abnormally low tenders, in some countries bidders are required to formulate and submit their technical and financial proposals in two separate envelopes. This permits the Contracting Authority to evaluate the technical quality of proposals without being influenced by their financial components.

#### EIC recommendation

The advantage of a two-envelope system is that first the technical proposals are evaluated, and **the technical solutions that are the most attractive to the Contracting Authority can be selected without any bias from the knowledge of the price of that solution** in those cases where the need for a good technical solution is obviously more predominant than the corresponding price. However, a transparent procedure is required if the two-envelope system is to work properly. Ideally, all second envelopes, containing the financial proposal corresponding with the technical proposal of the individual bidders, are placed in the hands of a third party (civil law notary or attorney), in whose presence only the financial proposal corresponding with the desired technical solution is opened. If the financial proposal does not correspond with the Contracting Authority's budget, the financial envelope relating to the technical solution deemed "second best" is opened and so forth until a selection is made. The unopened envelopes are sent back to the non-successful bidders after award of the contract.



## 4.2 TWO-STAGE PROCEDURE

An increasing number of engineering projects world-wide are being procured as so-called “turnkey” or “design-build” projects on the basis of so-called “performance” or “functional” specifications which set out the performance or “output” that the facility is required to achieve. In these cases, the employer only sets out in his Employer’s Requirements the performance specifications and the result that is to be achieved, and should leave the contractor a free hand to propose how best to achieve that result.

The decision between having a single or a two-stage procedure will normally be based on how precisely the technical requirements can be defined. There might be cases where the Contracting Authority has not determined the design or the type of technical and material input that would be suitable for the project in question. In order to draw on the experience and the skills of the tenderers, the Contracting Authority may wish to divide the selection proceedings into two stages and allow a certain degree of flexibility for discussions with tenderers. The invitations to bidders would allow bidders to offer their own solutions for meeting the particular needs in accordance with the defined standards of the project.

### EIC recommendation

In EIC’s view, involvement of the private partners at tender stage is one of the best guarantees for promoting innovation and maximising value for money although the conduct of such a dialogue requires a transparent and non-discriminatory framework. EIC therefore recommends that **MDBs and Contracting Authorities seriously consider to award larger infrastructure projects on the basis of “turnkey” or “design-build” arrangements.** The combination of “single point” responsibility for design and construction will decrease the overall time for completion. Furthermore, efficiencies in the design and construction process are likely to reduce the price of the project. As the responsibility for the management of the interfaces passes from the Contracting Authority to the contractor, the potential for disputes is also diminished significantly.

However, under such procurement methods, the tender stage takes on greater importance. Bearing in mind some bad examples, where “turnkey” type of contracts have been awarded on the basis of ill-defined Employer’s Requirements in a single-stage procedure, there are good reasons to apply a **two-stage tender procedure** in these cases, provided that the process is run efficiently and does not take too long. We would recommend that the first stage be considered by the Contracting Authority and the tenderers as an opportunity to exchange ideas with a partnering attitude, however, without putting the intellectual property of any of the bidders at risk (“cherry picking”). The Contracting Authority must define minimum mandatory requirements in terms of objectives, quality, timeframe and special features of the contract which should remain unchanged throughout the entire procedure. The dialogue procedure should also provide for a mechanism to answer queries and to disseminate to all bidders any additional information supplied to one of them. Subsequently, a selected short list of bidders is compiled and these bidders are asked to make a financial proposal on revised and equal terms.

## 4.3 PERFORMANCE-BASED PROCUREMENT

Since the traditional approach of providing infrastructure facilities on the basis of an input-driven specification has not always led to positive results, especially not in the context of development financing, the international donor community has started to look for new ways to better target government and donor funds. The new approach of “Performance Based Procurement” (PBP) tries to improve the delivery of services by outsourcing their provision to the private sector and linking the payment of subsidies to the delivery of services to targeted groups. As the transport sector poses a particular challenge for creating the necessary financial capacity and incentives for ongoing maintenance and capital investments, there is a need to ensure that the facility will not only be constructed but also maintained and operated over the project’s anticipated life-time.

Whereas under traditional projects the Contracting Authority orders and receives a facility (e.g. a water treatment plant or a highway), under many PBP projects it purchases a service (e.g. the supply of treated water or the provision of a highway – which includes duties relating to its maintenance and operation). However, since the MDBs follow the general policy of encouraging their clients to operate and maintain their own new or rehabilitated facilities, in the interests of positive development and experience within their organisations, projects procured on the basis of “performance” or “output” specifications may, as an alternative, be operated and maintained by the Contracting Authority.

### EIC recommendation

EIC generally welcomes the PBP concept, as it allows tenderers to compete on a much broader spectrum of award criteria than just price. Moreover, PBP would ensure the above-mentioned general objective of development aid, i.e. to ensure that aid-funded spending for infrastructure reaches the poor, that the services this money finances respond to their needs and preferences, that these services are delivered efficiently, and that public funds are used in a way that leverages private financing of service delivery.

Therefore, EIC fully backs a recent World Bank research study\* which comprises an analysis on Performance-Based Procurement of MDB and BDO-funded large, complex projects with the purpose of investigating whether procurement of large, complex projects funded by the World Bank and other donors should, in some cases, be made on the basis of performance or functional specifications. The Study, which is limited to infrastructure type projects, particularly in the fields of power production, water and sewage, and the other utilities, has concluded that there are **“a number of very significant benefits to be gained by all concerned when PBP of projects of the types mentioned are adopted. For large, complex projects, these benefits would appear to outweigh any negative aspects by far”**.

\* Study on Performance-Based Procurement of IFI and Donor-Funded Large, Complex Projects -- Final Report, March 29, 2004.



The main conclusions of the Study can be briefly summarised as follows:

- **Contractors and manufacturers may offer their own newer, more efficient and often cheaper technological solutions;**
- **Research and development by plant manufacturers and suppliers will be stimulated to the benefit of all concerned;**
- **Nothing in the World Bank's Procurement Guidelines or Standard Bidding Documents precludes the use of performance or functional specifications;**
- **Pre-qualification followed by a two-stage procurement procedure is most suitable;**
- **European experience shows that PBP has worked well where Employers with qualified and experienced staff have taken over and operated the completed facilities themselves;**
- **In developing and transition countries, when Employers do not have suitably trained operation and maintenance staff, more satisfactory results may be achieved by requiring the contractor to be responsible for the operation of the completed facility, i.e. for providing a service to the users rather than just a facility;**
- **Preparation of functional specifications and evaluation of tenders requires consulting engineers with competent and experienced technical draftsmen.**

The European Commission has taken a preliminary position that donors should consider inviting tenders for design and construction work together, as combined tendering could lead to significant cost savings and bring about creative solutions to certain problems of service provision. When using grants, donors should increasingly consider using Output-Based Aid approaches.\*

However, the PBP concept carries with it inherent challenges which have to be tackled by the supply side. A significant challenge may be the **warranty system** where it will be crucial to find out what the market has to offer. Bonding on PBP is even more critical than bonding on standard warranty projects because the contractors assume a larger investment over a much longer period of time and they create a burden on both the contractor and the surety industry. Another challenge is the need for symmetrical warranties for contractors who wish to embark on PBP schemes. While Contracting Authorities look for suitable warranties for their projects, contractors would also like to have certainty that they will be paid. Payment has often proven to be problematic in some developing

\* "Public-Private Partnerships in Developing and Transition Countries – A Critical Review of Existing Experiences and Analysis of Possibilities of Donor Intervention", European Commission Staff Working Document, 30 July 2004.



and transition countries; the situation is likely to be worse if contracts are to be extended to periods much longer than seen in traditional contracts. Adequate tools should therefore be introduced for PBP schemes, such as partial risk guarantees.

#### 4.4 PUBLIC-PRIVATE PARTNERSHIPS

Contracting Authorities have in recent years increasingly tried to attract the private sector to the development, planning, financing, construction and operation of infrastructure projects in the transport (roads, railways, ports, airports), energy (power plants, transmission lines, etc.), sanitation (water supply, wastewater treatment, waste disposal) and public building sectors (schools, hospitals, military buildings, etc.). Under the generic term “Public-Private Partnership”, numerous project models have been created and implemented (PFI, DBFO, BOT, BOOT etc.) which all aim at organising private sector participation in the project. Between 1990 and 2002, 136 developing and transition countries introduced private participation in infrastructure sectors. During that period the private sector took over the construction or operating risk, or both, for more than 2,600 infrastructure projects, attracting investment commitments of more than US\$ 800 billion in developing and transition countries. Annual investment flows to PPP models grew strongly between 1990 and 1997, but have since declined, mainly because of the financial crises in South East Asia and Latin America.

Unfortunately, the allocation of funds by MDBs and other International Financial Institutions, which in many cases could play the role of a catalyst for PPP schemes, has, due to the stronger role of the private sector, been shifting away from infrastructure investments to structural credits in order to level out the balance of payments of borrowing countries and reinforce their financial sector programmes. Given the financial limits for most national budgets and MDB credit lines, it will simply be impossible to achieve the Millennium Development Goals without organising some form private participation – which has to be guaranteed – in the provision of infrastructure in the developing world. Therefore, a new balance between public and private sector roles has to be found for infrastructure financing and service provision.

#### EIC recommendation

Evidence from many national sources shows that well-designed PPP schemes in fact produce improvements in the quality and the quantity of infrastructure services, as well as major efficiency gains. **By shifting risks from the public to the private sector, either through competition or through an effective regulatory framework, additional value for money can be created.**

One of the most important risks is the **construction risk**: recent experience of Government procurement shows that all too often new assets have been delivered by contractors late, to poor quality and over budget, additional costs being borne by the taxpayer. Conversely, according to U.K. studies, 88% of the PFI (Private Finance Initiative) construction projects were delivered on time or early, and 78 % were within budget, whereas only 30% of non-PFI major construction projects were delivered on time and only 27% within budget.



Cost advantages can also be drawn with regard to the **operation risk**: the sooner the private sector is involved in an infrastructure project, the greater the scope for reducing operating costs and generating savings.

But there are obvious challenges. In recent years, there has been a growing concern and even frustration by governments, sponsors and investors alike about the difficulties in successfully implementing private infrastructure projects. The core of the problem lies in the lack of overall sectoral reform in developing and transition countries' infrastructure markets, combined with the very complex nature of project finance transactions, unfamiliar to the typical civil servant in developing and transition countries. Moreover, practically every country experiences resistance from special interest groups and existing state-owned monopolies to introduce competition by opening markets to private sector providers.

EIC recommends that **MDBs should start to look deeper into the possible synergies between Official Development Aid (ODA) and Foreign Direct Investments (FDI)**. It is the firm belief of EIC that **ODA could act as a catalyst** to trigger more foreign direct investment into infrastructure projects in the developing world. In developing and transition countries, the role of the MDBs is absolutely crucial in the development of PPP projects, in order to compensate for the non-existence or the deficiencies of the local capital markets. Therefore, the existing tools should be revised and assessed with reference to their efficiency and new instruments could be created to respond to the needs of PPP projects in developing and transition countries.

Apart from the important task of **institutional capacity-building**, the **MDBs' "core competence" is to provide very favourable financing conditions, in terms of equity, debt and guarantees**, in order to promote infrastructure PPPs in transition countries.

MDBs could play a leading role in establishing the following financial framework conditions:

- In order to reduce the debt-equity ratio in PPPs, more equity, e.g. through the **IFC**, should be made available, e.g. in form of **infrastructure funds**. Such a financing structure would provide more of a cushion in difficult times.
- In order to provide reserves in the event that project revenues fall below the critical thresholds, **credit enhancement structures** should be introduced, e.g. through **MIGA**. MDBs could replenish such extra layers on a periodic basis.
- In order to develop an adequate operation tool to finance large infrastructure projects, new infrastructure loans could be pooled into a **specialised ODA Infrastructure Bank** which would most likely work in conjunction with the existing MDBs and a host country's development bank.

## CONCLUSION

At the beginning of the 21<sup>st</sup> century, the world community acknowledges a growing infrastructure gap with the result that around 1 billion people lack adequate road access, some 1.1 billion lack a safe water supply, 2 billion do not have access to improved sanitation and 2.4 billion are estimated to lack electricity connection. It is estimated that meeting the challenge of increasing access to quality infrastructure services will require sizeable investments in the range of about 7% of GDP for all developing countries for both new investment and maintenance expenditures.

It is for that reason that all parties responsible for or interested in infrastructure development in world regions where infrastructure is desperately needed to achieve the Millennium Development Goals have an almost sacred obligation, towards both the recipients and the providers of such funds, to maximise the added value of every Euro or dollar spent in the realisation of such infrastructure.

In the light of the obvious demand, EIC feels that **there is a market for all types of infrastructure projects, large, medium and small, and thus for a much broader range of procurement methods than currently applied by the MDBs**. In our view, more infrastructure projects must be established, but at the same time in a more professional manner. Realistically, the traditional design-bid-build tender system will not be replaced by more flexible procurement regimes on a very broad scale. However, from our perspective, improvements could also be promoted within the conventional system.

**“Sustainable Procurement” starts with an efficient pre-qualification of applicants, followed by a tender process based on high-quality documents and balanced contract conditions.** The period that follows the submission of bids and runs until the contract becomes effective is not only the part of the procurement process that is the least prescribed but is also the most under-utilised. It is the period when the contractor’s offer must be rigorously tested to ensure that it is completely compliant with the requirements of the Contracting Authority. Such requirements must be technically robust, clear and unambiguous.

**To ensure the highest quality for the lowest price, however, MDBs should more often apply innovative tender procedures that allow qualified bidders to bring their expertise adequately to the competition.** Through “turnkey” or “design-build” tenders, Performance-Based Procurement and Public-Private Partnerships, added value can be achieved, such as:

1. Investment in the developing markets;
2. Transfer of knowledge to local contractors;



3. Increased efficiency through early involvement of contractors in the initial phases of the project;
4. Optimised life-cycle costing; and
5. Adherence to the principles of sustainable development, including the principles of socially responsible enterprising.

In the light of the disillusioning findings of the “*Global Monitoring Report 2004*”, EIC holds the view that the international development agenda could be addressed more efficiently if the **international donor community were to co-ordinate its requirements and processes** for preparing, procuring, delivering and monitoring the implementation of infrastructure projects financed under Official Development Assistance. A crucial step to overcome the current lack of funds from the international donor community will be for **MDBs and BDOs to pool a certain fraction of their funds for infrastructure investments** in order to “scale-up” projects and to create synergies between them, not only on the abstract policy level, but also on the very concrete level of financing and project implementation.

Against this background, we very much welcome the **Rome Declaration on Harmonisation of 25 February 2003** of the MDBs and BDOs and, in particular, their intention “*to simplify individual systems and procedures and to work together toward common formats, content, and frequency for a single periodic report that meets the needs of all partners*”. We hope that MDBs and BDOs do not cease in these efforts and European international contractors are willing and able to take part therein.

We believe that, under the right framework conditions, the participation of European international contractors shall be an important element in fulfilling these criteria. In particular, there are no contradicting interests if large contracts were awarded to foreign contractors, who have the required skills and resources to manage the job, and then subcontract to local contractors, wherever possible.

## EIC Publications

- EIC Turnkey Contract (1994)
- EIC Synopsis on Contract Bonds (1999)
- EIC Contractor's Guide to the FIDIC "Silver Book" (March 2000)
- EIC Contractor's Guide to the FIDIC "New Red Book" (March 2002)
- EIC Contractor's Guide to the FIDIC "New Yellow Book" (March 2003)
- EIC White Book on BOT (April 2003)
- EIC Blue Book on Sustainable Procurement (November 2004)

## 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](mailto:eicontractors@compuserve.com)
- [www.eicontractors.de](http://www.eicontractors.de)