

**TRANSPARENCY INTERNATIONAL**



**PREVENTING CORRUPTION ON  
CONSTRUCTION PROJECTS**

**CONSTRUCTION INTEGRITY PACTS**

**March 2005**

## EXECUTIVE SUMMARY

1. This report examines the use of enforceable and independently monitored agreements between parties to act with integrity in relation to construction projects (“integrity pacts”).
2. Corruption on a construction project increases project costs, and imposes business, economic and legal risks on both corporations and individuals. It also has an adverse effect on international development, resulting in increased poverty.
3. In TI’s view, corruption could be materially reduced by the use of integrity pacts on construction projects. An integrity pact is a tool developed by Transparency International during the 1990’s. It has been used in varying forms in over 14 countries ([www.transparency.org](http://www.transparency.org)). Three separate model integrity pacts have been designed by TI specifically for use in relation to construction projects. They are intended for use in both the public and private sectors.
  - a) **Integrity Pact - Sector:** An agreement between companies working in the same sector to act with integrity when they compete against each other in tendering for any project anywhere in the world.
  - b) **Integrity Pact - Project - Pre-qualification and Tender:** An agreement between the project owner, designer (if applicable) and all bidding contractors to act with integrity in relation to the pre-qualification and tender process for a specific project.
  - c) **Integrity Pact - Project - Execution:** An agreement between the project owner, certifier (if applicable) and the selected contractor to act with integrity in relation to the execution of a specific project.

In appropriate cases, governments, banks and other relevant parties would also sign the pact. To download these model integrity pacts see “Preventing Corruption on Construction Projects - [www.transparency.org](http://www.transparency.org).”
4. In order to be effective, agreements of this nature require three key elements:
  - a) undertakings by all relevant parties that they will act with integrity in relation to specific obligations;
  - b) an independent system of verifying that the parties are complying with their commitments;
  - c) effective sanctions in the event that a party fails to comply with its commitments.
5. The undertakings cover key integrity issues, such as commitments not to pay or receive bribes, objective assessments of pre-qualifications and tenders, and fair procedures for certification, payment and claims management.
6. The independent verification is carried out for the duration of the project by an independent assessor who has free access to relevant books, records and staff.
7. The sanctions are provided by:
  - a) the obligation of the assessor to report any suspected offence to all the parties and to relevant third parties, and to any appropriate professional association and prosecuting authorities;
  - b) the obligation of the parties to report any suspected offence to the assessor, and the right of the parties to report any suspected offence to any appropriate professional association and prosecuting authorities;
  - c) the right of the parties to claim damages from a defaulting party;
  - d) disqualification and blacklisting.
8. The following paragraphs examine this concept in more detail.

## **ANALYSIS**

### **INTEGRITY RISKS IN RELATION TO A CONSTRUCTION PROJECT**

9. The following section examines some of the events which could occur during the different phases of a construction project which are caused by lack of integrity. It is these types of risk which need to be covered by the integrity pact.
10. **Planning and Design Phase**
- a) The project owner may pay a bribe to a government official in return for planning permission, or a waiver of building regulations.
  - b) The project may, as a result of a bribe, be designed or specified by the project owner or engineer in a manner which improperly favours one bidder over the others.
11. **Pre-Qualification and Tendering Phase**
- a) A bidder which is properly qualified may find itself being rejected at pre-qualification stage as a result of a bribe paid to the project owner or engineer by another bidder.
  - b) A bidder may pay a bribe in return for being awarded a contract.
  - c) The bidders may secretly collude with each other to share the market.
12. **Project Execution Phase**
- a) A contractor may win a contract tender as the lowest priced bidder without including a bribe in the contract price, but agree secretly with the project owner's representative that a large variation including a bribe will be agreed at a later stage.
  - b) A contractor may pay a bribe to the architect/engineer in return for the architect/engineer issuing a payment certificate or an extension of time to the contractor.
  - c) A contractor may pay a bribe to the project owner's works inspector in return for him approving defective or non-existent work.
  - d) A project owner may pay a bribe to the architect/engineer in return for the architect/engineer refraining from issuing a payment certificate or an extension of time to the contractor, or for issuing a certificate entitling the deduction of liquidated damages from the contractor.
  - e) A contractor may submit falsified records to support a claim (e.g. false programmes, invoices, timesheets etc.).
  - f) An architect/engineer may know that an extension of time should properly be granted to a contractor, yet refuse the extension of time as a result of pressure from the project owner not to grant it, or in the hope of gaining future work from the project owner.

- g) A project owner may submit false or exaggerated claims against the contractor alleging that the contractor has delayed the project, or that the contractor’s works are defective. In many cases, the project owner will use these false or exaggerated claims as a pretext to draw down on the contractor’s performance bond, deduct liquidated damages, or withhold the retention.

13. **Operation and Maintenance Phase**

Bribes can be paid to win operation and maintenance contracts, and fraudulent practices can lead to inflated operation and maintenance costs, in just the same way as during the tender and project execution phases referred to above.

**Detailed Examples**

- 14. More extensive and detailed examples and analysis of corrupt practices are contained in TI’s report “Preventing Corruption on Construction Projects – Examples of Corruption” ([www.transparency.org](http://www.transparency.org)).

**WHO SUFFERS FROM THE INTEGRITY RISKS?**

- 15. All parties involved in project suffer from the above integrity risks. Each participant is examined below.

Contractor’s risk

- 16. Most companies wish to be able to tender for a project without paying a bribe to a representative of the project owner or applicable government. However, a company which does not wish to pay a bribe frequently finds itself facing difficult choices, particularly in the international market where bribery is common. If the company believes that a bid is only likely to be won by paying a bribe, it faces three choices.
  - a) It decides not to bid. It knows that the contract is unlikely to be won by a company which does not pay a bribe. It is unwilling to pay a bribe. It therefore loses potential business, which may in turn result in loss of jobs.
  - b) It decides to bid without paying a bribe. However, if the contract is won by another organisation which does pay a bribe, the company loses potential business and its bidding costs due to an illegal act.
  - c) It decides that the contract is so important to the company (e.g. if failing to win the contract results in job losses) that it decides to set aside temporarily its principle of integrity and pay a bribe. It may pay the bribe in a manner which it believes minimises the risk of discovery (e.g. through an agent in another country). It may justify the bribe morally on the basis that it is the standard way of doing business in the country in question, and that jobs are at stake. However, it still runs the risk of losing the contract (e.g. to a company which pays a higher bribe, or pays a more influential recipient). If it wins the contract, it faces the potentially devastating corporate and personal consequences if the bribe is uncovered.

A company facing the above choice will be only be able to tender without feeling compelled to pay a bribe if it can be reasonably assured either that its competitors will not pay a bribe, or, if they do pay a bribe, that they will be found out and appropriate sanctions applied.

17. During project execution phase, the contractor may suffer as a result of the architect/engineer wrongfully withholding certificates, or the project owner wrongfully creating false claims to set off against the contractor's payment certificates. The contractor may anticipate this problem, or retaliate against this problem, by creating its own false claims to counteract the project owner's false claims, but this leads to unsatisfactory and expensive disputes.

#### Project owner's risk

18. The project owner does not benefit from bribery. It is one of the project owner's senior representatives, or a government official, who normally receives the benefit of the bribe, not the project owner itself. The wrongful elimination of the best bidders from a pre-qualification or tender may deny the project owner the benefit of the most economic or best technical bid. Secret collusion between contractors at tender stage can result in the project owner paying a higher price for the project, or paying the cost of losers' fees. During project execution phase, the project owner may suffer as a result of the contractor wrongfully creating false claims. Falsification of work reports may result in a defective or inferior project.

#### Funders' risk

19. The funders of the project comprise anyone who is financing, guaranteeing or insuring the project. They could include a combination of taxpayers, international donors, financial institutions, export credit agencies, private sector banks, surety companies, guarantors, insurers or equity investors. In the event of collusion at bid stage, or wrongful exclusion of the best bidder, the funders will be financing, guaranteeing or insuring a project which may not be to the best design, to the best quality or at the best price. Corruption may result in losses and reputational risk for the funder. For example, the additional costs caused by corruption can make the project uneconomic which may result in non-payment to the funder. Claims against the funder may be fraudulent. Contracts which are procured through bribes may be invalid, or can be terminated, resulting in the collapse of the project or contractor, and resultant irrecoverable losses to the funder. Failure to undertake adequate anti-corruption measures could expose the funder and its employees to the accusation that they were aiding and abetting bribery.

#### No winners

20. All the parties to a project therefore lose as a result of these integrity risks. Even the parties who participate in these practices and who benefit in the short term, will lose in the long term. For example:
- a) A contractor may win a project as a result of a bribe. However, in the future the contractor is likely to lose many projects as a result of other contractors bribing more successfully than it.
  - b) A contractor or project owner may gain in the short term as a result of an unwarranted payment received from a false claim. However in the long term, they are likely to suffer at the hands of false claims submitted by other parties.
  - c) All participants in these practices face the risk of penalty if the practices are uncovered, including:
    - i) criminal prosecutions and fines for the organisation;
    - ii) criminal prosecutions, disqualification from office, fines and imprisonment for individuals;
    - iii) the organisation being blacklisted from accessing projects sponsored by international aid agencies, banks and export credit agencies;
    - iv) the contract in respect of which a bribe was paid being declared void for illegality, resulting in the organisation being required to indemnify the project owner, banks, export credit agencies and other relevant parties;
    - v) vulnerability to private prosecutions and civil claims for compensation by aggrieved parties;

- vi) reputational risk and adverse publicity for the organisation;
- vii) economic damage to the organisation, resulting at best in downward pressure on the value or share price of the organisation, and at worst in total destruction of the organisation.

### **Elimination of Integrity Risks through use of Integrity Pacts**

21. It is therefore in all parties' interests to try to eliminate the integrity risks on a project. All the parties would benefit from a more transparent and objective project environment. It is for this purpose that the integrity pacts have been designed. In the integrity pacts, the parties expressly undertake that they will not participate in the above types of practice, and measures are put in place to ensure that the agreements are policed and enforced.

### **THE TYPES OF INTEGRITY PACT, AND THEIR KEY COMPONENTS**

22. The following section examines three types of integrity pact designed by TI specifically for use in relation to construction projects. It looks at the key components of these pacts. Model pacts can be freely downloaded from "Preventing Corruption on Construction Projects" - [www.transparency.org](http://www.transparency.org). The three types are:
- Integrity Pact - Sector
  - Integrity Pact - Project - Pre-qualification and Tender
  - Integrity Pact - Project - Execution
23. Every situation is different. Therefore, while these integrity pacts have been designed to apply as widely as possible, they will need to be modified to take account of specific circumstances. It is important that anyone using these integrity pacts takes their own independent legal advice to ensure that they are suitable for their purposes, and comply with applicable laws.

#### **Integrity Pact - Sector**

24. The Integrity Pact - Sector is an agreement between companies working in the same sector to act with integrity when they compete against each other in tendering for any project anywhere in the world. It has the following key components.
25. It is signed by all companies which regularly compete against each other in a particular sector. It is only likely to be achievable in a sector where there are a relatively limited number of competitors.
26. Each party provides the following undertakings to the other parties:
- a) It will not offer or accept a bribe or other improper advantage in connection with the pre-qualification or tender for any project in that sector anywhere in the world.
  - b) It will not take any steps which could unduly influence the function of the independent assessor.
  - c) It will take all reasonable steps to ensure compliance with the terms of the integrity pact by all of its staff, consultants, parent and associated and subsidiary companies, agents, consortium and joint venture partners, sub-contractors and suppliers.
  - d) It will maintain and enforce a written anti-bribery policy applicable to its business.
27. The parties agree to appoint a suitably qualified and experienced independent assessor whose duty is to assess on an independent and objective basis the extent to which the parties comply with their obligations under the integrity pact.

28. The parties will, after submission of a tender for any project, and after award of any project to them:
  - a) allow the independent assessor unrestricted access to all books, records and staff relevant to such tender or project;
  - b) procure that the independent assessor has unrestricted access to the relevant books, records and staff of their consultants, parent and associated and subsidiary companies, agents, consortium and joint venture partners, sub-contractors and suppliers.
29. In the event that the independent assessor believes that there is evidence that there has been a failure by a party to comply with any provision of the integrity pact, the independent assessor will include full details of such suspected non-compliance in a written report which will be circulated simultaneously to the chief executives of each of the parties.
30. In the event that any failure by a party to comply with the provisions of the integrity pact may constitute a breach of any disciplinary code of any professional association, or a breach of the criminal law, the independent assessor will notify the breach to the relevant professional association or criminal authorities.
31. In the event that any party believes that there has been a failure by another party to comply with any provision of the integrity pact, such party:
  - a) will report the matter to the independent assessor with copies to the chief executives of each of the parties;
  - b) may report the matter to the relevant professional association or criminal authorities;
  - c) may claim damages.
32. Upon receipt of a report from the independent assessor, the chief executives of all the parties will discuss and try to agree the appropriate action which should be taken to deal with such non-compliance.
33. The parties will take appropriate disciplinary or enforcement action against any of their staff, consultants, parent and associated and subsidiary companies, agents, consortium and joint venture partners, sub-contractors and suppliers who cause or assist in any breach of any provision of the integrity pact.
34. In the event that a specific integrity pact is to be entered into in relation to a project, then the parties may, as far as the specific project is concerned, agree to suspend the operation of the sector integrity pact, and allow the specific project integrity pact to take precedence.
35. The integrity pact contains a dispute resolution clause (normally arbitration).

#### **Integrity Pact - Project - Pre-qualification and Tender**

36. The Integrity Pact - Project - Pre-qualification and Tender is an agreement between the project owner, designer (if applicable) and all bidding contractors to act with integrity in relation to the pre-qualification and tender process for a specific project. In appropriate cases, governments, banks and other relevant parties would also sign the pact. It has the following key components.
37. It is signed by the project owner and all bidding contractors. This is achieved by the project owner sending out with the project documents two copies of the pact signed by the project owner to each contractor which intends to submit a pre-qualification or tender. Any contractor which submits a pre-qualification or tender must return one integrity pact counter-signed by the contractor. This will mean that there will be an identical duplicate agreement for each bidder.

38. In the event that the project owner has appointed a designer to design the project on its behalf (for example an independent firm of architects or engineers) then the designer will also countersign each integrity pact.
39. Each party provides the following undertakings to the other parties:
- a) It will not offer or accept a bribe or other improper advantage in connection with the pre-qualification or tender for the project.
  - b) It will not take any steps which could unduly influence the function of the independent assessor.
  - c) It will take all reasonable steps to ensure compliance with the terms of the integrity pact by all of its staff, consultants, parent and associated and subsidiary companies, agents, consortium and joint venture partners, sub-contractors and suppliers.
  - d) It will maintain and enforce a written anti-bribery policy applicable to its business.
40. The project owner and designer provide the following undertakings to the contractor:
- a) No part of the project has been designed or specified with the intention of offering an undue advantage to one or more bidders.
  - b) They will not disclose confidential information to any third party who may use this information for an undue advantage in the pre-qualification process or tender process.
41. The project owner provides the following undertakings to the contractor:
- a) All pre-qualifications and tenders will be assessed by fair, objective and arms-length criteria.
  - b) The bidder chosen to construct the project will be selected by fair, objective and arms-length criteria.
  - c) All pre-qualifications and tenders will be received by the project owner sealed, and will only be opened at a public opening exercise at which the independent assessor and all bidders and other interested members of the public are entitled to be present. The price of each tender will be read out at the public opening exercise.
  - d) Within one month after completion of the selection procedures under the pre-qualification process and tender process, the project owner will publicly disclose its decision, the major elements of the evaluation, and the reasons for its decision.
  - e) The project owner will disqualify from the pre-qualification and tender process any bidder who does not sign an integrity pact in identical terms, or who breaches any provision of the integrity pact.
42. The designer undertakes to the contractor that it will use fair, objective and arms-length criteria in relation to the following:
- a) Recommendations from the designer to the project owner as to bidders who will be invited to tender after the pre-qualification process.
  - b) Recommendations from the designer to the project owner as to the bidder who will be selected to construct the project.
43. The contractor provides the following undertakings to the project owner:
- a) The contractor has not co-operated with any other bidder in connection with the pre-qualification process or tender process, except to the extent that all material terms of co-operation have been informed in writing by the contractor to the project owner together with the pre-qualification or tender.
  - b) The contractor will provide the project owner together with its tender with a schedule which shows:
    - i) the name and address of any agent to which the contractor, or the contractor's parent, associated or subsidiary company, consortium or joint venture partner, or sub-contractor, intends to make any payment, directly or indirectly, in relation to the project;
    - ii) the amount intended to be paid to each agent, and the currency of such payment;
    - iii) a summary of the services which each agent is intended to provide.

- c) The contractor will provide such further details in relation to the above agents and payments as the project owner shall require.
44. The parties agree to appoint a suitably qualified and experienced independent assessor whose duty is to assess on an independent and objective basis the extent to which the parties comply with their obligations under the integrity pact.
45. The parties will, after submission of a tender, allow the independent assessor unrestricted access to all books, records and staff relevant to the tender, and procure that the independent assessor has unrestricted access to the relevant books, records and staff of their consultants, parent and associated and subsidiary companies, agents, consortium and joint venture partners, sub-contractors and suppliers.
46. The project owner will permit the independent assessor to attend meetings at which will be discussed any material matters in relation to the pre-qualification process or tender process.
47. Within one month after completion of the pre-qualification process, and within one month after completion of the tender process, the independent assessor will issue a written report simultaneously to each of the following:
- a) the project owner;
  - b) the designer;
  - c) all bidders;
  - d) any organisation providing financial aid or project financing in relation to the project;
  - e) any export credit agency providing export credit guarantees or other insurance in relation to the project.
- These reports will provide details of all suspected or actual breaches of the provisions of the integrity pact, and all follow up actions taken. The reports will also, in the case of public sector projects, or publicly financed projects, be published by the independent assessor on the internet.
48. In the event that any failure by a party to comply with the provisions of the integrity pact may constitute a breach of any disciplinary code of any professional association, or a breach of the criminal law, the independent assessor will notify the breach to the relevant professional association or criminal authorities.
49. In the event that the project owner or designer breaches any provision of the integrity pact:
- a) The contractor may withdraw its pre-qualification and/or tender without liability to the project owner.
  - b) If the contractor withdraws, the project owner will return the contractor's bond or other payment security.
50. In the event that the contractor breaches any provision of the integrity pact:
- a) The project owner will disqualify the contractor from the pre-qualification process and tender process without liability to the contractor.
  - b) The project owner will not permit the contractor to bid for any other work for the project owner, or for any of the project owner's parent, subsidiary or associated companies, for a fixed period from the date of the breach.
51. In the event that any party believes that there has been a failure by another party to comply with any provision of the integrity pact, such party:
- a) will report the matter to the independent assessor;
  - b) may report the matter to the relevant professional association or criminal authorities;
  - c) may claim damages.

52. The parties will take appropriate disciplinary or enforcement action against any of their staff, consultants, parent and associated and subsidiary companies, agents, consortium and joint venture partners, sub-contractors and suppliers who cause or assist in any breach of any provision of the integrity pact.
53. The integrity pact contains a dispute resolution clause (normally arbitration).

**Integrity Pact - Project - Execution**

54. The Integrity Pact - Project - Execution is an agreement between the project owner, certifier (if applicable) and the appointed contractor to act with integrity in relation to the execution of the project. In appropriate cases, governments, banks and other relevant parties would also sign the pact. It has the following key components:
  55. It is signed by the project owner and the contractor. In the event that the project owner has appointed a certifier to issue extensions of time, payment certificates etc. (for example an independent firm of architects or engineers), then the certifier will also countersign each integrity pact.
  56. In relation to major infrastructure projects, it would be beneficial if the applicable government departments also become a party to the integrity pact, as the actions of their staff (e.g. in issuing import permits, visas, exchange control certificates etc.) can have a major impact on project performance.
  57. Each party provides the following undertakings to the other parties:
    - a) It will not offer or accept a bribe or other improper advantage in connection with the execution of the project.
    - b) It will not take any steps which could unduly influence the function of the independent assessor.
    - c) It will take all reasonable steps to ensure compliance with the terms of the integrity pact by all of its staff, consultants, parent and associated and subsidiary companies, agents, consortium and joint venture partners, sub-contractors and suppliers.
    - d) It will maintain and enforce a written anti-bribery policy applicable to its business.
  58. The certifier undertakes to the project owner and contractor as follows:
    - a) It will use fair, objective and arms-length criteria in making recommendations or decisions in relation to the following matters under the contract:
      - i) variations;
      - ii) extensions of time;
      - iii) defects;
      - iv) certification;
      - v) payment;
      - vi) the performance of the contractor under the contract;
      - vii) any other matters requiring the recommendation or decision of the certifier.
    - b) It will issue the above recommendations or decisions within a reasonable time.
  59. The contractor provides the following undertakings to the project owner:
    - a) Every six months for the duration of the project, and one month after completion of the final account for the project, the contractor will provide the project owner with a schedule which shows:
      - i) the name and address of any agent to which the contractor, or the contractor's parent, associated or subsidiary company, consortium or joint venture partner, or sub-contractor, has made any payment, directly or indirectly, in relation to the project;
      - ii) the amount paid to each agent, and the currency of such payment;
      - iii) a summary of the services which each agent has provided.

- b) The above schedules will be accompanied by a statement that “all payments shown in the schedule are appropriate compensation for legitimate services provided”. The schedules and statements will be signed by the head of the contractor’s head office finance function.
  - c) The contractor will provide such further details in relation to the above agents and payments as the project owner shall require.
60. The parties will deal with all claims between them in accordance with the following procedures. “Claims” includes claims or disputes in relation to or arising out of the contract or the integrity pact, including payment, extension of time, variations, the issuing of certificates, defects, non-performance, or any other claim or dispute between the parties.
- a) The claimant will take all reasonable steps to ensure that:
    - i) the claimant only submits a claim to the opponent or to the dispute resolution tribunal which it honestly believes to be true, and which can be reasonably substantiated by accurate written or oral evidence;
    - ii) the claimant has a bona fide legal or contractual entitlement to the matters claimed by it;
    - iii) the quantum of the claim has been accurately calculated in accordance with the contract requirements, or, in the absence of contract requirements, on a reasonable price basis;
    - iv) the amount claimed has not been artificially marked up to include a “negotiating margin” or other illicit gain;
    - v) evidence contrary to the claim is disclosed to the opponent or dispute resolution tribunal alongside evidence in favour of the claim.
  - b) The recipient of the claim will take all reasonable steps to ensure that:
    - i) it reviews the claim diligently, objectively and in good faith;
    - ii) it promptly pays any sums, awards any extensions of time, and issues any certificates which it believes are due in relation to the claim;
    - iii) it promptly provides full reasons in relation to any items of the claim which it refuses to accept;
    - iv) it complies with the obligations imposed on the claimant referred to above in relation to any allegation which it raises as a reason to reject the claim, or by way of set-off or counterclaim.
  - c) Nothing in the claims procedure is intended to limit the conscientious and vigorous pursuit of legitimate claims. The aim is to eliminate false or inflated claims.
61. The parties agree to appoint a suitably qualified and experienced independent assessor whose duty is to assess on an independent and objective basis the extent to which the parties comply with their obligations under the integrity pact.
62. The parties will:
- a) allow the independent assessor unrestricted access to all books, records and staff relevant to the project, and procure that the independent assessor has unrestricted access to the relevant books, records and staff of their consultants, parent and associated and subsidiary companies, agents, consortium and joint venture partners, sub-contractors and suppliers.
  - b) permit the independent assessor to attend all meetings at which will be discussed any material matters in relation to the project.
63. For the duration of the project, the independent assessor will issue written monthly reports simultaneously to each of the following:
- a) the project owner;
  - b) the certifier;
  - c) the contractor;

- d) any organisation providing financial aid or project financing in relation to the project;
  - e) any export credit agency providing export credit guarantees or other insurance in relation to the project.
64. Within three months after completion of the project, the independent assessor will issue a written final report simultaneously to each of the above organisations.
  65. The above reports will provide details of all suspected or actual breaches of the provisions of the integrity pact, and all follow up actions taken. The final report will also, in the case of public sector projects, or publicly financed projects, be published by the independent assessor on the internet.
  66. In the event that any failure by a party to comply with the provisions of the integrity pact may constitute a breach of any disciplinary code of any professional association, or a breach of the criminal law, the independent assessor will notify the breach to the relevant professional association or criminal authorities.
  67. In the event that the contractor breaches any provision of the integrity pact, the project owner will not permit the contractor to bid for any other work for the project owner, or for any of the project owner's parent, subsidiary or associated companies, for a fixed period from the date of the breach.
  68. In the event that any party believes that there has been a failure by another party to comply with any provision of the integrity pact, such party:
    - a) will report the matter to the independent assessor;
    - b) may report the matter to the relevant professional association or criminal authorities;
    - c) may claim damages.
  69. The parties will take appropriate disciplinary or enforcement action against any of their staff, consultants, parent and associated and subsidiary companies, agents, consortium and joint venture partners, sub-contractors and suppliers who cause or assist in any breach of any provision of the integrity pact.
  70. The integrity pact contains a dispute resolution clause (normally arbitration).

### **INDEPENDENT ASSESSOR**

71. The independent assessor is a critical part of the integrity pact concept, in that he provides the necessary independent expert verification that the parties are complying with their obligations. A detailed analysis of the role and terms of appointment of the independent assessor is contained in TI's report "Preventing Corruption on Construction Projects – Independent Assessment" ([www.transparency.org](http://www.transparency.org)).

### **BREACHES OF THE INTEGRITY PACT**

72. The integrity pacts will be of little value if no action is taken in the case of a breach. Reporting of breaches of the integrity pacts to professional associations and criminal authorities is a powerful weapon. Reporting of corrupt practices has in the past been extremely rare. This has led to the situation where corruption has in many cases become the norm because no-one fears reporting or prosecution. The integrity pacts require reporting. The independent assessor is obliged to report any suspected breaches to all the parties, and to any appropriate professional associations and criminal authorities. The parties are required to report any suspected breaches to the independent assessor, and are entitled to report any suspected breaches to any appropriate professional associations and criminal authorities. An individual who is reported to a professional association to which he belongs faces being disciplined by

that association. A company or individual who is reported to the criminal authorities can be prosecuted and fined, and, in the case of individuals, imprisoned. A criminal conviction for a company would normally be expected to lead to blacklisting.

73. The integrity pacts also permit claims for damages for breach. The losses which parties could suffer as a result of a breach vary considerably in scope. For example, breaches of the integrity pact could result in a competitor losing a tender due to a bribe being paid by an opponent, and therefore wasting its bidding costs; or the project owner paying for a more expensive design or construction; or the contractor being wrongly denied an extension of time. Even within the same category of breach, the loss could vary tremendously according to the outcome. If a contractor initially loses the tender due to a bribe being paid, but the bribing competitor is disqualified and the contract is subsequently awarded to the former contractor, such contractor's loss may be minimal. However, if the bribe is only uncovered after project completion, the former contractor may have lost its profit and overhead recovery on the whole project. The provision for damages in the integrity pact assists in the recovery of these damages.
74. The success of the Integrity Pact - Project - Pre-qualification and Tender depends on all bidders entering into identical commitments. If a bidder tries to bribe one of the project owner's staff and fails, no other bidders are likely to have lost any money, and the bribing bidder will be disqualified. If the bidder's attempt to bribe succeeds, the other bidders who suffer damage as a result can claim compensation from the project owner (as the project owner will have been in breach of its obligation not to accept a bribe, or of its obligation to ensure that its employees do not accept bribes). The project owner will then be able to claim compensation from the bribing bidder.
75. Some users of integrity pacts may prefer to pre-agree the level of damages (e.g. as a fixed sum, or as a percentage of the contract price). This may in some cases be an attractive option, in which case the agreed damages should be included in the integrity pact. However, care should be exercised in this regard. As stated in paragraph 73 above, losses can vary enormously according to the outcome, and therefore pre-fixing damages can lead to an extremely unsatisfactory result. Furthermore, some jurisdictions disallow pre-fixed damages on the basis that they are a penalty except in situations where they are genuine pre-estimates of loss. It will be difficult to have genuine pre-estimates of loss in situations where the circumstances and outcome of the breach can vary so enormously.

### **DISPUTE RESOLUTION**

76. The integrity pacts contain arbitration clauses. These clauses can be varied to take account of the specific situation. In particular, the arbitration language, law, rules and location can be changed. In some jurisdictions, court may be preferable to arbitration.
77. Consideration should be given to whether the arbitration rules and the governing law should be the same as those contained in the construction contract, so as to avoid the danger of two separate laws and dispute resolution procedures.
78. The dispute resolution procedure must be one of repute. The integrity pact will be of little value if it is unenforceable.

### **ANTI-BRIBERY POLICY**

79. The integrity pacts require each party to maintain and enforce a written anti-bribery policy applicable to its business. TI has, in conjunction with leading organisations in the industry, prepared a document, guidelines and implementation plan which could be used for such purpose. See "Business Principles for Countering Bribery" ([www.transparency.org](http://www.transparency.org)).

### **REAL EXAMPLES OF THE INTEGRITY PACT WORKING**

80. TI's web-site ([www.transparency.org](http://www.transparency.org)) provides numerous examples of situations where integrity pacts in varying forms have been used with perceived success in over 14 countries, including Argentina, Colombia, Ecuador, Italy, Korea and Pakistan. Projects in Colombia and Pakistan have reported cost savings which they believed were attributable to the use of integrity pacts. Companies have been blacklisted in Italy and Korea as a result of breaches of integrity pacts.

### **HYPOTHETICAL EXAMPLES OF THE INTEGRITY PACT WORKING**

81. The following are a few brief hypothetical examples of how the integrity pacts analysed in this document may work successfully in practice.
82. *After a tender exercise, the project owner announced the winning bidder. The tender exercise was witnessed by the independent assessor, and the contract appeared to have been awarded on an arms-length basis. The winning bidder was technically and financially competent, had a compliant bid, and was the lowest evaluated price taking into account both the anticipated construction and operation costs of the project. The independent assessor, as required under the integrity pact, then visited the offices of the winning bidder. He inspected the price schedules of the bidder, and discussed the costings in detail with the bidder's estimating, procurement and project staff. He found out that an agent's commission of 5% (US\$1 million) was included in the contractor's price. He investigated the agent by visiting him and making local enquiries. The agent turned out to be an individual with no organisation capable of carrying out the scope of work required of him in the agency agreement. He was also a close friend of the chief executive of the project owner. The amount of the commission was significantly disproportionate to the scope of work. The bidder had not disclosed this commission to the project owner during the tender process. The independent assessor, as required by the integrity agreement, published details of his findings in his report which was circulated to the project owner, all bidders, and financing organisations, and sent his report to the professional association to which the directors of the bidder belonged, and to the criminal authorities in both the bidder's home country and the country in which the project was to be built. The bidder was disqualified by the project owner, and the project owner's chief executive was suspended. Criminal prosecutions and disciplinary action by the professional associations followed.*
83. *A project was awarded to a contractor after a tender exercise in which the independent assessor found no evidence of impropriety. Shortly after commencement of project execution, the project owner proposed a large variation to the contractor's scope of work which would significantly increase the project price. The independent assessor examined the proposed variation, and was concerned both as to its necessity, and as to the proposed cost being charged by the contractor. The independent assessor believed that the variation may be concealing a deferred bribe (i.e. that the contractor won the project without including a bribe in its price, but with the agreement of a senior representative of the project owner that the project scope would be increased after award, and that the bribe would be concealed in the variation). The independent assessor reported his suspicion to all parties. He was not sufficiently confident of the position to report his suspicions to the authorities without further analysis. He therefore requested in his report that an expert be appointed to assess the necessity and cost of the variation. Shortly after receipt of his report, the project owner decided against the proposed variation. No further action was taken by the independent assessor in this regard as the variation had never been more than a proposal, but a major bribe had probably been avoided.*
84. *At the end of a project, the project owner submitted to the contractor a major claim for liquidated damages for delay, and for damages for alleged defective work. The amount of this claim exceeded the*

*amount of the contractor's retention and final progress payment. The project owner refused to pay the final payment and retention to the contractor on the basis that it was setting off its claims against these payments. The contractor reported to the independent assessor that it believed that the project owner's claim was a breach of the claims procedure in the integrity pact, and was possibly fraudulent. The independent assessor visited the project owner's offices to examine the claim and the project owner's staff who prepared the claim. After investigation, the independent assessor found that timesheets had been falsely allocated to the claim, that the claim had been enhanced by a 30% "negotiating margin" and that the project owner had written a letter to the engineer who had designed the project blaming it for one of the events for which it was claiming from the contractor. The independent assessor, as required by the integrity agreement, published details of his findings in his report which was circulated to the project owner, the contractor, and financing organisations, and sent his report to the professional association to which the relevant staff of the project owner belonged, and to the criminal authorities in the project owner's home country and the countries from which the project owner's relevant professional staff came. The project owner withdrew the claim, and the contractor was paid. Criminal prosecutions and disciplinary action by the professional associations followed.*

85. While no-one finds the concept of criminal investigation and disciplinary action attractive, it is imperative that the independent assessor does have the ultimate sanction of an obligation to report breaches to these authorities. Without real teeth, the integrity pacts will be largely ineffective.

### **CONCLUSION**

86. TI believes that integrity pacts which are properly written, which are policed by an effective independent assessor, and which are properly enforced, can make a major contribution to reducing bribery and deceptive practices in relation to construction projects. As such, their adoption is in the interests of all project participants. There is no reason why they should not become a routine part of the contractual structure of construction projects.

### **DISCLAIMER**

87. The comments in this report on the law and its consequences are neither comprehensive nor complete, and should not be relied on. They are intended merely to give indicators as to possible consequences. Independent legal advice should always be obtained. The proposed actions referred to in this report are suggestions only, and will need to be adapted to the specific circumstances of each case. Neither TI nor the author can accept responsibility for the consequences of any action claimed to be taken in reliance on the contents of this report.

### **COMMENTS**

88. This report is issued as a discussion document. TI welcomes comments which would lead to its improvement. These should be sent to [neill.stansbury@transparency.org.uk](mailto:neill.stansbury@transparency.org.uk)

### **FURTHER INFORMATION**

89. TI has published a series of reports and business tools under the title **"Preventing Corruption on Construction Projects"**. These reports and business tools can be freely downloaded from TI's website at [www.transparency.org](http://www.transparency.org).

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