

Briefing for Investors

Balfour Beatty: WCD Resolution

Summary

With corporate governance an increasingly important focus of shareholder attention and in the light of the new Turnbull rules¹, shareholders will undoubtedly be looking to Balfour Beatty for reassurances that:

- any reputational risks to the company are justified financially and do not threaten future shareholder value;
- steps have been taken to contain reputational risks and to ensure the company's standing;
- the company's strategy for containing reputational risks matches or betters that of its peers and strengthens its future competitiveness.

Although Balfour Beatty has yet to report under the Turnbull rules, there are strong grounds for believing that the company will face difficulties in giving shareholders adequate assurances on these key concerns.

In particular, evidence from the hydro-power sector suggests that the company management has no coherent strategy for managing reputational risks in this area. Consequent adverse publicity has significant implications for future earnings. In addition, Balfour Beatty's competitors in this sector have stolen a lead on the company by recognizing the business significance of publicly endorsing the World Commission on Dams' (WCD) Guidelines

Friends of the Earth proposes that Balfour Beatty should therefore recognise the importance of the report and adopt the Guidelines contained within it as company policy.

Recommendation

Developing an overall company strategy for containing reputational risks will take time. However, committing the company to the Guidelines of the WCD's report (see below for details) would show leadership in a key area of corporate social responsibility and help rebuild Balfour Beatty's damaged reputation.

Friends of the Earth has submitted a resolution to Balfour Beatty's 2001 AGM, calling on Balfour Beatty to recognise the importance of the WCD report and to endeavour to ensure that all future relevant contracts meet the Guidelines contained within it. It does not require the company to become involved in the dam planning process about dams nor to take any other responsibilities not befitting of a contractor. It calls on the company to adopt those guidelines in the report developed specifically for contractors.

If adopted, this resolution would ensure that, in the hydro-power sector, the company is operating within the framework of international recognition of human rights, the right to development and the right to a healthy environment which the report builds upon. Balfour Beatty would be seen to be endeavouring to ensure that its operations in this sector are in line with industry best practice, helping the company to develop a positive reputation. It would also bring commercial benefits in competing for business, particularly in the public sector, and is likely to help reassure investors that Balfour Beatty is moving in the right direction, with positive consequences for the share price.

It is therefore recommended that investors vote for the ordinary resolution on the World Commission on Dams.

Reputational Risks and Shareholder Value

The Balance of Risk and Reward

All companies take risks. Nonetheless, those risks need to be well managed and they must not damage the company's reputation and value. Any potential reputational risks of a project must therefore be compared with the contribution to expected profitability of the project.

In the case of the Ilisu Dam, shareholders may question whether or not management has got the balance of risk and rewards right.

Balfour Beatty is heading the construction consortium for the Ilisu project, which would be built in the Kurdish region of South East Turkey, an area that has been wracked by a 17 year long war and which remains under emergency rule. The company has applied to the British Government for a \$200 million export credit guarantee in support of its contract.

Criticism of UK support for the project is widespread and growing. In the past nine months over 5,000 people have written to the Prime Minister to urge the government not to support Balfour Beatty's export credit application. There has been widespread media coverage of concerns over the project's environmental and human rights impacts, with highly critical editorials in the *Financial Times*, the *Guardian*, the *Daily Express*, and coverage on the BBC News, Newsnight, Channel Four News and ITV's 'Tonight with Trevor MacDonald'.

The damage that such criticism is doing to Balfour Beatty's reputation must be compared with the contribution to expected profitability from Ilisu. Far from providing a major boost to bottom line profit, the company's own figures suggest that the project will be worth under \$2 million a year to the company, which is less than 1 per cent of group profits.² Even this small margin may be under pressure because of the risks and controversies associated with the project which have already led to slippage in the project schedule.

Containing Reputational Risks

Does Balfour Beatty have a Credible Strategy?

Given the growing importance of reputational risks, it is essential that the company has in place a credible strategy for containing unjustified reputational risks. At a minimum, such a strategy would include:

- candidly acknowledging reputational risks where they arise;
- ensuring that shareholders are accurately appraised of such risks and the steps taken to address them;
- actively engaging in and responding to discussions and debates that affect its operating environment and standing.

Evidence from the hydro-power sector (below) suggests that such a strategy does not exist and, furthermore, that the company has missed key opportunities for enhancing its reputation.

Misleading Shareholders?

The company's account of its involvement in Ilisu as laid down in a statement to shareholders issued for distribution at the 2000 AGM is potentially misleading, particularly for shareholders who are not familiar with the history of the project. Discussing the Environmental Impact Assessment (EIA) for the Project, for example, Balfour Beatty states:

*"As soon, therefore, as the consortium discovered that Turkey had not yet conducted a formal Environmental Impact Assessment for this project, it commissioned an international group of consultants to produce one. The first draft report (March 1998) indicated that, whilst in some ways the impact would be neutral or positive, there were also serious concerns and specific measures would have to be taken by Turkey to avoid unacceptable consequences. Following various independent reviews of that original report, and discussions with potential providers of finance, a number of key issues have emerged as critical. These have become the subject of inter-governmental discussions. Meanwhile, as the original report is now two years old, an update is under way with the objective of producing a more definitive edition by the summer of 2000."*³

This statement suggests that the new EIA will merely be an “update” of the original, required because the first (1998) report is “now two years old”. This gives a misleading impression of the level of completeness of the original report.

The original EIA was found to be deficient in a number of important respects and was not deemed by independent reviewers (including a team commissioned by the UK government) to meet international standards of best practice.⁴ The UK government's review does not indicate that the first EIA was a "draft" (as now claimed by the company) but refers to it throughout as the "the Ilisu EIA".

The UK government's review highlighted a number of key areas which the report had overlooked. For example:

- no consideration was given to the cumulative effects of the dam in conjunction with other projects;
- no information was made available on the effects of altered river flow on wetlands downstream.

In addition, few or, in most cases, no details were provided regarding:

- the timetabling of proposed data collection and mitigation measures;
- the institutional responsibilities and capacities for their implementation;
- the estimated resources (financial and manpower) needed;
- the proposed methods or sources of finance.⁵

In effect, the new EIA was required not because the 1998 EIA was "now two years old" but because it did not meet international standards. The only sense in which it could be said to have needed "updating" was that many of the necessary studies had not been done to date.

Failure to Engage with the WCD

The World Commission on Dams (WCD) was set up by the World Bank and the IUCN (World Conservation Union) the International Union for the Conservation of Nature in 1997 “to review the performance of large dams and make recommendations for future planning of water and energy projects”. The Commission consisted of and was supported by government representatives, the private sector, academics, respected civil servants, members of the NGO community, multilateral development agencies and affected communities.

The WCD's independence - reflected in the composition of the Commission - is widely acknowledged and its report, based on two and a half years of in-depth research and consultation, constitutes the most comprehensive, global review of the economic, social and environmental impacts of dams ever undertaken. The WCD published its report, *Dams and Development*, in November 2000.

A number of international companies⁶ assisted the WCD in developing guidelines for the future of water and energy development. Balfour Beatty, however, took no part in the WCD process, apart from attending its launch and a press seminar organised jointly with Reuters. The company made no formal submissions to the WCD.

This failure to engage with a process that will inevitably impact on an area of business to which the company is committed will rightly be of concern to shareholders. The company's non-engagement not only ensured that its voice went unheard in drawing up new guidelines for and impacting on the industry but also that it appears out of the loop, with potential damage to its standing in the sector.

Reputational Risk and Competitiveness

The WCD's guidelines are widely acknowledged as the benchmark for international best practice. Indeed, any company wishing to remain in the hydropower sector without damage to its reputation will, in the opinion of many commentators, need to adopt the Commission's guidelines.

A number of Balfour Beatty's competitors have thrown their weight behind the Guidelines, as have some key institutional players in the field of international development.

On the day of the launch of the WCD's report, for example, Skanska, until recently a partner of Balfour Beatty in the Ilisu dam construction consortium, announced in a press release:

“Skanska intends to apply the guidelines for major hydropower projects recommended by the World Commission on Dams”⁷

Axel Wenblad, Vice President of Environmental Affairs of the Skanska Group, said:

*“We find the Commission’s work to be extremely valuable. It represents a major stride for sustainable development, with open and transparent processes in which all affected parties can participate, particularly those groups that are affected directly. Our hope is that the Commission’s work can serve as a model for dealing with other types of controversial infrastructural projects. At Skanska, we hope that the Commission’s new criteria and guidelines become accepted globally and we are prepared to actively strive toward these being accepted among the stakeholders concerned.”*⁸

Other companies and industry associations have also welcomed the WCD’s report. Harza, a major hydropower development firm, wrote in a letter to the *Washington Post*:

*“The report offers a unique insight into dams and their benefits and associated costs. The report proposes a sound approach to the future development of a very old, yet important, water resource technology.”*⁹

An editorial in *Hydro Review Worldwide*, a leading industry publication, stated:

*“... as Commission Chair Kader Asmal has declared, the ‘real work’ must now begin. This work includes reducing the broad findings of the Commission into practical, implementable policies and practices. These, in turn, can lead to the creation of socially beneficial, politically acceptable, and affordable and financeable developments -- including new dam based water resource projects.”*¹⁰

The management of Balfour Beatty, meanwhile, has responded lukewarmly to suggestions that it should endorse the WCD guidelines, both to secure its position as an industry leader and to restore the damage to its reputation incurred through involvement in Ilisu.¹¹

Balfour Beatty appears to be reacting passively to the WCD process and has not made any public statements on the report, surrendering the leadership role to its competitors. By adopting the Guidelines of the WCD report, however, the company has the opportunity to develop a proactive, coherent approach to reputational risk that will ensure its future competitiveness

Friends of the Earth, March 2001

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References

1. Institute of Chartered Accountants new Turnbull rules, adopted by the Stock Exchange, under which directors in listed companies are obliged to take account of all "significant risks", including social and environmental risks, which could damage the company when carrying out their duties and to put in place internal controls to manage these risks and review them regularly to ensure their effectiveness.
2. Response to oral question to Tim Sharp at Socially Responsible Investment and Construction Seminar organised by the UK Social Investment Forum, July 2000. (Figures should be regarded as an estimate)
3. Ilisu Dam Project: Information for Shareholders’, 9 May 2000.
4. The ECGD commissioned Environmental Resources Management to conduct a desk study of the EIA. ERM concluded: “The scope of work to date would need to be extended to bring the analysis to international best standards”
5. “ECGD Environmental Review of the Ilisu Dam Project: desk review of EIA and associated documents”, Environmental Resources Management, London, December 1999. (Study commissioned by ECGD)
6. Including ABB, Alstom, Atlas Copco, Coyne & Bellier, Enron, Harza, Hydro-Quebec, Lahmeyer, Voith Siemens and Skanska
7. Press release: “Skanska supports the World Commission on Dams’ recommendations for long-term sustainable hydropower projects”, Skanska, 16 November 2000
8. Press release: “Skanska supports the World Commission on Dams’ recommendations for long-term sustainable hydropower projects”, Skanska, 16 November 2000.
9. Letter to The Wall Street Journal, from Edward F. Carter, Director, Managing Partner, Harza Engineering Company, 30 November 2000
10. Hydro Review Worldwide: ‘Reaction to the Final Report’, Viewpoint, on: http://www.dams.org/report/reaction_hrw.htm accessed 12 March 2001.
11. Letter to Friends of the Earth from Lord Weir, Chairman, 15 February 2001.