



FAIR CONTRACT CONDITIONS AND COMPETITION

ABSTRACT

One of the aims of the International Association of Dredging Companies (IADC) as espoused on its website is “to promote fair contract conditions and fair competition within the dredging markets”. FIDIC published a set of contract conditions for use by its members in construction works. One of FIDIC’s objectives is to “promote and enhance the leading position of FIDIC’s Forms of Contract”. The FIDIC Conditions of Contract of the future – based on using a fair and reasonable risk allocation – will become essential as increasingly complex contracts will be needed to tackle global macro-economic issues.

INTRODUCTION

One of the aims of the IADC as espoused on its website is “to promote fair contract conditions and fair competition within the dredging markets”. This notable aim is specified in the articles of association establishing the IADC back in 1965 with the stated goal of “the advancement of straightforward work conditions”. It is in line with subsequent policies of both the World Bank and the World Trade Organisation (WTO), which are concerned with reducing

trade barriers so that organisations can compete on a level playing field on a global basis. Fair contract conditions and competition by means of open tendering process is at the cornerstone of that aim.

The present-day dredging industry is mainly underpinned by six primary economic drivers namely the exponential growth in world trade, increasing population growth, energy demand with increasing need for coastal protection due to climate change as well as the rise in tourism and environmental projects. However, looking back to the time when IADC was founded in 1965, the world was a much different place. The WTO reports that international trade after World War II entered a long period of record expansion with world trade rising by more than eight per cent per annum in real terms over the 1950-73 period. This growth, however, was from a small base and the consumption was largely domestic, as the major economies such as the USA, Europe and Japan rebuilt after WWII, rather than from external, export markets using seaborne

Above: FIDIC Contract: A cargo ship sailing along the Port of Savannah. The dredging industry is underpinned by several drivers including world (seaborne) trade and future FIDIC Conditions of Contracts will be necessary for fair and reasonable risk allocation.

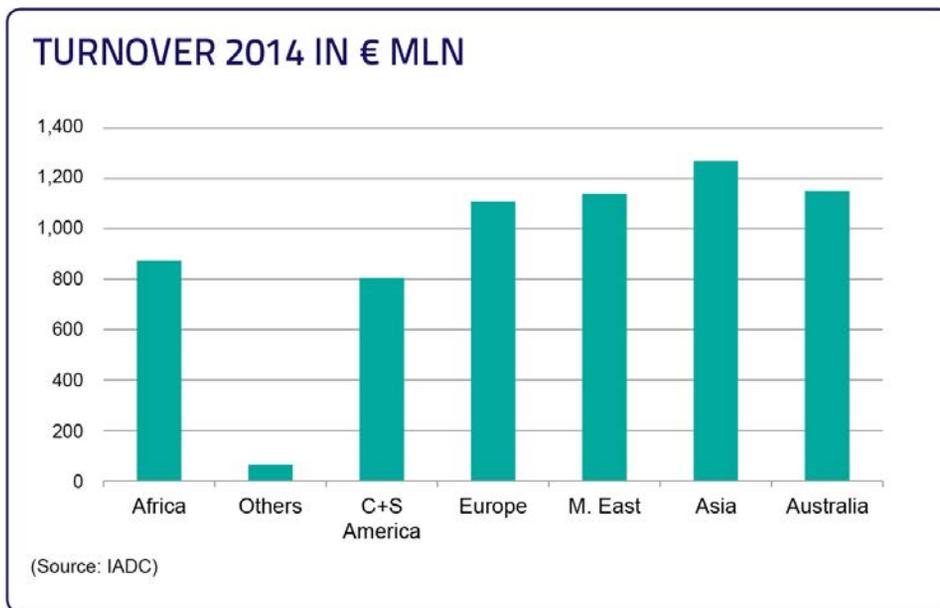
trade. World trade was hampered by restricted practices, ‘closed economies’ and trade barriers in one form or another.

THE PAST

The world dredging market in the 1960s was subject to substantial trade barriers and closed markets in many parts of the world. The world was in the grip of the ‘Cold War’. Countries that may have sought to open their infrastructure markets were in an East-West divide where political interests kept the status-quo and disallowed any foreign contractors from entering national markets. The vast majority of the worlds’ ports were seen as a country’s strategic asset and were largely owned by state entities, which employed their own dredging vessels to carry out infrastructure tasks. The result was little to no competition. This was the world in which the IADC was born.

Closed versus open markets

Despite the multilateral free trade agreements created by the General Agreement on Tariffs and Trade (GATT) established in 1948, which was superseded by the WTO agreements in 1995, the market share of dredging closed to international tenders is still substantial with China and the US effectively closed to foreign contractors. In contrast, US and Chinese contractors have access to and are indeed



Dredging in Figures 2014

increasingly active in the infrastructure markets of both the developing and developed economies. In China, only very few projects are open for international tenders. In the US, the market is completely closed to foreign entrants by virtue of the Jones Act, which makes it impossible for non-US owned and controlled contractors to import non-US vessels to undertake dredging activities.

According to IADC's *Dredging in Figures 2014*, globally, the market share of the open markets was estimated at € 6.415 billion for 2014 (see turnover figure). However, the market share of closed markets in the 1960s – although not reported at the time – was likely to be almost double today's market share, with independent dredging contractors largely operating in their own national markets. This changed somewhat during the 1970s to the 1990s; the fall of the Berlin Wall also hastened this change. Markets gradually opened to foreign entrants in resource-rich countries in the Middle East as well as the emerging economies of India, South-East Asia, Korea, Brazil, Latin America, Russia and Eastern Europe.

In addition, emerging economies have been able to harness globalisation to achieve unheard-of rates of economic growth – with eleven economies, representing half the world's population, growing collectively at

over six per cent per year since 2000 (*World Trade Report 2014*).

Infrastructure development is recognised as one of the key factors in driving the economic growth of a country, this is particularly so in emerging markets and developing countries as access to markets and trade is viewed as the best way to lift people out of poverty. Direct investment in infrastructure creates new transportation facilities and stimulates economic activity by reducing transaction and trade costs whilst improving competitiveness for the export of products into global markets (IADC, 2011).

The container revolution

World trade is also underpinned by the use of containers. The container was invented in the US in 1956. The Vietnam War aided its use and as more ports adapted to the containers, shipping was revolutionised. In 1980 the largest vessel could ship 4,100 twenty-foot equivalent unit (TEU). This jumped to 6,400 TEU in 1996 and 15,000 TEU in 2012. As of 2013 Maersk's 18,000 TEU vessels have been delivered and are sailing main routes with deepened ports and both the Panama and Suez Canals have been expanded to cope with larger and increasing numbers of vessels.

In China, annual capital expenditures for transportation (including harbours and coastal ports), electricity, piped gas, tele-

communications, urban water supply and sanitation increased steadily from US\$39 billion in 1994, to US\$88 billion in 1998, and to US\$123 billion (about 8.7% of GDP) in 2003 (Wassink, 2011).

Fédération Internationale des Ingénieurs-Conseils (FIDIC)

With the entrance of foreign contractors into a previously closed market, the often state-owned employer was faced with a particular issue – in order to attract foreign investment, funding had to be acquired through an open tender process. Also, a set of 'balanced' contract conditions had to be stipulated. For this, foreign contractors and various consulting firms from developed nations such as the UK, USA, France and the Netherlands were able to tender for projects for the first time. Many of these firms were affiliated members of Fédération Internationale des Ingénieurs-Conseils (FIDIC) which published a set of contract conditions for use by its members in construction works.

One of FIDIC's objectives is to "promote and enhance the leading position of FIDIC's Forms of Contract". FIDIC provides many publications including procurement and contract guides as well as organises many seminars together with Cornerstone Seminars and industry experts. The organisation is also involved in many initiatives as reflected on its mission statement. "To improve the business climate and promote the interests of consulting engineering firms globally and locally consistent with the responsibility to provide quality services for the benefit of society and the environment".

The first edition of FIDIC's *Conditions of Contract (International) for Works of Civil Engineering Construction* also known as the Red Book due to its cover was published in 1957. It was the first contract specifically prepared to govern international contracts. It was based on an English domestic standard form of contract for civil engineering works as published by the UK's Institution of Engineers (ICE) Form of Contract. This was eventually superseded by the second edition in 1969 with little change in style or format, but with an additional section (Part III) to deal with dredging and reclamation projects. FIDIC President, Julian S. Tritton, stated in the



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introduction of Conditions of Contract in 1957 that "FIDIC published the first edition of the Conditions of Contracts of which the purpose was the fair allocation of risks between the Contractor and the Employer" (Turegun, Dr. Jur. Tunay Koksal, 2011).

In the late 1970s, given the booming dredging market, employers in the Gulf states largely used the third edition of the book (1977), which had retained the Part III section of the second edition specifying various exceptions for dredging contracts such as no defects liability period and no vesting of plant. It came as quite a blow to the dredging contractors when the fourth edition (1987) of the Red Book was published in which the FIDIC contract committee did away with the Part III exceptions. This was lamented in an article in *Terra et Aqua* Nr 36 - *A first impression of the 4th edition of the FIDIC Conditions of Contract* (Goudsmit, J.J.). Interestingly, both the Kingdom of Bahrain and the Sultanate of Oman both have their own standard conditions of contract that have a style and format that follows the format of the third edition of the 1970s. This presumably is a format which is known and accepted by both employers and contractors alike in these countries.

The fourth edition, however, by not dealing with the dredging provisions, did create issues for both employers and contractors who wished to use the contract for dredging and reclamation works. In 1990, in cooperation with FIDIC, the IADC published a *Users' Guide to the Fourth Edition*. This provided a valuable guide on how to amend the fourth edition to

make it suitable for dredging and reclamation projects. It proved a popular contract and during the 1990s was increasingly used in the emerging markets of Latin America, India and South-East Asia. It did, however, draw some criticism from employers in civil law jurisdictions as being too Anglo-Saxon biased. It was translated by FIDIC into a number of languages including French, Spanish and Arabic. In a number of countries in South Asia, the Middle East, Africa and Latin America, the book is still used when drawing up construction contracts although this is now tailing off with the introduction by FIDIC of its new contracts.

FIDIC'S RAINBOW SUITE

The next significant update of the FIDIC Conditions of Contract came in 1999 with the publication of the First Edition Rainbow Suite of Contracts. The Contracts Committee of FIDIC headed by John Bowcock carried out a root and branch review and redrafted the Rainbow Suite (Red, Yellow, Silver and Green) following some of the principles of the New Engineering Contract (NEC) from the UK but moving away from the Anglo-Saxon model and language. Three editions of the NEC had been published – the first in 1993, the second in 1995, and the most recent in 2005. Clearly, the drafting style and language of the NEC had an influence on the language of the Rainbow Suite of 1999.

One of the biggest differences between the fourth edition of the Red Book and FIDIC's 1999 Suite of Contracts was that the latter had clear contract documents with a straightforward language and structure that could be easily understood by a non-native English speaker with no legal training. Also, the clauses were reduced down from the previously unwieldy 72 clauses to just 20 and legal terms were reduced to an absolute minimum and otherwise defined. To aid all users of its contracts, the 20 clauses were standardised in the three new major forms (Red, Yellow and Silver). Also, besides the essential differences, the definitions, layout, clause numbering, and clause wording were identical over the Rainbow Suite.

The IADC was not represented on the FIDIC Contracts Committee for the Rainbow Suite so no special attention was given to the

different circumstances surrounding dredging and reclamation works. Following the publication of the Rainbow Suite, the IADC Secretariat contacted FIDIC about the possibility of a separate FIDIC 'Dredger's Contract' meeting the specific needs of employers and contractors alike. A task group was set up by FIDIC in which IADC representatives were involved which reported to FIDIC's Contract Committee.

The chosen format of the now titled *FIDIC Form of Contract for Dredging and Reclamation Works* was based on the *FIDIC Short Form of Contract* (Green Book) with the major difference from the Short Form is that the role of the engineer was re-introduced. The now named Blue Book was published by FIDIC as a test edition in June 2001. The test edition was reviewed in *Terra et Aqua*, Number 85, December 2001. The author, Constantijn Dolmans, stated: "*The FIDIC Form of Contract for Dredging and Reclamation Works* creates a fair and balanced legal framework for the optimal execution of dredging and dredging related projects". The formal first edition of the Blue Book was to be published the following year, taking into consideration industry comments about the test edition.

However, the Blue Book remained as a test edition for the next five years. In the intervening time, the fact that the contract was a test edition put potential users off. It was also clear that the dredging industry was confused that FIDIC had not followed up on the test edition to publish final version. In the years following the publication of the test edition, it was rarely used, if at all, in the international arena. This, however, changed from 2006 onwards when the *Form of Contract for Dredging and Reclamation Works* (1st Edition Blue-Green Book) was published. Now, it is more commonly referred to as the Blue Book.

From 2007 onwards, the use of this book by both employers and contractors has increased to the present day. Feedback from some IADC members seemed to indicate that a significant portion of tenders in the 'free' market has used the FIDIC Blue Book in one form or another with the FIDIC 1999 Red and Yellow Contracts being used for more complex



FIDIC books: Green, Red, Silver and Yellow (Rainbow Suite)

projects. Some parties have also taken the step of translating this book into the native languages of emerging market countries such as Brazil and Russia with the aim of increasing its acceptance and usage in the same manner as the Red Book (fourth edition) in the 1990s. FIDIC discontinued this with the Rainbow Suite, despite that the clear and simple language of the FIDIC Blue Book does make translations a viable option. Perhaps, FIDIC should consider this in future.

PRESENT DAY

Currently, in the global infrastructure market there is a wide range of factors which influence how an infrastructure project is ultimately awarded and performed. Major factors include financing of a project, the procurement procedures and use of standardised contract forms, export credit insurance and the removal of barriers of entry for non-national contractors. Today, export credit agreements (ECAs) are collectively amongst the largest sources of public financial support for foreign corporate involvement in industrial projects in emerging markets and the developing world. According to the ECA Watch website, for example, ECAs are estimated to support twice the amount of oil, gas and mining projects as do all Multilateral Development Banks (MDBs) such as the World Bank Group.

The FIDIC Rainbow Suite of Contracts has become the default choice over any national standard contract conditions and now covers a wide range of project types and methods of procurement. It is quite likely that any international contractor or consultant working in the international arena will frequently

encounter FIDIC Conditions of Contract. Legal advisors to both employers and contractors are also very familiar with the FIDIC provisions having worked regularly on many projects. Whilst bespoke forms of contract are still used, they are often reviewed against the benchmark of the FIDIC provisions.

From 2000 onwards, new construction markets such as offshore wind farms have developed the use of FIDIC's *Conditions of Contract for Plant and Design-Build Contract* Yellow Book; it has become the default choice of contract for these multifaceted marine projects. Contract users have recognised this contract as ideal to allocate the risk between employer and contractor on these high value and complex projects.

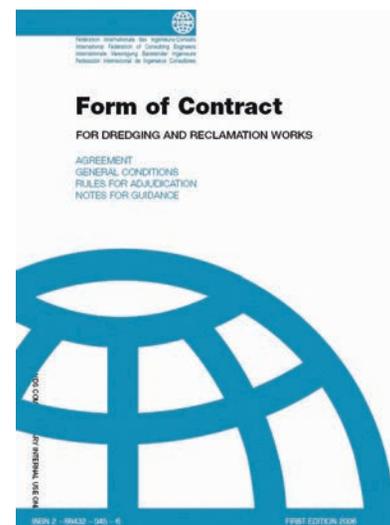
Currently, the total free dredging market size is approximately 6-7 Billion euros (*Dredging in Figures 2014*) and dominated by the big four Benelux based dredging and marine contractors (Van Oord, Royal Boskalis, DEME and Jan de Nul) who collectively have a 70-80% share of the 'open market' (Boskalis, 2015).

These contractors benefit from an active home infrastructure market that can be the test bed for innovative forms of contracts such as the Delta Plan/Delta Project started in 1954 with the Storm Surge Barrier on Hollandse IJssel. It formally came to an end with the completion of the Oosterschelde Barrier in 1988 to the more recent Betuwe Route, Sand Motor and Maasvlaakte 2 projects, as well as the works on the Scheldt river and the major environmental remediation projects (AMORAS) of the Antwerp region in Belgium. The

Ministry of Works of both countries are willing to explore new contract forms and enter into long-term maintenance arrangements once the project is completed.

The major IADC members have identified and placed increasing focus on multifaceted projects which are typified by an increasingly complex working environment and detailed employer requirements. This trend is no doubt set to continue in the coming years and the nature of the contracts required to facilitate such projects will also have to adapt.

Employers have no doubt benefited from utilising FIDIC conditions where potential bidders are from different countries. In such cases the bidders will perceive the use of the familiar FIDIC conditions as providing a balanced risk allocation between employer and contractor. This translates into lower



The Blue Book

priced tenders as the contract risks are fairly allocated and better understood by the potential bidders.

The FIDIC for MDBs

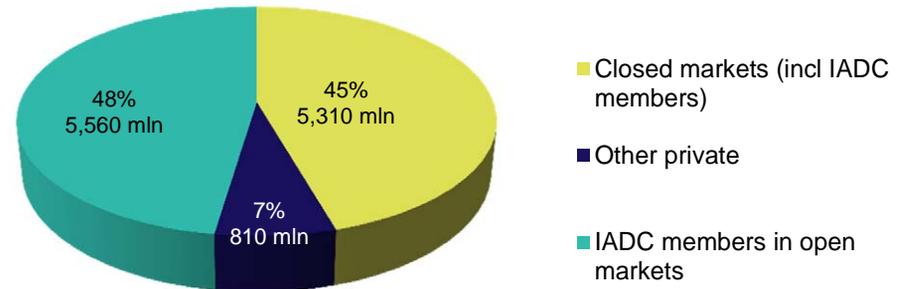
In 2005, FIDIC published the *Construction Contract MDB Harmonised Ed* book also referred as the Pink Book; it cemented the relationship that banking organisations have with FIDIC. Prior to the publication of this book, the MDBs were originally utilising a FIDIC contract for the projects they were funding with amended general conditions. As a result of negotiations between FIDIC and the MDBs, the book was drafted, which incorporated the amendments that were commonly inserted by the MDBs.

FIDIC is conscious that its standard contract forms have to keep pace with developments and feedback from the contract users. In the intervening 15 years since the last major publication, disputes have arisen between contracting parties and FIDIC's contract terms and conditions have come under increased scrutiny and subject to new case law when such disputes are brought to the courts. At present, FIDIC's Contract Committees are preparing updates to the Rainbow Suite including the Blue Book and it is anticipated that updated contract forms will be published in 2016.

The FIDIC Gold Book

The *FIDIC Design, Build and Operate Projects (DBO) Contract Guide (Gold Book)* was published in 2011 following extensive input from industry stakeholders including those from the water sector but not from the maritime sector. Under the Gold Book the contractor must operate and maintain the completed project on behalf of the employer for a period of typically 20 years from the date of the Commissioning Certificate, which is issued at completion of construction of the project. During this 20-year period the contractor must meet certain targets and, at the end of this period, the project must be returned to the employer in an agreed condition. The DBO element is a new concept in the marine infrastructure sector. It will be interesting to see if this form of contract is taken up for complex projects such as offshore windfarms, coastal protection or long-term maintenance dredging projects.

OPEN/CLOSED MARKETS



(Source: IADC)

Dredging in Figures 2013

FUTURE

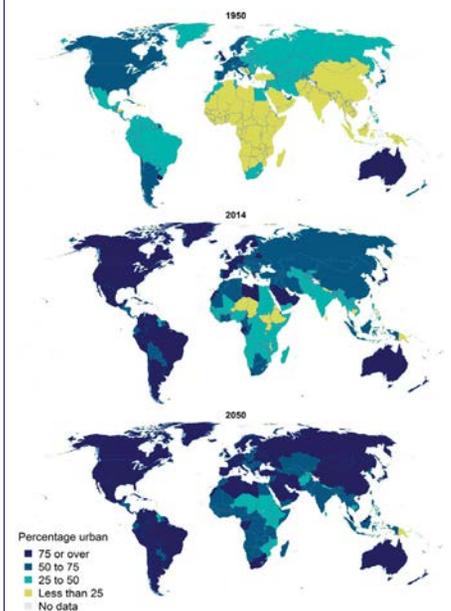
It remains to be seen whether the process of deregulation of 'closed' markets which has occurred from the 1960s onwards will continue apace or stagnate through strong political opposition and lobbying. In 2001, China became a member of the World Trade Organization (WTO), yet the results are mixed. Although the Chinese port construction market is opening up and transforming as decentralisation measures have been enacted, the Chinese government has intervened with more regulations that makes entry of foreign contractors almost impossible. Due to the Chinese legal system with its taxes and license arrangements, foreign marine contractors still have great difficulty participating in a profitable project (Wassink, 2011).

Yet, the CEO of China Communications Construction Company (CCCC) has made clear the organisation's plans to enter the global dredging market. So far, the CCCC's non-Chinese sales have been limited, but the Chinese government is increasing its economic and political influence in Africa, Brazil and the Middle East, which could lead to dredging orders for CCCC in the coming years (Rabobank, 2013). In the US market, the Jones Act is an effective barrier to a foreign company – vessel building and ownership restrictions for non-US firms remain steadfastly in place.

Previously closed markets such as Russia,

Brazil and India have seen the benefits of the entrance of non-national contractors into the marine infrastructure market. Given that their port expansion projects could not be met by the nationalised dredging companies, a direct result has been a growth in competition that inevitably led to lower prices for projects. The FIDIC Forms of Contract play a key role in

PERCENTAGE OF THE POPULATION RESIDING IN URBAN AREAS, 1950, 2014 AND 2050



The boundaries and names shown on this map do not imply official endorsement or acceptance by the United Nations.

(Source: UN World Urbanization Prospects 2014)

Dredging in Figures 2014

setting out the allocation of risk between the parties and are recommended for use by the majority of the global and regional lending agencies. In a capital-intensive industry such as dredging, cooperative agreements between the employer, contractor, consultants and the

project funders are a prerequisite. Win-win situations will arise on projects provided all contractual partners and stakeholders work for the project's inception with a common interest – as if they are in a joint venture, with shared risks and shared

benefits. The relative success of the Alliance/Private-Public Partnerships (PPPs) type projects that have been used on infrastructure projects are a testimony to this.

CONCLUSIONS

Internationally recognised standard form of construction contracts such as FIDIC the Rainbow Suite, with the support of project funders like the World Bank and various MDBs have set the benchmark for fair contract conditions. Conditions that allocate risks fairly to the party that is best able to bear and control that risk. However, the management of this risk distribution does differ depending on the chosen form of contract.

In looking back at how far the marine infrastructure and dredging industries have come over the past 50 years, the continuing development of fair contract conditions as espoused by the IADC does bid well for the future. It is likely that future WTO trade

agreements will set a level playing field for international contractors and unfair procurement barriers will face increasing scrutiny and must inevitably be lifted if a balanced playing field is to be achieved.

The macro economic trends identified by the World Bank indicate continuing growth in world trade, the United Nations expects that the world population will go up from nearly 7.7bn in 2020 to 8.3bn in 2030 and 9.3bn in 2050 with much of the growth in Asian coastal areas (See graph on urban population). Preventive coastal protection initiatives will certainly be needed worldwide to combat the predictions for sea level rise of 0.5 m up to 1 m until 2100 according to a report from National Academy of Sciences issued in 2011. Thus, both global project funding and

international expertise will be essential to take on such projects. It could anticipated that in certain instances PPPs between employer, project funder and contractors may be the best contractual mechanism to take on complex projects. At present there is no standard form of contract for such projects. However, this may change in the future.

The FIDIC Conditions of Contract of the future that are based on using a fair and reasonable risk allocation will be key as increasingly complex contracts will be needed in order to tackle the global macro-economic issues. Co-operative agreements between contractors, employers, consultants, legal advisers and public authorities will be needed more than ever.

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