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Dispute Resolution Model of Construction Work Contract: A Case Study In Indonesia

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Abstract

The complexity of the construction industry causes the potential for construction disputes to be very large and cannot be avoided. There have been many methods of resolving construction contract disputes, such as litigation and non-litigation method, but the resolutions still cause losses to the conflicting parties, both financially and non-financially. Thus, it is necessary to explain the construction work contract dispute resolution model in Indonesia, and propose its ideal model. Considering that a construction work contract dispute arises as a result of an escalation of disagreements, a dispute resolution should be done quickly, and without harming each other, this study is adequate to use normative legal method. The method works to find correct answers for proof and to give legal prescriptions by using secondary data sources, which consisting of primary, secondary, and tertiary legal materials. This study yields two conclusions. First, the dispute resolution model of construction work contracts still reflects the *win-win solution* principle, which consists of mediation, conciliation, and dispute council, that only produces suggestions and does not have binding force and is not final. Whereas, the construction sector which basically has a high business risk, needs a quick resolution and can be complied with by all parties in the construction work contract. Second, the ideal dispute resolution model of construction work contract in Indonesia is sufficient to use arbitration in a broad sense, which accommodates final and binding mediation and conciliation. It is recommended to remove the word "court" in the explanation of Article 47 paragraph (1) letter (h) of the Construction Services Law, as well as adopt a compromise on the revocability doctrine and its exceptions and ratifies the New York Convention in 2015 in the reformation of the 1999 Arbitration Act.

Keywords: construction work contract, *win-win solution* principle, arbitration

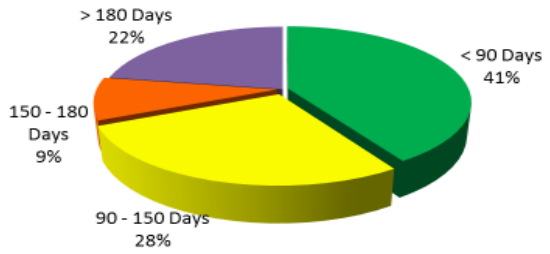
Introduction

The very significant increase in the development of facilities and infrastructure carried out in Indonesia shows that the construction sector is one of the most important sectors in increasing economic growth. The priority of the construction services sector is seen in the 2021 State Budget (APBN), which shows the existence of things, such as maintenance/rehabilitation of 2,375 km of roads, widening of 229 km of roads, construction of 699 km of bridges, construction of 41,488 ha of irrigation networks, construction and improvement of 1,769 km strategic village roads, construction of 971 public health center (*Puskesmas*) buildings, provision of housing in 50,000 units of slum resolutions, and construction of 1,000 km of farming/production roads (Ministry of Finance, 2021).

However, it must be realized that the construction sector is a complex business activity, wherefrom a legal point of view, this sector is in direct contact with many regulations, such as highway road construction which must intersect with construction service regulations, environmental regulations, land regulations, investment regulations, labour regulations, tax regulations, banking regulations, and other regulations (Lature, 2018: 212). The complexity of this construction industry activity causes the potential for construction disputes to be very large and cannot be avoided.

Indeed, there have been several dispute resolution methods that have arisen in construction services in Indonesia based on Law Number 2 of 2017 concerning Construction Services (Construction Services Law) and Law Number 30 of 1999 concerning Arbitration and Alternative Dispute Resolution (Arbitration Law), that are litigation and non-litigation (such as deliberation to reach consensus, mediation, negotiation, conciliation, formation of dispute boards, and arbitration). However, the resolution still causes losses to the conflicting parties, both financial and non-financial. Hidayat and Gunawan's research on 330 State-Owned Enterprises *(BUMN)* contractor litigations at the Supreme Court *(MA)* level in Indonesia concluded that the parties had to incur huge costs to be able to resolve the dispute in a fairly long period of time, which ranged from three up to six years (Hidayat, 2013). Even resolutions with non-litigation mechanisms take a short time as the data in Figure 1 processed from the Indonesian National Arbitration Agency *(BANI)* as of 2017 on about 955 cases that have been processed, there were 59% dispute resolution cases in 2014-2016 which the resolution is more than 90 days.

Figure 1. Completion Time
Time Required for BANI Arbitration Tribunal to issue an award for disputes, period of 2014-2016



Source: Data processed from BANI Center for the period 2014-2016

In addition, other losses await the conflicting parties, such as the occurrence of bad business relationships in the future, unfocused corporations in running their business, reduced levels of third party trust in the conflicting parties, and additional costs that are not necessary. Few can reduce the company's liquidity (in the form of lawyers and expert witnesses/consultant fees) (Gebken, 2006).

The vital role of the construction industry in development in Indonesia and the potential for construction disputes to arise which are very detrimental to the conflicting parties lead to two problem formulations in this study. First, does the current construction work contract dispute resolution model in Indonesia reflect the *win-win solution* principle? Second, what is the ideal dispute resolution model of construction work contracts in Indonesia?

Material And Method

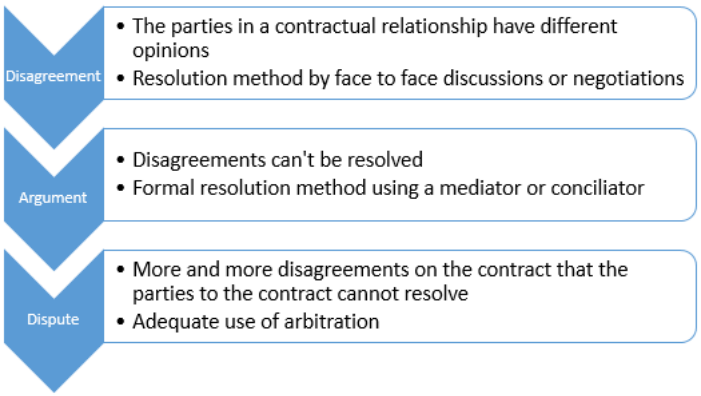
This study is a normative legal study or a doctrinal law study that works to find correct answers for proof of or from written legal prescriptions (Wignjosoebroto, 2009: 121). This study uses secondary data sources, which are seen from the point of view of their binding strength consisting of legal materials, which have binding power, secondary legal materials, which can help to analyze and understand primary legal materials, and tertiary legal materials, which can provide information on primary and secondary legal materials (Soemitro, 1990: 10-12).

The primary legal materials used in this study include the Civil Code (KUH Perdata), the Construction Services Law, the Arbitration Law, Government Regulation No. 22 of 2020 concerning Implementing Regulations of Law no. 2 of 2017 concerning Construction Services, and Supreme Court Regulation (PERMA) Number 1 of 2016 concerning Mediation Procedures in Courts. The secondary legal materials used in this study consist of books, journal articles, national and international proceedings. The tertiary legal materials used in this study consist of legal dictionaries, Indonesian language dictionaries, encyclopedias, internet sources, and other tertiary legal materials. The secondary data obtained were analyzed in a qualitative juridical manner, compiled systematically, and conclusions and suggestions were drawn (Sinaga et al., 2020: 177).

Results

The problem of claims and disputes in the construction industry is a worldwide phenomenon. According to Eilenberg (2003: 9-10), a dispute in construction work contracts cannot be separated from the escalation of disagreements that escalates into arguments escalates again into disputes. Disagreement as the forerunner of dispute should be resolved by the parties involved based on a common goal to resolve the issue quickly and without harming each other. However, when a disagreement is not resolved immediately,

it can escalate into an argument or fight, the level of difference in such a way cannot be easily resolved. If an argument cannot be resolved, it will lead to a dispute whose differences are such that it cannot be resolved without the help of a formal system and outside assistance. A brief description of the escalation of disagreements according to Eilenberg (2003: 10-11) is briefly described in Figure 2 below.

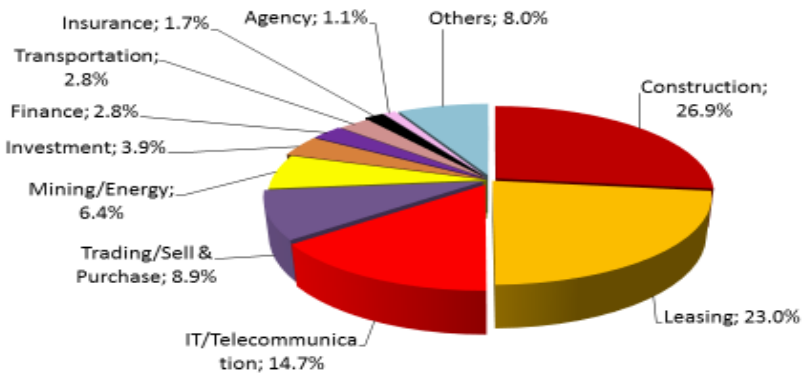


As a legal relationship, disputes arising from construction work contracts must be legally resolved. The trend in the last ten years shows that non-litigation resolutions dominate over litigation resolutions. The urgency of this non-litigation resolution is emphasized by Chistoper W. Moore in Emirzon (2000: 20), whose scope is in the form of volunteerism in the process; the procedure is fast, efficient in time and cost, the decisions are non-judicial, the manager carries out the control, who are most aware of the needs of the organization, whose procedures are confidential, great flexibility in designing the terms of problem-solving, protection and maintenance of excellent working relationships, have a very high level of possibility to carry out agreements, a higher level of control and easier to predict results, have agreements that are better than just a compromise or the results obtained from a win/lose resolution, and decisions that last over time (Emirzon, 2000: 20).

In terms of resolution of construction disputes in Indonesia, the Construction Services Law has emphasized resolutions outside the court (non-litigation) to achieve a "*win-win solution*" by providing space for the disputing parties to use Alternative Dispute Resolution. (Lature, 2018: 218). However, there is an explanation in Article 47 paragraph (1) letter (h) of the Construction Services Law which seems to be able to justify the resolution of construction disputes through litigation as it states: "...Dispute resolution is pursued through, among others, deliberation, mediation, arbitration, or courts. In fact, it must be realized that disputes in the construction service sector must be handled immediately considering that the abandonment of construction projects will pose a big risk, such as costly costs, fluctuating material prices, project abandonment can endanger human lives, and the potential for material theft in the project

environment so that it is hoped that legal settlement in a progressive legal context, that is the parties involved in the contract must carry out the mandate of the contract actively, transparently, and accountable in fulfilling justice, benefit, and certainty (Hermawan et al., 2020: 157) in the contract. The urgency of a construction dispute resolution period as quickly as possible can be compared with the average period of arbitration resolution at BANI during 2014-2016, which was still above three months on average, while the business sectors that dominated case resolution at BANI during 2014-2016 were the construction sector, as Figure 3 presents data on the completion of cases which have reached 26.9%.

Figure 3.
Sectors of Expertise
Case Submissions, by business sectors, over the last 3 years (2014-2016)



Source: Data processed from BANI Center for the period 2014-2016

Discussion

1. Overview of construction contracts in Indonesia

Article 46 and Article 49 of the Construction Services Law have emphasized that the working relationship between Service Users and Service Providers as well as between Service Providers and Service Sub-Providers must be stated in a Construction Work Contract, where the form of a Construction Work Contract can follow the development of needs and be implemented following the provisions of the regulation. What is meant by a Construction Work Contract following Article 1 point 8 of the Construction Services Law is "the entire contract document that regulates the legal relationship between Service User and Service Provider in the implementation of Construction Services". Furthermore, Article 47 of the Construction Services Law stipulates that a Construction Work Contract must at least include clear identities of the parties, a job formulation (which explains and details the scope of work, work value, unit price, lump sum, and implementation time limit), and implementation period. And

maintenance that is the responsibility of the Service Provider, equality of rights and obligations between the Service User and the Service Provider, the obligation to employ certified construction workers, payment methods, default, resolution of disputes, termination of the Construction Work Contract, coercive circumstances, Building Failure, worker protection, protection to third parties other than the parties and workers, environmental aspects, guarantees for risks that arise and legal liability to other parties in the implementation of Construction Works or as a result of Building Failures, and options for resolving construction disputes. In addition to containing the provisions as referred to in Article 47, Article 48 of the Construction Services Law stipulates that the Construction Work Contract: 1) for planning services must contain provisions on intellectual property rights, 2) for the implementation of Construction Services, may contain provisions concerning Service Sub-providers and suppliers of materials, building components, and/or equipment that must comply with applicable standards, and 3) which is carried out with foreign parties, contains the obligation to transfer technology.

Construction Work Contracts in Indonesia show that the engagement that arises cannot be separated from the agreement, as Article 1233 of the Civil Code formulates that "every engagement is born good because of approval, whether because of the law". Furthermore, Article 1234 of the Civil Code confirms that achievement as an object of a contract can be in the form of giving something, doing something and not doing something, as long as it fulfils the four legal requirements of a contract (according to the four conditions of Article 1320 of the Civil Code, in the form of agreeing that those who bind themselves, are capable of making a contract). An engagement, a certain matter, and a lawful cause), and fulfils the requirements of the achievement itself, that is the form must be certain or can be determined (Article 1320 paragraph 3 of the Civil Code), the object is permitted by law (Article 1335 and Article 1337 of the Civil Code). Its achievements are possible to be implemented.

The existence of a Construction Work Contract as a contractual relationship will be evidence for each party if there is a violation committed by one of the parties in the contract. Violation of the contractual relationship will give birth to a dispute, which in the context of legal science, the lawsuit should be in the realm of civil law referring to the possibility of a breach of contract (Lature, 2018: 218), as Article 47 paragraph (1) letter g of the Construction Services Law requires a Contract Construction work must contain provisions regarding responsibility if one of the parties does not carry out the obligations as agreed.

2. Resolution of construction contract disputes that apply in Indonesia

Article 88 of the Construction Services Law stipulates that the resolution of a Construction Work Contract dispute must begin with the basic principle of deliberation to reach a consensus. Still, if this principle is not achieved, then the parties will take the stages of dispute resolution as stated in the Construction Work Contract, which can be in the form of mediation, conciliation, and arbitration, where the resolution of each of these processes can be terminated if

the previous stages of the dispute have been resolved. Then, Article 93 paragraph (3) - paragraph (5) of Government Regulation Number 22 of 2020 stipulates that in addition to efforts to resolve disputes through Mediation and Conciliation, the parties can appoint a Dispute Council, which functions as an effort to prevent and resolve construction disputes. Regarding mediation and conciliation as Alternative Dispute Resolution, as Article 1 point (10) confirms that Alternative Dispute Resolution is an institution for resolving disputes or differences of opinion through procedures agreed upon by the parties, that is resolution out of court by means of consultation, negotiation, mediation, conciliation, or expert judgment.

The use of the Dispute Board in disputes of construction contracts in Indonesia is based on Article 94 – Article 96 of Government Regulation No. 22 of 2020. The authority of the Dispute Board arises after the parties agree to use the Dispute Board in the clauses of the Construction Services engagement and make a tripartite Dispute Board agreement. The process and decision of the Dispute Board must be based on the principle of justice. Still, if the parties/one of the parties object to the decision of the Dispute Board, the stages of dispute resolution in the form of mediation, conciliation, and arbitration can be taken.

Arrangements regarding construction mediation in Indonesia can refer to the Arbitration Law, Government Regulation Number 22 of 2020, and PERMA Number 1 of 2016 concerning Mediation Procedures in Courts. There are two understandings of mediation that can lead to various interpretations, where Article 1 number (28) of Government Regulation Number 22 of 2020 defines mediation as an effort to resolve disputes by involving third parties who act as advisors, while Article 1 number (28) of PERMA Number 1 of 2016 defines mediation as a way of resolving disputes through a negotiation process to obtain an agreement between the Parties with the assistance of the Mediator. Article 1 number (2) of PERMA Number 1 of 2016 stipulates that a mediator is a judge or other party who has a Mediator certificate as a neutral party who assists the parties in the negotiation process in order to seek various possible dispute resolutions without resorting to a way of deciding or forcing a settlement. Then, Article 6 paragraph (3) of the Arbitration Law stipulates that if a dispute or difference of opinion through a direct meeting by the parties cannot be resolved, then upon the written agreement of the parties, the dispute or difference of opinion is resolved through the assistance of one or more expert advisors or a mediator. However, if the parties within a period of 14 days with the assistance of one or more expert advisors or through a mediator fail to reach an agreement, or the mediator fails to bring the two parties together, then, following Article 6 paragraph (4) of the Arbitration Law, the parties may contact an arbitration institution or alternative dispute resolution body to appoint a mediator. After the appointment of a mediator by the arbitration institution or alternative dispute resolution institution, within a maximum of 7 days, the mediation business must start. Efforts to resolve disputes or differences of opinion through a mediator by upholding confidentiality within a maximum period of 30 days must be reached in writing signed by all parties concerned. The agreement to settle disputes or differences of opinion in

writing is final and binding on the parties to be implemented in good faith. It must be registered at the District Court within 30 days of signing.

The understanding of conciliation is only obtained from its definition contained in Article 1 number (29) of Government Regulation Number 22 of 2020, which reads: "Conciliation is an effort to resolve disputes by involving a third party (conciliator) who actively intervenes". There are no further regulations regarding the mechanism and procedures for conciliation in the Arbitration Law, the Construction Services Law, and Government Regulation Number 22 of 2020.

As for Arbitration, following Article 1 number (1) of the Arbitration Law is a way of settling a civil dispute outside the general court based on an arbitration agreement made in writing by the disputing parties. Article 3, Article 6, and Article 11 of the Arbitration Law have confirmed that the disputes of the parties who have been bound in the arbitration agreement nullify the rights of the parties to submit dispute resolutions or differences of opinion to the District Court. The arbitration award is final and has permanent legal force, and is binding on the parties; however, by Article 70 of the Arbitration Law, the parties may apply for annulment of the arbitral award if the award is suspected to contain the following three elements: 1) a letter or document submitted in the examination, after the decision is handed down, it is recognized as false or declared false, 2) after the decision is taken, a decisive document is found, which is hidden by the opposing party, or 3) the decision is taken from the results of a ruse carried out by one of the parties in the examination of the dispute.

3. The ideal dispute resolution model of construction contract in Indonesia

Many factors cause construction contract disputes in an economic relationship. The first factor is the misinterpretation of legal certainty as merely legal certainty in a practice of economic activity. The second factor is the development of business contracts from time to time, the variety of types of businesses, and the increasingly complex problems that arise, which have prompted the emergence of new forms of business contracts that cannot be separated from the following three factors: internal factors (dominated by various government policies), external factors (a factor for business development that comes from abroad), and factors for increasing the frequency and various forms of business activities. The increase in contract activities requires adjustments to certain legal areas, which inevitably can cause business disputes or conflicts. At the same time, the third factor is the assumption that the occurrence of disputes is a means of seeking justice and or legal certainty in terms of the emergence of legal liability.

These factors often make disputes in the construction industry long, complex and expensive to resolve and can cause long-term damage to the commercial relationship between the parties. Construction contract disputes should be avoided (or at least overcome) by ensuring there is a spirit of obligation due to propriety to act or act and obligations due to propriety not to act or not to act for the parties to the contract made, which of course the draft will be clear and

fair. And contains early dispute resolution and effective contract management (Chambers, 2011: 7). The contractual method that has the spirit of legal liability so that it can be a basic preventive measure that contributes to the minimization of disputes is carried out with the following four main things: 1) ensuring that the parties have signed the final contract before the work begins, 2) ensuring that the scope and quality of work have been determined. Clearly defined at the pre-contract stage, 3) ensure that the terms of the contract are fair and clear, and use standard contract forms wherever possible, 4) ensure that the contracts used contain provisions on early notification of potential disputes and well-structured dispute resolution clauses which is not limited to litigation but also to arbitration and alternative dispute resolution (Chambers, 2011: 7).

Considering that in general, construction disputes arise from violations of Article 47 paragraph (1) letter g-letter k of the Construction Services Law, that is violations related to default, dispute resolution, termination of Construction Work Contracts, coercive circumstances, and Building Failures, the resolution of construction contract disputes can be based on on the idea of legal liability which must provide justice to parties who do not carry out their contractual obligations through non-litigation resolutions (Priyambudi et al., 2020: 11993). This legal liability must refer to obligations due to propriety to act or do and obligations not acting or not acting. There are 4 (four) criteria attached to the obligation due to propriety to act/act, that are: 1) it is carried out in good faith to fulfil its legal obligations unless it can be proven that a state of *force majeure* or coercion or other things make it act otherwise, 2) carried because of the danger or damage or loss that may occur immediately and or cannot be avoided, 3) there is no better alternative, or if the action is not taken it will cause even greater harm or damage or loss, and 4) the act or deed is purely by accident. While the obligation due to propriety not to do/not act is attached to 4 (four) criteria, that are: 1) it is a *mala prohibita* act, 2) it is not within the scope of its capacity so that it cannot act/act according to its professional judgment, 3) there are still some alternative actions/other actions that are even better that do not violate the applicable laws and regulations, and 4) are actions/actions that enrich oneself/a group and/or other parties that cause financial losses to the victim (Sinaga and Sinaga, 2018: 103-104).

The existence of an obligation due to propriety to act or act and an obligation due to propriety not to act or not act in a construction contract (dispute) is adequate to be carried out through non-litigation channels as a *win-win solution*, considering that a contract cannot be separated from the legal relationship between two or more persons. More, where one party is entitled to achievement, and the other party is obliged to fulfil that achievement. This is reinforced by the doctrine of *pacta sunt servanda*, which teaches that a contract made legally, in good faith, and based on the applicable laws and regulations, binds the parties who made it so that every contract implementation must not harm the parties in the contract. Contracts and other third parties related to the contract (Fuady, 2013: 211).

The non-litigation construction work contract disputes in the Construction Services Law in the form of mediation, conciliation, and the Dispute Board are not yet binding considering that the stages of the dispute can still be arbitrated, even though efforts to resolve mediation, conciliation, and the Dispute Board have taken months. The moon and its position are only suggestions by not deciding who is right or wrong (Chern, 2015: 6). Not to mention the matter of mediation, conciliation, and the Dispute Council, which still lacks laws and regulations at the level of Government Regulations and their implementing rules. Of course, if the stages of mediation, conciliation, and the Dispute Board have been terminated, arbitration can still be submitted as the arbitration decision is final and has permanent legal force and is binding on the parties (as long as it does not meet the elements of Article 70 of the Arbitration Law). In addition, the arbitrator or arbitral tribunal is obliged to make peace between the disputing parties in the arbitration process itself. The arbitrator or arbitral tribunal draws up a deed of reconciliation that is final and binding on the parties if peace is reached.

Arbitration should meet the qualifications for applying the legal liability doctrine and the *pacta sunt servanda* doctrine to resolve construction work contract disputes. This has also been emphasized by Hasan (2010: 25-26), who argues that the three expectations for the outcome of the arbitration are: 1) impartiality and expertise of the arbitrator who decides the case because the parties can choose a qualified arbitrator with the required expertise (Hoellering, 1984: 35), which has no interest and is impartial, and can fully give the necessary time to understand the facts and applicable rules, 2) examination through closed arbitration and private and confidential, and 3) efficiency an arbitration process that is more efficient than going through the courts, one of which is a binding and final arbitration award.

The three pillars of the expectation that every construction work contract dispute is resolved through arbitration will be better if some shortcomings or weaknesses can be addressed. Hasan (2010: 26) and Besaiso *et al*. (2018) stated several challenges and weaknesses of arbitration in Indonesia, such as 1) there is no guarantee that the arbitration process will run fairly, while the arbitration award is binding and final, so there will always be a risk of prejudice against the arbitrator, 2) the concept of arbitration in each country often different because each is influenced by the law and their respective legal structures, resulting in the reluctance of many international organizations/companies to participate in arbitrations in Indonesia, and 3) arbitration decisions always depend on the technical ability of the arbitrators to be able to provide satisfactory decisions for the parties and following the sense of justice of the parties.

Of course, some of the shortcomings or weaknesses of arbitration can be corrected if re-understanding the nature of arbitration that is as a dispute resolution process that is faster and cheaper than litigation, which binds the parties who have agreed to submit their dispute to a neutral third party who hears from the parties. All parties impose binding decisions on the disputing parties because they use simplified procedures to achieve results based on the principles of law,

equality, custom, and practice unique to a particular industry (Jill, 2019: 193). Thus, the equality of the parties in the contract shows that the central concept behind arbitration is to provide enforceability of the results of the arbitration between the disputing parties as equal bargaining power while still not allowing the defaulting party to escape from its obligations (Norris, 2018: 259).).

One of the disputing parties can do several things if it is suspected that the arbitration process is running unfairly, such as the right to deny and revive the revocability doctrine. Article 22 of the Arbitration Law stipulates that if a reason is found and sufficient authentic evidence is found, a claim for denial may be filed against the arbitrator. The revocability doctrine allows either party to withdraw their agreement to arbitrate until the arbitrator decides (Horton, 2013: 1225). The compromise on the revocability doctrine and its exceptions has been adopted in Part II of the 1980 Vienna Convention on Contracts for the International Sale of Goods (CISG) Article 16, as the formula reads: "*1) Until a contract is concluded an offer may be revoked if the revocation reaches the offeree before he has dispatched an acceptance. 2) However, an offer cannot be revoked: a) if it indicates, whether by stating a fixed time for acceptance or otherwise, that it is irrevocable; or b) if it was reasonable for the offeree to rely on the offer as being irrevocable and the offeree has acted in reliance on the offer*" (Lookofsky, 2018: 580-581). The existence of the revocability doctrine will increasingly provide equality to the disputing parties and provide mutual control and give the disputing parties the right to make peace when the arbitration process is in progress. Meanwhile, the efforts made by Indonesia in dealing with the reluctance of international companies/organizations to participate in the arbitration in Indonesia by ratifying the New York Convention in 2015 concerning its prospective guarantee that the parties to the contract will follow international practice (Besaiso et al., 2018).

Conclusion

This study yields two conclusions. First, Indonesia's current construction work contract dispute resolution model still reflects the *win-win solution* principle in a narrow sense. This means that the *win-win solution* principle is limited to the Arbitration Law and the Construction Services Law, which stipulates that the resolution of construction contract disputes must be carried out in a non-litigation manner. In fact, the non-litigation resolution of construction work contracts consisting of mediation, conciliation, and dispute councils only produces suggestions. It does not have binding and non-final power, which will harm the parties in the construction sector, which basically have high business risks. Second, the ideal construction work contract dispute resolution model in Indonesia is adequate by using arbitration in a broad sense, that is, arbitration in which mediation and conciliation are accommodated. However, the results are still final and binding.

Recommendation

Based on the two conclusions that have been drawn. There are several suggestions in producing an ideal arbitration model in resolving construction work contract disputes in Indonesia, including:

a. Removing the word "court" in the explanation of Article 47 paragraph (1) letter (h) of the Construction Services Law because it can justify the resolution of construction disputes through litigation.
b. The need to consider reforming the 1999 Arbitration Act by adopting a compromise on the revocability doctrine and its exceptions and ratifying the New York Convention in 2015.***

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