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Construction Disputes and Their Settlement in Indonesia

A. Legal Basis

1. Law No. 2 of 2017 on Construction Services ("**Construction Law**")
2. Law No. 30 of 1999 on Arbitration and Alternative Disputes Resolution ("**ADR & Arbitration Law**");
3. Government Regulation No. 29 of 2000 on Construction Services Implementation ("**Regulation 29/2000**");
4. Government Regulation No. 59 of 2010 on 1st Revision of Regulation 29/2000 ("**Regulation 59/2010**")
5. Government Regulation No. 79 of 2015 on 2nd Revision of Regulation 29/2000 ("**Regulation 79/2015**")
6. Government Regulation No. 54 of 2016 on 3rd Revision of Regulation 29/2000 ("**Regulation 54/2016**")

B. Types/Source of Construction Disputes

1. Types of Construction Disputes

The construction service industry has a higher 'level of uncertainty' risk factors compared to other industries (Flanagan and Norman, 1993), and it is prone to triggering the dispute. In a Construction Work Contract, which requires high cost and lengthy duration, it is always possible to have a dispute between the parties. Disputes that can occur in construction projects usually involve:

- a. Users and Contractors;
- b. Main Contractors and sub-contractors;
- c. Contractors and Suppliers; and
- d. Users/Contractors and Other parties.

2. Source of Construction Disputes

Disputes can originate from various potential sources. In construction services, a dispute can occur in the stage of planning, procurement, implementation and supervision, and it usually begins when there is a claim from one of the parties. Construction claims are requests or demands arising from or in connection with carrying out a construction project work. The reasons for the claim can be as follows:

- i. delayed design information;
- ii. inadequate design information;
- iii. inadequate site investigations;
- iv. slow client response;
- v. poor communication;
- vi. unrealistic time targets;

- vii. inadequate contract administration;
- viii. uncontrollable external events;
- ix. incomplete tender information;
- x. unclear risk allocation;
- xi. lateness or non-payment.

Basically, there are three 'root of disputes' leading to disputes in the implementation of construction projects, which can be divided as follow:

- o Uncertainty factors in each construction project;
- o The problems related to construction contracts;
- o Opportunistic behavior of the parties involved in a construction project.

C. Settlement of Construction Disputes

1. Non-Litigation Procedures

Under the provision in Article 8 section (1), the Construction Law encourages that any disputes be settled by deliberation to reach consensus. When consensus cannot be reached, the Parties can follow the dispute settlement procedures as stated in the Construction Work Contract that the parties can settle the dispute through the ADR procedures, which are further regulated in the ADR & Arbitration Law.

The ADR & Arbitration Law states that any disputes can be resolved by the parties through ADR based on their good faith by waiving resolutions by litigation in the court. Under its provisions, the ADR & Arbitration Law also provides guidance on the conduct of ADR procedures, and that can be applied to resolve construction disputes, i.e. through Mediation and Conciliation, as follow.

i. Mediation

Mediation is a voluntary proceeding, where the parties involved are free to agree and attempt to resolve their dispute through mediation. The process is flexible, allowing parties to define the time, structure and content of the mediation proceedings. These proceedings are rarely public and the whole of the process is conducted confidentially. They are interest-based since the mediator will, when proposing a settlement, not only take into account the legal positions but also the commercial, financial and/or personal interests.

Mediation is generally used in the construction industry to resolve disputes. The process involves a mediator who acts as a neutral third party. Article 6 paragraph (5) of the ADR & Arbitration Law requires parties in dispute to meet at least within 7 days after the appointment of the mediator. The mediation process shall be commenced to reach an amicable dispute settlement, which must be stated in a written agreement. The written agreement for such the dispute resolution shall be final and binding on the parties concerned, implemented in a good faith, and registered with the court within no more than thirty (30) days after it is signed.

ii. Conciliation

Like mediation, conciliation is a voluntary, flexible, confidential and interest-based process where the disputing parties seek to reach an amicable dispute settlement with the assistance of a conciliator acting as a neutral third party.

The main difference between conciliation and mediation proceedings is that at a certain point during the conciliation, the conciliator will be asked by the parties to provide them with a non-binding settlement proposal.

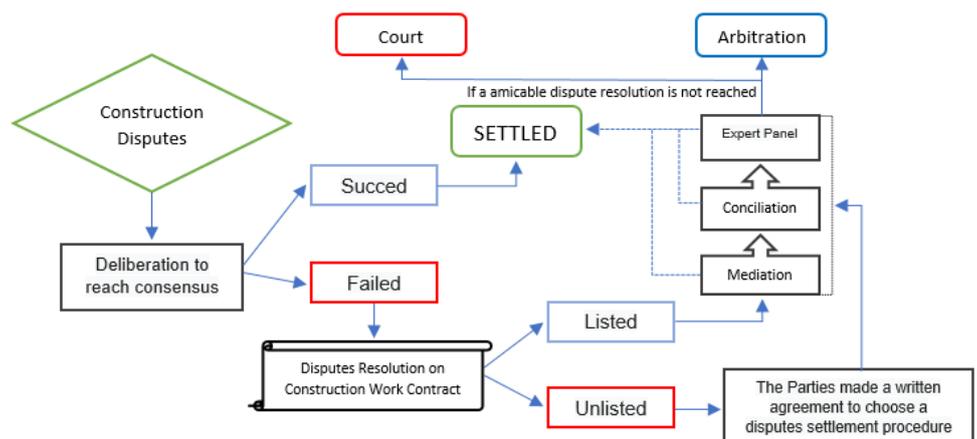
iii. Expert Panel

In the ADR & Arbitration Law, the "expert panel" is stated as one of the bases for alternative dispute resolution through what is referred to as an expert judgment, a product or result of an assessment carried out by someone who can be categorized as an expert in a particular field, especially in the construction industry.

In Regulation 29/2000, article 37 defines expert panel as subjects who meet certain requirements, namely as Expert Assessors as referred to as those who meet the requirements such as having a certificate of expertise, registered with the Construction Services Development Institute and being DRBF-certified.

The ADR dispute resolution mechanism/procedure is described in the scheme below:

1.1. The ADR Mechanism Chart



iv. Arbitration

Unlike other forms of ADR, arbitration has characteristics that are more similar to adjudicative dispute agreements. Arbitration shall mean a mechanism of settling civil disputes outside the general courts based upon an arbitration agreement entered into in writing by the disputing Parties. Arbitrations in Indonesia are governed by the ADR & Arbitration Law which ensures that the arbitrations are fair, cost-effective and rapid, as well as accessible. Arbitration is often used in the context of international construction disputes, but can equally be used for pure domestic disputes.

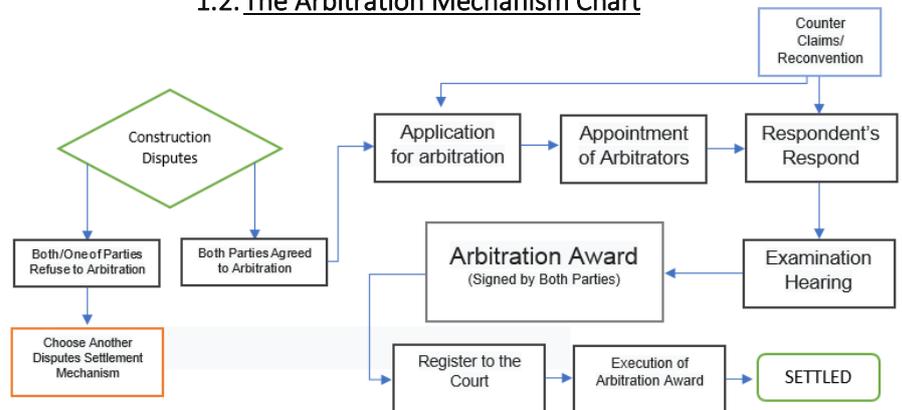
There are several arbitration agencies in Indonesia which generally conduct construction dispute settlements, such as Indonesian National Board of Arbitration (BANI) and Construction Dispute Arbitration and Alternative Dispute Resolution Centre ("BADAPSKI"), which was established by the Ministry of Public Works in 2014. The establishment of BADAPSKI is intended to provide a more efficient and productive arbitration procedure for the disputing parties. The arbitrators in BADAPSKI are very familiar with the construction industry and are therefore well-informed to assess disputes of this nature.

Under the provision Article 2 paragraph 1 and Article 4 paragraph, Arbitration can only be used if it is expressly agreed upon by the parties in writing. Once it has been agreed, the parties in dispute have no right to bring the claim to the courts. The designation of arbitration as a way to settle the dispute must be made in a written agreement signed by the disputing parties.

Under the ADR & Arbitration Law, it is possible for the disputing parties to nominate their "judges" (arbitrators) who specialize in the case involving the parties, and who can give a more in-depth analysis of the dispute in the judgment. The arbitrator requirements are specified in article 12 of the ADR & Arbitration Law. In addition, the ADR & Arbitration Law provides procedures for using a sole arbitrator or three arbitrators in the arbitration panel.

The parties can agree on procedural arbitration rules by a written agreement, provided that these rules are not contrary to the ADR & Arbitration Law. If the parties do not determine the arbitration process, the ADR & Arbitration Law procedures will apply. If arbitration is conducted in Indonesia under the rules of a national or international arbitral institution, the rules and procedures of that institution will apply, unless the parties agree otherwise. The arbitration process is described in the scheme below:

1.2. The Arbitration Mechanism Chart

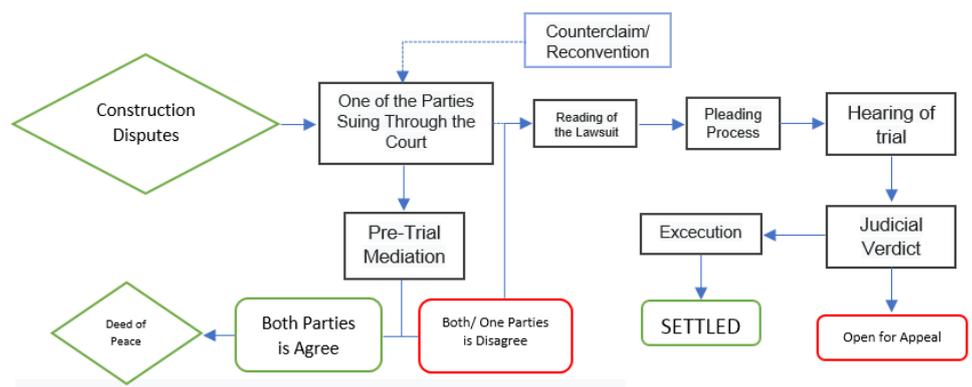


2. Litigation Procedures (Courts)

To resolve disputes in court, all parties to a dispute face each other to defend their rights before the court. The final result of a dispute resolution through litigation is a decision having the nature of a 'win-lose' solution. In addition, litigation process through court is a final dispute resolution (ultimum remidium) after other alternative dispute settlements do not reach any results.

The procedure in this litigation court is more formal and very technical. The dispute resolution procedure carried out in court (litigation), also commonly known as the trial process civil as determined under the civil procedural law/*Herzien Inlandsch Reglement* (HIR), is described in the scheme below:

1.3. The Litigation Mechanism Chart in Court



Based on the chart above, a litigation proceeding is initiated by way of filing a civil claim with the relevant district court, namely the court where one of the parties is domiciled, but in some cases the court selection can be either in accordance with:

- the parties' choice of court, as specified in the construction work contract document, or
- the district court where the object of the dispute is located.

Before filing a claim, the claimant must pay a registration fee of which the amount varies depending on the number of parties to the dispute and the domicile of the parties. There is no time limit for each of the above stages. However, the Supreme Court will expect the district court to issue their judgment within six months of the first hearing after mediation. In practice, the whole process usually takes between six months and one year. A district court's judgment can be appealed to the relevant high court (and ultimately to the Supreme Court).

D. Comparison Between ADR and Court Procedure

1. ADR Advantages compared to Court Procedure

No.	ADR and Arbitration	Court
1	Free to determine rules and institutions of ADR.	Absolutely bound by applicable procedural & arbitration law
2	Avoiding uncertainty due to differences in the legal system, having a higher possibility of an unfair Judge, as well as protecting the domestic interests involved in the dispute.	What really applies is the legal system of the State where the dispute is examined
3	Free to choose a professional, expert, and independent mediator, conciliator as well as arbitrator.	The Panel of Judges of the Court is determined by the Court Administrative
4	More efficient in time, procedure and arbitrator cost. Decisions are final and binding and closed for appeal	Judicial decisions are determined by Judicial Administration
5	Trial procedure provides protection for information or business data that is confidential or may not be publicly known.	Open to the public (except divorce cases)
6	Legal considerations take precedence private aspects with a win-win solution	The pattern of consideration of the Court and Judges' decisions are win-lose solution

2. ADR Disadvantages compared to court procedure

No.	ADR and Arbitration	Court
1	The honorarium of mediator, conciliator, and arbitrator is relatively expensive and generally determined by the value of the claim (dispute).	Case costs are relatively inexpensive and have been determined by the Supreme Court
2	It is relatively difficult to form an Ad Hoc Arbitration Assembly	There were no significant obstacles in the formation of the Panel of Judges who examined the case
3	Not having their own bailiffs and that hinders effective resolution	The bailiff's assembly is determined by procedural law
4	The resolution does not have effective coercive power, and is dependent on the Court if the award is not carried out voluntarily	Implementation of the decision can be imposed effectively on the losing party
5	Execution of resolutions tends to be easily intervened by the losing party through the judiciary (Rebuttal, Verzet) so that it takes longer to settle, which in turn makes the compensation payment relatively more expensive	Execution of the Verdict which has definite legal power can certainly be implemented even though there is a Rebuttal or Verzet afterwards.

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