



Palestine Economic Policy Research Institute (MAS)

Small Construction and Contracting Contracts in Palestine between Deficiency in Theory and Difficulties in Application

Mahmoud Fayyad

2013



*Empowered lives.
Resilient nations.*

**This study was made possible through
the generous support of the UNDP/PAPP**



M A S

Palestine Economic Policy Research Institute

**Small Construction and Contracting Contracts
in Palestine between Deficiency in Theory
and Difficulties in Application**

Mahmoud Fayyad

2013

The Palestine Economic Policy Research Institute (MAS)

Founded in Jerusalem in 1994 as an independent, non-profit institution to contribute to the policy-making process by conducting economic and social policy research. MAS is governed by a Board of Trustees consisting of prominent academics, businessmen and distinguished personalities from Palestine and the Arab Countries.

Mission

MAS is dedicated to producing sound and innovative policy research, relevant to economic and social development in Palestine, with the aim of assisting policy-makers and fostering public participation in the formulation of economic and social policies.

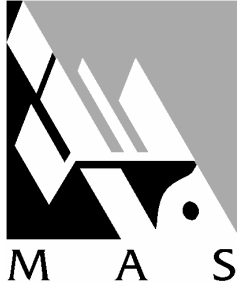
Strategic Objectives

- ♦ Promoting knowledge-based policy formulation by conducting economic and social policy research in accordance with the expressed priorities and needs of decision-makers.
- ♦ Evaluating economic and social policies and their impact at different levels for correction and review of existing policies.
- ♦ Providing a forum for free, open and democratic public debate among all stakeholders on the socio-economic policy-making process.
- ♦ Disseminating up-to-date socio-economic information and research results.
- ♦ Providing technical support and expert advice to PNA bodies, the private sector, and NGOs to enhance their engagement and participation in policy formulation.
- ♦ Strengthening economic and social policy research capabilities and resources in Palestine.

Board of Trustees

Ghassan Khatib (Chairman), Jawad Naji, Jihad Al Wazir, Lana Abu-Hijleh, Luay Shabaneh (Secretary), Magda Salem, Mohammad Mustafa, Nabeel Kassis, Nafez Al-Hussieni, Raja Khalidi, Sabri Saidam, Samir Huleileh (Treasurer), Samir Abdullah (Director General).

Copyright © 2013 Palestine Economic Policy Research Institute (MAS)
P.O. Box 19111, Jerusalem and P.O. Box 2426, Ramallah
Tel: ++972-2-2987053/4, Fax: ++972-2-2987055, e-mail: info@mas.ps
Web Site: www.mas.ps



Palestine Economic Policy Research Institute

**Small Construction and Contracting Contracts
in Palestine between Deficiency in Theory
and Difficulties in Application**

Mahmoud Fayyad

2013

Project: **Strengthening the Rule of Law and Fostering Economic Development Through Improving Contract Enforcement**

Team Leader: Dr. Samir Abdullah

Legal Consultant: Dr. Anis Fawzi Qassim

Small Construction and Contracting Contracts in Palestine between Deficiency in Theory and Difficulties in Application

Researcher: Dr. Mahmoud Fayyad

Reviewers: Dr. Jamil Tahir
Dr. Amin Dawwas
Dr. Mohammad tharf

Layout: Lina Abdallah

Funding: This study was funded by the United Nation Development Program UNDP/PAPP – Rule of Law and Access to Justice Program in the oPt



*Empowered lives.
Resilient nations.*

Palestine Economic Policy Research Institute (MAS)
Jerusalem and Ramallah

ISBN 978-9950-374-33-1

Foreword

This study represents one of the studies of the project “Strengthening the rule of law and enhancing the investment climate by improving the enforcement of contracts”, which was conducted by the institute in collaboration with the United Nations Development Program (UNDP). The study aims to identify the weaknesses in the legal framework and its application to the private house construction sector, with the goal of making recommendations in order to improve access to justice and enforcement of contracts in this vital sector. Home constructions are mainly financed by the life savings of families with limited income who seek to improve their quality of life. The families that build their homes lack technical expertise in housing construction, and the legal environment in this sector is complex, outdated and incomplete.

The study seeks to analyze the legal environment for building and construction contracts as well as the practical application of the law in search of the weaknesses, which are the main sources of dispute. Moreover, the study also attempts to identify the weaknesses in the disputes resolution instruments in order to improve their effectiveness.

With the release of this study, I would like to thank the main researcher and his assistants, reviewers and discussant of the study, and all participants of the special workshop and the final conference for their comments. In particular, I would like to thank the Minister of Justice for his valuable remarks at the opening of the conference, and the representatives of the Engineers and Contractors Unions for their comments which helped in developing the recommendation of the study. Finally, I would also like to extend MAS’s gratitude and thanks to the UNDP/PAPP - Rule of Law and Access to Justice Program in the oPt, for sponsoring this study.

Dr. Samir Abdullah
Director General

Executive Summary

This study aims at demonstrating the legal regulation of construction and contracting agreements in Palestine as well as its suitability in practice. In the absence of legal regulations of these contracts in the *Majallah el-Ahkam el- Adliya* (“Majallah”), the Civil Code applicable in Palestine, the Majallah only addresses contracts of manufacturing and hiring. Such contracts which, in their essence and nature, dramatically differ from construction and contracting agreements. Recently, the Palestinian legislator has realized the importance of such legal regulation, and thus incorporated special legal provisions for contracting agreements in the draft Palestinian Civil Code, which has not been adopted by the Palestinian Legislative Council.

In 2006, the Palestinian legislator approved the application of the FIDIC model contract to govern government contracts. The private sector in Palestine also adopted the same model in major construction contracts, because of their belief in its universality and fairness. In contrast, the results of field research showed lack of efficacy of such model in regulating small and medium contracting agreements, which form the majority of construction works in Palestine in terms of their numbers and values. This situation led us to realize that Palestine lives in a legal vacuum as far as construction contracts are concerned.

The scope of research in this study was limited to small construction and contracting agreements characterized by private entities or consumers but not commercial entities, with little consideration given to government contracts and large buildings and construction contracts (macro projects). The reason for limiting the scope is due to the goal of the study that seeks to explore the fairness of the legal regulation governing the construction and contracting agreements and to what extent they represent the interests of the parties in a balanced manner. In reality there are three types of construction and contracting agreements at the national level, which vary in terms of the balance of the contractual relationship between their parties. These contracts are: government contracts, large construction and contracting agreements, and small construction and contracting agreements. In government contracts, they are concluded between a government institution and a private sector company to complete the required works through tendering procedures stipulated in the law with certain contractual forms that must be included as part of the relevant tender. This type usually takes into account the interests of the two parties

in a balanced manner, and there is no harm if the public sector is rigorous with regard to some of its legal rights to achieve public interests and give them priority over the special interests of the counterparty. The company that seeks to enter into such contracts is fully aware of all its legal rights and obligations and enjoys a professional experience and knowledge that are sufficient to handle such contracts. On the other hand, contracts from the second type are concluded basically between companies and commercial entities, each of which has an engineering and legal representation allowing it to negotiate its commercial interests in a balanced manner with the counterparty. The legal relationship here is between professionals, by which the interests of both parties are represented in a balanced and fair manner, and thus there is no need for legislative intervention to protect any party on the basis of the rule "pacta sunt servanda" or "the contract is the law of the parties".

Finally, the importance of this legislative intervention in Palestine appears in the third type of contracts (micro contracts), under which contracts are concluded verbally between the two parties assuming good faith in their implementation. When conflict of interests or disputes arise, we find ourselves in a legal vacuum due to the lack of special rules governing construction and contracting agreements, which forces us to inevitably apply the general legal rules (general security rules stipulated in Majallah and Islamic Jurisprudence or "Fiqh") that do not consider the issue of contractual weaknesses concerning the employer, or resort to professional norms which often prevail for the contractor's legal interests. From this perspective comes the importance of this study, which aims at establishing grounds to implement a clear legislative intervention that protects the weaker party in this contractual agreement.

The importance of this study is derived from the dramatic prevalence of jobs with such small contracts in the national market. The data issued by the Central Bureau of Statistics indicates a vast spread of construction works via such contracts. It is observed that the value of spending on the establishment of new and expanded buildings in the year 1997 was approximately \$700 million and reached nearly \$909 million in the year 2012, an increase rate of 30%. Additionally, the number of building licenses granted in Q1 2013 was 2281, of which 2053 were licenses for residential units (accounting for 90% of the total licenses granted). In the same period, the number of licensed residential units was 4159 out of the 4208 total residential units (accounting for 98% of the total units). This study shows little difference from what existed in the previous two decades, which reflects the significant spread of works with such simple contracts.

This study adopted the descriptive, inductive, comparative and analytical approach. The descriptive approach is featured through describing the practical reality of construction contracts in Palestine in terms of their composition, effects and settlement of disputes in addition to clarifying the possible difficulties that intersect with these topics and to what extent they differ from reality.

The study relied heavily on the results of field research interviews, where the field research team conducted nearly (50) interviews with the subject matter professionals and experts (consulting engineers, contractors, lawyers, judges ...etc.) in all the regions of the West Bank and East Jerusalem (Al-Quds). The goal of this field research in general is to serve the objectives of the inductive approach, through developing general legal rules derived from the collection of detailed information as a ground for determining the form and features of the practical organization of construction contracts in Palestine. The comparative approach, on the other hand had, an important role in concluding practical recommendations through comparing the legal regulation with the reality and finally with the international FIDIC model contract, which was adopted by all the comparative legal systems, in addition to its comprehensive and fair provisions. This was also clearly evident through the outcomes of the field research. Finally, analytical approach had an important role in cognizing the factors of contractual weakness in construction and contracting agreements in question, and eventually coming out with findings and recommendations for the study.

The study consists of three main parts. The first part examines the formation of construction agreements, and aims at demonstrating the concept and nature of construction and contracting agreements, the role of the Palestinian Contractors Union in organizing construction and contracting works in Palestine, and the content of FIDIC model contract, which was adopted for government projects. This part of the study discusses the properties of contracting agreements, formality in its organization at theoretical and practical levels, the role of engineering supervision in giving some kind of formality to these contracts, the nature of commitments made by each party to these contracts and finally explaining the customary measure and geometrical measure as essential means for measuring quid pro quo in these contracts and a variation factor that has emerged in the interviews of field research because of which many conflicts arise in practice.

The second part of the study discusses the effects of the contracting agreements represented in the obligations of the two parties to the contract and the cases that require terminating such contracts. The basic obligation of the contractor is to carry out the agreed on work and guarantee its quality in a way that enables the owner to utilize the building and take advantage of it properly. In some cases, the responsibility of the contractor may intersect with the responsibility of the engineer depending on the nature and type of the engineering supervision agreed upon between the owner and the supervising engineer to the extent that they become jointly and severally liable may reach. Moreover, the main contractor is responsible for all the works of subcontractors when contracting with them at his own risk to execute part of the work agreed upon with the owner.

The last part of the study discusses the means for settling disputes of contracting agreements through examining the nature of such disputes, their causes, and the appropriate means for resolving such disputes. This study deals with multiplicity of those means to include mediation and conciliation practiced by the legal departments in the provincial offices, the consulting engineers and the Dispute Resolution Board, which may be agreed upon by the two parties during contracting. The results of field research showed the efficacy of these methods, and that such disputes rarely reach the stage of arbitration and prosecution to settle disputes through issuing decisions binding on the both parties. The research results also showed that the individuals involved in this sector prefer to resort to arbitration rather than judicial methods for several reasons the most important of which is the speed factor in resolving disputes.

In general, this study demonstrated the following facts and results:

- ✧ The existing legal system in Palestine to handle the issue of dealing with construction and contracting agreements is not commensurate with the wide spread use of these contracts;
- ✧ The formal element (writing and documentation) is available for those contracts only in government projects, government-rated contracting companies and engineering-supervised construction projects. On the other hand, the rest of agreements (micro contracts) are characterized by being consensual without any documentation, which makes them susceptible to future conflicts between their parties;
- ✧ The majority of contractors working in this construction sector have no prior authorization, rating, or any kind of control over their works (approximately 95%), which makes controlling construction works extremely difficult;

- ✧ There is no actual overall engineering supervision in cases stipulated by the law, but rather signing formal engineering supervision contracts for the purpose of meeting the licensing requirements only, which harms the objectives of the overall supervision in these projects and may raise many conflicts during and after the execution of construction contracts;
- ✧ Some typical construction contracts that are not suitable in their content to include all the various construction works are widespread, whereas each type needs special terms and conditions that suit its nature;
- ✧ Usually, the value of a construction and contracting agreements is determined by the amount of work delivered by the contractor, which is measured by using unit measures. This measure is among the most common causes of disputes in construction agreements due to the difference between customary measures and geometric measures and in the absence of any prior agreement by the two parties on the approved measure, which leads to inequality in cognition between the building owner and the contractor with regard to the customary measure during the agreement;
- ✧ This measure is among the most common causes of disputes in construction agreements due to the difference between customary measures and geometric measures and in the absence of any prior agreement by the two parties on the approved measure, which leads to inequality in cognition between the building owner and the contractor with regard to the customary measure during the agreement;
- ✧ The responsibility of the engineer may intersect with the contractor's responsibility in cases of overall engineering supervision. Here, the engineer shall be asked about the works of the contractor in solidarity if the engineer did not observe the requirements and conditions of such supervision, or if he neglected inspecting the work before providing the contractor with casting permissions or receiving the work(rephrase);
- ✧ There are several causes of conflicts relating to construction and contracting agreements, including: the measure and how to calculate it, specifications and inclusiveness of prices, changes in works that may arise during the execution of the contract, eligibility for extending time, entitlement for additional financial payments, entitlement for recovering already paid financial payments, poor fulfillment of contractual commitments and failure to fulfill all the contractual obligations;
- ✧ Typical means of settling disputes relating to construction and contracting agreements begin with mediation and conciliation between

the parties. Here, the legal departments in provincial offices, the consulting engineer and the Dispute Resolution Board appointed by the contract parties play an important role in the mediation;

- ✧ The consulting engineer has an important role in settling disputes related to contracting agreements in Palestine. This is incompatible with the orientation of the amendments to FIDIC model contract for the year (1999), as its producers realized the possibility of the non-neutrality of the consulting engineer in settling such disputes due to the fact that he is appointed by the owner of construction and represents his interests and thus it will be difficult to perceive fairness in his intervention. The role of the engineer was replaced by the role of the Dispute Resolution Board in accordance with the amendments took place in FIDIC model contract in the year (1999);
- ✧ Arbitration has an important role in settlement of disputes related to construction contracts in Palestine compared to the work of the judiciary, where the time factor has an important role in this outcome and because the parties to the dispute have faith in the ability of experts and specialists to consider the settlement of these disputes compared to the work of the judges who are not specialized in the basic technical aspects of the conflicts' topics.