

Compensation Practice in Construction Contracts Between the Government and Service Providers: a Review of the Principles of Equality and Freedom of Contract

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| KEYWORDS | ABSTRACT |
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| construction contracts, compensation, equality principles, freedom of contract, government, service providers | This study aims to analyze the practice of compensation in <i>construction contracts</i> between the government and service providers by reviewing their conformity with the principles of <i>equality</i> and <i>freedom of contract</i> . The practice of compensation in government construction projects is often characterized by an imbalance of power between the parties, primarily due to the administrative dominance of the government. This research employs a qualitative approach, utilizing a <i>case study</i> method focused on the Settlement Infrastructure Supporting Special Housing for <i>Ex-East Timorese Residents</i> project in Kupang, East Nusa Tenggara. Data were collected through in-depth interviews, a review of contract documents, and field observations. The findings indicate that the implementation of compensation does not fully embody the principle of <i>equality</i> , owing to the weak bargaining position of service providers during negotiations. Furthermore, the principle of <i>freedom of contract</i> is constrained in government construction contracts due to stringent regulations and administrative procedures. This study recommends the reformulation of compensation clauses to ensure they are fairer and more flexible, the strengthening of dispute resolution mechanisms, and the enhancement of transparency and accountability in the execution of government construction contracts. |

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Introduction

The practice of compensating in construction contracts between the government and service providers is a very important aspect of the implementation of construction projects (Gupta & Jha, 2024; Pour & Sharafatpeima, 2016; Shi, 2023; Tripathi et al., 2023). The government, as the contracting party, has a responsibility for providing appropriate and fair compensation to service providers for the work that has been carried out. However, in practice, there are often imbalances in contractual relationships that can affect the principles of equality and freedom of contract (Ekegren et al., 2023; Hoque et al., 2018; Masuch et al., 2021; Mat Desa et al., 2020; Pei et al., 2019). The principle of equality requires that the parties have a balanced position in contract

negotiations, while the principle of freedom of contract gives the parties autonomy to draft the content of the contract according to their respective wishes, if it does not conflict with the law and the public interest.

In Law No. 2 of 2017 concerning Construction Services (UUJK), it is known as a construction work contract, which is a total contract document that regulates the legal relationship between service users and service providers in the implementation of construction services (Handoko & Priyadiati, 2023; Pemerintah, 2020; PP No.22 Tahun 2020, 2020; PP RI Nomor 14, 2021; Priambodo, 2021). The principle of freedom of contract gives each party the right to voluntarily enter into an agreement and determine the content of the contract. However, this freedom in the context of government contracts becomes pseudo (Dao et al., 2023; Flammer, 2018; S.H & Sugiyono, 2024; Vendrell-Herrero et al., 2022). When delays occur due to external factors such as underground utilities that have not been moved or design change orders, service providers often struggle to get recognition for the compensation they deserve. Governments tend to reject claims on the grounds that there is no written consent from the commitment-making official, even though the technical facts support the claim. This shows that legal principles are often defeated by administrative formalities. The principles of good faith and contractual fairness should be applied in assessing compensation claims.

In some arbitration awards, dispute resolution agencies consider the principle of propriety even though the contract document does not explicitly govern the service provider's right to specific compensation. This is proof that contract law should not only be seen from a formal aspect but must also accommodate the principle of justice to prevent abuse of dominance by one party.

The Special Terms of Contract (SSKK) also regulate several things that can cause the occurrence of compensation events which are a right that must be fulfilled by service users. With several conditions as referred to in the contract, the service provider is entitled to compensation in the form of an extension of the implementation time. However, different conditions occur in project contracts carried out by the private sector. In private contracts, there are no standard rules or standard forms that specifically regulate the content of the contract, everything related to rights and obligations is left to the parties, therefore contract standards for private projects are very diverse and formulated over a long period of time because they must unite the interests of service users and service providers in a contract that will be executed by both. Service users certainly want the work to be completed quickly and as desired, but service providers can realize that service users are cooperative such as never being late and never changing specifications arbitrarily.

This imbalance may be caused by a stronger bargaining position from the government, or regulations that limit the room for service providers to claim their rights. Therefore, this study is very important to examine how the practice of compensation is implemented in the field and whether it reflects the two principles fairly.

This study conducted a critical analysis of two previous relevant studies. First, Aditya's (2018) research examines construction contract disputes in government projects but does not explore compensation practices and the principles of equality and freedom of contract in depth. Second, Hasibuan's (2015) research is descriptive on compensation practices, but does not provide

concrete recommendations for regulatory reform. This research fills the gap by conducting a holistic study of the principles of equality and freedom of contract in the context of compensation, using a qualitative approach through specific case studies in Kupang, and providing practical recommendations such as simplifying compensation procedures and strengthening dispute resolution mechanisms. In addition, this study connects the findings with public policies to encourage systemic change, such as the reform of the Law and the Presidential Regulation on the Procurement of Goods/Services.

The purpose of this study is to analyze compensation practices in government construction contracts by assessing their conformity to the principles of equality and freedom of contract, as well as identifying the imbalance of power between the parties involved. The benefits of the research include three main aspects: first, providing policy recommendations for fairer and more transparent reform of compensation clauses; second, strengthening dispute resolution mechanisms; and third, increasing accountability in the implementation of government construction projects. Thus, this research is expected to encourage efficiency and fairness in the management of the state budget, as well as create a more balanced contract climate between the government and service providers.

Materials and Methods

This study uses a qualitative descriptive method that aims to describe and analyze the practice of compensation in construction contracts between the government and service providers in depth. A qualitative approach was chosen in order to explore a contextual understanding of the implementation of the principles of equality and freedom of contract in real practice in the field.

The data in this study consists of two main sources, namely:

- a. Primary data: obtained through in-depth interviews with relevant parties, such as government officials handling construction contracts, construction service providers, and other parties involved in the compensation process.
- b. Secondary data: obtained from contract documents, related laws and regulations, procurement reports, scientific articles, and relevant legal literature.

1. Data Collection Techniques

The data collection techniques used in this study include:

- a. Semi-structured interviews are the main method of obtaining qualitative information from key informants.
- b. Document study, namely the analysis of contract documents, regulations, and related reports to corroborate the data of interview results and as a triangulation material.
- c. Observation of the contract implementation process and compensation when possible.

This research was carried out on the construction project of Residential Infrastructure Supporting Special Houses for Ex-Residents. East Timor financed by the government from the source of funds for the 2023-2024 State Budget in the Camplong Village area, Fatuleu District, Kupang Regency, East Nusa Tenggara Province. The research period lasted for 8 (eight) months, starting from July 2024 to February 2025.

The data collected were analyzed by:

- a. Data reduction, which is sorting and selecting data that is relevant to the focus of the research.
- b. Data display, displaying data in the form of descriptive narratives and tables to make it easier to understand the relationship between data.
- c. Verification or drawing conclusions, triangulating data through comparison between interview results, documents, and observations to ensure the validity and reliability of data.

To maintain the validity and reliability of the data, this study uses the triangulation technique of sources and methods. Validity is obtained through checking the validity of data from various sources and data collection methods, while reliability is maintained with careful documentation and consistency in the implementation of interviews and observations.

This study pays attention to ethical aspects by asking for permission from related parties before conducting interviews and observations, ensuring the confidentiality of informant identities, and using data only for academic research purposes.

Results and Discussions

1. Compensation Practices in Construction Contracts

Based on the results of interviews and document studies, the practice of compensating construction service providers by the government still shows a number of significant problems. The process of compensation practices often does not run transparently and in a timely manner, which has an impact on cash flow and project sustainability issues for service providers. The main causes of this irregularity include complicated bureaucracy, inconsistencies in the claim mechanism, and suboptimal regulatory implementation. This indicates an imbalance of power and an imbalance in the implementation of contracts.

2. Application of the Principle of Equality in Compensation Practices

The application of the principle of equality in the context of construction contracts should be the legal basis that governs the relationship between funders and service providers. However, in practice, this is not optimal because there are significant differences between the positions of the two parties. The government, as the funder, often has a much stronger bargaining position than the service provider. This has an impact on the practice of delaying payments as well as providing compensation that sometimes does not comply with contractual agreements.

This imbalance of bargaining power creates injustice in the implementation of contracts that should be based on the principle of equality. Service providers experience financial losses and uncertainty that can worsen cooperation and project quality. This situation allows for legal conflicts between the two parties, which can prolong dispute resolution and increase project costs and risks. The need for a fair dispute resolution mechanism.

To address potential conflicts and ensure fair treatment, a more effective, transparent, and independent dispute resolution mechanism is needed. This mechanism must be able to balance the bargaining position between the government and service providers so that the

principle of equality can be realized in the implementation of contracts. Thus, justice and legal certainty for all parties can be maintained, while supporting the smooth implementation of construction projects.

3. Freedom of Contract and Its Limitations in the Context of Government

Although the principle of freedom of contract provides flexibility in drafting the content of the contract according to the needs of the parties, in the context of a construction contract with the government there are quite strict restrictions. Government regulations limit the scope of service providers to negotiate compensation, especially about claims for additional costs and changes of employment. The purpose of this is to protect the public interest, but it can sometimes result in rigidity in the execution of contracts that require more flexibility in terms of compensation.

4. Conflict between the Principle of Equality and Freedom of Contract

The analysis shows that there is a normative conflict between the principles of equality and freedom of contract in the practice of compensation. With the dominance of the government, the freedom of service providers in negotiations is significantly restricted in order to protect the interests of the state. This imbalance creates a dilemma between contractual fairness and regulatory compliance, leading to disputes and dissatisfaction among the parties.

5. Legal and Practical Implications of Research Findings

The findings of this study show that there is an urgent need to reform the regulations governing construction contracts, especially in terms of compensation. The inequality of legal relations between the government as a service user and private service providers indicates that the principle of equality in contracts has not been fully realized. Therefore, a more adaptive legal policy is needed, which not only protects the interests of the state as a holder of fiscal power, but also provides balanced protection for the rights of service providers.

In this context, increased transparency in the formulation and execution of contracts is of great importance, especially in relation to payment and compensation mechanisms that are often delayed or do not correspond to the value of the losses suffered by the provider. In addition, strengthening the right to negotiation for service providers is urgently needed so that they are not trapped in subordinate positions that make it difficult to fight for contractual justice. On the other hand, to anticipate and resolve disputes efficiently, alternative dispute resolution mechanisms such as mediation and arbitration need to be strengthened both institutionally and procedurally. This strengthening will create a healthier and fairer contractual climate and encourage the efficiency of government projects financed by the state budget.

6. Recommendations for Improving Compensation Practices

- To improve compensation practices, the following recommendations were made:
- a. Simplification of the procedure for the administration of compensation payments.
 - b. Strengthening regulations to provide more balanced protection for service providers.

- c. The implementation of a periodic supervision system on the implementation of contracts and payments.
- d. Development of a fast and efficient dispute resolution mechanism.
- e. Increasing the capacity of human resources in managing construction contracts is oriented to the principle of justice.

Conclusion

The analysis reveals that compensation practices in government construction contracts remain inconsistent, particularly regarding transparency and timely payments. The principle of equality is undermined by the government's dominant role in compensation arrangements, resulting in an imbalance of power and insufficient protection for service providers. Additionally, the principle of freedom of contract is constrained, especially in the negotiation of compensation claims, as government interests take precedence. This creates a normative conflict between equality and contractual freedom, leading to potential injustice and legal disputes. To address these issues, regulatory and procedural reforms are necessary to ensure compensation practices are fairer, more efficient, and conducive to sustainable project outcomes. Future research should explore innovative models for compensation frameworks that balance public interest with the rights and protections of service providers in government construction contracts.

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