IN-DEPTH

Construction Disputes

ISRAEL

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Construction Disputes

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In-Depth: Construction Disputes (formerly The Construction Disputes Law Review) is a useful guide to the most consequential aspects of international construction disputes, highlighting the practical implications of the relevant case law, statutes and procedures. Topics covered include time bars as condition precedent to entitlement; right to payment for variations; concurrent delay; suspension and termination; penalties and liquidated damages; defects correction and liabilities; overall liability caps; and much more.

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Summary

Introduction

Israel is among the most dynamic and rapidly developing construction markets in the Middle East. Driven by strong population growth, urban density and large-scale national infrastructure programmes, the country's construction sector plays a significant role in the national economy. According to the Central Bureau of Statistics (CBS), GDP from construction in Israel stood at approximately 18,202 million shekels in Q1 2025.[1-] Data also indicates that the broader industry (which includes manufacturing, utilities and construction) contributed about 17.35 per cent of GDP in 2024.[2] Furthermore, independent market research estimates that the construction industry recorded US$53 billion in revenue in 2024.[3] Israel's ambitious modernisation and infrastructure strategy is part of a broader effort to enhance national resilience, connectivity and housing supply. Major areas of investment include, but are not limited to, urban renewal and affordable housing (the government recently approved a housing-acceleration plan of approximately 1.4 billion shekels to stimulate housing construction in the peripheral areas to the centre of the country and ease rising prices)[4] and national transport and infrastructure projects (the government has published a programme listing infrastructure projects costing over 100 million shekels each, in sectors such as railways, highways and water networks).[5]

As project sizes and, concomitantly, their complexities increase, the sector faces growing engineering, financial and regulatory risks, resulting in a corresponding rise in disputes and claims – particularly those linked to delays, cost escalation and force majeure events as well as war-related disruptions.

Year in review

The past year has witnessed significant developments in the field of construction disputes and arbitration in Israel, including several notable judicial rulings and evolving policy positions by the government concerning dispute resolution in national projects.

The enforceability of arbitration clauses remains a fundamental fixture of construction contracting in Israel, given the complexity and technical nature of disputes arising from large-scale projects such as the Tel Aviv Light Rail, the Haifa–Nazareth line, and numerous residential and energy infrastructure ventures. Israeli courts have consistently reaffirmed that the arbitration agreement stands independently from the underlying contract, applying the principle of severability set out in Section 3 of the Arbitration Law 1968.[6] Recent rulings such as *Carmel Tunnels Ltd v. Shapir Civil and Marine Engineering Ltd* (Tel Aviv District Court, 2024) have reiterated that technical or procedural deficiencies do not nullify the parties' consent to arbitration, provided the intention to arbitrate is clear.

Concurrently, setting aside arbitral awards is discouraged as doing so not only requires courts to involve themselves in arbitration proceedings that undermine the integrity of arbitrations but also, practically, upends the alleviation of case load that arbitration provides in favour of the courts. In *Israel Electric Corporation v. Dor Alon Energy Ltd* (2024), the Supreme Court reaffirmed that courts may intervene to set aside an arbitral award only in limited circumstances, and even then, specifically in accordance with the provisions of Section 24 of the Arbitration Law. The Court cautioned that judicial correction of factual or evidentiary determinations by an arbitral tribunal would constitute an overreach. A further example of limiting the court's interference in matters undergoing arbitration was demonstrated in *Mekorot v. Solel Boneh* (Jerusalem District Court, 2024), in which the Court criticised parties for filing interlocutory motions while arbitration proceedings were ongoing, reaffirming that judicial intervention should be minimal until an arbitral award is rendered.

The developments of the past year underscore the maturing sophistication of Israel's construction dispute landscape. Courts are reaffirming arbitration's autonomy while tightening evidentiary standards and limiting judicial interference.

Courts and procedure

In Israel, parties to large-scale and international construction contracts typically prefer to resolve disputes via alternative dispute-resolution mechanisms (ADR) (such as mediation or arbitration). Unlike in some jurisdictions, Israel does not operate designated 'construction courts' specific to high-value construction disputes. These disputes – absent an arbitration clause – will therefore be accommodated by the civil courts.

The Israeli court system is hierarchical:

- magistrates' (lower) courts: handle most civil disputes, including contractual ones, up to a pecuniary threshold;
- district courts: handle more complex and higher-value civil and commercial disputes, including construction contract claims above the Magistrates' threshold and also act as appellate courts for Magistrates' decisions; and
- Supreme Court: serves as the highest court for appeal (leave required) and extraordinary petitions (such as constitutional issues).

Owing to the fact that ADR plays such a strong role in construction disputes, Israeli courts adjudicating matters of this nature may refer parties to mediation even without the parties being directed as such by the contract. Generally though, when dealing with mega-projects concerning international parties, arbitration (domestic or international) is frequently used in infrastructure contracts.

Jurisdiction

- Territorial jurisdiction: in Israel, service of process (including extraterritorial service) and territorial reach are regulated by filing an affidavit showing grounds for out-of-Israel service.
- Pecuniary jurisdiction: the level of court (magistrate as opposed to district) is determined by the amount in dispute (among other factors).
- Subject matter jurisdiction: construction contract disputes (defects, delays, additional costs) fall within the jurisdiction of the civil courts since there is no separate construction court in Israel.

Arbitrations: if there is a valid arbitration clause, the courts' involvement is limited. For example, under its new International Commercial Arbitration Law, 2024 (ICA Law),[7] Israel aligned its arbitration regime with the UNCITRAL Model Law – a topic that will be explored further hereunder. The ICA Law relates to international arbitrations, while the previous legislation (the Arbitration Law) pertains to domestic disputes. Accordingly, the interaction between courts and arbitrations has undergone a level of harmonisation such that the latter has been granted autonomy that is supported by the former:

- Israeli courts may stay litigation in favour of arbitration.
- Courts may grant interim relief in support of arbitration (e.g., by freezing orders or evidence preservation).
- Challenges to awards, recognition or enforcement of foreign awards, and annulment of awards are handled under the ICA Law or Arbitration Law.
- In respect of jurisdiction clauses specifically, Israeli courts generally enforce foreign jurisdiction agreements, but with conditions particularly where Israeli public policy or consumer contract issues may arise.

Procedural rules

- The Israeli procedural framework for civil and commercial litigation is governed primarily by Civil Procedure Regulations and other relevant court rules and case law.
- In construction-contract disputes, if arbitration is stipulated, the ICA Law (or for domestic arbitrations, the earlier Arbitration Law) provides that the arbitration tribunal may determine its own procedure, subject to mandatory sections of the statute.
- Mediation: Israeli courts may refer large or complex commercial matters (including construction disputes) to mediation. For instance, certain courts may have a pilot requiring a preliminary meeting in disputes exceeding a specific amount to consider mediation before proceeding to court.

Evidence

- Documentary evidence, expert testimony (in construction matters, this will be required to prove delays, defects, additional costs, etc), witness evidence, inspections and site visits and third-party expert reports are all relevant in construction disputes. For example:
    - Regarding courts: inspections, commission reports or the appointment of experts to examine construction status may be ordered.
    - Regarding arbitration: under the ICA Law, Israeli courts may assist in adducing evidence in support of arbitration (Sections 33–36 of the ICA Law) such as issuing orders for evidence collection.
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Burden of proof: generally, the claimant must prove the breach, delay, defect or additional cost, as in most civil litigation frameworks. Israeli litigation practice emphasises good faith, disclosure and efficient management of proceedings.

Application to construction disputes

When the above principles are applied to high-value infrastructure contract disputes in Israel, parties should pay specific attention to the following:

- The existence of a clear and robust dispute-resolution clause. If arbitration is selected, parties should ensure the location, language, applicable rules, number of arbitrators and interim relief provisions are well articulated.
- Where no arbitration clause (or where an arbitration clause fails), the dispute will likely be brought in the district court (for high-value disputes) rather than the magistrates' court.
- For international parties or cross-border projects, the ICA Law provides modern features aligned with the UNCITRAL Model Law (e.g., the arbitrator's jurisdiction, limited court intervention and enforcement of awards).
- Proving delay and/or defect and/or additional costs will likely require detailed expert evidence, site inspections, well-documented contract records, and possibly cross-examination of technical experts.
- Interim relief is crucial in construction disputes: Israeli courts (and arbitration tribunals) can issue freezing orders, injunctions or evidence-preservation orders where required.
- With respect to the choice of applicable law and jurisdiction: parties should ensure that these are unambiguous. Israeli courts will generally enforce foreign clauses but will condition such enforcement on fairness and jurisdictional limitations (especially where Israeli parties could be disadvantaged).

Alternative dispute resolution

On 12 February 2024, the Israeli legislature passed the International Commercial Arbitration Law (the ICA Law), marking a pivotal moment in the country's legal landscape. This long-awaited legislation aimed to address the shortcomings of Israel's outdated legal framework concerning international arbitration and bring it in line with global standards. This legislative development showed Israel's commitment to facilitating efficient and fair dispute resolution while adhering to international norms.

Prior to the introduction of the International Arbitration Law, Israel's legal framework for international arbitration was reliant on the Arbitration Law of 1968 (the Arbitration Law), which had remained largely unchanged for decades, failing to keep pace with the evolving demands of the global legal landscape. While international arbitration gained momentum globally, Israel found itself lagging behind, with many companies and individuals opting for foreign tribunals due to a lack of trust in the local system.

The need for modernisation and alignment with international standards became increasingly apparent, prompting calls for legislative reform. With the promulgation of the International Arbitration Law, Israel has taken a decisive step toward embracing international norms and improving its attractiveness as a destination for international dispute resolution.

One notable aspect of the new legislation is its adoption of principles outlined in the Model Law on International Commercial Arbitration, established by the United Nations Commission on International Trade Law (UNCITRAL). This framework provides a comprehensive basis for addressing the unique requirements of international arbitration proceedings and aligning Israel's legal system with established global practices. The ICA Law introduces several key provisions aimed at enhancing the efficiency and effectiveness of the arbitration process. For instance:

- Section 6 of the Law imposes explicit restrictions on the intervention of courts in arbitration proceedings, ensuring greater autonomy for arbitrators.
- Section 17 of the Law empowers arbitrators to decide on their own authority, a principle known as competence-competence, streamlining the resolution process.
- Sections 18 to 25 of the Law establish a detailed regime governing the provision and enforcement of reliefs by arbitrators, providing clarity and certainty to parties involved in arbitration proceedings.
- Other provisions address critical issues such as determining the default number of arbitrators, eliminating the need for additional regulations.

The significance of the ICA Law goes beyond mere legislative reform; it reflects Israel's broader commitment to promoting a business-friendly environment and fostering economic growth. With globalisation shaping the dynamics of international trade and commerce, the ability to resolve disputes efficiently and fairly is essential for maintaining investor confidence and encouraging foreign investment. By modernising its arbitration framework, Israel aims to instil greater trust in its legal system and attract businesses seeking reliable mechanisms for resolving cross-border disputes.

Furthermore, the enactment of the ICA Law underscored Israel's recognition of the importance of international cooperation in the realm of dispute resolution. As infrastructure projects are increasingly attracting international players, the need for consistent legal frameworks and mechanisms for resolving disputes becomes imperative. By aligning its arbitration laws with internationally recognised standards, Israel has demonstrated its willingness to engage with the global community and participate in the evolving landscape of international commerce of which national projects constitute an important part.

In addition to its immediate impact on dispute resolution mechanisms, the ICA Law is likely to contribute to the development of Israel's broader legal infrastructure. By fostering a conducive environment for international arbitration, Israel lays the groundwork for future legislative initiatives aimed at enhancing the country's competitiveness and attractiveness as a destination for other forms of dispute resolution. The law serves as a catalyst for broader legal reforms, for example, reforms regarding international mediations and the recognition and enforcement of foreign judgments – significant developments when considering that Israel has been increasing its massive infrastructure industry to provide a substantially more cutting-edge offering to its growing population. The successful implementation and enforcement of the International Arbitration Law will depend on various factors, including the capacity of Israeli courts to continue supporting and enforcing arbitration agreements and awards in both infrastructure matters as well as in many more commercial disciplines.

Construction contracts

The form of contract utilised in construction projects in Israel is not limited to a particular model. The parties have discretion to draft their own contracts or utilise a more standardised form, such as the forms of contract options presented by the International Federation of Consulting Engineers.

Additionally, the parties are free to determine under which laws of which state the contract will be governed. Notwithstanding the aforementioned, in all public construction projects, the choice of law will be Israeli law and the jurisdiction will be the Israeli courts (or an arbitration held in Israel). Finally, the language of the contract is not prescriptive but, rather, will be based on an agreement between the parties. Often, if one or more of the parties is a foreign entity, the parties may agree to conclude the contract and conduct the dispute resolution proceedings in English.

English will also be the language used in all international tenders. In a dispute, the parties may include an arbitration clause in terms of which the arbitration will be conducted in English. However, disputes that are brought before the court will be conducted in Hebrew.

Common substantive issues and remedies

Time bars as conditions precedent to entitlement

Time-bar provisions in Israeli construction contracts serve to set strict deadlines for contractors to notify and substantiate claims for extensions of time or additional payment. Such clauses are increasingly common in FIDIC-based contracts used in major Israeli projects (e.g., NTA Light Rail, Netivei Israel and Israel Railways agreements). Typical clauses (such as sub-clause 20.2 of the FIDIC 2017 edition) require a contractor to submit a notice of claim within 28 days of becoming aware of the event giving rise to the claim. Failure to do so may bar entitlement to time extension or payment. Many public employers in Israel, including Netivei Israel, NTA Metropolitan Mass Transit System and the Ministry of Defence, adopt similar notification requirements in their standard contracts.

Israeli courts have not developed a rigid 'time-bar' doctrine equivalent to that in English law, but they enforce contractual notice provisions if drafted clearly and proportionately. Under Section 39 of the Contracts (General Part) Law 1973,[8] the principle of good faith applies; therefore, if strict enforcement would lead to unfairness or a result contrary to good faith, the court may decline to uphold a strict time bar.

Prolongation costs

Prolongation costs refer to additional expenses incurred by a contractor owing to delays extending beyond the agreed completion date, often arising from employer-related causes (e.g., design changes, delays in access to site, delivery of late approvals, etc).

Israeli arbitral tribunals and courts recognise claims for prolongation costs under Section 10 of the Contract (Remedies for Breach of Contract) Law 1970, which entitles an aggrieved party to recover foreseeable losses caused by breach. Prolongation costs may include extended overheads, idling of equipment, additional supervision and loss of profit opportunities. Where the contract includes an escalation bar clause, courts may allow recovery nonetheless if the employer’s conduct constitutes a fundamental breach or frustration of the contract’s purpose, invoking Sections 18 and 39 of the Contracts (General Part) Law (good faith and prevention of conditions).

Extension of time

Most Israeli construction contracts, especially public sector and FIDIC-based forms, require the contractor to notify the employer of any delay within a defined period (typically 14–28 days) and to provide a detailed justification for an extension of time (EOT) claim. Failure to submit timely notice may result in rejection of the claim, though courts usually assess compliance in light of good faith and practical fairness. Common grounds for EOT include changes in design, force majeure, delays in permits or approvals, archaeological findings, security-related events and supply issues.

Often, the contract is drafted in favour of the employer in an attempt to limit the employer's exposure for delays brought on by its actions or omissions. Accordingly, Israeli courts have held that contractual provisions excluding compensation for employer-caused delays may be voidable if they contradict public policy under Section 30 of the Contract Law or, if they are inconsistent with the principle of good faith under Section 39.

Variations

A 'variation' refers to any change in the original scope, quantity, or quality of work ordered by the employer or engineer. Israeli contracts, especially those based on FIDIC, provide mechanisms for variation approvals, pricing, and payments. Under Israeli law, a contractor is likely to be entitled to payment for additional work if it can show that the employer either explicitly instructed the change or implicitly accepted and benefited from it (under Section 1 of the Unjust Enrichment Law, 1979).[9]

Concurrent delay

Concurrent delay occurs when both the employer and contractor contribute to project delays. While there is no statutory law that specifically deals with such an occurrence, the allocation of liability will be dependent upon the determination of causation, factual analysis and expert scheduling evidence. Israeli courts generally favour apportionment of responsibility, granting time relief without monetary compensation if both sides share responsibility.

Suspension and termination

Suspension clauses allow parties to temporarily halt works due to non-payment, unsafe conditions or other breaches. Israeli public contracts require suspension notices to be in writing, specifying reasons and expected duration. If the suspension is not due to the contractor's fault, the contractor may claim an extension of time and, in some cases, compensation for idle resources. Generally, suspension is a last resort and is viewed as an undesirable course of action for a contractor to take in circumstances when same may be avoided.

Termination provisions are common in Israeli contracts, both for employer and contractor. Typical grounds include prolonged suspension, material breach, insolvency, or failure to maintain progress. Under Israeli law, termination must comply with good faith and proportionality principles (Sections 39 and 61 of the Contract Law).

Penalties and liquidated damages

Under Sections 15–16 of the Contracts (Remedies for Breach of Contract) Law 1970,[10] Israeli law recognises agreed compensation (liquidated damages) clauses. Such clauses are enforceable provided the amount represents a reasonable estimate of loss. If the sum is disproportionate or punitive, a court may reduce it (CA 579/83 *Ben-Ami v. Menorah Insurance Co*).

Defect liability period and curing of defects

The Defect Liability Period (DLP) in Israeli contracts usually lasts 12–24 months after taking-over, during which the contractor must rectify defects at its own cost. FIDIC-based contracts specify separate periods for structural and non-structural defects, generally with longer terms for latent structural defects.

Bonds and guarantees

Bonds and guarantees are fundamental in Israeli construction to ensure performance and payment security. The performance guarantee (typically 10 per cent of the contract price) and advance payment guarantee are mandatory in the majority of public projects. Guarantees are generally issued by Israeli banks or insurance companies under the Guarantees Law 1967,[11] and must clearly specify expiry dates and forfeiture conditions.

Liability caps in construction contracts

Israeli law permits limitation of liability clauses, provided they do not contravene public policy or exempt a party from liability for intentional or grossly negligent acts (under Section 3 of the Torts Ordinance).[12] Public sector contracts often limit the contractor's liability to the contract value, except in cases of fraud, wilful misconduct or gross negligence.

Special considerations

Notwithstanding the fact that several years have passed since the matter of *Bibi Roads and Development Ltd v. Israel Railways* 8100/19 was brought before the Supreme Court in November 2019, it is important to nonetheless recognise the significance of the Court's ruling owing to the potential impact on the resolution of construction disputes. The matter set a worrying precedent for contractors for the manner in which courts would consider a claim of additional costs and extensions of time for additional work carried out by the contractor in a public tender. The Court rejected some of the claims for additional payment and extensions of time, inter alia, on the basis that any contract awarded following a public tender would be classified as a 'closed contract with all stipulations included' and, therefore, cannot be deviated from, even if a change of circumstances was not anticipated by the parties. Under this precedent, the contractual procedures for requests for additional payment or extensions of time must be strictly fulfilled, otherwise the contractor's claim will almost automatically be dismissed (even if it was justified on the merits).

In April 2020, an application for an additional hearing was brought before the Supreme Court. However, the application for a further hearing was not granted for the following reasons. First, according to the Supreme Court, a determination according to which all contracts following public tenders would be classified as a 'closed contract with all stipulations included' and, therefore, cannot be deviated from was not explicitly set out in any of the judgments by any of the judges. Second, no new precedent was required by the decision, as the parties explicitly agreed on a pricing mechanism for the execution of specific works and, therefore, the situation is not one in which unforeseen circumstances not anticipated by the parties will occur.

The impact of the judgment on the canon of construction litigation has yet to be tested. Some have suggested that as the Supreme Court did not grant a further hearing, the case does not create significant consequences that are objectionable for contractors. If it did, the Court would have had to allow an additional hearing. However, the judgment was handed down by the Supreme Court, which binds other courts.

It must be stated that employers frequently use the judgment in the *Bibi Roads* case to deny requests for extensions of time or additional costs submitted by contractors based on procedural arguments and on the principles established in this case. Consequently, contractors tend to request that additional legal services be provided throughout the lifetime of a project from a much earlier stage with the intent to foresee the raising of such a defence by an employer when confronted with the appropriate claim.

Outlook and conclusions

The legal and contractual framework governing Israel’s construction industry has become increasingly sophisticated, blending statutory law, judicial interpretation and international contracting practice. The legislation included herein forms the backbone of contractual regulation, supported by public procurement directives and sectoral circulars issued by various regulatory bodies. Israeli courts have progressively refined the boundaries between strict contractual enforcement and the broader duties of good faith and proportionality under Section 39 of the Contracts Law. These principles guide judicial determination of claims involving time bars, variation orders and delays, ensuring that contractual mechanisms are not applied in a manner that gives voice to the parties' intentions while not undermining fairness or public policy.

At the contractual level, FIDIC-based contracts have become popular in large-scale infrastructure projects, adapted to align with Israeli statutory norms and risk preferences. Their structured claim and dispute resolution procedures have encouraged greater discipline and transparency in project administration. A defining feature of the Israeli construction disputes is the centrality of arbitration. The Arbitration Law and more recently, the ICA Law, provides a robust framework that prioritises party autonomy and finality of awards. Many major public and private construction contracts now include multi-tiered dispute resolution clauses, beginning with negotiation or dispute adjudication boards, and culminating in arbitration, often conducted under institutional rules. Judicial intervention in arbitral proceedings remains limited, reflecting the courts' policy of non-interference and respect for arbitral independence.

In more recent years, government authorities have also experimented with conciliation panels and expert advisory committees, seeking to reduce escalation of the dispute while maintaining project continuity. These developments, coupled with a judiciary increasingly supportive of ADR mechanisms, signify a broader institutional shift toward efficient, pragmatic and commercially realistic dispute resolution. As Israel's infrastructure landscape expands, the success of future undertakings will amplify the need for clear contractual drafting, risk allocation, and a continued commitment to efficient dispute resolution. These trends demonstrate that Israel is home to a maturing, globally aligned construction law environment that balances international standards with local legal principles.

Endnotes

1 Trading Economics: GDP from Construction in Israel, https://tradingeconomics.com/israel/gdp-from-construction. ^ Back to section

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