



Disputes related to EPC Contract Price Adjustments resulting from Inflation: Trends and Analysis

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1. Trends in disputes related to adjustment of EPC contract price resulting from inflation

According to Korea Fair Trade Mediation Agency, disputes over a rapid increase in supply prices, such as price of raw materials, have recently increased between owners (employers) and contractors. As raw material prices have skyrocketed in the aftermath of the global supply chain disruption caused by the COVID-19 crisis and the Ukraine war, many predicted that the number of such disputes would increase significantly, and such prediction turned out to be correct. In the first quarter of 2022, the number of disputes filed with Korea Fair Trade Mediation Agency increased by 250% compared to the same quarter of the previous year.

While subcontractors receive some protection through strong regulations, such as the Guidelines for Screening of Unfair Special Agreements of Korea Fair Trade Commission, contractors take the biggest hit as they are stuck between owners who refuse to adjust their contract price and subcontractors who raise their prices. In cases where the contract price is fixed regardless of the changes in raw material prices, such as when there is a special agreement to exclude price changes or there is no provision allowing for adjustment to the contract price based on price fluctuations, contractors have no other option but to solely bear all of the losses resulting from price fluctuations. Being exposed to such risk, more and more contractors are inclined not to accept additional construction contracts and some are even seriously considering giving up the ongoing construction work altogether.

This situation affects the private sector and the public sector alike. In particular, in construction projects under a special agreement to exclude price changes, fierce disputes have erupted over the issue of whether such a special agreement constitutes a “special agreement or condition that unreasonably limits the contractual interests of the contracting counterparty” (public contracts) under the Act on Contracts to which the State is a Party (the “State Contracts Act”) or Act on Contracts to which a Local Government is a Party (the “Local Government Contracts Act”) or a “case which is significantly unfair to one of the parties in that a change to the contract price occasioned by changes in design or economic conditions after the execution of the contract is not conceded without a reasonable ground or the burden is

shifted onto the other party” (primarily private contracts) under the Framework Act on the Construction Industry (the “Construction Industry Act”).

Moreover, after the Ministry of Land, Infrastructure and Transport issued an interpretative response to an official inquiry to the effect that “if a contract expressly provides that “the contract price shall not be adjusted according to price fluctuations such as inflation”, the contract may be invalidated to the extent of such provision unless there are good grounds to deny contract price adjustment based on price fluctuation” (Ministry of Land, Infrastructure and Transport’s Reply dated April 5, 2022: “Construction Policy Department – Reply to the Inquiry No. 1644”), many contractors are taking a more aggressive position in disputes with owners regarding the issue of contract price adjustment due to price fluctuations.

2. Review of Judicial Precedents

There are already established precedents as to whether a special agreement to exclude price changes is invalid as it is in violation of the prohibition of unfair special agreements under the State Contracts Act.

The Supreme Court, in en banc Decision no. 2012da74076 dated December 21, 2017, held that: “it is not sufficient to demonstrate that the special agreement in question is somewhat disadvantageous to the contracting counterparty. One must prove that the special agreement is against the legitimate interests and reasonable expectations of the contracting counterparty and, as a result of the state’s inclusion of such special agreement in the relevant contract, the state has unfairly disadvantaged the contracting counterparty,” adding, “whether a special agreement unreasonably limits the contractual interests of the contracting counterparty should be determined in consideration of all relevant circumstances, including, but not limited to, the content and degree of disadvantages that may result to the contracting counterparty by the special agreement, the possibility of the occurrence of such disadvantages, their effects on the entire contract, the contract execution process between the parties, and the provisions of the relevant laws and regulations.” Applying the foregoing criteria, the decision held that “considering the nature of public contracts, and the content and legislative purpose of the provision on the adjustment of contract price according to price fluctuations under the State Contracts Act, the provision on the adjustment of contract price according to price fluctuations under the State Contracts Act merely provides for the matters to be complied with by the officers responsible for contracts to ensure that the state, etc. can fairly, rationally and efficiently handle contractual relationships with private persons, and it does not prohibit or restrict the state, etc. from imposing special conditions that are effective only between the contracting parties based on an agreement, and under the principles of private autonomy and freedom of contract, the effect of such contractual term or measure must not be easily denied,” making it clear that a provision providing for an adjustment of a contract price according to price fluctuations is not compulsory under the State Contracts Act, and any provision excluding such adjustment may be held invalid in only very exceptional cases (Supreme Court en banc Decision no. 2012da74076 dated December 21, 2017; and Supreme Court Decision no. 2014da233480 dated November 29, 2018).

As such, the question is whether the current “soaring raw material prices” can be considered to be an exceptional case enough to deny the effect of the special agreement to exclude the adjustment of contract price according to price fluctuations. The rates of price increases in 2021 and 2022 are indeed unprecedentedly high across all economic sectors

at home and abroad. If we take the construction cost index and increase/decrease rates over the last 5 years, the index rose by an average of 2 to 4% per year from 2017 to 2020, but it increased by 13.48% in 2021 compared to the previous year and rose by 2.8% in the first quarter of 2022 alone.

Month/Year	Dec. 2017	Dec. 2018	Dec. 2019	Dec. 2020	Dec. 2021	Mar. 2022 (for three months)
Index	108.98	114.12	117.24	121.62	138.02	141.88
Annual Increase Rate	기준	+4.71%	+2.73%	+3.74%	+13.48%	+2.80%

※ The Construction Cost Index compiled by Korea Institute of Civil Engineering and Building Technology

Considering this exceptional situation, the construction industry is cautiously predicting that there will soon be cases where the court will deny the effect of the special agreement to exclude price changes on a case-by-case basis.

3. Will the court take a new step forward?

The prolonged COVID-19 outbreak and the occurrence of extreme inflation due to the Russia-Ukraine war are exceptional circumstances that no party involved in a project could have easily predicted. If such inflation caused by these anomalous and force majeure events cannot be reflected in the project cost, this not only may impose an unreasonable disadvantage on the affected contracting party, but may also lead to a situation in which the purpose of the contract cannot be achieved as it can force the affected party to give up performance of the contract or to fail to fully and completely perform its obligations.

There is an increasing number of cases in which the judgment of the Contract Dispute Mediation Committee is sought, in particular in construction projects to which the State Contracts Act or the Local Government Contracts Act applies. Article 28 of the State Contracts Act (Raising Objections) was amended in 2020 (effective as of May 27, 2020) to allow the contracting counterparty to file an objection with respect to matters related to unfair special agreements and apply for a judgment of the Contract Dispute Mediation Committee if the contract price for the relevant construction work is above a certain threshold amount, which varies depending on the contract type. In some of the actual dispute resolution cases, the special agreement to exclude price changes was held invalid on the ground of the characteristics of public contracts, such as public interest, that distinguish them from private contracts.

While it is not easy to predict how the court sees the current situation, it is clear that the view of the industry that traditionally regarded a special agreement to exclude price changes as being basically valid is beginning to change.

In the end, a final judgment on the validity of a special agreement to exclude price changes will be determined based on consideration of all the relevant circumstances, such as the nature and the degree of disadvantages to be suffered by a contracting party, the likelihood of the occurrence of disadvantages, their effects on the entire contract, and the process by which the parties came to enter into the relevant contract. It goes without saying that in order to successfully adjust the contract price based on actual price fluctuations, it is necessary to make sufficient preparations for disputes over facts, which includes securing relevant evidence ahead of time.

For private construction projects, the issue is whether the effect of a special agreement to exclude price changes can be denied under the Construction Industry Act. The Construction Industry Act provides that “in any of the following cases where the terms of a contract are substantially unfair to either party to the contract, only such part of the contract shall be deemed ineffective: 1. Where either party to the contract does not approve changes to the contract price which is triggered by a design change or changes in economic conditions after the execution of the contract without reasonable grounds, or shifts the burden resulting from such changes onto the other party to the contract; (...) 3. Where either party to the contract shifts responsibility for matters which could not be foreseen at the time of the execution of the contract in light of all the relevant factors, such as a type of a contract for construction works and the scope of construction works, on to the other party to the contract.” (Subparagraphs 1 and 3 of Article 22(5) of the Construction Industry Act) The above reply of the Ministry of Land, Infrastructure and Transport is understood as a reaffirmation of the above principle.

It is difficult to find a judicial precedent which expressly addresses the issue of whether a special agreement to exclude price changes constitutes an unfair special agreement under the Construction Industry Act. A case in which a lower court ruled that a special agreement requiring the contractor to bear certain indirect construction costs resulting from the extension of the construction period, considering the amount of such indirect construction costs and other factors, constitutes a condition that unreasonably limits the plaintiff’s contractual interests, may serve as a useful precedent. Depending on the specific circumstances of construction projects, it is certainly possible that there will be cases in which a special agreement that excludes contract price adjustment due to price fluctuation is held to be invalid in accordance with the Construction Industry Act.

4. A solution to disputes by application of the principle of change of circumstances

The principle of change of circumstances is a principle that allocates the risk of significant change of circumstances, which is not allocated by the relevant contract, ex-post between the parties, and the Supreme Court has recognized this principle in some cases. However, the general view is that the Supreme Court has applied the principle of change of circumstances in a very limited manner and denied the application of the principle in a number of cases (Supreme Court Decision no. 2004da31302 dated March 29, 2007, Supreme Court en banc Decision no. 2012da13637 dated September 26, 2013, and Supreme Court Decision no. 2016da249557 dated June 8, 2017, etc.) including a case in which the value of forest land soared by 1,620 times due to economic upheaval such as war (Supreme Court Decision no. 63da452 dated September 12, 1963).

While some point to the principle of change of circumstances in explaining the theoretical basis for permitting adjustment of contract price due to price fluctuation and view such adjustment as an application of such principle, others view such adjustment as a matter of policy regulation that takes into account the nature of public contracts, considering that price fluctuations, in and of itself, is not a change in circumstances that is difficult to foresee at the time of entering into the contract.

Court precedents take the stance that provisions regarding the adjustment of contract price according to price fluctuations and other amendments to the contract (Article 19 of the State Contracts Act) are not provisions intended to

generalize the application of change of contract price based on the principle of good faith or the principle of change of circumstances (Supreme Court Decision no. 2009da91811 dated November 13, 2014).

Despite the above discussions, it has been repeatedly pointed out that the principle of change of circumstances should be more actively applied in various areas especially due to the prolongation of the COVID-19 outbreak, and there are sufficient reasons to rethink whether the current inflation constitutes generally predictable price fluctuations. Therefore, the argument that now is the time to more actively apply the principle of change of circumstances can be persuasive.

In this respect, it is certainly timely that the Supreme Court ruled, in its decision no. 2020da254846 dated December 10, 2020, that “in a case where the circumstance that served as the basis for the execution of the contract has significantly changed, the parties could not predict such change at the time of the execution of the contract, and the maintenance of the contract causes a significant imbalance in the interests of the parties or the purpose for which the contract was executed cannot be achieved as a result thereof, the parties may cancel or terminate the contract on the ground of change of circumstances as an exception to the pacta sunt servanda.” This decision went beyond merely explaining existing legal principles and recognized the termination of a contract based on the principle of change of circumstances in an actual case.

This is why we believe that a precedent in which change of a contractual term is recognized based on the principle of change of circumstances is mostly likely to emerge from private/public construction projects which are currently facing soaring raw material prices.

5. Response to Disputes in this Field by the Construction and Real Estate Dispute Group of Shin & Kim LLC.

The Construction and Real Estate Group of Shin & Kim LLC provides legal and practical solutions for parties in disputes to public and private construction projects amid global supply chain disruptions and soaring raw material prices due to the COVID-19 outbreak and the Russia-Ukraine War. If you have any additional questions or need help regarding the above, please contact us using the contact information below.

[\[Korean version\]](#) 물가변동에 따른 계약금액 조정 관련 분쟁의 동향과 대응 방안

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