



Liquidated damages in contracts with DAPA

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Liquidated damages are a form of delay compensation that the debtor agrees to pay to the creditor in the event that the debtor fails to fulfill its contractual obligations within the agreed-upon period¹. In public procurement contracts, including national contracts, local government contracts, and defense acquisition contracts, the specificity of public procurement is taken into account, and separate provisions regarding liquidated damages are stipulated in laws such as the Act on Contracts to Which the State Is a Party ("National Contracts Act"), the Act on Contracts to Which a Local Government Is a Party ("Local Contracts Act"), the Defense Acquisition Program Act, and the contract regulations issued by the Ministry of Economy and Finance.

In particular, defense acquisition contracts are governed by regulations that differ from general public procurement contracts, reflecting the unique characteristics of the defense industry. Therefore, it is essential to have an accurate understanding of the relevant provisions to appropriately respond to the imposition of liquidated damages. The following sections will examine various aspects of liquidated damages, including the recent amendments to the Defense Acquisition Program Act, which have partially relaxed the liquidated damages rate.

1. Criteria for Calculating Liquidated Damages - Liquidated Damages Rate

Liquidated damages are calculated by multiplying the contract amount by the "liquidated damages rate" for each day of delay (pursuant to Article 74 of the Enforcement Decree of the National Contracts Act and Article 90 of the Enforcement Decree of the Local Contracts Act). The specific "liquidated damages rate" applicable to public procurement contracts is stipulated in the Enforcement Rules of the National Contracts Act, the Enforcement Rules of the Local Contracts Act, and the Enforcement Rules of the Defense Acquisition Program Act.

The liquidated damages rate for defense acquisition contracts has generally been applied in the same manner as under the National Contracts Act. However, to address the issue of excessively high liquidated damages that hinder the development of defense contractors and to reflect the unique characteristics of the defense industry, the Defense Acquisition Program Act was amended on April 30, 2024. This amendment relaxed the "liquidated damages rate" applicable to contracts for weapon systems R&D and core technology R&D projects, as outlined below

It is important to note that the relaxed liquidated damages rate applies only to contracts in which the contractual period expires and liquidated damages arise on or after May 1, 2024.

Type of Defense Acquisition Contract	Before Amendment	After Amendment
Research and Development (Prototype Production)	0.05%	0.05%
Initial Mass Production of Defense Materials	0.075%	0.05%
Follow-up Production of Defense Materials	0.075%	0.05%

2. Cap on Liquidated Damages

The Defense Acquisition Program Act imposes a cap on liquidated damages to prevent excessive financial burdens on contractors. Initially, on March 16, 2016, the Act limited liquidated damages for weapon system and core technology R&D projects involving prototype production to 10% of the contract amount. On October 26, 2018, this cap was extended to include initial mass production contracts for defense items developed from prototypes. An amendment on April 30, 2024, further expanded the cap to “Follow-up Mass Production Contracts” after initial production. However, the cap only applies to contracts whose period expires, and liquidated damages arise, on or after May 1, 2024. Therefore, verifying the contract's expiration date is essential to determine the applicability of the new liquidated damages rates.

After the Defense Acquisition Program Act introduced a cap on liquidated damages, similar provisions were subsequently established in the National Contracts Act and the Local Contracts Act. Following such precedent, the Enforcement Decree of the National Contracts Act (Article 74, Paragraph 3), and the Enforcement Decree of the Local Contracts Act (Article 90, Paragraph 3), set the cap on liquidated damages at 30% of the contract amount. Additionally, related regulations were introduced in the Space Development Promotion Act. According to the Enforcement Decree of the Space Development Promotion Act (Article 19-10), the cap on liquidated damages for “Prototype Manufacturing Contracts” and “Initial Final Product Manufacturing Contracts” in space development projects is restricted to 10% of the contract amount.

National Contract s	Local Contract s	Defense Acquisition Contracts					Space Development Project	
		R&D	Initial Mass Production	Follow-up Mass Production	Domestic Procurement ⁱ	Overseas Procurement ⁱⁱ	Prototype Manufacturing	Initial Manufacturing of Final Product
30%	30%	10%	10%	10%	30%	10%	10%	10%

3. Exemption or Reduction of Liquidated Damages in Defense Acquisition Contracts

In the case of defense acquisition contracts, since May 1, 2024, the Defense Acquisition Program Act and its subordinate regulations have introduced grounds for exemption or reduction of liquidated damages under specific circumstances. Assuming that the contractor is not at fault, these provisions will apply in the following situations:

1. When the contractor has faithfully completed a defense R&D contract that requires a high level of technical proficiency.
2. When the cause of the delay is attributed to:
 - (i) Both the contractor and the government or subcontractor;
 - (ii) The subcontractor alone; or
 - (iii) Severe testing conditions.

In particular, if the delay in contract performance is caused by a subcontractor's fault, there is room for full or partial reduction of liquidated damages, provided that certain conditions are met. This includes cases where the contractor did not have the option to select the subcontractor, and it can be demonstrated that a proper management and supervision system for subcontract performance was established and appropriately implemented.

However, as there have not yet been many disputes regarding the reduction or exemption of liquidated damages under the amended provisions, it is crucial to carefully examine not only the technical issues specified in the amendment but also the legislative intent behind the changes and relevant court precedents in similar matters. This thorough analysis will help formulate appropriate reduction arguments and evidence for each individual case. Therefore, when facing potential imposition of liquidated damages, it is essential for contractors to seek assistance from legal experts with extensive experience in this area to proactively prepare for exemption or reduction of the damages.

4. Dispute Resolution Measures for Liquidated Damages

When liquidated damages are imposed and there is a disagreement regarding their validity or extent, it is possible to challenge the imposition through civil dispute resolution procedures, as courts generally view public procurement contracts as civil contracts. The primary methods of disputing liquidated damages include:

1. Filing a Civil Lawsuit: Initiating litigation to contest the validity or amount of liquidated damages.
2. Utilizing Contract Dispute Resolution Systems: Engaging with bodies such as the National Contract Dispute Mediation Committee or the Local Contract Review and Adjustment Committee.
3. Arbitration: Submitting an arbitration request in accordance with a previously agreed arbitration clause.
4. Specific to Defense Acquisition Contracts: Submitting a Request for Liquidated Damages Exemption under the Regulations on the Management of Military Supply Procurement and applying for exemption through the Defense Acquisition Contract Review Committee.

However, each of the above dispute resolution methods has its own set of advantages and disadvantages, including differences in cost, time required, and the likelihood of achieving a one-time resolution. Therefore, it is crucial to carefully evaluate the type of public procurement contract, the specific contractual terms, the grounds for claiming an

exemption, and the feasibility of presenting evidence. To effectively navigate the dispute process, it is essential for contractors to make an informed decision on the most efficient and appropriate method from the outset. Engaging legal experts from the early stages can ensure a systematic approach and robust preparation for any challenges related to liquidated damages.

Shin & Kim's Military Procurement and Defense Industry Team is composed of experts with extensive practical experience and specialized knowledge acquired through handling cases involving the Ministry of National Defense, the Defense Acquisition Program Administration (DAPA), and various defense contractors. Our team has successfully managed a wide range of issues, including the imposition of liquidated damages, proceedings before review committees, and related administrative and civil litigation. We offer the most effective solutions to all legal issues arising from defense acquisition contracts and other public procurement contracts, including bidding procedures, imposition of liquidated damages, and sanctions against disqualified contractors.

If you have any questions or need assistance with any of the above, please feel free to contact us and we would be happy to discuss further.

ⁱ This constitutes a form of "penalty" under civil law. Unless there are special circumstances, courts generally regard it as predetermined compensation for damages arising from delayed performance. If the amount of liquidated damages is deemed excessively high, the court may, at its discretion, reduce the amount, pursuant to Article 398(2) of the Civil Act.

ⁱⁱ Cap of 30% of the contract amount applies in accordance with the National Contracts Act.

ⁱⁱⁱ General Terms and Conditions for Overseas Procurement (Weapon Systems) (Defense Acquisition Program Administration Regulation No. 961, amended on January 2, 2025) Section 20 Na.

[\[Korean version\]](#) 방위사업계약 이행과정에서 지체상금(지연배상금)을 부과받는 경우 지체상금 제도에 대한 정확한 이해를 바탕으로 가장 적절한 대응 방법을 선택하는 것이 중요합니다

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