

A miniature scene of people on a large US dollar bill, symbolizing economic activity and inflation. The scene includes a woman in a green dress carrying a shopping bag, a man in a brown jacket carrying a bag, and another man in a brown jacket carrying a bag. They are walking on a large US dollar bill, which is the background of the page. The bill is a 100 dollar bill, and the words "ONE HUNDRED DOLLARS" are visible. The scene is set against a blurred background of more dollar bills.

EPC Contract Price Adjustments Amidst Inflation

1. Disputes on Adjustment of EPC Contract Price

Due to the disruptions in the global supply chain caused by COVID-19 and the Ukraine war, raw material prices have skyrocketed resulting in a significant increase in such disputes. As compared with the same quarter last year, the number of disputes filed with the Korea Fair Trade Mediation Agency increased by 250% in the first quarter of 2022.

Contractors take the biggest hit since owners refuse to adjust their contract price and subcontractors raise theirs. The firm price contracts (e.g., those without provisions for price adjustments) require contractors to solely bear price fluctuations. Contractors are becoming hesitant to accept more construction contracts, and some consider abandoning the ongoing construction work.

In particular, disputes have erupted over whether such contracts “unreasonably limit the contractual interests” (public contracts) or “are significantly unfair 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 on a reasonable ground or the burden is shifted onto the other party” (primarily private contracts).

After the Ministry of Land, Infrastructure and Transport stated that a provision that expressly prohibits contract price adjustment according to price fluctuations “may be invalidated except for good reasons to deny it” (April 5, 2022, “Construction Policy Department – Reply to the Inquiry No. 1644”), many contractors take a more aggressive stance against owners over the firm price contracts.

2. Review of Judicial Precedents

The Supreme Court ruled that 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 very exceptional cases (e.g., Supreme Court en banc Decision, no. 2012da74076 dated December 21, 2017).

The question is whether the current “soaring raw material prices” can be considered an exceptional case enough to deny the effect of firm price contracts. The rates of price increases in 2021 and 2022 are unprecedented across all economic sectors. From 2017 to 2020, the construction cost 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 by 2.8% in the first quarter of 2022.

While it is not easy to predict how the court sees the current situation, some public contracts that exclude price changes were held invalid in light of public contract characteristics like public interest.

For private construction projects, 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 unreasonably limits the contractor’s contractual interests.

3. Resolving Disputes by Application of the Principle of Change of Circumstances

The principle of change of circumstances allocates the risk of significant change of circumstances, which is not allocated by the relevant contract, ex-post between the

parties. The Supreme Court has applied the principle in very limited cases.

Simultaneously, the Supreme Court ruled, in its decision no. 2020da254846 dated December 10, 2020, that “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*.” The decision recognized the termination of a contract based on the principle of change of circumstances.

We accordingly expect that changes in contractual term would most likely emerge under the principle of change of circumstances for private/public construction projects which are currently facing raw material price spike.



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** The opinions expressed in this article are the author’s own and do not reflect the views of KOTRA.*