

# MITIGATION AND REMISSION OF CONTRACTOR'S DEFECTS LIABILITY IN KOREAN CONSTRUCTION CONTRACTS

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**ABSTRACT :** The purpose of this study is to improve regulations such as law and standard contract forms related to defects liability in Korea. Defects liability has been one of the major causes of construction contract disputes in Korea in recent years. It is important to avoid or resolve disputes regarding defects liability through regulations containing clear criteria and to specify the standard regarding the mitigation and remission of the contractor's defects liability. This study was carried out through document research and analysis of judicial precedents. The following are the courses of improvement regarding the mitigation and remission of defects liability in Korea.

First, laws and standard contract forms must contain more detailed clauses regarding exemption of a contractor's defects liability, which clearly set out the scope of the defects liability of the contractor. Second, the current system for defects liability favors the owner rather than the contractor - it is necessary to change the defects liability system in order to give the owner and the contractor an equal standing. Third, strict liability is taken on by the contractor even when the term of guarantee for defects lasts longer than the legally set period of liability for defects. Hence, it is necessary to improve the system by alleviating the liability of the contractor through applying negligence liability as opposed to strict liability during the term of guarantee.

*Key words : Construction Contract, Mitigation and Remission of Defects Liability*

## 1. INTRODUCTION

### 1.1 Background and Goals

Construction works, formed by a number of contracts, may appear to be a unified body but in reality the parties concerned in a contract are bound by a set of complicated rights and responsibilities. The owner has the responsibility to provide remuneration based on completion of construction, and the contractor's responsibilities lie in the area of fulfilling the contract, delivering the construction objectives, and defects liability.[1] Of the responsibilities undertaken by the contractor, the number of disputes with regards to defects liability have been increasing recently. According to Du(2003), conflicts arising from defects are the second-largest problem (34%) in this area.[2]

When defects are found in a structure during a project, they lead to a reduction in buying and trade-in price for the owner, and lower the utility of a building. On the contractor's side, they lower the efficiency of the natural resources being used, and increase uncertainty in the managerial environment. The unexpected discovery of defects therefore increases the temporal and economic expenses for both sides, and is thus undesirable.

Problems arising from defects liability, at the core, are based on which side bears responsibility when a defect occurs. Defects liability is strict liability by law, and thus the

contractor bears primary responsibility. However, conflicts arise when the whereabouts of the liability are unclear. In this case the law regarding mitigation and remission of the defects liability for the contractor can be the key to resolving conflicts that arise. However, Korea has placed importance on quantity of construction since the expansion of the economy starting in the 1960s and up to now, and minute details such as mitigation and remission of defects liability have not been addressed in the law.

Nevertheless, existing researches are defined in civil law article 669. Moreover, it has not been possible to investigate comprehensively 'Construction Industrial Law', civil law and standard contract forms habitually used in construction contracts. Therefore, the purpose of this study is to improve regulations such as law and standard contract forms related to defects liability in Korea. It will contribute to reduce and resolve the disputes related to defects liability.

### 1.2 Scope and Methods of Research

This study deals with mitigation and remission of defects liability in construction contracts in areas of Korea. Also, this study qualifies the scope of the relationship between the owner and the contractor.

This study was carried out through document research, analysis of judicial precedents and principals of law.

## 2. SIGNIFICANCE OF MITIGATION AND REMISSION OF DEFECTS LIABILITY

### 2.1 Concept

In a construction contract, the contractor is required to deliver a complete building to the owner. Defects liability refers to the contractual responsibility of the contractor to repair defects when they occur. When a defect occurs in a building the contractor is obliged to repair it or pay compensation.

However, certain cases exempt the contractor from defects liability. There are also times where defects liability for the contractor has not been concluded. A sharp conceptual distinction can be made between defects liability not being set up, and from being exempted. In spite of that, through clear analysis of the law one can present the standards for prevention of conflicts through defects, and to put each of the two sides in their proper category.

### 2.2 Theoretical and Legal Basis

The theoretical basis for mitigation and remission for a contractor is as follows. Defects liability is treated as strict liability. In principal this is carried out to mean that a contractor is liable for defects regardless of whether they are his or her own errors or not. However, when the owner is responsible for defects, or when complete defects liability on the contractor is recognized as being too severe, mitigation and remission can be made.[3]

A number of laws exist regarding mitigation and remission in defects liability for a contractor, namely civil law article 669, Construction Industry Law article 28, National Contract Law article 17. There are also provisions such as the General Conditions for Construction Contracts article 32, Standard Civil Construction Contract article 18.

## 3. ANALYSIS FOR MITIGATION AND REMISSION OF DEFECTS LIABILITY

### 3.1 When Defects Occur under The Owner's Liability

Provisions exist regarding when the contractor is not liable due to defects that are the result of the owner; these are addressed under Civil Law article 669, Construction Industry Law article 28 clause 2, as seen in the following.

Civil Law article 669

The previous two (2) articles are not to be carried out when defects in the building are the result of faulty materials delivered to the contractor, or the directions of the contractor.

Construction Industry Law article 28 clause 2

Regardless of the provisions in clause 1, the contractor is not liable for defects due to the following reasons.

1. The materials provided by the owner are of low quality or substandard
2. When the owner has directed construction
3. When the life of a building has expired according to relating laws or when it has been used in a way which exceeds the structural strength

Civil law article 669 exclude contractor's defects liability when defects have occurred by the materials delivered by the owner being not up to standard, or directions of the owner. Also, Construction Industry Law article 28 clause 2 denies defects liability to the contractor when the life of a building has reached its limit and when building structure strength has been exceeded. As mistakes by the owner through use in this way are often misperceived as being defects, it must be stated clearly that liability does not take place under these circumstances. In conclusion, when defects are found to be as a result of the owner, the contractor is to be exempted; this ensures equality as required by law.

A special problem regarding negligence of the owner occurs when the contractor carries out the project according to the blueprints but nevertheless defects occur; in such a case the question of who is liable must be ascertained by checking to see if the problem occurs in the blueprints themselves or not. If the blueprints are devoid of error then the liability is put on the contractor, but if errors are present it is not possible to hold the contractor liable.

Previous judicial precedents show instructions given by the owner, bringing liability to the owner's side and not the contractor.[4]

However, in the case that the contractor knows the instructions of the owner to be inappropriate but fails to inform the owner of this and completes the building, in spite of the fact that the instructions were incorrect the liability falls on the contractor for carrying out instructions known to be incorrect.[5]

### 3.2 Force Majeure

*Force majeure* – FIDIC Conditions of Contract for Works of Civil Engineering Construction uses terms such as Special Risk - signifies events that are beyond the control of the parties involved in a contract. Article 32 clause 1 of the General Conditions for Construction Contracts defines it as "situations beyond the scope of the parties involved in a contract such as typhoons, flooding and other climate-related disasters; war and conflict, earthquakes, fire, disease, riots and disturbances". Civil law and the Construction Industry Law do not have stipulations concerning *force majeure*.

The General Conditions for Construction Contracts define *force majeure* in somewhat more detail, in the following forms. First of all are climate-related phenomena such as typhoons, flooding and tidal waves, along with geological phenomena such as earthquakes and volcanic eruptions. Second are phenomena such as war, uprisings, internal strife, rebellion, workers' strikes, and political or social phenomena. Third are artificial disasters such as fires and radiation leaks. Fourth are pathological phenomena such as plagues. Also, there is a fifth category of other non-controllable phenomena that occur outside the scope of a contract.

General Conditions for Construction Contracts article 32 and Standard Civil Construction Contract article 18 have stipulations regarding the occurrence of *force majeure* and the effects it has on defects liability for the contractor.

General Conditions for Construction Contracts article 32

clause 2

Owner is to be liable for the followings in cases of *force majeure* stipulated in clause 1:

1. Already established sections that have undergone inspection as in article 27
2. Parts that have yet to be inspected but have been objectively verified (director's notes, photographs, video recordings, etc.) as having been completed
3. Damages according to article 31 provisory clause 1, and clause 3 of the same article

Standard Civil Construction Contract article 18 clause 2

When "A" receives a report of clause 1, s/he is to immediately inspect and confirm the veracity of it; if it takes place in an already finished and inspected portion of the building, "A" is responsible. In other cases "A" is to confer with "B" to decide on a solution.

The original intention of the clauses pertaining to *force majeure* is to share and remove risks involved in areas beyond the control of the signatories when engaging in construction; it is reasonable to think of it as stipulating the center of liability when damages occur, and the scope and time thereof. Nevertheless, according to the unchanged Roman law principle that "the owner is to be responsible for damages," defects liability for the contractor is not realized here. Also, in long-term construction when one regularly sees completed objects being shipped as a common practice, there is meaning to be found in clearly stating the scope of the risks involved for the signatories to the contract.

Defects occurring through *force majeure* are treated as if they did not exist in the first place; nonexistent defects thus cannot hold the contractor liable. Following judicial precedents up to now have also shown the same.

Severe earthquakes and accompanying storms with the highest precipitation in decades; the highest standards of safety were not always upheld, and in those instances as well defects were found in the building. (ellipsis) Liability for these damages cannot be placed in this case. (The Supreme Court 1978.2.14, 76da1530)

### 3.3 When a Contract Contains an Exemption Clause

Exemption clause refers to an agreement whereupon the contractor is not held liable even if defects are to be found in a project. Civil law article 672 stipulates on this indirectly. Other laws and standard contract forms do not have these stipulations.

Exemption clause gains its effect from an agreement within a contract, and is not generally recognized. When special exemption is present regarding defects liability, the contractor is not liable for defects even should they occur. Therefore, the owner may not seek compensation or damages from the contractor. When special exemption is included, the contract itself still has conditions regarding defects liability of the contractor, but their effect is nullified by the contract. Here we can see a difference in the area before referring to the occurrence of liability on the owner's side as well as *force majeure*, where the liability of the contractor is not set up in the first place.

### 3.4 Limits of Mitigation and Remission in Defects

#### Liability

Having reasons for enacting mitigation and remission when defects have been discovered in a building does not always mean that the contractor is not to be held liable. When the contractor does not take care to prevent the occurrence of defects as bound by contract, and when s/he fails to carry out contractual responsibilities in good faith, s/he is liable for defects.

First, even when the owner is responsible for defects and defects liability does not exist for the contractor, if the contractor has used faulty materials knowingly and has not reported on them to the owner, or does not file a report on directions of the owner considered to be unreasonable, the contractor cannot be exempted from liability (Civil law article 669 provision). If the contractor is not aware that materials are faulty or that the directions of the owner are unreasonable, then the contractor is liable due to violation of integrity. Following previous judicial precedents show the same.

When the contractor carries out orders knowing them to be unreasonable and does not report them, when defects are found in the completed building, though they occurred through the orders of the owner the contractor cannot be exempted from liability. (the Supreme Court 1995.10.13, 94da31747).

Also, even in cases of *force majeure*, when *force majeure* and liability of the contractor concur, defects liability for the building is to be on the contractor. The following judicial precedent is related to compensation for damages, but the sense of it is the same as for cases involving defects liability.

When floods caused by typhoons coincide with errors from the damaging side, it is fair to assign damages to the damaging side for the extent caused, and should be restricted to the amount remaining after damages resulting from natural forces are subtracted (the Supreme Court 1993.2.23, 92da52122)

Even in cases of special exemption, when defects occur as a result of the contractor being aware of but not reporting them, s/he may not avoid liability (Civil law article 672). 'Being aware of but not reporting them' refers to when the contractor is aware of causes that will lead to defects but does not give notice, and of inappropriate materials being offered and inappropriate instructions given by the owner which falls under this area as well. When the contractor is aware of the possibility of defects occurring but does not give notice and does not give the opportunity to the employer to take action on the emergence of defects it can be viewed as a violation of integrity on the contractor's part, and giving the contractor special exemption in such a case is seen as unreasonable; thus it is reasonable to revoke it in this circumstance. Following judicial precedents show the same.

When defects liability is exempted by agreement, and the contractor does not give notice (of a problem), this constitutes a violation of integrity and defects liability cannot be exempted in this case (the Supreme Court 1999.9.21, 99da9032).

## 4. PROBLEMS OF REGULATIONS

### 4.1 Lack of Precision in Laws and Contract Conditions

Civil law and the Construction Industry Law provide stipulations for defects liability on a general level. They do not have detailed stipulations regarding conditions of standard contracts, the largest direct influence, nor on exemption of defects liability.

In reality it is no easy task to determine who is liable when defects occur, the owner or contractor. This is why the contractor is often held liable even when s/he is not at fault. Nevertheless, the problem lies with the fact that provisions regarding exemption of defects liability are unclear.

### 4.2 Unbalance in Risk Sharing

As defects liability is strict liability, the weight of the responsibility is determined by the contractor. However, the maximum length of time for defects liability is 10 years, and liability lies on the contractor for long-term defects. Defects may occur within a few years of completion of construction. However, there is a lack of balance in assigning strict liability to a contractor for a ten year period when a building is being used over the long term.

### 4.3 Mixing of Defects Liability and Responsibility of Surety

The Construction Industry Law stipulates the term of responsibility of surety through defects liability as 1 to 10 years depending on the type of construction involved. The legal defects liability of the contractor is systematically guaranteed by the guarantor.

However, the case often occurs where the period of guarantee is longer than the period of defects liability. Therefore, when the period of defects liability ends but the period of guarantee has not, the contractor is generally liable under strict liability.

## 5. COURSES FOR IMPROVEMENT

### 5.1 Clarifying Laws and Contract Conditions

One object in enacting standard contracts is to reduce the number of uncertainties in carrying out contracts and to raise the clarity of definitions in problems frequently occurring during a contract, and finally to lower the probability of conflicts occurring. This is why the legal stipulations regarding mitigation and remission must be supplemented.

The civil law system used in standard private contracts is not easy to change. However, deliberation is required on the plan with details for mitigation on defects liability found in the Framework Act on Construction Industry, national contract law, and standard contract conditions, which do not have direct references to mitigation and remission of defects liability.

### 5.2 Achieving Balance in Risk Division

When considering the culture related to contracts between an owner and a contractor and the realities thereof in Korea, it can be seen that a program must be considered to bring

about equal footing in between the two parties involved in a contract.

According to laws enacted at present, a contractor who wishes to be exempt from defects liability must provide proof that the responsibility for the emergence of the defects lies either with the owner, or through *force majeure*. This negative air seems to be grounded by the assumptions in Civil Law article 667 regarding defects liability that gives strict liability. However, if we are to consider when construction of a project goes into the long term and use of the building is considered to be long term, there is a need to change the defects liability from the ones at present giving risk to the contractor, to ones giving risk to the owner. In other words, to break out of the negative air regarding defects liability seen at present it is necessary to stipulate in which cases the contractor is to be held liable for defects, and in other cases to make the owner liable for risks, and thus to widen the scope of exemption for defects liability for the contractor.

On the other hand, it is necessary to adjust the long-term period of strict liability to a more reasonable one.

### 5.3 Division of Defects Liability and Responsibility of Surety

It is necessary to have a division between defects liability and responsibility of surety. Even if the contractor is to be given strict liability for defects, there is a need to reform the system to relieve the liability put on the contractor afterwards, during the period of guarantee.

## 6. CONCLUSION

This study was drafted in order to show rational solutions to conflicts relating to defects liability by making clear the standards and scope in which liability is to be exempted.

The courses for improvement to the problems in the legal system in Korea with regards to the mitigation and remission of defects liability is as follows.

First, though defects liability has the properties of strict liability, defects liability does not occur, or responsibility to enact it does not arise in cases of liability of the owner, *force majeure*, and special contract exemption. According to these cases, the contractor is relieved of liability for defects. However, the laws and contract conditions regarding mitigation and remission in defects liability is extremely general and vague. Therefore it is necessary to create specific stipulations in, and clarify the scope of the laws and contract stipulations regarding defects liability for the contractor.

Second, not only does the system of standards of mitigation and remission of defects liability in Korea give a superior position to the owner, but there is a need for reform to expand equality of owner and contractor when considering the culture of predominance for the owner present in the country. There is a need to consider a positive method of stipulation whereby the contractor is liable for defects liability only under a set of pre-existing reasons, and where defects under all other reasons are transferred to the risk of the owner.

Third, an occurrence is often found whereby the period of guarantee is longer than that of the legal period of defects liability, giving strict liability to the contractor. There we see a need for a reformation of the system alleviating the liability for the contractor from strict liability to negligence liability.

Besides the above study, there is a need for further concrete research into the standards for mitigation and remission of defects liability of contractors, the standards and scope of *force majeure*, and appropriate periods of time for defects liability.

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