Change of Circumstances in Korean Contract Law

: an exception to *Pacta Sunt Servanda*

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I. Introduction

Pacta Sunt Servanda is one of the most important and basic principles in Korean contract law. Contracts should be kept. When a party fails to perform an obligation under a contract, and if it is intentional or negligent, he or she is liable for damages for the default,[1] and the other party may terminate the contract if it is a material breach.[2] Even when compensation is available, the other party could, in principle, claim the compulsory execution to the court, which is similar to the specific performance or an injunction.[3] In law and economics, the theory of efficient breach of contract is argued, which means that a party should be allowed to breach a contract and pay damages, if doing so would be more economically efficient than performing under the contract.[4] In Korean law, this legal theory of efficient breach is not generally accepted, because contracts have sanctity that goes beyond the economic interests of the parties.

If there is any defect in the contract in the first place, for instance, if the contract was entered into by the parties with fraud or coercion, or if the contract is unfair to the extent that it is contrary to the social norms, the contract may be invalidated or canceled.[5] However, the effect of a contract that has been duly established could be denied only when there is a reason for the termination of the contract or it becomes impossible without any cause attributable to the debtor. Other than that, the contract

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[1] Article 390 of the Korean Civil Code.

[2] Articles 543, 544 and 545 of the Korean Civil Code.

[3] Article 389 of the Korean Civil Code.

[4] Richard A. Posner & Andrew M. Rosenfeld, Impossibility and Related Doctrines in Contract Law: An Economic Analysis, 6 J. Legal Stud. 83, 89 (1977); See also the opinion of Judge Richard Posner in Lake River Corp. v. Carborundum Co., 769 F.2d 1284 (7th Cir. 1985).

[5] Article 103ff. of the Korean Civil Code.

must be kept. This is taken for granted from the perspective of contract law, which considers the will of the parties more important than anything else.

Is there any exception to this principle? In modern society, new contracts have emerged, and especially when there is a considerable imbalance in the capacity of the parties, it is unreasonable to enforce the contract. For example, in multi-level sales or online transactions where consumers frequently enter into a contract without fully considering the details of the contract, or financial transactions where it is difficult for a party to understand the contents or effects of the contract, the right of withdrawal is granted for a certain period of time even if there is no special reason.[6] In this regard, the withdrawal right under some special acts could be seen as an exception to *Pacta Sunt Servanda*.

In addition, Korean courts expressly state that the doctrine of change of circumstances is an exception to *Pacta Sunt Servanda* (the principle of compliance with the contract). Since there is no explicit provision under Korean law to declare the doctrine, we have had many debates historically as to whether to recognize it. The court's traditional view was to deny the change of circumstances on the basis of the principle of compliance with the contract. However, since the Supreme Court declared that the change of circumstances was recognized in principle in 2007, similar rulings have followed. Furthermore, in the case decided in December 2020, the Supreme Court admitted the termination of a contract in accordance with this doctrine, and thus confirmed that the change of circumstances doctrine is a practical norm, not a theoretical declaration.

Therefore, the doctrine of change of circumstances will be a good starting point to understand the meaning of *Pacta Sunt Servanda* in Korean contract law. It could lead to a discussion of how the doctrine functions in a rapidly changing and unpredictable society, and what the principle of contract compliance means in this changing era. In particular, we are facing unprecedented situations due to COVID-19, which could be appropriate to consider whether the doctrine applies and under what conditions.

II. The Doctrine of Change Circumstances in Korean Contract Law

[6] For instance, see Article 8 of the Door-to-Door Sales Act or Article 46 of the Financial Consumer Protection Act.

1. Overview

The change of circumstances under Korean law is defined as the doctrine that a party may alter or extinguish the effect of the contract so as to be consistent with the principle of good faith and justice, if it is unreasonable to maintain and enforce the contents of the originally determined contract as it is, as the environment which existed at the time of the execution of the contract or the circumstances under which the act was conducted are remarkably changed thereafter.[7]

The law of contracts in Korea, is in great part codified in the Korean Civil Code (the "KCC"). In the KCC, there is no provision which generally recognizes the doctrine of change of circumstances. In 2004 and 2013, there were attempts to specify the doctrine in the KCC initiated by the Ministry of Justice (the "MOJ"), but the amendments to the KCC were not passed by the Council. With no codification until now, there has been disagreement on whether to accept this doctrine in Korean contract law. Generally, legal theories are positive, although there are some opposing views. The main argument of the dissenting opinion is that recognizing the change of circumstances will greatly threaten the binding force of contracts and the safety of transactions. However, this position has been reduced after the court declared the doctrine of change of circumstances and furthermore admitting it in a specific case. The majority of legal theories affirms the doctrine of change of circumstances now.

In actual, the term "principle of change of circumstances" is more general in Korea, rather than term of "doctrine of change of circumstances." Generally speaking, the term "principle" shall be applied unless it is an exception, but it is somewhat awkward that "the principle of change of circumstances" is applied as an exception to "the principle of compliance with the contract." It may be explained that the scopes or conditions are different so that the principle of compliance with the contract is about the attribution of risks inherent in the contract, while the principle of change of circumstances relates to the risks that go beyond the contract. However, it would be more adequate to use the term "doctrine" for that the court has been very reluctant in approving change or termination of a contract by applying the change of circumstances in a specific case.

If we can recognize the doctrine of change of circumstances in Korean contract law, and there is no specific provision on it, what are the grounds for it? It shall be agreed on the finding of the grounds for it in Article 2 of the KCC which prescribes the principle of good faith. As the situation is beyond ordinary risks, which occurs outside the contract, it would be reasonable to solve the problem in

[7] Yun-Jik Kwak, Obligations (special part), 2003, p. 92.

accordance with the principle of good faith as a general norm of contract law. Provided, the principle of good faith is a general provision, and it is necessary to specify the requirements for application and to determine whether to apply the doctrine in an individual case.

2. Changes in Judicial Precedents

Korean courts had rejected to accept the doctrine of change of circumstances for a long time. For instance, the courts did not recognize the doctrine even with significant change of circumstances before and after the Korean War. The Korean War would be a representative case in the history of Korea when there were unexpected and significant external changes. At that time, we had currency reforms and skyrocketed inflation. Accordingly, there had been several cases of claiming to change or terminate a contract due to market price fluctuations or other change of circumstances after execution of the contract.

In one of the Supreme Court decisions in 1950's, the plaintiff requested for an increase in the price in a sales contract of a land or termination of the contract on the grounds that the market price had soared 30 times after the signing the contract.[8] In another case, a request for termination of a paper sales contract was filed where the market price of paper had been increased by 25 times.[9] In response, the court concluded, "The principle of so-called change of circumstances, which is the norm that in case where original benefit becomes remarkably unfair to a party as a result of changes in the circumstances which became the basis of at the time of execution of the contract, and both parties were unable to predict and unforeseeable to the changes, the party may suggest the other party to modify the details of the benefit in a proper manner in accordance with the principle of good faith, and if it is refused by the other party, the party may terminate the contract, shall not be approved by the interpretation of the KCC." This trend of precedents was maintained in such cases where the value of the payment in contracts had risen 571 times for following 9 years or 1620 times during 14 years due to the Korean War and the currency reform.[10]

In the decades since then, the Supreme Court repeated the ruling that the case in question did not

[8] Supreme Court Decision 4298MinSang109, Decided February 10, 1955.

[9] Supreme Court Decision 4286MinSang231, Decided April 14, 1955.

[10] Supreme Court Decision 4288MinSang234, 235, Decided March 10, 1956; Supreme Court Decision 63Da452, Decided September 12, 1963.

meet the requirements for the change of circumstances in several cases.[11] However, unlike the above earlier precedents, it was difficult to know what the Supreme Court's position was on the doctrine itself, as it did not specifically mention that the change of circumstances doctrine itself was not recognized.[12] However, the Supreme Court clearly stated in 2007 that the "doctrine of change of circumstances" was recognized.[13] The view that the change of circumstances should be denied under Korean law has rapidly lost its strength with the case and following precedents thereafter. In addition, the court admitted termination of a contract under the doctrine of change of circumstances in 2020, which made the opposing view far less persuasive.

3. Requirements and Effects

There are some disagreements on how to understand the requirements of the change of circumstances, but in general, precedents and theories require (i) significant changes after the execution of the contract, (ii) unpredictability, and (iii) unreasonable conclusions.

The MOJ prepared the amendments to the KCC containing these details in 2004 and in 2013, but they were not legislated. The latter one was proposed as follows: “If circumstances forming the basis of the contract are significantly changed, the parties were unable to predict such change at the time of execution of the contract, and maintaining the contract as it is would cause a serious imbalance in the interests of the parties or make it impossible to achieve the purpose of the contract, the parties may request the revision of the contract or terminate the contract.” The requirements for recognizing the change of circumstances doctrine are substantially the same as those of precedents.

In terms of its effect, termination of a contract has been mainly argued in the previous court cases. Can we admit modification of a contract as an effect of the doctrine of change of circumstances? In the discussion on the amendments to the KCC, it was pointed out that if the parties may have the right to request revision of the contract as well as the right to terminate it, we couldn’t tell in what cases,

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[11] Supreme Court Decision 80Da414, Decided April 22, 1980; Supreme Court Decision 90Da19664, Decided February 26, 1991, etc.

[12] Exceptionally, even in this time, there were some cases that the Supreme Court admitted the termination of the contract in accordance with the doctrine of change of circumstances, which were related to continuous guarantee agreements. However, the decisions have been criticized that such matters shall not be resolved on the basis of the change of circumstances. See III. 4 below.

[13] Supreme Court Decision 2004Da31302, Decided March 29, 2007.

and to what extent, the revision can be accepted.[14] It would be desirable to recognize revision of a contract as an effect of the change of circumstances, in that the doctrine could provide a variety of means to appropriately allocate the risks arising from unexpected changes in circumstances, rather than the both ends of the solution of remaining the contract as it is or denying the validity of the contract as a whole.[15] As cases accumulate in the future, more concrete considerations will have to be made as to when and to what extent the request for amendment of the contract will be recognized based on the change of circumstances.

Although the doctrine of change of circumstances is recognized, it is not always applicable to any cases. The rule of thumb is that the contract is to be observed. The change of circumstances shall be applied in some exceptional cases, in a supplementary manner, only when the requirements are met. Nonetheless, it is of considerable importance that case law makes clear the acceptance of the doctrine, and clarifies that it is a practical norm. This is because we are living in an unpredictable era and the change of circumstances may play a role in allocating unexpected risks. In order to examine the meaning of the doctrine in this situation, it would be meaningful to take a look at the important cases of the Supreme Court and their meanings.

III. Notable Supreme Court Cases

1. Supreme Court Decision 2004Da31302, Decided March 29, 2007

In this case, the Korean Supreme Court recognized the change of circumstances doctrine explicitly as follows: “A so-called termination of a contract due to a change in circumstances occurs when a significant change in circumstances happens that a party to the contract could not have foreseen at the time of contract formation and when such change in circumstances occurs due to a reason for which the party with the right to rescind is not responsible. Where the binding power is recognized as stipulated in the contract, instances in which outcomes run significantly counter to the principle of good faith are

[14] Jae-Hyung Kim, “The Proposed Amendment to the Korean Civil Code on Rescission and Termination of the Contract, Risk of Loss, and Change of Circumstance”, Seoul Law Journal 55(4), 2014, 54.

[15] Chinwoo Kim, “COVID-19-Pandemie und Leistungstoerungen”, The Journal of Comparative Private Law 27(3), 2020, 308-309.

recognized as an exception to the general rule of the observance of contracts."

However, after reviewing the specific facts and circumstances, the Supreme Court concluded that the case did not fall under the change of circumstances that lead to the right to terminate the contract. The plaintiff intended to construct a restaurant on a land and purchased the land from a local government, the defendant. It was subsequently annexed as public land after completion of the sales contract, thereby making the purchaser's intended construction of a restaurant on the land impossible. The court denied the plaintiff's termination right, mentioning that even if a circumstance that did not form the foundation of the contract changes afterwards and results in damages to one party because he could not achieve the goal of the contract as intended at time of formation, it shall not be deemed to contravene the principle of good faith in maintaining the contract, unless there are special circumstances. According to the decision, the circumstances here refer to objective circumstances forming the foundation of the contract, do not include any subjective or personal situation of one party.

In particular, the purchase agreement in this case went through the public bidding procedure of the defendant. The terms and conditions of the public sale stated that the land belonged to a development restricted zone, and that the defendant would not be liable any subsequent administrative restrictions if any. The change of circumstances is based on the rule of good faith, and it is not appropriate to apply it if the parties predicted the risk in advance at the time of signing the contract and determined the attribution. The change of circumstances doctrine cannot function when risk sharing is established within the contract. It can be applied when a risk that the parties did not expect occurs, that is, when there is significant change of circumstances outside the contract. If it is clear that the defendant will not be liable for any administrative restrictions in the sale of public land, it is not appropriate to apply the doctrine of change of circumstances even if administrative restrictions make it impossible to achieve the purpose for which the defendant purchased. I agree with the conclusion of this case.[16]

2. Supreme Court en banc Decision 2012Da13637, Decided September 26, 2013

[16] There are other interpretations. One view is that it was annexed as public land after implementation of the sales contract, but the doctrine of change of circumstances does not take into account the circumstances after the implementation of the contract. See Jae-Hyung Kim, Analysis of Civil Law Cases, 2015, p. 8. On the other hand, there are some opinions against the conclusion of this precedent. The defendant knew the purpose of the plaintiff's purchase and sold it at a higher price than the general one (more than five times the expected auction price), so that it should not be considered as the plaintiff's mere subjective purpose. See Jinsoo Yoon, "Retrospection of Major Cases Related to Civil Law in 2007", Seoul National University Law Vol. 49, No. 1, 2008, p. 323.

This case was related to a knock-in knock-out ("KIKO") currency option contract. According to the contract at question, buyers would earn profits when the won-dollar exchange rate was within a certain range, while the contract would become void when the exchange rate was below the range, and if the exchange rate was above the range, buyers would have to resell the dollars to banks suffering a loss. As a background, the exchange rate fluctuation had showed a box pattern for a while, many small and medium-sized enterprises executed the KIKO currency option contracts with banks in the name of currency hedging from 2006 to 2008. However, after the Lehman Crisis, the global financial market began to become unstable, and as the exchange rate surged in a short period of time, the kick-out condition was met, and many companies went bankrupt. These companies filed a lawsuit against the bank, and this case was one of them. Among the plaintiff's allegations, there was a claim for termination of the KIKO currency option contract as a result of change of circumstances.

At first, the court made it clear, citing the above 2007 decision, that termination of a contract on the grounds of the change of circumstances is recognized as an exception to the principle of compliance with the contract. In particular, this case is meaningful in clarifying that such judicial doctrine shall apply equally to the long-term contract cases where the parties have a continuing contractual relationship. For reference, although it is a relatively recent trend, Korean contract law recognizes that continuous contracts are different from general temporary or discrete contracts. While the termination of a contract under Korean law shall have a retroactive effect in general, the termination of a continuous contract shall have a future effect. Scholars also point out that the change of circumstances is more likely to occur in a continuous contractual relationship which is to be maintained for a long time, rather than a temporary or discrete contract.[17]

It would be conceded that it is more likely that external situations will change after the execution of a long-term contract. But I would like to add that the possibility of change of circumstances is also expected to the parties to some extent and they would have more chance to prepare for the risks arising out of the change. In some typical long-term contracts or material contracts for the parties, the parties imagine possible changes in circumstances as many as possible and agree in advance on how to allocate the risks involved. In Korea, more lawyers are participating in various contracts signed by companies to prevent or reduce potential disputes. Therefore, it would be half true to say that the change of circumstances is more likely to be applied to continuous contracts than to temporary or discrete

[17] As to the characteristics of continuous contracts, see Chang, Boeun, The Continuous Supply Agreement, 2020, pp. 27ff.

contracts in general. It can be said that there is a higher possibility for long-term contracts that various circumstances will change, but whether it is significant change or not should be judged on a stricter basis.

Returning to this case, the court stated that the KIKO currency option contract could not be terminated for the reason of change of circumstances. According to the court, exchange rate volatility was the premise or contents of the contract, and both parties assumed the risk of exchange rate volatility which may realize in the direction against expectation, and a stable exchange rate within a certain range was not the basis of the contract. Therefore, enforcement of the original contents of the contract does not violate the principle of good faith.

3. Supreme Court Decision 2016Da249557, Decided June 8, 2017

In this case, the members of hotel fitness club sought compensation for damages when the hotel suspended the operation of the club due to a decrease in membership and an increase in management expenses. The defendant's hotel argued that it had terminated the club membership contract with the plaintiffs for the reason of cumulative deficit, and cited the change of circumstances as one of the grounds for such termination.

The court generally admitted that the contract may be terminated on the grounds of the change of circumstances referring the above two cases. With respect to the circumstances, more details are stated as follows; "Circumstances in this context means the underlying circumstances based on which the parties entered into the contract. It does not encompass circumstances on which the parties did not base their decision to enter into the contract or circumstances in which either party agreed to assume any disadvantage or risk emanating from a change thereof."

The club membership contract was a long-term, continuous one. The Supreme Court conceded that, in the context of a continuous contract, the long interval between the signing and the performance of the contract increases the likelihood of change of circumstances that could not have been foreseen by the parties. However, it stated that, yet in such cases as well, the mere fact that the economic situation had changed to a party's detriment is insufficient for contract termination.

More specifically, it was difficult to view the circumstances cited by the defendant mentioning the causes for its deficit accumulation, including the number of new members or existing members and facility maintenance costs, as the underlying circumstances on which the club membership contract was

based. Unless change was made due to significant change of economic conditions, it shall be deemed that the defendant agreed to assume the risk in principle. Furthermore, as the defendant had operated the club enduring some loss in the spirit of customer service as a subsidiary facility to the hotel, its primary business, it was also difficult to view that the decrease in revenues of the club and the accumulation of deficits constituted significant changes in circumstances that could not have been foreseen at the time of contract formation.

4. Supreme Court Decision 2020Da254846, Decided December 10, 2020

Similar decisions have been repeated since the Supreme Court ruled that the change of circumstances was recognized in principle in 2007. However, prior to this case, Supreme Court Decision 2020Da254846 last year, there was virtually no case in which the Supreme Court conclusively admitted termination of the contract based on the doctrine of change of circumstances.

Exceptionally, there were some cases in which the contract was to be terminated as a result of change of circumstances, but those were related to continuous guarantee agreements.[18] For example, when a director of a company signed a long-term guarantee contract for the company's contingent liabilities because he/she was a director of the company. After some years, he/she retired the company and no longer wanted to be a guarantor for the company. But can it be said that it was not expected for a director to leave a company some day?

In order to understand this group of precedents, it is necessary to know the peculiarity of guarantee contracts under Korean contract law. Guarantee contracts are used as personal collaterals. It is not uncommon that a guarantee contract is executed in favor of a family member or a friend who do not have a sufficient collateral or security, without any compensation or reasonable consideration. In addition, most of the guarantee contracts for financial institutions as creditors were not limited in terms of guarantee period or guarantee amount,[19] and it is also allowed that the cause of the debt subject to guarantee is not specified. This type of guarantee can lead to an unexpected excess of the guarantee

[18] Supreme Court Decision 92Da10890, Decided November 24, 1992; Supreme Court Decision 95Da27858, Decided December 10, 1996; Supreme Court Decision 2002Da1673, Decided May 3, 2002.

[19] For the reference, from the implementation of the Special Act on the Protection of Guarantors in 2008, the duration and maximum amount of guarantee contracts shall be specified in the written contract.

obligation. Therefore, the Supreme Court have developed some measures to protect guarantors.[20]

A director of a company could be compelled to guarantee the continuing obligations of the company because of his/her status. If the director is to be liable for the obligation as a guarantor even after his/her retirement, it shall be unreasonable. Hence, the Supreme Court has attempted to limit the scope of the guarantee liability, mentioning that the circumstances have changed. However, this is not a matter to which the change of circumstances doctrine in its original meaning applies. The retirement of the director some time is not an unforeseen change in circumstances for the parties of the guarantee contract. This is, rather, a matter of good faith as a general norm, not the doctrine of change of circumstances. In actual, in some cases, the Supreme Court have concluded that a guarantor may terminate a guarantee contract under a similar factual relationship if it is unreasonable in good faith to maintain and continue the continuous guarantee contract, without mentioning the change of circumstances.[21]

In any event, before this Supreme Court Decision 2020Da254846 was rendered in December 2020, there was no case in which the Supreme Court admitted the allegations of a party advocating the change of circumstances, except for the cases of continuous guarantee contracts. In individual cases, while the court conceded the doctrine of change of circumstances would be acknowledged in principle, it decided that the particular event was not unforeseeable or that it was not a significant change in circumstances, etc. For this reason, there were opinions explaining that our case law still did not accept the doctrine of change of circumstances in principle. However, the Supreme Court finally admitted that a lease contract, not a continuous guarantee contract, was terminated on the grounds of the change of circumstances doctrine.

Provided, however, it is necessary to consider whether this issue should have been resolved on the basis of the change of circumstances. In this case, the lessee entered into a lease contract for the land owned by the lessor for the purpose of constructing a model house for a housing construction project, and the purpose was specified in the lease contract. Later, it became impossible to construct a model house on the land when the local government rejected the report of a temporary building construction. The lessee requested the lessor to terminate the lease contract and return the deposit money. The Supreme Court concluded that the construction of a model house constituted the basis for the establishment of the lease contract. As it was impossible to achieve the objective of the contract, and maintaining the contract would result in a significant imbalance between parties, the lease contract was

[20] Yang, Chang-soo / HyoungSeok Kim, The Civil Code III, 2020, p. 264.

[21] Kwon, Youngjoon, “The Doctrine of Change of Circumstances as a Risk-allocation Mechanism”, The Korean Journal of Civil Law No. 51 (2010), pp. 225-226.

to be duly terminated by the lessee's notice of termination, and the lessor was liable for returning the lease security deposit to the lessee.

It could be regarded as a significant change that it became impossible to construct a model house on the land. The lessee could not achieve the objective of the contract. Since parties had stipulated that the construction of a model house was the objective of the lease contract in the written contract, this shall not be only a subjective circumstance of one party. Rather, it could be said that this was the basis for the execution of the contract. The question is whether the parties could not anticipate that the construction of a model house may be difficult due to administrative reasons, etc. at the time of the execution of the contract. It is hard to find any special circumstances suggesting unpredictability based on the facts presented in the case. If, however, parties specified the purpose of a contract, it would be reasonable to say that they did not want to maintain the contract any longer if it became impossible to achieve the purpose. That is, if the lease contract in this case was executed for the purpose of constructing a model house, and it was explicitly specified in the agreement, the parties' implied intention would be not to maintain the contract if it became impossible to achieve the specified purpose. This is a process of completive interpretation, which is to fill the gap in contents of a contract.

The change of circumstances doctrine shall be an exception to the principle of compliance with the contract, and shall be deemed to be recognized in accordance with the principle of equity or good faith. The doctrine is exceptionally recognized under strict requirements. Although it is more likely to be applied to long-term continuous contracts rather than to short-term or discrete contracts, even to the continuous contracts, it is to be applied in a supplementary manner. Where it is possible to resolve in accordance with the general principles of contract law, the doctrine of change of circumstances should not intervene. Therefore, this case could be resolved in accordance with the interpretation of the contract without going to the change of circumstances.[22]

IV. Change of Circumstances in Changing Era

1. Contracts in unpredictable times

[22] Kwon, Youngjoon, "A General Review on the Supreme Court Decisions on Civil Cases in 2020", Seoul Law Journal Vol. 62 No. 1, March 2021. p. 312.

We are living in a rapidly changing era. As the term of the Fourth Industrial Revolution suggests, the technologies, such as artificial intelligence, genome editing, augmented reality, robotics, and 3-D printing, will be expected to change the way humans create, exchange, and distribute value. As occurred in the previous revolutions, this will profoundly transform institutions, industries, and individuals. For instance, artificial intelligence is already permeating into our daily lives. AI secretary services are being used, many contracts are being executed by AI services, and self-driving cars are developing rapidly, which is no longer a story in a science fiction. Several studies are underway from the perspective of contract law, such as on the effect of a contract where artificial intelligence commits an unforeseen act, on the premise that artificial intelligence will have considerable autonomy in the near future.[23]

In addition, climate change will potentially cause significant changes. The Paris Agreement and the United Nations Sustainable Development Goals call for a global movement. In particular, at the EU level, the EU Green Deal is promoted, and there is an emphasis on discussion that we should fundamentally change the economic, environmental, and living patterns, including production and consumption, in the face of climate crisis. Climate change has the potential to change even the rules of trade. The sale of a product does not end with a single sales agreement. The demand for sustainability will require a long-term contractual relationship including repairs of products, update of software, and removal of used goods at the expiration of the term of use. There would be more service contracts or contracts that combine services into sales contracts.[24]

How will the technology change our lives? Can we wisely overcome the crisis of climate change? During the time that a long-term contractual relationship is maintained, it is highly likely that many unexpected changes in circumstances may be involved. What if the cost of repairs has become significantly higher than expected? What if a sales company closed its business? What if the paradigm of the relevant market has been completely changed due to the drastic development of technologies? What will the contract look like then? Would there be thorough provisions on a wide variety of things for the potential risk allocation. Some contracts could be designed very elaborately in detail like a thick M&A contract that is prepared by professional lawyers. However, not all contracts can be executed that way, and our imagination cannot cover all circumstances. How should we cope with changes in circumstances that we have never foreseen? Could the change of circumstances doctrine be a useful

[23] See Chang, Boeun, “Development of Artificial Intelligence and the Role of Contract Law”, The Justice, Vol. 183, 2021, pp. 117ff.

[24] See Chang, Boeun, “The Sustainable Consumption and Consumer Law - focusing on the discussion of circular economy in the EU”, The Journal of Consumer Law, Vol. 5, No.3, 2020, pp. 105ff.

tool in these situations?

Without going any further, we are witnessing an unprecedented situation, COVID-19. The impact of and the response to it may differ from one society to another, but it is clear that COVID-19 is changing the daily lives of people all over the world. Some anticipated that the situation would be soon stabilized at the beginning of last year, but the issue has been prolonged for more than a year, and it is evident that it has affected several contracts. As in many other countries, there has been much debate in Korea on how to resolve the breach of contracts due to COVID-19. Among them, let us examine the role of the change of circumstances doctrine and derive the meaning of it in this changing era.

2. COVID-19 outbreak and the doctrine of change of circumstances

(1) Changes in circumstances that were impossible to predict

The coronavirus pandemic has had a serious impact on the global economic cycle, and has made it difficult to execute or perform many private contracts properly on a micro scale. Fear of unknown circumstances undermined people's activities, and many events were cancelled. People have postponed planned trips and cut down nonessential consumption. Instead, the consumption of masks has exploded, and online life has been strengthened. At first, people believed the situation was temporary, but unfortunately it turned out to be continue much longer. Humanity has been developing vaccines and treatments at unprecedented speed, but we are still struggling with COVID-19.

The Korean government has restricted the operation of specific types of business, such as gyms, public baths, restaurants, bars, etc. and has banned private meetings with more than a certain number of participants to prevent the spread of the epidemic. Telecommuting has increased, and the number of customers to restaurants or bars has decreased significantly, and the number of persons who can visit some facilities such as a gym or a church at the same time and the time they can visit have been also limited.

The number of manufacturers who have failed to supply goods and services in timely manner has increased, and this has affected the next stage of production as raw materials or parts are not supplied. Due to the change of the government's policies, wedding hall contracts or travel contracts have been entered into in a situation where no one can guarantee whether the event could be possibly and properly taken place. Some commercial lease contracts for operating a business have suffered from the situation

where the business fall sharply or is closed by the governmental order. How should we treat this non-performed or impedimental situation?

(2) Where the risk is allocated in the contract

If the contract has allocated the risks from the situation regarding pandemics even in a comprehensive manner, it would be most desirable to revert the risks according to the will of such parties.

Force Majeure provision

For instance, many international contracts have a provision for *force majeure*, although it is not very common in domestic contracts in Korea. If a pandemic or an order of an administrative authority is specified in such a force majeure provision, there is a good chance for the debtor to be discharged from contractual liability. What if it contains only "*force majeure* of a natural disaster, etc." without such specification? It shall be determined whether COVID-19 falls under this provision after reviewing the totality of circumstances. There are four elements for *force majeure*: a) there is an impediment that is beyond the party's control; b) the impediment is unforeseeable; c) the impediment and its consequences could not have been reasonably overcome or avoided; and d) the non-performing party has to show that the non- performance is due to the impediment.[25] It seems that the impediment caused by COVID-19 satisfies the requirements of a) externality and d) causality, but determining whether it is impossible to perform the contractual obligation is not a simple matter. It should be reviewed on a case-by-case basis. The element of foreseeability is also to be considered on a case-by-case basis, and the conclusion will depend on the timing of the contract and the specific reason for non-performance. If the contract is one to which the United Nations Convention on Contracts for the International Sale of Goods ("CISG") is applied,[26] as the CISG has a provision addressing *force majeure*, the above discussion would be also valid to it.[27]

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[25] Refer to Article 79 of the CISG.

[26] The CISG is applicable when the parties to a contract are from different, yet signatory countries or when the private international law rules lead to a contracting country. See CISG Article 1.

[27] Generally speaking, economic hardship alone is not considered a ground for *force majeure*. However, when performance becomes unequivocally burdensome for one of the parties, this has been considered as *force*

Korean contract law approach

The KCC does not provide any exemption clause due to *force majeure* in relation to the liability for breach of contracts. Although the term "*force majeure*" is found in the KCC, but it is used for the case where something happened without negligence. That is the case where a collateral is destroyed or damaged without negligence,[28] or the lessee's liability for damages without negligence when he/she subleases.[29] Courts often acknowledge the concept of *force majeure*, but it is hard to find the case admitting the non-performing party was excused from performance due to *force majeure*. So, it is true that there have been little studies under Korean law on *force majeure* until now.[30]

Therefore, if the governing law of a contract is Korean law, and the parties did not allocate the related risks from COVID-19 in advance, *force majeure* would not be a good starting point to resolve the case. Rather, it is more adequate to follow the general rules of Korean contract law, the impossibility of performance and the doctrine of change of circumstances.[31]

(3) Boundary against impossibility of performance

Draw a line

If the contract can no longer be performed, even when it is due to significant change of circumstances that was not foreseen at the time of the execution of the contract, it is a matter of the impossibility of performance. If there is a cause attributable to the debtor for the impossibility, he/she shall be liable for damages, and if not, the question remains as to who shall bear the risk under Korean

majeure. For the reference, there is precedent CISG case law from CIETAC concerning the SARS outbreak. In the said arbitral award dated 2005, SARS was not considered a *force majeure* event, the non-performing party was not excused from performance under Article 79 of the CISG, because SARS had happened a few months before the contract was signed. Arbitration Award, 5 March 2005 (COETAC), L-Lysine case [2005].

[28] Article 314 and Article 336 of the KCC.

[29] Article 308 of the KCC.

[30] Chinwoo Kim, *supra* note 15, p. 290; Kwon, Youngjoon, "COVID-19 and Contract Law", The Korean Journal of Civil Law No. 94 (2021), p. 229.

[31] Chinwoo Kim, supra note 15, p. 300.

contract law. If performance is still possible, the contractual obligations shall be performed in principle. Even if the cost of implementation has increased considerably, contracts should be kept so far as it is possible. Only in the case where the performance is still possible, but seems unreasonable, we can take into account whether to apply the change of circumstances to the case.

It appears to be simple in theory to distinguish between the case where the performance is impossible and the case where the change of circumstances is to be applied. However, it is not always easy to establish boundaries, as sometimes it is not clear whether or not the performance is still possible. Based on whom should the possibility of performance be determined? It will not be the debtor subjectively. The impossibility is generally understood in Korean contract law that the performance of obligations cannot be expected from the debtor in view of the general notion of society. Hence, not only cases where no one can perform the obligations, but cases where performance is not expected from the perspective of the general notion of society are considered as impossible ones.[32]

Various forms of impossibility

In practice, the impossibility is recognized in various forms. First, the performance is physically impossible when the obligation to return the leased premises cannot be fulfilled because it was burnt down by a fire. Even if it is not physically impossible by the law of nature, sometimes the performance is prohibited by law or legally impossible. For instance, if the exporting country has issued an order of embargo in a trade transaction, the obligations to deliver goods cannot be performed.[33] Suppose that A has entered into a travel contract with a travel agency B for overseas travel before COVID-19. If the country where A had intended to travel was designated as a travel-prohibited country due to the pandemic situation thereafter, the obligations of B under the travel contract would become impossible for legal reasons. Neither A nor B is responsible for this event. In such a case, the risks shall be distributed according to Article 537 of the KCC: Unless otherwise stipulated, B shall be exempted from the obligations under the travel contract, and A shall be exempted from the obligation to pay the fee. No one may claim damages in relation to the non-performance, since it became impossible to perform without negligence of both parties. For reference, the issue of how to compensate for losses incurred by a travel agency due to the government order is beyond the scope of contract law, and some bills to compensate for business losses due to COVID-19 have been under review by the national assembly.

[32] Yang, Chang-soo / Jae-Hyung Kim, Civil Code I, 2020, p. 401.

[33] *Ibid.* p. 403.

In addition, there are cases where the debtor is not expected to perform due to factual obstacles. For example, a debtor who bears the obligation to deliver a specific thing has been stolen or the date has been exceeded in a periodic obligation where the due date is very important for the other party. How about economic hardship of the debtor? If it can be regarded as an impossible event, the doctrine of change of circumstances will not be considered, because the doctrine is applicable only to the cases where the performance is possible. It is certain that we cannot admit the impossibility of performance for the reason that the cost of performance has increased, but if an extraordinary hardship may result in actual economic ruin to the debtor, or requiring the performance in accordance with the original terms and conditions is different from the will of the contract parties, could it be deemed as impossible?[34] It would not be a simple matter because the concept of the impossibility shall not be based solely on the subjective circumstances of the debtor. Also, it is common that contracts are not to be performed immediately after the execution, and the risk of uncertainty that arises over time shall be taken over by the parties to the contract. The circumstance that the expenses incurred in the performance of the contract have increased in the meantime shall be borne by the debtor. Korean contract law does not recognize the impossibility of performance for monetary payment. It is not appropriate to reach a different conclusion depending on whether the debt is a monetary one or not. In this regard, it would be reasonable that economic hardship cannot make the performance impossible.[35]

Let's assume that a wholesaler of medical supplies C entered into a contract for supplying medical masks with a hospital D before COVID-19, but the price of the mask has soared due to a shortage of masks after the outbreak. The obligation of C to supply medical masks cannot be deemed impossible solely on the grounds that prices have risen. If the shortage of masks has made it extremely difficult for C to obtain masks to supply to D, is it impossible to supply them? The totality of circumstances should be considered on a case-by-case basis: Whether it is possible to secure the quantity with a higher price, whether there is another supplier in the market, how difficult it is in practice to find an alternative supplier, what efforts C has made or could have made, and what efforts have been made in the case of other wholesalers, etc. If there is a way to supply at an additional cost and effort, it shall not be easily recognized as impossible. Once it is determined that the supply is impossible, it shall be examined whether there was any cause or negligence attributable to A for the impossibility. If it is determined that the performance is not impossible, then it is necessary to consider whether to apply the doctrine of

[34] As to the opinion that it is impossible to perform the contract in this case, see *Ibid.* pp. 404-405; as to the opposing opinion, see Sangyong Kim, Obligations (general part), 2003, p. 128.

[35] Park Yeong-bok, “Force Majeure and Hardship as Limits of Contract Liability”, HUFS Law Reivew Vol. 35 No. 4 (2011), pp. 91-94.

change of circumstances.

Temporary impossibility

The question of how to deal with the temporary impossibility is another issue. In general, the impossibility to perform as a default means permanent inability. According to studies on temporary disability, the contractual obligations are temporarily suspended until when it becomes possible again. If the parties are not responsible for it, compensation shall not arise. It would be fair that the other party's benefits in return shall be suspended while the obligation is suspended, since both obligations ordinarily should be performed in a concurrent matter. It is not the case where a party is to bear the eventual risk. Provided, however, if the achievement of the objectives of the transaction is questioned due to the prolonged period of incapacity, the impossibility may no longer be said to be temporary, and it becomes a final one.[36]

For example, if a factory owner F entered into a contract for manufacturing and supplying masks with a mask supplier E, and the factory has to be shut down for two weeks due to a confirmed case among workers, it could be said that the supply of masks becomes temporarily impossible. Of course, in order to determine whether it is impossible to perform the obligation even in this case, additional examinations such as whether it is possible to produce in another factory during that period or whether it is necessary or possible to procure the same quality of masks on the market. Suppose it is concluded that it is impossible to perform the obligation for some time. F may begin to perform its obligations as of the time when it becomes possible to re-produce masks after two weeks. E's obligation to pay may be postponed accordingly. As there will be several following contracts in the distribution chain, this may affect other contracts as well. In the event that the supply has been delayed even temporarily, it shall be seen whether there has been any cause attributable to the parties to each contract. Otherwise, the liability for damages shall not be imposed. If the closure of the workplace is prolonged because of additional confirmed cases, for instance, it shall be examined whether the supply becomes permanently impossible. It shall not be concluded easily that the performance is impossible just for the reason that the factory of F has to be closed for a longer time. It may be required for F to find an alternative production or procurement method proactively, because humans are capable of adapting to changing environment.

[36] Chinwoo Kim, *supra* note 15, pp. 302-303.

(4) Application of the doctrine of change of circumstances

Conditions

If there is significant change of circumstances not foreseen by the parties, but the parties have not agreed on the allocation of the risks involved therein, and furthermore, the performance of the contract is not impossible, now it shall be examined whether the doctrine of change of circumstances is applicable.

As seen above, even if the cost of performance becomes excessive, the debtor shall bear such risk in principle. When a business owner entered into a commercial lease agreement for his/her business, even if there is an unexpected business failure, it is basically in the area of the lessee's risk. The rent fee should be paid even if the business is sluggish. What if, however, it is deemed unreasonable to implement such obligation as it is a significant and unexpected change? It would be difficult to conclude that such economic hardship made the performance impossible. Then, it is time to review the doctrine of change of circumstances.

Requirements

In general, the requirements for the doctrine are as follows: a) the circumstances on which the contract was established shall have changed substantially; b) the parties were not able to foresee it at the time of execution of the contract; c) maintaining the contract would cause a material imbalance in the interests of the parties or make it impossible to achieve the objectives for which the contract is concluded.[37]

If it is not a mere increase in the cost, but a remarkable change, it would be deemed as too severe to enforce the contract as it is. When the price of the masks drastically increased after the execution, if the supply contract for an enormous volume of masks should be bound as executed, the supplier will suffer damages and possibly go bankrupt. What about a lessee who is unable to engage in any business because of the government's administrative order? The parties may not have specified, but in the case of a commercial lease, it is presumed that the lessee is using the premises for his/her business. The

[37] Tuck-Soo Song, "Beiträge zu aktuellen Fragen der Lehre von der Geschäftsgrundlage in dem koreanischen BGB", Ewha Law Journal Vol. 23 No. 1 (2018), p. 97.

assumption seems no longer valid.

In continuous contracts, the parties are agreed upon for a long-term contractual relationship at the time of execution of the contract. It would be reasonable for the parties to anticipate and consider potential change of circumstances during the contract period. Even if it is true, no one could expect COVID-19 outbreak before having it, and its impact is still unattainable. Places where large numbers of people gathered before, such as gyms, restaurants, wedding halls, funerals, churches, schools, etc., are all being regulated by the government to varying degrees. Even now as of this writing, a policy on prohibiting private gatherings of five persons or more is still effective. Scholars warn that we will live in a totally different world after COVID-19.

It would be obvious that COVID-19 itself is a remarkable change in circumstances. However, when it comes to applying the exception to the principle of compliance with the contract, it should be reviewed whether it is related to the premise of the contract. Not all contracts have been directly affected by the aftereffects of COVID-19. There are contracts that are not significantly affected or that can be easily substituted by finding alternatives. For example, some restaurants have had a hard time due to decreased customers, while others have received more orders through delivery business. Private teaching institutes could not be opened at first due to the government's order, but when the period of time prolonged, they found alternative ways to open online classes and could reach out to more students without limitation of distance. Hence, it shall be examined in a case-by-case basis whether remarkable change of circumstances has occurred due to COVID-19.

The timing of execution of the contract is also important to determine the unforeseeability. We can tell the difference between the early stage when COVID-19 was not well known and the epidemic was expected to end soon, and the time when the Korean government raised the level of emergency alert for the infectious disease to a critical level on February 23, 2020, or the time when the WHO declared a pandemic on March 11, 2020. Although even now it may not be said that we know and understand COVID-19 well, the foreseeability has been secured in somewhat extent, compared with last year. We have been vaccinated sequentially, and are able to manage the number of confirmed cases and other circumstances. So, if a contract is executed now, it is generally expected to allocate the risks arising from COVID-19 to the extent possible. It would be more difficult to apply the change of circumstances to such contracts, unlike the one executed before COVID-19 or at the early stage of it.

The element that validly maintaining the contract would result in a serious violation of good faith means that it would result in a material imbalance in the interests of the parties or the inability to achieve the objectives of the contract. The first bill suggested by the MOJ states that it would be unreasonable to perform the contract as it is, and the latter one made more specification as it would cause a material

imbalance or the inability to achieve objectives. The latter appears to materialize the requirement, but still it is hard to ascertain to what extent it is a significant imbalance and whether the achievement of the objectives has become impossible, as court cases have not yet been accumulated. Nevertheless, there are several cases that seem obvious. Suppose when a performance producer rented a grand theater for a musical performance, but the performance became completely prohibited due to COVID-19. It is not impossible for the producer to pay the rent fee, but it shall be deemed impossible to achieve the purpose of the contract. In supply contracts of goods, there has been no established precedent as to the extent to which price fluctuations should be deemed significant enough to admit the change of circumstances. It is expected to develop the doctrine practically as actual disputes and cases are accumulated.

General effects

In most cases where the change of circumstances was at issue, the debtor claimed for the termination of contract. The right to terminate contract is the major effect of the doctrine. According to the MOJ amendments, however, in addition to the right of termination, parties may request modification of the contract when performance of the contract becomes excessively onerous because of the change of circumstances. Is the right to request adapting the contract a proper effect of the change of circumstances?

The change of circumstances doctrine is based on the principle of good faith. It is admitted when it is unjust to force performance of the contract. Then is it always fair not to perform the contract as a whole when it comes to significant change of circumstances that no one has anticipated? Is it an only way to reasonably allocate risks associated therewith? There could be a wider spectrum of solutions between termination of the contract and keeping the contents of the contact as originally agreed. In many cases, it would be desirable that the contract be maintained rather than terminated, although requiring the original performance becomes excessively onerous. Then the parties are to enter into negotiations on whether or how to adapt the contract, although it does not necessarily mean that they are responsible for reaching an agreement on modification of the contract.[38]

Let's consider the case where an investment was made based on the trust in a continual contractual relationship. Terminating the contract, even when there has been significant change of circumstances, may be severe to the parties or at least to one of them who made an investment, and it may be also economically detrimental to the public. In such cases, if it is difficult for the parties to agree on an

[38] Chinwoo Kim, supra note 15, p. 308.

amendment, it would be necessary to further consider whether to allow the judge to amend the contract. This may lead to a debate over judicial activism. There are various opinions on this, but in this article, I just raise the issue rather moving forward to discuss it.[39]

Of course, it is not always advisable to impose the performance of the contract on the parties. The most important thing in a contract is the will of the parties, and it may be disastrous to maintain the contract if the party has lost trust in the other party or no longer wants to perform the contract, especially in the case of a continuous contract. Therefore, it would be unreasonable to say that negotiations for adapting the contract should take precedence and termination can be claimed only after the failure. If a party requests to terminate the contract on the grounds of change of circumstances, terminating the contract is to be taken into account, without consideration of modification or adaptation.[40]

V. Conclusion

In Korean contract law, the doctrine of change of circumstances was once denied, and then it was thought that everyone knew it but it was not real. However, since the Supreme Court finally recognized its normative power last year, it is expected that more cases related to the change of circumstances will come in the future.

It is explicitly acknowledged by Korean courts that the change of circumstances is an exception to *Pacta Sunt Servanda*, but more precisely, the doctrine is to be applied in a different context from the territory governed by *Pacta Sunt Servanda*. In situations where the contract can cover, the contract must be fulfilled even if there has been some change, because that was the parties' intention. However, it could be a different story if the situation occurred was not covered and completely unexpected in the contract. We cannot predicate that the parties' intention was to force the contract to be complied with in its original form even if it seemed excessively onerous. In these exceptional circumstances, the change of circumstances doctrine will be considered.

The change of circumstances may also suggest more flexible and reasonable solutions, other than the both ends of termination of the contract as a whole or maintenance of the original contract as it is. In our society where things are changing rapidly and unpredictably, the doctrine may play a role in

[39] Jae-Hyung Kim, *supra* note 14, p. 54.

[40] Tuck-Soo Song, *supra* note 37, pp. 111-112

solving problems and coordinating interests. Since the concept of *force majeure* is not very familiar or well-researched in Korean contract law, the change of circumstances would be more efficient and adequate point for the discussion.

Since it is based on the general provision, it is necessary to further specify the requirements and effects to which the doctrine is applied, and to examine each individual case at issue. In order to respond in a timely manner to the rapidly changing environment in the future society, on the one hand, while it should be flexible to cover various changes as a general doctrine, on the other hand, it needs to further refine the doctrine so that it can be effective in solving problems in practice.

At the same time, if there is any repetitive circumstance or widespread phenomenon where the doctrine should be reviewed, it would be considerable to enact a special act to cover similar cases. It would be also desirable in terms of legal stability or reliability. In Korea, for example, a bill of an amendment to the Commercial Lease Protection Act is under discussion to specify that a lessee of a commercial lease who has closed down as a result of COVID-19 is entitled to terminate the lease contract without compensation. Including this, various disputes and issues related to COVID-19 are to be of great significance in the study of the doctrine of change of circumstances.