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Understanding Contract Law in Korea*

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I. Introduction

In most jurisdictions where a continental legal tradition prevails, a civil code is the central norm at the core of private law. As the word "civil" suggests, a civil code is closely related to the daily lives of citizens and the private legal matters arising therefrom. Therefore, a civil code shapes the very foundation of a society. Korea is no exception to this. The Korean Civil Code (hereinafter "CivC") was first enacted in 1960. Before then, Japanese Civil Code was in effect while Korea was under Japanese colonial rule (1910-1945). In 1945, with the end of the Second World War and Japan defeated, its colonial rule ended. The victorious Allies took over Japan's former colonies, and Korea was soon divided at the 38th parallel of latitude between the Soviet Union in the north and the United States in the south.

The new government of the Republic of Korea (South Korea) was established on August 15, 1948 in the southern part of the Korean peninsula. The creation of a new state generated momentum to rebuild Korea's legal system. To facilitate this process, a Committee of Law Compilation was organized under the newly established government. The committee took responsibility for drafting the CivC, a process that demanded considerable time and effort. The outbreak of the Korean War (1950-1953) made this daunting task even more difficult. Despite all the challenges, a draft of the CivC was prepared, deliberated, and finally enacted into law; the CivC was promulgated on February 22, 1958, and

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came into effect on January 1, 1960. In the course of the drafting process, laws of various civil law jurisdictions like Germany, Switzerland, and France were examined.

The CivC is undoubtedly the product of the continental legal tradition. Patterned after Germany's *Pandekten* system, the CivC is a comprehensive and fundamental body of norms covering the entire area of private law. It consists of five separate books: general provisions (Book 1), the law of rights in *rem* (Book 2), the law of obligations (Book 3), family law (Book 4), and the law of inheritance (Book 5). Reflecting the influence of the *Pandekten* system, the CivC places the general principles of civil law at the forefront of the code (Book 1) and provides rules on specific areas of law (Books 2 through 5) under those principles. Each book tends to follow the same pattern of providing general principles at the beginning before moving on to detailed contents. Accordingly, the CivC is a highly systematic yet also deeply abstract code. Although this approach might make the CivC a logical and systemic body of norms, it can also render it less accessible and readable for the ordinary citizen.

I have been given the task of providing an overview of contract law in Korea, but what I call contract law in this article is not an official title in law. Rather it is an aggregate body of substantive law that combines contract-related provisions scattered throughout the CivC and certain similar provisions in other special statutes. Most of the CivC provisions appear in Book 3, which deals with the law of obligations and has a separate chapter called "Contract." Meanwhile, other parts of the CivC contain provisions that, despite the lack of explicit reference, are applicable to contracts. For example, provisions on a juridical act in general in Book 1 are in practice mostly about contracts, since a contract is the central figure of a juridical act.

Given the diversity of legal doctrines in the vast area of contract law, it would not be feasible to cover every point in this article. Rather, I address several fundamental issues that are most important in contract law: namely, contract formation and its validity, contract interpretation, breach of contract and remedies, and discharge of a contract. Unjust enrichment is also addressed as a related topic. Although unjust enrichment *per se* is not necessarily considered part of contract law, it often becomes intertwined with contract law when a contract is invalid or discharged.

II. Contract Formation and Its Validity

Under Korean contract law, a contract is formed when parties voluntarily make an agreement to be legally bound by it.

A. Agreement

First, a contract is formed only when there is an "agreement" among the parties. The CivC postulates that a contract is formed by accord between an offer and an acceptance. An offer is a declaration of intention to make a contract in a concrete and definite manner, while an acceptance is a declaration of intention to accept that offer. To a certain extent, the CivC employs the mirror image rule regarding acceptance; a reply to an offer in the form of an acceptance but containing additions, limitations, or other modifications of the initial offer is deemed a rejection of the offer and constitutes a counter-offer (Article 534).[1] An offer becomes effective when it reaches the offeree and cannot be withdrawn unless the withdrawal reaches the offeree before or at the same time as the offer (Article 527). This means that an offer can be binding on an offeror once it reaches the offeree.

A more fundamental and comprehensive justification for the formation of a contract lies in the existence of an agreement in which a meeting of the minds occurs. In practice, it is much more important to determine whether there is an agreement rather than to micro-analyze whether there was an offer and an acceptance, since the essence of a contract is an agreement in which an accord of intents occurs. Consequently, it is quite natural to say that contract interpretation requires an exploration of the intent of the parties, as I explain below in the discussion of contract interpretation.

B. Voluntary Agreement

Second, a valid contract requires a "voluntary" agreement among the parties. Freedom of contract is a fundamental principle in contract law, and

1) The number of the article indicates the article in the CivC, unless otherwise indicated.

Korean law recognizes freedom of contract as a constitutional and fundamental right. Forcing a party to reach a certain agreement against his or her will infringes this fundamental freedom. Reaching a voluntary agreement does not necessarily mean that all parties must clearly understand every detail of the agreement before the contract is concluded. As is often the case with standard-form contracts, some parties, such as consumers, do not understand or even perceive everything that is stated in lengthy and complicated contracts. An agreement is still deemed to exist when a party agrees to accept all the terms and conditions as they are contained in the contract presented by the other party, regardless of his or her actual knowledge and comprehension of such terms and conditions. This practice may pose a threat to the fairness of a contract. The potential unfairness of a standard-form contract is specifically noted and separately addressed in the Korean legal system. Korea has a special statute to regulate standard-form contracts—the Act on the Regulation of a Standard-Form Contract—which imposes additional duties on business entities to provide information at the time of contract execution and provides additional regulations on the fairness of the contract's terms.

There are some exceptions to the overall principle of voluntariness. These exceptions are often recognized to serve compelling public interests. In the CivC, for example, there is an exception for the purchase of a structure or trees on land subject to superficies. Article 283 of the CivC entitles a person with the right to superficies on a land to request a settlor of the superficies for purchase of the structures (mostly buildings) or trees thereon when the settlor refuses to extend the period of superficies. Upon this request, a contract for the purchase of the structure or trees is formed by the force of law, regardless of the settlor's intent. This provision aims to protect any structures or trees on the land from being destroyed or removed, which might result in the reduction of social utility. Similar provisions exist in the CivC, such as Articles 285, 316, 643-647.

C. Agreement to be Legally Bound

Thirdly, a contract purports to be a "legally binding" agreement. Therefore, it is important to distinguish a non-binding agreement from a binding one. A contract is enforceable only when the agreement

incorporates the mutual intention of all parties to be legally bound by it. A mere social agreement, such as an agreement to treat somebody in return for his or her hospitality or an agreement to help somebody with homework, cannot constitute a contract, since the parties concerned generally do not intend any legal consequences from that agreement. The intention of the parties to be legally bound to the agreement may be inferred from several factors, including the nature of the agreement, the wording of the contract, and the parties' statements or conducts in the course of making the contract. In practice, there is not always a bright line between a legal and a non-legal agreement. There is no single standard for testing whether the parties intended to create a legal relationship.

Whether a best efforts clause is legally binding often becomes an issue in this regard. It is a clause in which parties express the intent to exert their best or reasonable efforts regarding certain matters. Whether this can become a legal ground for enforcement is an issue of controversy. While there have been a series of Supreme Court decisions denying the legally binding effect of best efforts clauses,[2] whether a specific best efforts clause is legally binding must be determined on a case-by-case basis by identifying the intent of the parties to the contract regarding the clause.[3] In general, the more clearly and specifically the act subject to best efforts is defined, and the more reasonable the trust placed by the other party regarding the realization of said act, the more likely a best efforts clause will be found to be legally binding.

D. No Consideration and Formality Required

There is no requirement for consideration in Korea. This differs from common law jurisdictions where consideration, which is generally defined as something bargained for and received by a promisee from a promisor is required for enforcement of a contract. In line with this, a gratuitous contract, in which one party gives something to another party but receives

2) Daebeobwon [S. Ct.], Mar. 25, 1994, 93Da32668 (S. Kor.); Daebeobwon [S. Ct.], Oct. 25, 1996, 96Da16049 (S. Kor.).

3) For example, Daebeobwon [S. Ct.] Jan. 14, 2021, 2018Da223054 (S. Kor.), acknowledged the legally binding effect of a best efforts clause.

nothing in return, is still an enforceable contract under Korean law. What ultimately matters is whether the contracting parties agreed to be legally bound by a voluntary agreement, as described above.

Further, as a general rule, no formality is required to create or enforce a contract under Korean law. Therefore, a contract can be made either orally or in writing. Signatures of the contracting parties are also not required for the formation or enforcement of a contract, although it is customary for the parties to stamp a seal or sign their names at the end of a contract when it is concluded in writing.

This no-formality rule is theoretically connected with the notion of freedom of contract. According to the Constitutional Court of Korea, freedom of contract includes freedom of formality.[4] Thus, contracting parties can freely choose the form of the contract, and along the same line of thinking, choose a contract that has no form at all. Consequently, the statute of frauds as recognized in common law does not exist in Korea. No matter how large the total amount of a sales contract is, it does not need to be made in writing or signed to be enforced.

However, there are some statutory exceptions to the no-formality rule. For example, Article 11 of the Act on Contracts to Which the State is a Party stipulates that any contract governed by that act is to be in writing. Similar provisions are found in other statutes, including Article 6 of the Installment Transactions Act and Article 8 of the Arbitration Act. The legal effect of non-compliance with these regulations varies. Under the aforementioned acts, non-compliance renders the contract invalid, but non-compliance with other consumer-related laws is generally construed as not affecting the validity of the contract.

E. Validity

It is one thing to say that a contract has been formed and quite another to say that it is valid. This means that simply forming a contract does not automatically lead to its validity. Further, when there is an inherent factor that may invalidate a contract, that contract may be valid at the time of its

4) Hunbeobjaepanso [Const. Ct.], June 3, 1991, 89Hunma204 (S. Kor.).

formation but may be invalidated by *ex post* factors, such as avoidance of a contract by one of the parties.

Factors that render a contract either void or voidable fall into one of two categories: (i) the contract does not comply with the form or content specifically designated by law, or (ii) the expressions of intent that constitute the contract are defective. Generally, a contract does not require any particular form to gain validity. There are no provisions or statutes comparable to the statute of frauds found in common law. However, there are some exceptions. We have seen above the requirement that a contract to which a government is a party be in wiring (Act on Contracts to which the State is a Party Article 11). In terms of content, a contract is void when its content is in breach of good morals and social order (Article 103) or mandatory law. A contract is also void when one party takes advantage of a weaker party and makes an excessively unfair contract (Article 104). Finally, a contract is also void or voidable when there is a defective expression of intent. A false declaration (Article 107) and a sham transaction (Article 108) are typical grounds for the nullity of a contract. A mistake (Article 109), fraud and duress (Article 110), or lack of the capacity to perform a juridical act (Articles 5, 10, 13) are all grounds for avoidance of the contract. Another party's breach of a contract does not in itself invalidate the contract. In addition, if a party wishes to assert that another factor that invalidates a contract, that party has the onus of proving that claim.

Although a contract is generally rendered null in its entirety, Article 137 of the CivC allows partial nullity if the contract would have been made without the invalid part. The same principle is applied to partial voidance. This is often used by the courts in modifying contracts to ensure fairer outcomes. In cases where excessive attorney fees were at issue, the Supreme Court used this device to render the excessive portion of the fee uncollectable while leaving an appropriate portion valid, based on the assumption that the attorney and client might have made a contract at that fee level.[5] The Supreme Court stretched the doctrine to some extent in order to judicially modify the contents of a contract for the purposes of

5) Daebeobwon [S. Ct.], Dec. 13, 1991, 91Da8722, 91Da8739 (counterclaim) (S. Kor.); Daebeobwon [S. Ct.], Mar. 31, 1992, 91Da29804 (S. Kor.).

reaching an equitable conclusion.

III. Contract Interpretation

There is no specific provision in the CivC that stipulates how one should read and interpret a contract. However, the Supreme Court of Korea has, in a number of different cases, enunciated various principles of contract interpretation. These principles, as developed through case law, can be categorized as follows: (i) natural interpretation, (ii) normative interpretation, and (iii) supplemental interpretation. Since these are general canons of contract interpretation applicable to both written and oral contracts, I first explain these general rules and then proceed to explain how text functions in a written contract.

A. Seeking the Intent of the Contracting Parties

1. Natural Interpretation

Natural interpretation is the interpretation of a contract based on the actual intent of the parties. Such interpretation is particularly useful when the parties have agreed to a contract, but the plain language of the contract is different from what the parties had intended. For example, party A and party B enter into a contract with the intent to conclude an agreement for the sale of property 1. By mistake, the contract lists property 2 as the subject of the agreement. Based on the principle of natural interpretation, this contract should be interpreted as having been entered into with respect to property 1 rather than property 2, thus reflecting the true intent of the parties. The Supreme Court of Korea has held in a similar case that for "contract interpretation one should, in general, not limit oneself to the text of the contract but should search for the true intent of both parties."[6)]

6) Daebeobwon [S. Ct.], Oct. 26, 1993, 93Da2629 & 2636 (consol.) (S. Kor.).

2. Normative Interpretation

Normative interpretation is the interpretation of a contract based on the objective meaning of the contract, as read from the point of view of a reasonable counterparty. If the parties' actual intents are in accord, it is sufficient to interpret the contract based on that mutual intent (i.e., natural interpretation). However, most disputes over contract interpretation arise when one party expresses an intent that is understood differently by another party. The question in such cases is which party's understanding should form the basis for interpreting the contract. Under the principle of normative interpretation, the contract is interpreted based not on the intent of the party having expressed it, but as it would have been understood by a reasonable counterparty. In this regard, the Supreme Court held that "the interpretation of a juristic act consists of clearly defining the objective meaning given by the party to the juristic act, without being limited to the plain language employed, but rather with a reasonable interpretation of the objective meaning the party attributed to the juristic act based on the plain language, irrespective of the actual intent of the party."[7)]

3. Supplemental Interpretation

When a court is confronted with a situation that has not been contemplated by the contract, the court supplements the contract with the presumed intent that the parties would have had at the time of the contract. This interpretive exercise can be said to constitute an exception to the freedom of contract, as the court supplements the parties' contract by relying on what the parties would have agreed upon, rather than what they actually agreed to. Therefore, supplementary interpretation is applied to augment a contract where there is a lacuna in the contract that cannot be addressed by either natural or normative interpretation. In this regard, the Supreme Court has held as below:

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7) Daebeobwon [S. Ct.], May 14, 2009, 2008Da90095, 90101 (S. Kor.).

> If both parties to a contract made the same error in respect of matters which form the premise or bases of the contract and omitted to address such matters, the contract may be interpreted by supplementing it on matters which the parties would have agreed upon had it not been for such mistake.[8)]

The court further noted that the basis for such supplementation is "not the actual or subjective intent of the parties but an equitable intent which is objectively determined taking into consideration the purpose of the contract, trade practices, applicable laws, principles of good faith, etc.[9)]

4. Commonality in Interpretation Methods: Seeking the Intent of the Parties

Since the principle of party autonomy and freedom of contract constitute the core ideas of contractual law, it is natural to seek to interpret a contract in accordance with the intent of the parties. The foregoing principles of natural, normative, and supplemental interpretation provide different mechanisms for determining such intent. In other words, the ultimate goal of interpretation is to define "the intent of the parties to the given contract," in pursuit of which natural interpretation relies on the parties' "actual intent." Normative interpretation relies on the parties' "reasonable intent," and supplemental interpretation relies on the parties' "presumed intent."

B. Means of Ascertaining Intent: A Written Contract

In order to determine the parties' intent, a court needs to refer to certain means of ascertaining that intent. While it is possible to describe these means in a number of ways, they can succinctly expressed as comprising the text of the contract on the one hand and the context of the contract on the other. In other words, the interpreter uses the words of the contract and the circumstances surrounding the contract to determine the parties' intent. Of course, if the contract is an oral agreement, there will be no text to

8) Daebeobwon [S. Ct.], Nov. 23, 2006, 2005Da13288 (S. Kor.).

9) Daebeobwon [S. Ct.], Nov. 23, 2006, 2005Da13288 (S. Kor.).

interpret. In practice, however, most contracts are in writing (including the agreement at issue), and thus the interpreter may rely both upon the text and context of a contract in the course of interpretation.

1. Text

The wording of the contract is the primary source of contract interpretation. Text is an important medium that the parties use to express their true intent. Therefore, interpretation based on the wording of the contract is not contrary to the principle of natural interpretation, which requires interpretation to be in accordance with the true intent of the parties. Further, text is an objective means for the communication of the parties' mutual intent. Therefore, interpretation of a contract based on its wording is also in accord with the principle of normative interpretation, which requires objective interpretation from the point of view of a reasonable party. In practice, the Korean courts give due importance to the actual wording of the contract in interpreting its meaning. Accordingly, when presented with a contract and any other relevant documents, the starting point of the court's inquiry is the text of the contract. In this regard, the Supreme Court held that for written instruments such as contracts, "the court shall acknowledge the existence and substance of the intent expressed in the text as it is stated in the contractual document unless there is any counter evidence to deny such stated intent."[10] This ruling indicates that the text of a contract has strong evidentiary value.

2. Context

Context is another factor considered in interpreting contracts; if the text always allowed for only one possible interpretation, disputes over contract interpretation would be far less common. However, the wording of a contract is often abstract and ambiguous; reliance on the text is limited to situations where it is specific and clear regarding the intent of the parties, and parties often attribute different meanings to the words in a contract. In

10) Daebeobwon [S. Ct.], Feb. 10, 1995, 94Da16601 (S. Kor.).

such cases, contracts should be interpreted considering the context as well as the text. The context incorporates various elements including the purpose of the contract, negotiation history, and trade usages.[11] The context functions as an additional means of interpreting the intent of the contracting parties.

3. No Parol Evidence Rule

Korean law does not recognize the parol evidence rule that is found in countries with Anglo-American legal systems; it states that written contracts should be interpreted based solely on the wording of the contract, without reference to any extrinsic evidence that might suggest an alternative meaning. In Korea, it is therefore open to courts to rely, along with the plain language of the contract, on extrinsic evidence that establishes the context of the contract as they endeavor to interpret contracts. Accordingly, there are cases where the court reaches interpretations that contradict the plain written language of contracts on the grounds of extrinsic evidence. Along these lines, the holding of the Supreme Court ruling to this effect is helpful in understanding Korean law:

> If the text expressed by the parties does not clearly show the objective meaning, the contract should be reasonably interpreted considering, in general, the form and substance of the plain language, the motive and progress of the juristic acts, the purpose and true intent of the parties behind the juristic acts, commercial practices, etc., and then in accordance with logic, equity, common sense and trade practices of the society.[12]

However, the holding of the Supreme Court ruling to the effect that "the court shall acknowledge the existence and substance of the intent expressed in the text as it is stated in the contractual document unless there is any counter evidence to deny such stated intent"[13] needs to be understood in

11) Daebeobwon [S. Ct.], Nov. 26, 1999, 99Da43486 (S. Kor.).

12) Daebeobwon [S. Ct.], Nov. 26, 1999, 99Da43486 (S. Kor.).

13) Daebeobwon [S. Ct.], Feb. 10, 1995, 94Da16601 (S. Kor.).

weighing the evidentiary value of the written text of the contract. This means that a written contract enjoys the presumption that it was made with the substance as written. For example, if the written contract stipulates that a certain piece of property is to be transferred to somebody at a specific price, the existence of that contract as written is presumed. Another party who wishes to overturn this presumption must present evidence that the intent of the parties as to the contract was otherwise.

IV. Breach of Contract and Remedies

A. Breach: Non-Performance of Contractual Obligations

When a valid contract is made and its substance is confirmed, the parties have contractual duties to perform their obligations thereunder. The performance of an obligation may also be effected by a third party unless the nature of an obligation does not so permit or the parties have declared a contrary intention (Article 469(2)). The time and place of such performance are to be determined by the parties. If not, the CivC provides supplementary default rules. The time for performance, if not agreed upon in the contract, is when the obligee demands the performance of the obligation (Article 387(2)). Regarding the place for performance in the absence of any agreement, delivery of specific goods shall be made at the place where the goods were situated at the time of the contract; any other performance shall be made at the obligor's present domicile (Article 467). A tender of performance relieves the obligor of liability for non-performance (Article 461).

When performance is not effected as agreed in a contract or provided by law, the issue of non-performance arises. Non-performance refers to the failure to carry out some activity in accordance with an obligation. When non-performance occurs, an aggrieved party is entitled to demand specific performance in accordance with the contract, unless enforcing such performance is impossible or inappropriate by its nature. Specific performance in the case of non-performance does not require intention or fault in non-performance by the breaching party. In fact, it may be understood as enforcing the agreement to which the breaching party has

already consented. Unlike some jurisdictions in which specific performance is regarded as a secondary and equitable remedy in relation to damages, demanding or ordering specific performance does not require inadequacy of damages as a remedy. An aggrieved party is entitled to choose between specific performance and damages and may them both as long as doing so does not amount to double remedy.

B. Damages in General

The most commonly used remedy for non-performance is to claim damages. In this case, either intention or fault in non-performance is required. This requirement of attributability is clearly different from the case of specific performance where such attributability is not required as its prerequisite for the claim. Article 390 of the CivC provides that if "an obligor fails to effect performance in accordance with the tenor and purport of the obligation, the obligee may claim damages: Provided, that this shall not apply to where such non-performance is not due to the obligor's intention or negligence." Under this article, an aggrieved party is entitled to claim damages for a breach of contract if all the following requirements are fulfilled.

First, non-performance of obligation is required. In the context of a contract, a Korean court will accept that there has been non-performance of a contractual obligation if a breach of contract has been established. Non-performance takes diverse forms. Delayed performance, impossibility of performance, and defective performance are typical examples of non-performance, but the generality of the non-performance clause means that non-performance is not restricted to these types. For instance, an anticipatory breach is another type of non-performance. The aggrieved party bears the burden of proof of the existence of non-performance by the breaching party.

Second, intention or negligence is required. A breaching party must have intend non-performance of an obligation or be negligent in that regard. Under Korean law, intention is the state of being aware of and desiring (or at least accepting) the relevant result of the non-performance, while negligence is the state of failing to recognize and avoid the relevant result by failing to exercise an appropriate duty of care. Although either

intention or negligence is a prerequisite to claim damages, the court will presume that this requirement is satisfied in presented proof of the non-performance of a contractual obligation. Therefore, it is the breaching party (rather than an injured party) that bears the burden of proving that the non-performance was not intentional or negligent.[14)]

Third, unlawfulness is required. The non-performance of an obligation is presumed to be unlawful unless there are special circumstances that negate unlawfulness. For example, Article 536(1) of the CivC provides for a right to simultaneous performance that allows a party to a contract to refuse to perform its obligation until the other party tenders performance of its obligation. In cases where a contract party duly exercises its right to simultaneous performance, the *prima facie* non-performance of obligation would not be assessed as unlawful and therefore would not give rise to a right to claim damages. In any case, it is the breaching party that bears the burden of proof regarding the existence of circumstances that negate unlawfulness.

Fourth, damage to an aggrieved party in the form of loss is required. Under Korean law, damage is defined as any involuntary loss or disadvantage suffered by an injured party due to an infringement of legally protected interests.[15)] An aggrieved party bears the burden of proving the existence of damage,[16)] which must be actual and concrete. Mere harm that *may* materialize into actual loss in the future is not deemed damage until such materialization occurs. This frequently becomes an issue when an aggrieved party alleges that it has suffered damage by bearing an obligation to a third party. For instance, if A (the breaching party) supplied a defective good to B (the aggrieved party), and B alleges that it bears compensatory obligation to its purchaser C (the third party), who allegedly suffered loss arising from the defective good, such obligation is deemed B's loss vis-à-vis A only when such obligation is evaluated as an actual and

14) Daebeobwon [S. Ct.], Mar. 26, 1985, 84Daka1864 (S. Kor.); Yong-Dam Kim et al. eds, Juseogminbeop: Chaegwonchongchik 1 [Commentaries on Civil Law: General Provisions (1)] 758 (4th ed. 2013) (In Korean).

15) Chang Soo Yang & Jae-Hyung Kim, Minbeob I: Gyeyakbeop [Civil law I: Contract Law] 444-445 (2nd ed. 2015) (In Korean).

16) Yong-Dam Kim et al. eds., Juseogminbeop: Chaegwonchongchik 1 [Commentaries on Civil Law: General Provisions (1)] 757 (4th ed. 2013) (In Korean).

definite loss to B.[17]

Fifth, causation is required. There must be a causal relationship between the non-performance of an obligation and the damage to an aggrieved party. That is, the loss must be attributable to the act or omission of the party from which recovery is sought. The aggrieved party bears the burden of proving causation. The Supreme Court of Korea has held that the test for causation when determining the scope of liability or the extent of damage caused by a breach of contract is based on the legal doctrine of *adequate causation*.[18] The purpose of this test is to normatively restrict natural causality that can be extended without limit. Adequate causation can be established when non-performance is considered a normatively sufficient cause of the damages, even when the breach itself is not the sole cause of the loss. The presence of other contributing causes may be reflected in the final assessment of the amount of damages but does not *per se* negate causation for purposes of establishing the elements of a claim. While the concept of adequacy is not clearly defined under the CivC itself, Korean courts normatively evaluate the existence of causation by considering all relevant factors, such as the gravity and culpability of the cause, the proximity or directness between the cause and the outcome, and the degree of the damage.

C. Scope of Damages

Under the CivC, the general provision setting forth the scope of compensation for damages caused by contractual breach is Article 393(1), which provides that "the scope of compensatory damages for non-performance of an obligation shall not exceed that of ordinary damage"; Article 393(2) provides that "any damage arising under special circumstances shall be compensated only if the obligor had foreseen or could have foreseen such circumstances." The legal principle set forth in Article 393 can be summarized as (i) any ordinary damages are subject to compensation at any time, whereas (ii) any special damages are subject to compensation only when the obligor could have foreseen the damages.

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17) Daebeobwon [S. Ct.], Nov. 27, 1992, 92Da29948 (S. Kor.).

18) Daebeobwon [S. Ct.], Jan. 27, 2012, 2010Da81315 (S. Kor.).

Special damages are distinguished from ordinary damages since not all special damages are subject to compensation; whether special damages in a given case are subject to compensation is determined by the foreseeability of the particular circumstances giving rise to the damages.

Ordinary damages are those which, in ordinary trade usage, are deemed to have occurred if a certain obligation is not performed.[19] The Supreme Court defines ordinary damages as those which, in light of ordinary trade usage and empirical rules of the general public, are deemed to have occurred if an obligation of the type at issue is not performed, unless there exist extraordinary circumstances.[20] Meanwhile, special damages are any and all damages other than ordinary damages; when defined actively, special damages are those that occurred due to an individual, specific, or extraordinary circumstance of a contracting party.[21] In other words, any damages generally and objectively foreseeable by the relevant parties to occur upon non-performance of certain obligation are ordinary damages and thus subject to compensation, while any damages not foreseeable to that extent are subject to compensation only when the obligor had foreseen or could have foreseen the circumstances to which the damages are attributable.[22] Thus, the scope of compensation for damages under the CivC is determined based on the standard of foreseeability.

In general, loss of profits expected to be generated directly from the relevant contract falls under ordinary damages, but loss of profits expected to occur from specific circumstances outside the relevant contract falls under special damages. However, what constitutes ordinary or special damages is to be determined on a case-by-case basis, depending on the details and characteristics of a specific case. For instance, the agreed price or (if no agreed price exists) the market value of an object under a sale agreement is a type of ordinary profit that falls under performance profits. In this regard, if it is impossible to deliver the object that is the subject of the sale agreement due to a contractual breach by the purchaser, the seller may

19) Yoon-Jik Kwak et al. eds., Minbeopjuhae: Chaegwon 2 [Civil Code Commentary: General Provisions of Claims (2)] 477 (1st ed. 1995) (In Korean).

20) Daebeobwon [S. Ct.], Dec. 24, 2008, 2006Da25745 (S. Kor.).

21) Daebeobwon [S. Ct.], Dec. 24, 2008, 2006Da25745 (S. Kor.).

22) *supra* note 21, at 534.

seek compensation against the purchaser for ordinary damages equivalent to the agreed price or the market value. That is because it is already expected under the contract that the seller would receive the agreed price or market value by delivering the object of the sale agreement to the purchaser. Meanwhile, the loss of performance profits that may be generated from a resale of the object of sale may be categorized as either ordinary or special damages, depending on the foreseeability of the loss. According to the Commentaries on Civil Code, such damages are special (extraordinary) damages in a sale of real properties between individuals but ordinary damages in a sale of movables between merchants.[23] This means that even the same type of damages—here, the loss of opportunity for resale—may be evaluated differently, based on the facts of a specific case.

D. Performance Interests and Reliance Interests

Another perspective on the assessment of damages arising from breach of contract concerns the notion of performance interests and reliance interests. Briefly speaking, the principal approach to the assessment of damages in this regard is that performance interests become the criteria for assessing damages. This arises from the principle of difference,[24] according to which damages are the difference between (1) the profits that might have been earned if the cause of damage did not exist, and (2) actual profits. In this view, damages caused by non-performance of any obligation should be compensated by restoring the obligee to his or her original state in which he or she would have been if the obligation had been carried out as agreed. Therefore, the breaching obligor is to compensate the non-breaching party for such economic profits as would have occurred if the contract had been adhered to in full.[25] This is called the principle of compensation of performance interests.

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23) Yoon-Jik Kwak et al. eds, Minbeobjuhae: Chaegwon2 [Civil Code Commentary: General Provisions of Claims Part 2] 538 (1st ed. 1995) (In Korean).

24) Yoon-Jik Kwak et al. eds, Minbeobjuhae: Chaegwon2 [Civil Code Commentary: General Provisions of Claims Part 2] 468 (1st ed. 1995) (In Korean).

25) Daebeobwon [S. Ct.], Dec. 24, 2009, 2006Da25745 (S. Kor.).

Performance interests may include future profits. In this line of this thinking, the Supreme Court allows compensation for damages for lost profits to be obtained upon completion of performance of a contract to be executed in the future and the completion of the performance of an already executed contract, as long as certain requirements are met. For instance, according to a Supreme Court decision,[26] if a party under a continuous trade relationship fails to perform its obligation to execute an individual contract without any justifiable grounds, the scope of damages can be as much as all the profits that would have been generated if the transaction contract had continued; these are performance interests.

The Supreme Court also allows compensation of profits lost based on reliance interests in lieu of performance interests.[27] Damages regarding reliance interests are those caused by trust that the relevant contract would be fulfilled properly. For instance, costs of entering into a contract, costs to prepare for the performance of a contract, or losses arising from refusal of a more favorable sales offer by a third party while trusting that another party to an existing contract would fulfill the contract all constitute damages based on reliance interests.[28] The reason why reliance interests can be compensated in lieu of performance interests is that it is not always easy to prove the existence of performance interests. Therefore, reliance interests are compensated to supplement the principle of compensation for performance interests. This avenue does not necessarily mean forsaking the principle of compensation for performance interests.

E. Liquidated Damages

Liquidated damages are an agreement to determine in advance the amount of damages to be paid to the obligee by the obligor when grounds for compensation, such as breach of contract, occur in the course of the

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26) Daebeobwon [S. Ct.], Jun. 25, 1999, 99Da7183 (S. Kor.).

27) Daebeobwon [S. Ct.], Apr. 28, 1992, 91Da29972 (S. Kor.) (This decision mentions performance profits and trust-based profits together); Daebeobwon [S. Ct.] Jun. 11, 2002, 2002Da2539 (S. Kor.).

28) Yoon-Jik Kwak et al. eds, Minbeobjuhae: Chaegwon2 [Civil Code Commentary: General Provisions of Claims Part 2] 474 (1st ed. 1995) (In Korean).

contract. Liquidated damages are themselves a type of contract. However, cases in which liquidated damages are entered into as an independent contract are rare; more often, text on liquidated damages will be included in the main transaction contract.

Liquidated damages mainly perform two functions. First, they simplify the claim for damages. If liquidated damages exist, the person bringing the claim for damages can claim the predetermined liquidated damages amount without proving the facts and amounts of actual damage. Liquidated damages simplify the legal process by regulating the issue of compensation in advance. Through this, the parties gain legal stability and predictability concerning compensation. Second, liquidated damages serve to warn the parties. If liquidated damages exist, parties can expect that if they breach the contract, they will have to compensate any damages based on the predetermined amount of liquidated damages. With such a clause, a contracting party will be reminded of the disadvantages of breaching the contract and be more cautious about causing grounds for breach.

The CivC expressly provides one ground for liquidated damages in Article 398(1), which states that the "parties may determine in advance the amount of damages payable in the event of breach of contract." Of course, under the principle of freedom of contract, the parties are free to enter into a contract on any matter not prohibited by law. Therefore, even without such a provision, the parties are free to enter into a liquidated damages contract. In this sense, Article 398(1) of the CivC is there for the purpose of confirmation. CivC Article 398(2) and CivC Article 398(4) have important practical implications. The former states that when the amount of liquidated damages is unduly excessive, the court may reduce the amount to an appropriate sum, while the latter states that an agreement on the sum payable in case of breach of contract (*wee-yak-keum*) is presumed to be liquidated damages.

V. Discharge of a Contract

A. Discharge of a Contract in General

Just as a contract is formed, interpreted, and carried out, it can also be

brought to an end for a variety of reasons. A contract may be null and void at the time of its formation. In that case, a contract never has any legal effect. A contract may also be voided after being validly executed. For example, a contract may be voided or cancelled when it turns out that it was executed by fraud or under duress. However, a contract may also be brought to an end by *ex post* factors, which take different forms.

One example is a voluntary agreement between the contracting parties to terminate their contractual relationship. Based on freedom of contract, parties can freely terminate a contract by agreement, just as they agreed to establish a contractual relationship. These agreements take different forms. Parties may bilaterally and directly agree on termination of a contract; they may also agree to reserve a unilateral right to rescind or terminate a contract. This agreement does not directly end the contract but rather grants a unilateral right to do so to both or either of the parties when certain grounds stipulated in the contract are satisfied.

Furthermore, Articles 543-546 of the CivC allow a party to discharge a contract when there is breach of contract. In that instance, an aggrieved party can rescind a contract, meaning that parties can unwind a contract as if it had never been executed or can terminate a contract, meaning that parties will cease to have a contractual relationship from the point of termination, with the executed part of the contract left intact. Rescission of a contract refers to a declaration of intention that retroactively (*ex tunc*) extinguishes the effect of a valid contract on the grounds of breach of contract. Similarly, contracts can also be terminated, which refers to a declaration of intention that extinguishes the effect of a valid, continuous contract for the future (*ex nunc*) on the grounds of a breach of contract. Termination, as opposed to rescission, matters in the case of a continuous contract. A lease contract is a typical continuous contract in that it requires the obligations of a contract to be performed for a certain period of time (the lease period). In the case of a lease contract, a breach like the lessee's failure to make rent payments constitutes grounds for termination of the contract. However, it does not unwind the contractual relationship that existed up to the point of termination.

Rescission or termination of a contract should be effected by a declaration of such intention to the other party or parties. If there are two parties to a contract, such declaration should be communicated to the

counterparty. If there are three or more parties to a contract, unless otherwise agreed, such declaration should be communicated to all other parties. Rescission or termination of a contract has no influence on claims for damages.

The requirements of rescission or termination are not identical. For instance, if there is a delay in performance by a certain party, the aggrieved party may set a reasonable deadline and give peremptory notice demanding its performance and terminate a contract if proper performance does not occur within that period (Article 544). In case of impossibility of performance that is the responsibility of an obligor, the obligee may also terminate a contract without giving peremptory notice (Article 546). Based on these provisions, it is a generally accepted position that a breach of contract entitles the aggrieved party to terminate the contract as long as the breaching party is held responsible for such breach.

B. Breach in Discharge of a Contract

A breach should be significant enough to frustrate the purposes of the contract and justify the rescission or termination of the contractual relationship. This is different from claims for damages where the significance of the breach is not brought into consideration, as long as the damage occurred as a result of the breach. What kind of breach, then, rises to a level that justifies the rescission or termination of a contract?

The Supreme Court limits default to a breach of a principal obligation and thus excludes breaches of incidental obligations. In one judgement, the Supreme Court held as below:

> In order to rescind a sales contract on the ground of default, the obligation that was breached must be a principal obligation that is indispensable to the fulfillment of the purpose of the sales contract, and for which, if not fulfilled, the seller would not have entered into the contract because the purpose of the sales contract cannot be achieved. In contrast, a party cannot rescind the entire sales contract on the ground of the breach if the obligation unfulfilled is merely an incidental obligation.[29)]

Although the judgement deals specifically with a sales contract, the same logic can be applied to rescission or termination of contracts in general. The ruling of the Korean Supreme Court reflects the view that unless there is a breach of a principal obligation indispensable to achieving the purpose of the contract, upholding the validity of a contract is preferable to annulling it.

The Supreme Court provides a standard to distinguish principal from incidental obligations by stating that "one must look into, without regard to its independent value, the parties' reasonable intentions that were expressed, or manifestly and objectively recognized, in light of the circumstance at the time of execution of the contract, and also consider the contents and purpose of the contract as well as the consequences of the breach of the contract."[30] In light of the foregoing, the more directly an obligation is connected to the purpose of the contract, or the more significantly the breach of the obligation obstructs the fulfillment of the purpose of the contract, the more likely it will be determined to be a principal obligation.

For example, in the sale of a shopping center, the seller sold lots in the center with a designation that a given type of business would be the only one on a floor so that buyers could operate without the risk of direct nearby competition. The seller also required buyers to promise not to unilaterally change their business type to protect the spirit of the one-per-floor requirement. Under these facts, the Korean Supreme Court ruled that this non-competition obligation was a principal obligation since it was indispensable to the fulfillment of the purpose of the contract; furthermore, without its being respected, the buyers would not have entered into the contract because they could not achieve the purpose of the contract.[31] Therefore, the court allowed the buyer to terminate the contract on the grounds of the seller's breach of the above obligation.

In another case of a video production agreement, the Korean Supreme Court held that where the contractor of a video production agreement failed to provide a preview service on the expected date due to schedule

29) Daebeobwon [S. Ct.], Apr. 7, 1997, 97Ma575 (S. Kor.).

30) Daebeobwon [S. Ct.], Nov. 25, 2005, 2005Da53705 (S. Kor.).

31) Daebeobwon [S. Ct.], Jul. 14, 2005, 2004Da67011 (S. Kor.).

delays caused by internal issues, that default was only a breach of procedural obligations that were incidental to the contract and occurred in the course of performing the principal obligation that was the purpose of the contract; therefore, the customer was not entitled to terminate the agreement on the grounds of default of such incidental obligation.[32)]

C. Discharge of a Contract without Regard to Breach of Contract

1. Change of Circumstances

The main purpose of contract law is to enforce valid agreements, as is expressed in the maxim of *pacta sund servanda* (one should abide by agreements). However, the sanctity of contract is challenged when an *ex post* change of circumstances takes place and puts one party in a drastically disadvantageous position. Imposing an excessively onerous burden on a faultless party who had never considered such a risk at the time of the contract seems unfair. The doctrine of change of circumstances addresses this pathological issue of contract law by allowing for the modification or termination of the contract.

The CivC does not have a provision expressly stipulating the principle of change of circumstances, but it has been recognized by academic commentaries as one of the principles derived from the principle of trust and good faith stipulated in CivC Article 2.[33)] The Supreme Court had previously taken a negative or unclear position. A party's argument based on the principle of change of circumstances is rarely accepted by courts in Korea. The strict position of Korean courts against the principle of change of circumstances is found as early as a Supreme Court decision from the 1960s. In a case where the purchaser of forest paid the balance of the purchase price 14 years after the execution date of the sale and purchase agreement and requested to register a transfer of title, the price had soared about 202 times, due to sudden changes in economic conditions arising out of the Korean War and two currency reforms. The Supreme Court (decision

32) Daebeobwon [S. Ct.], Jul. 9, 1996, 96Da14364 (S. Kor.).

33) Yong-Dam Kim et al. eds, Minbeobjuhae: Chaekgonchongchik 1 [Civil Code Commentary: General Provisions Part 1] 173-174 (1st ed. 2010) (In Korean).

No. 63Da452, September 12, 1963),[34] ruled that even though the value of the won had declined dramatically between the time when the sale and purchase agreement was executed and the time when the balance of the purchase price was paid, and that acquisition of the forest in return for payment of the originally agreed balance was found to be significantly unfair, the seller was not entitled to the right of rescission on the grounds of a change of circumstances.[35]

However, in 2007, the Supreme Court ruled that termination of contract on grounds of a change of circumstances should be recognized as an exception to the principle that the terms of a contract are to be respected in cases where the following conditions are met: (1) a significant change of circumstance occurs that could not have been anticipated by the parties at the time of execution of the contract; (2) this change occurs due to a cause not attributable to the party seeking the right to terminate; and (3) recognizing the binding force of the original contract would lead to a consequence that violates the principle of trust and good faith.[36] The Supreme Court further ruled that the term "circumstances" in this context means the objective circumstances underlying the contract rather than a party's subjective or personal circumstances. The Supreme Court has rendered similar rulings in connection with the principle of change of circumstances ever since.[37] Still, recognizing an exception to a rule did not mean that the Supreme Court immediately began granting termination due to a change of circumstances. However, the Supreme Court has since handed down several decisions in which termination of a contract was admitted due to a change of circumstances,[38] revealing an expansion in its willingness to apply this doctrine.

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34) Daebeobwon [S. Ct.], Sep. 12, 1963, 63Da452 (S. Kor.).

35) Yong-Dam Kim et al., Minbeobjuhae: Chaegwonchongchik 1 [Civil Code Commentary: General Provisions Part 1] 177-178 (1st ed. 2010) (In Korean).

36) Daebeobwon [S. Ct.], Mar. 29, 2007, 2004Da31302 (S. Kor.).

37) Daebeobwon [S. Ct.], Jun. 24, 2011, 2008Da44368 (S. Kor.); Daebeobwon [S. Ct.], Jun. 30, 2021, 2019Da276338 (S. Kor.).

38) Daebeobwon [S. Ct.], Dec. 10, 2020, 2020Da254846 (S. Kor.); Daebeobwon [S. Ct.], Sep. 26, 2013, 2012Da13637 (S. Kor.).

2. Continuous Contract

A continuous contract may be terminated without breach if the trust relationship breaks down such that it would be useless to hold the parties to the contract. A continuous contract is a type of contract whose content and performance is determined and influenced by the passage of a certain amount time. Partnership, lease, and employment contracts are all typical examples. In the context of discharge of a contract, a continuous contract is treated differently from a one-time contract in that it is, in principle, subject to termination with prospective extinguishing effect as opposed to rescission with retrospective extinguishing effect. In the context of the contractual relationship, it is more likely that a continuous contract will be founded on a relationship of trust between or among the contracting parties. In this regard, although the CivC only envisages termination of a contract when there is a breach, it would be meaningless and inefficient to bind parties to a contract when, even absent such a breach, there is no longer a relationship of trust. Along this line of thinking, the Supreme Court has ruled that "a continuous contract is based on a mutual trust relationship between parties, and one of the parties can terminate contract *ex tunc* when there is a grave ground for a breakdown in the relationship of trust upon which the contract is founded, due to, for example, inappropriate acts by the other party during contractual period." Even when such an inappropriate act by the other party does not rise to the level of a breach of contract, the counterparty may invoke this doctrine to resolve a contractual relationship that has become meaningless.

VI. Unjust Enrichment

Although unjust enrichment in itself is not necessarily a matter of contract law, it is often associated with contract law. This is because when a contract is null and void or is voided, a performance that has been provided to the other party should be returned to the tendering party. This is addressed under unjust enrichment law but is closely related to contracts since it involves the liquidation of contractual relationship. It is in this

regard that I address unjust enrichment law.

Article 741 of the CivC provides that "a person who without any legal grounds derives a benefit from the property or services of another and thereby causes loss to the latter shall be bound to return such benefit." This is the general provision regulating the doctrine of unjust enrichment. To quote the Supreme Court, the unjust enrichment regime "imposes upon a person who enjoys enrichment unsupported by any legal grounds the obligation to return such enrichment based upon the principles of fairness and justice," and "where there is a change in property values between certain parties and, such change, while it appears to be justified from a general and formal perspective, creates conflict with the principle of fairness—an ideal sought after under law—from a relative and practical perspective, the regime seeks to remove such conflict by ordering the return of the value of the property acquired by the person so enriched."[39] In brief, the doctrine of unjust enrichment, grounded in the principle of fairness, provides for measures to finally rectify the distortions made to the order of property which cannot be completely resolved by applying individual legal principles alone.

Unjust enrichment can be divided into (1) performance-based unjust enrichment arising in cases where an obligor–obligee relationship terminates, (2) infringement-based unjust enrichment arising in cases where there is an act that objectively infringes the rights of another, and (3) expense-based unjust enrichment arising in cases where the business of another is managed at one's own expense without an obligation to do so. In addition, compensation-based unjust enrichment that occurs in cases where one discharges another's indebtedness without obligation to do so is often discussed as a fourth type. However, if one interprets expense-based unjust enrichment broadly, compensation-based unjust enrichment can be said to be subsumed thereunder. Performance-based, infringement-based, and expense-based unjust enrichment are interpreted as supplementary norms of contract laws, tort laws, and *negotiorum gestio* (management of business) laws, respectively. It is the first category—performance-based unjust enrichment—that supplements an *ex post* legal relationship when a contract

39) Daebeobwon [S. Ct.], Jun. 25, 2015, 2014Da5531 (S. Kor.).

is found to have no legal effect. When a given performance, such as making a payment, was carried out on the basis of a contract that is then found to have no legal effect, the benefit from such performance should be returned to the performer because the benefit is "without any legal grounds," as stipulated in CivC Article 741.

Therefore, it is when a contract is found null and void or is cancelled, rescinded, or terminated so that it is found to have no legal effect that the law of unjust enrichment steps in and unwinds the benefits derived from performances based on that invalid contract. It should be noted, however, that there is a special provision on rescission. Article 548(1) of the CivC stipulates that if "one of the parties has rescinded the contract, each party shall be liable to restore the other party to his original position: Provided, that the rights of third persons shall not be prejudiced thereby." That is, the CivC makes clear that the rescission of a contract has a retroactive effect and that an obligation to restore the other party to its pre-contract position arises therefrom. In its legal nature, this is a special form of unjust enrichment specifically tailored to the rescission of a contract. Its legal effect is differentiated from ordinary unjust enrichment in that Article 548(2) states that interest accrues on the monies that are to be returned, regardless of the knowledge or ignorance of the unjustly enriched party about the legally groundless state, while ordinary unjust enrichment holds that an unjustly enriched party who did not know of that state is obliged to return only the amount that he or she still possesses, in accordance with Article 747(1).

VII. Conclusion

In this article, I have addressed several key aspects of Korean contract law, focusing on contract formation and its validity, contract interpretation, breach of contract and remedies, and discharge of a contract, along with unjust enrichment, an issue that is often connected with the discharge or nullity of a contract. On the whole, legal doctrines in the ambit of Korean contract law have been formulated and developed in tune with international trends, thanks to myriad Supreme Court decisions and scholarly opinions that shed new light on the CivC. However, the CivC

itself has remained the same since it came into force in 1960. Given that civil code reform has become a global trend in recent decades—Germany, France, China, and Japan are some examples of countries that have undertaken civil code revision—the next task for Korean contract law is to reform and amend the CivC to keep pace with the modernization of society and the ever-evolving globalization of contract law. In fact, CivC reform on a large scale has been attempted twice by the Ministry of Justice, resulting in a 2004 draft and a 2014 draft. However, neither draft made it through the legislative process, largely due to a lack of consensus for comprehensive change at the National Assembly level. Meanwhile, it remains imperative that the CivC, as the fundamental standard of all of Korean private law, provide an up-to-date normative foundation that reflects the needs of Korean society today and tomorrow. In this regard, civil code reform efforts deserve more attention.