Title: Law of Obligations
Contract for a completed piece of work

- ✓ **Instructor:** 김기창
- ✓ **Institution:** 고려대학교
- ✓ **Dictated:** 김나정, 김민겸, 김성도, 문혜린, 박현서

[0:00]

And a construction project… They almost always have an international arbitration clause.

So, you need to study quite carefully, and also it takes place over a very long period of time.

And the parties also have a detailed arrangement about how the payment must be made usually by stages, right?

Of course, it must be made by stages.

And also what will happen if design is changed.

It's a very complicated contractual relationship.

The parties try to provide for many of the circumstances or imaginable circumstances.

But then in reality, there will happen always something which the parties have never thought that it would arise, and then it would lead to dispute.

But you need to get the essential features right, and then you can apply those ideas to the actual dispute circumstances.

Right, so it's a consensual contract that you all know there is a contractor who does the job, and the counterpart. Sometimes you call it owner.

It's a term of art.

The owner, this is the contractor, right?

It doesn't matter whether that party actually owns the land or the building, but you often call it owner.

Sometimes, there might be a dispute as to whether this is a contract of sale or this is a contract for a completed piece of work.

And we do have the couple of cases where that dispute was raised, that dispute came to the surface.

The basic rule to remember is that if the completed work is not for general purpose, then it is most likely to be a contract of completed piece of work.

[3:23]

The 88.ka31866 case is a good example.

Axle housing, do you know what axle housing is?

Axle, you know what axle is, it is a shaft.

And… you know what shaft is.

Shaft is connecting the wheels.

But this is axle, and axle housing is a piece of metal, some kind of ring, all right?

And then, the axle is maintained in that housing, and this housing is connected to the larger structure which uses the wheel.

So, axle housing is some part which connects the shaft to the remainder of the structure, right?

So, that's the axle housing.

And what you do is that you take a cylindric piece of metal, and then you bore holes in it.

And then you have that housing, right?

So, the contract was to supply axle housings, but of course, the housing, the size differs, right?

So, you cannot use axle housing for one product for some other product.

This particular product was to be used for a particular type of vehicles which were to be manufactured by a vehicle manufacturer.

But the problem was that the raw material was entirely owned by the contractor.

So, the contractor used his own material and made the thing, made the housing, and ultimately delivered it to the owner.

So, when the dispute arose, the owner claimed that actually it was just a sale.

Yeah, it was his material, and he prepared the thing, and he ultimately delivered it.

And I don't care how he made it.

I don't care when he completed the work as long as he supplies that axle housing.

That's it, that's all that mattered.

So, in one sense, of course it looks, it might look very similar to contract of sale. That's why dispute arises.

And the court reasoned that since this completed housing cannot be used for any other vehicles, this is not contract of sale even if the contractor used his own material.

[6:59]

You need to distinguish this case from 94da42976 case.

If contract is own material is used, and the completed item is generic, it is a contract of sale.

If the completed item is specifically for the counterpart, then it is more likely to be a contract for completed piece of work.

88.ka case, there were a few more issues.

The duty to inspect was also very often an issue.

The parties may agree that, upon delivery, the owner must inspect and then must notify if owner finds defect within certain date.

And then, very often, the owner does not do it and then discover the defect later and demand repair or demand compensation.

And then contractor claims that you failed to do the inspection in time.

So, that's another very difficult way in which dispute arises.

In this case, the parties agreed that the inspection of the contractor's counterpart is final.

That's what the parties agreed.

So, they agreed that the owner shall inspect and that inspection shall be fine.

The problem is that the owner actually didn't inspect.

So, owner didn't say there was any defect, simply because owner didn't inspect.

So, what the supplier said was that look, your decision is final.

And you didn't say there was any defect, so there isn't any defect that we must be held liable, because we agreed that you will have the final say, and you said, you didn't say that there was defect.

That's the argument.

How does that sound? Excuse me, how does that sound?

[9:57]

It's that owner who has final say is to defect, and owner didn't say that there was a defect.

Isn't it clever argument?

But the owner cannot now say that look, there is a defect now, because they agreed upon a period when the owner can say that there is a defect, the inspection period they agreed.

And if owner tries to say look, we now know that there is a defect, then the contractor will say look, you failed to keep the inspection period.

It's another tricky part of that case.

So, my question is how to interpret the parties' agreement where they said the contractor's counterpart inspection is final.

The court held that the final, that means that if the contractor's counterpart declares that there is defect, then there is no more any needs to refer that issue to any court, in the sense that the owner can reject the completed piece of work on the basis of owner's own judgment.

But that agreement cannot put an obligation on the owner to inspect.

Owner can inspect and reject, but owner does not have obligation to inspect.

So, even if owner did not in fact inspect, if there is a defect, of course owner can resort to the remedies available to the owner.

That agreement cannot deprive the owner of a remedy in respect of defect.

That agreement only gives more power to the owner.

It does not reduce the power from the owner.

What about the argument that if an owner fails to meet the deadline for inspection, the owner shall have no remedy?

Because that, very often, happens.

In the contract of sale, commercial court also has that clause.

[13:40]

So, delivery took place at this point.

Delivery took place at this point.

Suppose it's a sale contract.

6 months, you can raise the claim.

You can bring the claim in this respect of defect, things delivered, right?

But, let's say the parties haven't say that anything about the purchaser did not inspect.

Within 6 months, the purchaser brings a claim.

Can the seller argue that you failed to inspect within reasonable period?

What do you think?

In other words, what's the commercial codes clause?

It says, the title says the purchaser duty to inspect and notify effect.

And it says in a sale between merchants, the purchaser upon receipt of the things sold must without delay inspect the thing delivered.

And if he finds shortage of quantity or the effect, the purchaser must immediately notify the seller failing that the purchaser may not claim damages, price reduction, or termination of contract.

Does that mean that even if you bring a claim within 6 months, if you haven't done it, it says without delay, the purchaser cannot bring any claim.

[16:50]

And there is another article 69.

It continues in the first paragraph, if there is a defect which cannot immediately be discovered, if the purchaser discovers it within 6 months, the previous sentence shall apply which probably mean the purchaser must immediately notify.

So if the purchaser does not notify, then there is no remedy even if there is a defect.

I don't think so.

The limitation period is not shortened by article 69 of the commercial code.

So in reality, how article 69 shall be actually applied?

It's not easy to tell.

Sometimes, you may successfully block the attempt.

But most of you won't be able to rely on 69 to block the claim in reality.

But anyway, in the 88 daka[?18:36] case, the code completely refuses to give effects to the parties, the specific agreement, regarding the owner's inspection be final because the code interpreted that final here means that only if owner rejects the completed thing, that rejection is final.

But this agreement does not impose duty on the owner to inspect.

Contributory negligence of the owner was taken into account in this case because the owner even after receiving a report and the complaint from the ultimate purchaser of this axle housing.

[19:53]

The counterpart in this contract kept shipping the axle housings to, I think it was Canadian [?20:03] manufacturer, which ultimately need this axle housings.

So if the shipment was reasonably quickly stopped the loss could have been contained as smaller scale.

So the quote took that into account and adjusted damage amount.

Second point to understand this subcontracting is allowed in principle.

Only when the parties specifically agree that no subcontracting is permitted, then subcontracting is not allowed.

But otherwise, in principles of subcontracting, allowed.

But then in reality in construction business, subcontracting is really a bit problem probably because the subcontracting is in principle allowed.

Now two remedies, terrible problems of subcontracting, the parties specifically agree that subcontracting is not allowed.

But then if the contractor actually violates that agreement, then the owner may terminate the contract.

But quite often the owner is dependent on the contract to complete the job.

So it's just another bargaining chip in the process.

The manner of carrying out the work for the contract to this side.

And that's why subcontracting is in principle allowed.

The ownership of the completed piece of work, it depends on who supplied the material on the one hand.

That's one factor which determines the ownership.

And then perhaps more importantly, what was the parties' agreement?

So if the owner provided the material, the completed item belongs to the owner.

That's the usual rule.

[22:48]

If the value added by the contractor is manifestly higher than the value of the raw material, then upon completion of the work, the ownership automatically vests with the contractor.

But, contractor has contractual obligation to transfer the ownership and delivered thing, delivered possession as well as transfer the ownership to the owner.

That's a property law clause, which applies to this contractual relationship as well.

But if the parties agree specifically that contractor shall use his own material, and upon completion, the ownership shall vest with the owner.

Owner, here, means the technical term, right?

Counterpart of the contractor.

Does article 29, have you looked at article 59?

Does it apply?

If the parties agree, otherwise, yeah.

The second sentence of paragraph 1, sales if the added value is manifestly higher, then the value of the raw material, then the person who made the thing is the owner.

Now does that article apply if the parties specifically agree?

The other way, automatically upon completion, it becomes mine.

What do you think?

Excuse me, what do you think of article 259?

[25:40]

Supersedes the parties' agreement, or can parties exclude application of 259?

(student speaking)

So in spite of the parties' agreement, ownership vests with the contractor, and then the contractor has to convey.

Do you all agree?

(student speaking)

Property law clause often mandatory clauses.

But I think article 259 is not such a mandatory clause.

If the parties agree differently, then the ownership is not [?26:39] by article 259.

Building contractor who uses his material will acquire the ownership of the completed building.

Here again, unless, otherwise, agrees between the parties.

Now building a house, it's a gain creating a new thing into the world, right?

Just like assembling a car.

You use many parts and assemble a car.

And the assembled car is a different thing altogether from bolts and nuts, and all these pieces

[27:25]

So in fact, we are dealing with the specific [?27:36] in law term, in other words making new species.

So this property law rules dealing with who owns a thing which is perused like butter, for example.

You produce butter from milk or wine, you produce wine from grapes, right?

Let's say grapes are owned by A, and wine is produced by B using A's grapes, who owns the wine?

That kind of problem that [?28:34] to eat by the property law closes, right?

But, suppose vineal owner, contracts with wine brewer and if they agree that the completed wine shall be, you know, which vineal owners, let's say, then the property law close does not apply.

So you need to realize that that property laws close dealing with the ownership of perused good may come in contact with this type of contract, all right?

Building house, usually it's the building contractors who uses his material.

Owner does not even bother to buy its concrete bricks, tiles or whatever, it's all contractor's material.

And contractors uses his labor to build a house.

So everything belongs to the contractor, but immediately upon completion, automatically who becomes the owner?

Most often the owner becomes the automatically owner. Why?

Because that's their vineal.

[30:23]

97.860 Won slight twists there, because in that case the builder is actually the purchaser of the land upon which this building is built.

And, they agreed that upon completion, the land owner shall be the owner of the completed building.

That is a bit different from the situation where I owned the land, and I want my house to be built, and I enter into a contract for completed peace of work with the builder.

In that case, yes, it is very often that we agree that completed building shall be mine, automatically as soon as it is completed.

That's very often the case and the court will appall that kind of agreements.

So as soon as it is built, even if I don't register it, it is mine.

Even if it is used with builder's material and everything, right?

Builder uses his labor and his material, but as soon as it is completed, the building belongs to me.

But in this case, the land is technically mine because the land title transfer has not yet been done, but I basically sold the land to this guy who is builder. I simply did not receive the money.

Say, the land price I haven't received the money.

So in order to make sure that I can receive the money, we agreed that I shall be the owner of the completed building.

And look at the situation of the builder who has no money, who can only come up with just a little bit of money by stages

So he can buy the materials, and he can mobilize the workers, but he does not have substantial sum of money to pay for the lands price.

[31:14]

Basically what his business proposal to me was that he will somehow build the building and sell it to the individual households.

It's town house.

It's some kind of little apartment complex, little tiny development project, right?

I used to own this land, and a builder approaches to me and say, right, we will build this little apartment, and I will sell this and then I will pay the land price.

So that's the…

And something went wrong obviously, and the builder cannot pay the land purchase price and I want to exercise my right as an owner of this building, and I refuse to convey the land either because I haven't received the purchase price.

So that's the dispute.

And, the end uses, the households who bought the completed units, they were about to be kicked out by me who is exercising the right of ownership.

So that's the situation.

The court in that case held that my ownership is valid only to the extent of securing the land price payment.

So the moment that prices paid by payer, I automatically lose the right.

Ok.

Contracts, warranty, liability, ok?

(student speaking)

[35:58]

On what ground.

Without delay, right?

That is one very important requirement which court can interpret and manipulate a little bit to allow the remedy on the purchaser.

That is actually another, the very important concept there, reasonable inspection is required.

So the purchaser now claims that look, I kind of inspected, I invested reasonable amount of effort to inspect the thing I received.

I couldn't find he effect at that time.

Now I found the effect.

Saying 6 months from knowledge of the effect, isn't it?

And that's the usual limitation period.

So let's say about 2 years has gone by.

And now claim is brought, saying yeah, this is still 6 months from knowledge.

And the courts will have to decide whether to allow it or not on the basis of the limitation period.

And I think this two can be very important tools available to the court to come to a reasonable conclusion in the end, ultimately.

If it was the nature of the defect, if the nature of the defect is such that it could quite easily be discovered.

And if the purchaser didn't really properly inspect, than the court can rely on article 69 on commercial court and dismiss the whole claim.

On the other hand if the defect is not easy to find out, then the court can say that well, this reasonable inspection was done and the no defect was found on that occasion and that's fine, and 6 months from knowledge that applies so purchaser has a remedy.

So, article 69 only requires reasonable inspection.

It does not require purchaser to do complete inspection, right?

If you receive, let's say if you are mobile phone manufacturer, you buy LCD monitor screen which will be used in making your mobile phone.

You received LCD monitor, let's say one hundred or one million units of LCD, not at one goal but like monthly you receive as your production schedule permit.

This much of, this many units, but how many units can you check?

Only a very small sample amount can be checked, right?

And you thought that it was all goods, and you actually put those money LCD monitor units to the assembly line, and now mobile phones are manufactured and sold to and uses but it turns out that this unit is defective, let's say.

[40:45]

Can you be accused of not doing that simply because you inspected a tiny little sample unit?

You should have inspected all of them before putting them into a production?

All these questions may arise how thorough your inspection must be.

You see?

That kind of concept is very important for the court to soften the edge of 96, article 96 of commercial court.

So, although it might look very, very powerful weapon for the seller, in fact, as long as what the purchaser did was reasonable, article 69 will not be very, very powerful.

Of course if purchaser was really very careless, then the purchaser may be blocked from bringing claims because of article 69.

Q : But sir, you are talking that the 6 months from the knowledge, but I think according to this article, it should be interpreted as 6 months from delivery.

A : Yeah, so, that's right.

That's what I'm saying.

Article 69 of commercial court requires purchaser to do inspection, and if he finds defect, notification, within 6 months from delivery, alright?

So it's a really very short period.

Now, if you didn't do anything, if the purchaser literally didn't do anything, and then the defect was found, let's say, about 1 year after the delivery, OK?

And then, immediately after it was found, the purchaser brings a claim.

Let's suppose a situation like that.

It will all be an issue of what kind of defect it is.

If it was quite easily discoverable defect, then such a claim will fail because of article 69 of commercial court.

But if it's not an easy to discover defect, then article 69 will not be very powerful.

The court will say reasonable inspection would not have discovered it.

So, it is OK. You can bring a claim as long as that was within 6 months from discovering the defect.

[44:19]

A : Sir, if we just compare the stance of this article to that of CISG, article 38 and 39, things like that.

The buyer should inspect, within a time as soon as practically possible.

And it'll be found and really a reasonable prime, shouldn't the reasonable article seen will be very reasonably?

I think it's a very strict time for such hidden defects, which is allowed very much in that way in CISG.

So, I think what the stance of commercial court is quite clear.

It's very strict, it's very rigid.

A : No, I don't think it's very different.

As soon as commercially practicable, or as soon as reasonably practicable, without delay, although it might appear to be very strict, it can also open up to a wide room for interpretation; what is without delay.

Korean commercial court 69 does not even talk about what kind of inspection.

You don't need to talk about inspection, right?

But then the court can read into "reasonableness."

Q : So they allow for a without reasonable …?

A : Yeah, I think so.

I do accept all your points that article 69 of commercial court is to encourage speedy resolution of disputes.

But then that encouragement should not work injustice to either party.

So, there is a sense of balance which is required.

But the interesting and important points to notice is that article 69 of commercial court will not apply to contract of completed piece of work.

Article 69 only applies to contract of sale.

(student speaking)

Yeah. oh, yeah. Of course.

[47:06]

What happens to the parties if completed piece of work has a defect?

Civil court provides remedy.

Basically, the owner may demand repair.

The owner may seek compensation.

And the owner may terminate the contract.

But it all depends on what kind of defect it is, and how serious it is.

The first point is, if the defect is not material, and if the cost for repair is excessive, then the only remedy available to the owner is to seek compensation.

In that case, the amount of compensation will be calculated. How?

If the defect is not material, and if the cost for repair is excessive, you cannot compel the contractor to repair.

But you can only ask for damage, but how are you going to calculate the damage?

[49:40]

Suppose a building, this is an actual case, a building about 40-story building, a big

building was built.

And the building is tilted; just a little bit, about 2 degree.

It's tilted.

Of course we have a quite severely tilted building also, like the bell tower of Pisa.

It's quite severely tilted, and it's still functioning, and it can last for many centuries, right?

At the same time, it is a defect.

It is tilted, and compare to a building which is really upright, maybe this building is slightly weaker to other, sort of external impacts, such as movements of ground or earthquake.

But then this was an area where it is not known to be affected by earthquake.

So it is highly unlikely that this defect will actually make a big difference.

But still it is a defect.

It's tilted a little bit.

And people who use the building simply do not notice, because it's really very slightly tilted.

So, I don't think it's a material defect, but it is nevertheless a defect.

How are you going to repair it?

I mean, it's almost impossible to repair.

It is actually a project done by a Korean construction company in Singapore.

And they were building a building at a reclaimed area, which used to be sea, but now it's a reclaimed area.

And they made everything possible to, you know, build a high arise building there.

But then, somehow, it's just tilted.

They used many piloti, reinforce concrete piles, which was punched into the ground.

But somehow it's tilted.

So, what are you going to do about it?

So, can you compel the builder to repair it?

It's too expensive to do that.

It's not very material defect.

So how are you going to do, then?

[52:54]

(Student Speaking)

Rent?

There is virtually no difference because people don't realize it.

But if you want to sell the building, building of that price range or that magnitude, the purchaser would do everything, all these technical surveys.

So, they will find out that it's a tilted building, so the market price would definitely be affected for the building.

Rent itself won't be affected

Their profitability or the businesswise, it's all fine.

You can rent it.

What remedies are available?

The only remedy in that case is the difference of market value of defect-less building.

Of course, it's difficult to find out what's the market value of a not tilted building, but then professional surveyors will give expert opinion about what the market value would have been.

60 story building in this area, whatever, whatever…

And the value of the thing with the defect.

So, that's the only thing you can claim as the owner.

You cannot compel repair.

That's the point about it.

[55:18]

If the contractor is willing to actually do the repair, the owner may not demand that the owner himself will do the repair and then contractor must pay the price of repair.

See, it's all question of trust when things don't turn out well and the owner no longer trust the builder and the owner does not want builder to do the repair.

That kind of situation may quite easy, right?

But I think as long as builder is prepared to do the repair or may not insist that he will do it himself.

There is a case 2001Da9304 where payment was to be made in stages of completion, the contractor's counterpart may withhold payment regardless of whether the defect was in the stage of the work corresponding to the payment obligation.

So let's say every quarter, the owner pays the compensation, the fee corresponding to the stage of completion which was done during that quarter year period.

Suppose that's the party's agreement.

And if the owner finds defect, the owner can set off the compensation with the damage.

[58:00]

But that set off can be done regardless of any, does not have to correspond to that period.

Usually a building project can last for many many years, right?

So the owner can as soon as defect is found, the owner can set off with the current stage of payment.

With 95Da30345, that case has some suggestion is to well the repair may be compelled.

The counterpart may elect to seek compensation instead of repair.

The actual cost of repair may be claimed.

If there is other loss, that may also be claimed.

If the defect of the completed work defeats the purpose of the contract, the counterpart may terminate the contract.

Now, let's have look at the situation about the defect and what will happen.

Let's try to simplify the thing little bit.

So, defect of the completed work, let's say it's not material.

But then sometimes it's easy to repair, it's not excessively expensive to repair.

So, repair possible, in that case repair can be compelled, that's the remedy.

But if it's too expensive, then you can only get the difference of market value.

Repair may not be compelled.

[1:01:05]

If it's material, material means you cannot use the completed object for its intended purpose.

If it is building, it cannot be used for its intended purpose, right?

There is again, two possibility.

If it cannot be used, then termination.

However, where buildings and installations are completed, or if the completed stage of work is beneficial to the owner and if it is wasteful to order restoration of the completed stage of work the termination may not have retroactive effect.

Termination usually would require restoration.

But the defect is material but still it can be useful.

There may be situations.

Let's say the building was completed but it cannot be used for its original intended purpose.

But it can be used for some other purposes, storage, warehouse, something like.

If it's useful then no restoration may be sold and also fees need to be paid, must be paid.

Reflecting to that stage of work, it's all very practical approach, all right?

You don't need to be dogmatic.

You should not be dogmatic about who is its fault and whose fault it is and if the builder did something wrong, it's must all be undone, not that kind of dogmatic approach.

You should, must be very practical.

So termination on the basis of defects of completed work, is possible on fairly narrow range of cases.

[1:04:00]

If quite often the completed stage of work is useful and if it is useful, then it would always be considered to be wasteful to tear it down, right?

Then the contract may be tell terminated, but it will not have retroactive effect.

So termination with retroactive effect is possible only when defect is material what has been completed is useless and if it's useless, then it is not wasteful to tear it down.

If it is useful, then it is wasteful to tear it down. If it is useless, then of course it's not wasteful to tear it down.

So it must be rested cleared up.

The builder has to clear up everything.

But if it is useful, builder does not have to clear up.

So, this would be quite rare, it is possible but it would be rare.

There is limitation period.

Ground work and installations.

Ground work is preparing the ground and installations means not buildings but study objects which are fixed to the ground.

They are 5 years.

Stone, concrete, brick, metal or other durable structures, they are 10 years.

Of course the parties may agree upon different limitation period.

Other works, like movable objects.

That's 1 year.

[1:07:00]

But, although stone, concrete, brick, metal or other durable structures, the limitation period is 10years, it must be exercised if the building is destroyed because of the defect.

Then it is plain knowledge.

The owner now knows that it has defect.

Then it must be exercised within 1 year from that.

That's I think article 671.

Wednesday we'll talk about payment for completed work.