UK DEFENCE CLUB

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soundings

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The sun comes out on the Rainy Sky

RAINY SKY vs Kookmin Bank

The Association's Member entered into shipbuilding contracts with the JINSE Shipbuilding Co., Korea for the construction of 6 ships. As is normal practice, refund guarantees were provided to secure the pre-delivery instalments. The refund guarantees were issued by Kookmin Bank. The yard subsequently encountered financial difficulties and entered into a debt workout procedure and the Member claimed under the refund guarantees for the return of the advance instalments of US$45 million.

The key provisions of the guarantees were as follows:

(2) Pursuant to the terms of the Contract, you are entitled, upon your rejection of the Vessel in accordance with the terms of the Contract, your termination, cancellation or rescission of the Contract or upon a Total Loss of the Vessel, to repayment of the pre-delivery instalments of the Contract Price paid by you prior to such termination…

(3) In consideration of your agreement to make the pre-delivery instalments under the contract… we hereby, as primary obligor, irrevocably and unconditionally undertake to pay to you… on your first written demand, all such sums due to you under the Contract…"

The key issue raised by the case was whether the words "all such sums due to you under the Contract" in paragraph (3) of the refund guarantees referred back to the words "the pre-delivery instalments" at the beginning of that paragraph or to the specific repayments or payments referred to in paragraph (2).

Essentially the Bank argued that the terms of paragraph 3 and the phrase "all such sums due to you" referred to amounts set out in paragraph 2 and therefore only to repayments due upon rejection or total loss of the ship, or termination, cancellation or rescission of the contract and payments due for buyer's supplies. As Article 12.3 of the contract did not refer to the yard's insolvency the Bank argued that this did not give rise to a liability under the refund guarantee.

The Member's claim was first heard in the English Commercial Court where the Court found for the Member. It held that the terms used in paragraph 3 of the refund guarantees were clear and it considered that one of the main purposes of refund guarantees was to protect a buyer from the insolvency of a yard.

Court of Appeal judgment

The Bank was given permission to appeal and the case was considered by the Court of Appeal before Sir Simon Tuckey, Lord Justice Patten and Lord Justice Thorpe. Sir Simon Tuckey found for the Member:

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"On the Bank's construction the bonds covered each of the situations in which the Buyers were entitled to a return or refund of the advance payments which they had made under the contracts apart from the insolvency of the Builder. No credible commercial reason has been advanced as to why the parties (or the Buyers' financiers) should have agreed to this. On the contrary, it makes no commercial sense."

However, Lord Justice Patten considered that the wording of the relevant provisions was clear and that payment under the refund guarantees was not triggered by the insolvency of the yard. He went on to say:

"…that it is impermissible to speculate on the reasons for omitting repayments in the event of insolvency from the bond. Although the judge is right to say that cover for such event was, objectively speaking, desirable, that is not sufficient in itself to justify a departure from what would otherwise be the natural and obvious construction of the bond. There may be any number of reasons why the Builder was unable or unwilling to provide bank cover in the event of its insolvency and why the Buyer was prepared to take the risk."

Lord Justice Thorpe concurred with Lord Justice Patten. The Bank's appeal was therefore successful.

Supreme Court judgment

The Supreme Court granted leave to appeal and a hearing took place on 27th July, 2011 before Lords Phillips, Mance, Clarke, Kerr and Wilson. The positions of the parties remained essentially unchanged with the Bank's position being that the contract should be interpreted strictly in accordance with the words used, and that commercial considerations should not be taken into account unless it was not possible to construe the contractual terms without them being put into a commercial context.

The Member's position was that the proper approach is to regard considerations of business common sense as forming part of a single interpretative process, the aim of which is to attribute a sensible commercial meaning to the language used by the parties. The Member further contended that the majority in the Court of Appeal gave insufficient weight to the assessment of the Commercial Court as to the business common sense of the transaction.

In a judgment handed down on 2nd November, 2011 the Supreme Court upheld the Member's appeal.

Lord Clarke gave judgment which was unanimously agreed by the other Lords. He considered the role that 'business or commercial common sense' should apply to construction. He said:

"…the language used by the parties will often have more than one potential meaning… the exercise of the construction is essentially one unitary exercise in which the court must consider the language used and ascertain what a reasonable person, that is a person who has all the background knowledge which would reasonably have been available to the parties in the situation in which they were at the time of the contract, would have understood the parties to have meant. In doing so, the court must have regard to all the relevant surrounding circumstances. If there are two possible constructions the court is entitled to prefer the construction which is consistent with business common sense and to reject the other".

Lord Clarke disagreed with Lord Justice Patten [in the Court of Appeal] and considered that there were two arguable constructions of paragraph 3 of the guarantees, as argued by the parties. Of the two, Lord Clarke preferred the Member's construction because he said it was consistent with the commercial purpose of the guarantees in a way in which the Bank's construction was not. He therefore agreed with the Commercial Court judge and Sir Simon Tuckey who dissented in the Court of Appeal.

In relation to the Bank's case, Lord Clarke found that the Bank had put forward no credible reason for excluding repayment to the Member in the event of the builder's insolvency and concluded:

"…I would if necessary, go so far as to say that the omission of the obligation to make such repayments from the bond would flout common sense…"

The Member's appeal was allowed.

Conclusion

The decision of the Supreme Court is one to be welcomed not only in terms of the case itself but for shipping generally. A common sense commercial interpretation has been applied to the construction of these guarantees. This is precisely why the Commercial Court was established in the first place to reflect business practice.

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