2 November 2011

PRESS SUMMARY

Rainy Sky S.A. and others (Appellants) v Kookmin Bank (Respondent) [2011] UKSC 50
On appeal from the Court of Appeal [2010] EWCA Civ 582

JUSTICES: Lord Phillips (President), Lord Mance, Lord Kerr, Lord Clarke, Lord Wilson

BACKGROUND TO THE APPEALS
This case concerns the correct construction of refund guarantees issued by the Respondent bank in relation to six shipbuilding contracts.

In May 2007 the first to sixth claimants ('the Buyers') entered into shipbuilding contracts ('the Contracts') with Jinse Shipbuilding Co Ltd ('the Builder'). Under the Contracts the Builder agreed to build and sell one vessel to each of the six Buyers. The price of each vessel was US$33.3m, which was to be paid in five equal instalments. Article X.8 of the Contracts stated that payment of the first instalment was conditional upon the Builder providing the Buyer with a satisfactory refund guarantee from a first class Korean bank. Article X.5 gave the Buyer a right to a full refund in the event that the Buyer exercised their right to reject the vessel or to terminate, cancel or rescind the Contract. Article XII.3 of the Contracts then gave the Buyers further rights to repayment of instalments paid in the event of a default by the Builder. In particular, Article XII.3 stated that if the Builder became subject to certain insolvency proceedings, "*the Buyer may by notice in writing to the Builder require the Builder to refund immediately to the Buyer the full amount of all sums paid by the Buyer to the Builder*".

As envisaged by Article X.8 of the Contracts, in August 2007 the Respondent bank issued each of the Buyers with materially identical Advanced Payment Bonds ('the Bonds'). Paragraph 2 of the Bonds stated that, under the terms of the Buyer's Contract with the Builder, the Buyer was entitled to a refund in the event that they exercised their right to reject the vessel or to terminate, cancel or rescind the Contract. The Respondent's guarantee obligation was then set out in paragraph 3, which stated that the Respondent promised to pay the Buyer "*all such sums due to you under the Contract*". The first line of paragraph 3 explained that this promise was given "*[i]n consideration of your agreement to make the pre-delivery instalments under the Contract*". Paragraph 4 stated that payment would be made upon receipt of a written demand from the Buyer stating that the Builder had failed to fulfil the terms of the Contract and specifying the amount claimed. Paragraph 5(v) stated that the Respondent's liability under the Bonds would not be affected by "*any insolvency, re-organisation or dissolution of the Builder*".

Each of the Buyers duly paid the first instalment of US$6.66m due under the Contracts. One of the Buyers also subsequently paid a second instalment in the same amount.

In 2008 the Builder experienced financial difficulties and in January 2009 it became subject to a formal debt workout procedure under the Korean Corporate Restructuring Promotion Law 2007. In April 2009 the Buyers wrote to the Respondent demanding repayment under the Bonds of the instalments that had been paid to the Builder under the Contracts. The Respondent rejected the Buyers' demands on the basis that, on the true construction of the Bonds, the Respondent had not undertaken to guarantee payment of refunds arising under Article XII.3 of the Contracts.

In the High Court the judge ruled in favour of the Buyer's construction of the Bonds and entered summary judgment against the Respondent. On appeal, the majority of the Court of Appeal (Thorpe

and Patten LJJ) overturned the High Court's ruling and entered summary judgment in favour of the Respondent. Sir Simon Tuckey gave a dissenting judgment in which he explained his reasons for preferring the High Court judge's construction of the Bonds. The Supreme Court granted the Appellants leave to appeal to the Supreme Court.

JUDGMENT

The Supreme Court unanimously allows the appeal and restores the order of the High Court. Lord Clarke gives the sole judgment, with which Lords Phillips, Mance, Kerr and Wilson agree.

REASONS FOR THE JUDGMENT

References in square brackets are to paragraphs in the judgment

The issue at the heart of this appeal is whether, on the true construction of paragraph 3 of the Bonds, the Buyers are entitled to payment from the Respondent in respect of refunds that they are entitled to from the Builder under Article XII.3 of the Contracts **[6]**. It was common ground that everything depends upon the true construction of the Bonds and that the terms and meaning of the Contracts are only relevant to the extent that they inform the true construction of the Bonds **[7]**,**[10]**.

Under paragraph 3 of the Bonds the Respondent promised to pay the Buyers "*all such sums due to you under the Contract*". The question is therefore what was meant by "*such sums*". On this point, neither Article X.5 nor Article X.8 was intended to set out all the circumstances in which the refund guarantee should operate **[37]**. The Buyers said that the expression covered the "*pre-delivery instalments*" referred to in the first line of paragraph 3 – in other words, the phrase referred to all pre-delivery instalments paid by the Buyers. The Respondent, on the other hand, contended that the expression "*such sums*" was limited to the sums that were referred to in paragraph 2 of the Bonds. Since paragraph 2 did not include any reference to the Buyers' rights under Article XII.3 of the Contracts to repayment upon the Builder's insolvency, the Respondent was under no obligation to make any payment to the Buyers in the present case.

On the face of it, the correct approach to the construction of the Bonds is not in dispute. The cases show that the ultimate aim of interpreting a provision in a contract, especially a commercial contract, is to determine what the parties meant by the language used. This process involves ascertaining what a reasonable person would have understood the parties to have meant. A reasonable person, for these purposes, is one who has all the background knowledge that would reasonably have been available to the parties in the situation in which they were at the time of the contract **[14]**.

The issue between the parties is the role to be played by considerations of business common sense in determining what the parties meant **[15]**. Where the parties have used unambiguous language, the court must apply it **[23]**. However if there are two possible constructions, it is generally appropriate to adopt the interpretation that is most consistent with business common sense and to reject the other **[21]**, **[29]**. It is not necessary to conclude that a particular construction would produce an absurd or irrational result before proceeding to have regard to the commercial purpose of the agreement **[43]**.

In the present case, since the language of paragraph 3 is capable of two meanings, it is appropriate for the court to have regard to considerations of commercial commonsense **[40]**. Although the Buyers are unable to provide any very good reason why paragraph 2 was included in the Bonds **[34]**, a construction of paragraph 3 which excluded the Builder's insolvency from the situations that trigger the Respondent's obligation to refund advance payments made by the Buyers would make no commercial sense **[41]**. Accordingly, of the two arguable constructions of paragraph 3 of the Bonds, the Buyers' construction is to be preferred because it is consistent with the commercial purpose of the Bonds in a way that the Respondent's construction is not **[45]**.