# Legal Briefing

## *Kookmin Bank v Rainy Sky SA & Others*
**[2011] UKSC 50**

*The Facts*

The Buyers ("the Buyers") engaged Jinse Shipbuilding Co. Ltd ("the Builder") to build and sell one vessel to each of the Buyers. The price of each vessel was US$33.3m payable in 5 equal instalments of US$6.6m with a final payment becoming due upon delivery. It was a condition precedent to payment of the first instalment by the Buyers that the Builder would secure and deliver to the Buyers a satisfactory advance payment bond. On 22 August 2007 the defendant, Kookmin Bank ("the Bank") issued six materially identical advance payment bonds, one to each of the Buyers. The key events are summarised as follows:

- On 29 August 2007, in accordance with the provisions of the contract, and upon receipt of the Bonds, the Buyers each paid the first instalment of US$6.6m due under the contract.

- In 2008, the Builder began experiencing financial difficulties, and by January 2009, it became subject to a debt workout procedure under Korean Law.

- On 25 February 2009, the Buyers wrote to the Builder, giving it notice that it had breached the terms of the contract, and demanding an immediate refund of all the instalments paid to date, which the Builder unsurprisingly refused.

- On 23 April 2009, the Buyers wrote to the Bank making a "call" on the advance payment bond, which the Bank refused, arguing that the terms of the bond did not cover repayment in the circumstances which the Buyers found themselves (i.e. insolvency of the Builder).

- That argument was rejected by the Judge in the first instance, who gave summary judgment for the Buyers. However, the Court of Appeal overturned that decision, and the Buyers then applied to the Supreme Court.

*The Issues*

The principal issue that the Supreme Court was asked to determine was whether the bond covered the obligation to refund the full amount of all advance payments made in the event of the Builder's insolvency.

The key clauses of the bond were:

> *[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…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, your successors and assigns, on your first written demand, all <u>such sums</u> due to you under the Contract (or such sums which would have been due to you but for any irregularity, illegality, invalidity, or unenforceability in whole or in part of the Contract).* [emphasis added]

The resolution of the issue between the two parties depended upon the true construction of clause 3. The Bank promised to pay on demand "all such sums due to you under the Contract". What was meant by "such sums"?

The Buyers argued that "such sums" referred back to the "pre-delivery instalment" which was itself referred to in the opening part of clause 3 and that the purpose of the bond was to guarantee the refund of those pre-delivery instalments.

The Bank put forward an alternative argument that "such sums" referred to the "repayment of the pre-delivery instalments" only in the event of a breach in accordance with clause 2. In other words, the only triggers for payment under the bond, were rejection of the vessel, termination, cancellation or rescission of the contract, and not in the case of an insolvency event as experienced by the Builder.

As it did in the Court of Appeal, the Buyers argued that such literal interpretation of the bond made no business sense and that there was no good commercial reason why insolvency should be excluded from the terms of the bond. Indeed what use is an advance payment bond if a party cannot rely on it to pay out in the event of insolvency?

*The Decision*

The Court held unanimously that the words "such sums" in clause 3 of the bond referred back to "pre-delivery instalments" in clause 3 and not to clause 2 of the bond.

The Court reached this conclusion on the basis that the Buyers' interpretation of the bond was to be preferred because it was consistent with the generally accepted commercial purpose of advance payment bonds, in a way in which the Bank's construction was not. The Bank was unable to advance any reason as to why insolvency should be excluded. The appeal was therefore allowed and the Bank was ordered to repay the pre-delivery instalments to the Buyers.

*Comment*

Following this decision, the Court has seemingly clarified the law in respect of ambiguously drafted clauses, not only it seems in relation to bonds, but also generally, with Lord Clarke concluding that:

> "*where a term of a contract is open to more than one interpretation it is generally appropriate to adopt the interpretation which is most consistent with business common sense…*".

Whilst this is clearly a victory for common sense, going forward parties will need to take particular care when negotiating bonds, warranties etc, ensuring that the commercial requirements of the parties are clear and well documented, and therefore avoiding a similar situation to one above.

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January 2012