

INTERPRETING ENGLISH LAW CONTRACTS - RECENT DEVELOPMENTS

Rainy Sky SA v Kookmin Bank (2011) UKSC 50 (SC)

On 10th January 2012 we circulated a case note of the English Supreme Court's decision in *Rainy Sky SA v Kookmin Bank* (2011) UKSC 50 (SC) handed down on 2nd November 2011.

The speech of Lord Clarke reflected the approach of the Court in emphasising the need for "commercial sense" to be given to commercial contracts. In this article we outline "The *Rainy Sky* Doctrine" – what it is and why it is important.

What is the *Rainy Sky* doctrine?

The *Rainy Sky* doctrine can be summarised as: *“The test for determining what the parties intended in a contract is the test of the relevant reasonable person who has all the background knowledge which would reasonably have been available to the parties at the time of the contract. If ambiguity continues to exist, then preference must be given to the interpretation which is least commercially surprising or unsound.”*

This means, where the words of a contract are capable of more than one meaning, it will be legitimate for the Court to try to interpret the words so as to give them commercial meaning and effect. Anyone drafting or entering into a contract needs to be aware of the potential for terms in their agreements to be interpreted in a manner that they may not have understood or intended – all the more reason to deploy careful drafting and understand what the words of a contract might be taken to mean.

What happened in *Rainy Sky*?

Facts

A shipbuilder (the “Builder”) agreed to build a number of ships for an equal number of buyers (the “Buyer”). Under the contracts (the “Contract”), which were materially identical, the builder was required to provide advance payment bonds or guarantees from a first-class bank. A bond (“the Bond”) was issued by a bank (the “Bank”) on behalf of the Builder.

20% of the price (US\$6,660,000) was paid as provided in the contract. The Builder subsequently went into insolvency and the Buyer called the Bond; the Bank asserted that this eventuality was not covered by the Bond.

The Bond contained two relevant clauses, articles 2 and 3. Article 2 stipulated that repayment would be due in case of “**rejection** of the Vessel ... **termination, cancellation or rescission** of the Contract or upon a **Total Loss**”; article 3 stipulated that the Bank “undertake to pay... **all such sums** due ...under the Contract” (all emphasis added).

The Contract contained also two clauses, X.5 and XII.3. X.5 stated that “If the Vessel is **rejected** ...or if the Buyer **terminates, cancels or rescinds** this Contract ...the Builder shall forthwith refund... the full amount of total sums paid”. Article XII.3 stated that “If the Builder... shall be adjudicated **insolvent**... the Buyer may ...require the Builder to refund immediately to the Buyer the full amount of all sums paid” (all emphasis added).

In other words, the provisions of the Contract in article X.5 were mirrored directly in article 2 of the Bond (the reference to rejection, termination, cancellation and rescission); the provisions of article XII.3 (the reference to bankruptcy) were not mirrored anywhere in the Bond.

Hence the Bank argued that the Bond, on its face, only insured the Buyer on some but not all causes for repayment under the contract. As the Buyer was relying on the bankruptcy reference in article XII.3, the Bank refused to pay.

Judgment

The Bank's interpretation of the Bond appeared literally plausible but suffered from uncommerciality – it would have been surprising to see the Bond cover only a part of what the contract envisioned; more so since the part left out was the most likely cause for use of the Bond and also because that interpretation was not spelt out explicitly.

The Buyer's contrary interpretation suffered from the fact that it required the court to 'read down' the text of the Bond for a commercially sound and contextual construction of the contract. In this view, article 2 would become a mere preamble.

The Judges – Simon J (first instance), Sir Simon Tuckey (Court of Appeal – dissenting) and Lord Clarke all concurred with the Buyer's interpretation.

Why *Rainy Sky* is important

The *Rainy Sky* doctrine has in the last few months been applied in cases dealing with complex commercial issues.

These include:

- *Spencer v Secretary of State for Defence* [2012] EWHC 120 (Ch) where it was held that parties are bound by a contractual interpretation which accords with the law even if the parties were unaware of said law;
- *Premier Food v RHM Pension Fund* [2012] EWHC 447 (Ch) where a purposive interpretation was taken on deeds relating to a pension scheme; and
- *RGI International Ltd v Synergy Classic Ltd* [2011] EWHC 3417 (Comm) where a complex shareholding agreement was interpreted to provide a commercially sensible result.

Rainy Sky is an enforcement of the *ICS* doctrine laid down by Lord Hoffman on contract interpretation. The *Rainy Sky* doctrine works subject to the *ICS* doctrine. The possible interpretations offered to the court must be compelling to the objective reasonable bystander. It is only where those interpretations are viable and are open to the reasonable business man as defined in *ICS* that the court is allowed to make a choice along the lines of *Rainy Sky*.

The broad reach of cases which *Rainy Sky* in its short period of existence has affected – commercial matters ranging from shareholding to partnership issues – shows that 'commercial common sense' is a conceptual and flexible construct.

It will be difficult for a commentator or judge to decisively state what commercial sensibility entails. While the courts, based on this decision, will give more leeway towards interpreting contracts in a businesslike fashion, the abstract nature of 'commercial construction' is far from a precise standard. Commercial parties will hence be advised to be very clear and detailed in their contract drafting.

Finally, this case continues a line of reasoning of the Supreme Court which have moved away from a strict "literal" interpretation of the contract towards an approach of interpretation based on commercial considerations.

16th May 2012