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Dispatch

Dispatch highlights some of the most important legal developments during the last month, relating to the building, engineering and energy sectors.

Case Update: bonds and guarantees

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

We covered this case back in Issue 120. The case has now reached the Supreme Court where the decision of the Court of Appeal was overturned. In doing so, Lord Clarke adopted the interpretation of the bond which was most consistent with business common sense.

The claimant had sought summary judgment against a defendant bank for a total of US$46.6million plus interest under the terms of six materially identical on demand advance payment bonds. The issue before the courts was whether the bond covered the obligation to refund the full amount of all advance payments made in the event of the shipbuilder's insolvency. The key clauses of the Bond were these:

[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 such sums 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)" .

The resolution of the issue between the parties depended upon the true construction of paragraph 3. The Bank promised to pay on demand "all such sums due to you under the Contract". What was meant by "such sums"? Two possibilities were suggested. The Buyers said (and the Judge at first instance held) that the expression referred back to the "pre-delivery instalments." The purpose of the Bond was to guarantee the refund of pre-delivery instalments and that the promise was therefore to refund pre-delivery instalments.

By contrast the Bank said (and the majority in the CA agreed) that the expression "such sums" was a reference back to the sums referred to in the paragraph, namely the repayment of the pre-delivery instalments paid prior to a termination of the Contract. On the Buyers' analysis the Bond guaranteed pre-delivery instalments in the case of any insolvency event, whereas on the Bank's analysis it did not. In other words, Kookmin argued that insolvency was not a trigger for repayment under the terms of the bonds. There had been no right to "terminate, cancel or rescind".

The buyers' case was that this literal interpretation made no business sense: there was no good commercial reason why insolvency should be excluded. There was general agreement that the correct approach to construction of a bond was same as any contract. When interpreting a provision in a contract, especially a commercial contract, you must determine what the parties meant by the language used. This involves ascertaining what a reasonable person would have understood the parties to have meant. The relevant reasonable person is one 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. Lord Clarke noted that the language used by the parties will often have more than one potential meaning. If there are two possible constructions, then the court is entitled to prefer the construction which is the more consistent with business common sense and to reject the other. Here, Lord Clarke quoted with approval from the dissenting CA judgment of Sir Simon Tuckey:

"As the judge said, insolvency of the Builder was the situation for which the security of an advance payment bond was most likely to be needed. The importance attached in these contracts to the obligation to refund in the event of insolvency can be seen from the fact that they required the refund to be made immediately. It defies commercial common sense to think that this, among all other such obligations, was the only one which the parties intended should not be secured. Had the parties intended this surprising result I would have expected the contracts and the bonds to have spelt this out clearly but they do not do so."

Therefore, the Buyers' construction was to be preferred because it was consistent with the commercial purpose of the Bonds in a way in which the Bank's construction is not. Kookmin was unable to advance any reason as to why insolvency should be excluded. The appeal was therefore allowed and Kookmin was ordered to pay.

Adjudication: appointment of adjudicators

Sprunt v London Borough of Camden
[2011] EWHC 3191 (TCC)

This was an adjudication enforcement case where Mr Justice Akenhead had to consider whether or not there was a contract in writing as required by s107 of the old HGCRA. During the course of his judgment, the Judge made a couple of interesting comments about the extent and scope of the incorporation of the Scheme in circumstances where the underlying contract does not comply with s108 of the HGCRA and where a party says that it can choose the adjudicator. Clause 25 of the contract indicated that:

25.4 The Council shall be the specified nominating body for the purposes of paragraphs 2(1)(b) and 6(1)(b) of Part 1;

That clause went on at paragraph 25.11 to list a number of circumstances where if any decision of the adjudicator required either party to make payment to the other, then such decision would be suspended. Camden conceded that the clause offended against the requirement that adjudication decisions are binding until they are resolved by legal or arbitration proceedings.

The recent Scottish case of *Profile Projects v Elmwood* (see Issue 132) had suggested that there was no reason why only part of the Scheme could not be implied into the contract in question in respect of any parts of that contract which that were not compliant with section 108. Mr. Justice Akenhead confirmed that this did not apply in England & Wales. He thought that the wording of s108(5) was "reasonably clear": "If the contract does not comply with the requirements of subsections (1) to (4), the adjudication provisions of the Scheme for Construction Contracts apply." He added that:

"if there is in the contract adjudication provisions at least one material non-compliance, they all go"

The Judge made another interesting comment, and it is no more than that, in relation to Tolent clauses, noting that Mr Justice Edwards-Stuart had decided in the *Yuanda* case (see Issue 119) that the Tolent-type clause in question did offend against the Act and was unenforceable. Here the Judge said that his colleague had:

"…confirmed …that the intention of Parliament "in enacting HGCRA was to introduce a speedy mechanism for settling disputes in construction contracts on a provisional interim basis, and requiring the decisions of the adjudicator to be enforced, pending the final determination of disputes by arbitration, litigation or agreement". He found at Paragraph 43 that "it would be in express conflict with the requirement that the parties were to comply with the decisions of adjudicators". This does not directly apply to the current case but it is at least an illustration that one needs to consider the purpose of the Act when construing it."

Then there was the question of the nomination of the adjudicator. Sprunt approached the RICS. Camden argued that it was the nominating body. The Judge noted that the concession that clause 25.11 was contrary to s108(3) of the HGCRA, meant that all the adjudication provisions of the Scheme applied. However he then went on to make a further, in his words "stronger point", namely that:

"it is inherently unsound and contrary to the policy of the HGCRA for the contract to specify that one side should nominate the adjudicator. Section 108(2)(e) imposes a statutory requirement that the contract should impose a duty on the adjudicator to act impartially. Impartiality in an adjudicator, or indeed an arbitrator or judge, is judged in two ways, the first being by reference to actual partiality or bias and the other by reference to ostensible or apparent partiality or bias."

The Judge stressed that he was not suggesting any actual bias on the part of Camden, but he did note that it would be difficult to dispel the real possibility that Camden had appointed what it thought was a "horse for the course" and someone who was or might be sympathetic to Camden. The fact that Camden were a party to the construction contract in question meant that it lacked the necessary quality of independence in the nomination of an adjudicator. Here, adjudication was different to arbitration as there is only a limited time in which a party to adjudication can determine if an adjudicator nominated by the other party is or might be considered potentially, actually or ostensibly partial or biased. The Judge concluded that:

"Essentially, what Camden would have is not a judge in its own cause but the right to nominate a judge in its own cause and that strikes against the policy of the act of having actually and ostensibly impartial adjudicators."

Adjudication: interest

Partner Projects Ltd v Corinthian Nominees Ltd [2011] EWHC 2989 (TCC)

Here, Mr Justice Edwards-Stuart agreed that following the decision in *Carillion v Devonport Royal Dockyard* an adjudicator has no freestanding or inherent power to award interest in the absence of a contractual provision granting such power. The contract here was based on the JCT Standard Form of Building Contract, Private Without Quantities, 1998. Clause 30.1.1.1 does not confer a power to award interest on sums which have not been certified. However, the Judge considered that the adjudicator was able to award sums greater than those certified by the architect because the contract gave him the power to open up and review certificates. In the view of the Judge, what the adjudicator had done was to have opened up, reviewed and revised the architect's certificates and to substitute for the sums actually certified the sum that he considered should have been certified. Once this had been done, the adjudicator must be entitled to award interest on the sums due under the corrected certificates.

This was not an excess of jurisdiction. This was particularly the case where the Adjudication Notice specifically invited the adjudicator to decide whether, pursuant to clause 30.1.1.1 PPL was entitled to interest. Accordingly, the question of PPL's entitlement to interest was squarely covered by the adjudicator's terms of reference. If the adjudicator had concluded that PPL was entitled to interest when, on a true construction of the contract, it was not entitled to such interest, then that would have been an error of law in determining a question that was referred to him. It would not have been a case of answering the wrong question; rather he would have answered the right question in the wrong way.

Dispatch is produced monthly by Fenwick Elliott LLP, the leading specialist construction law firm in the UK, working with clients in the building, engineering and energy sectors throughout the world.
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Edited by Jeremy Glover, Partner, Fenwick Elliott LLP
jglover@fenwickelliott.com

Fenwick Elliott LLP
Aldwych House
71-91 Aldwych
London WC2B 4HN

www.fenwickelliott.com