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Thomas Heintzman is counsel at McCarthy Tétrault in Toronto. His practice specializes in litigation, arbitration and mediation relating to corporate disputes, shareholder's rights, securities law, broadcasting/telecommunications and class actions.

He has been counsel in many important actions, arbitrations, and appeals before all levels of courts in many Canadian provinces as well as the Supreme Court of Canada.

Thomas Heintzman is the author of *Goldsmith & Heintzman on Canadian Building Contracts,* 4th Edition which provides an analysis of the law of contracts as it applies to building contracts in Canada.

Goldsmith & Heintzman on Canadian Building Contracts has been cited in over 183 judicial decisions including the two leading Supreme Court of Canada decisions on the law of tendering:

M.J.B. Enterprises Ltd. v. Defence Construction (1951), [1999] 1 S.C.R. 619 and
Double N Earthmovers Ltd. v. Edmonton (City), 2007 SCC3, [2007] 1 S.C.R. 116-2007-01-25 Supreme Court of Canada

Remember *Rainy Sky:* The Commercially Sensible Interpretation Prevails

Every once in a while, an important decision comes along which should be put in your hip pocket so that it can be pulled out when needed. ***Rainy Sky S.A. v. Kookmin Bank*** is such a decision. In this decision, the U.K. Supreme Court (formerly the House of Lords) recently held that if there is a choice between interpretations of an agreement, the commercially sensible one should be adopted.

That principle may not be rocket science, but it is crucially important for two reasons.

First, the Supreme Court held this principle applies even if another interpretation is arguable. The more commercially sensible interpretation will be selected whenever there is a contest over the meaning of a contract.

Second, this approach may make it more important to lay the groundwork for a sensible interpretation in the evidence.

Rainy Sky is an easy case to remember: whenever the sky looks gloomy in a dispute, think of Rainy Sky! It concerned a bond given by the Koomin Bank in relation to a shipbuilding construction contract. The bond was given to protect the buyer in the event of the builder's/seller's default under the contract and obliged Koomin to pay "all such sums due to you under the Contract, between the buyer and the seller."

The question was: what "such sums" did the bond cover? Did it cover only events such as the rejection by the buyer of the vessel, the cancellation or rescission of the contract by the buyer or the total loss of the vessel, all of which were specifically mentioned in the bond as events obliging the seller to repay the buyer? Or did the bond also cover the insolvency of the seller?

In fact, the seller went bankrupt and failed to refund the advances paid by the buyer to the seller, and that event triggered Rainy Sky's claim on the bond. Rainy Sky asserted that the return of the advances was included as an obligation of Koomin under the bond. Koomin asserted that the bond did not cover the seller's insolvency, and that it covered only the specifically mentioned obligations of repayment contained in the construction contract.

The trial judge held that the bond covered the insolvency of the seller. The Court of Appeal held that it did not, and that only the events of repayment specifically mentioned in the bond were covered by it. The UK Supreme Court restored the trial judgment.

The Supreme Court's decision is a ringing endorsement of the reliability of commercial common sense as a touchstone to contract interpretation. The Court adopted the following statement by the dissenting judge in the Court of Appeal:

> "As the [trial] judge said, insolvency of the Builder was the situation for which the security of an advance payment bond was most likely to be needed….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."

The Supreme Court re-iterated the principle stated by Lord Justice Hoffman in another case to the effect that "if the language is capable of more than one construction, it is not necessary to conclude that a particular construction would produce an absurd or irrational result before having regard to the commercial purpose of the agreement."

The Court also referred to a previous decision of Lord Justice Longmore to the effect that "if a clause is capable of two meanings, it is quite possible that neither meaning will flout common sense, but that, in such a case, it is much more appropriate to adopt the more, rather than the less, commercial construction."

The Supreme Court ended its judgment with the following statement:

> "..the omission of the obligation to make such re-payment from the Bonds would flout common sense but it is not necessary to go so far…..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 in which the Bank's construction is not."

The court did not limit this principle to contracts in the nature of bonds and indemnities. Rather, its pronouncement was clearly intended to relate to the general interpretation of contracts. As such, it is of the highest persuasive authority in all common law countries.

The face of the judgment does not indicate that there was any expert or other evidence demonstrating the commercial common sense that the Supreme Court adopted. So that sense of commercial reasonableness had to be derived from other sources.

In the *Rainy Sky* case, a primary source was the commercial skill and experience of the U.K. Supreme Court. A court with that experience can make that judgment which other courts, even of high authority, may not be able to make if composed of judges who have not had extensive commercial experience.

If a judge or court does not have commercial experience, then that experience may have to be provided by expert or other testimony. That circumstance may result in an unfortunate dispute between expert witnesses about what is "commercially sensible". That is a dispute which the Court of Appeal may have felt was undesirable. The Court of Appeal also seemed unwilling to be the judge of what result amounted to commercial common sense when sophisticated parties had not themselves expressly stated that result in their contract.

In any event, we now have a judgment that we can rely upon for a crucial principle: the commercially sensible interpretation of a contract prevails, even if another interpretation is arguable.

Construction Law - Interpretation of Building Contracts - Bonds:

***Rainy Sky S.A. v. Kookmin Bank,* [2011] UKSC 50**

Thomas G. Heintzman O.C., Q.C. **December 3, 2011**

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