



Korea University Maritime Law Research Centre

Maritime Law News Update

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- o Korea University Maritime Law Research Centre aims to provide information regarding domestic and foreign maritime law developments regularly to practitioners, for the future development in Korean Maritime Law. We kindly ask for your support and interest.
- o **This News Letter has been published upon the Maritime Development Fund from Spark International (www.sparkinternational.com) president Sam Park (The President of the Korean Maritime Insurance Arbitrator's forum). We appreciate Mr. Park's contribution.**

1. Refund Guarantee

(Korean Supreme Court case 2015. 2. 26. Docket No. 2012da79866)

1.1 Facts

Dong-Bang Shipbuilding Co. (Builder) and Sun-Woo Shipping Co. (Buyer), entered into a contract for building a chemical tanker. Thereafter, Builder, Buyer and the Suboram Shipping Co. Ltd. (Suboram) entered into another agreement that the Suboram took over the Buyer's status in the contract from the Buyer.

On the same day, the Suboram borrowed 12,600,000\$ for shipbuilding from the Shin-Han Bank (the plaintiff). They made an agreement of transfer all rights from the shipbuilding contract and on the refund guarantee (R/G) to the plaintiff as a security. In this agreement, the Suboram as the principal obligor handed over its right to get the payment from the guarantor in the R/G to the plaintiff as the creditor by way of the contract transferring title for security (Yangdo-Dambo in Korean).

The next day, the Suboram received a refund guarantee letter from the defendant (an insurance company in Korea) in which it will guarantee of payment in case that the Builder has to return the prepaid proceeds from the Buyer due to the Builder's failure to build the ship. The guarantee letter said that the defendant issues a refund guarantee which is "irrevocable and unconditional", and the governing law shall be the English law. Following the agreement, the Suboram notified, to both the Builder and the defendant, that the rights were transferred to the plaintiff. They accepted the notice and agreed the transfer.

In the meantime, the Builder failed to build the ship on time. 6 months later, the Builder handed over all assets on shipbuilding business and the Builder's status to Sunwoo Merchant Marine Co. Ltd. One year after, the plaintiff declared that the contract was terminated or canceled due to default of the Builder under the contract, and asked to the Builder to return the prepayment to it. As soon as the Builder refused it, the plaintiff asked the defendant as the guarantor, to return the prepayment to it pursuant to the R/G letter. The defendant refused to refund the prepaid sum, arguing that i) because the plaintiff was in a status only as the mortgagee, the payment by the Buyer (in this case Suboram) as the main debtor, should be done in advance. ii) Because the R/G in this case is not an independent guarantee, when the principal obligor was changed, the guarantee was cancelled, as a result the right was extinct, and in addition, the claim was also extinct due to the confusion of claims.

1.2. Court's Ruling

(1) Whether the plaintiff is allowed to invoke its rights over claims which was the subject of the contract transferring title for security

The plaintiff acquired all the right from the Suboram based on the R/G letter pursuant to the contract for transferring title for the security over the claim (and thus the plaintiff became the title holder of the claim in the R/G letter), and the Suboram as the creditor gave notice to the defendant as the debtor who, in turn, answered back of approval to the plaintiff. Therefore, the plaintiff has a right to claim full refund against the defendant, regardless of internal adjustment between the plaintiff and the Suboram.

(2) Independent Guarantee in English law

The defendant insists as follows: (i) the Builder handed over its status as a shipbuilder to Sun-Woo Merchant Marine Co. and thus the principal obligor of refund prepayment was changed, as a result, the guarantee was canceled. (ii) Further, the Sun-Woo merchant marine Co as the real owner of the ship assumed the statue of shipbuilder. Therefore, the obligation to refund of the pre-payment and the right for it were taken by the same party, which resulted in the extinction of the main obligation. However, the R/G in the case was "irrevocable and unconditional" guarantee and it is regarded as an independent guarantee under the English law. The defendant is not allowed to invoke the defense of underlying relation in the contract.

1.3. Comments

(1) Whether the plaintiff is allowed to use his rights which was transferred

The plaintiff entered into the contract transferring title for security over the claim with the Suboram. It is non-formal security and only available by case law in Korea. It can be done by the way in which the claim is transferred. The plaintiff made an agreement with the Suboram about the

transfer of claim, and the Suboram gave notice about the transfer to the defendant as the obligor, and the defendant answered back of approval, therefore, the formal requirement under the Korean Civil Code Article 450 and 451 was satisfied. According to the Korean case law, in the contract transferring title for security in case of the property right without official registration, the creditor obtains title in relation to the third party. Therefore, the plaintiff as the creditor obtained full right over the claim against the defendant and thus it was allowed to exercise the full right. The adjustment matter between the plaintiff and the Suboram (obligor) was an internal matter and thus the defendant was not allowed to raise the defence of adjustment in advance.

(2) Independent Guarantee in English law

“Irrevocable and unconditional” guarantee is recognized as an independent guarantee under the English law. In the independent guarantee, the guarantor is not allowed to raise the defence based on the underlying contract. Only when there is the apparent fraud and the banker as the guarantor knew the fact, the guarantor is allowed to refuse the execution of guarantee.¹

The defendant insisted as followings; (i) the R/G in this case was not an independent guarantee. If that is the case, the defendant would be able to raise the defence based on the underlying contract. The defendant argued that the guarantee was extinct because of the change of principal obligor (“takeover of obligation”); (ii) When the Builder handed over the contractor’s position as a ship builder, to Sun-Woo merchant marine Co., the principal obligor of prepayment refund was changed to Sun-Woo merchant marine. (“takeover of obligation with exemption”) from the Builder; (iii) According to Korean Civil Code Art. 459, the guarantor’s duty is extinct when the assumption of the duty takes place. The defendant also insisted that Sun-Woo Merchant Marine Co. as the former buyer, was true owner of the ship, and had the right for prepayment refund. And at the same time, Sun-Woo Merchant Marine took over the status of shipbuilder as the obligor of prepayment refund; (iv) In such case, because the same person has the status as the claimant and the obligor at the same time, such right will be extinct by confusion(KCC, Art. 507), and when principal obligation(main duty) is extinct, obligation by the guarantor(secondary duty) will be extinct too, resulted from the nature of following in the guarantee under the Korean law.

However, the Korean Supreme Court rendered that the R/G in the case was “irrevocable and unconditional” one, therefore it was independent guarantee under the English law, as a result, the defendant was not allowed to raise the defence based on the underlying contract. All claims from defendant falls within the scope of underlying contract.

Therefore, the defendant is not allowed to raise defence against the plaintiff.

¹ More discussion in a paper by Seo Young-hwa, “Several discussions on shipbuilding contract”, Korea Maritime Law Association Review No.32-1(2010.4), page 54.

2. The Applicability of the Standardized Contract Regulation Act to Warranties

[Korean Supreme Court case 2015. 3. 20. Docket No.2012da118846, 2012 da 118853(counter action)]

2.1 Facts

The plaintiff(the insurer), and the defendant (the ship-owner) entered into a hull insurance contract which has a warranty limiting trade area to sail only within an area in the Indian Ocean and an English governing law clause. However, the defendant and the plaintiff made an additional agreement to expand the limited trade area of the contract for a certain period of time, but the refrigeror vessel as the subject matter of the insurance sank and lost all the catch outside the limited area the day after the agreed period for the expanded limited area in the insurance expired. The plaintiff rejected to pay the insurance proceeds to the defendant, arguing that the defendant breached the warranty due to sailing the vessel outside the limited trade area after the period of the additional agreement had expired, and as a result, the hull insurance contract was terminated. The defendant alleged that the insurer breached the duty of explaining the material fact which was “the warranty” in the case to it pursuant to Korean Law regulating General Terms and therefore, the insurer is not allowed to invoke the effect of the breach of the warranty.²

2.2 Court’s Ruling

2.2.1 ‘The duty to explain’ under the Act Regulating Terms and Conditions

‘Terms and conditions’ which is subject to the Act Regulating Terms and Conditions (hereinafter “ARTC”), is defined as the contents in the contract that a party to a contract prepares in a specific form in advance in order to enter into a contract with multiple other parties, while a specific agreement made upon individually does not constitute ‘terms and conditions’. In this case, the plaintiff and the defendant particularly agreed upon a limited trade area as a part of the Antarctic Ocean that reaches higher than 60 degrees South Latitude before entering into the hull insurance contract. Because the particular agreement does not constitute ‘terms and conditions’, the obligation of the insurer to explain the important details in the terms and conditions to the customer under the ARTC is not triggered.

2.2.2 Breach of Warranty

The statement in the insurance policy of ‘Trading Limit: Indian Ocean within I.W.’ and the Institute Warranty Clause Art. 5 that stipulate the vessel shall not trade lower than 50 degree Southern Latitude constitutes as a warranty under English Law, and taking the vessel outside of the trade area limit after the period to expand the trade area has expired was a breach of the warranty.

² Refer to Korea Maritime Law Research Centre Maritime Law News Update Vol.2 (June 13, 2013) p.2

2.2.3 Applicability of the ARTC pursuant to The Act on Private International Law article 25 (4).

In principle, the ARTC is not applicable when the governing law is foreign law. The defendant argues that the warranty did not become a part of the contract pursuant to the ARTC Art.3 because the plaintiff did not explain the contents of the warranty, and the effect of the breach of the warranty under English Law to it.

The English governing law clause was inserted in the insurance contract and it is the common practice in marine insurance. It is neither against the public interest of Korea and the public policy nor infringes the interest of the insured. Therefore, the English law should be applied as the governing law and there is no ground for applying for ARTC. Consequently, the defendant's argument that the plaintiff breached the duty to explain according to ARTC was wrong and rejected.

3. Comments

3.1 'The duty to explain' under the ARTC

Pursuant to the ARTC Article 3, a party which prepared the terms and conditions has a duty to explain material facts to the opposite party. If not, the party is not allowed to make use of the material fact as the agreed terms in the contract. However, 'terms and conditions' which is the subject of the ARTC means any and all provisions that are included in a contract, prepared in advance in a prescribed form for the benefit of one party to enter into separate agreements with multiple counterparties

Whether or not the warranty in English Law falls within the definition of the 'terms and conditions' in ARTC is determined by whether it was included in a contract that have been prepared in advance by one party or if the parties made a specific and separate agreement on the fact at issue.

In this case, the Korean Supreme Court decided that the agreement to limit the trade area of the insured vessel constitutes a warranty in the English Law. The Supreme Court also stipulated that the warranty shall not be construed as 'terms and conditions' because it was not provided in the prescribed form prepared in advance by the insurer but it was agreed upon between the parties separately. Therefore, the defendant's argument that the warranty agreement at the case constitutes the terms and condition in the ARTC and thus the plaintiff had duty to explain of the warranty to the defendant was rejected.

3.2 Warranty under English Law

The Korean Supreme Court has maintained the position that the English governing law clause and warranty clause are enforceable since 1977 when it first addressed it. Under English Law, a warranty must be exactly complied with. If it be not so complied with, even for a minor breach whether it be material to the risk or not, the insurer is discharged from liability as from the date of the breach. It is very different from the Korean Law in which the insurer is allowed to terminate the contract only when the insured did not notify the insurer of the fact that the possibility of the occurrence of a

peril insured against has been substantially changed or increased and, in addition, the fact which was not notified affects the possibility of the occurrence (Commercial Act article 652). In this case, the parties agreed upon the governing law to be English Law, and the lower Court and the Korean Supreme Court stipulated that the agreement for the trade area limit of vessel should be construed as a warranty under the English Law. Then the vessel being outside of the limited trade area constitutes a breach of warranty, and the insurer can treat the contract void regardless of that the breach affected the loss.

3.3 Applicability of the ARTC pursuant to The Act on Private International Law article 25 (4).

The Act on Private International Law Article 25 admits that the parties are able to choose the governing law freely by party's autonomy. Therefore, only when the exceptional circumstances exists the ARTC as a Korean law, the ARTC can be applied in case that the contract includes foreign governing law clause.

The Act on Private International Law article 25(4) stipulates that if all of the elements-the parties, the vessels trade area, the place of the accident etc. - are solely related to one country, the mandatory provisions of the law of the relevant country should be still applied, regardless of the agreed governing law clause, in order to prevent the parties from choosing a unrelated foreign law for the purpose of evading the application of the certain regulations.

The defendant as the ship owner argued that both parties in the contract are Korean entities, therefore, the ARTC which is mandatory law should be applied to the contract pursuant to the Act on Private International Law article 25 (4).³

However, the lower Court found that the contract does contain foreign factors, taking into consideration followings; (i) the vessels trade area was the Indian Ocean, (ii) the accident occurred on the Antarctic Ocean, (iii) the insurance policy was written in English and (iv) the insurance was fixed in US dollars, and therefore that the Act on Private International Law Article 25 (4) does not apply to this case. The Korean Supreme Court supported the lower court's judgment.

3. Events

(1) The 3rd Newly Licenced Maritime Lawyer Training Course

- o Held at Korea University from Mar 23 ~ 25 2015
- o 15 experts including graduates from Korea Univ. Young-Nam Univ. and Chon-Nam Univ. attended.

³ The leading case which the court applied the ARTC to an insurance contract with a foreign governing law provision; Korean Supreme Court case 2010.9.9. Docket No. 2009da105388 – please refer to; In Hyeon Kim, 'Whether Warranty Clause with English Governing Law is subject to Korean Law regulating General Terms', The Korea Maritime Law Association Vol.35-2(2013.11.),p.387-391

- (2) Seminar for the 1st anniversary of Sewol tragedy - “Where we are: Maritime Safety” was held.
- o Held at Veritas Hall, CJ Law Building, Korea Univ. on Apr 16 2015 13:30~20:00,.
- (3) The 19th Asian Maritime Arbitration Conference (Hong Kong, May 11~15, 2015)
- o The KU maritime research centre participates as one of supporters.
 - o Prof. In Hyeon, Kim will deliver the speech on “How to protect the cargo interest under the Korean Commercial Code” on May 11, 2015.
- (4) KMLA’s 2015 Spring Conference
- o Held at Korea Shipowner’s Association’s building on April 23, 2015.
- (5) Clyde & Co. 2015 Spring Seminar- on Shipbuilding contract
- o To be held at the CJ Law Hall, Korea Univ. School of Law on May 20, 2015
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4. Developments in the Research Centre

- (1) Prof. Lee-Sil Chai
- o Retired as the professor as of Feb 28. 2015 after 28 years’ service in the faculty of law of Korea Univ.
 - o Admitted as the attorney at law in Korean and UK as well (Barrister)
 - o Served as the former chairman of Korea Maritime Law Association and IMO legal committee
 - o Also served as the former dean of Korea University Faculty of Law, and School of Law
- (2) Prof. In Hyeon Kim
- o Delivered a speech on “Legal Implication of Sewol Accident in Korea” on Jan 22th at the University of Hong Kong as a visiting professor.
 - o Appointed as arbitrator of SCMA, singapore on Feb 25th
 - o Presented on “Oil Pollution Accident of Hebei Spirit” at Legal Port conference in Long Beach, CA, US on Mar 17th
- (3) Mr. Byung-Suk CHUNG, Attorney at Law (KIM & CHANG)
- o Appointed as adjunct professor of Korea Univ School of Law, for 2yrs from Mar. 1st 2015
- (4) Mr. Woo Young JUNG, Attorney at Law (LEE & KO)
- o Appointed as adjunct professor of Korea Univ School of Law, for 2yrs from Mar. 1st 2015
- (5) Mr. Jum Yul SON
- o Invited as Vice president of TECHMARINE Co. Ltd.