The English Legal View of Trade Credit Insurance – A Practitioner's View

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Summary

Historically, trade credit insurance in the UK began as cooperative protection. It carried through to early insurance contracts some ideas and definitions which continue to be exclusive to it and which arise from the nature of an insurance attaching to a contract of sale.

The attempt to introduce this class of business as an admitted Line at Lloyds, in the early 20th Century, failed as a result of a fraud, but demonstrated a need to establish underwriting discipline. The risk was probably not well-enough understood at that time.

Because trade credit insurance became directly linked with export promotion and government promotion of trade generally, support for the insured became a key feature. Since the carrier of the insurance was often a government department, the duty of care for the insured's business sometimes overcame the usual conditional character of insurance. At the same time, the commercial insurers considered that their overview of industry in their Country gave them a duty to be proactive in guiding insureds away from potential loss by withdrawing cover or restricting terms.

There remains a question as to the relative positions of insurer and insured. Is the insured, even when a large, established commercial undertaking, at a position of disadvantage in negotiation with the insurer? Must the insurer, despite the policy wording, defer to the commercial judgement of the insured? Is there asymmetry between the value of the "overview of industry" on the one side and the "commercial judgement" of the other?

The present writer considers that, as proved by the Court's judgement seen in an English case described, trade credit insurance is an established class of insurance, having over a century of development and refinement of its characteristics in the commercial environment of western Europe. The rights of the parties are identical to those established in insurance law and practice generally.

An Introduction

It may seem odd to start by asking the question; is trade credit insurance an insurance? because the answer may appear to be given. However, the birth of this activity is found in cooperative protection societies where tradesmen of various kinds shared information in an attempt to avoid being left unpaid. The idea of an indemnity for the unfortunate member that the shared information did not protect followed from the idea that this cooperative effort could also take on the task of pursuing the debt. An "insurance policy" was issued in the early 19th century and a "trade credit insurance company" was in operation in England from 1850.

All of the above were responses to a difficulty faced by all businesses; to whom to give credit and how much? By the early years of 20th century and after the First World War, governments saw that promotion of exports was an important economic objective and agreed that the question of extension of credit to potential customers was an essential part of exporting and that the difficulties of knowing whom to trust and to what extent were increased by distance and unfamiliarity with local conditions in the buyer's country. In the

UK the Export Credits Guarantee Department was founded to support exporters in these circumstances.

Initially, the modus operandi was simple; the Department endorsed Bills of Exchange and paid the beneficiary if they were dishonoured. This developed over the years, but there was essentially a "guarantee" function until the Niemeyer Committee proposed an insurance model and the Export Guarantees Act (1947) put this into effect. This model drew on the experience of the Trade Indemnity Company and was refined and copied and promoted around the world.

In the Union Internationale de Assureurs de Credits (Berne Union) several bodies both state (known as "export credit agencies" (ECA)) and private came together in 1934 to "actively facilitate cross-border trade" and establish norms for credit periods for specific products and types of contract (known as "terms for goods"), as well as to exchange information, much as the cooperative protection societies had in the past. While the Berne Union has always been open to private insurers as members, it has to be accepted that the ECA's were the dominant force and that the transactions and decisions had something of the character of "economic disarmament" as individual governments committed their ECA not to offer an unfair advantage by evading the "terms for goods".

While the idea of support for trade credit risks had been moving towards the idea of insurance, its acceptance within the mainstream would have been seen as the point at which the respected Lloyds Underwriter, Cuthbert Heath, became first Chairman of the Trade Indemnity Company (and founded a "trade body" The Credit Insurance Association"), while introducing trade credit insurance into Lloyds. He established "8 Principles" as the foundation of professional underwriting of such risks. However, in 1923 the "Harrison Affair", involving fraud and loss to Underwriting Members of Lloyds, brought the Committee of Lloyds to declare that no Lloyds Syndicate may engage in any form of credit insurance. This prohibition was rescinded only within the last twenty years.

In the present writer's opinion, the way in which trade credit insurance developed through specialist companies and the fact that Lloyds "expelled" the class of risks from consideration by Lloyds Syndicates, has had the effect of establishing the idea that trade credit insurance is not within the "true" definition of a Line of Insurance. This history is bound to have an effect on the way that this class of insurance is treated at least in Courts in the United Kingdom.

Some weight should also be given to the fact that, apart from ECA's the usual trade credit insurer is a monoline company, offering only this Line. The ECA tended to dominate in export trade business and, to set the tone for way in which the insurer related to the insured.

Clearly, any party applying for trade credit insurance is going to be a commercial undertaking which may be assumed to have knowledge of its own industry and business, which is likely to be superior to that of the insurer. However, the ECA, being usually a government undertaking, has generally been seen to lean towards the "export promotion" aspect of its remit and to be supportive of the insured, to the extent of giving a wide measure of "benefit of the doubt". On the other hand, the trade credit insurer (ECA or private) has, under the traditional form of contract, taken the view that their ability to see the experience of a large number of similar firms operating in a market gives them a superior insight into the risks and opportunities that are presented to the individual firm. They might be insuring the sales of the buyer whose risk they are insuring for policyholders and so know a good deal about the risks being run and the success (or failure) of its trading. In this context, they may see the action of

withdrawing cover on a buyer as beneficial to their insured, preventing them from making a mistake which might result in loss. Likewise, the insurer's special position may imply that it is best placed to assess the prospects for recovery after payment of a claim and the best means to pursue this.

"A Lawyer's View"

In her LLM thesis of 2002, Jelena Gazivoda, quoted from a Chartered Insurance Institute publication "Credit Insurance – An Appreciation" (1977) that "There is very little literature on credit insurance". This seems an odd thing for the author (PJB Carson) to have believed, since the history related above shows that the Line had been established for several years and that its features as an insurance had been discussed in several places from the Report of the Niemeyer Committee to the documents of the Berne Union as well as in many books of practical advice, such as those of Burt Edwards, or Professor Clive M Schmittoff, where trade credit insurance is seen as a class of pecuniary risk insurance within the property insurance group.

However, it is a feature of this line of insurance that disputes between insured and insurer tend to be resolved by negotiation or by arbitration before going to Court. Hence, review of published cases, in order to see if the Court considers trade credit insurance questions in the same way as any disputed matters in insurance, reveals a sparse catalogue of reported cases in UK Courts. Gazivoda notes only two involving ECGD and one involving the Italian ECA (SACE) over about forty years. There are later cases (about three since 2002) and one will be discussed below. The leading question at issue in the reported cases appears to be the application of the principle of subrogation and the degree to which the insurer can control the process of recovery following payment of a claim.

The leading solicitors, Ince & Co, estimate that about 70% of all insurance cases reported as starting in the Commercial Court in the UK do not reach a final decision of a Court. The rest are settled either pre-trial or before the case is decided, or are dealt with by private arbitration. It is likely that a similar proportion of cases starts in arbitration, but settle without the arbitrator needing to make an award. Lloyds Insurance Law Reports list about 50 reported cases a year (taking a ten year average) of which about 50% were "procedural issues" rather than consideration of conditions of an insurance contract or its formation. Very few of these cases, whether in the Commercial Court or in arbitration are likely to refer to trade credit insurance.

Gazivoda reaches the clear conclusion that trade credit insurance carries all the marks of a true insurance, being a conditional contract of indemnification and notes that the Courts did not challenge the right of the insurer to exercise the usual rights of an insurer post payment of a claim. The cases considered rested on detail of wording and practice.

Unfortunately, each insurer tends to have their own wording and it is difficult or impossible to take the Court's decisions as being a definitive ruling on the wording as a class. For instance, the use of the term "dispute" can be seen as wider in one company's policy as against the same word used in another company's document, even when both are setting out the case of a buyer disputing the performance of the contract by the insured and the consequences of it for the insurance.

While the interpretation of an insurance contract under English Law will be considered both on the text and the wider intentions of the parties entering in to the contract, judicial opinion

can vary when faced with the instant case. This difference of view is evident in the recent case discussed below.

Euler Trade Indemnity v Apple p.l.c.

In 2002, Apple, the computer manufacturer decided to terminate the distributor contract of its agent "J" in Saudi Arabia on grounds of failure to do enough to promote sales. "J" disputed the termination, demanded compensation and refused to pay for some shipments made immediately prior to the notice of termination. Apple contended that there were no provisions for any compensation in their contract and insisted on payment for goods shipped, which "J" did not deny had been received. "J" also threatened to commence proceedings against Apple in respect of the distribution contract. Apple then became afraid that "J", whose principal was a man of high status, would make it difficult for them to operate successfully in the region. Matters drew on without a conclusion and neither party made any move towards legal proceedings, but several meetings were held and correspondence exchanged. "J" made an offer to place money in escrow towards payment for the shipments, pending a legal resolution of the matter of the distributor contract, although this was not taken up.

Under their insurance with Euler Trade Indemnity (ETI), Apple declared the payments for the goods sold as overdue in policy terms and, eventually, submitted a claim under the "protracted default in payment" section of the policy. It was accepted that the buyer was not insolvent and ETI paid the claim, although it was made subject to Apple "continuing its action to obtain payment". There was some confusion evident on both sides at this point. Apple had decided that they would suffer serious local repercussions if they attempted legal proceedings against "J" and they had decided to restrict their pursuit to occasional letters and meetings. ETI had not made it clear that they expected legal proceedings to be undertaken, but there were grounds for each side to think that the other understood their position. Eventually, in 2004, ETI made its expectations that Apple had commenced legal proceedings clear and requested a report of progress. Apple pointed out that they had decided at an early stage not to take this route for commercial reasons, which they found compelling, and that they had "written off the debt". ETI immediately requested repayment of the money paid against the claim, with interest, on the grounds that Apple had not been behaving as required under the policy to preserve the recovery rights of the insurer. Apple refused to comply and ETI commenced proceedings against them.

When the matter reached the Commercial Court, the Court's award was a surprise to ETI. They had presented the case as their having been prejudiced by Apple's failure to enter proceedings against "J" and, thus, Apple was in breach of policy terms, making them liable to refund the proceeds of the claim, which had been paid conditionally on such proceedings. The Court heard evidence about the problems of entering legal proceedings in Saudi Arabia and the likely damage to Apple's business if such a course were taken. There was also pleading that the instructions from ETI were imprecise and that Apple had been able to reach a reasonable conclusion that ETI was willing to follow Apple's decisions.

The Court decided that the danger which Apple saw in pursuing the debt was reasonable and that the potential loss of business outweighed the duty to ETI in respect of the claim payment. It is noteworthy that, in this case, the Court was taking the view that the insured did not have to follow the instructions of the insurer in respect of actions after claim payment, notwithstanding policy conditions and customary insurance procedure. While the Court considered that that ETI had proceeded in expectation that Apple was pursuing the buyer by legal action, it never the less absolved Apple from any action which might mitigate the loss

or bring about recovery of the debt, on the grounds that the insured's interests overtook those of the insurer. The usual rights of an insurer were negated.

If matters had rested at this point, it would have been necessary to say that, on the outcome of this case, trade credit insurance is not an insurance because it cannot rely on the insurer's normal expectations of the behaviour of an insured. It could be argued that the trade credit insurance policy had also been taken out of the class of a guarantee, because the insurer was also deemed unable to direct action which might recover the sum paid out. (There was no consideration of subrogation rights in the judgement, but it may be assumed that the Court would not have seen this as available to the insurer.).

The case went to Appeal and the Court of Appeal started from an entirely different premiss. The judgement opened with the relevant sections of the ETI policy set out in full. While the judgement carried some criticism of the clarity with which ETI had expressed its expectations and sought to define its rights as an insurer after paying a claim (and also, before paying the claim, as to effective action which might mitigate the loss), it was completely clear that the insured had no right to proceed entirely on their own opinion of what was the reasonable action to take. It was for the insurer to decide upon and direct action which they considered likely to be effective in making recovery. Apple was bound to return the claim payment because they were in breach of the terms of the insurance.

It is instructive to note that the whole argument heard and accepted by the Commercial Court (the earlier case) was that a trade credit insurance contract was less than a guarantee in the rights available to the insurer and also had not the force of an insurance policy in determining the way that an insured should behave towards the insurer. The lack of forcefulness in communications, via the intermediary (the Broker), between ETI and Apple, and the insurer's lack of clarity in some points, were seen as more important than the terms of the policy. The commercial judgement of the insured, even after claim payment, superseded the rights of the insurer.

The Court of Appeal (the later case) treated the case within the general class of insurance disputes. The judgement was founded on the terms of the policy. The Court went further than ETI in making the observation that, on strict interpretation of the policy, the original dispute over the distributorship agreement was a "dispute" as defined and would have entitled the insurer to decline to consider the claim until that dispute had been settled. While making criticisms of the communication between ETI and Apple, the Court of Appeal was clear in awarding ETI the full extent of the rights of an insurer.

<u>Conclusion</u>

The basis of English insurance law is the Marine Insurance Act 1906, but actual insurance contracts frequently move away from the clear definitions included in the Act (see the paper by Croly and Merkin reviewing the Marine Insurance Act in 2006). Trade credit insurance often rests on proprietary contracts specific to each insurer, which include their own definitions. There is no codification of trade credit insurance law in England; it is a commercial insurance, so the Financial Services Authority recognises that the parties have wide discretion as to the terms on which they contract.

The usual source of established definitions is through a history of decisions in reported cases, as in the old saying that "every word of the Lloyds Marine Form has been litigated on", this is not the case with trade credit insurance. Anecdotally, the majority of disputes appear to be

settled either through negotiations between insurer and insured, or by arbitration. This suggests that the relationship is more between equals than an overbearing insurer against a weaker insured, however, it presents the problem that, since arbitration decisions are not reported, it is not known what wordings or aspects of the relationship have been tested and proved.

However, it is clear that the norms of insurance practice and law have been followed over the years and that the Financial Services Authority considers trade credit insurance as an insurance among others for registration purposes. Likewise, in the few decided cases which have been published, trade credit insurance has been treated in an equivalent manner to other Lines, even if the course of the actions has not been direct, as in the case described above.

References

Gazivoda, Jelena University of Cambridge LLM Thesis 2002 "Distinctive Features of Export Credit Insurance: A Lawyer's View". Gazivoda looked for reports of settled cases and approached the question from the treatment of claims. Her case review is useful.

Croly, Colin and Merkin, Professor Rob. "Doubts about Insurance Codes (Codification in English common law, with particular reference to the Marine Insurance Act 1906)" Journal of business Law, Nov 2001, Sweet & Maxwell.

Heath, Cuthbert: the 8 Principles of Credit Insurance are:

Credit risks for goods sold and delivered
Losses due to insolvency
No guarantee of payment at due date or payment of disputed items
Insured debts to be self liquidating
Terms of payment should be short
Coverage of no more than 75% of sums at risk
No cover for existing commitments
No insurance of loans or advances by banks

Euler Trade Indemnity v Apple Computer BV (CA April 2006 on appeal from Mackie J) EWCA Civ 375