

Trade credit insurance - “to sue or not to sue”

The Court of Appeal has had important things to say about whole turnover policies and protracted default.

The wording of trade credit policies is not often analysed by the senior English courts. So the decision of the Court of Appeal in April 2006 allowing the appeal against the decision of Judge Mackie QC in the case of Euler Hermes UK plc v Apple Computer BV [2006] EWCA Civ 375 has been of considerable interest to professionals and others in this field. In particular, Lord Justice Moore-Bick has provided an insightful analysis of:

- when a debt is a disputed debt, and whether it has become payable; and
- whether the policy obligation to take ‘all practicable measures’ to prevent or minimise loss, and to realise salvage, is such that an insured’s commercial interests can be taken into account.

Background facts

Apple purchased from Euler an export credit whole turnover policy, protecting it against the standard trade credit risks of insolvency and protracted default. Towards the end of 2000, Apple terminated its distribution agreement with Jeraisy, its agent in Saudi Arabia, and sought payment for outstanding debts owed to it in respect of goods delivered to Jeraisy. The agent did not dispute the debts but counterclaimed for the termination of the distributorship; and, in support of the counterclaim, withheld payment of the invoices due.

Apple claimed indemnity under its policy and informed its insurer that it would begin legal proceedings to recover the debt in the very near future. Euler accepted the claim for indemnity, as evidenced by a letter sent to the broker. This letter - which the Court of Appeal described as ‘inept’, and which gave rise to serious problems of interpretation - seemingly required a court ruling to the effect that Jeraisy was indebted to Apple. The letter also requested the insured to execute a letter of undertaking (LOU). The LOU provided that Apple would “continue to take action against the debtor ... to recover the outstanding debt in full.” The insured gave the undertaking and payment by insurers was made.

Apple subsequently decided that it was not in its commercial interests to start legal action, given the amount of money involved, the uncertainties of taking proceedings in Saudi Arabia and the fact that Jeraisy was a highly influential Saudi businessman who had threatened a substantial counterclaim (points frequently taken by trade credit insureds).

Euler took the view that Apple’s failure to pursue proceedings against Jeraisy amounted to a breach of the settlement and sued Apple for the indemnity paid.

Trial court decision

Judge Mackie QC in the Commercial Court decided that the terms of the settlement were contained solely in the LOU and not (as argued by the insurer) in the covering letter. The judge ruled that the obligation imposed by the LOU was the requirement “to continue to take action” – which meant taking such steps as were reasonable from Apple’s perspective. This requirement had been met by Apple. Judge Mackie considered that a decision about whether to start legal proceedings in a foreign jurisdiction was a difficult one; it was a wholly different situation from a domestic debt collection. Apple’s decision not to sue was reasonable, he concluded.

The appeal

The Court of Appeal reversed the decision and interpreted the covering letter as imposing an obligation on Apple to ensure that the dispute with Jeraisy was resolved in its favour and that its right to recover the debt was clearly established, whether through legal action or otherwise.

Apple had therefore breached the settlement and the insurer was entitled to recover the indemnity.

Lord Justice Moore-Bick also gave trade credit insurers a helpful indication of the Court of Appeal's approach on two key issues:

- (1) whether a debt is disputed, and has become payable; and
- (2) whether the obligation to take "all practicable measures" to prevent or minimise a loss and to realise salvage is such that the insured's commercial interests can be taken into account

Disputed and payable

The claim had been presented to the insurer on the basis that the debts were not disputed and were all due for payment, and that therefore there was a protracted default within the meaning of the policy. However, under the policy wording, Euler was entitled to withhold payment if the buyer claimed that he was entitled to withhold payment and Euler was satisfied that an unresolved dispute between the insured and the buyer existed. The broad intention of the policy was to provide cover in respect of non-payment of undisputed debts but not for the nonpayment of disputed debts. However, that left open the question of what type of dispute would justify paying up under the policy.

Apple argued that the word 'dispute' in the policy wording referred to a dispute about the existence of the debt and that, since the debt itself had never been challenged, payment had fallen due. However, the Court of Appeal ruled that the term 'dispute' covered any claim by the debtor to a right to withhold payment. Since the buyer in this case said that he was entitled to compensation for termination of the distributorship and was withholding payment on those grounds, that was enough to render the debt disputed.

Consequently, even though there was no allegation that the insured goods were defective or delivered late, the counterclaim (although described as 'specious' by Judge Mackie) nevertheless did constitute a dispute within the meaning of the policy wording.

"All practicable measures"

Lord Justice Moore-Bick observed: "Since the clauses [were] intended to benefit Euler as well as the insured, I very much doubt whether the obligation to take 'all practicable measures' to prevent or minimise a loss and to realise salvage, entitles the insured to take only such steps as it considers to be in its own wider commercial interests."

While not binding, this is a useful indication of the approach the court may take to any argument by an insured that it cannot be expected to sue because that may damage its wider commercial interests.

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