The principle of due diligence and the requirement to try to minimize the loss during the waiting period in trade credit insurance.

I am approaching this subject firstly, from the viewpoint of a practitioner, rather than a lawyer, but, secondly, with an eye to the question of the relative positions of the insured and the insurer; which is the stronger party? [Slide 2]My scheme is to look at what insurers want, what they expect and what they often get in terms of application of the due diligence principle.

I will be approaching the subject generally from English Law principles and cases.

My remarks will apply almost exclusively to what is termed "short term credit", a term of payment up to 360 days; I will not consider project contracts involving structured finance.

Due diligence appears to me to be one of those terms which gives comfort and assurance to laymen and assurance of a comfortable income to lawyers. I need to unpack the term a little.

To approach a question about insurance in English Law, one could start with the Marine Insurance Act 1906; a codifying Act according to the practice of the time. While referring to marine insurance and giving directions for the interpretation of the Lloyds SG Form, it was taken from its inception as a guide to insurance generally. The Act defines the duty of "utmost good faith", but does not mention such a thing as a "claims waiting period". One could then go on to look for decided cases and see how these have modified our understanding or brought about modifications of standard insurance clauses. Overall, one will find, firstly, that Marine Insurance Act definitions are not mandatory and have long been avoided in actual insurance contracts; secondly, there is a very sparse list of reported cases involving trade credit insurance contracts and, thirdly, not all trade credit insurance policies take the same line in setting out what the insurer expects from the insured in case of a loss under the policy.

The waiting period sometimes passes without the insured having any duties except to follow policy conditions and immediately, or very soon after, buyer default pass the debt to the debt recovery company specified by the insurer. The recovery company takes on recovery action reporting to the insurer. Any step requiring action by the seller (the insured) is done under instruction from the insurer, with the recovery company acting as agent. In such a case, the waiting period gives time for the recovery to be made, or for the buyer to be made insolvent, or possibly simply disappear.

In fact the claims waiting period may not exist in some forms of trade credit insurance in respect of specified causes of loss, particularly insolvency.

At this point we should consider the definition and purpose of the claims waiting period. While loss arising from insolvency often carries no waiting period after receipt of the confirmation of debt by the insurer, other causes of loss may define a waiting period as "X" days from due date of payment, or from date of deposit of local currency. In all cases a proof of loss acceptable to the insurer will be required before claims payment, although the insurer may issue an admission of liability before expiry of the waiting period. So what is the waiting period for?

[Slide 3]The usual view of the waiting period is that it exists for the loss to "crystallise" or for the maximum recovery to be realised and so is established on an empirical basis of how long this process might take. We see a difference between the two main forms of credit insurance; wholeturnover, which I prefer to call "limits based", and excess of loss. [Slide 4]The insurer under the wholeturnover form, which is the traditional form, requires the insured to have all buyers approved as to maximum value of credit and often of the term extended. Any discretionary limit is small, but, more importantly, the freedom of the insured is restricted. Due diligence is required of the insured in the sense that they must be alert as to the progress of the sale, make appropriate declarations and reports to the insurer and, when required, pass the debt to the collection agency nominated by the insurer.

An excess of loss policy, [Slide 5] where the insured bears a deductible or aggregate first loss, generally based on actual loss history, usually gives the insured a discretionary credit limit often equal to the deductible. Both forms of policy require the insured to warrant their credit procedures, but this form requires the insured to exercise the procedures independently of the insurer, for example in setting most of the credit limits. In case of an overdue payment, or potential loss, the insured reports to the insurer, but proceeds to take recovery action as under their credit procedures and at their own cost until ultimate recovery or established loss**.** The due diligence required of the insured under such policy terms is of a high order and it is assumed that the insured will have the resources and experience to handle the matter better even than the insurer's claims department. Where the insurer is involved it is more akin to a partnership than direction.

[Slide 6] Under either form the starting position is always that the insured should "behave as a prudent uninsured", which means that they should establish a debt which is legally enforceable and maintain the debt and their relation to the debtor such that action to recover will succeed or that the debt will rank for full value under the insolvent estate. A well managed seller will maintain this position irrespective of insurance.

[Slide 7] However, if the seller wants to make a claim under trade credit insurance, then they must ensure that the contract falls within the terms of the insurance policy and this will include its attaching within the policy period, for goods and terms of payment defined in the policy and within any definition of territory and, of course, payment of relevant premium. Other requirements might be that the contract, or shipment is duly reported to the insurer and that the insurer is advised promptly of any changes to the contract and of any delays in collection by the buyer or delay in payment after due date.

The insured must follow the policy requirements and behave as if the loss will be entirely retained, irrespective of whether the insurer has made any check as to compliance with the policy terms. As we have seen there is a distinction between the two main types of policy, in terms of what the insured is required to do and to what extent the insured may exercise judgement as to effective recovery action; [Slide 8] the due diligence requirement includes maintaining the legally enforceable indebtedness as well as taking measures, such as establishing where the goods are and, if possible, enforcing retention of title.

It is clear that it is part of the due diligence required of the insured that, for a debt to be insurable, nothing should have been done to impair the prospect of collection or enforcement, at any time. This is part of the assessment of a claim.

Where there is greatest freedom extended to the insured the insurer is exposed to some danger that a well-intentioned action taken on the best advice might actually result in the recovery being compromised or failing. In such a case, one would like to turn to an insurance code or a legal definition or to decided case law to establish the position of the parties. As has been mentioned earlier, in English Law, one turns in vain. Generally, disputes arising under trade credit insurance are settled by negotiation, or by arbitration, so there is probably a continual process of "learning by doing" or "re-inventing the wheel" by insurers and also by insured. Specialist trade credit insurance brokers sometimes maintain files of decisions taken by insurers in difficult cases and use them as precedents.

Under the provisions of the discretionary credit limit an insured seller might approve a limit, or change terms of credit, and require some form of security to support it. What is their position if, on buyer default, they discover that such security cannot cover business debts under local law? Insured had certainly behaved with utmost good faith, but had not asked the fatal question of their local legal advisers. Would the claim be settled?

It is very clear, whether from the side of the insurer or from the insured, that the insurer has the right to control all action after claim payment, even to exercise rights of subrogation and to take over documents and legal actions in progress if they so decide. However, without specific wording in the policy, the insurer has no right to instruct the insured on action prior to claims payment. The sanction of not admitting the claim as insurable because the insured has not taken reasonable steps always exists.

[Slide 8] The insurer's position is a strong one. The terms of the policy are likely to require the insured to follow the unpaid debt. The option of doing nothing is perilous if it is intended to make a claim. At least, the insured is required to submit necessary documents to the nominated collection agency. In other cases, the insured must behave according to the collection processes set out in their credit procedures. Failures which result in a debt being increased or a possible recovery not being made can justify denial of the claim.

The insured may find that they must take a wider view than the immediate potential loss. Where the insurer has given discretion and before rights have arisen under subrogation, the insured is likely to look to the business implications. It is possible that early legal action might have a negative effect, the struggling buyer might have no resources to meet a judgement; an easy instalment plan might bring full recovery. In some cases the insured might be afraid for the company's reputation if they are seen as "unsympathetic". In the case of Euler v Apple Computer NV 2006, the insured claimed that they genuinely feared for their future business in Saudi Arabia if they took legal action against the buyer.

Looking at a default from the position of the insured seller, there is the cashflow cost of a delayed payment; on the other hand there is a commercial opportunity. If the buyer can be managed out of the problem, and the seller's financial condition can support it, then the buyer is likely to have a very good opinion of the seller and a more close relationship can be established, even if the buyer's activities are reduced after financial reconstruction. In fact, some legislations make it advantageous for a seller to maintain this position if they can. [Slide 9]This can open a dilemma for the insurer; whether to insure new shipments or risk the insured failing to keep the favoured relationship through lack of financial backing. Is it required under due diligence that the seller should put themselves at greater risk by extending unsupported credit which might give a better position at the conclusion of insolvency proceedings?

In situations where the insured claims that wider business concerns preclude legal steps for recovery or pursuit of the buyer, the objective proof of the insured's view may come only after the case has been pursued and the damage is seen. There have been situations where local legislation has prevented exporters from pursuing non-payment cases (the crisis in Argentina comes to mind), and the cause of loss moves into the category of political, when only an insurer, or even the Berne Union, can enter into a dialogue with the host government to try to minimise loss or promote recovery. In this case the insured's due diligence can refer only to providing supporting documents and keeping the insurer advised of any communications received from the host government or the buyer.

So far as I know, no English Court has ever considered a case where the insured was able to present objective and unassailable proof that normal, legal pursuit of a debt had, or would have, caused catastrophic loss of reputation or future business in the industry or in the buyer's country generally. Hence, the insurer is in a strong position against the insured, the insurer may decline a claim on the grounds that the insured has taken no steps which were likely to mitigate the loss. [Slide 10] Obviously, where through want of due diligence the insured fails to present proof of debt to a liquidator in an insolvency and falls out of time to register the debt, the insurer has strong grounds for declining a subsequent claim. If however an insured seeks local legal advice and receives an estimate of costs which is disproportionate to the debt, together with a verbal suggestion that the matter would be better not proceeded with, how would the balance of power rest between insurer and insured and how might a court decide if the case came before a judge?

As we know, much that is uncertain or unexpected in trade credit insurance is settled by negotiation between insurer and insured, or by arbitration, and most claims are settled without arbitration. The partnership principle is very important, but a key aspect of any partnership is the free transmission of information. To proceed on an assumption that "what they don't know won't hurt them" or "I know what I am doing, they will just have to put up with it", is likely to place any relationship in serious doubt and legal relationships in court with a bad outcome.

Some insurers issue a settlement letter setting out in great detail what the insured is expected to do and restating what the policy requires. I have heard lawyers say that such a letter "restating what the policy requires" rather than clarifying or strengthening the insurer's hand, will introduce uncertainty in the event of litigation or arbitration.Can such a settlement letter imply that the insurer is uncertain of the strength of the original policy wording, or that the claim has left a doubt in the claims officer's mind? Is this an admission of a weak position on the part of the insurer, is the insured the "strong party" after all?

While many insurers and, even state export credit agencies (ECA), have "fraud units" reviewing paid claims, ECA used to believe that it would look bad if they took sellers to court because it might put people off seeking export credit insurance and, thus, put them off exporting. This may be all in the past, but I might submit that, especially in the wholeturnover class of insurance, there remains something of that rather paternalistic view. As if to say that the insured is struggling in a difficult world and a quick payment of the whole claim is needed to keep the insured from going under. If this is still part of the culture, then the long, defensive settlement letter is an understandable, if a slightly hazardous way, of guarding one's back.

After payment of a claim, there is no doubt that the insurer's position is strong and quite rightly so. Even if it is decided that a claim should be paid conditionally, or a part payment made on account, pending the result of further action, the insurer is entitled to expect the insured to continue agreed lines of action and to report fully. Even if the insurer is remiss in following up reports or is careless or imprecise as to what is expected, there is no licence for the insured to assume that all decisions are theirs to be taken and that the insurer has no rights. [Slide 11] The duty of due diligence owed by the insurer to their reinsurers obviously requires that no claim payment is imposed on the treaty which has features which would exclude it from the treaty if known. At this point, the weight of due diligence falls on the insurer to be satisfied that the debt itself met all relevant policy conditions and everything customarily and reasonably required has been done by the insured towards mitigation of loss and recovery of the debt. In the majority of cases, it is the actions of the insured which are conclusive and the insurer is under due diligence required to follow, document and understand them.

It is one of the attractive things about the world of trade credit insurance that one has never seen it all and that the last word will never be said. It depends at every step on trade flows, economic movements and the attempts of human beings to address them and also sell something to someone else and make a profit. The credit insurer who forgets the reality of trade, especially international trade, and insists that the wording of the contract can cover all eventualities at all times, is a menace to his company and to the reputation of our line of insurance. There is always the case that you have not seen before or the way out of a problem that you have not thought of or that you did not have the nerve to suggest, but someone else has. The wording of the policy might give the insurer great strength against the insured, but it might not suggest the best outcome.

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