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AUSTRALIAN COURT OF APPEAL UPHOLDS JUDGMENT AGAINST TRADE CREDIT INSURERS IN PHOENIX NON-PAYMENT CASE

On 20 February 2023, the New South Wales Court of Appeal issued judgment in the case of *BCC Trade Credit Pty Ltd v Thera Agri Capital No 2 Pty Ltd*.

The Court of Appeal dismissed the appeal brought by BCC against the first instance judgment in favour of Thera. Building on the decision of the Kuala Lumpur Courts in Westford Limited v Archipelago (HFW | HFW Advises Westford In Successful Trade Credit Ins...), this represents another example of a common law court ruling in favour of policyholders following the non-payment by an insured buyer under a trade credit insurance policy.

Background

In February 2020, Thera, an Australian non-bank structured credit financier specialising in agricultural commodities, entered into a supply chain finance facility with the Phoenix Group, a commodity trader operating out of Dubai.

The purpose of this facility was to facilitate the pre-export operations of grains and pulses from Australia for sale in Asia. So as to comply with sharia law, the facility was structured as follows

- Phoenix would approach Thera with a Request to finance certain trades by way of Murabaha Contract. The parameters of the trade and the supplier was organised by Phoenix.
- If the Request was accepted, Thera would appoint Phoenix as its agent to purchase certain approved commodities from the supplier on Thera's behalf.
- The funds for this purchase would be provided to Phoenix by Thera to allow them to purchase the commodities as agent of Thera
- Thera, following the purchase, would acquire title to the commodities from the supplier.
- Thera would then immediately sell the commodities back to Phoenix, inclusive of a pre-agreed margin (i.e. a profit disclosed sale).
- Phoenix would repay Thera in full (inclusive of the agreed margin) on credit terms at an agreed deferred payment date.

The facility was guaranteed by the Phoenix holding company in the BVI, namely Phoenix Commodities Pvt Ltd. Thera also took out a trade credit insurance policy with BCC to cover any non-performance of the guarantee by Phoenix BVI.

Pursuant to the facility, Thera advanced some USD 7.3 million to Phoenix in four drawdowns. However, it was agreed that the actual drawdowns did not operate in compliance with the above steps. In fact, Phoenix never purchased the commodities as agents of Thera and the funds were advanced by Thera to Phoenix after entering into the purchase and sale contracts, not before.

Phoenix BVI went into liquidation on 20 April 2020, following shortly after by Phoenix Dubai. None of the funds advanced to Phoenix have been repaid and the guarantee did not respond.

As a result of this non-payment, Thera filed a claim under the policy which was rejected by BCC. Among the reasons cited for rejecting the claim, BCC argued that:

- The documents used by Phoenix to obtain financing were "shams".
- Thera had failed to establish that it had acquired title to the goods before selling to Phoenix, particularly as the funds advanced to "purchase" the commodities had been advanced after the purchase and sale contract had been entered into.

- Thera had failed to comply with the appropriate structure in the facility.

Court of First Instance Decision

At the outset, the trial judge (Rees J) acknowledged that certain of the underlying trade documents were shams i.e. "*the commodities existed and had been shipped under the bills of lading but were not, in fact, the subject of the Purchase Contract and Commercial Invoice*". However, Rees J noted that Thera was not involved in any fraud but rather:

> *"The insured was the victim of a fraud practised by its customer, perhaps to 'prop up' their parlous financial position".*

The question for the Court therefore was whether Thera would be entitled to an indemnity under the policy notwithstanding that the underlying trade documents were likely shams. On this point, Rees J found in favour of the Thera and held that:

> *"Loss caused by the material default or fraudulent, dishonest or criminal acts of the Counter-Party or Guarantor falls within the insuring clause".*

Per Rees J, construing the contractual documentation in any other way would *"make commercial nonsense or work commercial inconvenience where the Company could simply avoid its obligation to repay the funds advanced by providing false documents and information when requesting the funds"*.

On the issue of title. Rees J cited favourably the case of MGICA Ltd v United City Merchants (Australia) Ltd and the principle that *"whether title to the goods had passed to the customer was a matter within the customer's knowledge but not matters which the insured and insurer contemplated would be within their knowledge"*. The issue of title, insofar as it was relevant to the policies, would therefore need to be judged on the faith of documents relied on by Thera and presented to BCC i.e. the invoices and supporting documents provided by Phoenix. An actual sale and purchase of the goods was not necessarily required.

Finally, on the compliance point, Rees J held that the variations from structure under the facility (as above, it was uncontested that the structure in the facility was not followed) did not take the transactions outside the scope of the Policy. Thera was still entitled to repayment from Phoenix and to call on Phoenix BVI to honour the guarantee.

On this basis, the Court issued judgment in favour of Thera.

Court of Appeal Decision

On appeal, the majority (Macfarlan JA and White JA) accepted the reasoning of Rees J and dismissed the appeal. Per Macfarlan JA, the key point was that:

> *"the Insured's loss arose out of the non-fulfilment of contractual obligations of the Counter-Party (and Guarantor) of the type described in the Exhibit A documents, and therefore as contemplated by the Policy".*

In his dissent, Basten AJA declared that the policy could not respond in circumstances where the terms and conditions of the Facility documents were not followed. He was of the view that the departure from the structural framework was sufficiently material such as to deprive Thera of cover under the Policy:

> *"It may not have mattered if, for example, Phoenix had merely not sent Thera a "purchase confirmation" pursuant to cl 2.3 of the Purchase Agency Agreement, but it did matter that the purchase on behalf of Thera never took place. Further, as title in the commodities did not pass from Thera to Phoenix, no Murabaha Contract was created by the letter of offer and acceptance. While there was an obligation created on the part of Phoenix to repay an amount calculated as if the earlier transactions had taken place under the Master Agreement, that was not an obligation which arose "in accordance with" the Master Agreement, although it used the language of the Master Agreement and related documentation. Accordingly, the obligation upon which Phoenix defaulted was not an obligation created in accordance with the Master Agreement and therefore the default was not one to which the Policy responded."*

However, the majority disagreed. As per MacFarlan JA:

> *"it is not in my view important that the transaction documents were not executed in the sequence contemplated by the Master Murabaha Agreement".*

White AJA noted that while it was agreed that the sequencing in the facility wasn't followed, there was no dispute as to whether Phoenix was liable under the guarantee. He concluded therefore that:

> *"the policy is engaged because the Guarantor failed to honour its obligation to repay the payment advanced to the Counter-Party by Thera in accordance with the Trade Finance Agreement as it was implemented in accordance with the proposal."*

Fraud

The majority judgment also included some useful dicta on the relevance of allegedly sham contracts to the issue of trade credit insurance cover and whether fraud on the part of the buyer (Phoenix in this instance) could deprive an Insured of cover. On this point, Macfarlan JA held that:

> *"By reason of the objective theory of contract, a fraudulent intention of only one party to the contract, uncommunicated to the other, does not suffice to render the contract a sham "sham""*

He further noted that this was consistent with the fraud exclusion in the Policy, which excluded loss arising out of *"the fraudulent, dishonest or criminal acts of the Insured"*, but not similar fraudulent, dishonest or criminal acts of the buyer. On the contrary, *"Loss arising from such acts of a person with whom the Insured has contracted is however the very type of loss one would expect to be covered."*

The key question therefore was not whether the buyer acted fraudulently but whether the contract between the Thera and Phoenix giving rise to the receivable was enforceable or not i.e. was there any basis under the contract for Phoenix to withhold payment to Thera. As per Macfarlan JA:

> *"the Insured is entitled to claim indemnity for its contractual loss suffered under its genuine contracts entered into with another party (here the Counter-Party), notwithstanding that that other party may, unbeknownst to the Insured, have acted fraudulently."*

The Court's reasoning in this regard should provide guidance on how instances of fraud are to be interpreted in trade credit insurance policies going forward.

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