I begin this chapter by discussing a number of ethical issues that touch on the promise to pay a debt, the forgiveness of a promise to pay that is not kept, and on liquidation, fraud and recklessness. Thereafter I list a number of matters that the credit insurer needs to keep in mind in order to comply with his moral duties in the settlement of claims.

HAS A TRADE DEBTOR A MORAL DUTY TO PAY HIS DEBT?
A trade debt is the result of a contract. It is the promise to pay the debt that is intrinsic to a contract of buying and selling on credit, and it is this promise that is the moral force behind a contract.

There are three Kantian reasons for a moral duty to pay a debt:
1. The Formula of Universal Law (see page 11). It would not be possible to universalize a maxim that would allow breaching a promise (unless a much weightier issue forced the breach) as this would be irrational – a promise would be a totally meaningless concept, and hence one could not achieve whatever goal one had in making the promise if everyone broke promises. To break the promise to pay would be unfair, unreasonable, based on the wrong intentions and an action not from duty, i.e., it would not be morally
and legally right (unless there are very good reasons), and as we have seen from the
discussion on pages 13 and 14, a maxim providing for the dishonouring of a promise is a contradiction. According to Kant, moral actions are based on good reason and impartiality. While the debtor may wish not to pay and enrich herself in this way, such an action would be driven by her personal inclination and would therefore not be ethical. A person of good character, or a business wishing to perform the right action, would act from a maxim that is universalizable. Universalization treats all people in the same way – one cannot just take without giving. The universalization principle is the key for an act to be moral. As has been shown earlier (see page 13), a maxim that would include breaking a promise would be a contradiction in conception.

2. The Formula of the End-in-Itself (see page 11). If we promise something to another person that person relies on it. Were we to break our promise willy-nilly we would ignore the categorical imperative always to treat the humanity in a person as an end, and never merely as a means. Breaking the promise would indicate that we do not care for the person, that we have used the person to get what we want without paying our due, and ignoring the person’s rights. As Kant said through the categorical imperative: do not merely use a person to achieve your own goals – to do so ignores the intrinsic dignity and autonomy of the person. Such a maxim would also represent a contradiction in will because it would endeavour to use the concept of a broken promise to obtain something (see page 13).

3. A promise has moral force because it has been made autonomously by a rational being. Autonomy is intrinsic to the human being enabling and forcing the person to choose (as opposed to other sentient beings). A promise creates expectations about the future behaviour of the agent. The agent, through the promise (an expression of free will) limits his future choices, but not his ability to exercise autonomy (which is guaranteed by our being rational agents). As Jukka Kilpi says (37. Kilpi, 1998: 58/9) “The expression of an autonomous will is not just a contingent, ethically irrelevant moment in the endless sequence of events, but a demonstration of the capacity to reshape the future through the imposition and observance of moral principles. This statement
amounts to more than just a definition. It is a true description of a uniquely human characteristic, and as such it is powerful enough to make true the moral principle that promises should be kept. The moral permanence of promissory obligations rests on the autonomy of the promissors, on their capacity to shape the future by introducing permanence which is valid independent of changes of mind and mood.”

As has been noted in pages 49 and 50, a corporation has no autonomy but because the persons representing the corporation have (through their autonomous action) agreed to treat the corporation as an agent and built a decision structure that expresses its intention, the corporation has secondary moral agency. Because of this status those who represent the corporation have the duty to honor the corporation’s promises, and others their promises to the corporation. When a company makes a promise to pay it does so through the natural person who represents the company. The natural person does not incur personal liability - unless she specifically states so - and her making the promise on behalf of the company does not affect her autonomy because the promise is made on behalf of the limited liability corporation. The limit liability character of the debtor is public and all have agreed to the transaction in the full knowledge of the debtor’s status. The parties have thus accepted that the natural person is acting for the debtor and has a personhood quite distinct from that of the debtor and although the natural person is not personally liable for the fulfillment of the debtor’s promise, the corporation, as a secondary moral agent, must honor its promises.

FORGIVENESS OF A PROMISE TO PAY THAT IS NOT KEPT.

I stated above that a debtor (whether an individual or a company) has a moral duty to pay her debt and that promises must be kept. However, there is general agreement that there may be good reason to release an insolvent from her promise, provided that her state is not due to her own fraudulent or reckless action. The following are suggested grounds for such forgiveness:
1. Forgiveness of debt can at any time be granted by creditors if they wish to show mercy. However, there is no institutional way to forgive; it can only be done by a unanimous act by all the debtor’s creditors.

2. Impossibility of the debtor to comply with the promise to pay, e.g., if the debtor simply does not have the funds. As has been said earlier, an ethical “ought” implies a “can”. It would be absurd to impose a moral duty where the performance of such duty is impossible.

3. Utilitarians believe that it is ethical to release an insolvent from his promise to pay because such release is seen as providing the best outcome for the debtor, for society and often also for the creditors. Clearly, for the debtor it is advantageous to be released, and for society it also seems preferable because a debtor who is forever obliged to repay his creditors has no incentive to find a new way to earn an income – it would stifle economic initiative. Often insolvencies cannot repay their debt in any case, and creditors therefore do not lose out if a debtor’s promise to pay is exonerated through liquidation. It is also argued that the supply of credit is elastic – as credit losses increase, so the price for credit to debtors will rise, meaning that all debtors will have to pay for the few that default. Thus creditors do not lose out. Nevertheless, the utilitarian endorsement of freeing the debtor from her duty to repay her debt through liquidation is subject to all the criticisms of utilitarianism as pointed out earlier in this report (see pages 8 to 10), that is of calculating the actual benefit to all parties, disregarding the very real harm that may be done to a creditor and absolving the debtor from her moral duty to comply with her promise merely for consequential reasons.

4. In terms of Rawls’s distributive justice, one can also argue that the insolvent is in the worst position and ought to be brought into a more equal standing with others. This would be achieved by expunging her debt through liquidation/sequestration.

5. As has been said earlier, in accordance with Kantian theory, a human being has autonomy. The autonomy of the person means that she has a prima facie moral duty to
keep her voluntarily made promise to pay her debt. But, this duty falls away if it becomes impossible to perform in accordance with her promise, because a duty to do something that cannot be done is inherently contradictory. A promise narrows the promissor’s future choice and if either intentionally or unintentionally her promise removes all her choices she has lost her ability to make free choices and thus her autonomy. For instance if her promise to pay cannot be fulfilled because she does not have the means, and if her creditors will not forgive her, she can no longer make, in her economic life, free choices. As an example, according to law, an unrehabilitated\(^{58}\) insolvent is not able to start a new business, may not enter into any credit transactions, and is in fact in a position similar to that of a minor. In such a situation a debtor has become totally subordinated to her creditors; she is denied her freedom of will in economic matters and can therefore no longer be held morally responsible for her promise to pay her debt. Having no autonomy because there is no freedom left to make a choice is different from breaking one’s promise. In the first instance one has no way to choose and one’s life can no longer be influenced by one’s will, whereas in the second instance one can always decide to honor one’s debt. The institutional discharge of debt, i.e., the liquidation of the debtor expunges the debt and thereby frees the debtor to chose again – she has regained her autonomy. This is the basis for Kantian ethical theory supporting the institutional liquidation process as a tool for an insolvent to regain autonomy. Non-discharge of debt through the liquidation process would amount to debt bondage – a status similar to slavery. As Kant has noted, a person’s natural right ceases to exist if she is nothing but a debtor. The way out is to grant an insolvent a discharge of her debt, which can be seen as an expression of the Kantian concept of treating people as ends in themselves (37. Kilpi, 1998: 81).

LIQUIDATION DIVIDEND DISTRIBUTION:
The liquidation of a company requires the distribution of the company’s assets among its creditors in accordance with the debts they proved, and if there remains any residue it needs to be distributed among the company’s shareholders. Such a distribution is done on

\(^{58}\) Once an insolvent has gone through the insolvency process and her creditors have been settled in terms of the insolvency procedure, she has to apply to the court for rehabilitation. This tends to be a reasonably simple process.
a pari passue basis – each receives from the pool of assets remaining after preferred creditors have been settled in full, the same percentage of the debt owed to the respective creditor. Is it fair that every creditor receives the same percentage of his claim, or would it be more just to apply the Rawlsian difference principle (see page 24) which would maximize the worst off creditors’ shares?

Liquidation is an orderly collection principle that is much preferable to a first grab system. It is not a mechanism to redistribute creditor’s rights that existed before the liquidation occurred. It seems therefore correct to use the pari passue basis unless all the affected creditors agree to some other method of distribution, e.g., in large liquidations it is sometimes agreed, for administrative reasons, to pay all the small creditors out in full.

FRAUD, RECKLESSNESS AND NEGLIGENCE:

Ethics demands that those who commit **fraud** should be punished. Thus a debtor who is being liquidated as a result of a fraudulent act is not entitled to be released through liquidation procedures from her promise to pay her debt. Creditors should, in addition to liquidating the debtor, take action against her under criminal law for the fraud perpetrated by her. According to the Oxford Dictionary fraud is defined as “criminal deception; false representation by means of a statement or conduct, in order to gain a material advantage. If fraud is used to induce someone to part with money, this may amount to theft.” Fraud is constituted by the distinctive attribute of causing damage with intention, i.e., by false pretences and other ways of seeking improvement in one’s own position by misleading creditors. I don’t believe there is any moral theory that can condone such behaviour.

The distinctive characteristic of **recklessness** is disregarding the consequences or danger of one’s action – it means knowingly accepting excessive risk of harm. But what is excessive risk? With the privilege of hindsight, one may conclude that any firm that is liquidated acted recklessly, otherwise it would not have reached this state. However, there is risk in any business, and debt always involves the risk of harming a creditor. A company is entitled, as a secondary moral agent (see page 49), to risk its property in business operations, both as a debtor or as a creditor. In fact there would be no business without the entrepreneur’s willingness to take some risk.
It seems impossible to say in advance where the line should be drawn between acceptable and excessive financial risk. It would therefore be wrong to punish a company that made a mistake in its judgment and as a result went under. But as indicated earlier, if the acceptance of high risk is done with the intention of harming the creditor, the act would be fraudulent. If the high risk is accepted in the full knowledge of a person who ought to understand the unacceptable high level of risk, e.g., in a financial transaction by a financially well qualified individual, or one who makes out to be such a person and others are harmed as a result, then I believe the acceptor has acted recklessly, should not be released from her promise and should be penalized. It is the creditor who must consider before extending the credit whether the debtor has sufficient knowledge and is sufficiently circumspect to deserve the credit. If the debtor has withheld vital information or made dishonest disclosures, a creditor has reason to claim that the debtor should not be released through liquidation proceedings and should be punished for fraud or recklessness.

COLLUSION:
Collusion is an agreement between two or more parties in order to prejudice a third party, or for any improper purpose. Collusion is unethical because it has as its aim to harm others or enrich the colluders at the expense of others. Collusion to carry out an illegal act is punishable in terms of criminal law. Where a debtor has colluded with others to be liquidated with the purpose of being released from promises and/or debts, she should not be set free from her obligations and given back her autonomy after liquidation, but should be sued under criminal law.

NEGLIGENCE:
A failure to comprehend the risk in a credit transaction that a reasonable person would have seen is not a morally punishable act. However, if the debtor knew of the excessive risk and in spite of this she went ahead with the transaction, it would be a case of recklessness. But, as noted earlier, it is usually very difficult, if not impossible, to know whether a person applied her mind carefully enough to a situation. Someone who claims to be an expert in a particular field can be expected to understand the risks connected
with an action in his area of expertise and would rightly be judged much harsher than a layman. A credit underwriter would therefore act negligently; he would display a lack of proper care and attention and act unethically if he did not consider all the issues that can reasonably be expected from a credit specialist to be taken into account when making a decision, for instance on a credit limit. Such negligence by an underwriter would be culpable carelessness, could be seen as a breach of the duty of care which a policyholder can expect from the insurer and might give the insured a right of action against the credit insurer under the law of tort.

Generally, recklessness and negligence are morally bad only if a criminal intent is present except, I believe, where people who hold themselves out as expert – and probably charge for their “expert” advice – do not pay the attention to a situation that a reasonable person could expect from them. Such experts have either misrepresented their skill or have shown no respect for the dignity and autonomy of their counterpart and these are clearly unethical acts.

* * *

The following are ethical issues that the credit insurer needs to keep in mind in his claims processing and other related activities:

1. Any claim is the moment of truth for the credit insurer. The policy is a promise to indemnify a loss on certain conditions and for this promise the insurer has received premiums, often long before he is asked to make good on his promise. It would be highly unethical if the insurer would not fulfill his promise in a correct and efficient manner. Claims that are lodged with the insurer need to be attended to efficiently, promptly and professionally.

2. Once the insurer has received a claim, he needs to assess the claim carefully and diligently. Where such a thorough assessment may not be feasible because the claim is
for a minimal amount, the insurer must give the benefit of the doubt to the policyholder if there is any uncertainty about the validity of the claim.

3. The insurer should find reasons for paying a claim rather than trying to find fault with the submitted claim. He should not, in order to avoid a claim, try to find little administrative errors on the part of the policyholder or pick on trivial technical issues that do not affect the loss or make a material difference to the credit insurer, e.g. late submission of a claim (unless it is by a material period that would affect the insurer’s reserving policy or re-insurance arrangements).

4. Material breaches of policy conditions must, however, lead to repudiation in order to be fair towards the insurer, its shareholders and re-insurers. The reasons for refusing the claim need to be fully explained to the policyholder and suggestions offered in order to avoid a recurrence of repudiation. Any attempt by a policyholder to defraud the insurer needs to be handled by the insurer in a strict and resolute manner and in accordance with the relevant conditions provided for in the policy.

5. The credit insurer should, where required, assist the policyholder in the handing over of a debtor to attorneys and in the conducting of legal action against the derelict debtor and/or guarantor of a debt.

6. The insurer has a duty to make every effort to mitigate a loss, e.g., address the delinquent debtor directly – with the prior approval of the insured – in an effort to obtain payment from him before a claim under the policy is due. Where there are misunderstandings or disputes between the debtor and the policyholder, the insurer should help sort them out. Because the credit insurer is often in a very powerful position due to his heavy involvement in the debtor’s business, pressure by him for payment of over-dues on the delinquent debtor can be very effective because the buyer realizes that the insurer could withdraw cover provided to many of his other suppliers and such action could precipitate the demise of the debtor’s business. Using his position
in this way should not be seen as unethical or as blackmail on the part of the insurer provided he handles the collection effort in a professional and correct manner.

7. The credit insurer needs to act responsibly. By taking too tough a line with a particular defaulting debtor he may push the debtor into insolvency. But, on the conversely, if he is lax in his actions, the credit insurer may increase the losses for all concerned (as the saying goes: the first loss is usually the best loss). The insurer must ensure that he does not damage any long-term supplier/customer relationship through the collection effort. An agreed and successful repayment plan will provide opportunities to the policyholder for future sales.

8. The insurer has an obligation to guide a policyholder in decisions to be taken concerning the following matters:
   - Whether to accept, reject or alter compromises or schemes of arrangements;
   - Whether an investigation in terms of the insolvency act into the affaires of the insolvent firm should be undertaken;
   - Who should be appointed as liquidator;
   - Whether or not the creditor should prove his claim against the insolvent estate;
   - How to address other issues that may have to be voted on at creditors’ meetings.
   The obligation results from the insurer’s claim that he is a specialist in the field of business-to-business credit.

9. The insurer should, where necessary and where he can, prevail upon the liquidator to act ethically, e.g., to ensure that his actions are fair towards all creditors, that they are legal and practical. In many cases the credit insurer may indirectly be one of the largest creditors of an insolvent estate due to the accumulation of amounts owed by the debtor to all the insurer’s policyholders. The insurer can therefore influence the manner in which defaulting debtors are dealt with and has a moral duty to guide proceedings to secure an ethical outcome. As such the insurer can help direct the liquidations industry toward correct, clean and fair dealings to the advantage of all concerned. Foreign
prospective investors will want to be satisfied that the host country’s insolvency procedures are efficient, correct and ethically carried out.

10. Invalid claims against the estate, fraudulent actions, incorrect preference of certain creditors, the withholding of important information, coercion, incorrect recognition of securities or purported securities, the hiding or wrongful dispossession of assets or the unnecessary delay in bringing the liquidation to conclusion are all actions that the credit insurer can often prevent in the interest of his policyholders, other adversely effected creditors and his own business. The credit insurer should maintain a blacklist of all those liquidators who are inefficient, untrustworthy and have acted unethically.

11. Fraudulent behaviour by directors, owners and management of the insolvent business must be discovered and punished. The insurer is many a time in a good position to notice such unethical actions and support measures that are in the interest of all creditors (see paragraph 16, page 171 for an example).

12. The credit insurer should insist on receiving copies of reports prepared by liquidators and/or judicial managers in terms of sections 311, 400 and 402 of the South African Companies Act dealing with possible criminal or personal liability and acts which may disqualify directors and officers of the company from holding such positions in future.

13. In order to be able to follow up on over-dues from foreign debtors under export policies, the insurer needs a good network of debt collecting agents and attorneys situated in the various countries for which credit insurance cover is available. The insurer’s colleague credit insurers in such countries are also very useful partners in the collection of arrears.

14. Losses that are due to political actions by an importing country need to be followed up by the credit insurer on behalf of the export policyholder and in the insurer’s own interest. This can be done by:
   - Calling for the assistance through diplomatic channels of the government;
   - Seeking help from the colleague credit insurer in the importing country;
• Reporting to and threatening withdrawal of credit insurance cover worldwide through the members of the international export credit insurance association – the Berne Union;
• Negotiating a settlement agreement with the defaulting importing country’s government; and
• Being, in case of need and where appropriate, part of an official debt rescheduling agreement.

15. Insufficient, impractical, loose, deficient insolvency laws are detrimental to business, economic development and investments, and the credit insurer needs to play a constructive role in rectifying and redrawing the necessary laws and regulations. The credit insurer has to engage government and other relevant parties to ensure that the Insolvency Act is brought and kept up-to-date, that it prescribes practical, effective and fair action and that breaches of criminal law by delinquent directors and officers are appropriately punished. Sufficient resources must be available to the State, the Registrar of Companies, the Police Services and other relevant people in the judicial system for these bodies to be able to perform their duties in an efficient and effective manner. (See also chapter 6 “The Importance of Institutions”). South Africa’s Insolvency Act is in dire need of a complete rewrite. It was promulgated in 1936 and no material changes have been made to it since. Work on a new act has been in progress on and off since 1988 but it seems that certain parties are not prepared to agree to necessary compromises in order to bring the new act, which will be known as the “Bankruptcy Act”, to finality. All parties concerned, including government and creditors such as the South African Revenue Services and the Labour Unions, need to support this effort and ensure its speedy accomplishment.

16. Has a credit insurer the moral duty to pursue a defaulting debtor by taking legal action against the firm, and, where indicated, against its directors, owners and managers and, where appropriate, against any guarantors of the debt? I believe he has because of his prominent position in the field of business credit. Only by taking tough action where necessary can foul play, corruption and fraud be countered. While such action may also
result in the collection of additional salvages for both the policyholder and the insurer, which would be sufficient justification for proceeding along these lines, unfortunately the legal costs involved are often so high that they exceed any possible recovery and the time and expertise that needs to be set aside to manage such actions is extensive and costly. It often takes years to bring such proceedings to conclusion.

17. Is it in all cases right to liquidate a business that cannot pay its creditors, and has the credit insurer a duty to consider preventing such action in the interest of the future of the business, its employees and other stakeholders? Modern insolvency laws, for instance in the UK, tend to make it more difficult to liquidate a business that is in payment default. Efforts need to be made, in terms of such thoughts, to provide business recovery services, to seek ways and means to save businesses from going to the wall. In the US the law provides for Chapter 11 protection for businesses economically thought to be deserving cases. This stays all actions against the business in order to give it time to recover and then repay its old creditors over an agreed period. In South Africa we have a similar situation under Judicial Management (section 427 of the Companies Act), where the judicial manager can obtain new credit for running the business on the basis that such new credit has preference over old credit. A further possibility under section 311 of the Companies Act is to enter into a “Scheme of Arrangement” which usually results in a compromise of debt. Creditors accept such a scheme to avoid a drawn-out winding-up procedure. However, secured creditors (who are usually the largest creditors) and a conservative attitude by the courts normally prevent these mechanisms from being employed. Credit insurers should support rescue efforts where they are clearly deserving because it will help resuscitate some businesses and in the end result in full recovery of the amounts owed, although over a protracted period. Such support should be withheld where there is not a good chance of success because in such cases inefficient business, which has no right to continue under protection, will be encouraged at the possible expense of new, more efficient enterprises (see page 177 (case 2) for an example of a credit insurer’s dilemma in deciding on a rescue operation).
18. Where the insured has employed the services of an insurance broker, the insurer needs to keep the broker fully appraised of developments in claims cases.

19. The credit insurer needs to keep in mind his reinsurance arrangements in all claims matters. Where appropriate or required by the reinsurance treatise, the re-insurer needs to be informed or even consulted before very large, contentious claims are settled.

20. A competent salvage operation is essential so that the insurer can effectively follow up on debts which he has indemnified and where there is a possibility of making some recoveries. As the insurer never compensates 100% of the loss sustained by the policyholder (co-insurance principle – see chapter 10 “Introduction to Credit Insurance” – page 89), he has the duty to account promptly to the policyholder for his share of any such salvage received.

21. Clearly, the insurer has a moral duty to employ well qualified, professional staff to handle all claims issues and to deal efficiently and quickly with any claims queries raised by a policyholder.

22. Last but not least, the insurer must have a professional, disciplined and reasonably conservative reserving policy. The proper and careful preparation and constant maintenance of the following reserves:
   - Claims;
   - Salvages;
   - Incurred but not reported claims (IBNR);
   - Unearned premium (UPR);
   - Statutory reserves;

is crucial to the health of the insurer. Conservative reserving is an important part of good corporate governance (see chapter 2). The correct reporting of his financial results and figures to shareholders and the effective management of the reinsurance treatise depend on adequate provisions for the items listed above. It is not only a matter of establishing reserves based on historical evidence but the insurer also needs to evaluate
carefully anticipated market conditions in order to adjust salvage and particular IBNR reserves. Independent actuaries should report to the audit committee and the board of directors on the adequacy of all reserves.

Many of the issues mentioned in this chapter as ethically important are common sense interests of the insurer. Not paying claims or not handling them expeditiously and correctly will soon result in the insurer acquiring a poor reputation, forfeiting trust (see chapter 7 “Trust”) and losing business. But the basic normative ethical theory in which the professional and equitable settling of claims is grounded is Kantian deontological ethics. The policyholder and the insurer have agreed to the terms and conditions of the policy and they are therefore morally bound to abide by them. The insurer has a moral duty to keep his promise and the policyholder must comply with his obligations under the insurance contract.
CASE STUDY NO. 1:

The following case study is based on an actual case and deals with fraudulent and reckless behaviour by directors, owners and management – as referred to earlier in this chapter.

1. A large corporation (hereinafter referred to as “A”) wishes to sell a subsidiary because it is unprofitable and does not fit into its re-structuring plans.

2. “A” offers a substantial reward to its financial director (FD) for successfully negotiating and concluding a deal. “A” knows that it will not be easy to sell the business.

3. The FD concludes the transaction with parties (hereinafter referred to as “B”) who know that they do not have the funds to pay for the shares in the subsidiary.

4. The sales agreement provides for a deferred payment plan.

5. “B” takes over the subsidiary and milks it of its assets and cash to pay for the purchase.

6. As a result of 5 the subsidiary’s resources are depleted and it is unable to pay its creditors.

7. The subsidiary goes into liquidation and creditors lose considerable amounts of money.

Clearly, “B” has acted unlawfully by having used the subsidiaries assets to purchase the shares in it – section 38 of the Companies Act. “B” has also behaved immorally by having entered into the transaction knowing full well that they, “B”, did not have the means to pay for it; by defrauding creditors; by having forced the subsidiary into liquidation; and by having milked it of its entire means for “B’s” own purposes.
On the face of it “A” may not have transgressed any laws, but has acted in an unfair and unwise manner by enticing the FD into an action that he would probably not have undertaken had he not been encouraged by the large commission. In fact, it can probably be claimed that “A” colluded with the FD in encouraging him to conclude a questionable transaction. In that case legal action against “A” should be pursued. Certainly any connivance by “A” with the FD would be immoral.

The FD has behaved recklessly in concluding the sale with a party who did not have any means with which to pay the agreed price. He may have shown disloyalty towards his employer, being driven purely by greed but if there was collusion between A and the FD this would not apply. The FD is partially responsible for the demise of the subsidiary, particularly where he, as the financial director of a large corporation, should have foreseen the troubles that are created by selling to someone who does not have the requisite funds.

Both “B” and the FD have ignored what to my mind is the basic ethical duty, namely, to treat others (in this case the stakeholders of the subsidiary) not merely as means but as ends in themselves.
CASE STUDY NO. 2

An example of a Credit Insurer’s dilemma in a claims case – as referred to in paragraph 17 (page 172) of this chapter.

These are the facts of the case:

1. The credit insurer (hereinafter CI) knows both the policyholder (hereinafter PH) and the risk (hereinafter R) very well as trustworthy businesses.
2. The PH has a credit limit (see page 121) of R1 million on R.
3. Due to PH’s administrative error, PH has R2 million outstanding on R but has always paid premium to CI on an outstanding amount not exceeding R1 million.
4. R is unable to pay its debts due to a considerable appreciation of the Rand. Export competitiveness has sharply deteriorated and imports have become very cheap.
5. R approaches PH and CI with the request to extend the due date for the R2 million debt by 120 days and requests additional new credit of R1 million. R gives as motivation the fact that it is developing a new product that will be competitive and for which there is a good market.

The credit insurer’s dilemma:

6. If he refuses the request, R will go into liquidation and the credit insurer will have a loss of R800 000 payable to PH (credit limit of R1 million less 20% co-insurance).
7. PH will have a loss of R1.2 million (R1 million in excess of credit limit plus R0.2 million co-insurance).
8. PH will be unhappy because of the large loss and because of the loss of an important outlet (even R’s new product will use PH’s raw material).

9. By putting R into liquidation 500 people will lose their jobs.

BUT:

10. If CI agrees to R’s request, he will increase his exposure on R by 100% from R1 million to R2 million.

11. CI is not sure whether R’s new product will meet with sufficient success to pull R’s business out of its difficulties.

12. By agreeing CI may save R’s business and 500 jobs and it may secure an ongoing customer for PH and a continued premium flow to itself.

13. It is quite possible that the first loss. i.e. R800 000 will be the best loss for CI.

Is this a moral dilemma for CI? I think it is because it represents a conflict between reasons of business and moral reasons. From a strictly cold business point of view, looking after only the interests of CI, CI should not be swayed by R’s pleadings and apply for R’s liquidation. At this stage there may even be a better liquidation dividend for creditors than in some months' time.

However, if CI keeps the other affected parties\(^{59}\) in mind the situation may not be that clear. Consider:

- PH who is prepared to support R and hopes to retain an important customer.
- R who obviously wants to protect and re-build its business.
- R’s 500 employees who wish to keep their jobs.
- R’s customers, the market, who may wish to buy R’s new product.
- CI’s shareholders and CI’s re-insurers
- The latter two may both prefer the certainty and the possibility of the lowest loss.

Further, if R should be successful CI will have cemented its relationship with PH and may even convert R into a new policyholder. The market will see CI as an understanding and valuable business partner who is prepared to take risks – an insurer’s business.

\(^{59}\) I have with purpose omitted other creditors/suppliers of R in order to keep the example simple.
Looking at Laura Nash’s suggested way of finding solutions to dilemmas (see pages 69 to 71) for the question that are being answered hereunder) we can say:

a. The problem has been accurately defined.
b. We have looked at the problem from all sides.
c. We know how the situation occurred: The strengthening of the Rand and a reaction by R to this problem which was probably too slow.
d. We are looking at the moral issues of this dilemma because we have a strong loyalty to ethical principles.
e. Our intention in making a decision is to find a win/win answer for all concerned.
f. How does our intention compare with the possible result? This is the million dollar question – we are not certain whether R will succeed with its plan.
g. We know that our decision to support R could injure CI, its shareholders and re-insurers, or, that if we go for immediate liquidation, R, its 500 employees and PH will be hurt.
h. The matter has been discussed with the major players.
i. The question of time is a difficult one. We need to take a decision now and do not have the luxury of being able to wait. It may well be that our decision would be different if we needed to take it at another time due to changing circumstances.
j. Any decision we take needs to be defensible vis-à-vis the board, the shareholders, the re-insurers and the public.
k. The symbolic potential of our action, if understood, would be more positive if we agree to support R because CI would be seen as a caring insurer who is prepared to take a risk in the interest of protecting and re-building a business, saving jobs and standing by his policyholder. This could even be the case should R not succeed.
   If our action is not understood, CI may be considered to have acted stupidly if we support R and cold, irresponsible and typically insurance-like if we do not support R.
l. In this case, I believe more facts would help us to decide or make an exception to our normal way of deciding on such issues.

I believe this analysis highlights the fact that in order to find the best solution CI needs to find out a little more about the reality and beliefs on which R is basing its hope that the new product will succeed. If CI can be reasonably satisfied that R’s arguments are sound,
it should support R and negotiate with PH about the extent of the new cover, e.g. perhaps they can agree to carrying the additional R1 million new credit on a 50/50 basis or PH may accept that a considerably higher premium has to be paid to CI for the business with R. The excess of R1 million due to PH’s administrative error should continue to remain uninsured.

Considering this dilemma in accordance with Jürgen Habermas’s “ideal speech situation” or Michael Pendlebury’s manner of employing the “veil-of-ignorance” (see pages 74 to 76), we would, I believe, arrive at the same answer. The outcome of the deliberation between the truly equal discussion partners, based on the details described above and provided R does supply credible grounds for the success of the new product would be to support R.