

# Three Tips for Avoiding the Non-Disclosure Defense in Trade Credit Insurance Claims

by Peter A. Halprin and Vivian Costandy Michael

Faced with a growing number of insolvencies worldwide and a global crash in commodities prices, trade credit insurance policyholders are increasingly filing claims. According to a joint survey of members of the International Union of Credit Investment Insurers and the International Credit Insurance and Surety Association, more claims were filed under trade credit insurance policies in 2015 and 2016 than at any time since the 2007-2008 global financial crisis.

Although there is a view that trade credit insurance claims are paid at a higher rate than other insurance claims, disputes over trade credit claims can be just as contentious as other insurance claims. One issue common to such disputes is alleged non-disclosure.

## WHY DISCLOSURE MATTERS

In all lines of insurance, insurance companies sometimes raise the defense of nondisclosure to avoid paying claims, arguing “If we had known about X term, we never would have sold you this insurance policy.” In other words, the failure to disclose X term was an allegedly material representation (or omission). If an insurance company can prevail on this argument, in some jurisdictions it can void the policy altogether, denying coverage for any claim under that policy. In some jurisdictions, insurance companies that prevail on a material misrepresentation defense do not even have to return the premium.

For trade credit policyholders, the best way of avoiding rescission requires a three-pronged approach: identifying potentially material facts, disclosing them in writing during underwriting, and maintaining a helpful, cooperative, open flow of information.

### 1. Identify the Material Facts

Insurance companies may raise the nondisclosure defense even if a claim is otherwise valid. In the U.K. and in many U.S. jurisdictions, including New York, an insurance company may be able to rescind a policy that was issued in reliance upon a material misrepresentation. The key question becomes whether the non-disclosed fact was material. This is because in the U.K. and in many U.S. jurisdictions, the insurance company has the burden of proving 1) that the applicant for insurance made a material misrepresentation and 2) that the insurance company would not have issued the policy had it known the actual fact.

A misrepresentation may be a false statement or a failure to disclose where a duty to disclose exists. Under New York law, it has been material if it “substantially thwarts the purpose for which the information is *demand*ed and *induces action* which the insurance company might not otherwise have taken.” Typically this is a fact-intensive inquiry and may require extensive, costly discovery.

Policyholders and their insurance brokers should think through what elements or terms that are not being sought could be material at the outset of the policy application or renewal process. Working with a diligent broker can significantly reduce the risk of non-payment of a claim on the ground of non-disclosure. For example, some brokers use proprietary application forms that are simply appended to the application provided by the insurance company. Many brokers suggest that policyholders follow the maxim: “when in doubt, disclose.”

If a trade credit insurance company refuses to cover a claim on the ground that a non-disclosed fact was material, policyholders can look to past dealings with the insurance company to refute the argument. Prior transactions with the same insurance company, either with the same policyholder

## Fine Print

or with another policyholder underwriting the same risk, may help a policyholder make the case that the same policy would have been issued had the disclosure been made. Internal insurance company materials such as underwriting manuals and guidelines may also help confirm that the policyholder identified all of the necessary prerequisites for coverage, i.e., that the insurance company would have sold the policy in spite of the alleged misrepresentation.

### 2. Disclose the Facts in Writing

Trade credit insurance policies cover sophisticated transactions. Applications require detailed financial information such as sales data, debts, credit exposure and payment terms for all of the parties. For underlying financial transactions, policyholders must identify all the proposed parties to the transactions. Policyholders should make expansive disclosures with regard to such information, and work closely with joint insureds, additional insureds and any other potential partner in the transaction to make a full and complete disclosure.

The Insurance Act of 2015—a recent change to English insurance law—requires policyholders to make a “fair presentation of the risk” during the application and renewal period. While there has been no case law interpreting the act to date, this concept provides a helpful framework for disclosing material facts to trade credit insurance companies. Under the Insurance Act of 2015, a fair presentation of the risk:

- makes disclosure of every material circumstance that the [policyholder] knows or ought to know or gives sufficient disclosure to put the [insurance company] on notice that it needs to make further enquiries to reveal material circumstances; and
- makes that disclosure in a manner which would be reasonably clear and accessible to a prudent insurance company; and
- in which every material representation as to a matter of fact is substantially correct, and every material misrepresentation as to a matter of expectation or belief is made in good faith.

For trade credit insurance policies that are to be interpreted under English law, the 2015 Act may be binding. Even for

policies governed by the law of an American state, these concepts provide useful guidance for determining what information to disclose.

### 3. Stay Helpful

There is much to gain and little to lose for policyholders in reaching out to their trade credit insurance company during the initial policy application or renewal periods to be as helpful as possible. Policyholders and their brokers should always ask the insurance companies if they need anything further or have additional questions. If the insurance companies do not respond in the affirmative, the record will still demonstrate that the policyholder was helpful and cooperative.

## PLANNING AHEAD

Because nondisclosure is the most common defense against coverage under trade credit insurance policies, policyholders and their brokers must start thinking about this issue from the outset. Identifying material facts, disclosing them in writing, and staying helpful will help get claims paid. To combat a non-disclosure defense, policyholders should look to prior policies and claims, as well as internal insurance company documents, to establish the non-materiality of any alleged misrepresentation. And, when in doubt, disclose. ■

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**Peter A. Halprin** is an attorney in Anderson Kill's New York office. His practice concentrates in commercial litigation and insurance recovery, exclusively on behalf of policyholders, and he also acts as counsel for U.S. and foreign companies in domestic and international arbitrations.

**Vivian Costandy Michael** is an attorney in Anderson Kill's New York office. Ms. Michael's practice concentrates in commercial litigation and insurance recovery, exclusively on behalf of policyholders.