WILHELM

RECHTSANWÄLTE

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Cancellation without instruction – no protection for policyholder acting with fraudulent intent

1. INTRODUCTION

Insurers need information from the policyholder prior to the conclusion of the contract in order to evaluate the risk to be taken over and to assess the premium calculation. To meet the demand for information, the legislator regulated in section 19 Insurance Contract Act ("VVG") the policyholder's duty of disclosure before the conclusion of the contract. The requirements for a sanction to be imposed on the policyholder for breach of the duty of disclosure have so far been restrictively followed. A current decision of the Federal Court of Justice softens the strict requirements of the courts at least for exceptional situations.

2. PRINCIPLES OF THE DUTY OF DISCLOSURE

Before the conclusion of the insurance contract, the policyholder has to disclose to the insurer all circumstances known to him which are relevant to the insurer and which the insurer asks for (cf. section 19 para. 1 VVG). A breach of this duty has severe consequences for the policyholder (2.3.1 – 2.3.4).

2.1 Risk-related circumstances

Risk-related circumstances are those relevant for the insurer's assumption of risk. What is relevant to the insurer is always a question of the individual insurance contract.

For a health insurer, a pre-existing condition of the policy holder constitutes a risk-relevant circumstance, the religious confession certainly doesn't. The business interruption insurer will be interested in the large fire in the production hall; the D&O-insurer will probably not be interested in that.

2.2 Questions of the insurer

Since it is difficult for the policyholder to know which circumstances are relevant for the insurer's risk assessment, the insurer has to ask for risk-relevant circumstances in written form (cf. sec. 126 German Civil Code (cf. sec. 126 BGB). Questions of the broker to the policy holder are not considered to be questions by the insurer (Higher Regional Court Hamm of 3 November 2011, File No.: 20 U 38/10).

Since the reform of the Insurance Contract Act in 2008, a spontaneous duty of disclosure of the policyholder without being asked by the insurer does not exist anymore.

If the D&O-insurer does for example not ask the policyholder about previous breaches of duty of the executive management, the D&O-insurer may not refer to such known breach of duty later. If the fire insurer does not ask the producer about the production steps, he may later not refer to a failure to inform about the processing of spontaneously inflammable material.

2.3 Legal consequences of a breach of the duty of disclosure

The legal consequences of a breach of the duty of disclosure are regulated by law depending on the degree of negligence to which the policy holder breaches the duty.

2.3.1 Cancellation

If the policyholder breaches the pre-contractual duty of disclosure intentionally or by acting with gross negligence, the insurer may withdraw from the insurance contract within one month after learning of the breach of duty (cf. sec. 19 para. 2 in conjunction with sec. 21 para. 1 VVG).

The cancellation becomes retroactively effective at the day the contract is concluded. This means that the performance granted by the insurer and the policy holder is to be reimbursed.

Example 1:

After a fire, the insurer pays EUR 10.0 m for destroyed machinery and the burnt down production hall. After that, the insurer learns that the policy holder has intentionally provided untrue information about the QA-measures applicable within the company for which the insurer has asked. The insurer would not have concluded the contract if he had known about the QA-measures. The insurer then withdraws from the insurance

contract. The insurer has to repay insurance premiums received until the cancellation. The policyholder has to reimburse the insurance benefit in the amount of EUR 10.0 m.

2.3.2 Termination (in case of simple negligence)

If the policyholder breaches the duty of disclosure only with simple negligence, thus neither intentionally nor acting with gross negligence, the insurer's right to withdraw from the contract shall be ruled out. In such cases the insurer shall have the right to terminate the contract subject to a notice period of one month. (cf. Sec. 19 para. 3 VVG).

Example 2:

As example 1, but here the policyholder acts with slight negligence in providing incorrect information about the QA measures. The insurer terminates the contract for the future. The policyholder may then keep the insurance benefit, EUR 10 m. The policyholder will though need new insurance coverage for the future.

2.3.3 Policy adjustment (in case of gross negligence)

The policyholder breaches the duty of disclosure with gross negligence. The insurer would though also have concluded the contract in the knowledge of the facts which were not disclosed, albeit with other (more expensive) conditions. In this case, the insurer's right to withdraw from the contract shall be ruled out as well (cf. sec. 19 para. 4 VVG). The insurer may request that the other (more expensive) conditions shall become an integral part of the contract with retroactive effect. This may cause an obligation of the policyholder to make additional payments for past insurance periods.

Example 3:

The D&O-insurer asks the policyholder before conclusion of the insurance contract for circumstances which have led in the past to a claim for compensation against one of the executive managers. Executive manager A does not remember the damage claim which has been asserted against executive manager B four years ago. Executive manager A was at that time involved in the assertion of the damage claim against the executive manager B. He denies gross negligently the written question of the insurer. The D&O-insurer would still have concluded the insurance contract in the knowledge of the damage claim, but would have requested a higher premium. The D&O-insurer may charge additional payment.

2.3.4 Contract adjustment (in case of simple negligence)

If the policy holder breaches the duty of disclosure with simple negligence and if the insurer had concluded the insurance with adjusted conditions in the knowledge of the true circumstances, the insurer may adjust the contract only with effect for the future (cf. sec. 19 para. 4 s. 2 VVG).

Example 4:

As example 3, but here the executive manager A was not involved in the assertion of the damage claim against the executive manager B. He may only have learned about the damage claim after long and intensive research. Executive manager A thus simply negligently provided the D&O-insurer with an incorrect answer which may have the effect that the D&O-insurer requesst a higher insurance premium for the next insurance term after gaining knowledge about the incorrect answer.

2.4 Obligation to instruct

The insurer is only entitled to all above mentioned rights (cancellation, termination, contract adjustment) if he has instructed the policyholder in writing of the consequences of any breach of the duty of disclosure (cf. sec. 19 para. 5 VVG).

If the insurer does not unambiguously and comprehensively instruct of all theoretical consequences of a breach of the duty of disclosure, the breach has no consequences.

In the past, jurisdiction restrictively denied the insurer's rights of cancellation, termination and contract adjustment, if any of above mentioned requirements had not been fulfilled. Jurisdiction examined especially strictly the formal requirements (questions in writing, comprehensive and correct instruction).

3. CURRENT DECISION

In a current decision, the Federal Court of Justice considered a cancellation of the insurer justified, though the insurer had not instructed the policyholder duly according to sec. 19 para. 5 VVG about the consequences of a breach of the duty of disclosure (cf. BGH of 12 March 2014, File No.: IV &R 306/13).

3.1 Facts of the case

The policyholder requests judicial determination that his private health insurance contract persists despite the cancellation declaration by the insurer. The policyholder had answered incompletely to questions about his health when concluding the health insurance contract via an insurance broker. When asked, the policyholder fraudulently answered to the insurer's questions. A due instruction of the policy holder had not taken place.

After that, the insurer issued the insurance policy.

After gaining knowledge of the incorrectness of the answers to the questions, the insurer declared cancellation from the insurance contract.

3.2 Legal assessment by the Federal Court of Justice

The Federal Court of Justice confirmed the effectiveness of the insurer's cancellation, though the insurer had not instructed the policyholder of the consequences of a breach of the duty of disclosure according to the requirements of sec. 19 para. 5 VVG when concluding the contract.

According to the Federal Court of Justice, no such instruction was required, since the policyholder acted fraudulently, thus with an increased intent to the detriment of the insurer.

The Federal Court of Justice correctly points out that the fraudulently acting policyholder does not require protection by formal instruction. The fraudulently acting policyholder consciously accepts to deceive the insurer in respect of relevant circumstances. This fraudulently acting policyholder is aware of his incorrect acting even without any instruction. It would be a mere formality to show to this policyholder the incorrectness of his acting by formal action (instruction). It is therefore unnecessary.

4. CONCLUSION

In its current decision, the Federal Court of Justice deviates from the strict formal requirements the law poses on cancellation. As long as this deviation only applies for policyholders acting fraudulently, this decision is to be welcomed.

The policyholder acting fraudulently is an exception in practice. Further deviations in favor of the insurer from the strict requirements on cancellation, termination and contract adjustment are not to be expected.

Since insurers often fail on the strict requirements to a due and complete instruction, some insurers might be tempted to make use of the argument of fraudulent intent. Every individual reproach of fraudulent intent has to be examined critically. A relevant increase in unjustified reproaches of fraudulent intent should not be expected.

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