

Claims series clauses

# Risk of coverage gaps in commercial insurance contracts

## 1. INTRODUCTION

Commercial insurance contracts regularly contain claims series clauses.

Claims series clauses aggregate several claims to one single claim or several losses to one single loss. The German Insurance Industry uses claims series clauses in various sectors and characteristics. Particularly liability insurance contracts as in the D&O insurance, in the product liability insurance and the general liability insurance but also i.a. insurance contracts in the fidelity insurance contain claims series clauses.

From the policy holders' point of view claims series clauses have practical significance because they, apart from certain benefits for policy holders, may mainly lead to coverage gaps. Claims series clauses determine the scope of the insurance coverage and may significantly limit the insurers' duty to indemnify at the expense of policy holders.

The following article gives an overview of the functioning and the purpose of claims series clauses and describes potential impacts of claims series clauses for policy holders and shows which concerns may exist in individual cases with respect to the effectiveness of claims series clauses.

## 2. FUNCTIONING AND PURPOSE OF CLAIMS SERIES CLAUSES

### 2.1 No uniform term for claims series clause

The German Insurance Contract Act ("VVG") does not contain any provisions relating to claims series clauses. Insurers regularly use claims series clauses in commercial insur-

ance contracts in form of standard terms and conditions. There is no uniform term for claims series clauses in the insurance practice. “The” claims series clause does not exist.

Claims series clauses may be characterized by typical features. Essential features of claims series clauses are their purpose and their functioning.

## 2.2 Purpose of claims series clauses

The insurer’s interest to make the insured risk and thus the duty to indemnify calculable, respectively to limit it is deemed the main purpose of claims series clauses.

## 2.3 Functioning of claims series clauses

Claims series clauses aggregate several claims/insured events to one single claim/insured event or several losses to one single loss.

A claims series clause may stipulate that i.a. two actually separate claims (two infringements) under a liability insurance are to be regarded as a single claim. Due to this insurers have to pay the agreed sum insured for the claim only once even if the total damage resulting from both claims exceeds the sum insured.

Thus, claims series clauses aggregate several relevant facts related to the insurance contract to one single fact. The clauses regulate how individual facts have causally, temporally or objectively to be related to each other so that the insurance contract treated them as *one* single fact.

### 2.3.1 Terms of regulation: fiction

In terms of regulation a claims series clause is a fiction. The clause equalizes something that is not actually equal.

For example, standard D&O insurance conditions i.a. feign *one claim* and *one time of occurrence* (cf. cyper 4.5 AVB-AVG 2013):

*“Irrespective of the individual insurance years, several claims made by one claimant or several claimants during the effective insurance period*

*a) due to a breach of duty committed by one or more insured persons,*

- b) *due to several breaches of duty committed by one or more insured persons insofar as these breaches can be assigned to the same set of facts and stand with each other in legal, economic or temporal connection and shall be deemed one insured event.*

*Irrespective of the actual time of the assertion of individual liability claims it [the insured event] is deemed to have occurred when the first liability had been asserted."*

Hence, the clause shows the following function:

Initially the claims series clause aggregates two claims to one single claim. If the factual requirements are met, *"it should be pretended that one claim would have occurred although actually several claims have occurred."*<sup>1</sup>

Furthermore, the claims series clause used as example regulates when the (aggregated) claim shall be deemed to have occurred under the insurance contract. If the requirements of the claims series clause are met *„it should be pretended that as if this one claim had occurred on the date when the first of several aggregated claims has occurred."*<sup>2</sup>

### 2.3.2 Factual requirements of claims series clauses

The legal consequence (legal fiction) only takes effect when the requirements of the claims series clause are met.

- a) Several individual claims/ losses?

If a claims series clause i.a. aggregates several claims to one single claim (fiction of one claim) then several claims, as subject to the connection according to the prevailing claims definition of the insurance contract must actually exist.

- b) Requirements for the connection of claims/ losses met?

Furthermore, requirements for a connection of claims or losses must be met according to the claims series clause.

---

<sup>1</sup> cf. Lange, German Insurance Law („VersR“) 2004, 563 regarding claims series clause under the D&O insurance.

<sup>2</sup> cf. Lange, reference above

In the above example of the claims series clause of the D&O insurance (see above 2.3.1), several breaches of duty *have to be connected legally, economically or temporally*. Claims series clauses used in product liability insurance aggregate several claims i.a. when claims arise from delivery of products “*affected by the same defects*”.<sup>3</sup>

The requirements for the connection shall be determined by way of interpretation of contract. In particular, this regulating part (connection) of the claims series clause can, in practice, lead to considerable legal uncertainty (see subsequently under 3.5.3).

### 3. EFFECTS AND RISKS OF CLAIMS SERIES CLAUSES FOR POLICY HOLDERS

Mainly, the effects presented in the following are of practical relevance.

#### 3.1 Deductible is applied only once

The fact that policy holders have to pay the deductible agreed for the claim only once as the aggregated claims shall be deemed as one single claim, is considered a possible economic advantage for the policy holders. In particular, this can be economically advantageous in case of repeated damages which exceed the deductible in individual cases not or only a little.

#### 3.2 Possible periodical advantage

In addition, policy holders are said to benefit from the so-called periodical advantage with respect to the following aspects. In several successive periods different sums insured or different insurance conditions may be agreed (e.g. extension of cover or exclusions). A claims series clause may cause that several claims or damages would be aggregated in an earlier and more favorable insurance period.<sup>4</sup> However, the opposite effect is also possible when the subsequent period offers more favourable conditions.

#### 3.3 Effects on the scope of the insurance coverage – sum insured is only available once

Considerable practical importance for policy holders – and with respect to liability insurance indirectly for injured third parties – has the risk that the insurer does not or on-

---

<sup>3</sup> cf. cypher 8.3 product liability model (“Produkthaftpflicht-Modell”).

<sup>4</sup> cf. with examples of the D&O insurance Lange, reference as above

ly partially reimburse actual losses of considerable extent. There is a risk of major gaps in coverage for policy holders.

Claims series clauses determine the scope of insurance coverage. In certain circumstances the actual claim is not covered solely due to the claims series clause. The sum insured agreed for the claim is only available once. If the sum of the aggregated individual claims exceeds the sum insured thus there is a gap in coverage for policy holders: An individual loss that would be insured without claims series clause is totally or partially uncovered.

In temporal terms claims series clauses may aggregate claims beyond the individual insurance periods. Losses from several insurance years may coincide in one and thus considerably exceed the sum insured. A claims series clause may also transfer a claim into an uninsured period before the inception date of the insurance.

Due to their function claims series clauses are a disadvantage to policy holders mainly where high losses are involved, but also in case of a high number of aggregated claims, losses respectively.

### 3.4 Relevance for contract drafting and contract performance

Under the following aspects claims series clauses may have substantially meaning for policy holders when concluding or executing the contract.

In order to avoid that the claims series clause transfers the loss into an uninsured period (pre-inception stage), the policy holder may agree on a retroactive cover upon conclusion of the insurance contract.

In case of transfer of cover/ changing the insurer, it is important to make sure that there is no coverage gap between contracts due to the claims series clause. In the framework of layer programs, excesses must also correspond to the basic contract regarding the provisions of serial damages.

In the individual case e.g. issues regarding the notification periods may arise – for instance when policy holders argue a claim (not notified separately) is considered appropriately notified by a previously notified claim due to the claims series clause.

### 3.5 Possible ineffectiveness of claims series clauses in individual cases

Claims series clauses may massively restrict the insurance coverage. Thus, the question regarding the legal effectiveness of general terms and conditions of the relevant clause can arise. If a claims series clause is ineffective the insurer cannot rely on its effects (fiction/ connection) due to the principle of good faith.

The question of the effectiveness of claims series clauses is ultimately not conclusively answered by the courts and legal writers due to the different forms of the clauses. Relevant court decisions do not provide principle statements that would generally apply to common claims series clauses with respect to the question of the legal effectiveness in accordance with the legal requirements for terms and conditions.

According to case-law the following aspects seem to be essential for assessing claims series clauses in each individual case:

#### 3.5.1 The starting point of case-law: strict interpretation as risk limitation

According to the Federal Court of Justice (“Bundesgerichtshof”) claims series clauses are risk limitations and shall thus be interpreted in a restrictive way.<sup>5</sup>

Even after a strict interpretation a claims series clause may violate the principle of transparency and therefore be invalid.

#### 3.5.2 A possible infringement of the transparency requirement

An unreasonable disadvantage of the policy holder contrary to the requirements of good faith may also arise if a clause is not clear and understandable (section 307 paragraph 1 page 2 German Civil Code – “transparency requirement”)

In individual cases it is questionable whether the terms typically used as legal prerequisite of claims series clauses meet the transparency requirement. This applies i.a. to the prerequisites of a legal, economic or temporal connection in D&O conditions. The German Federal Court of Justice (“Bundesgerichtshof”) declares in connection with a deci-

---

<sup>5</sup> cf. German Federal Court of Justice, NJW 2003, 511, 513; NJW 2003, 3705, 3706.

sion to a claims series clause in professional liability insurance that the terms used “legal or economic” connection are difficult to specify.<sup>6</sup>

### 3.5.3 Possible unreasonable disadvantage of policy holders

An adequately transparent claims series clause may disadvantage policy holders particularly in the following aspects and therefore be invalid.

#### 3.5.3.1 Possible deviation from legal principles of liability insurance

An unseasonable disadvantage shall be assumed in case of doubt if a clause in general terms and conditions cannot be reconciled with essential basic principles of statutory rule from which it deviates (cf. section 307 paragraph 2 No. 1 German Civil Code).

A claims series clause may be invalid if it unilaterally unreasonably disadvantages policy holders contrary to the basic principles of liability insurance. The German Federal of Court of Justice repeatedly referred to the essential basic principles of statutory regulation of liability insurance and emphasized its character as statutory concept (section 149 German Insurance Contract Act old version, section 100 German Insurance Act). Policy holders are liable toward a third party from an individual claim. According to this regulation the insurer’s contractual promise covers this liability.

A clause deviates from this if several claims would be aggregated into one single claim for the settlement by the insurer.<sup>7</sup>

#### 3.5.3.2 Weighing of interests

When auditing general terms and conditions a weighing of interests of the contracting parties shall decide on the effectiveness of a clause. According to case-law an unreasonable disadvantage occurs when the insurer tries, by unilateral contract drafting, to enforce his own interests in an abusive manner at the expense of policy holders and without adequately taking the policy holders interests into account and without granting a reasonable compensation (cf. German Federal Court of Justice, German Insurance Law 2012, 1149)

---

<sup>6</sup> cf. German Federal of Court of Justice, NJW 2003, 3705.

<sup>7</sup> cf. German Federal of Court of Justice insurance law 1991, 175 (professional liability insurance); NJW 2003, 511, 513 (general liability insurance); NJW 2003, 3705, 3706 (professional liability insurance).

It appears possible, that a weighing of interests shows that a claims series clause does not sufficiently take the policy holders interests' into account. It is to determine in each case what the contracting parties' interests are.

The policy holder has interest in having an insurance coverage formulated comprehensively and clearly. This interest contradicts a restriction of insurance coverage by a claims series clause.

The insurer has interest in using a claims series clause in order to calculate or restrict its duty to perform.

In a previous decision the German Federal Court of Justice agreed that it has to be considered a legitimate interest of the insurer to be able to avoid liability claims which need to be regulated by the insurer through a claims series clause. Based on the judgment of the claims series clause in the architect liability insurance the German Federal Court of Justice declared that it is obvious that such a clause leads to a reduction of insurance coverage. This alone would not be sufficient to regard the clause as inappropriate and therefore as invalid.

A certain interest on agreeing of a claims series clause by insurers could not be denied due to the fact that it helped to prevent careless work and thus to avoid liability claims (cf. German Federal Court of Justice, VersR 1991, 175). The German Federal Court of Justice further did not explain its argumentation. The court appears to assume that a policy holder is acting more carefully because otherwise there is a risk that claims incurred could not be covered merely due to the claims series clause.

The above mentioned – to a certain extent general preventive – argumentation of the German Federal Court of Justice is not convincing. The insurer may have an interest in using a claims series clause. However, no such interest follows from the argumentation of the German Federal Court of Justice.

Statutory and other contractual regulations allow the insurer in individual cases to rely wholly or partly on the release from the duty to perform (causing a claim, omission of duty, increase of risk). These regulations request from the policy holder to act with due care in order not to endanger insurance coverage. These regulations are sufficient to avoid damages. If the policy holder is acting sufficiently careful no reduction of benefits shall be made. Then it is not obvious why a claim/ damage is to be treated as uncovered under a claims series clause although the claim/ damage otherwise is insured.

## 4. SUMMARY

Claims series clauses are commonly used in commercial insurance contracts. Claims series clauses carry the risk of coverage gaps which have to be weighed carefully in contract drafting and contract performance. If the insurer refers to a claims series clause to the detriment of the policy holder in the insured event, effectiveness might be doubtful considering the laws with respect to general terms and conditions ("AGB" law).

Christian Drave, LL.M.

Lawyer

Master of Insurance Law

Specialist Solicitor (Fachanwalt) for transportation and shipping law

Wilhelm Rechtsanwälte

Partnerschaft von Rechtsanwälten

Reichsstraße 43

40217 Düsseldorf

Phone: + 49 (0)211 687746 - 43

Fax: + 49 (0)211 687746 - 20

[www.wilhelm-rae.de](http://www.wilhelm-rae.de)

[christian.drave@wilhelm-rae.de](mailto:christian.drave@wilhelm-rae.de)