WILHELM

RECHTSANWÄLTE

Christian Becker Versicherungspraxis, February 2014

Contract drafting

Incomprehensible clauses in insurance conditions

1. INTRODUCTION

Insurers always incorporate standard insurance conditions in their insurance contracts. Regularly unfavourable provisions for policy holders (risk exclusions, obligations) are included in clauses of standard insurance conditions. Despite careful reading, policy holders do often not understand these clauses. This may indicate the ineffectiveness of the clause.

The following article deals with the requirements concerning the comprehensibility of clauses and consequences due to the lack of comprehensibility.

2. REQUIREMENTS WITH RESPECT TO THE TRANSPARANCY OF CLAUSES IN STANDARD INSURANCE CONDITIONS

Standard insurance conditions are standard business terms. Thus clauses in standard insurance conditions have to satisfy legal requirements regarding standard business terms according to secs. 305 et seq. German Civil Code („Bürgerliches Gesetzbuch, BGB“).

Among other things insurers are not allowed to disadvantage their customers unreasonably by clauses in standard insurance conditions according to sec. 307 paragraph 1 sentence 1 German Civil Code. According to sec. 307 paragraph 1 sentence 2 German Civil Code an unreasonable disadvantage exists, in particular, when a clause is unclearly formulated (requirement of transparency). The requirement of transparency obligates insurers to formulate the rights and obligations of their customers according to the

principles of good faith as clear and legible as possible (cf. Staudinger/Richters in Fachanwaltskommentar Versicherungsrecht, 2013, section 1 recital 69)

Over the past decades, the jurisdiction developed standards by which the insurers' clauses can be examined regarding the observance of the requirement of transparency (cf. 2.1 to 2.4).

2.1 Understanding of the average policy holder

In order to satisfy the needs of the requirement of transparency, the clause has to be formulated clear and comprehensible for the policy holder without specialized knowledge of insurance law (cf. German Civil Code from 8 May 2013, reference IV ZR 84/12). Special attention should be given to the insurers' average customer reading the clauses carefully and trying to understand them (German Civil Code of 23 June 1993, reference IV ZR 135/92).

If the meaning of a contractual clause for this average policy holder is not clear and obvious despite reviewing the clause, the clause is contrary to the transparency requirement.

For example, the German Federal Court of Justice regarded a clause concerning the documentation of disability in the market value insurance for professional footballers as incomprehensive. Average policy holders (and also licensed clubs as policy holders) could not "even nearly" recognize by the formulation of clauses alone when the necessary documentations of disability have to be provided for the insurance benefit (cf. German Federal Court of Justice of 16 September 2009, reference IV ZR 246/08). An average policy holder could not determine its obligation in a clear-cut manner (procure documentations of disability at due date) according to insurance conditions so that the German Federal Court of Justice valued the clause as intransparent.

2.2 Visibility of economic burdens and disadvantages

Thus clauses meet the needs of the requirement of transparency clauses must indicate economic disadvantages and burdens resulting from them insofar as this may be required according to circumstances (cf. German Federal Court of Justice of 30 April 2008, IV ZR 241/04). On the basis of contract clauses, the policy holder must be able to determine financial consequences in the context of the provisions of the insurance contract. If this would be impossible for the policy holder, the clause is intransparent.

For this reason, the German Federal Court of Justice regarded i.a. clauses in endowment insurance contracts as intransparent (collection of the decisions of the German Federal Court of Justice 147, 354). The clauses, used at that time, in life insurance contracts had not clearly demonstrated policy holders the economic disadvantages of a premium payment, of a contract termination as well as the surrender value and the acquisition costs.

2.3 No terms without clear meaning

In order to meet the requirement of transparency insurers should avoid terms if possible.

Indeed not every term used inevitably leads to a lack of transparency (Präve in Beckmann/Beckmann-Matusche, section 10, recital 366). If insurers, however, use terms which have no clearly meaning these terms shall be deemed as incomprehensible for policy holders as the following example shows:

The German Federal Court of Justice recognized in an exclusion clause of a legal protection insurance contract a term without clearly meaning (cf. German Federal Court of Justice of 8 May 2013, IV ZR 84/12):

> *„There is no legal protection for legal representation of interests in casual connection with the acquisition or disposition of effects (e.g. bonds, shares, investment certificates) as well as investments in capital models to which the present principles of prospectus liability shall be applicable (e.g. tax loss companies, property fonds)"* [emphasis added by the author of this article]

In the jurisprudence it is still not clear when litigation is or is not associated with the "principles of the prospectus liability" – fulfilling the exclusion fact. Thus, the policy holder is not able to understand the term "principles of the prospectus liability". Hence, the German Federal Supreme Court considered the clause as intransparent formulated.

2.4 Special conditions for policy holders of the industry

Policy holders of the industry have much greater experience with insurance contracts as the average policy holder. As regards the transparency of a clause, the knowledge of the average industry policy holder may exceptionally have to be considered (collection of the decisions of the German Federal Court of Justice 112, 115; Präve in Beckmann/Beckmann-Matusche, section 10, recital 365).

The objective knowledge of industry policy holders is only to be considered when a homogenous group of beneficiaries of standard insurance conditions has an almost identical knowledge of the meaning of the clause. Usually this is not the case. Thus e.g. the group of policy holders in the D&O insurance contracts is so inhomogenous (from medium-sized companies to multinational companies) that there is no homogenous knowledge of the meaning of clauses. Hence particular attention should be given to the average policy holder without specific knowledge when examining the transparency of clauses in D&O insurance contracts.

If exceptionally there is a homogeneous group of industry policy holders with a homogenous knowledge of the meaning of clauses this knowledge may be relevant when examining the transparency. However, this does not mean that insurers agree with industry policy holders on incomprehensible clauses in standard insurance conditions and may justify a lack of transparency with the policy holder's wealth of experience. In fact, there are differences in exceptional cases when assessing the transparency of clauses if particular attention is not only given to the comprehension of the average policy holder but also to special knowledge of industry policy holders (Präve, reference as above.), as the following example shows:

The clause in a property insurance contract of an industrial customer whereupon "restrictions imposed upon the renovation by authorities are, when replacing restoration costs not taken into account", was incomprehensibly formulated (cf. German Federal Court of Justice of 30 April 2008, file IV ZR 241/04). Not only the average policy holder but also industry policy holders could not exactly recognize the meaning of the clause. They could not recognize that additional costs occurring due to official directives during the restoration of a damaged plant should not be insured. Hence the clause was intransparently formulated.

3. LEGAL CONSEQUENCES DUE TO INTRANSPARENTLY FORMULATED CONTRACT CLAUSES

An inappropriate disadvantage to the policy holder occurs when a clause is intransparently formulated. Clauses which inappropriately disadvantage the policy holder are ineffective according to section 307 paragraph 1 sentence 1 German Civil Code. The ineffective contract clause does not affect the validity of the remaining insurance contract (cf. section 306 paragraph 1 German Civil Code).

The ineffective clause shall be replaced by legal provisions if an appropriate provision exists. In case e.g. a clause in liability insurance contracts is ineffective, whereupon defense costs have to be credited on the sum insured, the ineffective deduction clause shall be replaced by the corresponding statutory provision according to section 101 paragraph 2 German Insurance Contract ("Versicherungsvertragsgesetz, VVG"). According to this statutory provision, defense costs will not be credited on the sum insured and thus they do not reduce the exemption sum (cf. Higher Regional Court of Frankfurt of 9 June 2011, file 7 U 127/09).

The clause is invalid if there is no statutory provision which could replace the ineffective clause. The above mentioned (2.3) exclusion clause in legal protection insurance contracts is invalid i.a. due to its invalidity and due to a lack of an alternative statutory rule. If a legal protection policy holder is involved in litigation according to the "principles of prospectus liability" the legal protection insurer is liable.

4. CONCLUSION

The requirements of the jurisdiction regarding the transparency and thus effectively formulated insurance conditions are high. Many clauses reviewed by the German Federal Court of Justice fail as intransparent. Due to this fact policy holders should question the repudiations of cover critically, which insurers justify with incomprehensibly formulated clauses.

Policy holders should be asking themselves i.a. the following control questions:

- Is the meaning of the relevant clauses for the average policy holder clearly obvious?
- Are the economic disadvantages and burdens of the clause clearly formulated?
- Is the insurer using terms which have no fixed meaning?
- Can unified knowledge of a homogenous group of industrial policy holders be taken into account?

The responses to the questions above will often lead to the conclusion that a repudiation of cover should not be accepted by the policy holder.

Christian Becker
Lawyer
Specialist solicitor (“Fachanwalt”) for insurance law

Wilhelm Partnerschaft von Rechtsanwälten mbB
Reichsstraße 43
40217 Düsseldorf

Telephone: + 49 (0)211 687746 - 14
Telefax: + 49 (0)211 687746 - 20

www.wilhelm-rae.de
christian.becker@wilhelm-rae.de

AG Essen PR 1597