WILHELM

RECHTSANWÄLTE

Christian Drave, Dr. Fabian Herdter August 2017

Insurance Litigation in Germany 2017

1. PRELIMINARY AND JURISDICTIONAL CONSIDERATIONS IN INSURANCE LITIGATION

1.1 In what fora are insurance disputes litigated?

Insurance disputes are litigated before civil courts. The competent court of the first instance is the competent local court for claims up to €5,000 and the competent district court for claims exceeding €5,000. The court of the second instance is the Court of Appeal. In the last instance, the German Federal Court of Justice may hear insurance cases if, for example, the case is of general legal relevance.

Generally, the claimant must bring its insurance case to the local court or district court at the domicile of the defendant. The insured may, however, at its choice also file suit against the insurer at the domestic district of the insured. As a rule, the parties cannot derogate this forum to the detriment of the insured prior to the dispute arising.

Commercial insurance contracts may refer insurance disputes to the courts of a certain district through jurisdiction clauses or to arbitration by agreement. German law generally respects arbitration agreements in commercial insurance contracts.

Insured consumers may also bring insurance claims not exceeding €50,000 to the Insurance Ombudsman. The decision will be binding upon the insurer if the claim does not exceed €10,000; otherwise, such decision is merely advisory. Any decision against the insured will not be binding.

Most of the Ombudsman's decisions are delivered within three months. Filing the application will prevent the consumer's insurance claim from becoming time-barred.

1.2 When do insurance-related causes of action accrue?

Insurance-related causes of action usually accrue when the insurer refuses to provide cover under a certain policy and the insured believes that it has a valid coverage claim. This is often the case if the insurer:

- disputes that there was an insured event triggering the policy (the insured event must be determined according to the respective policy wording and may vary);
- relies on exclusions from cover;
- argues that the insured did not comply with its obligations (eg, did not provide the

information necessary for the insurer to determine whether a claim is covered); or

- disputes the amount of the claim or loss.

Coverage disputes may arise at any time when the above scenarios occur. From the insured's perspective, it is crucial to note that it has to duly notify its claim (see question 8) and that its coverage claim may become time-barred. A general limitation period of three years also applies to insurance claims. The limitation period generally commences at the end of the year in which the insured's coverage claim arose and the insured obtained knowledge of the circumstances giving rise to the claim (or would have obtained such knowledge if it had not shown gross negligence).

1.3 What preliminary procedural and strategic considerations should be evaluated in insurance litigation?

Any insurance litigation is determined by the facts of the matter, the applicable law and the policy terms, and these should be considered carefully. In light of these main aspects, the following preliminary procedural and strategic considerations should be evaluated in insurance litigation:

- which law is applicable to the insurance matter according to the policy terms and statutory provisions;
- when, at the latest, and how the claim must be notified to the insurer and any co-insurer;
- when the insurance claim becomes time-barred, and when at the latest any judicial action must be taken;
- whether the claim must or should be referred to arbitration;
- which civil court is competent to hear the case. In cases where the claimant may choose between several competent courts, the convenient forum needs to be chosen;
- whether the insured should try to pursue its claim by way of out-of-court negotiations to achieve a lump-sum agreement, or whether the parties may agree on alternative dispute resolution;
- regarding the costs that potential procedural ways to pursue the claim will possibly cause, the most cost-efficient way should be chosen. German procedural law requires an advance payment of court fees upon filing of the matter. As a rule, the losing party bears the legal costs of the winning party plus court fees. Recoverable legal costs are calculated by statute and depend on the amount in dispute. A winning party may not be able to recover all its costs (eg, in cases where its attorneys' fees are based on hourly rates that exceed the amount that it can recover by statute);
- the amount of time possible procedures may take (eg, civil trial of possibly three instances, arbitration);

- whether the claim is also covered by another insurance contract (multiple insurance);
- whether evidence must be secured (eg, by experts, witness statements);
- with respect to consumer policyholders, whether an application to the Insurance Ombudsman is suitable; and
- what obligations the insured has to comply with after the insured event took place (deriving from the policy and the applicable law). For example, pursuant to section 86 paragraph 2 Insurance Contract Act, the insured is obliged to secure any possible recourse claim against a third party that initially caused the loss. If, for example, a tortfeasor causes the insured's house to burn down, the insured has a liability claim against the tortfeasor. If the fire insurer compensates the insured, the insured's liability claim against the tortfeasor will pass over to the insurer ipso jure. In order to secure the insurer's recourse action against the tortfeasor, the insured is obliged to cooperate. The insured may aim for a quick settlement with the tortfeasor before the insurer pays any compensation. If the insured wants to accept partial payment by the tortfeasor, it will thereby reduce the claim that passes over to the insurer upon payment under the policy. The insurer may therefore deny cover. Thus, the insured should try to obtain the insurer's consent prior to the settlement.

1.4 What remedies or damages may apply?

1.4.1 Insured's remedies

In the event that the insurer refuses to provide cover, the insured may claim for performance according to the policy terms.

If the insurer breaches its contractual duties under the policy, the insured can claim any loss caused by a breach of contract by the insurer.

In cases of late payment, the insured may claim interest from the insurer. The statutory interest rate is 5 percentage points above the interest base rate. Pursuant to section 14 paragraph 1 Insurance Contract Act, the insurer must indemnify the insured when enquiries necessary to establish the occurrence of the insured event and the extent of the insurer's liability have been concluded. If these enquiries take longer than one month after notification of the claim, the insured is entitled to claim part payment in the amount that it may at the least be expected to claim. Disputes may arise as to when the insured can claim payment or – as the case may be – part payment from the insurer.

1.4.2 Insurer's remedies

As the most relevant remedy under German insurance law, the insurer may refuse to perform under certain prerequisites. The insurer is released from liability for any claim if the insured intentionally caused the insured event (in liability insurance: if the insured intentionally caused the loss suffered by the third party). The insurer is further released from liability if the insured intentionally breached a statutory or contractual obligation. If the insured breached the obligation recklessly ('gross negli-

gence'), the insurer is entitled to reduce its payment by a proportion corresponding to the severity of fault. The insurer remains fully liable if the violation by the insured was only negligent ('simple negligence'). However, for a release of the insurer from liability, the insured's violation has to be relevant to the occurrence of the insured event or the extent of the insurer's liability. If the insured event would have occurred even without the breach of an obligation, the insurer remains liable for the claim. If the insured breaches an obligation, the court will generally assume that the obligation was violated recklessly. To be fully released from liability, the insurer must prove intentional violation of the obligation. In contrast, the insured must prove that it acted merely negligently to achieve full indemnification.

In the case of non-disclosure of a material circumstance by the insured, German insurance law allows the insurer to terminate the contract and avoid paying future claims by giving one month's notice (in cases of no more than simple negligence), or to withdraw from the contract and treat the contract as void ab initio (in cases of at least gross negligence). Notwithstanding its withdrawal, the insurer may still be obliged to pay a claim if the non-disclosed circumstance is not responsible for the occurrence of the insured event that gave rise to the claim or for the extent of the insurer's liability. In cases of fraudulent misrepresentation, the insurer can avoid the contract and retain the premium paid.

1.5 Under what circumstances can extracontractual or punitive damages be awarded?

German law does not acknowledge punitive damages. Extracontractual damages are rarely subject to German insurance litigation.

2. INTERPRETATION OF INSURANCE CONTRACTS

2.1 What rules govern interpretation of insurance policies?

General principles of contract interpretation also apply to insurance policies. Most insurance contracts are based on standard terms provided by insurers. The interpretation of standard terms is governed by special rules pursuant to the laws on general terms and conditions (section 305 et seq German Civil Code). Mainly, the following key principles apply:

- generally, words shall be given their natural meaning. As a special rule, judicial phrases shall be given their judicial meaning rather than their natural meaning, provided that a clear and consistent judicial meaning of the phrase exists;

- any provision that the parties individually negotiated on shall prevail over standard terms and shall generally be given the meaning that the parties intended;

- insurance policy standard terms shall be interpreted from an objective perspective. The individual understanding of the parties is not decisive. Rather, the courts will establish what meaning the provision has to a reasonable insured without any special

knowledge of insurance matters given the wording and context of the policy. It must be noted, however, that single aspects of interpretation are disputed in this context;

- as to insurer's standard terms, the courts may hold provisions invalid if they unreasonably disadvantage the insured, thereby violating the requirement of good faith. For example, this may be the case if a provision deviates from the essential provisions of the law to the detriment of the insured; and

- certain provisions of the Insurance Contract Act are mandatory. Certain provisions are mandatory to the benefit of the insured only. This means that the parties cannot deviate from the provision to the detriment of the insured. Any provision agreed to the contrary is invalid. The invalid provision is replaced by the respective provision of the Insurance Contract Act.

2.2 When is an insurance policy provision ambiguous and how are such ambiguities resolved?

An insurance policy provision is ambiguous if the interpretation, in accordance with the rules of contract interpretation (see question 6), shows that the provision may have more than one meaning and none of the meanings clearly overrules the others. If an ambiguous provision is part of the standard terms, the provision will be interpreted against the party who drafted the provision (section 305c paragraph 2 German Civil Code). If, for example, a policy provision is utterly unclear to the detriment of the insured, it may be deemed null and void and therefore to form no part of the policy. The policy will then be construed in accordance with the Insurance Contract Act.

3. NOTICE TO INSURANCE COMPANIES

3.1 What are the mechanics of providing notice?

Pursuant to section 30 paragraph 1 Insurance Contract Act, the policy-holder shall notify the insurer of the occurrence of the insured event without undue delay after it has learned thereof. Notice should also be made by a third (insured) party as far as the third party is entitled to the right to obtain compensation.

Notice can generally be made orally or in writing, although most policies require notice to be in writing.

3.2 What are a policyholder's notice obligations for a claims-made policy?

There is no statutory law providing special requirements for a claims-made policy. In most claims-made policies, the insured has to give written notice without undue delay after the claim is made.

3.3 When is notice untimely?

There is no exact time limit after which a notice is deemed untimely or delayed. In general, the policyholder has to give notice without culpable delay, that is, within three days after the insured event occurred. In liability insurance, the policyholder shall be obligated to disclose to the insurer within one week those facts that could give rise to its re-

sponsibility in relation to a third party (section 104 paragraph 1 Insurance Contract Act).

3.4 What are the consequences of late notice?

The consequences of giving late notice generally depend on the gravity of fault (see question 4). The insurer is released from liability for any claim if the policyholder has intentionally breached its statutory or contractual obligation. If the policyholder breached the obligation recklessly ('gross negligence'), the insurer is entitled to reduce its payment by a proportion corresponding to the severity of fault. However, the insurer remains fully liable if the violation by the policyholder was negligent ('simple negligence'). Negligent violations are, therefore, without legal effect.

The violation (late notice) needs to be relevant to the extent of the insurer's liability to release the insurer from payment, that is to say, that the late notice of the policyholder essentially complicated the insurer's enquiries necessary to establish the extent of the insurer's liability. The burden of proof for such missing causality remains on the policyholder. However, this principle does not apply in the case of fraud, where the insurer is generally fully released from liability.

If the duty to give notice is in dispute, the court will generally assume that the duty to give notice has been violated recklessly. To be fully released from liability, the insurer must prove intentional violation of the duty. In contrast, the policyholder must prove that it acted merely negligently to achieve full indemnification.

4. INSURER'S DUTY TO DEFEND

4.1 What is the scope of an insurer's duty to defend?

Pursuant to section 100 Insurance Contract Act, in the case of liability insurance, the insurer shall be obligated to release the policyholder from any claims asserted by a third party on the basis of the policyholder's responsibility and to fight off unfounded claims. The insurance shall also cover the judicial and out-of-court costs arising from claims asserted by a third party insofar as the circumstances necessitate the expenditure.

Further, the insurer generally covers expenses incurred on the instruction of the insurer for defence in criminal proceedings if such proceedings could result in the policyholder becoming liable in relation to a third party. At the policyholder's request, the insurer shall advance the costs.

4.2 What are the consequences of an insurer's failure to defend?

In general, the consequence of an insurer's failure to defend is a breach of contract on the side of the insurer. The insured is then entitled to file a declaratory action or even to sue performance in cases where the policy-holder advanced costs.

5. STANDARD COMMERCIAL GENERAL LIABILITY POLICIES

5.1 What constitutes bodily injury under a standard CGL policy?

Standard CGL policies in Germany issued to business organisations provide cover resulting from the statutory liability of the insured for personal injury and property damages. Cover for personal injury is provided in the event of death, wounding or other bodily injury.

5.2 What constitutes property damage under a standard CGL policy?

Property damage under a standard CGL policy is established by the occurrence of an insured event resulting in the damage or destruction of property (material damage).

5.3 What constitutes an occurrence under a standard CGL policy?

The insurer will provide the policyholder with insurance cover in the event that a loss occurs during the period of the insurance. Loss occurrence is the event directly resulting in the injury or damage to the third party. The event directly resulting in the injury or damage to the third party often occurs at a later point in time than the event that set the first causal link to the later damage.

5.4 How is the number of covered occurrences determined?

According to German statutory law, there exists no special provision that determines the number of covered occurrences. It is rather at the discretion of the parties to determine the number of covered occurrences and to agree on the amount insured. Depending on the specific insurance or industrial branch, or both, many different insurance concepts in the market have to be examined on a case-by-case basis.

5.5 What event or events trigger insurance coverage?

Statutory law does not define what event triggers insurance cover in a standard CGL policy. The insurer will provide cover in accordance with the terms and conditions of the policy (subject to relevant exclusion clauses).

Therefore, the parties are basically free to define the event that triggers insurance coverage in a CGL policy. In most CGL policies, the event of loss occurrence (see above) triggers coverage. However, in some policies the parties may agree on the event of claims being made as a trigger for coverage.

5.6 How is insurance coverage allocated across multiple insurance policies?

Multiple insurance is identified if one interest is insured against the same risk with several insurers (section 78 paragraph 1 Insurance Contract Act). In such a case, the multiple insurers are liable as joint and several debtors in such a manner that each insurer must pay the sum in accordance with its contract, but the policyholder cannot demand more than the total amount of the loss.

With regard to the internal compensation of the insurers, they are liable to pay in proportion to the amounts for which they are liable in accordance with each respective contract. If foreign law is ap-

plicable to one of the insurances, the insurer to whom the foreign law applies may only assert a claim for compensation against the other insurer if it is itself liable to pay compensation under the relevant law (section 78 paragraph 2 Insurance Contract Act).

Insurance contracts often contain simple or qualified subsidiary clauses. Theses clauses have the purpose of limiting the insurer's liability in cases of multiple insurance. The insurer has the intention to rank its own liability and those of other insurers insuring the same risk in order to be liable only in the second degree in case of an insured event. Policyholders should carefully review subsidiary clauses in order to avoid legal uncertainty or even coverage gaps. If the insurer denies coverage under an already existing contract due to a subsidiary clause, policyholders should examine whether the employed clause complies with the laws on general terms and conditions (section 305 et seq German Civil Code).

6. FIRST-PARTY PROPERTY INSURANCE

6.1 What is the general scope of first-party property coverage?

As a rule, any legal insurable interest of the insured can be subject to first-party insurance. First-party insurance provides compensation for the loss suffered by the insured. The insured may generally not claim more than the actual loss incurred. However, the parties can agree on how the insured's loss shall be determined. For example, they may agree on a fixed value. First-party policies usually contain agreements on a sum insured. The sum insured is the maximum compensation the insured is entitled to for a claim or as aggregate for several claims under the policy.

First-party insurance may, for example, cover losses resulting from damage to or loss of:

- real estate, industrial plants or machinery affected by fire, storm or water damage, as well as other named perils;
- motor cars, yachts and airplanes;
- homes and personal belongings; and
- buildings under construction.

In addition to mere property damage, commercial insurance contracts may cover consequential losses (eg, if a fire in an insured industrial plant causes business interruption).

Depending on the respective insurance contract and branch, first-party property insurance covers named perils (eg, for homes) or provides all-risk cover (eg, in yacht insurance).

6.2 How is property valued under first-party insurance policies?

Under first-party insurance, property is valued according to the parties' agreement in the insurance policy or, if not agreed, according to the Insurance Contract Act. Agreements vary according to the respective branches and policies.

As a non-mandatory statutory rule, the insured may claim the amount that it must spend upon the occurrence of the insured event to replace or restore the insured property to mint condition, minus the reduced market value resulting from the

difference between old and new. If, for example, an old crane is wrecked by a storm, the insured may thus only claim the amount necessary to replace the old crane by another old crane of the same type and age. However, the insurer may undertake (and, under German policies, in certain cases often does undertake) to pay the full replacement value without any deduction of the difference between old and new. In this case, the insured may recover the costs for replacing the wrecked old crane by a new crane of the same type.

7. DIRECTORS' AND OFFICERS' INSURANCE

7.1 What is the scope of D&O coverage?

In general, German D&O insurance mainly covers losses of a company resulting from breaches of duty by its own managers or executives (called internal liability cases (insured versus insured)). Insured persons are all authorised representatives and executives, and include board members, directors and managers, and supervisory board members. If insured persons commit a breach of duty (wrongful act) to the detriment of the company, and if the company asserts damage claims against such person, the D&O insurance is triggered for the benefit of the insured person.

In cases where the company or an insured person gives notice of a claim made against the insured person, the D&O insurer has first to examine whether the insured is liable to the (allegedly) aggrieved company. If the D&O insurer considers the claim of the company against the manager to be unfounded, the insurer must fight off the claim and indemnify defence costs, which are comparable with legal protection insurance. The insurer reimburses costs for lawyers, experts and court fees required to fight off the claim. By contrast, the D&O insurer settles the claim of the company if it considers the claim to be justified. However, in most German D&O cases, the insurer will not pay any compensation to the (allegedly) injured party as long as the question of liability is pending (and, if necessary, not until the court decides the liability matter of the insured company against the insured person in a final judgment).

7.2 What issues are commonly litigated in the context of D&O policies?

D&O claims in Germany are mainly an issue of internal liability (insured versus insured) and not third-party claims. As a consequence, the issues commonly litigated in the context of D&O policies concern claims for damages of a company against a manager based on his or her breach of duty.

In accordance with the German Stock Corporation Act and the Laws on Limited Liability Companies, executives who violate their duties shall be jointly and severally liable to the company for any resulting damage with their private assets (section 93 paragraph 2 Stock Corporation Act). The members of the management board have to employ the care of a diligent and conscientious manager in conducting business. The mangers shall not be deemed to have violated their duty if, at the time of taking the entrepreneurial decision, they had good reason to assume that they were acting on the basis of adequate information for the benefit of the company. The managers bear the burden of proof in the event of a dispute as to whether they have employed the care of a diligent and conscientious manager.

As the Stock Corporation Act requires a two-tier board structure consisting of a managing board and a supervisory board, such principle also applies to members of the supervisory board as to any breach of supervisory obligations.

Apart from internal liability claims, the majority of external liability claims refer to claims made by insolvency administrators against the insured persons (after companies have become insolvent).

In 2016 the German Federal Court of Justice (BGH) handed down two important decisions (file numbers IV ZR 304/13 and IV ZR 51/14 of 13 April 2016). In the two cases at hand two companies had claimed for compensation against their current managers for different breaches of duty (insured vs. insured). Subsequently, the managers (insured persons) assigned their indemnification claim (insurance cover) under the D&O insurance to the respective company (policy holder).

The BGH held that

- an insured manager has the right to assign his or her indemnification claim to the policy holding company (so that the company can claim direct coverage from the insurer); and
- a "serious" intend of the claimant to pursue its claim for compensation in respect of the manager (who committed the alleged breach of duty) is no precondition for the insured event in D&O insurance. According to the BGH the occurrence of an insured event in D&O insurance only requires that a claim for compensation is made in writing. The aggrieved policy holder does not need to prove "seriousness" of its claim as long as there is no such provision in the respective terms and conditions of the D&O policy.

The decisions of the BGH are important for insureds under D&O-insurance in Germany as they resolve legal uncertainties that existed following contrary decisions by the Higher Regional Court (OLG) Düsseldorf in 2013.

8. CYBER INSURANCE

8.1 What type of risks may be covered in cyber insurance policies?

Cyber insurance policies in general cover both first-party losses and third-party losses (cyber liability cover). In addition, cyber insurance policies provide assistance for a variety of aspects, and may especially cover the following types of risks (respectively, losses and costs):

- business interruption losses incurred by the insured in consequence of hacking attacks or data manipulations;
- costs of forensic investigations and data restoration in consequence of data spying and data protection infringements;
- costs of customer notification (eg, a hacker attack on a retailer leads to the disclosure of millions of customer records concerning personal data. The retailer is obliged to inform all customers. The insurer bears mailing costs);
- costs of credit card monitoring;

- costs of public relations to prevent reputational harm;
- contractual compensations resulting from non-compliance with data security standards (eg, the data security standards of the payment card industry);
- third-party losses claimed against the insured in consequence of a data security breach by the insured;
- costs of legal defence; and
- regulatory fines in consequence of data security breaches.

It must be noted that the German cyber insurance market is evolving, and that no market standard currently exists.

8.2 What cyber insurance issues have been litigated?

Given that the German cyber insurance market is still evolving, no coverage disputes have yet been litigated in the German courts.

9. TERROR INSURANCE

Is insurance available in your jurisdiction for injury or damage caused by acts of terrorism and, if so, how does it generally operate?

Common (commercial) property and business interruption policies typically exclude losses caused by acts of terrorism. However, German insurers provide coverage upon individual agreement up to a limit of EUR 25 million. In excess of such limit, specialty insurer Extremus (formed by a group of carriers) offers coverage for major losses caused by acts of terrorism up to a single limit, annual aggregate respectively, of EUR 1.5 billion per insured company. Personal injury/death caused by acts of terrorism may constitute insured events under personal insurance policies (e.g. an "accident" covered under a personal accident policy).

If you have any queries, please do not hesitate to contact the authors:

Dr. Fabian Herdter, LL.M. Eur.
Attorney and Partner

Wilhelm Rechtsanwälte
Reichsstraße 43
40217 Düsseldorf
Germany

Tel: +49 211 687746 50
fabian.herdter@wilhelm-rae.de

Christian Drave, LL.M.
Attorney

Wilhelm Rechtsanwälte
Reichsstraße 43
40217 Düsseldorf
Germany

Tel: +49 211 687746 43
christian.drave@wilhelm-rae.de

Reproduced with permission from Law Business Research Ltd. Getting the Deal Through: Insurance Litigation 2017, (published in March 2017; contributing editors: Mary Beth Forshaw and Elisa Alcabes, Simpson Thacher & Bartlett LLP) For further information please visit https://gettingthedealthrough.com/area/62/insurance-litigation-2017.