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Insurance contract law

„Collision“ of subsidiary clauses in insurance contracts

Insurance contracts often contain subsidiary clauses. Theses clauses have the purpose to limit the insurer’s liability in case of multiple insurance. The insurer has the intention to rank its own liability and those of other insurers insuring the same risk and to be liable only in the second degree in case of an insured event.

A multiple insurance is given if one interest is insured against the same risk with several insurers (sec. 78 para. 1 Insurance Contract Act, *Versicherungsvertragsgesetz*, “VVG”). It can have several reasons. Firstly, it may be caused by the policy holder purchasing the same insurance product twice. A typical case is the existence of several travel health insurances. On the other hand, multiple insurance might result from overlapping coverage of different types of insurance, e.g. coverage of defense costs through D&O and legal expenses insurance, of property damages to transporting construction vehicles through hull insurance and cargo insurance or pecuniary loss after computer misuse through fidelity and cyber risk insurance.

It is questionable which insurer is liable if all insurance contracts in case of multiple insurance contain subsidiary clauses. The question depends on the subsidiary clause used in the individual case (cf. cypher 1) and recently caused the Federal Court of Justice to deal with the legal consequences of colliding subsidiary clauses (judgment of 19 February 2014, file no. IV ZR 389/12, cf. cypher 2).

1. TYPES OF SUBSIDIARY CLAUSES

Subsidiary clauses in insurance contracts are drafted in different ways. Depending on the scope of the clause employed, it is differentiated between so-called simple (limited) and qualified (unlimited) subsidiary clauses.

1.1 Simple subsidiary clause

A simple subsidiary clause is given if the insurer is not liable insofar as the policy holder can demand compensation from another insurer. Typical clauses are:

> *„Obligations to provide coverage arising under other insurance contracts will have precedence over the insurer's coverage obligation."*

or

> *„If, in the case of an insured event, compensation can be claimed under another insurance contract, the other contract shall have priority over this contract."*

Insurance coverage will only be effective if and in so far as another insurer (primary insurer) grants coverage. Insurance coverage under a subsidiary insurance contract will be effective independent of why there is no effective insurance coverage under the primary insurance contract (e.g. because the policy holder does not pay premiums or has breached obligations).

A special form of subsidiary clauses is the so-called "double" subsidiary clause. It additionally regulates that the insurance coverage is subsidiary also in case the competitive insurance contract contains a subsidiary clause. It has the following additional wording:

> *„Insurance coverage under this contract is subsidiary even if one of those* [competitive] *insurance contracts contains a subsidiary liability clause."*

Simple subsidiary clauses are regarded effective by jurisdiction.

1.2 Qualified subsidiary clauses

A qualified subsidiary clause is given if the insurer excludes liability in case a competitive insurance contract exists. A qualified subsidiary clause for example says:

> *„Insurance coverage under this contract is only subsidiary to other insurance coverage: other insurance contracts have precedence if the same risk is insured with another insurer."*

According to the qualified subsidiary clause, the insurer's duty to provide coverage does no longer apply independently of whether the other (primary) insurer does in fact grant insurance coverage for the insured event or not. This clause may in the individual case have the effect that the policy holder may not claim for any insurance coverage because the primary insurer is released from liability and the subsidiary clause is effective under the other insurance contract.

Sometimes qualified subsidiary clauses are formulated in such way that only specific objects (jewelry, objects of art) are excluded from insurance coverage or specific liability claims which are "usually" subject to another liability insurance (e.g. environmental or product liability insurance).

Whether qualified subsidiary clauses are effective and withstand an examination in general terms and conditions, is disputed in the individual case and has not yet been decided by the highest courts.

2. COLLISIONS OF SUBSIDIARY CLAUSES

So far it has not yet been decided by highest judicial authority which legal consequences arise from conflicting subsidiary clauses. By decision of 19 February 2014 (file no. IV ZR 389/12), the Federal Court of Justice decided that simple subsidiary clauses cancel each other out. Both insurers are liable at the discretion of the policy holder. Insurers may take recourse against other insurers for indemnity payments made.

2.1 Facts of the case

The case before the Federal Court of Justice concerned two travel insurers. Both had concluded insurance for traveling abroad with the same policy holder.

The defendant insurer (defendant) had made indemnification payments for undisputed insured events. He then requested half of these amounts back from the plaintive insurer (plaintiff). The plaintiff paid the requested amount of compensation to the defendant under the reservation of reclaim. After the defendant paid for another insured event as well, he again requested compensation from the plaintiff.

The plaintiff sued the defendant for repayment of the amounts paid under reservation. He further claimed for declaration that he was not liable to pay for the further insured event due to the double subsidiary clause within its General Insurance Terms (*Allgemeine Versicherungsbedingungen*, "AVB").

The subsidiary clause in the AVB of the plaintiff says:

> *„In so far as in case of an insured event compensation may be claimed under other insurance contracts, these payment obligations precede. This applies also in case a subsidiary liability has been agreed upon in one of those insurance contracts."*

In contrast, the AVB in the insurance contract of the plaintiff contained the following simple subsidiary clause:

> *„Obligations to provide coverage arising under other insurance contracts have precedence over the insurer's obligation* […]*. This especially applies for statutory obligations of the social insurance carrier."*

The defendant was of the opinion that the subsidiary clauses employed were equal and cancelled each other out. The plaintiff thus was obliged to compensate half of the owed insurance payments already made.

2.2 Decision

The Federal Court of Justice supported the defendant's view of the case. In relationship to the plaintiff the defendant is entitled to compensation for insurance payments already made according to the legal provisions regarding multiple insurance (sec. 78 para. 2 s. 1 VVG). The internal settlement according to sec. 78 VVG shall not be excluded by means of subsidiary clauses.

2.2.1 Policy holder as reference for clause interpretation

At first the Federal Court of Justice clarified that the interpretation of subsidiary clauses as General Insurance Terms was only determined by the understanding of the average policy holder with no special knowledge of insurance law and his interests. This reference of interpretation was also applicable if the interpretation finally had an impact on the relationship between insurers. A clause interpretation from the point of view of the involved insurers might not be considered. The insurers did not have a direct contractual relationship but separate insurance contracts.

2.2.2 Understanding of the policy holder

The average policy holder would understand the subsidiary clause in such way that the insurer's liability would not already be omitted if another insurance covered the same risk, but only if the other insurance payed for the loss.

When comparing the subsidiary clauses, the policy holder would see that no insurer involved is willing to grant coverage under consideration of the liability of the respective other insurer. The policy holder payed insurance premiums for both contracts. He would therefore not assume that the dispute of the insurers about the subordination of their liability shall be at the expense of the policy holder, resulting in a loss of insurance coverage. The policy holder would rather understand the clauses in such way that he will be able to choose one of the involved insurers for full insurance coverage.

In relation to the policy holder, colliding subsidiary clauses therefore cancel each other out. The settlement among insurers is made according to the provisions concerning multiple insurance. This corresponded to the prevailing opinion in literature and jurisdiction.

2.2.3 No change of meaning by amendment to the subsidiary clause

The Federal Court of Justice further decided that the „double“ subsidiary clause as well had no further meaning than the simple subsidiary clause.

The average policy holder would not attribute another meaning to the amendment that insurance coverage is subordinate if the other insurance contains a subsidiary clause.

Also in this case the policy holder would not assume that the insurer was released from liability if the contract with the other insurer contained a subsidiary clause as well. The policy holder could not see an insurer’s interest in such extensive limitation of liability that was worthy of protection. The policy holder paid premiums and the conclusion of another insurance contract against the same risk is admissible. The amendment to the clause only underlined the already regulated subordination of the insurance coverage.

2.3 Reimbursement between insurers

The Federal Court of Justice further pointed out that the reimbursement between insurers according to sec. 78 para. 2 s. 1 VVG was alterable by mutual consent. The insurers did though not agree on an alteration. An agreement on alteration would also not result indirectly from the subsidiary clauses. It rather followed from the clauses that no insurer was willing to bear the insurance payment alone in relationship to another insurer and without possibility of reimbursement only because of a subordinate insurance coverage resulting from another insurance contract.

3. OPEN QUESTIONS: COLLISION OF OTHER SUBSIDIARY CLAUSES

The Federal Court of Justice has not decided on the legal consequences in case of colliding qualified subsidiary clauses or in case a qualified and a simple subsidiary clause collide.

3.1 Collision of qualified subsidiary clauses

The interpretation principles developed by the Federal Court of Justice are transferable to the collision of equally ranked qualified subsidiary clauses. The policy holder indeed understands that the insurer does not want to provide coverage in case it exists another insurance contract against the same risk. But also in this case the policy holder would not assume that he will lose the entire insurance coverage in case of colliding subsidiary clauses though he pays premiums for two insurances. Besides, the conclusion of another insurance contract is regularly not prohibited according to the insurance contracts.

According to the opinion represented here, colliding qualified subsidiary clauses therefore cancel each other out in relationship to the policy holder as well. The policy holder can request insurance coverage from the involved insurer at his own discretion.

Some argue[1], the policy holder had no insurance coverage in case of a collision of qualified subsidiary clauses. This view cannot be accepted against the background of the decision presented above. Such result of interpretation would be surprising in the meaning of sec. 305 c para. 1 German Civil Code (*Bürgerliches Gesetzbuch*, "BGB"). An informed policy holder would not expect to have no insurance coverage due only to the existence of two insurance contracts subject to premiums. Such content of an insurance clause would also be intransparent (sec. 307 para. 1 s. 2 BGB) and would inappropriately deviate from legal principles at the detriment of the policy holder (sec. 307 para. 1 s. 1, 307 para. 2 Nr. 1 BGB). When concluding the contract, the policy holder does either not know that a multiple insurance is given due to coverage overlaps or the policy holder is just buying additional insurance coverage in order to avoid coverage gaps so that, as the case may be, only partial overlaps occur. The loss of insurance coverage despite (or precisely because) of double premium payments is not predictable and does not correspond with the policy holder's interests.

[1] *Armbrüster* in: Prölss/Martin, VVG, 28th edition 2010 marginal note 35; *Brambach* in: Rüffer/Halbach/Schimikowski, Versicherungsvertragsgesetz, 2nd edition 2011, sec. 77 marginal note 26.

3.2 Collision of simple and qualified subsidiary clause

If simple and qualified subsidiary clauses come together, the prevailing opinion is that only the “simple subsidiary” insurer is liable. Due to the hierarchy established by the subsidiary clauses, the insurer who employs a qualified subsidiary clause is not liable.

It is dubious whether this view can be accepted:

On the one hand, a hierarchy among insurance contracts may only exist in so far as the applied qualified subsidiary clause is effective. The effectiveness depends on the individual case. It depends on the wording of the clause whether the policy holder is able to see whether coverage exists. Qualified subsidiary clauses which exclude specific (otherwise insured) risks from insurance coverage equal risk exclusions and as such have to be interpreted restrictively. It is questionable whether a policy holder is able at all to assess during conclusion of the insurance contract whether insurance coverage exists on the basis of a qualified subsidiary clause. For this purpose, the policy holder would not only have to be able to tell that a multiple insurance leads to a loss of the insurance claim but also, under which circumstances a multiple insurance is given. This is hardly possible especially - independent of the individual case - in case of a coverage overlap.

On the other hand, there are no obvious reasons why the collision of different subsidiary clauses in relationship to the policy holder shall cause other legal consequences than the collision of equally ranked clauses. A race of insurers for the better subsidiary clause should be avoided. The interest of the policy holder is the same in this situation. He does not expect that he might have no insurance claim in case of a multiple insurance and double premium payment (e.g. in case of a breach of obligation under the simple subsidiary insurance contract) or only limited insurance claim (e.g. in case of partial adjustment of the damage due to deficient cover).

Better reasons therefore speak for the fact that subsidiary clauses of different hierarchy levels cancel each other out towards the policy holder and possibly have only effect in the relationship among insurers.

4. CONCLUSION

If the policy holder agrees on insurance contracts with colliding subsidiary clauses, he may in case of multiple insurance choose the liable at his/ her discretion.

The policy holder does also not lose insurance coverage in case of colliding qualified subsidiary clauses. He may claim against the insurer of his choice for full insurance benefit.

Already during the purchase of insurance coverage it should be taken care that contracts do not contain qualified subsidiary clauses in order to avoid legal uncertainty. If the insurer denies coverage under an already existing contract due to a qualified subsidiary clause, policy holders should examine whether the employed clause complies with laws on general terms and conditions.

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