WILHELM

RECHTSANWÄLTE

Dr. Fabian Herdter Versicherungspraxis, December 2014

Claim settlement

Knowledge of circumstances that aggravate risks does not mandatorily result in insurer's release from liability

(assessment of BGH judgment of 10 September 2014, IV ZR 322/13)

1. INTRODUCTION

Since, according to the reform of the German Insurance Contract Act ("VVG"), a gross negligent breach of obligation mostly "only" results in proportional (limited) compensation of the policy holder, insurers and some courts seem to lower the standard of intentional behavior on the part of the policy holder.

In property insurance, insurers increasingly argue after the occurrence of the insured event that the policy holder breached contractual and/ or statutory obligations intentionally or rather fraudulently. The reason for alleging intentional or fraudulent behavior of the policy holder is that the legislator with the VVG reform modified the legal consequences for breaches of contract in such way that the insurer will only be fully released from liability in case of an intentional or fraudulent breach of an contractual obligation.[1]

In its judgment of 10 September 2014 (IV ZR 322/13), the Federal Court of Justice ("BGH") examines the subjective requirements that may constitute aggravation of risk caused by the policy holder. The court held that the insurer will not only become liable in case a policy holder had knowledge about circumstance that aggravated the insured

[1] In exceptional cases, a gross negligent breach of obligation could even result in so-called "limitation of 100%".

risk. The policy holder should rather have to "consciously" recognize that his conduct might have aggravated the risk.

In the following, we classify the decision of the BGH with regard to the law of aggravation of risk by the policy holder and examine the consequences of this decision from the policy holder's point of view.

2. THE TERM OF RISK AGGRAVATION

The aggravation of risk obligation of the policy holder describes his obligation to inform the insurer about an aggravation of the insured risk circumstances. This obligation results from the fact that due to the aggravated risk, the principle of equivalence between the insurer's performance (insurance cover) and the policy holder's performance (premium) may shift.[2] Thus, an aggravation of risk changes the original basis of the contract with retroactive effect compared to the point of time the contract was concluded. In the BGB (German Civil Code) this case is governed in sec. 313 BGB as "interference with the basis of the transaction". The specific provisions for insurance law in sections 23 et seqs. VVG replace the general provisions of sec. 313 BGB.

In sec. 23 VVG, the VVG differentiates among three different forms of aggravation of risk which we explain in the following:

2.1 Subjective aggravation of risk

Subjective aggravation of risk according to sec. 23 para. 1 VVG is deliberately affected by the policy holder itself. The insured risk aggravates as a result of intentional behavior of the policy holder.

Example: After conclusion of a fire insurance contract, the policy holding company stores easily combustible raw materials in a warehouse insured as being vacant.

[2] Cf. *Wandt*, Versicherungsrecht, 5. edition, recital 822.

2.2 Subjective unconscious aggravation of risk

Subjective unconscious aggravation of risk according to sec. 23 para. 2 VVG is affected if the policy holder recognizes only later that he has aggravated the risk without the consent of the insurer.

Example: After concluding a homeowner insurance, the policyholder installs a fireplace in his house and fails to recognize that the security measures taken (fire-protection measures) are not sufficient.[3]

2.3 Objective aggravation of risk

Objective aggravation of risk according to sec. 23 para. 3 VVG differentiates from the above mentioned subjective aggravations of risk forms by the fact that the policy holder has not arranged for the aggravation of risk himself but it occurs notwithstanding his intention.

Example: After the policy holder concluded the homeowners insurance, the neighbor of the policyholder storages high explosive material in his cellar, which is immediately adjacent to the cellar of the policyholder.

2.4 Attribution of risk aggravation in corporate insurance

In German insurance law the attribution of intent or fraud with reference to circumstances that aggravate corporate risks is based on the principles of formal representation (Repräsentant) and knowledge representation (Wissensvertreter). In addition, if the policy holder entitles a third party to fulfill contractual obligations towards the insurer, the declaration of facts of such third party representative may be attributed to the policy holder as well (Wissenserklärungsvertreter).

For the policy holder it is important to evaluate the knowledge carried by formal and knowledge representatives of the company re circumstances that could aggravate the insured risks and that those representatives disclose all circumstances duly and in time to the insurer. According to jurisdiction, a formal representative of the company is someone “who in the business unit where the insured risk belongs to, takes the place of

[3] Example following *Langheid* in Römer/Langheid, 4th ed. 2014, sec. 23 VVG recital 39.

the policy holder on the basis of representation or similar relationship"[4]. A knowledge representative, however, is someone who had been (partly) entrusted by the policy holder on his behalf – or on behalf of the appointed board member – to receive all relevant information regarding the insurance relationship[5] (in order to disclose it to the insurer). If such a knowledge representative is entitled to fulfill the risk aggravation obligations (thus with the disclosure of risk aggravating circumstances to the insurer), the company has to ensure that all information have been duly provided to the insurer (e.g. by implementing the Four-Eye-Principle or similar).

Further, if the company seeks insurance cover for the account of a third party according to sections 43 et seq. VVG, e.g. for subsidiaries, sec. 47 VVG has to be considered as well. According to this provision, intent and fraud of the insured (e.g. the representatives of the subsidiary) are relevant for the insurance cover of the entire group.[6]

3. JUDGEMENT OF THE BGH

The judgement of the BGH of 10 September 2014 (IV ZR 322/13) deals with subjective (intended) aggravation of risk by the policy holder pursuant to sec.23 para. 1 VVG as described in 2.1.

The decision is based on the following (shortly summarized) facts:

3.1 Facts

The policy holder requests compensation from the property insurer for a destroyed photovoltaic system. The photovoltaic system was located on the roof of a barn of the policy holder. The policy holder parked a tractor in this barn. Besides, the policy holder stored hay and straw in the barn. Some hours after parking the tractor, a fire broke out in the barn for unknown reasons which destroyed among others the photovoltaic system.

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[4] Cf. Overview of jurisdiction at *Pohlmann* in Looschelders/ Pohlmann, 2nd ed., sec. 28 recital 63.

[5] Cf. Overview of jurisdiction at *Pohlmann* in Looschelders/ Pohlmann, 2nd ed., sec. 28 recital 81.

[6] Cf. VP-Praxistipp 10/2014, *Drave*: „Anfechtung bei Eigen- und Fremdversicherung – wessen Kenntnis und Verhalten schadet dem Versicherungsnehmer?", VP 2014, p. 201.

3.2 Legal assessment of the BGH

The Federal Court of Justice examined whether the insurer might be released from liability due to intentional subjective aggravation of risk caused by the policy holder (by parking the tractor in the barn) in accordance with sections 23 para.1, 26 para.1 VVG.

The court set forth that

- the knowledge of the policy holder about risk aggravating circumstances according to sec. 23 para. 1 VVG has to be separated from
- the awareness of the policy holder about the risk aggravation effect of his actions according to sec. 26 para. 1 VVG.

The question of awareness of the policy holder in accordance with sec. 26 para. 1 VVG re the risk aggravating effects of his actions is to be determined by his responsibility and the scale of intent resp. gross or even simple negligence. Insurer's release from liability only occurs when the policy holder breached the risk aggravation obligation intentionally what the insurer also has to prove.

The Federal Court of Justice overruled the reasoning of pre-instance courts according to which the knowledge of risk-relevant circumstances (here the parking of the tractor in the barn) automatically allows the insurer to conclude that the policy holder acted with intent according to sec. 26 para. 1 s. 1 VVG. Against that background a court should rather examine whether the policy holder was able to recognize that he affected an aggravation of risk that also increased the probability of the occurrence of an insured event. In accordance with sec. 26 VVG the court correctly pointed out that there would remain no scope of application in cases of simple and gross negligence provided that the mere knowledge of the policy holder about risk aggravating circumstances would automatically affect the insurer's release from liability (as in the previous instances affirmed).

The BGH further argues in a systematic way by comparing the case with the provisions of subjective unconscious aggravation of risk and objective aggravation of risk according to sec. 23 para. 2 and para. 3 VVG (see above 2.2 and 2.3).

In these cases, (intentional) knowledge of the policy holder is only triggered if the policy holder knows that the risk aggravating circumstances bore the character of an aggrava-

tion of risk.[7] As a consequence, in the case at hand (subjective aggravation of risk) the policy holder also had to be aware of the fact that his action had a risk aggravating effect.

At the end of the decision, the BGH refers to another interesting point. With reference to the case in dispute it would be even unclear whether a subjective aggravation of risk is given at all. According to sec. 27 VVG, it is required that the aggravated risk was at least of such a duration that it could form the basis of a new, natural course of risk and is thus qualified to aggravate the occurrence of the insured event. The aggravation of risk thus would have to reach a certain permanent state. In the case at hand (parking of the tractor in the morning, break out of fire in the afternoon) the court wondered whether on the basis of the explanations of previous instances, the aggravation of risk had reached such permanent state. The BGH turned back this question for clarification to the previous instance.

3.3 Implications of the judgment

The implications of the decision are in favor of the policy holder. In case of subjective aggravation of risk insurers will have difficulties to argue that the policy holder's mere knowledge about the aggravation of risk circumstances is sufficient to prove their own release from liability.

Since the insurer bears the burden of proof with regard to intentional behavior, the insurer has to prove the policy holder's intent or fraud with regard to the risk aggravating character of the policy holder's action. Since such subjective indications are hard to disclose, the insurer only has to bring evidence by presenting (objective) evidence for the policy holder's knowledge about risk aggravating circumstances. The policy holder will then have to explain why he did not know that his conduct would make the occurrence of the insured event more likely though he knew about the aggravation of risk. This explanation may succeed if the policy holder made the erroneous assumption that no aggravation of risk was given at all (e.g. because he compensated the aggravated risk situation with other measures), or if the policy holder relied upon the opinion of an expert

[7] Cf. BGH VersR 1969, 177, 178; BGH VersR 1999, 484, 2 b).

according to whom there was no aggravation of risk, or if the policy holder wrongfully assumed that the insurer agreed to the aggravation of risk.[8]

In this context, the examination of the different types of fault (simple negligence, gross negligence or intent), the corresponding standard of proof (gross negligence is basically assumed, simple negligence has to be proven by the policy holder, intent has to be proven by the insurer) and the subsequent legal consequences (full reimbursement of the insurer in case of simple negligence, proportional compensation in case of gross negligence, release from liability in case of intent of the policy holder) have to be taken into account . Errors of assessment with regard to the character of risk aggravating circumstances or to the relevancy of the aggravation of risk may release the policy holder from intentional subjective aggravation of risk and resp. lead to full reimbursement by the insurer.

4. SUMMARY

If the insurer after the occurrence of the insured event relies on allegedly intentional or fraudulent aggravation of risk caused by the policy holder, the policy holder should duly assess the legal situation. The mere knowledge of risk aggravating circumstances of the policy holder does not automatically leads to the assumption that the policy holder was also fully aware on the risk aggravating character of his actions.

In corporate insurance it has to be examined for the knowledge and notice of risk aggravation circumstances resp. the policy holder's awareness about risk aggravating circumstances whether on the company-side acted a formal representative (Repräsentant), knowledge representative (Wissensvertreter), or a third party representative (Wissenserklärungsvertreter) whose knowledge may be attributed to the policy holder.

Dr. Fabian Herdter, LL.M. Eur.
Lawyer

Wilhelm Partnerschaft von Rechtsanwälten mbB

[8] Cf. *Looschelders* in Looschelders/ Pohlmann, 2nd ed., sec. 26 recital 4.

Reichsstraße 43
40217 Düsseldorf

Tel: +49 211 687746 50
Fax: +49 211 687746 20

www.wilhelm-rae.de
fabian.herdter@wilhelm-rae.de