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# Leadership clauses in co-insurance and layered coverage

## 1. INTRODUCTION

Major risks are covered by several insurers. In industrial insurance the parties mostly agree on coverage by so called open co-insurances, by so called layered coverage, or by a combination of these two coverage forms. An open co-insurance is defined as coverage divided among several co-insurers that participate mutually with different risk shares. [1] Layered coverage[2] basically lines up several insurances based on a primary or basic coverage („primary"), the subsequent insurances are called excess insurances ("excess").[3]

In all these cases, the policy holder's intention is the same: he does not want to comply with contractual duties and obligations towards every single insurer involved in the insurance. In case of an insured event, he intends not to deal with every insurer individually, but to address his claims to only one insurer. If (possibly after a legal dispute) a settlement decision is taken, this decision should as far as possible be binding for all insurers involved.

The policy holder's objectives can be reached by agreement (and careful drafting) on leadership clauses. In that context – especially with regard to layered coverage – special contractual requirements must be considered. The article at hand highlights these requirements.

## 2. OPEN CO-INSURANCE AND LAYERED COVERAGE

There are differences between open co-insurance and layered coverage, even though these differences are in practice often blurred by a combination of the two forms.

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1 Cf. *Langheid* in: Römer/Langheid, Versicherungsvertragsgesetz, 3. edition 2012, sec. 77 No. 7.

2 Coverage through several layers.

3 Cf. *Schaloske*, Das Recht der so genannten offenen Mitversicherung, Diss. 2007, p. 4.

## 2.1 Open co-insurance

In case of an open co-insurance[4] the insured risk is horizontally distributed among several insurers (risk carriers). Every insurer involved covers a specific share of the risk that is to be insured. The policy holder enters into various separate insurance contracts with every insurer involved concerning each share of risk. By law, the risk sharing falls into the scope of divisible performance according to sec. 420 BGB (German Civil Code) rather than being classified as a case of joint and several liability according to sec. 421 German Civil Code.[5] As a matter of fact, the liability of every insurer involved is, therefore, limited to the share of coverage taken. The insurer does not cover risk shares of the other co-insurers. The insurers internally form, according to the prevailing opinion, a partnership organized under the Civil Code.[6]

In practice, co-insurance contracts are drafted in a way that all shares agreed upon with the policy holder are combined in only one co-insurance contract. Besides, the insurance contract usually highlights one leading insurer who is responsible for the contractual administration and service on behalf of all insurers involved. For that reason, the contract parties agree on leadership clauses to determine the rights and obligations of the leading insurer in such combined co-insurance contracts (see 3.1).

## 2.2 Layered coverage

In a layered coverage, the risk is generally not allocated horizontally (as in the open co-insurance), but vertically by a sequence of several insurance contracts. The separate "coverage levels" are called layers.

As soon as the coverage of the primary is exhausted, the coverage of the exceeding contract, so called excess, takes effect.[7] When the coverage of the first excess is exhausted, the coverage sum of the second excess is provided etc., so that there is full coverage with the exceeding contract following coverage provided by the preceding contract.

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[4] Hereof the hidden co-insurance must be differentiated. In such case, the insurer takes over the complete coverage of the risk towards the policy holder by spreading it internally to one or several (re-)insurers. This form of risk transfer is to qualify as a kind of reinsurance.

[5] *Armbrüster* in: Prölss/Martin, Insurance Contract Act („VVG"), 28. Edition 2010, preliminary note to sec. 77 No. 5 (with further reference).

[6] *Armbrüster* in: Prölss/Martin, supra, sec. 77 No. 6 et seq. with further reference.

[7] Often, the primary coverage is referred to as first layer and the first excess as second layer.

It is important to define, when and how coverage of the exceeding layer comes into effect while drafting layered coverage. The full coverage of the primary and excess policies is generally available if only one insured event occurs during the insurance period. The contract needs, however, careful interpretation of the layered coverage in case several insured events occur during the insurance period.[8]

In addition, the risk of layered coverage is not only diversified by different coverage layers on a vertical level. Also on a horizontal level – within each layer – there is often a risk allocation among several risk carriers. Such horizontal allocation falls – as shown in 2.1 – within the definition of an open co-insurance. To sum up, layered coverage in many cases is subject to a risk allocation on a vertical and horizontal level. Leadership clauses, therefore, play a major role for both levels (see 3.2).

## 3. AGREEMENT ON LEADERSHIP CLAUSES

### 3.1 Leadership clauses in co-insurances

The insurers involved in the co-insurance usually determine one leading insurer. He is assigned to supervise the contract and to fulfill contractual obligations towards the policy holder. In return, the leading insurer receives remuneration for its services.

The leading insurer's role is determined by the leadership clause in the insurance contract. The contents of leadership clauses vary considerably.

In the following, there is a short overview of some clauses often used in practice. We will also review the case that the parties did not agree on any leadership clause.

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[8] For the policy holder it is often important to agree on an additional so-called „drop-down". Otherwise there is a risk that e.g. in case a second insured event occurs, the excess does only take effect, if the amount of damage of the second insured event exceeds the total coverage sum of the primary coverage. This is also the case if part of the primary coverage was already consumed by the first insured event.

### 3.1.1 No leadership clause

In some cases, no leading insurer is determined and no leadership clause is agreed upon in the co-insurance contract. This may, for example, be the case for older contracts or coverage agreed upon abroad (e.g. co-insurance in an excess policy). If such constellation is at hand, the policy holder, in principle, has to deal with each insurer involved in such co-insurance.

In case of an insured event, the policy holder is not interested in lodging claims based on the same facts at different courts. The forum question, thus, needs clarification if the policy holder cannot reach an agreement with the involved insurers. In such a case, there are several forums to be considered.

The Code of Civil Procedure (ZPO) provides a solution in form of a determination procedure according to sections 36 para. 1 No. 3, 37 ZPO. [9] The determination procedure usually takes place before legal proceedings start and at the place of business of one of the sued co-insurers to be chosen by the claimant. The Higher Regional Court in charge will then determine a common forum for all co-insurers.

### 3.1.2 Reception clause

The leadership clause may be drafted as a so-called reception clause. The reception clause provides that the policy holder has to make declarations, disclosures, etc. only towards the authorized leading insurer. The declarations are then presumed to have been received by the co-insurers.[10] In case of applying this clause, the leading insurer acts passively. He is not allowed to act on behalf of the co-insurers or to make any announcements towards the policy holder on behalf of the co-insurer.

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[9] The involved insurers are co-plaintiffs according to sec. 60 ZPO.

[10] Cf. Example by *Armbrüster* in: Prölss/Martin, *supra*, introduction sec. 77 No. 20: *„The leading insurer is authorized to receive notifications and declarations of intent by the policy holder on behalf of all insurers involved.“*

The authorization of the leading insurer can be extended by providing him with additional power of declaration.[11] Depending on how this authorization is drafted, the insurer will then be entitled to make effective declarations on behalf of co-insurers, to handle the collection of premiums, and/or to settle claims.[12]

### 3.1.3 Litigation clause

Leadership clauses in terms of litigation clauses may differ in details. In many cases, clauses like the following one are used:

> *„Claims of the policy holder arising from this insurance contract are only to be asserted against the leading insurer and limited to the share of risk written by the leading insurer. Any judgment handed down by a court has a binding effect for all involved co-insurers.*“[13]

The aim of litigation leadership clauses is *inter alia* the limitation of costs with regard to a possible litigation for all parties concerned. The policy holder only has to sue the leading insurer with reference to his respective share. If a judgment against the leading insurer is handed down, this judgment has a binding effect for the co-insurers in the amount of their respective share. The litigation clause, thus, constitutes an acknowledgement by the co-insurers under the condition precedent that the leading insurer loses in the legal dispute. The facts determined by the judgment are also binding for the co-insurers. Though the policy holder cannot enforce the judgment against the co-insurers, the enforcement of his claims becomes, however, far easier.[14]

The policy holder should review the following aspects when negotiating the drafting of a leadership clause: First, a leadership clause should determine that the policy holder only has to claim against the leading insurer in the amount of his share. Secondly, the clause should provide for a binding effect of all decisions taken by the leading insurer (with effect for the remaining co-insurers). This particularly applies for cases where the leading insurer agrees upon to settle or to acknowledge the

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[11] Such clauses are often called „extended clauses“ (Anschlussklausel).

[12] Cf. *Armbrüster* in: Prölss/Martin, *supra,* introduction sec. 77 No. 21.

[13] Example taken from *Kretschmer* VersR 2008, 33,34; the clause differs from clausel 1802, which is among others used in commercial fire-, burglary-, theft- and storm-insurance.

14 The policy holder may reach a provisional judgment by means of a summary procedure where plaintiff relies entirely on documentary evidence according to sec. 599 Code of Civil Procedure, which is enforceable without any securities (sec. 708 No. 4 Code of Civil Procedure), cf. hereto VersR 2008, 289, 292.

claim, or even to settle the claim as a gesture of goodwill. Particularly in such cases, the decision of the leading insurer should be binding for the co-insurers. To achieve this goal, the contract parties could, for example, amend the leadership clause as follows:

> *„All declarations made by the leading insurer (towards the policy holder) or agreements entered into with the policy holder after the notification of the insured event*[15] *are expressly acknowledged by all insurers invoved."*

The clause contains a conditional acknowledgement of all insurers involved. The condition applies if the leading insurer makes a legally binding declaration after the notification of the insured event or enters into a settlement agreement with the policy holder. All disputes resulting from such decisions must be resolved internally (among the insurers involved).[16] From the policy holder's point of view, only the conduct of the leading insurer is relevant.

### 3.2 Leadership clauses in case of layered coverage

In layered coverage, leadership clauses play an important role on two levels: first with regard to the leading insurer within one layer on the horizontal level (insofar there are no differences to the normal open co-insurance) and second with regard to the relationship between the different layers on a vertical level (see *infra*).

In case of layered coverage, the policy holder might be interested in performing his contractual duties and obligations not towards each individual insurer of each individual excess (layer). This may become even more complicated if there are several co-insurers within each layer but without nominating leading insurers on that (excess) level.

The way to tackle the problem is a careful drafting of leadership clauses on the horizontal and on the vertical level. We advise to agree upon leadership clauses at both levels.

Risk share on the horizontal level is to qualify – as explained – within the scope of co-insurance. All explanations given under 3.1 about leadership clauses apply respectively.

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[15] To avoid antitrust law issues, the amendment of the clause should be limited to the handling and settlement of claims.

[16] If an insurer involved in the co-insurance does not agree with the decision taken by the leading insurer (e.g. referring to a settlement or similar), he might claim for compensation against the leading insurer due to breach of obligation.

Insofar as layered coverage (on the vertical level) is concerned, a common leadership clause should be established in the primary. Such a clause could then be followed by every excess insurer at its own discretion. We recommend a leadership clause according to which the leading insurer is entitled to receive, declare and/or to settle on behalf of the excess insurers.

The contract parties (of the excess) comply with such a vertical leadership clause even by following the terms and conditions of the underlying primary policy that contains the clause (follow form) or by explicitly declaring to accept the leadership clause of the primary contract. If the excess insurer refuses to accept the leadership clause of the primary, he may exclude it in the contract (e.g. by not following the clause).[17]

According to antitrust law, the vertical leadership clause must be drafted in such way that the leading insurer and the excess insurers only disclose specific information on the contract administration and/or the claim settlement in already existing layered coverage. A general exchange about premiums and calculation, for example in connection with a new tender or renewal of the layered coverage, would be unlawful.

## 4. SUMMARY

Leadership clauses in co-insurance contracts and layered coverage may be highly relevant for the policy holder, especially when it comes to a dispute. Leadership clauses should, therefore, be carefully drafted. With reference to layered coverage, the contract parties should agree upon a (vertical) leadership clause in the primary that triggers the excess contracts and that can be followed by the excess insurers on a voluntary basis.

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[17] For example „Follow form except clause xx“.

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