PART I

Overview and introduction

A. KNOWLEDGE IS POWER

The insight that knowledge means power – often quoted in shortened form as scientia potentia est – is owed to FRANCIS BACON (1561–1626), who formulated it in one of his major philosophical works, the Novum Organum.\(^3\) Although anything but specifically geared towards the banalities of economic life, the considerations underlying this dictum\(^4\) are applicable, even today, to nearly every process which is, in one form or another, related to markets and the transactions being made in them. All of these individual transactions are ultimately dependent on information available to the parties and normally it is thus a matter of utilising information advantages over the other market participants.

In the insurance sector, the importance of – in particular risk-related – information as the key factor for the conclusion or non-conclusion\(^5\) of the

\(\text{\footnotesize\(^3\) Cf JAMES SPEDDING, ROBERT L. ELLIS and DOUGLAS D. HEATH (eds), The Works of Francis Bacon, Vol I (Longman & Co, London 1857) 157 – the full text of the aphorism is: ‘Scientia et potentia humana in idem coincidunt, quia ignoratio causae destituit effectum.’}

\(\text{\footnotesize\(^4\) One has to note, however, that the original wording in BACON’s aphorism is formulated in a much more cautious way as it does not speak of a necessary congruity but of a possible coincidence of knowledge and power – see WOLFGANG KROHN, Francis Bacon (2nd edn C.H. Beck, Munich 2006) 93.}

\(\text{\footnotesize\(^5\) Cf generally NILI COHEN, ‘Pre-Contractual Duties: Two Freedoms and the Contract to Negotiate’ in JACK BEATSON and DANIEL FRIEDMANN (eds), Good Faith and Fault in Contract Law (OUP, Oxford 1997) 25.}

specific contract is obvious. On this account, there are grounds to believe that BACON’s observation is (also) transferable to the insurance business.

Thus, if one has a look at the typical knowledge of the two parties of an insurance contract, one quickly notices that each of them, in fact, has a rather different state of knowledge: while the insurer has a clear advantage over the (prospective) insured as far as the peculiarities of the offered insurance product are concerned, the latter is regularly better informed about the specific circumstances of the risk for which she seeks cover. This imbalance in information leads to an information deficit on both sides and effectively turns both contracting parties into information seekers from the outset of the negotiations. Furthermore, it results in the emergence of an entire market which deals solely with the eventual mediation of the relevant information, namely the insurance intermediation sector.

As relates to the information advantage of the insurer (and only this particular advantage and the duties which result therefrom are the subject of this book), one might say that it is simply in the nature of things that the insured can only to a very limited extent actually assess the product’s quality characteristics and, where she does not want to merely trust her contracting partner, she always has the option of engaging a neutral intermediary like an insurance broker or similar expert, and so on.

However, this would have the effect of making things too easy. Bearing in mind that the number of policies sold directly by the insurer is continuously increasing not least because of the opportunities offered by sales channels like the Internet today, it is obvious that, in such situations, there must also be a certain amount of information which an insured must have in order to avoid results which are highly unsatisfactory from any neutral point of view. The same applies to situations where consumers buy – without any further advice – ‘off-the-shelf cover’ in

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6 With regard to the terminology used in this book to refer to the insurer’s contracting partner, see p. 12, below.


8 This would also lead to the persistence of the old sales adage according to which ‘insurance is sold, not bought’ (cf RAY W. HODGIN, Protection of the Insured (LLP, London 1989) Preface, v).

supermarkets, and so forth. In all these cases, the mere indication of the theoretical possibility of obtaining advice from a neutral source disregards the realities of modern sales practices and falls short of satisfying actual information needs. Instead, it is the law that is asked to provide an adequate framework which, on the one hand, does not unduly handicap the emergence of new business opportunities, but also ensures, on the other hand, that the legitimate (information) interests of the insured are not unreasonably affected.

One way to achieve these basic standards is by establishing legal information duties which by their nature are intended to counteract the information deficit of the insured, but which are commonly also intended to facilitate what is described as an ‘informed choice’. Of course, such information duties are a phenomenon which goes far beyond the scope of insurance law and which can be observed in innumerable other contexts, such as in general consumer protection law, in the law relating to credit and leasing agreements, and also in food law (keyword: labelling requirements), to name but a few. All the information requirements which can be found there ultimately have one thing in common: instead of prohibiting risky or even clearly disadvantageous contracts and behaviours (keywords: drinking alcohol, smoking tobacco, gambling, and so on), the legislature restricts itself to ensuring that the particular person acting has access to the relevant knowledge to appreciate the possible consequences. Thus, information requirements represent a relatively gentle means of legal intervention into the free play of market forces. However, this does not say anything about the extent to which such requirements are at risk of not being efficient. What can be done to counter this danger is one of the questions this book tries to answer.

Despite all of the – legitimate – criticism of the ‘information model’, which is pursued at both the national and European levels today, the variety of information duties in the insurance field creates a situation which can ultimately be compared with the one that can be observed when it comes to the sale of drugs in a pharmacy. First, insurance

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products as well as medication have to be sold in conjunction with many standardised forms of information, which is expressed in the package leaflet for drugs and, in the case of insurance, for example, in the provision of general policy conditions, initial disclosure statements, policy summaries, and so on. Second, although the pharmacist has no duty to perform the same in-depth analysis as a doctor, she owes information if she, for example, recognises that her customer is allergic to a certain ingredient in the drug. Beyond that, she is obliged to answer questions concerning the composition, purpose, and mechanism of action of the product offered, and so forth. Although this is perhaps somewhat surprising, similar considerations apply mutatis mutandis to the insurer who offers its products within England or Germany today: as in the pharmacy context, the insurer not only has to comply with standardised but also with certain individualised information duties which may require, for example, bringing the insured’s attention to an imminent gap in cover or to essential risk exclusions. Moreover, the insurer equally has to answer the appropriate questions which may, for example, include explaining certain terms which the insured does not understand, and so on. Thus, while any similarity between the sale of drugs and that of insurance products may at first glance appear rather far-fetched, on closer consideration several parallels with regard to the purpose and the scope of the information duties in both fields can be identified.13

To return to the initial question regarding the potential transferability of BACON’s proposition to the situation concerning information in the insurance sector, the following can be asserted: as regards basically all aspects of quality and other characteristics of the product offered, the insurer is clearly in a superior position to the insured. This imbalance relating to the access to information ultimately leads to an imbalance of power which is generally not only present at the pre-contractual stage but also during the whole contract period. Where information is not available for the policyholder, she can either decide not to conclude the contract (which may be contrary to her need for cover) or she is forced to simply trust the insurer. Thus, two things become apparent: first and foremost, BACON’s conclusion is equally valid for the insurance sector and second, this insight can only be the starting point. Instead of merely accepting the ‘natural’ distribution of power which traces back to the (likewise natural)14

13 See generally also NADINE OBERHUBER and DYRK SCHERFF, ‘Was taugt ein Beipackzettel?’ FAS, issue of 28 February 2010, 45.
14 Nevertheless, more recent studies indicate that the extent of asymmetric information is essentially influenced by the type of risk covered and the extent of this cover – see MARTIN SPINDLER, JOACHIM WINTER and STEFFEN HAGMAYER,
information asymmetry which characterises all insurance contracts, modern insurance contract laws are required to undertake the necessary correction by intervening in the information disparity between insurer and insured. Interestingly enough, this has always been accepted in respect of the insurer’s interests, which is why the insured has always been obliged to disclose certain information that is difficult or impossible for the insurer to access. However, as relates to the converse situation, the common law in particular is strikingly reserved about imposing any information obligations on the insurer.

The present book nevertheless attempts to illuminate the soundness of establishing legal information duties for insurers and to discuss the extent to which the legitimate information interests of the insured are protected (or not) by the legal systems discussed here.

B. STRUCTURAL OUTLINE

This study is divided into two major parts, namely one which deals with considerations from an economic perspective and one which describes and compares the legal situation under English and German insurance law, and under the recently proposed Principles of European Insurance Contract Law (PEICL) which are intended to provide henceforth an option for a union-wide harmonised basis for the conclusion of insurance contracts.

Although definitely not a study about law and economics, it was too difficult to resist the temptation of incorporating considerations of economic nature throughout its entire course. This is not only due to the rather restricted amount of case law available on the matter, but also a consequence of the economic dimensions of information-related problems being particularly appealing. The latter is perhaps underlined by the fact that, in previous years, no fewer than five Nobel laureates have

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15 For the very general problems of information asymmetries and contract design, see JACK HIRSHLEIFER and JOHN G. RILEY, The Analytics of Uncertainty and Information (CUP, Cambridge 1992) 295 ff.
16 JÜRGEN BASEDOW et al. (eds), Principles of European Insurance Contract Law – PEICL (Sellier, Munich 2009).
17 Cf, in more detail, p. 209 ff, below.
18 GEORGE A. AKERLOF, MICHAEL SPENCE, JOSEPH E. STIGLITZ, JAMES A. MIRKLEESS and WILLIAM VICKREY.
received the prize for their investigations into market behaviour under asymmetric information conditions.

Broadly speaking, the main questions behind the considerations discussed here are those of why, where, and the extent to which legal measures which result in a kind of ‘information forcing’ are appropriate. These are naturally accompanied by related questions, such as how such measures could best be implemented. Thus, it appeared best to focus first on the validity of the main arguments which are commonly brought against the ‘information model’. Subsequent to this, there can be found several proposals on how information should be presented to ensure the best possible effect on the decision behaviour of the insured.

In summary, the economic-related considerations attempt to show that it is actually, in several contexts, more convincing to give the insured a ‘right to information’ by requiring the insurer to disclose certain information than to simply retreat back to the traditional caveat emptor position.

However, regardless of the particular emphasis on the frequently invoked ‘utmost good faith’ character of insurance contracts, the common law – at least in its practical result – has not done all that much to develop mechanisms to protect the legitimate information interests of the insured. In contrast, it relatively clearly adheres to the general rule that it is the individual contracting party – independent of whether or not this party is a consumer – who is responsible for looking after her own interests.19 Having said this, it must of course be added that modern regulatory approaches, such as those implemented in the ICOBS,20 have undoubtedly diverged from this traditional concept as far as at least insurance law is concerned. On this account, any comparison of the insurer’s pre-contractual information duties under English insurance law has to be split into two parts: on the one hand, it has to refer to the traditional position of the common law; on the other, it has to take into account the solutions which have been implemented by the FCA.

The approach with which the current English system is primarily compared in this book is that of Germany. Such a comparison appeared sensible for a series of reasons:

19 This is not to say that German law would not also follow the basic principle of self-responsibility. However, as will be seen, the measures which the principle of good faith may require of an insurer under German law are substantially more extensive than those which the principle of utmost good faith demands under English common law.

20 See p. 186 ff and 238 ff, below.
First, it is of course fascinating per se to compare the solutions which
have been reached for similar problems in a common law and a civil law
country, even more so where the starting point of the legal considerations
is the same; in the given context, both countries basically acknowledge
good faith as a possible basis for the information duties of the insurer.
This is not affected by the fact that the actual results reached are quite
different (keyword: legal consequences) and that the English law
acknowledges such a doctrine for only very particular contracts,21
whereas under German law, good faith is (as is well known) an
overriding principle of private law in its entirety, the application of which
is not dependent on the presence of a certain type of contract but rather
on the individual circumstances of the case. Nevertheless, due to the
dominance of the notion of good faith in the current field, the conditions
for a comparison of the two legal systems appear to be ideal.

Second, a comparison of the systems of two EU Member States such
as England and Germany seems to be worthwhile not least in view of a
possibly unified European insurance law in the future. Although a
comparison may in fact be of interest regardless of ‘how remote [an
actual unification] may finally prove to be’,22 recent developments in this
area23 give reason for cautious optimism to the effect that a union-wide
harmonised insurance law could one day be realised. In view of such
endeavours, it may prove useful to work out the starting points and
various concepts for the solution of specific legal problems as they can be
found in Member States with different legal traditions. This is – among
others – what the authors of the recently presented Principles of
European Insurance Contract Law (PEICL) aimed to achieve.24 This
book intends to make another (of course much more modest) contribution
to the understanding of a selected legal problem that is of relevance for
future developments at both the national and European level.

21 Cf the accurate statement by Lord JONATHAN MANCE, ‘In a Manner of
Speaking: How Do Common, Civil and European Law Compare’ (2014) 78
RabelsZ 231 (at 246) according to whom ‘the common law is famously
frightened of open-ended concepts of good faith.’
22 JOHN BIRDS, Book review (1976) 39 MLR 615 at 617.
23 See, for example, the final report of the Commission Expert Group on
European Insurance Contract Law (2014) 18 ff. The report is available at
<http://ec.europa.eu/justice/contract/-files/-expert_groups/-insurance/final_
report.pdf>.
24 See JÜRGEN BASEDOW et al. (eds), Principles of European Insurance
Contract Law – PEICL (Sellier, Munich 2009).
Third, the point in time for conducting this study appeared promising, as considerable changes have taken place in recent years. In England, the new Conduct of Business Sourcebook came into force in 2008 and, in Germany, a new Insurance Contract Act was passed in the same year. As regards the European level, the general part of the PEICL was handed over to the European Commission25 in 2007 and a second edition of the PEICL that contains rules for special branches of insurance is to be published in 2015. One of the aims of this work is to subject all three sets of rules (as far as they relate to the present topic) to a critical analysis.

C. SCOPE

1. Restriction to Pre-Contractual Information Duties of the Insurer

The current study limits itself to the pre-contractual stage of insurance contracts and thus to a period where information as such plays a particularly important role. This does not mean that there would not also be a series of information duties which refer to the period after the conclusion of the contract. Such post-contractual duties26 are outside the scope of this book, however.

Apart from that, the present work does not follow the tradition of examining the information duties of the insured, which play a considerably more prominent role in the case law. Instead, it is focused on the information duties which are to be met by the insurer and which have, to date, led a kind of shadowy existence (at least when compared to the insured’s duties and especially in regard to English law).27

Thus, this book aims at describing the differences in the scope, content, and (albeit by comparison considerably less extensive) legal consequences of the insurer’s information duties under English and German law as well as under the proposed Principles of European Insurance Contract Law (PEICL).28 As far as the basis for this is the

28 See note 24, above.
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notion of (utmost) good faith, it is needless to say that this principle may – depending on the situation – also entail other consequences than mere information duties. To be considered, in particular, are restrictions on the exercise of rights to which the insurer is otherwise generally entitled.29 Such consequences are however outside the scope of this study.

Other problems which are connected with information duties, such as those of documenting the information provided or questions regarding the burden of proof must, to a large extent, also be put aside (although they are of course briefly addressed where the particular context suggests it).

Although this book relates to the examination of the insurer’s duties, it should certainly not be overlooked that it is typically representatives (often insurance agents) who are in effect complying with these obligations in place of the insurer itself. From this situation, there may arise special questions regarding attribution and consequently liability. These again cannot be discussed within the given parameters, which is why the (oversimplified) assumption has been taken as a basis that the insurer can always be held responsible for breaches of information duties caused by its agents and that, if these have caused damage, it can be proved by the insured.

Ultimately, it must be emphasised that this book is restricted to specific aspects of insurance contract law in the contractual relationship between insurer and insured. Disclosure duties resulting from the principle of (utmost) good faith are an obvious example of such a peculiarity. More general questions which arise in relation to the entire law of contracts, like the prerequisites for and the consequences of fraud and misrepresentation30 fade into the background here, even though they certainly play a significant role in the field of insurance law. Nevertheless, the focus of this study is on decision-making errors of the insured which result from not being informed, rather than being given the wrong information – it is obvious that the insurer is generally liable in the latter cases. For this reason, the main question raised here addresses the extent to which the law requires – or should require – the provision of information and the extent to which this would be rather counterproductive as a result.

2. Restriction to General Consumer Insurance

As relates to the types of insurance contracts which are the subject of this book, it should first of all be underlined that in order to keep the topic

29 See, for example, BIRDS, 159 ff.
30 Cf, for example, BIRDS, 113 ff.
within bounds, a restriction to contracts of general insurance in the sense of the Regulated Activities Order (Interpretation: general)\textsuperscript{31} has been necessary.\textsuperscript{32} This, in particular, means that life insurance contracts have basically not been discussed in the given context. Such a restriction seems to be justifiable in consideration of its numerous peculiarities when compared with other types of insurance contracts and the very different forms they take in the practice of the legal systems discussed here, which make them difficult to compare. Furthermore, the impression has arisen that life insurance in the past already received particular attention when it came to insurer’s information duties whereas this applied to a lesser extent to non-life insurance.

A second restriction is added insofar as only general insurance contracts which are characterised by the participation of a consumer as the contracting partner of the insurer fall within the scope of the present study. In fact, in many areas of today’s insurance law and practice, the application of protective rules depends on whether the insured is acting outside of her trade or profession.\textsuperscript{33} Although this is particularly true for the situation in England\textsuperscript{34} and for countries like Sweden,\textsuperscript{35} it must not be overlooked that, for example, under German law the main source of insurance contract law (the ICA 2008) basically applies to all types of contracts except those covering large risks\textsuperscript{36} and reinsurance.\textsuperscript{37} Such an

\textsuperscript{31} 2001 SI 2001/544 sch 1 pt 1 art 3(1).
\textsuperscript{32} This understanding of general insurance contracts is also in line with the one underlying the ICOBS.
\textsuperscript{33} See, for example, the Consumer Insurance (Disclosure and Representations) Act 2012 s 1: ‘consumer insurance contract’ means ‘a contract of insurance between – (a) an individual who enters into the contract wholly or mainly for purposes unrelated to the individual’s trade, business or profession, and (b) a person who carries on the business of insurance and who becomes a party to the contract by way of that business (whether or not in accordance with permission for the purposes of the Financial Services and Markets Act 2000).’
\textsuperscript{34} See BIRDS, 14 ff and 16 according to whom it seems ‘… proper to speak of a “consumer insurance law” separate from that which appl[i]es to insurance contracts effected by commercial persons or organisations. The enactment of the Consumer Insurance (Disclosure and Representations) Act 2012 makes it quite clear that, in some respects at least, there is now a doctrinal distinction.’ See also PETER HINCHLIFFE, ‘Review of Principles of European Insurance Contract Law’ (2008) 9 ERA Forum 167 at 171 ff.
\textsuperscript{36} See s 210 of the ICA.
\textsuperscript{37} See s 209 of the ICA.
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absence of a fundamental distinction between consumer and commercial insurance contracts\(^{38}\) can also be observed in many other countries.\(^ {39}\) Nevertheless, even under German insurance contract law, the participation of consumers is (very) occasionally\(^ {40}\) presupposed. Advantageously for the purposes of this study, where the term ‘consumer’ is used, it is in essence defined identically in English and German insurance law.\(^ {41}\) Having said this, it is not to be overlooked that within English insurance regulation consumer definitions are not always completely congruent. This is particularly true for the question of mixed use-policies.\(^ {42}\)

Due to the ultimately well-established\(^ {43}\) English double-track concept of policyholder protection, the current study will – for reasons of better comparability – adhere to the classification into consumer and non-consumer transactions. Nevertheless, it has not been misunderstood here that in fact this classification is at best partly suitable for insurance law purposes.\(^ {44}\) It would certainly be far more appropriate to take into account the characteristics of the risk to be insured instead and therefore to grant the same protection for basically all types of risks, except ‘large risks’ which form an acknowledged special class that was established by

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\(^{39}\) See HELMUT HEISS, note 35, 24 and 34 who specifies that this observation typically does not apply to marine insurance and reinsurance contracts.

\(^{40}\) Cf s 4 of the Regulation on Information Duties concerning Insurance Contracts (VVG-InfoV) which requires the provision of a product information sheet to consumers only. See also s 214 of the ICA relating to the extra-judicial settlement of disputes.

\(^{41}\) Cf s 1(2) of the Consumer Insurance (Disclosure and Representations) Act 2012 (CIDRA) and s 13 of the BGB. For the consumer definition under the ICOBS and the special question of mixed use-policies, see note 951, below.

\(^{42}\) Cf ICOBS 2.1.1.G(3) and Consumer Insurance (Disclosure and Representations) Act 2012 (CIDRA) s 1 – only the wording of the latter definition includes mixed use-policies (provided that the main purpose is still a private one); see, however, note 951, below, and in general LOWRY, RAWLINGS and MERKIN, 142 and JUDITH P. SUMMER, Insurance Law and the Financial Ombudsman Service (Informa, London 2010) para 13-7.

\(^{43}\) Cf HELMUT HEISS, note 35, 25.

\(^{44}\) See the arguments given by ROBERT MERKIN and JOHN LOWRY, ‘Reconstructing Insurance Law: The Law Commissions’ Consultation Paper’ (2008) 71 MLR 95 at 98 f.
EU secondary law. In other words, it is the risk and not the insured’s capacity as a consumer which should be decisive for the application of the rules of insurance contract law which aim at the particular protection of the insured. Thus, it is not surprising in the end that the recently proposed Principles of European Insurance Contract Law (PEICL) follow the more adequate, former approach.

Apart from this conceptual criticism, the present focus on non-professional customers can in any case claim that the general importance of information regarding the features of an insurance product tends to be all the greater the less experienced and acquainted a policyholder is with concluding the contracts in question. For those customers who act for private purposes, both elements might apply. In general, consumers might, at least typically, be more in need of information as well as being more dependent on the completeness and accuracy of the information provided. On the whole, the importance of simply ‘trusting’ that the insurer is competent and fair might play a bigger role outside commercial transactions.

D. TERMINOLOGY

This book essentially employs three terms to refer to the counterpart of the insurer, namely ‘customer’ in its economic-related part, ‘insured’ when referring to English law, and finally ‘policyholder’ when referring to German law and to the PEICL. All these terms ultimately make reference to the same person.

There are two reasons for the decision to use variable terminology: on the one hand, the attempt has been made to use the description which is most common in the particular context; on the other hand, it appeared inevitable in the appropriate sections to adhere to the term ‘policyholder’.

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46 See note 24, above.
47 An overview of other approaches to differentiate the risks to be insured is given by HELMUT HEISS, note 35, 30 ff.
48 The only rule which requires the participation of a consumer is art 1:301(2) of the PEICL which is modelled on Directive 98/27/EC on injunctions for the protection of consumers’ interests. The other example where the PEICL (more implicitly) differentiates between consumer insurance and insurance for commercial or professional purposes is art 14:107 (not yet published) which deals with the insured event in liability insurance.
which has consistently been distinguished under German insurance contract\(^{49}\) law and under the PEICL from that of the ‘insured’, who is not (as the policyholder always is) the contracting partner of the insurer, but typically means a third person whose interests are covered by a contract concluded by the policyholder.

Whereas the term ‘customer’ includes anyone per se who has business dealings with an insurer, regardless of whether or not they have already concluded a contract, technically the situation is different as relates to the ‘insured’ and the ‘policyholder’. Both terms specifically require the existence of a valid contract. Since the present study deals with the pre-contractual stage, this prerequisite is often not met. To nevertheless avoid the continuous usage of the economic term ‘customer’ only – which would be rather unusual for a legal study – the terms ‘insured’ and ‘policyholder’ often had to be augmented with the descriptions ‘potential’ or ‘prospective’, as necessary. This was, at times, not done in order to avoid unnecessarily inflating the text.

Lastly, in respect of the characterisation of the duties of the insurer it should be pointed out that these were predominately not (as is commonly the case) classified into duties to disclose information, to give advice, to warn, to instruct or notify the policyholder, and so on.\(^{50}\) Instead, references have generally – wherever allowed by the context discussed – been made to standardized or individualised information duties. The difference arises in particular from whether or not the information in question:

- is – without need for any substantial modifications – re-usable for a large number of contracts (a general interest of the information recipients is anticipated); or
- was or should have been provided by the insurer because of a specific information need, for instance, to avoid otherwise given misconceptions or unilateral errors on the part of the insured.

As will be seen, the proposed distinction between standardized and individualised information duties is recommended from both the economic and the legal perspective.\(^{51}\)

\(^{49}\) In the area of insurance supervision law, this may be different – see Wandt, para 48.
\(^{50}\) For these terminological questions, see Miettinen, 199 ff.
\(^{51}\) See the tabular overview at p. 39 ff, below.