ON INSURER GENEROSITY

BY

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1. INTRODUCTION

Many studies of insurance law and claims adjustment have demonstrated that the insurance contract is not the only factor governing the outcome of an insurance claim. There seems to be a tendency for the insurer to apply the contract in a more generous way than would follow from its exact wording. In Scandinavian legal writing this behaviour of the insurer is referred to as *kulans,* from the French noun *coulance* which means smoothness. As this expression seems to be unfamiliar to Anglo-American writers I will instead use the expression *insurer generosity.* (Some aspects of the problem are covered by the expression nuisance claims.) In Scandinavia such generosity has been observed as a general concept of contract law, but the phenomenon has been most discussed in connection with banking and insurance.[1]

Some observations of insurer generosity may be mentioned as examples:

> In Norwegian life insurance, compensation has been granted on life insurance policies, when the death of the insured occurred before the first premium had been paid and before the policy was written. According to the relevant rules both conditions should have been met before the insurance policy became legally binding.[2]
>
> In Swedish travel insurance, an insurer has granted claims for travel expenses and lost vacation time from the insured party's relatives, although relevant conditions clearly state that it is only the losses of the insured party himself that must be compensated under a travel insurance policy.[3]
>
> In Swedish tenant's and home insurance, certain attractive property which the insured has taken along outside his residence was protected againsts theft only if it was locked up in a locked hotel room, etc. Nevertheless, claims have been

I should like to express my gratitude to Göran Skogh and Charles Stuart for inspiring collaboration on explanatory theories—see C. M. Roos–G. Skogh–Ch. Stuart, *The Swedish property and liability insurance market. An industry study,* Department of Economics, Lund University, Report 1980: 72—and to Eva Lindell-Frantz for valuable help with the case study.

[1] See *SOU* 1974: 83, pp. 145 ff.
[2] K. Selmer in *XIV Nordiske Livsforsikringskongres,* Copenhagen 1964, *Forhandlingsemne* 5, pp. 43–5.
[3] L. O. Wensäter, *Semesteravbrott* (mineographed), School of Law, Lund University, 1979.

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granted even where the stolen property was not properly locked up.[4] (The requirement that such property should be safely locked up has recently been partially abolished.)

These examples demonstrate that to a considerable extent insurers voluntarily give up their contractual rights and treat customers more generously. This occurs although the Scandinavian insurers draft their contract forms themselves, being able to formulate them so as to fit exactly with their practices. Indeed, their behaviour deserves explanation.

To understand the problem of insurer generosity, it is necessary to penetrate the economic aspects of contractual exchange in the insurance market (section 2, below). From a model of contractual exchange we may proceed to hypotheses on the nature of generosity (section 3). Having thus roughly defined the concept of insurer generosity there are possibilities for a meaningful discussion of its legal relevance (section 4).

A more concrete understanding of insurer generosity requires investigations in the field. Here a case study limited to one set of contract clauses and one insurance company will be presented (section 5). From this study and from recent literature we may discuss whether or not the theoretical hypotheses under (3) correspond to reality. Finally, these results are used in a short discussion on the desirability of insurer generosity (section 6).

2. A MODEL OF GENEROSITY AND CONTRACTUAL EXCHANGE

The insurance customer enters into the insurance contract in order to be protected against various rare accidents. One accident is seldom like another. Even the circumstances surrounding two accidents classified in the same way vary immensely.

If there were no transaction costs of writing insurance contracts and perfect competition prevailed, each possible set of circumstances would be termed a separate event, and each separate event included in the contract would give rise to a specific legal obligation for compensation. The contract would thus be fine-tuned to the exact circumstances of the accident.

In reality, the costs of writing such "exact" contracts rule out their use. The limits of human imagination alone make contracts of this type impossible. Nevertheless, the actually written insurance contract might be able to function as a condensed version of the contract which would be optimal given zero costs of writing contracts. In what follows this optimal or exact

[4] G. Blomqvist, *Resgodsmomentet i hemförsäkringen* (mimeographed), School of Law, Lund University, 1978.

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contract is called the *metacontract*. A precise application of the metacontract is, of course, impossible since it is unrealistic to assume that after a given accident there is a common *ex post* knowledge of the relevant contents of the metacontract and the circumstances of the accident among all affected agents in the insurance market. This follows from the presumption that the metacontract does not and cannot exist on paper.

It may occur, however, that there is *ex post* consensus among the parties on the contents of the insurance metacontract. There may, for instance, be situations where both parties agree their metacontract includes compensation for certain events. This may even be the case if the actual written contract is for reasons of cost vaguely or incompletely written. At the same time there will be numerous cases where the insured and the insurer will have conflicting judgments about the actual extent of coverage specified in the metacontract.

If the parties were completely informed and if there was perfect competition in the insurance market, then after a given accident they would agree to follow the metacontract.[5] In reality these conditions are not met. In the first place, it is evident that there is little or no competition among *buyers* of insurance. Generally, the insurer has very little information on individual customers' performance in insurance matters. Thus, there is little to prevent an insurance buyer from advertising himself as a lower-risk customer than he actually is. Among other things, this means that there are no incentives for insurance buyers to make concessions to insurers in order to remain customers, since such good behaviour does not make him more attractive as customer in the insurance market. Further, it should be noted that according to the Swedish Consumer Insurance Act an insurer has only limited options for refusing to enter a normal insurance contract with a consumer.

Among insurers, however, there does exist a certain degree of competition. Each insurance company has generally generated a significant number of observations of trustworthiness and good will in claims adjustment among insurance purchasers. Further, a good reputation has an important bearing on the insurer's ability to sell insurance. If an insurance company creates a poor reputation for not compensating its customers satisfactorily, it may have a hard time attracting customers without reducing its premiums. Paradoxically, in a market where only a few insurers compete to maintain the value of their brand names, competition may be

[5] This is a corollary of the Coase Theorem. See for further references G. Skogh. *Priser, skadestånd och straff,* Lund 1977, pp. 18f., and J. Hellner in *Festskrift till Per Stjernquist,* Lund 1978, pp. 101–25.

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more intense than in a market where the number of insurers is so great that the customer cannot meaningfully collect information on the reliability of single insurers.

As insurers are sensitive to information about them, whereas insurance customers typically are not, there should be a tendency for insurers to make concessions in insurance exchange but not for customers to do so. This corresponds roughly to the statement by a Swedish life insurance company manager that a good insurance policy should give the customer a level of protection corresponding to his expectations.

The principal details here may be illustrated by an example. A burglar breaks in and steals valuables in a house covered by homeowner's insurance. Such a broad description of an event can encompass many possible sets of exact circumstances. Some combinations would according to the metacontract definitely result in full compensation, others would definitely result in no compensation, and some combinations might result in partial compensation.

Let us place the distribution of rights to compensation on a line where zero denotes no compensation and one denotes that the written contract specifies compensation. The metacontract might specify four different sets of circumstances each with different levels of compensation, again with one denoting full compensation and zero denoting no compensation and intermediate values denoting partial compensation. For these four sets of circumstances, draw the metacontracts compensation for these as circles on the unit interval:

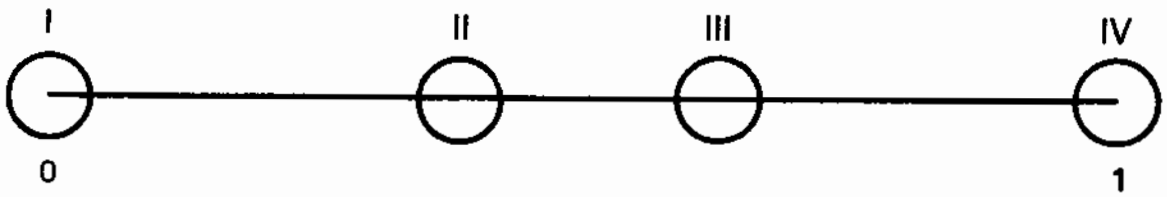

Fig. 1

If the written contract specifies compensation equal to one, then compensation will always be paid and no adjustment due to the actual circumstances in the amount of compensation can be made as in Fig. 1. On the other hand, if the written contract specifies compensation of zero, then each of the optimal compensations in Fig. 1 can be achieved for circumstances II, III and IV, in addition to circumstance I. This merely requires a concession from the insurer.

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3. EXPLANATION OF INSURER GENEROSITY

Various explanations of insurer generosity have been suggested. Ross[6] makes the following conclusions from a study of the handling of traffic insurance claims in insurance companies in the United States. Generosity is the insurer's way of minimizing his costs in situations where the insured party insists on better treatment than he is entitled to. In such cases, it is often less expensive for the insurer to pay a sum which is slightly too high instead of facing litigation. Deviations from legal norms in this connection are likely to be due to differing expectations among the negotiating parties as to the probable final outcome of litigation and of procedural costs.

Although Selmer[7] has collected a great many decisions from Norwegian life insurance companies, he is more inclined to demonstrate the quality and quantity of generosity than to explain it. From his paper, however, you can learn that generosity may be classified in two categories. One is the generosity necessary for practical reasons and owing to economy of procedure. This type of generosity is nothing but a form of that "give and take" which is a common feature of commercial life. Selmer notes that there is a second form of insurer generosity which goes further. This type of generosity depends on different motives as for instance the company's reputation, the social function of life insurance or considerations for the family of the deceased.

Hellner[8] does not make any definite statements on the reasons behind insurer generosity. Two possible explanations may be derived from his text. One is that the insurers have for practical reasons formulated the policy conditions restrictively so as to be able to decide for every case if they are going to make use of their rights or not. Another explanation is quite simply that it may give the insurer a good reputation if claims handling is generous in relation to the written conditions.

It appears that there exist chiefly two kinds of theories explaining generous behaviour in an insurance company. The first type of theory is founded on the assumption that the relevant condition is clear and unambiguous, so that one may easily observe whether there is generous behaviour or not. This is the case with the more far-reaching generosity described by Selmer and Hellner's observation of claims handling which gives the insurer a good reputation. Both these two authors stress the relevance of competition. The metacontract theory described above conforms to these theories and its basic foundations are, on the one hand, the notion of the exact norm and, on the other, the functioning competition.

[6] L. Ross, *Settled out of Court,* Chicago Ill. 1970, p. 146.
[7] Selmer, *op. cit.*, p. 27.
[8] J. Hellner, *Försäkringsrätt,* 2nd ed., Stockholm 1965, pp. 61 f.

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The other type of theory takes a vague condition or an uncertain state of law as its starting point. From this point of view Ross states that generous payments are a result of a cost-benefit calculation by the insurer. Selmer's description of a give–and–take process is merely another way of saying the same thing. In this case you cannot actually distinguish what is "pure" generosity and what is not, owing to the initial insecurity of the legal situation.

Which type of theory gives the best explanation of insurer generosity? I would say both, since you cannot in practice make a meaningful distinction between situations where the insurance conditions are unambiguous and situations where they are not. When one uses both types of theories one will arrive at the following concluding picture: Generosity has its origin in different expectations in the insurer and his customer. Owing to the amount of security in the legal situation, the insurer may wholly or partially accept the customer's view, taking into account the competitive situation and the costs of a continued claims-handling process.

> Hellner's suggestion—that generosity may be a consequence of a contract formulation policy where the insurer is assured a free choice between different actions—does not fit very well into this explanation scheme. The expectations of the customers and the impact of competition are not considered in this alternative construction of the concept of generosity. (It must be stressed, however, that there is no intention of analysing the concept of generosity in the cited work of Hellner.)

4. LEGAL RELEVANCE

4.1. The following statements on the legal relevance of generosity in Scandinavian contract law are based chiefly on reported Swedish cases, none of which deals with insurance conflicts.

The principal rule is that generosity has no significance whatever for the contents of the contract. The generous party may rely on his contractual rights whenever it suits him. There are many Swedish cases supporting this principle. In a number of cases the Swedish Labour Court has, for instance, expressed the opinion that the application of collective agreements in a certain manner—even for many years—does not have any legal relevance if contrary to the provisions in the agreement.[9] Hence an insurer may normally show generosity in claims handling without any increase of his duties towards the insureds.

[9] See A. Adlercreutz, *Avtalsrätt II*, 2nd ed. Lund 1978, pp. 72–5, K. Rodhe in *SvJT* 1968, p. 181, with further references.

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There are, however, two types of exceptions from the leading rule. The generous behaviour may constitute a renunciation of a legal right (4.2). Alternatively, it may be argued that contractual conditions could be disregarded as improper when generosity has been practised consistently (4.3).

4.2. In Scandinavian law several requirements must be fulfilled before generous behaviour or passivity of some other kind constitutes renunciation of a right in a contractual relationship. Primarily, the renouncing party must be aware of the fact that his behaviour is not in conformity with the contract. Secondly, the generous practice must have continued for a long time and without attempts from the generous party to enforce his contractual right.

Nevertheless, there are a few Swedish cases where generous behaviour from one of the parties has resulted in changed contract conditions according to the generous behaviour. A recent case deals with a conflict between a brewery and a beer distributor. The brewery argued that the distributor should compensate him for beer cases which had not been properly returned. Although the distributor was in principle obliged to return the beer cases, the Supreme Court did not order him to reimburse the brewer for the missing cases. One reason for this decision was that the risk of losses should to a certain extent stay with the brewer. Furthermore, the brewer had not claimed any compensation for lost cases until some time after the three-year period when the actual beer transports had taken place.[10]

Although no case with a corresponding insurance conflict seems to have been settled in the Swedish Supreme Court, it may be argued that an insurer who for a long time refrains from executing his rights and who does not inform the insured of them may in the long run lose them.

Is has been argued by Adlercreutz, who seems to be the scholar who has dealt most intensively in Scandinavian legal writing with the general problem of generosity in contracts, that systematic generosity towards customers, used as a marketing device, must be interpreted as a renunciation of the corresponding rights.[11] Yet there is no case supporting this statement. Probably this situation seldom occurs. Enterprises rarely seem to have tried to attract customers by giving them information of practices more favourable than follows from their own contract forms. In such a situation the most rational procedure is to change the policy conditions. Detailed information of generosity is not likely to be used for marketing purposes. Probably, this information is instead considered a business secret.

[10] 1965 NJA 427; Adlercreutz, *loc. cit.*
[11] *Op. cit.*, p. 73.

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4.3. Generosity in contractual relations may also be considered a good reason to set aside as improper what is stated in the written contract. According to Swedish law, sec. 36 of the Contracts Act, 1915, is applicable. Since the mid-seventies this section has replaced, among other provisions, sec. 34 of the Swedish Insurance Contracts Act, 1927. This last section offered a limited possibility for a court to modify or set aside particularly improper contract clauses in insurance contracts. According to the Contracts Act, sec. 36, a contract term may be modified or even set aside if it is improper or its application would be improper, considering other parts of the contract and what passed when the contract was made, as well as later incidents and other circumstances. From the *travaux préparatoires* it follows that generosity may be a relevant factor in the framework of sec. 36; especially in banking and insurance it occurs that the superior party through generosity gives up his legal rights. If in those areas a practice has developed which is more favourable to the inferior party than the contract conditions, the counterparty who has often himself drafted the contract should not be able to invoke such conditions, thereby subjecting the inferior party to his benevolence. In such cases the contract should normally be modified so as to conform to regular practice. This is especially the case when the regular practice is known among the customers. If, on the other hand, the customers are informed of an intended change of routines, there will be no purpose in applying sec. 36.[12] If the description and explanation of the nature of generosity in previous sections is correct, the situation aimed at by sec. 36 is a marginal one. Generosity is rather a consequence of the interplay between the insurer and the individual customer than a norm system communicated to the market. So far as I know, no question of modifying a contract under sec. 36 according to regular generosity has been considered by the Swedish Supreme Court.

4.4. In 4.1–4.3 above the reasoning is founded on the assumption that it is possible to distinguish generous behaviour in contractual relations from what is prescribed in the contract. As I have stated under 3 *in fine,* this is not always the case. It must be quite common in insurance that the insurer and the insured have different expectations regarding the contents of the metacontract and that the insurer gives up his view and accepts the customer's point of view. If the contract is vague and covers both alternatives, the solution appears as an application of the contract which is favourable to the insurance customer, although it cannot meaningfully be termed a generous concession from the side of the insurer. Furthermore, the appli-

[12] *SOU* 1974: 83, pp. 145 ff.

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cation proves to be an argument for understanding the actual contract clause in the same way for the future. Thus concessions by the insurer in a vague contract context will be taken into account according to a well-known principle of Scandinavian contract law, namely that a vague contract should normally be understood in accordance with the behaviour of the parties after concluding the contract.[13]

5. A CASE STUDY

The statements above concerning the nature of insurer generosity deserve to be tested empirically. The case study that I can present here is a very narrow one, however. I hope to be able to broaden the picture by further studies of the same kind.

The investigation is focused on the concept of "attractive goods" in Swedish tenant's and home insurance. According to the insurance conditions these goods are, in short:

objects of gold, silver and similar noble metals
pearls and precious stones, antiquities and objects of art
hand-made carpets
clocks and watches
cameras, projectors and looking glasses
musical instruments
tape recorders, gramophones, radio and television sets
including equipment for the items enumerated, also tapes and records
and, finally, furs, weapons, wine and liquor.

These goods are not protected against theft when they are stored in box-rooms in cellars and attics in blocks of flats or when taken along on journeys (unless in two odd situations). The case study is aimed at those cases where compensation has been granted for theft of attractive goods although the loss is not covered by the insurance conditions. Consequently, claims handled by ten out of twelve claims adjusters during the years 1977 and 1978 in a local office of a big national insurance company have been examined. All cases where the customer asked for compensation for stolen attractive goods, stored in attics or cellars in blocks of flats or stolen when taken along on a journey, have been recorded. After eliminating cases where there was some doubt whether facts corresponded to this descrip-

[13] See, for example, Adlercreutz, *op. cit.*, p. 71.

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tion or not, for instance some indication of robbery, 205 cases were left. When classing goods as attractive, the description in the customer's application has been compared with how the concept is understood in the conditions and comments on them. Cases of suspected generosity have been submitted to the respective claims adjusters for an explanation of the outcome.

The result of the investigation is demonstrated in the following table:

		% of recorded claims
Recorded claims	205	
Rejected claims	155	75.2
Granted claims	50	24.8
Benevolent interpretation	8	3.9
Mistake, time pressure	9	4.3
Customer relations	7	3.4
Small value	22	10.7
No satisfactory explanation	4	1.9

Some comments should be made on this table. Even if the statistical value of these small numbers is doubtful, it is still remarkable that as many as 24.8 % of the customers were compensated in spite of the opposite ruling. There are only eight cases where the claims adjusters argue that they have acted correctly (benevolent interpretation). This indicates that the initial classifications are correct. In 42 cases the claims adjusters admitted that compensation was paid againsts the rules.

The classification of the cases where claims have been more or less wrongfully granted are founded on the notes in the claims records as well as on interviews with the claims adjusters. Consequently it is the claims adjuster's own opinion of his behaviour that is reflected in the table. Naturally there must be a tendency for the claims adjusters to try to justify their behaviour rather than admit less honourable motives.

The cases where the claims adjusters have admitted generosity have been classified as "small value" or "customer relations". In many small-value cases compensation was granted for objects which were only partially "attractive", such as coats with fur round the necks and sleeves or pens which were only partly of gold or silver. In those cases the compensation should have been proportionally reduced according to the comments.

Under the heading customer relations are listed cases where the customer was old, sick, poor or otherwise under social pressure. In other cases, however, the written records demonstrate that compensation is due to relations with other officers in the company who support them. The

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result may also be due to the claimant's being a long-time or particularly insistent customer. It is interesting that the figures indicate that different claims adjusters have different attitudes to customer-related compensations. It may be suspected, too, that the share of compensation due to personal relations with company officers is higher in reality than in the table. This subject has quite naturally been carefully avoided by the claims adjusters interviewed.

6. CONCLUSIONS

From the theoretical analysis above, we have managed to get a picture of insurer generosity. Its origin is the conception of a metacontract completing the written insurance contract. The expectations on the contents of the metacontract may be identical in the insurer and in his customer, but they may also differ. In a case of different expectations there is a tendency for the insurer to accept the metacontractual version of the customer. This tendency is due to competition. The customers have no interest in giving up their standpoints, for such a behaviour does not give them a better position on the market. The insurer, however, may easily lose customers if he is conducting a severe claims-handling policy. There is a limit to the concessions the insurer is likely to make. In each individual case it is considered whether or not the costs of generosity exceed the future benefits. A generous alternative will only be chosen when the costs do not exceed the benefits. (The benefits may typically consist of reduced administration costs and reduced risk for losing customers to competitors.)

The case study presented here only deals with a limited set of conditions in a few types of insurance, and the claims handling is investigated only in a single firm. In spite of these limitations, it may be of interest to compare the case study with the picture founded on theoretical analysis. Such a comparison shows that many of the features discussed above are recognizable even in the case study.

The existence of metacontractual expectations and norms is obvious. So it appears that both parties agree to a norm that the insurer shall not bother about small sums when the loss is on the borderline between what is covered and what is not. Some cases indicate a norm that persons under social pressure should be treated generously.

The whole picture demonstrates that a substantial number of cases result in concessions to what could be called metacontractual expectations among customers. Striking examples of the tendency to achieve and legitimate concessions to customers are the eight cases where the claims adjusters

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described their decision as an interpretation of the contract, but this interpretation deviated from "the law in the books".

The case study is focused on the quality of the decisions in single claims. It is then not strange that there is nothing in the material especially indicating the importance of competition. A few cases where insureds have enjoyed especially favourable treatment in their capacity as old customers, however, reflect the importance of not losing customers to competitors.

The theory of Ross has received strong support in the case study. Most generosity cases deal with small amounts of money and the claims adjusters have explained their decisions by referring to the small costs involved. Evidently, the claims adjusters have figured that their claim settlement thus produced more benefits to the company than it caused costs.

In spite of its limitation, the case study confirms that generosity is of great practical importance and that it deserves more attention in insurance-law research.

A final, delicate and complicated question is whether something ought to be done about insurer generosity. It seems to me as if independent lawyers often tend to blame insurers and call for a strict application of insurance conditions, while insurers either claim that generosity does not exist—which is false—or that a certain amount of insurer generosity is necessary as a lubricant in the claims-handling machinery.

Let us see if any arguments can be derived from the case study. The generosity cases in this study may be classed in three main categories, viz. small-value cases, social-pressure cases and personal-relation cases.

If we leave aside the last category for a moment, it is evident that the small-value cases demonstrate a good solution for the customer as well as for the insurance company. The customer is better off and the company is not worse off, since the benefits from the claims handling exceed the costs. The norm not to make much fuss about the pence seems sensible even to an independent observer. The same judgment applies to social-pressure cases. If the insurer did not give special consideration to people who are old, sick or otherwise under special pressure, the rumour of its severity could deter new customers. The norm that social-pressure cases should be handled generously is probably accepted by most sensible persons.

The main problem, however, is that generous claims handling is discriminatory in the sense that a customer who relies in the written contract and does not make a claim will not obtain the same advantages as the insisting claimants. In the small-value cases from the case study, this argument does not seem to be of much weight. In most cases, the norms overruled by generosity did not appear in the written conditions but in the comments. Consequently, practically all customers are expected to submit

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claims in these situations if they consider it worth while. Moreover, the "nuisance claim" is often only a part of the consumer's total claim. Possible discriminatory effects are also somewhat neutralized by the fact that the amounts are marginal. In social-pressure cases, one may imagine a tendency to submit claims even if the chances look minimal. The discriminatory effect is probably not very great.

Discrimination in the form of benevolent treatment of social-pressure cases is also likely to be accepted among other insurance customers. Most of them will expect the same treatment by the company when they are in a similar situation. In these cases one could speak of a mutually accepted metacontractual norm supplementing the insurance contract. In these circumstances, there is some doubt if one could speak of discrimination at all.

For most generosity cases in the study, the conclusions rather tend to what has been described as the insurer view—that generosity is a useful rather than a harmful device. When generosity is so limited as the case study shows, no interventions are required. The registered cases demonstrate, however, that further efforts are needed to make claims handling consistent. (It must be mentioned that the generosity cases are very unevenly distributed among the claims adjusters. But even here there must be a cost limit to consider.

As mentioned, there are some cases registered where personal relations with employees in the insurance company were decisive. A few of them fall outside the scope of the study. Further, it is probable that there are more cases of this kind which we have not been able to detect. (Perhaps one case where the insistence of the insured was decisive ought to be considered in the same connection.) Generosity in these situations is nothing to encourage but rather something to fight. As it is a problem of personal relations one cannot get far with legal interventions. Only the insurers themselves may take effective precautions against such incidents. This seems to be a task for internal auditors and a suitable subject to be regulated in ethical rules for claims handling.

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