

MORAL DAMAGES AND THE ACTIVITY OF INSURANCE COMPANIES

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Abstract: The article addresses moral damages inflicted as a result of road accidents, in terms of motor third-party liability insurance. We explain the nature of moral damages and analyse their relevance to the activity of insurance carriers. Special attention is paid to the major factors that cause moral damages. We also review the main stages in ascertaining inflicted moral damages and give some recommendations about the process. The underlying idea of this article is that an Ordinance on the Ascertainment of Moral Damages must be designed. In conclusion, a methodology for determining liability limits is proposed.

Key words: moral damages, insurance compensation, liability limit, Bonus-Malus system.

JEL: G22.

One of the most complicated issues in insurance practice relates to non-patrimonial (moral) damages caused by accidents¹. Things are further complicated, should the occurrence of such accidents affect several insured persons, i.e. when an accident results in several insurance coverage cases².

In addition, caused damages vary widely in nature and scope, which renders it even more difficult to ascertain incurred damage. Although insurance companies have a damage-assessment methodology, that

¹ A fortuitous event that causes damage (financial losses and moral damages).

² An insurance coverage case is a materialized danger, which is part of the liability under an insurance contract and binds the insurer to pay a compensation to the insured (the policyholder, the beneficiary or a third party).

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guidance is not sufficient since different situations may arise during the assessment process.

The aim of this paper is to explain the nature of moral damages and the difficulty that insurance companies face when assessing them. Related issues, which need to be researched further, are also reviewed.

Special attention is paid for the debate on the effect, which the Bonus-Malus System has upon the size of the insurance liability, i.e. on determining the limits of ascertained financial losses and non-patrimonial damages.

1. Damage. Moral (Non-patrimonial) Damage

Before explaining the meaning of the concept 'moral damages', we will focus on the meaning of 'damage'. The noun is a synonym of 'detriment, harm, trouble, prejudice, loss, ruin, wrong'. Some definitions of 'damage' also include 'poorly delivered services'.

Damage is the inevitable consequence of the materialisation of an unfavourable event, i.e. of a risk. What is more, the concept is used to refer to both direct and indirect patrimonial and non-patrimonial (moral) losses.

Several years ago, the prevalent opinion was that moral damages might only be claimed if an accident had produced bodily injuries. Hence, such injuries were mainly associated with the life and health of third parties.

Yet, moral damages also occur in cases when assessable personal non-property rights are infringed. The insurance liability assumed by the insurance company in such cases does not relate to property. Nevertheless, insurance practice suggests that in most cases the infringement of personal non-property rights results in patrimonial damages as well.

In many countries, the amount of the insurance compensation is paid to the insured as an indemnity for *pretium doloris* (the Latin for '**pain and suffering**'). In English insurance terminology, the phrase '*pain and suffering*' is used to refer to the principle of fully compensating a claimant for all the damages they have suffered (Shipkarenko, I., 1999). In Bulgaria, the concept is equivalent to 'moral damages'. In some countries, no compensation is due for 'pretium doloris', yet, such cases are an exception.

What does the concept of 'pain' imply? The International Association for the Study of Pain defines 'pain' as 'an unpleasant sensory and emotional experience associated with actual or potential tissue damage, or described in terms of such damage. Pain is the earliest symptom of an impairment or disease of the tissues'. The factor, which provokes pain, is predominantly mechanical (a trauma, a cut, a strained tendon or muscle). Furthermore, pain may be acute or chronic and it may vary in severity or duration. In contrast to pain, the term **suffering** is used to refer to a combination of unpleasant, distressed and painful feelings. Suffering causes to individuals physical or emotional discomfort, anguish, fear or grief. Individuals may experience those feelings when they are caused damages or when they face the threat of being caused damages. The intensity of suffering may vary from moderate to extreme.

Pain and suffering go hand in hand, therefore insurance companies approach them as a unitary risk.

According to Aristotle, only God knows the true price of human life. To the insurance companies, that price is the compensation they have to pay when an accident occurs and moral damages are caused.

Damages do not merely refer to the financial losses that the insurer has to compensate, since an accident causes non-patrimonial damages, too. Therefore, the term 'moral damages' also refers to the pain and suffering that cause unpleasant, distressed and painful feelings to individuals when they experience physical and/or emotional discomfort, pain and grief. Although suffering may relate to physical pain, the term is more frequently used to refer to the psychological and emotional state of individuals.

Pain and suffering relate to certain circumstances which can be objectively described – for example, the nature and degree of the impairment; the manner and the situation in which the impairment has been caused; the harmful consequences, their duration and intensity; the age of the person who has been afflicted with pain and suffering; their social and public status, etc.

Fear and anguish; infringed personal, aesthetic and moral interests and missed intellectual enjoyments may also be approached as a relative damage that causes a change in the mental state of individuals, thus affecting their working capacity negatively. In a number of countries (the

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USA, for example), missed intellectual enjoyments are recoverable by liability insurance (third-party liability insurance). The focus of our attention is on automobile Third-party liability insurance, since there have been heated debates about that type of insurance lately. Those debates have predominantly been held by persons who are not professional, i.e. disputes have been caused and arrangements made by individuals who are not familiar with the underlying principles or organization of insurance practice.

2. Major Factors Which Cause Moral Damages (Characteristics of the Risk)

Human beings have always been apprehensive of any dangers in their environment that might cause them pain and suffering. The liability of an insurance company where pain and suffering are concerned is usually assessed in rather abstract terms.

In order to specify the liability of the insurer when assessing the amount of moral damages, we need to clarify the meaning of the term 'liability', which may have several different implications in scholarly articles and in insurance practice.

Liability may be classified as:

- Social responsibility, which includes economic, legal and moral responsibility.
- Moral responsibility, which refers to the disapproval of any acts or behaviour that are deemed as immoral by the public.
- Legal liability, which relates to existing laws and legal requirements. Legal liability includes disciplinary, administrative, material and criminal liability.

Insurance companies repair damages related to social responsibility, as well as to civil liability. The latter arise in cases when the property and non-property (moral) rights of individuals are infringed, or those of economic entities and the state (damages caused to the environment, for example). Civil liability includes both contractual and delictual liability. Delict (which literally means 'something wrong') is a concept used in Common law to refer to various circumstances that render an entity liable to another entity. Hence

the difficulty that insurance companies face when determining the amount of the indemnity to be paid. While in the matter of contracts the existence and the size of liability depend on the arrangements between the two parties, in the matter of delict, liability may also exist when there is no contractual agreement between the parties, or even when there has been no contact between them. The underlying concept of delict is that liability shall be based on the obligation not to cause any damage. Drivers of motor vehicles are obliged to be careful not to cause damage or injury to other drivers, pedestrians, etc. Should those obligations not be fulfilled, the insurer must pay a compensation for the losses caused by the insured to a third party. When the insurance liability is wider in scope, the insurance company may pay an indemnity even in instances of negligence or defamation on behalf of the insured.

We should emphasize that the amount of the compensation for moral damages arising due to some tort relates to the criterion of fairness, i.e. the moral injury that has been caused must be commensurate. Furthermore, fairness, as a criterion for determining the pecuniary equivalent of moral damages inevitably involves circumstances that relate to the depreciation of the value that the injured/impaired attributes have previously held for their owner. What is more, fairness is not an abstract notion, since when an insurance contract is signed, the insured party will expect the insurer to fulfil their obligations meticulously and in good faith. This is not always the case in insurance practice, though, therefore parties whose interests have suffered in an accident are often dissatisfied with the decisions of the insurance company.

Hence the question: when is it appropriate to consider an accident to be an insurance coverage case? For example, are any moral damages inflicted when someone's honour or dignity have been hurt? In our opinion, this is only the case when a person is a public figure and any impairment to their moral image would result in a negative public response. In other words, when it is necessary to ascertain if someone's dignity has been injured, a judgement should be made whether their moral, professional, etc. image has been damaged.

It is extremely difficult, even impossible, to assume that any moral damage has been caused when an unfavourable event hurts an entity's

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business reputation. Such instances are usually approached as an impairment of professional dignity that causes damage.

These are only a few examples of cases that have ended in court since the insurance company has refused to pay an indemnity or because the third party has not been satisfied with the amount of the compensation.

3. Ascertaining the Amount of Moral Damages

3.1. Fair Appraisal of the Insurance Compensation

Risk assessment in terms of moral damages is rather complicated due to the wide variety of factors that inflict moral damages as a result of someone's death or bodily injury.

In order to avoid potential difficulties, the terms and conditions of the different types of insurance contracts need to clearly specify the liability of the insurer. Those commitments might be stated en bloc or individually for every single aspect of a moral damage.

Problems have been further exacerbated by the Resolution of the Supreme Court of Cassation to widen the range of the insured persons who may claim an insurance coverage under automobile Third-party liability insurance. The underlying reason for that resolution directly relates to the social fairness, which is an intrinsic element of insurance. This has given rise to three major issues of controversy in terms of the economic interests of the two parties to the insurance contract, i.e. the insurance carrier and the insurance policy holder.

On the one hand, insured persons seek compensation for the pain and suffering inflicted to them by the occurrence of an insurance coverage case, i.e. when there has been a road accident.

Insurance companies, on the other hand, seek to protect their financial interests.

This could only be accomplished in a manner that is fair and at the same time acceptable to both parties to the insurance contract.

A third party is also present when disputes over insurance coverage need to be settled, that of solicitors, who try to benefit from the situation.

Hence the question, who is the winner and who is the loser in similar complex and delicate situations. 'The road to hell is paved with good intentions,' as the old saying goes. This is also the case with motor Third-party liability insurance. The manner in which compensations are currently calculated allows for conflicts arising between the interests of the insured and the insurers. Those conflicts result in lawsuits from which solicitors gain. At this stage, insurance compensation is calculated by an insurance expert panel. A number of issues then need to be addressed. If the person who has suffered moral damages will accept the resolution of the insurance expert panel will depend on whether those issues have been adequately addressed.

An insurance expert panel is part of an insurance company. The management of the insurance carrier has the obligation to appoint as panel-members professionals who are well-grounded in insurance practice and are knowledgeable about all implications of the 'moral damages' concept. In our opinion, insurance carriers do not always comply with this requirement. When selecting the experts for their insurance panels, insurance companies need to ensure absolute legitimacy of that subsidiary body, since the insurance expert panel will determine the amount of insurance coverage payments on behalf of the insurer. A relevant issue then is that of the authority of the insurance expert panel. A reasonable assumption would be that those panels determine the amount of the insurance coverage on the basis of the moral damages which a person has suffered. Hence the question whether the insurance expert panel is a subsidiary body or a decision-making body in such situations. If approached as a subsidiary body of experts, then the limits of its power need to be clearly defined. If, however, an insurance expert panel is approached as a decision-making body in determining the amount of an indemnity, the requirements to that body (and the experts appointed in the panel) will have to be different. In that case, the competence and the qualifications of the members of the insurance expert panel will be of primary importance due to the wide variety of claims for moral damages, which might be made.

Even when the competence and qualifications of the people in the expert panel are guaranteed, the question remains whether the decisions made by that body will be the right ones. In our opinion, a decision made by a body that is subordinate to the management of an insurance company

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cannot be totally unbiased. In other words, in such situations, the body that determines the amount of the insurance compensation is also the body that should pay that amount.

The only way to avoid this situation is by adopting an Ordinance on determining the amount of insurance coverage for motor third-party liability insurance. The Ordinance must be designed by the Financial Supervision Commission. We believe that a quick retrospection will be helpful in justifying our proposal. In 1926, an Office for Insurance Supervision was established. The Office was responsible for designing all regulations that governed the activity of Bulgarian and foreign insurance companies on the territory of the country. The Vice-President of the Office, Hr. Petrov, supervised the process of designing the first mortality table, which became known as Mortality Table B-41.

Should an Ordinance on determining the amount of insurance coverage for moral damages be adopted, all insurance carriers will determine the amount of the indemnity according to the same principle, which will prevent any remonstrance on behalf of the insured, since the amount of the insurance coverage they are due will be based on an Ordinance approved by the Minister of Finance or adopted by the National Assembly.

Such a solution will reduce the number of lawsuits that currently result in paying huge compensation sums.

The Ordinance must clearly specify the major parameters for calculating the size of indemnity according to the type of injury suffered – a broken limb, a spinal cord injury, injuries affecting the aesthetic aspects of tissues and organs, etc.

We therefore believe that an Authority for Insurance Supervision needs to be established in order to ensure the efficient and competent management of the insurance sector.

3.2. Liability Limits

A heatedly debated insurance issue on a global scale is that how to determine liability limits for moral damages in compulsory insurance, including motor Third-party liability insurance. Hence the need to introduce

terms like liability limit, insurance limit, annual liability limit, aggregate liability limit, limits on individual claims, liability limits for specific bodily injuries, etc. Upon the occurrence of an accident causing patrimonial damages, the latter are ascertained on the basis of the sum insured. When moral damages are inflicted, however, it is essential to take into consideration two basic principles:

- a) Not to infringe the patrimonial interests of the insured who have been injured in a road accident;
- b) To protect the financial interests of the insurer.

The amount of the insurance premium is determined based on these two principles.

Another consideration to take into account is the amount of liability limits set for moral damages in other countries.

In our opinion, there must be a clear-cut difference in the liability limits set:

- per the members of households that have suffered an accident resulting in death or bodily injuries;
- for persons who are not members of the family but have directly been affected by the occurrence of the insurance event.

Insurers then have two available options:

a) To apply low insurance premiums when the liability limits are low, which is of no interest to either the insurance company, or the persons who have been involved in a car accident, since the amount of the insurance compensation they are paid will be smaller. The arrangements of the Green Card insurance also render low liability limits inappropriate. Low liability limits will be in favour of foreign insurers whose clients have caused a road accident on the territory of Bulgaria, thus causing pain and suffering to Bulgarian citizens. In contrast, Bulgarian insurance companies will have to pay substantial compensations to foreign citizens who have suffered moral damages in road accidents caused by Bulgarian drivers;

b) High liability limits will make it necessary to raise insurance premiums substantially, to which citizens will surely protest.

It is therefore necessary to seek for the golden mean between those two options. In addition, when determining liability limits, insurers need to

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take into account the principle of fairness, rather than set a certain limit en bloc.

Another issue that needs careful consideration when determining liability limits is the circle of people who will be entitled to claim insurance compensation.

In most cases, bodily injuries caused by road accidents affect negatively not only the persons involved in such accident, but also their close relatives (spouses, children, parents, etc.). Furthermore, moral damages are also inflicted when peoples' feelings have been affected. Such damages are a variety of personal damages that is defined as a state of mental or emotional fear and suffering.

Children who have not been officially adopted, yet have been raised by victims of road accidents, must be entitled to compensation, and so must cohabitants of road accident casualties.

Cases in which insurance compensation is due to family members not sharing the same home with the person who has died in a road accident pose significant difficulty when determining liability limits.

In many countries, existing legislation renders it possible to make claims to legal, as well as to physical entities, that, through their action or inaction have caused moral damages to third parties' life, health or property. Different liability limits are set for legal and for physical entities.

Another issue is determining liability limits for moral damages in contracts for comprehensive tourist insurance, carrier liability insurance, employers' liability insurance, liability insurance of business entities whose operation entails higher risk, etc.

The process of determining liability limits relates to the process of ascertaining future pains and suffering. Hence the question: what would be the deadline for submitting claims to the insurer after an insurance event has occurred? The matter is further complicated when ascertaining moral damages resulting from breach of contract, plagiarism, an injury inflicted upon someone's reputation and dignity, etc.

This article is an attempt to provide some guidelines about the manner in which inflicted moral damages should be ascertained.

The aim of the research we have conducted is also to initiate a debate on the subject matter since, in our opinion, insurance compensation is still paid within the limits prescribed by law, and the latter are not always in line with contemporary insurance practice. A fact that tends to be overlooked is that inappropriate liability limits usually result in higher insurance premiums. Lower liability limits provoke dissatisfaction in the insured and increase the number of lawsuits.

Shedding light on the nature and specifics of moral damages will hopefully provide food for thought to the managers of insurance companies. At the same time, we are fully aware that many of the issues we have discussed in this article need to be addressed in greater detail.

Finally, we hope that our readers will acknowledge the fact that this research is a tentative attempt to study moral damages in terms of insurance practice and will be less judgmental to any statements that might sound a bit extreme.

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