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# Insurance Contract Law in Western Europe Examples for Central and Eastern European Countries ?

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# INSURANCE CONTRACT LAW IN WESTERN EUROPE :

## EXAMPLES FOR CENTRAL AND EASTERN EUROPEAN COUNTRIES ?

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## Introduction

This paper is a short presentation of insurance contract law in Western European countries, with some observations on the ways Central and Eastern European countries could derive some inspiration from it when adopting new statutes fit for a market economy.

The organizers of this colloquium have asked us to start with a brief reminder of the main principles of insurance contract law. This will be useful as it will give the opportunity to restate the basic original features of the insurance contract, which should normally be included in any new piece of legislation (I). We will then proceed with some comparative remarks, which will stress the differences existing between countries, or, more precisely, the levels at which differences appear (II). The next part will be devoted to the current state of the question of harmonizing insurance contract law between the E.E.C. countries (III). Finally we shall try to single out the main questions legislators from Central and Eastern European countries should ask themselves when preparing a new statute on the insurance contract, on the basis of the experience of Western countries (IV).

## I. Main principles of insurance contract law

At a very general level, it is possible to present a description of the main principles of insurance contract law. There is indeed a common core of basic rules that are found in all legal systems. These rules demonstrate the specificity of the contract of insurance. This particular contract is normally subject to the law of contract in general, but it is also governed by some very unique rules, corresponding to the original characteristics of the operation involved.

Of course, this does not mean the solutions are identical everywhere. Statutes on the insurance contract have appeared in their respective national contexts, and mainly, at different periods. A 19th century legislation will be less advanced, technically, that a recent statute, and it will hardly be concerned with consumer protection as the latter is likely to be. In a common law country like England, there is even no statutory law on the insurance contract in general, and principles have to be found in case-law. Such differences will be elaborated later.

Yet, the main basic issues are apparent. We will try to summarize the most important ones. The following is of course far from being a systematic and exhaustive presentation of insurance contract law.

## 1. Risk description

Insurance is risky business. The insurer undertakes an aleatory obligation. In order to conduct its activities properly, the insurer must evaluate the risk with accuracy, to decide whether it can afford to underwrite it, and if so, to calculate the adequate premium. Since the insured is the person in the best position to know the characteristics of the risk, it is usually burdened with an obligation of disclosure at the conclusion of the contract. The future insured must give the insurer a description of all circumstances pertinent for the evaluation of the risk.

It is possible that the risk changes during the course of the contract. Legal systems usually also oblige the insured to inform the insurer of aggravations of the originally underwritten risk.

In the past, these obligations of the insured were subject to severe sanctions. Contemporary legislations aim at more balanced solutions.

## 2. Payment of the premium

Apart from disclosure requirements, the insured's main obligation is to pay the agreed premium. Most aspects of performing that obligation (when the premium should be paid, where, to whom, by whom, etc...) are usually left to general principles and to agreements between parties. More specific developments have often appeared in statutory or case law concerning remedies available to the insurer in case of breach, in order to prevent situations where the insured would be too easily, or too rapidly, or unawares deprived of coverage because of its failure to pay.

## 3. Obligations of the insured in case of loss

At the critical moment when a loss occurs, insurance contract law generally imposes two specific obligations on the insured.

First, the insured must strive to mitigate the loss as it is occurring (e.g. attempt to put the fire out, protect rescued goods against rain or theft, etc...). Costs reasonably incurred for such preventive measures are covered by the insurer.

Then, the insured must notify the event to the insurer without undue delay. It is indeed important for the insurer to be informed rapidly, so that it can accomplish the necessary verifications, and take the appropriate measures to cover the loss.

In the past, insurers often attached extremely severe sanctions to those obligations. Modern legislations attempt to keep a better balance between the breach and its remedy.

## 4. Insurance of property vs. insurance of persons

Two main types of insurance contracts have developed in practice, and legal systems generally recognize the distinction.

When property is insured, the insurer's intervention in case of loss consists in indemnifying the actual damage suffered, i.e. paying an amount calculated according to the justified prejudice. The so-called "principle of indemnity" forbids payments that would exceed the actual loss; the main concern is that the insured should not derive any enrichment out of being insured (otherwise there would be a temptation to provoke the loss intentionally).

The same principle of indemnity has other important corollaries. So-called "over-insurance", i.e. insurance contracted for an excessive amount, is not permitted; if the insured value is in excess of the "insurable interest", it will be reduced (in case of bad faith, the contract may even be avoided). "Multiple insurance", i.e. the existence of two or several coverages with different insurers, the total of which exceeds the insurable interest, is also regulated in order to reduce the global coverage adequately. If the loss is caused by a third party, against whom the insured has a claim in liability, the insured may not exercise both claims against the insurer and the third party, which would enable it to be indemnified twice for the same loss : its claim against the third party is transferred by "subrogation" to the insurer who has compensated the loss.

Liability insurance also belongs to the same category where the principle of indemnity applies, though some of the rules just mentioned are adapted to the specific characteristics of such coverages.

On the other hand, where the risk insured is related to the life or the physical integrity of a person (life assurance, health, accident insurance), the principle of indemnity does not have to intervene, and very different rules apply : the insurer's obligation is to pay a pre-determined "sum", or "capital", and no justification of the actual loss will be required; consequently, there is no such thing as "over-insurance", and "multiple insurance" can be freely contracted; if a third party is liable for the death or the accident, beneficiaries may cumulate claims against the insurer and the third party, and the insurer is not subrogated. Such rules always apply to life assurance; other forms of insurance of persons, such as accident insurance, are sometimes organized along the indemnitary scheme described above.

### 5. "Under-insurance"

Another rule is typical of property insurance (and to some extent, also liability insurance) : the so-called "proportional rule", that applies in case of "under-insurance", i.e. insurance for an insufficient amount, below the value of the insurable interest. Premiums have been set by the insurer in accordance to different factors, among which the declared value of the insured property naturally takes place. If that value is insufficient, so is the premium, and the insured may not then claim to get full coverage in case of loss. According to the proportional rule, payment by the insurer will be in the same proportion to the actual loss as the paid premium was in proportion to the premium that should have been paid if the insured property had been adequately valued.

### 6. Third party claims

Insurance contract law is characterized by the existence of different situations and mechanisms by which the rights deriving from the contract may be exercised by parties other than the initial subscriber or its agents.

Many coverages are subscribed "on account of third parties" (*assurance pour compte d'autrui, Versicherung für fremde Rechnung*) i.e. to protect other persons' insurable interests. Such formulas, which originated in transport insurance, have found many other applications in modern-day insurance. Motor liability insurance, for instance, does not only cover the subscriber's liability; it can also guarantee that of other drivers. Group life assurance is subscribed by a firm to cover the insurable interests of members of its personnel. Legislations often devote some provisions to that mechanism, for instance to determine the extent to which the beneficiaries' rights are dependent of the subscriber's correct performance of its obligations.

Another very common mechanism is the "stipulation to the benefit of a third party", by which the subscriber asks the insurer to pay to a beneficiary the indemnity or the sum due in case the insured event occurs. A traditional feature of life assurance and other insurances of persons, that formula also knows applications in credit insurance, where a bank is often designated as beneficiary of the indemnity. Such stipulations raise several problems which are regulated in some legislations, mainly concerning life assurance in connection to the law of donations, successions and marriage contracts.

Still another group of cases includes different situations where creditors of the insured are granted special rights on the indemnity. Mortgage and other privileged creditors often have special claims against the insurer or on the indemnity in case of loss. In liability insurance, the victim is generally given similar rights, which can culminate in a "direct action" (*action directe*) against the insurer, reinforced by the right to be paid irrespective of the insured's failure to perform its obligations towards the insurer.

## II. Comparative overview of insurance contract law in Western Europe

Such are some of the main features of insurance contract law in most countries of Western Europe. Their general presence demonstrate the relative universality of that legal sector. A more thorough study naturally reveals important differences in the ways these characteristic rules and concepts have developed in the different legal systems.

a) One should first set apart the situation of common law countries such as England and Ireland. There insurance contract law is not codified[1], and it is not even usually considered as separate body of law. Common lawyers are somewhat allergic to systematization and conceptualization. The elaboration of contract law in general is a relatively recent development, and the legal status of specific contracts is still very much considered to be a mere application of the general rules. Though most of the principles of insurance contract law described above also apply in common law countries, they are seldom the object of organized presentations.

b) Civil law countries, on the other hand, all have special codifications of insurance contract law, either as a chapter of the civil or commercial code, or as a separate statute. However, important differences appear considering the date when those codifications were promulgated. Some countries still have insurance legislations from the 19th century. Most have statutes enacted in our century, but that can span from 1908 till 1992 (Belgium has the newest statute, dated June ..., 1992). It means that from the technical point of view, the respective legislations differ widely. Early statutes are not very sophisticated by contemporary standards : their provisions are often unprecise and contain many gaps. Recent legislation is usually much more developed, in accordance with the developments of both insurance practice and legal science.

c) Another major difference between the legal systems concerns the degree of protection given to the insured, i.e. the “consumer”. In the past, legislators were not very sensitive to that preoccupation. If anyone was to be protected, it was the insurer against various risks of fraud on the insured’s side. Otherwise the large contractual freedom granted by the legal systems used to enable insurers to impose often very drastic clauses in their policies. Contracts of insurance were filled with causes of exclusion and extremely strict sanctions against the insured.

Reactions have started to materialize long ago. Courts have more and more often worked to correct the unbalance between insurers and the small insured. Legislators have also taken the initiative, starting with the German and the Swiss laws of 1908; later statutes adopted in this century have generally submitted the insurance contract to mandatory rules designed to give the consumer more and more protection. Sweden even adopted a special statute of the insurance consumer in 1980.

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[1] With the exception of marine insurance, codified by an Act of 1906.

But each civil law country has its own legislation, enacted or last modified in a certain year, and this diversity corresponds to various degrees of consumer protection; in a common law country like England, the lack of mandatory legislation maintains a situation where the insured has relatively little protection by contemporary standards. Thus the level of consumer protection is a factor of differences between the various countries of Western Europe.

## III Harmonization of insurance contract law : the issue in the E.E.C.

What has just been said about the state of insurance contract law in Western Europe indicates that no harmonization has yet taken place within the E.E.C. Actually, the surprising fact is that there was much talk about such harmonization, and a draft directive with that purpose, a little more than ten years ago, but that at the eve of 1993, paradoxically, nothing is pending on the subject any more. This deserves some explanation.

Among the different purposes that harmonization of laws can serve, facilitation of international trade occupies a central place. Differences between legislations are obstacles to business across borders. This explains why harmonization efforts have been accomplished, often with significant success, about several contracts of special importance in international trade, such as sales and transport. The same concern could be expressed about insurance.

Within a community of states aiming at realizing a single integrated market, like the E.E.C., harmonization should have special importance, and it is indeed one of the objectives of the Treaty of Rome. Actually, efforts towards harmonization have been under way in a wide variety of fields. More specifically, in a sector such as insurance, harmonization of the rules on contract has been seen as a pre-requisite for the realization of freedom of services. An insurer based in a E.E.C. country must be allowed to provide its services to customers of other member states without having to have an establishment in the latter country. Such activities, however, are handicapped if the legal systems remain different; harmonization of contract law would encourage the exercise of freedom of services.

It was thus natural that the question of harmonization of insurance contract law came up in the midst of the discussions concerning the ways to make freedom of services effective. This long story need not be told here, but member states had many divergences to solve before being able to implement directives on freedom of services in insurance, and it turned out that harmonization of contract law was one of those difficulties. In spite of fundamental common traits, the systems have important differences, that have been described above. The draft directive, published in 1979, tried to harmonize only a few important aspects of insurance contract law; yet it could not succeed to overcome resistance from different sides. It was finally felt hat this attempt to harmonize the rules of contract, intended to facilitate freedom of services, was on the contrary going to postpone its realization, and the project was abandoned - at least for the moment. The directives on freedom of services adopted in 1988 and 1990, as well as the current draft "third generation" directives, have replaced harmonization of material law by harmonized rules on determination of the applicable law.

It seems evident, however, that the subject of harmonization of insurance contract law within the E.E.C. will come up again some time in the future. Already, in special sectors, such as motor insurance, or legal protection insurance, several directives have brought a certain degree of harmonization.

## IV. Evaluation for Central and Eastern European countries

Central and Eastern European countries certainly need no legal assistance from anyone. They enjoy a very old legal tradition, and have produced scores of remarkable lawyers. At the moment, however, the radical changes these countries are going through call for the adoption of new laws adapted to the introduction and the development of market economies. For this formidable task, they can find some sources of inspiration in the Western European systems. That is probably true in the sector of insurance contract law. The following remarks suggest a few important points to consider when taking Western legal systems as possible models.

a) Countries of Central and Eastern Europe belong to the **civil law tradition**. It means their new insurance contract law will more adequately find its inspiration in the codifications of continental Western Europe than in the developments of the common law. The same may not be necessarily true concerning regulation of insurance companies, where the different systems have developed in relatively recent times, and are less the product of a long historical legal tradition (besides, as far as regulation of companies is concerned, much harmonization has already taken place in the E.E.C.). But insurance contract law, in each country, is tightly integrated in the mold of general contract law, which in turn is the product of the legal tradition, civil law or common law, to which the country belongs. For a Central or Eastern European nation, to look to a common law country as a main source of inspiration to revise insurance contract law would bring the risk of graft rejection[2]. This of course does not mean some common law solutions of individual problems could not provide useful models.

b) Should the new provisions of insurance contract law be included in the **Civil code**[3]**, or** be the object of a **specific statute** ? This question seems to cause much debate in some countries. Apparently the consequences of the choice are not very significant. It seems that a statute has the same legal value whether it is independent or inscribed in a more general codification. We would tend to think that it is mainly a matter of presentation. If the Civil code already contains rules about several major contracts, it would make sense to incorporate the insurance contract too. However, regulation of the insurance contract can become quite elaborate and lengthy (see point c below), and in a Civil code, it could constitute a chapter of disproportionate size.

c) A more important question is to decide whether the new act should only regulate the **general principles** of insurance contract law, or also enter into the details of **specific branches**.

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2 This is the occasion to warn against the use of the English language as an intermediary vehicle to transfer information about a civil law system to be used by other civil lawyers. Very often, English does not possess the precise equivalent concepts of the original legal statement, and the translation has to be loose and approximate. The further translation from English to the language of destination cannot recover the exact meaning of the original word. Lawyers will realize the devastating effect of this detour. The author of the present report has himself experienced much difficulty expressing some legal developments in the English language. It is suggested that Central and Eastern European countries wanting to make use of a civil law text of Western Europe translate it directly into their own language, or at least choose another "civil law language" (French, German, Italian, etc...) as the intermediary.

3 If not in the Commercial Code.

There are principles and rules normally common to all kinds of insurance, such as those that concern formation of the contract, description of the risk, duration of the contract or limitation of claims. Some other rules are specific to the main categories of insurance contracts, such as the principle of indemnity and its corollaries in property insurance, or the special rights which may be given to the victim in liability insurance. The most important of those basic rules have been described above. All of this constitutes the minimum to be regulated in an insurance contract statute.

But specific branches naturally have their specific features. Fire insurance, for instance, may call for a definition of the risks covered, "fire" in itself and assorted risks; special rules can be devoted to insurance of liabilities in case of fire, e.g. the tenant's liability towards the owner. Life insurance is a world in itself, with the different persons involved (the subscriber, the person at risk, the insurer, the beneficiary), with the interference of family law problems (donations, marriage contracts, inheritance), with the operations the existence of mathematical reserves permits (such as surrender). Motor insurance, as soon as it becomes compulsory, calls for a very elaborate legal framework, describing all the facets of the obligation of insurance and reinforcing the victim's protection in many ways. Less major branches also have their specific problems : some of the general rules may be inapplicable as such in credit insurance, and call for some derogations; legal protection insurance necessitates certain provisions to protect the insured against conflicts of interest.

Most Western European legislations on the insurance contract contain a second part dealing with some specific branches, the major ones, and some others. Very often, however, some branches are dealt with in separate pieces of legislation : it is usually the case for motor insurance (though most aspects of the relationship between the subscriber and the insurer are still governed by the general rules of insurance contract law).

Here again, it is a matter of presentation and convenience. It is practical to develop rules on specific branches in the same general statute on insurance contract, after the basic principles. But one cannot envisage to regulate all existing (and future !) branches. As a rule, the general principles should suffice. Provisions on specific branches should be adopted only where experience has shown that some special developments call for particular rules. Where these rules should be very elaborate, and at least partly also cover non-contractual aspects (such as the Guarantee Fund or the organization of control in motor insurance), a separate statute is advisable.

If priorities have to be established in the preparation of new legislation in some countries of Central and Eastern Europe, it would be quite acceptable to start only with the general rules and principles, and to leave the regulation of specific branches for a later stage (with the probable exception of branches such as motor insurance, where the presence of an adequate legislation is urgently needed). This could also be done by having provisions that would leave further and more detailed implementation to the executive branch of government[4].

d) Another question concerns **general conditions of insurance.** How should they be elaborated ?

In principle, in a market economy, their drafting should be left to the initiative of the insurers themselves, and it is generally the case in Western Europe. In many instances, each insurer prepares its own general conditions, which can be an instrument of competition as well as tariffs and services. In other cases, standard conditions are prepared by insurers' associations, and used by all members of the branch (which can create problems with the law on competition[5]). Naturally, such general conditions originating from the insurers themselves have to comply with the mandatory provisions of the law.

Sometimes, public authorities intervene in the drafting of general conditions. This can take many forms. General conditions can be imposed by the law or an implementation decree. Or a regulation can impose minimum guarantees to be contained in general conditions (which could only be made more favorable to the insured). Or public authorities can take part in the preparation of general conditions (e.g. by being present in the drafting committee). Or general conditions drafted by insurers are subject to a "material control", exercised *a priori* or *a posteriori.*

No general recommendation can be formulated, except that the principle should remain that insurers themselves prepare their general conditions, in conformity with mandatory provisions of the law. But this question is closely related to the following two

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[4] As an example, 25 of the 149 articles of the recent Belgian law call for further implementation by Royal decree.

[5] See Regulation n° 1534/91 of May 31, 1991 of the EEC Council.

problems, concerning compulsory insurances and the relationship between contract law and control law.

e) Cases of **compulsory insurance** proliferate in some Western countries[6]. A good piece of advise to Central and Esatern European countries would be to limit such developments to sectors where the risk is especially acute (e.g. hunting, nuclear risks), or constitutes a major problem for society (automobile accidents).

It should be understood, however, that in a market economy, compulsory insurance is not a strictly statutory phenomenon. There is of course a piece of legislation that creates the obligation of insurance, and determines its contents, but the relationship between the insured and the insurer still rests on a contract (and is thus governed by the law on insurance contracts) as in non-compulsory insurance[7]. This should be kept in mind by Central and Eastern European countries in the process of adapting their insurance contract legislation, because it seems that in the past, at least in some of those countries, compulsory insurance was organized on a purely legal basis. This should not be the case any more, and the general law on insurance contracts should apply to compulsory insurance as well.

f) At first sight, the law of contract operates on a very different level as the law organizing the **control of insurance companies.** While the former regulates the contractual relationship between the insured and the insurer, and thus belongs to private law, the former, part of public law, is concerned with the requirements for entering and exercising the activity of insurance, having especially in mind the insurer's solvency.

The two sets of rules are normally contained in separate pieces of legislation, which seems to be advisable (though the need to accelerate the adoption of new legislation may prompt some Central or Eastern European countries to combine the two in a single draft statute).

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[6] About 60 cases in France and 45 in Belgium, in the early nineties.

[7] The case is different in coverages granted by Social security, which are sometimes also referred to as some sorts of "insurance" (e.g. "old age insurance", "unemployment insurance"). There the coverage is totally organized by the law, without any contractual link between the beneficiary and the paying institution, and the term "insurance" is used in a vague analogical fashion. But it often happens that such social security benefits are complemented by private insurance coverages (e.g. pension group insurance).

There are however areas of interference. Control of insurance companies often extends to the so-called “material control”, i.e. control of conditions and tariffs. Insurance companies are requested to submit their conditions and tariffs, whether these cannot be used before approval by the control authorities (*a priori* control), or they are only controlled *a posteriori*. In regard to conditions, such control may only extend to the conformity of the submitted terms to the mandatory requirements of the law, but regulatory authorities have been known to go further and exercise some kind of praetorian jurisdiction about unfair terms (that was the case in Belgium until the recent past). Moreover, control laws have sometimes provided the legal basis for regulation by decree of contractual matters.

It is a matter of policy to decide how much control of contractual terms should be left to control authorities, and not only to the courts. The virtues of such preventive action can be argued for. Within the E.E.C., different systems were present in the different countries, but the trend is clearly towards less control of contractual terms from control authorities; draft "third generation" directives on freedom of services do not permit *a priori* control any more. As far as the responsibility for enacting regulations in contractual matters, it seems to us that it should be left to the authorities constitutionally competent for contract legislation, and that implementation decrees should be based on the general insurance contract law rather that on control legislation.

g) Another most important policy decision Central and Eastern European countries must take is to determine the degree of **protection** they want to grant their **consumers** in the insurance sector. One could probably not imagine to enact a new legislation in the style of the 19th century, containing only very broad, non-mandatory rules. The idea that the law must correct the usual lack of balance between the parties in an insurance contract with a set of generally mandatory provisions has prevailed almost everywhere in contemporary legislation (at least in civil law countries). But it was explained that there are different possible degrees of protection. Central and Eastern European countries have the advantage of being able to compare different models, including several recent ones like the Spanish law of 1980, the Swedish insurance consumer law of the same year, the French Code des Assurances as revised lately in 1989 or the Belgian law of 1992.

It can be argued that the development of a private market is encouraged when legal constraints are not too strict. This should plead against the choice of models that would be among the most progressive in the direction of consumer protection. But certainly, Central and Eastern European countries must find an acceptable compromise between this economic consideration and the need to give their citizens sufficient protection from contractual abuse. Here too, incidentally, one could proceed by successive steps, along with the progressive development of the market.

h) A final consideration. Western European countries are still experiencing the diversity of their legislations as impediments to international exchanges. As was said before, **harmonization** efforts concerning the insurance contract have been undertaken in the E.E.C., which have already cost much time and energy. They have failed so far, but they will have to be resumed in the not too distant future. Though it is perfectly legitimate for each nation to seek to adopt the sort of laws it deems adequate for its own needs, a unique occasion should not be missed at this time of intense legislative activity. The different countries of Central and Eastern Europe should follow each other's developments in drafting new laws closely, and attempt, perhaps through some forms of consultations, not to follow totally different paths which would make harmonization the more difficult in the future, when the issue is bound to come up. In countries with federal structures, it would especially be wise to consider adopting a common piece of legislation on the insurance contract.

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