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FURTHER OBSERVATIONS ON THE REVISED ESTONIAN DRAFT ON INSURANCE CONTRACT LAW

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FURTHER OBSERVATIONS

ON THE REVISED ESTONIAN DRAFT

ON INSURANCE CONTRACT LAW

Note n° 4[1]

Introduction

A further discussion of the new Estonian draft on the insurance contract inspired by the German VVG took place during our mission to Tallinn on June 3, 1996. Afterwards we received another version of the draft, dated July 30, 1996 and including further modifications.

The present note contains another series of observations following the above discussion and our examination of the latest version. It is intended to prepare a new mission to Tallinn, which is to take place on November 11-12, 1996.

This is obviously not a full analysis of this very elaborate, 173 paragraph-draft, since it is still basically the German VVG, a statute the qualities of which are well-known. We concentrate on the modifications brought to the model and to the other points which have been raised by us or the beneficiaries in our earlier papers and reunions. For a general discussion of the various aspects of importing a foreign piece of legislation, see our Observations of March 17, 1996.

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[1] Cf. *The insurance contract law draft of the Republic of Estonia. Some critical observations*, May 8, 1995, 22 pp. (note n° 1); *Observations on the new Estonian draft law on insurance contracts*, March 17, 1996, 10 pp. (note n° 2); *Observations on the revised Estonian draft on insurance contract law*, April 30, 1996, 8 pp. (note n° 3).

Definitions (§ 1)

- The definition of the *Versicherungsnehmer* in § 1 (2) is not fully adequate as the insurance sum or indemnity is sometimes paid not to the policyholder but to the beneficiary.

Also we feel the definitions of both parties, the insurer and the policyholder, should be conceived in a similar ways, which is not the case. The insurer is defined in (1) with a reference to the authorization given by the Versicherungsgesetz, while the insured, in (2), is defined in terms of the obligations that party undertakes.

Perhaps such definitions are not necessary. They are sufficiently implied in the definition of the insurance contract under (6).

- The risk is defined in (4) as the "probable" (*wahrscheinlich*) danger of the occurrence of the *Versicherungsfall.* We suggest the deletion of "probable". If the danger is really probable, it is not insurable any more. A better qualification would be to refer to the "uncertain danger" against which insurance is taken.

- The definition of the *Versicherungsfall* in (5) is unduly complicated. We feel it should be linked to that of the risk : the *Versicherungsfall* is simply the occurrence of the insured risk.

Mandatory provisions (§ 3 (1) and (2))

- The system of § 3 (1) is that certain provisions may not be deviated from to the disadvantage of the policyholder. *A contrario,* such rules may be contractually modified in a way more favorable to the policyholder, and all other provisions may freely be deviated from. This leaves freedom of contract as the principle.

Recent legislation on the insurance contract in Western Europe, on the contrary, often rule that all legal provisions are mandatory, except where the law provides otherwise (see e.g. the Belgian law, art. 3).

One criterium for choosing one system or another is whether or not the majority of provisions will be mandatory. In the Estonian draft, it seems that mandatory paragraphs will still be the minority.

- A thourough examination of the choices made could not be made in such a short time. It would imply a careful analysis of each single provision, often with the need to have first hand experience of the

situation and practices in the Estonian market. We will restrict our comments to four observations :

> The paragraphs enumerated in § 3 have been justifiably included in the list of mandatory provisions.

> We feel several other provisions should have been included, such as §§ 7, 10, 11, 18, 31, 33, 66-67 and 147. In many cases, the benefit of a carefully drafted consumer-oriented provision will be lost if freedom is left for insurers to deviate from it in their contracts.

> In some cases, the rules involved are even linked to public policy, and no deviation at all should be allowed. § 69, for instance, which is not even included in the list of § 3, simply cannot tolerate any deviation insofar as it excludes the coverage of intentional loss (on the other hand, it is adequate to keep it not mandatory for gross negligence; see below).

> We suppose it is clearly implied that no deviation is possible to the rules benefiting third parties such as mortgage creditors (however, only §§ 110-115 are listed in § 3, not § 107-109) or victims in liability insurance (e.g. § 133a).

Transport insurance (§§ 2-3)

- Marine insurance is no longer excluded in general, but only insofar as there would be other specific provisions (§ 2). This is a good solution that prevents marine insurance to have to face a legal vacuum.

- Transport insurance for goods remains immune from restrictions to contractual freedom (§ 3 (3), 1°). This is acceptable in general, but perhaps not for insurance of goods belonging to simple consumers, such as in removal and luggage insurance.

Laufende Versicherung (§ 3 (3), 4°)

- We state again that we do not see the purpose of such an exclusion (see Note n° 3, p. 3).

Insurance policy - documents pertaining to the conclusion of the contract (§§ 5, 7, 9, 10)

- We state again that we find it regrettable that the insurance contract should not be evidenced by a policy signed by both parties and assembling all contractual documents, but by the combination of different documents issued successively and unilaterally (Note n° 3, pp. 3-4).

Payment by the insurer (§ 18)

- The addition in § 18 (1) is to be approved, according to which the payment is due when the insurer has not responded within one month to the policyholder's enquiry as to why the investigation is not yet finished. This provision, however, should be mandatory.

Limitation of claims (§ 19)

- We have no objection to the changes made in the time limit for life insurance.

- For clarity's sake, the third sentence added to (1) should perhaps better be included in (2).

Insurer's bankruptcy (§ 20)

- Is the *Versicherungsgesetz* the law on supervision of insurance companies ?

Risk description (§§ 23-27)

- In line with the suggestion we had made in our Observations of March 17, 1996 (p. 9), more flexibility has been added to the consequences of lack of adequate risk description with the inclusion of a possibility of contract adaptation besides rescission (§§ 23-27), as well as with a system of proportional reduction of the indemnity in case of loss occurrence (§ 27).

- However we wonder about the respective consequences of the policyholder's intentional or non-intentional failure to describe the risk. It would seem that intentional failure should be severely

treated (rescission, refusal to cover) and the added flexibility should be reserved to non-intentional failure.

This does not always seem to be so. In the case of *arglistig* non-disclosure, § 23 (2) allows the insurer only to demand adaptation of the contract, except in the circumstances expressed in the last sentence. Adaptation is excluded by § 23 (3) if there was no fault on the policyholder's part (but § 48 provides for premium increase in such circumstances; how are the two provisions to be understood together ?). The rule in § 27 (2) combined with that of § 23 (2) seems to imply that a loss occurred before the insurer has asked for adaptation or rescission is to be proportionally covered in case of fraudulent misrepresentation !

Risk increase (§§ 28-36)

- Here again our suggestion to add more flexibility by providing fo contract adaptation besides termination and introducing a system of proportional reduction of the indemnity (Observations, p. 9; Note n° 3, p. 4) has been taken into account.

- The combination of §§ 30 and 33 is not absolutely clear to us. The former paragraph deals with the case the risk has been increased without the insurer's consent (§ 28) or the increase has not been notified (§ 29); then the insurer may rescind the contract (§ 30). On the other hand, § 33 (1) enables the insurer to demand adaptation of the contract or to rescind it if such adaptation is refused. Have §§ 30 and 33 the same scope of application ? Then they should perhaps be put together in the same paragraph. It seems that § 30 is only applicable when §§ 29 or 29 have been violated. The first sentence of § 33 (1) seems to be a rule of general application, while the second sentence of the same provision is limited to the case when the risk increase was independent from the policyholder's control. This is rather confusing.

In case a loss occurs before the contract is adapted or terminated, § 31 is applicable. However, this provision refers to violations of §§ 28 and 29, i.e. the situations covered by § 30. What are the applicable rules if a loss occurs in the circumstances covered by § 33 ?

- § 31 provides that if a loss occurs, the insurer has in principle to cover it *in der Umfange der Gefahrerhöhung*, a proportional reduction. However, in the case of § 31 (1), no reduction takes place when the breach was not imputable to the policyholder (unhappily,

this is not mandatory). This seems to imply that there will be proportional coverage in the case of fraudulent breach. Here again, as much as we approve less harsh remedies towards faulty policyholders, we think the law should be extremely severe with fraudulent behaviors.

- In the title of § 33, the word *Versicherers* should probably be replaced by *Versicherungsnehmers.*

Obliengenheiten (§ 38 - also § 11)

- The mandatory rule in § 38 (2) is a positive addition to the VVG. It adequately limits the possibility of excessive remedies.

It should be made clear that § 38 is special rule that deviates from § 11, a provision that also concerns *Obliegenheiten*, the more so as regretably in our view, § 11 is not mandatory.

Notice of loss occurrence (§§ 39-40)

The modifications introduced about notice of loss occurrence are also very satisfactory. An obligation to notify is also imposed on the beneficiary (§ 39) and the remedies have lost their excessive harshness (§ 40, a mandatory provision).

Payment of the premium (§§ 41-49)

- We find the rule in § 41 (3) very unfair. It is true that it is already corrected in many cases by the rule of § 47.

- According to § 44, the premium has to be paid at the insurer's office, which is extremely inconvenient for the policyholder, and out of line with contemporary means of payment.

The German VVG § 36, according to which the premium is to be paid at the policyholder's domicile, already gives a much better rule. However, it has become very rare, in Western countries, that the premium is paid in cash at any place.

Payment normally occurs through a bank transfer, or the sending of a cheque. The rule should then be that the insurer is obliged to send the policyholder an invitation to pay before the beginning of each insurance period, and that payment will be done according to

the modality agreed between the parties, which cannot oblige the policyholder to bring his payment to the insurer's office.

- The addition brought to § 46 (2) is a very good rule (coverage of a loss occured after expiry of the deadline given to pay the premium due, if the delay is not imputable to the policyholder).

- We have the same favorable comment concerning the addition to § 49 (premium eduction in case of durable risk decrease).

Indemnification in kind (§ 56)

- In answer to a question put to us, we had recommended to deviate from German VVG § 49 in order to allow for indemnification in kind. This has been done properly (§ 56).

Excluded risks (§ 58)

- Unlike most other laws, the German VVG has no general provision excluding insurance coverage in case the loss is caused by natural catastrophes, war or similar events, but only § 84 in the title on fire insurance. An earlier version of the Estonian draft followed the VVG example; we suggested to deviate from it during the meeting we had in Tallinn on June 3, 1996.

This is done by the inclusion of former § 92 between §§ 57 and 59 (the § number still has to be changed). The text is still the same as it was the title on fire insurance; it refers to fire and explosion risks. It should be amended to refer more generally to the occurrence of the insured risk instead.

Two other suggestions: first, replace "earthquakes" by "natural catastrophes"; second, delete the reference to declaration of war and cover all types of war, including civil war.

Overinsurance (§ 62)

- Is § 62 (3) necessary (no prejudice to the general rules on mistake) ?

Agreed value (§ 64)

- Our suggestion (Note n° 3 pp. 5-6) to delete § 64 (3) has been followed.

Coinsurance (§ 68)

- This useful provision could be complemented with a rule on the mission of the leading insurer (see for instance the Belgian law of 1992, art. 28).

Exclusion of gross negligence (§ 69)

- We had commented on the diversity of attitude of the different legal systems towards the exclusion of gross negligence (Observations, p. 10). An earlier version of the draft had discarded the exclusion of gross negligence. We see that it has been reintroduced. This is not in line with contemporary trends, but perhaps it is a better solution in a developing insurance market.

Since this provision is not mandatory, it will not prevent insurers from offering gross negligence coverage if it is felt to be advisable.

- About the non-mandatory character of this provision insofar as it applies to intentional loss, however, see above in the comments of § 3.

- Why is the basic rule of insurance law enacted in § 69 limited to damage insurance ? It should be a provision common to all types of insurance, to be included in the section currently covering §§ 1-49.

Mitigation of damages (§§ 70-71)

- The remedy provided in § 70 (3) is very adequate, in line with rule in § 40, and we approve its mandatory character. However it should replace § 70 (2) instead of being added to it. The two provisions are incompatible.

- According to § 71 (2), mitigation costs are to be reimbursed by the insurer even when together with the indemnity they go beyond the insured sum. This is a favorable solution for the insured, but it may prove very costly for insurers. In Belgium, this is also the basic

solution of art. 52 of the law of 1992, but insurers have successfully pleaded for the introduction in 1994 of limits to the coverage of salvage costs in certain lines of insurance.

Changes before loss assessment (§ 72)

- The remedy in § 72 (3) is in line with the softer remedies provided in several other paragraphs. Its relationship with § 72 (2) should be clarified. Perhaps start with (3); and add that however, in case of fraud, there will be no coverage at all.

Experts (§ 74)

- The new rule of § 74 (1) is excellent.

Subrogation (§ 76)

- We also feel the new version of § 74 (3) is an improvement on the earlier version.

Insurer's preferential rights (§ 77a)

- Another positive addition.

Notice of transfer of insured property (§ 80)

- The amendment provided in § 80 (2) is also rightly in line with the softer remedies provided in several other paragraphs.

Transfer of insured property by law (§ 82a)

- Adequate clarification.

Versicherung zugunsten eines Dritten (§§ 83-88)

- Some aspects of these provisions had been discussed in our Note n° 3, pp. 6-7. We approve the deletion of § 85, which could have brought too much insecurity in some commercial applications.

Fire insurance (§§ 89-116)

- § 89 (2) corresponds to a suggestion we had made in Note n° 3, p. 8. It is possible that there will be problems of interpretation about the notion of "similar risks", but it is the price to pay for the needed flexibility.

- §§ 94 and 96 state the basic rule that the insured value should be determined after deducting depreciation. This is the normal consequence of the indemnitary character of property insurance.

However *Neuwertversicherung*, i.e. coverage for a value that does not deduct depreciation, has become common at least in some countries, under certain conditions. Should not the Estonian law explicitly provide for such possibility (comp. the Belgian law of 1992, art. 53) ? We realize it is not excluded since §§ 84 and 96 are not mandatory.

- An interest rate of 6 % is provided by § 102. Since the level of interest rates is due to fluctuate over the years, it might be preferable to state that the rate to be charged will be determined by Decree.

Liability insurance (§§ 126-144)

- According to § 126, the insurer is obliged to cover the insured's liability deriving from *"facts occurred during the insurance period"*. This is a choice for the so-called *"occurrence basis"* type of coverage, as opposed to *"claims-made policies"*, nowadays the subject of so much discussion in many countries.

The rule in § 126 obliges the insurer to cover claims that may appear after expiry of the contract, sometimes many years afterwards (as in some cases of environmental, product or medical liability), provided they are related to a fact occurred during the contract (e.g. toxic waste was dumped at that time, but it took several years for some damage to appear, and still more time till a claim was made).

Claims-made policies, on the other hand, only cover claims introduced during the period the policy was in force. It considerably reduces the insurer's exposure to liability risks.

This is an important problem, which has brough specific legal developments in recent years in countries like France, Spain and Belgium.

A policy decision must be made, whether to leave it to freedom of contract (this apparently is the case with § 126, which gives a principle solution, but does not prevent contractual deviations : this provision is not included in the list of § 3 (1)), or to restrict the use of claims-made policies in a mandatory way, art least for consumer contracts (see the Belgian law of 1992, as modified in 1994, art. 78).

- The rules of this subtitle do not provide for the insurer's conduct of the litigation against the claimant, which is a typical feature of liability insurance in some countries. Following the VVG model, they only provide for coverage of the legal costs (§ 127). This approach should be examined in the light of the practices (or intents) of Estonian insurers.

- According to § 127 (3), legal costs and interests are covered even when together with the indemnity they go beyond the insured sum. This is a favorable solution for the insured, but it may prove very costly for insurers. In Belgium, this is also the basic solution of art. 82 of the law of 1992, but insurers have successfully pleaded for the introduction in 1994 of limits to the coverage of legal costs and interests in certain lines of insurance (compare above, a similar problem concerning § 71).

§ 127, however, is not mandatory.

- § 131 is a modified version of German VVG § 154. The difference is that it provides for the unlimited nullity of the clause which would allow the insurer to refuse coverage if the insured has indemnified the victim without the insurer's consent (in the German VVG, the nullity is discarded when the insured could not have refused such payment without manifest unfairness).

We are very reluctant about such a solution. In liability insurance the insurer's and the insured's interests are closely linked. One should by all means counter any temptation of the insured to be overly generous with the victim on the assumption that it will not cost him anything since he is insured. Our suggestion would be to keep the German solution, as it has been done with the other clause covered by § 131.

- We had pointed out that the German VVG does not grant the victim a direct action against the liability insurer, except in motor

TPL insurance, and suggested the Estinian law could take that step (Observations, p. 10).

This has not been followed. § 133a raises to the level of liability insurance in general some rules that the German VVG restricts to compulsory insurance (§ 158c), but the final (6) of that provision clearly excludes any direct claim. This may be regrettable as it seems bizarre, from the view of a comparative lawyer, to restrict the insurer's defenses against someone who does not have a claim against him (but apparently it works in Germany).

The law should probably include a provision concerning the organization of the *zuständige Stelle* and the determination of the minima mentioned in § 133a (2) to (4).

One should be aware that the limitation of the liability insurer's obligations contained in § 133a (5), coming from the German law, will add to the costs of property insurers and social security institutions, which otherwise would be subrogated against the liability insurer.

- The possibility to cancel the insurance contract after a loss occurrence is now provided in general in § 14a. Is it necessary to keep a specific provision on the same subject in liability insurance (§ 135), whereas the corresponding provision has been deleted in fire insurance (formerly § 104) ?

Life insurance (§§ 145-165)

- After three years the insurer may not invoke the policyholder's initial failure to disclose certain circumstances (§ 150). Such a rule is traditional in life insurance, but the case of fraud should be excepted. It is the case in the German VVG § 163, and we feel that this should not have been deleted.

- We have the same remark about § 151, concerning risk increase. The amnesty granted after three years should not apply in case of fraud; see the German VVG § 163.

- According to § 154 (4), if the policyholder has waived its right to change the beneficiary, it may not do so any more after the beneficiary has expressed its intent to take the benefit. Does it mean a policyholder who has not waived that right may still change the beneficiary even though the latter has accepted the benefit ?

This should be decided in accordance with general Civil law principles on stipulations to the benefit of third parties.

The expression *"nach der Art"* in the second sentence of § 154 (3) should probably be linked to the new rule in (5).

- Two provisions concern the case when the policyholder becomes bankrupt : §§ 155 and 165. They should perhaps appear in direct sequence and one has to be sure they are well coordinated.

In the light of rules applicable in some countries, it may be surprising that the beneficiary is affected by the policyholder's bankruptcy. One advantage of a stipulation to the benefit of a third party is that the beneficiary acts under its own rights, so that the policyholder's creditors have no claim on the benefit (see for instance the Belgian law of 1992, art. 125 and 126). Here again, it all depends on the general Civil law principles on stipulations to the benefit of third parties, which may be different in Estonia.

- Concerning suicide, the German VVG § 169 chooses to cover it when it results from a state of pathological disturbance of the mind. Other countries have preferred to cover suicide occurring a certain time after conclusion of the contract. § 158 of the Estonian draft combines both systems, with the effect that the German-inspired rule will be applied in the first two years. This is a possible solution. One should however point out that the second system has been introduced in some countries because of the great difficulty to prove the circumstances under which the suicide has taken place.

The same provision contains a paragraph (2) which excludes coverage if the death is the consequence of capital punishment. If Estonian criminal law does not provide for the death penalty, this provision may still be useful as such punishment still exists in some parts of the world.

- The requirement that notice of the occurrence of the insured event is given within three days (§ 160) seems to be much too strict. When the insured person dies, the emotional and practical problems faced by the beneficiary will very often prevent it from making that extremely short deadline. Besides, the beneficiary may not even know of the death before some time, and it may also be that it is not aware of the existence of the benefit in its favor. We suggest that notice must be given by the beneficiary within a reasonable period (one month ?) after it is aware of the death and of the existence of the life insurance benefit in its favor.

From the insurer's viewpoint, there is really no special reason for such a rush.

- The reference to § 46 in § 162 (1) seems to be inadequate. In life insurance, the policyholder may decide to stop paying the premiums at any time, converting its contract to paid-up insurance or asking for surrender of the contract. This is an original system, where the rules governing faulty failure to pay the premiums should not be applicable.

Accident insurance (§§ 166-173)

- This last title raises a general question about the whole draft.

Insurance contract law is traditionally divided between damage insurance, where the insurer pays an indemnity, and sum insurance, where the insurer pays a pre-determined capital or annuity. Property and liability insurance belong to the first category, while life insurance is the main application of the second type.

Damage insurance is characterized by several specific rules that are corollaries of the indemnity principle, such as the rules on over-insurance, multiple insurance and subrogation. Such rules do not apply to sum insurance.

Accident insurance was traditionally considered as sum insurance. However, more recently, forms of accident insurance conceived on an indemnitary basis have also appeared. Some recent laws have taken that phenomenon into consideration when arranging the different categories of insurance (see our Observations, p. 10).

Where does the Estonian draft stand in connection to such basic questions ?

The definition of insurance in § 1 (6) distinguishes between cases where the insurer indemnifies a damage and events, linked with human life, where the insurer pays sum or an annuity. This is inspired from the German VVG § 1 (1), except that the Estonian text apparently limits sum insurance to life insurance, whereas the German law extends it to life, accident and other types of insurance of persons.

Later, the Estonian draft develops a full section on damage insurance (§§ 56-144), starting with general rules (including the

specific rules mentioned above : over-insurance, multiple insurance and subrogation), followed by provisions on some particular types of insurance : fire, transport and liability. The following section concerns insurance of persons (§§ 145-173). It does not have a general part as it immediately deals with two types of insurance, life and accident.

The lack of general provisions concerning insurance of persons can be understood. This silence implies that *a contrario* , the rules governing damage insurance do not apply to insurance of persons. This is certainly the case for life insurance.

However, the principles governing accident insurance are made unclear. At first sight, their location in the section of insurance of persons, next to life insurance, would imply that they have the nature of sum insurance. But as explained above, the change made by the Estonian draft in the definition of insurance seems to restrict sum insurance to life insurance.

Where does accident insurance then stand ? The definition of § 1 seems to place it with damage insurance, but its location in the draft implies it is subject to the other regime.

This should absolutely be clarified, in the light of the practice described above according to which modern accident insurance can be of either kind.

Prof. M. FONTAINE
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