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# Do the Principles of European Insurance Contract Law Go Too Far in Protecting the Policyholder?

## 1. Introduction

One of the purposes of the European Union (hereinafter referred to as the EU) is a functioning uniform internal market. However, a common market is largely based on contract law. The EU contains 27 different contract laws, making cross-border activity complicated and expensive. The European Commission is about to develop the Common Frame of Reference (hereinafter referred to as the CFR) for European contract law, one part of which is to cover insurance contracts (in the Principles of European Insurance Contract Law<sup>1</sup>—hereinafter referred to as the PEICL<sup>2</sup>). The 1.7.2010 Green Paper from the European Commission on policy options for progress toward a European contract law for consumers and businesses<sup>3</sup> was presented for public discussion with the aim of consultation concerning the possibilities for further developing the field of European contract law. In its Green Paper, the European Commission in essence proposes seven approaches for improving the coherence of European contract law, including an optional European Contract Law (i.e., the ‘28th regime’<sup>4</sup> or the ‘second regime’), which would be an optional instrument for consumers and undertakings to apply in their contractual relationships.<sup>5</sup> This optional right would be an

<sup>1</sup> Principles of European Insurance Contract Law: Project Group ‘Restatement of European Insurance Contract Law’, Common Frame of Reference. Chapter III, Section IX1. Insurance Contract. Available at <http://restatement.info/cfr/Draft-CFR-Insurance-Contract-17122007-FINAL.pdf> (1.3.2011).

<sup>2</sup> The general part (I part) and the non-life insurance part (II part) of the PEICL were first published and presented to the European Commission in December 2007, the III and the IV part are not complete yet, but will include life insurance and civil liability insurance (Project Group ‘Restatement of European Insurance Contract Law’. Available at <http://www.restatement.info/> (1.3.2011).

<sup>3</sup> European Commission, COM(2010)348 final. Available at <http://eur-lex.europa.eu/Notice.do?mode=dbl&lang=et&lng1=et,en&lng2=bg,cs,da,de,el,en,es,et,fi,fr,hu,it,lt,lv,mt,nl,pl,pt,ro,sk,sl,sv,&val=518792:cs&page=1&hwords=Euroopa+lepingu%C3%B5iguse+loomise+v%C3%B5imalused+tarbijate+ja+ettev%C3%B5tjate+jaoks%7E> (1.3.2011).

<sup>4</sup> ‘Internal’ Contract Law of the 27 Member States vs. the 28th regime, that is, a 2nd regime for all Member States. The European optional procedure will become a part of the national law of the Member States similarly to other sources of the European law. The 2nd regime would give the parties an opportunity to choose between two regimes of national contract law, one of which is being enforced by the legislator of the Member State and another by the European legislator. This is an alternative to traditional approximation of legislations.

<sup>5</sup> Also see the opinion of the European Economic and Social Committee on ‘28th regime—an alternative allowing less lawmaking at Community level’ (own-initiative opinion). – OJ C 21, 21.1.2011, p. 26.

alternative to the national contract laws in force. Specialists in European insurance law have found that the 28th regime idea should be guided from within the field of insurance law<sup>6</sup>; a similar conclusion was stated in the European Economic and Social Committee's opinion on the European Insurance Contract.<sup>7</sup> The Green Paper solicited 319 distinct positions in the course of public consultations.<sup>8</sup> As to the answers given in relation to the questions on the PEICL presented for the Green Paper, it may be assumed that the central issue from the point of view of the insurance sector is not whether to support the optional instrument and whether it should be applied to B2B and/or B2C contracts but whether the PEICL protects the consumers/policyholders too radically<sup>9</sup> and whether a win-win situation is involved. The objective of this article is to analyse the PEICL with respect to the question of whether the policyholder is protected too radically, studying the differences of the PEICL from the regulation of insurance contracts<sup>10</sup> in the Estonian Law of Obligations Act<sup>11</sup> (hereinafter referred to as the LOA). On account of the question asked in the title of this piece and in view of criticism of the PEICL by some of the European interest groups, the author limits this analysis in accordance with the norms of the PEICL that are more beneficial to the policyholder than is the regulation of the LOA.<sup>12</sup>

## 2. Pre-insurance-contract legal relationships

### 2.1. The pre-contractual information duty of the policyholder

There are two main ways to regulate the pre-contractual information duty in insurance contracts:

- 1) the insurer shall present a questionnaire to the policyholder and the policyholder answers all of the questions;
- 2) the policyholder shall inform the insurer of everything relevant.<sup>13</sup>

<sup>6</sup> J. Basedow, J. Birds, M. Clark *et al.* Principles of European Insurance Contract Law (PEICL). Sellier European Law Publishers 2009, p. lxi. Also see the opinion of the Project Group 'Restatement of European insurance contract law' on the Green Paper. Available at [http://ec.europa.eu/justice/news/consulting\\_public/0052/contributions/284\\_en.pdf](http://ec.europa.eu/justice/news/consulting_public/0052/contributions/284_en.pdf) (8.6.2011).

<sup>7</sup> OJ C 157, 28.6.2005, p. 1.

<sup>8</sup> European Commission. Available at [http://ec.europa.eu/justice/news/consulting\\_public/news\\_consulting\\_0052\\_en.htm](http://ec.europa.eu/justice/news/consulting_public/news_consulting_0052_en.htm) (8.6.2011).

<sup>9</sup> German Insurance Association, European Financial Services Round Table and Allianz SE find in their response to the Green Paper in supporting the idea of PEICL that since PEICL is not based on a win-win situation and protects the policyholders too radically, it needs further development (available at [http://ec.europa.eu/justice/news/consulting\\_public/0052/contributions/163\\_en.pdf](http://ec.europa.eu/justice/news/consulting_public/0052/contributions/163_en.pdf) (8.6.2011), <http://www.efr.be/documents%5Cpublication%5C72.2011.02.%20EFR%20signed%20letter%20on%20European%20Contract%20Law%2031.01.2011.2011.pdf> (8.6.2011) and [http://ec.europa.eu/justice/news/consulting\\_public/0052/contributions/7\\_en.pdf](http://ec.europa.eu/justice/news/consulting_public/0052/contributions/7_en.pdf) (8.6.2011)). However, the Belgium Consumer Protection Board has pointed out that in comparison with the Belgian law, PEICL has advantages in only four issues, whereas in 16 issues the national law protects the consumer better (H. Heiss, M. Lakhan. Principles of European Insurance Contract Law: A Model Optional Instrument. Sellier European Law Publishers 2011, p. 96).

<sup>10</sup> Although the number of actions against insurers filed to courts of first instance is not high, the insurers tend to lose the disputes in litigations. In accordance with the judicial decision registry held by the Ministry of Justice of the Republic of Estonia (available at <http://www.kohus.ee/kohtulahendid/index.aspx> (10.6.2011)) and the specifying request for information submitted by the author to the Ministry of Justice (the author possesses the 9.6.2011 reply), the insurers won 28% of the cases in relation to the proceedings of the court of first instance in 2009, and on 72% of the cases, the policyholders won (also including the compromises made during the judicial proceedings, i.e., situations in which the position of the policyholder improved as a result of the judicial proceedings; the statistics does not include the actions by the policyholders that the court did not accept due to judicial shortcomings by the plaintiff). In 2010, 16.66% of the solutions were positive for the insurers and 83.34% to the policyholders. In 2009, the number of actions against the insurers increased by 7.5% in comparison with the previous year, and in 2010, this rate was 23.25%. In 2009, 43 actions were filed against the insurers and 42 decisions made, in 2010, 53 actions were filed and 39 decisions made.

<sup>11</sup> In Estonia, insurance contracts are regulated by Chapter 4 of the Law of Obligations Act (Võlaõigusseadus. – RT I 2001, 81, 487; RT I, 8.7.2011, 6 (in Estonian)). In English, the wording of 2009 is available at <http://www.legaltext.ee/et/andmebaas/tekst.asp?loc=text&dok=X30085K3&keel=en&pg=1&ptyyp=RT&tyyp=X&query=v%F51a%F5jigusseadus> (10.6.2011).

<sup>12</sup> There are situations in which the LOA is more beneficial to the policyholder than the PEICL, but they are not as relevant to the regular policyholder—i.e., the LOA does not enable to not return the insurance premium, unlike Article 2:104 of the PEICL; according to the LOA, the parties may also conclude an insurance contract for an unspecified term. The LOA (§§499–504) is also more beneficial in protection of the mortgagee's rights than the PEICL. There are also norms in which it is debatable which regulation is more beneficial to the policyholder.

<sup>13</sup> The difference between these two regulations lies in the party that should bear the risk for ascertaining all of the relevant circumstances as to the insurance contract.

According to Article 2:101 (1) of the PEICL, the applicant, when concluding the contract, shall inform the insurer of circumstances of which he is or ought to be aware, and which are the subject of clear and precise questions put to him by the insurer.<sup>\*14</sup> Therefore, the PEICL prefers the person responsible to be the insurer. The objective of the PEICL regulation is to present an insurer with a right to ask for information on the circumstances of risk and to decide either to enter into an insurance contract or to decline it on the basis of the information given.<sup>\*15</sup> The selection of the question method stipulated in Article 2:101 is mostly explained by the fact that it is considerably more difficult for a policyholder to assess what kind of information is relevant in evaluation of insurance risk. Imposing an obligation on the insurer to ask clear and precise questions is more likely to reduce unnecessary transaction costs and rule out later disputes between the insurer and a policyholder. Therefore, in present insurance practice, the method of asking questions is more deep-seated than the so-called own-initiative rule that was a valid law in most European countries until recently.<sup>\*16</sup>

In Estonia, according to the LOA's §440 (1), upon entering into a contract, the policyholder shall inform the insurer of all circumstances known to the policyholder that, on account of their nature, may influence the insurer's decision to enter into the contract or to enter into the contract on the agreed terms (material circumstances). Material circumstances are presumed<sup>\*17</sup> to be circumstances concerning which the insurer has directly requested information in a format that can be reproduced in writing.

The biggest difference between the PEICL and the relevant part of the LOA's regulation is that in the Law of Obligations Act, the own-initiative rule has been chosen and the LOA covers only information that is known to the policyholder, whereas in the PEICL, information that is known or should be known to the policyholder is also important.<sup>\*18</sup> The author considers the PEICL approach preferable, since the so-called own-initiative rule brings about too many disputes in practice, because the policyholder may not always know of what the insurer needs to be informed.

Article 2:102 of the PEICL specifies that when the policyholder is in breach of the duty to inform, the insurer shall be entitled to propose a reasonable variation of the contract or to terminate the contract. To this end, the policyholder has a right to reject the proposal within one month after receipt of the notice. In the latter case, the insurer shall be entitled to terminate the contract within one month. As a rule, the right of withdrawal is limited in the PEICL to only cases of a wrongful breach. However, the PEICL also provides a right of withdrawal if the insurer is able to prove that it would not have concluded the contract if it had known the information concerned.

According to the LOA, providing wrongful information on the material circumstances has two consequences. If a policyholder has wrongfully violated the obligation to inform, the insurer may withdraw from the contract (LOA §441 (1)). If the violation of the obligation to notify on the part of the policyholder is not due to the fault of the policyholder, the law (LOA §460) provides that the insurer has a right to increase the insurance premium.<sup>\*19</sup>

Therefore, there are two main differences between the LOA and the PEICL regulation. Firstly, the LOA—unlike the PEICL—does not enable the insurer to demand changing of the insurance premium (i.e., changing of the contract) if the policyholder has wrongfully violated its duty to inform. Secondly, the LOA does not provide a right of withdrawal if the insurer is able to prove that it would not have concluded the contract had it known the information concerned. The author holds that the LOA's strict and favourable regulation with regard to termination of the contract is not justified by any means, nor is it in the best interests of either of the parties to the contract.<sup>\*20</sup>

<sup>14</sup> J. Basedow *et al.* (Note 6), p. 77.

<sup>15</sup> *Ibid.*

<sup>16</sup> *Ibid.*, p. 78.

<sup>17</sup> In legal literature, it has been found that in the LOA, a middle ground between two extreme regulations has been found: on one side, the policyholder shall inform the insurer on his own initiative of all circumstances known to the policyholder which are relevant in the terms of entering into the agreement, on the other, he must inform of the circumstances on which the insurer has directly requested information. See J. Lahe. *Kindlustusõigus* (Insurance Law). Tallinn 2007, p. 48 (in Estonian).

<sup>18</sup> However, the author holds that a position should be taken that this difference is merely apparent, since according to the Law of Obligations Act, a negative consequence is only brought about by informed behaviour (LOA §441).

<sup>19</sup> The condition for the right of increasing the insurance premium is that the insurer has no right to withdraw from a contract in relation to wrongful violation of the obligation to notify by the policyholder.

<sup>20</sup> The insurer should be able to choose in each separate case in accordance with the gravity of the violation of the policyholder, whether it wishes to withdraw from the contract or it is possible to continue with the contract by increasing the insurance premium. Exclusion of the request to change the insurance premium in case of wrongful violation leads to termination of

If a policyholder violates the pre-contractual obligation to inform and this is discovered after an insured event, the insurer has a right under §442 (2) of the LOA to withdraw from the contract on the basis specified in §441 of the LOA also after the insured event has occurred. However, the insurer is not freed from its obligation to fulfil the contract if the circumstances in relation to which the information was not provided had no bearing on the occurrence of the insured event and do not preclude or restrict the validity of the insurer's performance obligation. The second sentence of the LOA's §442 (2), considering assessment of exclusion or limitation, provides that, among other things, account shall be taken also of the ratio of the insurance premiums paid to those insurance premiums that should have been paid if information concerning the circumstances had been provided.<sup>\*21</sup>

When one is contrasting §442 and §460 of the LOA with the PEICL's Article 2:102 (5), it can be concluded that withdrawal from the contract by the insurer due to the policyholder's violation of the duty to inform and also obligation to pay insurance premiums in the situation in which an insured event has taken place are almost identical.

Article 2:104 of the PEICL regulates the situation in which an insurer has been led to conclude the contract by the policyholder's fraudulent breach of the pre-contractual duty to inform. The PEICL does not directly define fraudulent behaviour, and the comments refer to Article 4:107 (2) of the Principles of European Contract Law<sup>\*22</sup> (hereinafter referred to as the PECL), according to which a party's representation or non-disclosure is fraudulent if it was intended to deceive.<sup>\*23</sup> According to Article 2:104, an insurer has as many as three ways to respond to fraudulent violation. The first of these is to do nothing and let the contract continue. The second and third derive from Article 2:101 and enable the insurer to change the contract (and withdraw from the contract if it fails) or to withdraw from the contract. It is worth emphasising that the PEICL does not demand that the contract be invalid and gives the insurer an opportunity to decide whether it wishes to withdraw from the contract or would rather give preference to an increase in the insurance premium. If the insurer wishes to withdraw from the contract, this is done retroactively and presents the parties with an opportunity to demand reversal of decision.<sup>\*24</sup> Nevertheless, the PEICL's Article 2:104 deviates from the PECL regulation from the point of reversal of decision and maintains the insurer's right to keep those insurance premiums already paid and to demand payment of the insurance premiums due.<sup>\*25</sup> Provision of said right has been justified by a need to prevent fraudulent behaviour and not let insurers develop the following way of thinking: 'If the fraud succeeds, I'll benefit and if it doesn't, I'll lose nothing (except in the case in which no insured event has taken place).' Fraud that had no influence on the decision of the insurer (because the information was irrelevant or the insurer was aware of its incorrectness) also has no consequences.<sup>\*26</sup> No situation similar to the one of Article 2:104 of the PEICL has been regulated in the Law of Obligations Act; only §441 (5) of the LOA refers to the right of the insurer to terminate the contract due to deception on the basis of §94 of the General Part of the Civil Code Act. The author holds that this rigid regulation of the LOA, favouring termination of contract and not enabling the insurer still to offer insurance cover to the policyholder, is also not justified.

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the contract by the parties. The author holds that the law should rather direct the parties to continue with the contract on different terms. The PEICL enables that. This is why the PEICL should be preferred in this situation, wherefore it enables the insurers to adequately react to the material circumstances. A change has also been made to the Switzerland's new Insurance Contract Act, enabling the insurer to choose on the basis of the circumstances whether it wishes for a contract to be terminated or the insurance premium to be increased and the contract continued on new terms. See F. Hasenböhler. Pre-contractual Obligation to Provide Information under Private Insurance Law, p. 118. Available at [http://www.kpmpg.ch/en/docs/20080505\\_Pre-contractual\\_obligation\\_to\\_provide\\_information.pdf](http://www.kpmpg.ch/en/docs/20080505_Pre-contractual_obligation_to_provide_information.pdf) (3.1.2011).

<sup>21</sup> P. Varul *et al.* *Võlaõigusseadus II. Kommenteeritud väljaanne* (Law of Obligations Act. Commented Edition). Tallinn 2007, p. 479 (in Estonian).

<sup>22</sup> Principles of European Contract Law. Available at [http://frontpage.cbs.dk/law/commission\\_on\\_european\\_contract\\_law/PECL%20engelsk/engelsk\\_partI\\_og\\_II.htm](http://frontpage.cbs.dk/law/commission_on_european_contract_law/PECL%20engelsk/engelsk_partI_og_II.htm) (1.3.2011).

<sup>23</sup> J. Basedow *et al.* (Note 6), p. 89.

<sup>24</sup> This right is provided in Article 4:115 of the PEICL.

<sup>25</sup> H. Cousy. The Principles of European Insurance Contract Law: Duty of Disclosure and the Aggravation of Risk. – ERA-Forum, September 2008, Vol. 9, No. 0, p. 130.

<sup>26</sup> J. Basedow *et al.* (Note 6), p. 90.

## 2.2. The policyholder's pre-contractual duty to warn

According to Article 2:202 of the PEICL, the insurer shall warn the applicant of any inconsistencies between the cover offered and the applicant's requirements of which the insurer is or ought to be aware. The insurer shall, analogously, warn the applicant that cover will not begin until the contract is concluded, if he is or ought to be aware of the fact that the applicant mistakenly believes that the cover commenced at the time the application was submitted (Article 2:203). In both cases, not providing said warning may create a situation in which the insurer is responsible for all losses due to this violation and the policyholder has a right to terminate the agreement. The Law of Obligations Act has no such direct consumer-protecting regulation, and the author considers this to be a problematic issue in Estonian law. Article 2:502 of the PEICL states that if the terms of the insurance policy differ from those in the policyholder's application or any prior agreement between the parties, such differences in the later materials shall be deemed to have been given assent by the policyholder; unless he objects within one month of receipt of the policy, he is deemed to have accepted the changes. Section 436 of the LOA includes a similar regulation, but in Estonian law, the term for the policyholder's presentation of an objection is limited to 14 days.

## 3. Contractual legal relationships in insurance

### 3.1. The period of insurance

According to the PEICL, in Article 2:601, the duration of the insurance contract is one year (except for personal insurance); however, the parties may agree on a different period if indicated by the nature of the risk. The EU tries to avoid the US mistakes in which insurers conclude too many short-term contracts that enable them to change the insurance premium often.<sup>\*27</sup> An example of consideration of this 'nature of the risk' is travel insurance, which is generally shorter in duration, since the risk of an insured event taking place is set in a shorter time period than one year.

After the one-year period, the contract shall be extended according to the PEICL's Article 2:602 unless:

- the insurer has given written notice to the contrary at least one month before the end of the contract period stating the reasons for its decision or
- the policyholder has given written notice to the contrary by, at the latest, the day the contract period expires or within one month after having received the insurer's premium invoice, whichever date is later. In the latter case, the one-month period shall start to run only if it has been clearly stated on the invoice in **bold** print.

On the basis of §453 of the LOA, it is presumed that the insurance period is one year, but since this is a dispositive norm, the parties may agree on a shorter or a longer insurance period.

Therefore, according to Estonian law, insurers basically have an opportunity to enter into short-term-insurance-period contracts and, in so doing, change the insurance payments. However, short-term (i.e., with a term of less than a year) insurance contracts (excl. travel insurance) are not widespread, in the author's experience. When comparing the insurance period regulations of the LOA and the PEICL, the author holds that, both for consumer protection reasons and for purposes of optimising the expenses of the insurer, the PEICL regulation should be preferred. The corresponding regulation of the LOA does not impose a duty on the insurer to ensure constant control for the policyholder via constant insurance protection (in relation to the case of an automatically extended contract, the PEICL states that the client shall receive notification for the next period, or a declaration of cancellation, but according to the LOA, the insurer has no obligation to inform the client of the contract ending). This also damages mortgagees, since it has to check annually whether a policyholder has entered into a new contract. The interest of an insurer in the case of an automatically extended insurance contract may lie in cancellation of new pre-contractual negotiations and reduction of costs thereby.

<sup>27</sup> *Ibid.*, p. 142.

### 3.2. Withdrawal from an insurance contract after conclusion of the contract

According to the PEICL's Article 2:303, the policyholder shall be entitled to avoid the contract by giving written notice within two weeks after receipt of the insurance contract documents. This principle is not applicable to contracts that last one month or less, and to contracts that have been extended; also it pertains to certain particular types of contract (i.e., civil liability insurance, group insurance, and immediate insurance cover). LOA §433 (1) also provides a two-week withdrawal right for a policyholder. At the same time, the imperatively provided right of withdrawal in Estonian law is limited to contracts that last more than one year, and life insurance contracts. Therefore, the biggest difference between the PEICL and the LOA's regulation lies in the fact that the PEICL provides policyholders with a right to withdraw in two weeks also from contracts with a validity period of 31 days to one year. The corresponding regulation of the PEICL is based on Article 6 of Council Directive 2002/65/EC of the European Parliament and of the Council.<sup>\*28</sup> Although non-life insurance contracts of less than one year are not commonplace in Estonia (except in the field of travel insurance), the author holds that, for purposes of consumer protection, the Law of Obligations Act should be changed in relation to its discrepancy with Article 6 of Council Directive 2002/65/EC of the European Parliament and of the Council.

### 3.3. Payment of the insurance premium

In comparison of the Law of Obligations Act and the PEICL's regulation as to payment of periodic premiums, it becomes evident that the system currently in place in Estonia is formally more liberal from the insurer's point of view and more disadvantageous to the policyholder. Namely, the PEICL, in Article 5:102 (1), states that, as the first operation, the insurer shall issue an invoice stating the precise amount of the premium due as well as the date of payment and the place for payment; after the premium falls due, the insurer sends a reminder to the policyholder of the precise amount of premium due, granting an additional payment term of at least two weeks and describing the legal consequences of not making the payment, and once the additional period has expired without payment having been made, the insurer has a right to release itself from the obligation to fulfil the corresponding duties. The Law of Obligations Act does not require that an invoice be issued by the insurer. In practice, there have been cases in Estonia in which insurers present all subsequent premiums in one invoice and no separate invoices are issued for subsequent payments.<sup>\*29</sup> In the interests of legal clarity, the author holds that the PEICL regulation should be preferred.

Article 5:104 of the PEICL provides that if an insurance contract is terminated before the contract period has ended, the insurer shall be entitled to premiums in respect of only the part of the period prior to termination.<sup>\*30</sup> Section 459 of the LOA (in an imperative provision in accordance with §427 (1) of the LOA) provides that if a contract is terminated prematurely during a term of insurance by cancellation or withdrawal or for any other reason, the insurer is entitled to only those insurance premium for the time up to the termination of the contract. However, most of Estonia's insurance undertakings state the so-called operation costs in their standard terms.<sup>\*31</sup> Therefore, it can be asked whether collecting such additional amounts is legitimate or not. If one takes the position that the insurer has a right to establish operation

<sup>28</sup> OJ L 271, 9.10.2002, pp. 0016–0024.

<sup>29</sup> In judgement No. 3-2-1-51-06, the Supreme Court has provided that 'in insurance relations, it is reasonable to presume that before the valid policy ends, the insurer shall notify the policyholder of its contractual obligations, issue a corresponding invoice and a warning'.

<sup>30</sup> In the commented edition of the PEICL, it is pointed out that if an insurance premium has been prepaid, returning of the money shall take place on the *pro rata* principle, since modern information technology enables virtual expenseless calculation on the principle of *pro rata temporis* (1), and due to lessening of the peril, an insurance premium is no longer necessary from the point of view of the insurer's solvency (2), the insurance risk is divisible on the basis of days/months/years in an economic sense (3), 'preservance' of an insurance premium is not justifiable as a 'contractual penalty' (4) and keeping such premium could be viewed as punishing of the policyholder, which is unjustifiable (5). See J. Basedow *et al.* (Note 6), pp. 203–204.

<sup>31</sup> For example, in Article 28.4 of the QBE Insurance (Europe) Limited Estonian branch home insurance conditions it has been stated that upon termination of a contract, the QBE has a right for the insurance premiums for the time until the termination of the contract, as well as operations expenditures that make up 20% of the insurance premium calculated for the insurance period. See QBE kodukindlustus. Koduvara määratud riskide kindlustus (QBE home insurance. Household insurance). Available at <http://www.qbeeurope.com/documents/estonia/Kodukindlustuse%20tingimused.pdf> (1.3.2011) (in Estonian).

costs, it would lead to a situation in which technically it would be possible to state in the standard terms that the amount of the so-called operations cost is as high as any insurance premium payment or the remaining insurance premiums through to the end of the period. It would be possible thus to create a situation in which the policyholder is obliged to pay insurance premiums for the whole insurance period regardless of the contract having been terminated. The author finds that, to address this issue, it would be reasonable to specify the terms of both the LOA and the PEICL additionally so as to avoid differing interpretations such that the insurance premium would always be returned on the *pro rata temporis* principle to a day's accuracy and with prohibition of deduction of any expenses.

### 3.4. Transfer of property

Section 494 of the LOA sets forth imperatively that if a policyholder transfers an insured thing, all the policyholder's rights and obligations arising from the insurance contract transfer to the acquirer of the thing. At that point, an insurer may cancel the insurance contract with respect to the acquirer of the thing within one month of becoming aware of the transfer of the thing if the insurer gives at least one month's notice of the cancellation (see §495 (1) of the LOA), and the acquirer of an insured thing may cancel the insurance contract by the end of the current period of insurance within one month from acquiring the thing (§495 (2) of the LOA). Thus, the LOA does not enable the acquirer of an insured thing to choose an acceptable insurer before the new period of insurance (which may theoretically mean that said person would have to remain in a relationship with an unwanted insurer for a year). If the insurer is not notified of the transfer of the thing in time, the insurer shall be released from its performance obligation according to §496 (2) of the LOA if an insured event occurs more than a month after the time when the insurer should have received corresponding notice. The corresponding regulation of the PEICL is considerably more flexible and concentrates more on the policyholder. Except in cases of inheritance and of agreement among the parties (insurer, policyholder, and acquirer) (Article 12:102 (3)), the insurance contract shall be terminated one month after the time of transfer, unless the policyholder and transferee agree on earlier termination (Article 12:102 (1)). The flexible approach of the PEICL is justified by the fact that an insurer cannot be forced to accept a policyholder whom it does not like and the acquirer may have just cause for not entering into a binding agreement that may not protect its economic interests.<sup>32</sup> The author agrees with these explanations and therefore considers the regulation in the PEICL to be more reasonable.

### 3.5. Agreed value

Insurable value is of central importance in property insurance contracts. The PEICL's Article 8:101 (2) provides that the insurer shall not be obliged to pay more than the amount necessary to indemnify losses actually suffered by the insured. In cases of agreed value, the agreed value shall be applied even if it is greater than the actual losses, with the proviso that no deception occurred or false information was given in agreement upon the agreed value. However, according to §480 (3) of the LOA, the agreed value shall not be deemed to be insurable value if, at the time of the occurrence of the insured event, it differs significantly from the actual insured value. In that case, the actual insured value applies. Therefore, the biggest difference between the PEICL and the LOA is in the fact that in cases of agreed value, the PEICL enables compensation for more than the actual value, where no deception or false information was involved in the agreement upon the agreed value. The author considers the corresponding PEICL regulation to be justified—the insurer is the professional in concluding an insurance contract, having, through its practice, fuller awareness of the value of the assets. Conventionally, an insurance payment is related to insurance value (this is not a linear relationship). By leaving the policyholder to bear the responsibility in cases of an agreed value determined in consequence of a mistake (or with knowledge but without intent to deceive), the balance of contractual rights is severely disrupted, since where the right to increase the insurance premium addressed in §481 of the LOA applies, it is difficult, if not even impossible, for the policyholder to calculate or check the amount of the actual insurance premium.

<sup>32</sup> J. Basedow *et al.* (Note 6), p. 276.

## 4. Legal relationships before an insured event

### 4.1. The policyholder's non-compliance with precautionary measures

According to the PEICL's Article 4:102 (1), a clause providing that in the event of non-compliance with a precautionary measure the insurer shall be entitled to terminate the contract shall be without effect unless the policyholder or the insured has breached its obligation with intent to cause the loss or recklessly<sup>33</sup> and with knowledge that the loss would probably result. This blanket standard term according to the PEICL is used by insurers in Estonia. Since in the Law of Obligations Act, an insurer's withdrawal from the contract has been regulated in a mostly imperative manner and ignoring of the precautionary measures is not a basis for withdrawal, whether such a standard term is applicable under Estonian law is called into question. There is no judicial practice concerning this matter at the level of the Estonian Supreme Court.

Article 4:103 (1) of the PEICL provides that a clause stating that non-compliance with a precautionary measure exempts the insurer partially or completely from liability shall have effect only to the extent that the loss was caused by the non-compliance of the policyholder or insured with intent to cause the loss, or recklessly and with knowledge that the loss probably would result. Therefore, the PEICL considerably limits the insurer's opportunity to exercise legal remedies in the case of non-compliance with precautionary measures—that is, use of conditions that require the policyholder to behave in one or another way before an insured event takes place. It expressly states those conditions in which the insurer is freed from the obligation to compensate for the damage if the policyholder does not meet some prerequisite. It also addresses conditions for confirmation of doing (or not doing) something upon the breach of which the insurance cover terminates. When we compare the conditions of Estonian insurance undertakings with this provision<sup>34</sup>, it emerges that the former are hostile toward the policyholder in comparison to the PEICL regulation. Numerous Estonian insurance undertakings<sup>35</sup> present a long catalogue of precautionary measures and their catalogue of cases of the insurer's exemption from liability states that non-compliance with any requirement of the precautionary measure catalogue (regardless of the form of guilt) causes the insurer to be exempted from liability. From the standpoint of protection of the policyholder's interests, the author finds the PEICL approach to be significantly more reasonable than the Estonian regulation is. The PEICL's Article 4:103 (2) states that in cases of a clear clause providing for reduction of the insurance money according to the degree of fault, the policyholder or the insured, as the case may be, shall be entitled to insurance money in respect of any loss caused by negligent non-compliance with a precautionary measure. If the insurance contract contains no corresponding clause, the policyholder shall be entitled to the insurance money in its full extent. The commented edition of the PEICL<sup>36</sup> emphasises that, in line with the main philosophy of insurance, an insurance contract is concluded not only to cover an incidental risk of accident but also for negligent conduct. Clause 452 (2) (1) of the LOA provides that the insurer is released from the performance obligation upon the occurrence of an insured event if the policyholder has violated an obligation or if the violation has affected the occurrence of damage or the extent thereof. The PEICL's Article 9:101, which provides for consideration of the policyholder's fault in causing a loss, is analogous with its Article 4:103; i.e., only intent and recklessness may be taken as a basis for reduction of denial of indemnity, and reduction on account of recklessness requires a corresponding clear provision in the terms of the insurance policy. Thus the PEICL principle concerning consequences of intent or recklessness goes further than the Law of Obligations Act regulation that only presumes a cause-and-effect relationship between violation and loss (or guilt).

<sup>33</sup> Recklessness is a lighter form of guilt than intent, but more severe than gross negligence and it originates from the Montreal Convention 1999 on international carriage. See J. Basedow *et al.* (Note 6), p. 247.

<sup>34</sup> For example, according to the home insurance conditions of ERGO Kindlustuse AS KT.0645.11 Article 17.1.4, the policyholder shall adhere to the instruction manuals of devices. The consequence of non-compliance with this obligation according to Article 20.1.1 of these conditions is partial or complete freeing of the insurer from the performance obligation, regardless of the form and extent of the guilt of the policyholder. Available at [http://www3.ergo.ee/HTMLPages/Kodu\\_tingimused\\_KT\\_0645\\_11/\\$file/Kodu\\_tingimused\\_KT\\_0645\\_11.pdf](http://www3.ergo.ee/HTMLPages/Kodu_tingimused_KT_0645_11/$file/Kodu_tingimused_KT_0645_11.pdf) (1.3.2011) (in Estonian).

<sup>35</sup> For example, ERGO Kindlustuse AS vehicle insurance conditions KT.0056.1 (ERGO Kindlustuse AS sõidukikindlustuse tingimused KT.0056.1). Available at [http://www3.ergo.ee/HTMLPages/S%C3%B5idukikindlustusetingimused/\\$file/s6idukindlustuse\\_tingimused.pdf](http://www3.ergo.ee/HTMLPages/S%C3%B5idukikindlustusetingimused/$file/s6idukindlustuse_tingimused.pdf) (1.3.2011) (in Estonian); Seesam Rahvusvahelise Kindlustuse AS home insurance conditions 1/2011 (Seesam Rahvusvaheline Kindlustuse AS kodukindlustuse tingimused 1/2011). Available at [http://www.seesam.ee/uploads/files/household-insurance/Kodukindlustuse%20tingimused%20\(01.01.2011\)\\_EST.pdf](http://www.seesam.ee/uploads/files/household-insurance/Kodukindlustuse%20tingimused%20(01.01.2011)_EST.pdf) (1.3.2011) (in Estonian).

<sup>36</sup> J. Basedow *et al.* (Note 6), p. 177.

Problems of non-compliance with precautionary measures are the main reason for which an insurer refuses indemnity. Therefore, the author considers the PEICL approach justified in comparison with the LOA.

## 5. Legal relationships after the insured event

### 5.1. Notice of an insured event

According to Article 6:101 of the PEICL, delay in notification of an insured event may reduce the money payable only to the extent in which the insurer proves that it has been prejudiced by undue delay. If a deadline for notifying of an insured event is set in the insurance conditions, it shall be reasonable and no less than five days.

In the standard terms of Estonian insurance undertakings, notice of an insured event is given a deadline of 2<sup>\*37</sup>–5<sup>\*38</sup> work days for reporting as soon as possible.<sup>\*39</sup> If a policyholder violates the obligation, stated in §448 (1) of the LOA, to inform the insurer immediately of the insured event, the result according to §449 (2) of the LOA is to immediately release it from its performance obligation, given that the violation was intentional. The author finds that, in essence, almost any delay in notice is intentional (unless the policyholder is ill, etc.) and, therefore, the insurer is almost always formally released from the performance obligation according to Estonian law in cases of late notice. In the event of unintentional violation, §449 (1) of the LOA, analogously with the PEICL's Article 6:101 (3), enables expressing the indemnity in the extent to which the insurer was prejudiced by undue delay. Since §448 of the LOA is a dispositive provision, the insurers have, in essence, an opportunity to set unreasonable deadlines for policyholders (i.e., the two-work-day deadline referred to above). The Supreme Court of the Republic of Estonia, in its decision 3-2-1-56-01 (before the Law of Obligations Act entered into force), affirmed the insurer's right to refuse an indemnity in a situation in which the policyholder notifies the insurer of the insured event after the deadline set in the standard terms and the delayed notice has no further impact on verification of the insurer's performance obligation. Therefore, the author considers the PEICL's regulation significantly more preferable as to reasoning and for consumer protection.<sup>\*40</sup>

### 5.2. Indemnity and the limitation period for claims

As to making the performance obligation of an insurer executable, the Law of Obligations Act's regulation is not as clear as the PEICL's. Namely, §450 (1) of the LOA states that becoming collectable depends on completion of the process of determining the extent of the insurer's performance, but if the corresponding activities have not been completed by one month after notice of the insured event, subsection 3 of the same section states that the policyholder may only request—in essence—a minimal advance payment that the insurer should pay. In practice, it enables avoiding advance payments to an insurer that acts with malice or making these payments to only an insignificant extent by also contesting the minimum extent of the loss to be indemnified. The insurer's obligation to perform a contract also comes into effect if, two months after notifying the insurer of the insured event, the policyholder requests an explanation from the insurer as to why the process of determining the extent of performance has not yet been completed and the insurer fails to respond to the enquiry within one month (LOA §450 (2)). However, the insurer can deviate easily from

<sup>37</sup> For example, Salva Kindlustuse AS general vehicle insurance conditions SÜ-11 (Salva Kindlustuse AS sõidukikindlustuse üldtingimused SÜ-11), Article 23.5. Available at <http://www.salva.ee/public/files/Kaskotingimused%20%28S%DC-11%29.doc.pdf> (1.3.2011) (in Estonian).

<sup>38</sup> For example, conditions of Codan Forsikring A/S Estonian branch's car insurance A101/2011 (Codan Forsikring A/S Eesti filiaali autokindlustuse tingimused A101/2011), Article 8.3.5. Available at [http://rsa.all-tec.ee/public/eesti/RSA\\_Autokindlustus\\_tingimused\\_A101\\_2011\\_EST.pdf](http://rsa.all-tec.ee/public/eesti/RSA_Autokindlustus_tingimused_A101_2011_EST.pdf) (1.3.2011) (in Estonian).

<sup>39</sup> For example, If P&C Insurance AS general insurance conditions ÜÜ 20021 (If P&C Insurance AS Kindlustuse üldtingimused ÜÜ 20021), Article 58. Available at <http://tingimused.if.ee/ViewPDF.aspx?ID=1d6efdf9-0353-4a03-ade8-f47da4370d20> (1.3.2011) (in Estonian).

<sup>40</sup> On certain cases, delayed notice may theoretically help to save the possible expenses for the insurer—for example, in a situation in which the windshield of a vehicle gets hit by a stone, replacing the windscreen immediately may not be in the best interests of the insurer since another analogous incident may happen during the insurance period, besides, delayed notice would not change anything as to investigation of the insured event (extent of damage does not change).

this obligation by acting maliciously and replying on the circumstances of the formal procedure. According to Article 6:103 (1) of the PEICL, the insurer shall take all reasonable steps to settle a claim promptly. Unless the insurer rejects a claim or defers acceptance of a claim through written notice giving reasons for its decision within one month after receipt of the relevant documents and other information, the claim shall be deemed to have been accepted (6:103 (1)). Therefore, under the PEICL, making the insurer's performance obligation executable is extended only when the insurer has not received the necessary information and documentation—receipt of these is ensured by the co-operation obligation of the policyholder stated in Article 6:102 of the PEICL.<sup>\*41</sup>

Unlike the LOA's insurance contract regulation, the PEICL directly stipulates the right of a policyholder to demand compensation for losses due to delay in payment of the indemnity (Article 6:105 (2))—i.e., in a situation in which the insurer acted in bad faith. In many European legal orders, a principle applies that the insurer is not responsible for losses caused by delay in indemnity and the insurer shall pay only the interest. However, in the modern legal literature, one finds that the insurer should compensate for all forecast losses that arise through delay in indemnity since the business activity of the insurer is to offer protection to the policyholder and the insurers are aware that delays in indemnity cause some sort of loss.<sup>\*42</sup> Although formally the policyholder could issue an analogous claim to the insurer for the compensation of damage on the basis of the general part of the Law of Obligations Act, the author holds that a corresponding regulation concerning insurance contracts (even as a reference to the general part) would preventively protect the interests of policyholders better.<sup>\*43</sup> Subsection 475 (1) of the LOA sets forth the rule that the limitation period for claims arising from an insurance contract is three years and that period commences at the end of the calendar year during which the claim falls due. However, §475 (3) of the LOA states that if the insurer denies the application for performance of its obligation, the insurer shall be released from the performance obligation if the policyholder does not file an action for compulsory performance of the obligation within one year, where the insurer has, in its response, informed the policyholder of the legal consequences of the expiry of the one-year term. Article 7:102 of the PEICL provides that action for insurance benefits shall be prescribed after a period of three years from the time when the insurer makes or is deemed to have made a final decision on the claim, or 10 years from the occurrence of the insured event. This enables emphasising that the corresponding regulation of the LOA<sup>\*44</sup> is significantly more to the disadvantage of the policyholder than is the PEICL. When we consider the applicable Estonian regulation, it can be pointed out also that the right of claim of the insurer against the policyholder (unpaid insurance premiums, subrogations, etc.) is three years (according to the regulation in §146 (1) of the General Part of the Civil Code Act<sup>\*45</sup>), whereas the right of claim of the policyholder applies in certain cases (LOA §475 (3)) for only one year—such inequality in the limitation periods ignores the equality of the parties. It is important to emphasise that Article 7:101 of the PEICL sets a shorter deadline for the right of claim of an insurance premium by the insurer: one year. In the PEICL's commented<sup>\*46</sup> edition, it is pointed out that the shorter deadline can be justified by the fact that policyholders generally pay the insurance premiums in parts (whether monthly or quarterly).

<sup>41</sup> Article 6:102 of the PEICL states that if the policyholder, insured or beneficiary, shall not co-operate with the insurer in the investigation of the insured event (i.e., does not guarantee access to the insured location, does not provide information, proof or documentation of the insured event), the insurance money payable may be reduced to the extent that the insurer proves that has been prejudiced by the breach. In the event of any breach committed with intent to cause prejudice or recklessly, the insurer shall not be obliged to pay the insurance money. The analogous obligation stated in §448 (2) of the LOA is more restrictive to the policyholder—according to Estonian law, the policyholder shall give reasonable amount of information which is necessary to determine the obligation to perform the contract. Willing non-compliance with this obligation frees the insurer immediately of the obligation to compensate according to §449 (2) of the LOA and in case of other form of guilt, the insurer may reduce the amount to be paid in an extent of the loss incurred to it.

<sup>42</sup> J. Basedow *et al.* (Note 6), p. 221.

<sup>43</sup> The author implies that willing delay in a loss adjustment process enables the insurer to earn additional profit (i.e., as interests) at the expense of unpaid indemnities. The author holds that the result of breach of the implied covenant of good faith and fair dealing cannot simply be paying a fine for delay to the policyholder, since the policyholder has a justified expectation that by buying an insurance cover, the results of the possible loss event will be covered in a fast loss adjustment process and thus, if compensation for the loss is delayed due to behaviour of the insurer in bad faith, obligating the latter to compensate the loss due to such behaviour is justified.

<sup>44</sup> Subsection 12 (3) of the German Insurance Contract Act (*Versicherungsvertragsgesetz*) that was used as a 'model' for the corresponding norm of the LOA has been revoked.

<sup>45</sup> Tsiviilseadustiku üldosa seadus. – RT I 2002, 35, 216; RT I, 6.12.2010, 1 (in Estonian).

<sup>46</sup> J. Basedow *et al.* (Note 6), pp. 223–224.

## 6. Conclusions

As an answer to the question stated in the title, the author finds that the PEICL as the European *ius commune* is considerably more consumer-oriented and flexible than the LOA is and limits the insurer's liberation from the performance obligation. However, this is not excessively radical; it balances the interests and opportunities of the parties reasonably. A win-win situation cannot be found in simply optimising the insurer's expenses by unifying the insurance products into a 'pan-European insurance product'. While one achieves a 'win' in terms of savings in expenses, the other party too has to win something. As a rule, the policyholder cannot be compared with the insurer in its knowledge and economic capabilities; therefore, protection of its rights needs heightened attention. The author holds that both saving on expenses and simplicity of provision of the service in the pan-European activity should be the arguments for insurers choosing the PEICL even in a situation in which the national law would be more favourable to them.