

Insurance Contract Law in the Single European Market

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The European Community's programme for the creation of the Single Market is now largely complete. Two specific objectives underlie the measures which have been adopted in the field of insurance. The first is the application of the principle of "mutual recognition" to prudential supervision. This is intended to allow insurers to conduct business throughout the Community subject only to the control of their home State. The second objective is that purchasers of insurance should be offered greater choice through the freedom to purchase insurance from any authorised insurer within the Community.

The introduction of the Single Market in insurance raises two important issues in the field of contract law. First, the law applicable to the contract must be clearly determined. Secondly, consideration needs to be given to the impact which differences in contract law among the Member States have on the functioning of the Single Market. In addressing these issues, the Commission initially focused on the need for harmonisation of insurance contract law. However, as it was not possible to reach agreement among the Member States, the harmonisation proposals were abandoned in favour of choice-of-law rules. These rules will not result in any material change in the rules of English or Scots law as regards the law applicable to insurance contracts. In most cases the common law principle allowing a free choice of law will be preserved. However, the implications of a choice of English or Scots law as the applicable law will vary according to whether or not the insured is resident in the United Kingdom.

The Community's approach to insurance contract law can be criticised on two grounds. First, the complexity of the choice-of-law rules makes it difficult for the parties to cross-border insurance transactions to determine their rights and obligations. Secondly, choice-of-law rules do not address the issue of the impact which differences in insurance contract law have on the functioning of the Single Market. The French, German and British models illustrate that there are fundamental differences among the laws of the Member States. If the benefits of the Single Market are to be realised it may be necessary to revert to the policy of harmonisation. This would permit a simpler approach to the determination of the applicable law and would also make it easier for business to be transacted on a cross-border basis. However, the original proposals may require substantial amendment if harmonisation is to make a material contribution to the achievement of the objectives of the Single Market in insurance.



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Declaration

This thesis is my own work and has been composed by me.

Signed ... *Jain MacNeil*

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INTRODUCTION

1. The Insurance Sector within the Community

As shown in Table 1, the Community accounts for 24% of the world's insurance business. This compares with 37% for the United States and 22% for Japan. Taken as a whole, the proportion of gross domestic product represented by the insurance sector within the Community is relatively small: the figure of 5.5% shown in Table 1 compares with 8.8% for the United States and 9.7% for Japan. Several other countries also have proportionately larger insurance sectors than the Community: Switzerland (8.4%), Sweden (6.0%), South Africa (10.0%), Australia (6.9%) and Israel (6.1%).

Table 1: Total Insurance Premiums in the European Community¹.

	(A) US\$(m)	(A) as a % of GDP	World Share (%)
Germany	81,043	5.47	6.70
United Kingdom	76,401	9.38	6.31
France	63,271	5.99	5.23
Italy	23,374	2.50	1.93
Netherlands	18,999	7.67	1.57
Spain	13,174	3.22	1.09
Belgium	7,009	4.06	0.58
Denmark	5,153	4.45	0.43
Ireland	3,880	10.42	0.32
Portugal	1,470	3.09	0.12
Greece	785	1.40	0.06
Luxembourg	327	3.95	0.03
Total EC	294,886	5.48	24.37

The aggregate figures for the Community disguise a substantial degree of disparity among the Member States, with the United Kingdom, the Netherlands and Ireland having proportionately large insurance industries and Greece, Italy, Spain and Portugal having a relatively

¹Data is extracted from Sigma publications of Swiss Reinsurance and relates to 1989. Figures for East and West Germany have been added together. The UK figures are boosted by substantial overseas business placed in the London market.

small involvement in the sector. Germany, the United Kingdom and France are by far the largest insurance markets, accounting for some 75% of total premiums in the Community. Given their predominance, the comparative sections of this thesis will focus primarily on the law and practice in those three countries. Moreover, the tradition of heavy regulation of insurance in France and Germany as opposed to the history of light regulation in the United Kingdom provides a suitable background for an analysis of the de-regulatory impact of the Single Market programme.

As illustrated in Table 2, there is considerable disparity in the Community as regards the distribution of spending by consumers between life and non-life insurance. In the United Kingdom, premiums per capita for life assurance are almost twice the level for non-life insurance, reflecting the importance of life assurance as a savings mechanism and as a method of financing house purchase. By contrast, in continental Europe, France is the only country where spending on life assurance exceeds that on non-life insurance.

Table 2: Premiums per Capita in the European Community(US\$)².

	Total	Non-Life	Life
United Kingdom	1,335.7	485.2	850.5
Netherlands	1,281.1	677.1	604.0
France	1,126.7	525.8	600.9
Ireland	1,105.4	412.8	692.6
Germany	1,036.4	636.8	399.6
Denmark	1,004.5	611.7	392.8
Luxembourg	860.5	607.9	252.6
Belgium	705.9	494.2	211.7
Italy	406.3	306.2	100.1
Spain	337.0	233.4	103.6
Portugal	140.4	111.4	29.0
Greece	78.3	47.0	31.3
Total EC	861.2	449.1	412.1

²Source as per note 1, above.

The way in which insurance is purchased varies substantially throughout the Community³. In the life sector, considerable change has occurred in recent years. In France and Spain, sales of life assurance over the counter by banks have increased rapidly to a point at which they now account for the bulk of sales. In the United Kingdom, independent agents⁴ have seen a sharp fall in their market share following the Financial Services Act 1986. In Germany, tied agents⁵ have continued to control the bulk of life assurance sales despite increasing competition from banks.

In the non-life sector, a distinction can be drawn between commercial and personal lines of business. In the commercial sector, internationally-orientated markets such as the United Kingdom and the Netherlands have a tradition of business being placed through brokers. In other Community markets, a tradition of direct relationships between insurers and their clients has tended to predominate. In personal lines of business, brokers have generally been less active, with insurers relying on sources such as motoring organisations, banks and building societies. Recent trends in personal lines show an emphasis on selling directly to the customer in order to cut costs.

2. The Single Market in Insurance

The Single Market⁶ is defined in Article 8A of the Treaty of Rome (the EEC Treaty) as an area without internal frontiers in which the free movement of goods, persons, services and capital is ensured in

³See Swiss Reinsurance Sigma publication (1992), Bancassurance: A survey of competition between banking and insurance.

⁴Such agents are free to place the business of their principal with any insurer.

⁵Tied agents are restricted in the choice of insurer which they can offer to a customer.

⁶The terms "Single Market" and "Internal Market" have the same meaning. The former is used in this thesis.

accordance with the provisions of the Treaty. Article 8A was inserted into the EEC Treaty by the Single European Act of 1986. The objective of free movement incorporated in Article 8A repeated the original provisions of the Treaty⁷ relating to the establishment of the common market. However, three factors were significant in introducing a more dynamic approach to economic liberalisation under Article 8A than had previously been possible. The first was the adoption of a target date (31st December 1992) for the completion of the Single Market Programme which was only six years away. The second was the change to majority voting contained in the new⁸ Article 100A of the EEC Treaty: prior to this, the requirement for unanimity in Article 100 had given each Member State a veto which hindered the adoption of Community legislation. Finally, the change in approach within the Community in the early 1980's in respect of harmonisation, which put greater emphasis on the mutual recognition of the rules of member States as the basis for free circulation of goods and services, greatly reduced the volume of proposals for harmonisation and introduced a new impetus in the development of cross-border trade within the Community.

The Single Market incorporates both political and economic objectives. The significance of economic integration to the broader objectives of political and social integration was recognised in the Treaty of Rome and re-iterated in the Treaty on European Union. In purely economic terms, the creation of the Single Market is intended to boost the Community's economy and to act as a staging post on the road towards the more ambitious objective of economic and monetary union.

In common with other sectors of the economy, the general objectives of the Single Market apply to the insurance sector. However, there are also specific objectives. As regards the financial services sector as a whole, it is intended that there should be a "level playing field" between providers of services in order to ensure fair competition. This is particularly important in areas such as investments, where banks,

⁷Article 3.

⁸Introduced by the Single European Act 1986.

insurers and other providers are competing with each other. Another objective is that purchasers of insurance should have access to the full range of products offered by Community insurers. In order to make this possible, it is intended that insurers which have been authorised by one member State should be free to market their products anywhere else within the Community (the "single licence").

3. Insurance Contract Law in the Single Market

The initial view within the Community was that harmonisation of insurance contract law was necessary for the creation of a framework within which the right of establishment, freedom to provide services and fair competition could be achieved. In 1979, the Commission published a draft Insurance Contract Law Directive⁹ which set out the following objectives:

"The harmonisation of contract law in connection with freedom to provide services and freedom of choice of applicable law has a twofold objective. Firstly, to guarantee the policyholder that whatever the choice of applicable law, he will receive identical protection as regards the essential points of the contract. Secondly, to eliminate as competition factors for undertakings the fundamental differences between national law. Such is the object of this directive."

An amended draft¹⁰ was subsequently published which incorporated most of the amendments suggested by the Economic and Social Committee and the European Parliament. However, the draft Directive was not adopted by the Council of Ministers. Difficulties arose from the fact that the proposal would have involved substantial amendment to the laws of some Member States and that the Treaty basis¹¹ of the Directive required unanimity.

The Commission subsequently changed its approach towards the harmonisation of insurance contract law. This was made clear by Sir Leon Brittan, the Commissioner responsible for insurance, in November

⁹COM (79) 355 final.

¹⁰COM (80) 854 final.

¹¹Articles 57(2) and 66, prior to amendment by the Single European Act.

1989:

"The forthcoming non-life framework directive will need to cover certain issues relating to contract law and policy conditions....but it is already certain that we will either withdraw or substantially amend the proposal for a contracts directive which has, in any case, made no progress in the Council."¹²

Recent measures have referred to the Commission's view that harmonisation of insurance contract law is not a prior condition for the achievement of the Single Market in insurance. However, the case for this view has not been made clear, with the result that some uncertainty attaches to the objectives identified in the original draft Directive. In particular, it is not clear why the Commission has chosen to abandon the draft Insurance Contract Law Directive whilst seeking to introduce measures which impinge on the substance of insurance contract law through the medium of other Directives.

The approach through harmonisation has been replaced by rules of private international law. These rules govern choice of law where a choice is permitted, and, where no choice is allowed, they identify the law applicable to the contract. However, the rules of private international law do not address two issues which lay behind the original proposal for harmonisation: first, the need for an equivalent level of consumer protection for all purchasers of insurance within the Community; and secondly, the distortion in competition which arises from differences in contract law. These differences relate not only to the substance of insurance contract law but also to the principle of freedom of contract and the extent to which laws on consumer protection apply to insurance.

In the light of the completion of the Single Market, this thesis will analyse the Community's approach to insurance contract law. The objective will be to determine the implications for the operation of the Single Market in insurance of the regime governing contract law and to examine the merits of alternative solutions. Consideration will also

¹²An address to the Comité Européen des Assurances, extracted from Regulation of Insurance in the United Kingdom and Ireland (editors T.H. Ellis and J.A. Wiltshire).

be given to the working of the choice-of-law rules of the insurance Directives in the United Kingdom with a view to clarifying two issues: first, the circumstances in which the contract may be governed by either English or Scots law; and secondly, points of substantive law which are important in determining the rights and obligations of insurer and policyholder where English or Scots law is the applicable law.

CHAPTER 1

THE SINGLE MARKET IN INSURANCE

Introduction

The Single Market in insurance is intended to foster open competition within a system which provides adequate protection for the consumer. Competition is expected to intensify as a result of two influences: first, the dismantling of national regulatory barriers within the insurance sector; and secondly, the recognition that in many aspects of their business, insurers will be required to compete with banks and providers of investment services, who are subject to a similar programme of liberalisation¹. There are two main objectives. The first is that European Community consumers should be able to choose any insurance policy offered by an insurer authorised in any Member State. The second is that Community insurers, once authorised in the Member State where they have their head office (the "home" state), should be free to market their insurance products in any other Member State (a "host" state).

The most important principle for the regulation of the Single Market in insurance is that of "mutual recognition" of the supervisory regime of an insurer's home state. It is this principle which attempts to link together the objectives of competition and consumer protection by creating a system in which the responsibility for authorisation and supervision of insurers lies with the home state (the "single licence") yet provides some measure of consumer protection irrespective of where the product is purchased. Competition has been encouraged as the "single licence" opens national markets to insurers whose main establishment is in other Member States. The objective of protecting the consumer has been pursued largely through the harmonisation of the process of authorisation and supervision, with particular emphasis being placed on the financial security of insurers.

¹See Sir Leon Brittan, "European Insurance in a Single Market", European Access, 1990 vol.4 p12.

A. THE LIBERALISATION PROCESS

1. Treaty Basis

As with other sectors of the economy, the creation of a Single Market in insurance is ultimately guided by the provisions of the EEC Treaty as amended by subsequent Treaties. Article 8A of the EEC Treaty provides that:

"The Community shall adopt measures with the aim of progressively establishing the internal market over a period expiring on 31 December 1992....

The internal market shall comprise an area without internal frontiers in which the free movement of goods, persons, services and capital is ensured in accordance with the provisions of this Treaty."

Article 3 of the Treaty, which sets out the activities of the Community, is also important as it provides for, inter alia, the institution of a system ensuring that competition in the common market is not distorted and the approximation of the laws of the Member States to the extent required for the proper functioning of the common market.

Insurance is mentioned only once within the Treaty: Article 61(2) provides that the liberalisation of banking and insurance services connected with the movements of capital shall be effected in step with the progressive liberalisation of the movement of capital. As argued by Chappatte², this provision appears to relate to the movement of capital in the sense of the investment of funds and does not govern payments of premiums and claims ("current payments") which fall under Article 106(1). However, this distinction is now of limited relevance as the series of Directives³ enacted under Article 67 of the Treaty cover both capital and current payments⁴ and have abolished all restrictions on movements of capital within the Community.

²Philippe P. Chappatte, "Freedom to Provide Insurance Services in the European Community", 9 ELR (1984) 3.

³Council Directive of 11 May 1960 [1960] J.O. 921, as amended by Council Directive 63/21 [1963] J.O. 62, Council Directive 85/566 [1986] O.J. L332/22 and Council Directive 88/361 [1988] O.J. L178/5.

⁴See: J. A. Usher, "Financial Services in EEC Law", 37 ICLQ (1988) 144,151.

Secondary Community legislation governing the Single Market in insurance is based primarily on Chapter 2 (The right of Establishment) and Chapter 3 (Freedom to provide Services) of the Treaty of Rome. The Directive has been the main legislative instrument through which the Community has sought to liberalise and regulate insurance business: those which are referred to in this and other chapters are summarised in Appendix 1.

2. Impediments to Liberalisation

The movement towards a Single Market in insurance has not been easy. In terms of attitude towards liberalisation, the Community was split between two camps: on the one hand, those countries which already had open and internationally-orientated insurance markets (the United Kingdom and the Netherlands) were in favour of rapid progress, whilst on the other, the remaining countries, which generally had a less open and more heavily regulated insurance sector, were much less enthusiastic. Several factors can be identified as major impediments in the process of liberalisation:

(a) The "General Good" or "Public Interest"

The insurance sector is regarded as particularly sensitive by Member States. As almost everyone purchases some form of insurance, considerations of the "public interest" or "general good" have a more obvious role than in sectors where the customer base is smaller. Moreover, as insurance in many cases has a direct social function (such as the guarantee of compensation for injured motorists provided by compulsory motor insurance), there has been greater reluctance to open national markets to foreign competitors for fear that the quality of the security provided to policyholders (and injured third parties) might be eroded.

(b) Consumer Interests

From an early stage, there was common agreement among the Member States on the principle that the "consumer" should be provided with special

protection. In this context, the "consumer" was taken to be a person purchasing insurance other than in a professional capacity: thus, consumer interests were regarded as absent from areas such as reinsurance, co-insurance and the direct insurance of large commercial risks, where business is typically conducted between professionals. However, this is not to say that the implementation of the principle was without difficulty: indeed, definition of the proper scope of consumer interests has attracted considerable attention both in the negotiating process and in the case-law of the Court of Justice.

(c) Differing Bases of Regulation

As noted by de Frutos Gómez⁵, the approach to regulation of the insurance industry among the Member States differed widely prior to the adoption of Community secondary legislation, both in respect of the degree and nature of the regulation. Twenty years after the adoption of the first Community measures, substantial differences are still apparent. Germany, for example, has a system characterised by a high degree of regulation, which includes prior approval of policy terms and conditions and rates for certain classes of business. In France, where a large part of the industry is still nationalised, there is also a system of administrative control of policy forms and rates for certain classes of business. These provisions are alien to the UK system, which focuses on the solvency of insurers but otherwise provides a liberal regime for the conduct of business⁶.

⁵J.M. de Frutos Gómez, "Vers un marché intérieur des assurances", *Revue du Marché Unique Européen*, 1991 vol.3 p45.

⁶As will be discussed below, the Community's system of regulation brings France and Germany closer to the British model.

(d) Fiscal Considerations

Fiscal considerations which impinge on the operation of the Single Market in insurance arise in three areas⁷: premium taxes, the taxation of the profits of insurers and tax incentives applicable to life assurance and pensions. The divergence in premium taxes among Member States has given rise to concern that business will gravitate towards those States, such as the United Kingdom, which do not levy premium taxes. Differences in the taxation of insurers' profits represent a potential distortion in competition, but to no greater extent than in other sectors where the same situation prevails. Finally, as the tax incentives applicable to life assurance and pensions are closely linked to economic and social policy, individual Member States have been keen to retain control over them⁸. The decisions of the Court of Justice in Bachmann⁹ illustrate that it is reluctant to strike down national fiscal measures even where they threaten the operation of the Single Market.

(e) Differences in Financial Reporting

Standards of accounting disclosure vary markedly between different Member States in areas such as the requirement for the preparation of

⁷See J. Biancarelli, "General Report" in Insurance Contract Law in the Single European Market - Law Applicable, Public Policy Provisions, International Conventions, XII International Colloquium of Magistrates and Insurers, Avignon 4-7 October 1991.

⁸Fiscal harmonisation, even when related to the operation of the Single Market, is still subject to a requirement of unanimous voting in the Council under Article 100A(2) of the EEC Treaty. Article 99 of the Treaty on European Union retains this requirement for unanimity.

⁹Bachmann v Belgium (case C-204/90) [1992] ECR I-249 and Commission v Belgium (case C-300/90) [1992] ECR I-314. In both cases (which concerned the same facts) the Court held that a provision of Belgian law which required insurance premiums to be paid to an insurer established in Belgium if they were to constitute a deduction for income tax purposes was contrary to Articles 48 and 59 of the Treaty. However, in the circumstances, it was held that the provision was justified as being necessary to preserve the integrity of the Belgian fiscal system. The possibility of finding a similar provision illegal under a different national system of taxation was left open.

These differences are an impediment to supervision, particularly as the main tool of supervision, the solvency margin¹⁰, is largely a function of the assets and liabilities shown in a company's balance sheet.

B. THE INITIAL PHASE

The initial phase of liberalisation can be said to be marked by two main features: first, the adoption of a framework which allowed for freedom of establishment in both life and non-life insurance¹¹; and secondly, the recognition that the regulatory framework should recognise a distinction between markets in which only professionals were active and those in which there was a "consumer" interest to protect. In this context, the "initial" phase is taken to cover the period from the creation of the Community in 1957 until 1979.

1. Liberalisation of "Professional" Markets

Given the recognition of consumer interests underlying the liberalisation process and the difficulty in reaching agreement among Member States as to how such interests should be protected, it is hardly surprising that the first measure to be adopted was in the area of reinsurance¹², where there was virtually no direct consumer interest to protect. This fact was recognised in the approach of the national authorities, who either imposed a minimal level of regulation on professional reinsurers¹³ or none at all (as in the case of Germany). Moreover, reinsurance was already in fact functioning as an interna-

¹⁰In its simplest form, the solvency margin is the ratio of net assets (gross assets less liabilities) to annual premium income.

¹¹The distinction between the two categories reflects their different functions: life insurance is often used as a form of investment and is generally a long-term contract whereas non-life insurance is generally short-term and does not constitute a form of investment.

¹²Directive 64/225, OJ Special Edition 1963/131.

¹³This term refers to those companies whose only business is reinsurance, as opposed to those companies who are also engaged in other classes of business.

tional business in that there were few restrictions in the major markets on either establishing local operations or conducting business on an ad hoc basis. Thus, it was relatively easy to reach agreement that the EEC Treaty provisions on freedom of establishment and services should apply in the area of reinsurance. The provisions of the Directive apply also to the reinsurance operations of direct insurers.

The adoption of the Co-insurance Directive¹⁴, albeit at the tail-end of the "initial phase", can be seen as confirming the approach adopted in the Reinsurance Directive. As the market was one in which all the participants were professionals and the interest of the consumer was therefore not to the fore, it was possible to introduce a limited form of freedom of services. This enabled insurers to act as "leader"¹⁵ in co-insurance on a "services" basis without the need for the authorisation procedure which applied in other classes of business¹⁶.

The Co-insurance Directive initially applied to categories of risk¹⁷ situated within the Community "which by reason of their nature or size call for the participation of several insurers for their coverage"¹⁸. Thus, the scope of the Directive was left open at this stage, although provision was made for co-operation between Member States to prevent abuse of the Directive through its application to risks which did not require co-insurance¹⁹.

¹⁴Directive 78/473, OJ 1979 L151/25. Co-insurance involves the sharing of large risks among several insurers.

¹⁵Article 2(1) provides that the leader should determine terms and conditions and rating.

¹⁶W. Pool, "Moves towards a Common Market in Insurance" 21 CMLRev. (1984) 123, notes that the Co-insurance Directive was experimental in that it allowed the observance of the operation of freedom of services in anticipation of its extension to insurance generally.

¹⁷Defined by Article 1.

¹⁸Article 1(2).

¹⁹Article 8.

2. Liberalisation of Direct Insurance

The extension of the liberalisation process to direct insurance, in which there was a considerable consumer interest, was accompanied by a narrowing of the scope of the proposed measures by comparison with the Reinsurance and Co-Insurance Directives. The direct insurance market differed from reinsurance in that there existed within the Community barriers to the exercise of both freedom of establishment and services. Moreover, as the volume of business transacted by insurers not established in the relevant Member State (services business) was minimal, the priority was to establish a framework for the exercise of the right of establishment. This also reflected the reality that the Member States were more willing to abolish restrictions in respect of foreign insurers becoming established within their territory, as they felt that effective control could be exercised over their operations, than they were to lift restrictions in respect of services business, where there was a suspicion that foreign insurers might escape effective supervision.

Two Directives were adopted in 1973 which put in place a limited programme of liberalisation in the non-life sector. The First Non-Life (Establishment) Directive²⁰ set out the principle that Member States were to abolish restrictions on the right of establishment, as provided for in Article 52 of the Treaty. The First Non-Life (Co-ordination) Directive²¹ had two principal objectives. First, it co-ordinated the conditions which must be met by an undertaking which seeks an authorisation to conduct non-life business; and secondly, it introduced an element of harmonisation into the process of supervision.

As regards the first objective, the Co-ordination Directive provided that an insurer seeking authorisation must submit to the relevant authorities, inter alia: a certificate of solvency from its home state; its statutes and a list of directors; and a business plan. Moreover,

²⁰Directive 73/240, OJ 1973 L228/20.

²¹Directive 73/239, OJ 1973 L228/3.

Member States were required to provide reasons for declining applications and to make provision for an appeal to the Courts against a decision. The main feature of the harmonisation of supervision was the introduction of a common solvency margin²² which all firms had to satisfy. The purpose of this was to ensure consistency in the quality of security provided by companies operating within the Community. This regime incorporated an element of "home country control" by providing that the home State was responsible for monitoring the solvency of an insurer's entire Community business. As noted by de Frutos Gómez²³, this represented, at that time, a major innovation in the sphere of insurance regulation in that the national supervisory authorities were no longer responsible for the solvency of all insurers operating within their borders.

However, there was a significant gap in the harmonisation of supervision in that it was left to each Member State to lay down rules for the calculation of technical reserves²⁴ and the nature and valuation of the assets which represent such reserves. This had two consequences: first, the absence of harmonisation of technical reserves meant that the "common" element of the solvency margin was compromised as differing rules on technical reserves lead to differing solvency margins²⁵; and secondly, it allowed Member States a considerable role in the supervision of all companies established within their territory. Thus, at this stage, there was only a limited harmonisation of supervisory functions.

It was not possible at the time of the adoption of the First Non-Life Directive to extend its principles to the life sector as national

²²The procedure for the calculation of the solvency margin is contained in Article 16.

²³op. cit. p53.

²⁴Technical reserves are mainly provisions made by insurers in respect of claims payable to policyholders.

²⁵See O. Mudrack, "Are solvency requirements for direct insurance undertakings in the EC really harmonised?", *Journal of the Society of Fellows of the Chartered Insurance Institute*, 1990 vol. 5, part 1, p38.

interests in this area were regarded as more sensitive. However, agreement was eventually reached in 1979. The procedure followed in the non-life sector, involving two Directives in the creation of the establishment regime, was shortened by making reference in the co-ordinating directive to the fact that Article 52 was directly applicable²⁶. The adoption of the First Life Assurance (Co-ordination) Directive²⁷ resulted in the co-ordination of authorisation procedures and the adoption of a common solvency margin. It also introduced the principle of the separation of life and non-life businesses²⁸ in order to ensure the protection of the respective interests of life and non-life policyholders²⁹. As in the case of non-life insurance, control of technical reserves was left to the individual Member States and therefore the limitations of the system of supervision observed in respect of the non-life sector above apply equally here.

3. Other Measures

Two other measures, which do not fit neatly into the analysis of the "initial phase" as being dominated by freedom of establishment and consumer interests, are worthy of mention. The First Motor Insurance Directive³⁰ harmonised the obligation to insure against liability in respect of personal injury arising from the use of a motor vehicle: although it did not impinge directly on freedom of establishment or

²⁶This was contained in the preamble to the Directive. It is assumed that the intention was to refer to the direct effect of Article 52. As regards the difference between direct effect and direct applicability see Wyatt & Dashwood, The Substantive Law of the EC (2nd. edn.) pp25-26. The Court of Justice did not originally recognise the distinction, but, since the early 1980's, has stopped using the terms interchangeably.

²⁷Directive 79/267, OJ 1979 L63/1.

²⁸Article 13.

²⁹This followed the approach to regulation in Member States such as France, the Netherlands and Denmark. The United Kingdom, by contrast, permitted the transaction of life and non-life business within the same company ("composites").

³⁰Directive 72/166, OJ 1972 L103/1. Two Directives in respect of motor insurance were subsequently adopted (Directive 84/5, OJ 1984 L8/17 and Directive 90/618, OJ 1990 L330/44).

services, in that it did not affect the conditions under which a company could operate in any particular Member State, it performed an important function in guaranteeing a minimum level of protection to injured motorists throughout the Community.

The second is the Insurance Intermediaries Directive³¹ which set standards³² for those wishing to become established or provide services as insurance brokers or agents: whilst it provided for freedom of services in that profession, it did not affect the regime governing insurers as regards establishment and services. Thus, an insurer wishing to transact business in another Member State could be and was subject to greater control than the intermediary through whom the business was channelled. The rationale here was that the primary relationship was between insurer and policyholder and justified limitations on freedom of establishment and services resulting from the protection of consumer interests, whereas the intermediary should be allowed freedom of services in the pursuit of his profession within that framework.

C. THE INSURANCE CASES

The absence during the "initial phase" of any measures designed to implement freedom of services in direct insurance meant that the transaction of insurance on a "services" basis was governed at the level of Community law only by the relevant Treaty provisions. The lack of a developed regulatory regime, combined with the divergence in views among Member States as regards the speed at which liberalisation should proceed, contributed towards differing views as to the interpretation of the Treaty provisions on services as applied to insurance³³. In

³¹Directive 77/92, OJ 1977 L26/14.

³²The Directive established qualifications relating to the period of time during which an individual had worked as an intermediary. It did not introduce mutual recognition of diplomas, certificates and other formal qualifications as conditions for entry to the profession varied widely among the Member States.

³³This comment applies equally to other sectors of the economy.

particular, there was a difference among Member States over whether the effect of Articles 52 and 59, providing for freedom of establishment and freedom of services respectively, was dependent on harmonisation of the laws of the Member States or whether a challenge to restrictive national provisions could be mounted on the basis of the Treaty articles alone. From a practical perspective, the issue was important as there was an increasing tendency in the commercial insurance market for buyers of insurance to place their business with foreign insurers for reasons of price and quality of service.

A series of cases³⁴ brought by the Commission under Article 169 provides the best guide to the interpretation of the Treaty provisions on freedom of services as applied to insurance. The most wide-ranging case was that of Commission v Germany, in which the Commission made three claims:

(i) that, by providing that where insurance undertakings in the Community wish to provide services in Germany in relation to direct insurance business other than transport insurance through salesmen, representatives, agents or other intermediaries, such persons must be established and authorised in Germany and that insurance brokers established in Germany may not arrange contracts of insurance for persons resident in Germany with insurers established in another Member State, Germany had failed to fulfil its obligations under Articles 59 and 60 of the EEC Treaty;

(ii) that German legislation implementing the Co-insurance Directive, in so far as it provided in relation to Community co-insurance operations that the leading insurer must be established in that State and authorised there to cover the risks also on its own, infringed Articles 59 and 60 of the Treaty as well as the Co-insurance Directive;

(iii) that, by fixing excessively high thresholds in respect of the risks which may be the subject of Community co-insurance, Germany

³⁴Case 205/84, Commission v Germany [1986] ECR 3755;
Case 220/83, Commission v France [1986] ECR 3663;
Case 206/84, Commission v Ireland [1986] ECR 3817;
Case 252/83, Commission v Denmark [1986] ECR 3713.

had failed to fulfil its obligations under the Co-insurance Directive and Articles 59 and 60 of the Treaty.

Although the Court's decision in Commission v Germany was wide-ranging, it is important to note that it was limited in scope by comparison with the three heads of claim brought by the Commission. The Court limited the scope of its decision to contracts of insurance against risks situated in one Member State concluded by a policyholder established or residing in that State with an insurer who is established in another Member State and who does not maintain any permanent presence in the former State or aim his business activities entirely or principally towards its territory³⁵. It did not directly address the issue of whether an insurance broker was free to place business with insurers who were not authorised in Germany³⁶. The decision was also limited by comparison with the range of business which is transacted on a services basis in the sense in which that was interpreted by the Court: for example, services business where the risk, the policyholder and the insurer are all in separate Member States is excluded from the scope of the decision. In the remaining three cases (Commission v France, Ireland and Denmark respectively), the scope of the Court's ruling was limited to co-insurance within the meaning of the 1978 Co-insurance Directive.

The decisions in the insurance cases can be broken down into two main issues: the definition of the scope of freedom of establishment and

³⁵As regards the last element, David Edward ("Establishment and Services: The Insurance Cases", 12 ELR (1987) 231) has argued that it must be read in the context of the Court's decision in van Binsbergen, (case 33/74) [1974] ECR 1299, which makes clear that the major concern is to prevent abuse of the services regime in order to escape rules relating to establishment.

³⁶J. Flynn, "European Court of Justice Judgements on Insurance", 37 ICLQ (1988) 154, comments on this omission (p165): "It is unfortunate that the opportunity was not taken to grapple with the issue of when and how Articles 59 and 60 apply to restrictions placed neither on the provider nor on the recipient of services, but on the go-between. It is an issue which will increase, not diminish, in importance as communications improve."

services in insurance; and the limitations which a Member State may impose on freedom of services. Each is dealt with separately below.

1. The Scope of Establishment and Services

Although the Treaty provides no definition of establishment, Article 52 is worded so as to apply expressly to "agencies, branches or subsidiaries". Chappatte³⁷, prior to the Court's decision in Commission v Germany, argued that the criteria of the permanency of the operation and continuing authority to transact business were the critical factors in determining the scope of Article 52. This view was supported by the case-law³⁸ of the Court, but there remained some doubt as regards the dividing line between establishment and services.

By way of background to the Court's ruling in Commission v Germany, it is useful to look at two instances in which the scope of "establishment" in insurance had been addressed prior to the insurance cases. The first is Article 6 of both the First Life and Non-Life (Co-ordination) Directives which provides that a company whose main establishment is in another Member State must apply to the host state for an authorisation if it intends to open a branch or an agency. Article 1 of both Directives provides that they apply to insurance undertakings which are established or wish to become established in a Member State. Thus, the regulatory regime envisaged from an early stage that agency as well as branch operations would be covered by the establishment regime.

³⁷op.cit. p8.

³⁸Chappatte, op.cit, cites case 33/78, Somafer v Saar-Ferngas [1978] E.C.R. 2183 at p2192, consideration 12:

".. the concept of branch, agency or other establishment implies a place of business which has the appearance of permanency, such as the extension of a parent body, has a management and is materially equipped to negotiate business with third parties so that the latter, although knowing that there will if necessary be a legal link with the parent body, the head office of which is abroad, do not have to deal directly with such parent body but may transact business at the place of business constituting the extension."

The second instance is the French Tax Credits³⁹ case concerning a French tax law which granted shareholder tax credits on the taxable profits of French companies, inter alia, to French insurance companies and French subsidiaries of foreign insurance companies which held qualifying shares, but not to unincorporated French branches of foreign insurance companies. The Court held that this law infringed the right of establishment contained in Article 52 as that right included a choice of form of establishment as between an agency, a branch and a subsidiary. Thus, Edward⁴⁰ has argued that it was already clear from this case that both branch and agency operations fell within the Treaty provisions on establishment and not those on services.

2. The Delimitation of Establishment and Services in Commission v Germany

Advocate-General Slynn proposed in Commission v Germany⁴¹ that:

"..in my opinion, the appointment of an agent or representative in the Federal Republic of Germany does not per se necessarily constitute establishment."

The Court did not directly address this proposition in holding⁴² that an insurance enterprise of one Member State which maintains a permanent presence in another Member State is covered by the Treaty provisions on establishment even if its presence is not in the form of a branch or agency but consists merely of an office managed by the enterprise's own staff or by a person who is independent but authorised to act on a permanent basis for the enterprise, as would be the case with an agency.

Taking the Court's definition of establishment in the context of the French Tax Credits case and Article 6 of the First Life and Non-Life

³⁹Case 270/83, Commission v France [1986] ECR 273. The Court's decision was delivered in January 1986, prior to the decision in the insurance cases which was delivered in December 1986.

⁴⁰David Edward, op.cit. note 35 above, p241.

⁴¹p3787.

⁴²Considerations 42-51.

Directives, it is difficult to reach any conclusion other than that the Court's decision had been well signposted and that the definition of "services" cannot be seen as unduly restrictive against that background. This is not to say, however, that the view of Advocate-General Slynn was without foundation. In some cases, an agent may be authorised by an insurer to act on a permanent basis for certain simple types of risk but may be permitted to act only on an ad hoc basis for more complex risks. This situation was not specifically considered by the Court, but it seems likely that the representation in this instance in respect of complex risks would not qualify as permanent representation and would not constitute an establishment in respect of those risks. Thus, it is possible to accommodate the view of the Advocate-General within that of the Court on the basis that it is the presence of permanent representation which is the most fundamental characteristic of establishment and not the form which that representation takes.

The Court's ruling also makes clear that freedom of establishment and services are mutually exclusive: an enterprise which is established in the sense indicated by the Court cannot avail itself of Articles 59 and 60 in respect of its activities in the relevant State. However, when compared with the provisions of subsequent Community legislation on the simultaneous pursuit⁴³ of establishment and services business, it seems clear that the Court's view does not accord with that of the Commission. The latter's view, applied consistently to both the insurance and banking sectors can be summarised in the words of Commissioner Paolo Clarotti⁴⁴:

"There exist two different freedoms (freedom of establishment and freedom to provide services) and therefore, any economic operator may benefit therefrom, even simultaneously, on the condition that it does not use the one (provision of services) to evade the regulations relating to the other (the right of establishment)."

⁴³This is also referred to as "cumulation" or "cumul".

⁴⁴A speech made at a seminar organised by the French Banking Federation on 16th March 1988 on the subject "1992: Quel Droit Bancaire?" Revue Banque Paris 16th March 1988 at p140.

This view of cumulation recognises the ruling of the Court of Justice in van Binsbergen⁴⁵, which was referred to in Commission v Germany. However, the decision in the latter case makes clear that the Court's view of cumulation was not qualified by considerations of whether the provider of services is seeking to avoid the rules of establishment: its view was that where an enterprise has an "establishment" within a Member State it cannot under any circumstances avail itself of the freedom of services provisions of Articles 59 and 60.

The provisions of subsequent Community legislation regarding the principle of cumulation show that it is the Commission's view which has prevailed⁴⁶. Both the Second Life and Non-Life Directives allow the Member States a limited option to restrict the simultaneous pursuit of business on an establishment and services basis⁴⁷. Those measures were regarded as temporary, pending further harmonisation. The "Framework"

⁴⁵Case 33/74, van Binsbergen v Bestuur van de Bedrijfsvereniging Voor De Metaalnijverheid [1974] ECR 1299. The Court held that a Member State cannot be denied the right to take measures to prevent the exercise by a person providing services whose activity is entirely or principally directed towards its territory for the purpose of avoiding the professional rules of conduct which would be applicable to him if he were established within that State.

⁴⁶This approach has not escaped criticism. The Comité Européen des Assurances (Position Papers 1990, p26) commented on the draft Third Life Directive as follows:

"Supervision in the head office country of all the undertaking's insurance activity (by way of establishment or freedom to provide services) must not result - either de jure or de facto - in the disappearance of the distinction in the Treaty of Rome between the two forms of activity (articles 52 et seq; articles 59 et seq)."

J. Biancarelli, op.cit. note 7 above p47, comments:

"I personally feel extremely reluctant to follow this line of thinking which, in the end, via texts of secondary community law, conflicts with what appears to me to be the very balance of constitutional order, as defined in the EEC Treaty."

⁴⁷Article 13 of the Second Non-Life Directive authorises a prohibition on cumulation in respect of "mass risks", whilst Article 16 of the Second Life Directive authorises a similar prohibition in respect of cases not falling into the category of "own initiative". The United Kingdom has not imposed any restrictions on the provision of services under the principle of cumulation.

Directives⁴⁸ abolish the limited option to prohibit cumulation, thereby introducing complete freedom for insurers to pursue business simultaneously on a services and establishment basis.

The Court's delimitation of the scope of the establishment and services regime was of considerable importance at the time in that it had the effect of consigning most transactions to the establishment regime, as permanent representation is required for most business other than large risks, which can be dealt with on an ad hoc basis. However, the delimitation of the scope of the two regimes is becoming less relevant as the completion of the Single Market will result in a system of regulation which does not make significant distinctions between the two. This is a consequence of the "single licence" provisions of the Framework Directives⁴⁹ which have recently been adopted: they will result in authorisation and supervision in respect of an insurer's entire Community business becoming the sole responsibility of its home State, both in respect of "establishment" and "services" business. Nevertheless, as will be discussed below, the abolition of restrictions on cumulation and the continued relevance of distinctions between establishment and services business are likely to remain contentious issues during the implementation phase of the Single Market programme.

3. Limitations on Freedom of Services

(a) Commission v Germany

The Court's starting point in Commission v Germany was that freedom of services was a fundamental principle of the Treaty: it followed the ruling in van Binsbergen⁵⁰ that Articles 59 and 60 became directly effective on the expiry of the transitional period and that their applicability was not conditional on the harmonisation or co-ordination

⁴⁸Article 9 of Directive 92/49, OJ 1992 L228/1 (Non-Life) and Article 37 of Directive 92/96 OJ 1992 L360/1 (Life).

⁴⁹See note 48 above.

⁵⁰Case 33/74, [1974] ECR 1299.

of the laws of the Member States. The Court then identified the conditions under which restrictions may be imposed on freedom of services, in the following terms: there must be imperative reasons relating to the public interest; the relevant interest is not already protected by rules to which the provider of services is subject in the Member State of his establishment ("equivalence"); the same result cannot be obtained by less restrictive rules ("proportionality"); and the provisions constituting a restriction must be applied equally to all persons or undertakings operating within the territory ("non-discrimination"). As noted by Chappatte⁵¹, each of those elements, which together constitute the "judicial exception" to Article 59, were already recognised in the case-law of the Court prior to its decision in the insurance cases.

In reaching its decision, the Court was heavily influenced by the state of development of the Community's regulatory structure, particularly the provisions of the first Life and Non-Life Directives. Given the changes which have since taken place in both the life and non-life sectors, it is likely that the Court's decision on the facts would now be different, albeit that the principles remain unchanged. The three areas in which a different decision would be likely under the regime which will be in place once the Single Market programme is complete are: the requirement for an authorisation procedure; the supervision of technical reserves; and terms and conditions of insurance. Each is discussed below.

(1) The Requirement for Authorisation

The Court upheld the German requirement for authorisation in respect of the supply of insurance services on its territory. The reasoning was that the co-ordination of the authorisation process implemented by the First Non-Life Directive was limited: in particular, an authorisation was still required from each Member State in which an insurer wished to conduct business. Whilst the proposal for a Second Non-Life Directive envisaged a change in procedure, it appeared likely that the

⁵¹op.cit. pp10-15.

requirement for individual authorisations from each Member State would be retained. Thus, the Court was able to conclude that only the requirement of authorisation could ensure the degree of supervision which was justified for the protection of the consumer, both as a policyholder and as an insured person.

The "single licence" principle of the "Framework" Directives⁵² will, however, result in a system of supervision in which the home Member State will have sole responsibility for all business conducted within the Community. Thus, it will no longer be possible for the host Member State to apply a separate authorisation procedure: the Court's decision on this point will therefore no longer be relevant.

(ii) The Supervision of Technical Reserves

As regards the extent to which the public interest was already protected by rules in the Member State of establishment, the Court reached different conclusions in respect of the rules on solvency margins and those on technical reserves. It held that a certificate of solvency from one Member State must be accepted by another as the provisions on solvency in the First Life and Non-Life Directives were sufficiently detailed and included a requirement to verify the solvency of the undertaking in respect of its entire Community business. However, as the First Directives had left the rules covering technical reserves to the individual Member States, and there had been no harmonisation, each Member State was justified in requiring compliance with its own rules.

The position of technical reserves has been altered by the Second Non-Life Directive⁵³ which transfers responsibility for the supervision of technical reserves in respect of "large" risks written on a services basis to the Member State of the establishment covering the risk. A further change will result once the Third Non-Life "Framework"

⁵²See note 48 above.

⁵³Article 23.

Directive⁵⁴ and the Insurance Accounts Directive⁵⁵ are implemented⁵⁶ as full control of technical reserves will pass to the home Member State. A similar regime is provided for in the Third Life Directive⁵⁷. Thus, the Court's decision in this area would also need to be reviewed to accommodate developments in the regulatory system.

(iii) Terms and Conditions of Insurance

In Commission v Germany the Court decided that a host Member State was entitled to require compliance with its rules in respect of terms and conditions of insurance. This finding has also been affected by subsequent developments in the Community's regulatory framework. The "Framework" Directives⁵⁸ prohibit prior approval by Member States of policy conditions although there is provision for a system of ex post facto examination on a non-systematic basis.

(b) The Co-insurance Cases

The cases⁵⁹ brought by the Commission against France, Ireland and Denmark were concerned mainly with the legality of provisions of national legislation which provided that a leading insurer had to be established and authorised in the relevant Member State. This issue was also present in the German case in addition to the broader questions of the scope of "establishment" and "services" in insurance and permissible limitations on freedom of services.

⁵⁴Directive 92/49, OJ 1992 L228/1.

⁵⁵Directive 91/674, OJ 1992 L374/7.

⁵⁶The respective implementation dates are 1st July 1994 and 1st Jan. 1994.

⁵⁷Article 18.

⁵⁸Articles 6(3) and 39 of the Non-Life "Framework" Directive and Articles 29 and 39 of the Life "Framework" Directive. For a more detailed discussion of control of conditions of insurance see section E below.

⁵⁹For citation, see note 34 above.

The Court's decision, applied in all four cases, was that a requirement for establishment of the leading insurer in the state where the risk is located infringed Articles 59 and 60. In this respect, it followed the approach towards establishment which it had taken towards insurance in general in Commission v Germany. However, the Court reached a different conclusion as regards authorisation in respect of co-insurance. Whilst an authorisation process had been justified in Commission v Germany as being necessary to ensure a sufficient degree of supervision to protect the consumer, the Court held that this reasoning did not apply to co-insurance and that a requirement for authorisation contravened Articles 59 and 60 as well as the Co-Insurance Directive. In reaching this conclusion, the Court made reference to the limitations on risks which fell within the Co-Insurance Directive: in particular, its limitation to risks whose size called for the participation of several insurers and the exclusion of life assurance, accident & sickness and road traffic liability indicated an absence of substantial "consumer" interest. Moreover, the creation of a system of co-operation between national supervisory authorities in respect of co-insurance represented a stage of development more advanced than that which applied to insurance in general. A similar view as to the legality of authorisation procedures was taken in the co-insurance cases involving France, Ireland and Denmark.

Nevertheless, the Court did uphold French measures which defined the scope of the Co-insurance Directive, which, as noted earlier⁶⁰, had been defined in very loose terms. The effect of this was to allow Member States some discretion in setting thresholds for Community co-insurance, thereby allowing them to set the boundary between those operations which required authorisation and those which did not.

4. The Significance of the Insurance Cases

The practical consequences of the Court's ruling are now of limited relevance to the insurance sector as several of the issues have been

⁶⁰Section B.1 above.

resolved by subsequent Directives. However, the insurance cases remain important for three reasons:

(a) First, they exerted an influence over the development of the regulatory regime in insurance in the years that followed, particularly as regards the need to ensure adequate consumer protection as liberalisation progressed. Indeed, the increasing erosion of their relevance can be said to be a measure of their success in focusing attention on problem areas such as technical reserves and terms and conditions of policies. Moreover, they remain the principal authority as regards the Treaty provisions on freedom of services in insurance should it become clear in future that not all the potential conflicts have been resolved by the existing regulatory structure.

(b) Secondly, the insurance cases occupy an important position in the overall development of the concept of freedom of services within the Community. Earlier cases such as Cassis de Dijon⁶¹ had clarified that "indistinctively applicable" measures could constitute barriers to the free movement of goods but the application of this principle to services remained less clear. The identification by the Court of Justice of permissible restrictions on services suggests that while the rationale of Cassis de Dijon - that products satisfying the rules of the country of origin should be entitled to free circulation - applies equally to services, the scope for restrictions imposed by Member States seems wider than in the case of trade in goods. Steindorff⁶² takes this a step further by arguing that the Court in the insurance cases widened the instrument for the delimitation of restrictions in Article 59 to an open category of "policy considerations". Whilst this probably overstates the scope for action on the part of Member States, limitations on freedom of services based on considerations of the "general good" are likely to remain a feature of the Single Market⁶³.

⁶¹Case 120/78, Rewe-Zentral AG v Bundesmonopolverwaltung für Branntwein [1979] ECR 649.

⁶²Ernst Steindorff, "Freedom of Services in the EEC", *Fordham International Law Journal* vol. ii Winter 1988 no 2.

⁶³This is discussed in more detail in chaps. 2 and 4.

(c) Finally, the delimitation of establishment and services in the insurance cases resulted in insurers focusing on expansion into new markets within the Community on an establishment rather than a services basis⁶⁴. This reflected both the limited definition of "services" adopted by the Court, the prohibition on cumulation⁶⁵ and the considerable restrictions on services business which were permitted. In these circumstances, insurers concluded that the services route offered no clear advantages over establishment.

D. THE SECOND GENERATION DIRECTIVES

Following the completion of the framework to facilitate the right of establishment during the "initial phase" of liberalisation, attention became more closely focused on freedom of services. The need to develop a regulatory framework to cover services was highlighted by the Court of Justice's ruling that Germany was in breach of its Treaty obligations in respect of its rules governing the provision of insurance on a services basis and that Germany, France, Ireland and Denmark were in breach of the rules governing co-insurance.

1. The Creation of a Two-Tier Structure

The development of the services regime shows a pre-occupation with the protection of the interests of the consumer. By contrast, those who were engaged in insurance in a professional capacity were not regarded as requiring special protection. This continued a trend which had been evident during the "initial phase" and also allowed for the development of a framework which could accommodate restrictions on freedom of services as consumer interests had been clearly identified by the Court of Justice in Commission v Germany as a basis for limiting the effect of Article 59.

⁶⁴See R.L. Carter, "Towards an Internal Market for Insurance Companies", 25 Cahiers de Droit Européen (1989) 552.

⁶⁵As noted above, the prohibition on cumulation has been removed by the "Framework" Directives.

The Court did not define the scope of consumer interests in the different categories of insurance. However, its identification of consumer interests as a key factor in the delimitation of permissible restrictions on freedom of services clearly influenced the provisions of the "second generation" Directives. The separation of the "professional" and "consumer" markets resulted in the adoption of a two-tier regulatory structure for the purposes of services business in non-life insurance: the effect was that consumer business (referred to as "mass" risks) was subject to a more restrictive regime than business conducted between professionals (referred to as "large" risks). Implicit in this was the acceptance of the potential distortion to competition resulting from the creation of a two-tier market in services: such distortion could be said to arise due to the fact that the two-tier structure would limit freedom of services to those insurers operating in the "large" risk market, and thereby exclude some companies from writing small commercial and mass risks on a services basis. However, as the services market was relatively small and the "second generation" Directives were an interim solution on the road to a Single Market, this shortcoming cannot be regarded as a major defect.

The two-tier system introduced by the Second Non-Life Directive⁶⁶ was based on category of risk. A liberal regime applies to "large" risks⁶⁷, in which case the insurer need only notify the relevant authorities and may then begin writing business immediately. In the case of other ("mass") risks, the authorities in the Member State where the risk is located may still exercise substantial control: in particular, they may require special authorisation and may regulate scales of premiums and terms and conditions of policies.

As regards technical reserves, the Second Non-Life Directive provides that where the provision of services is subject to authorisation (i.e.

⁶⁶Directive 88/357, OJ 1988 L172/1.

⁶⁷Article 5 defines "large" risks. Some classes are automatically considered large whilst others are dependent on the insured satisfying certain financial thresholds. The relevant thresholds were doubled for the period prior to 1st Jan. 1993.

in the case of "mass" risks), technical reserves shall be determined under the law of that Member State, as will the matching and localisation of assets. For "large" risks, the supervision of technical reserves was passed to the State of the establishment covering the risk⁶⁸, but for other ("mass") risks it remained with the host State.

The principle of a two-tier regime, justified on the basis of consumer protection, was also applied to the life sector by the Second Life Assurance Directive⁶⁹ although the definition of the areas to which each regime applied was on a different basis. The liberal regime operates as in the non-life sector but is limited to cases where a prospective policyholder actively seeks a policy in another Member State, by going there, by correspondence, or by instructing a broker ("own initiative" cases). In all other cases the restrictive regime will apply. The rationale here was that the person acting on his "own initiative" was taken to have disregarded the safeguards provided by his state of residence and therefore did not require the protection which would normally be necessary for the protection of consumers⁷⁰.

2. Limitations on Freedom of Services based on the Principle of Cumulation

Both the Second Life and Non-Life Directives contain options allowing Member States to apply restrictions on freedom of services based on the principle of cumulation. For non-life business, the simultaneous pursuit of business on an establishment and a services basis may be prohibited in respect of "mass" risks but not in respect of "large"

⁶⁸A limited exception exists in motor insurance. The Motor Insurance Services Directive (90/618, OJ 1990 L330/44) added motor insurance to the classes that may be considered "large", but left control of technical reserves to the host state for an interim period.

⁶⁹Directive 90/619, OJ 1990 L330/50.

⁷⁰The Directive set out a procedure by which the prospective policyholder would be made aware of the consequences of his action.

risks⁷¹. The intention was to allow Member States to control access to "mass" risks within their national markets whilst allowing free access to "large" risks on either an establishment or services basis. A similar option was contained in the Second Life Directive⁷² in respect of commitments not falling under the definition of "own initiative" cases: the rationale followed the reasoning applied in the non-life sector in respect of "mass" risks.

These limitations on cumulation were regarded by the Commission as being consistent with the decision of the Court of Justice in the insurance cases as regards the protection of consumer interests as well as the ruling in van Binsbergen in respect of the use of the services regime to avoid the rules relating to establishment. However, as discussed below, the subsequent lifting of all restrictions on cumulation via the "Framework" Directives does not appear to respect the delimitation of the respective regimes of establishment and services as developed in the case-law of the Court of Justice.

3. A Tighter Definition of Co-insurance

Finally, it is worth making reference to the provision of the Second Non-Life Directive concerning classes of business which may be covered by means of Community co-insurance⁷³, as this was an issue which had not been clearly defined by the Co-insurance Directive of 1978. Article 26 of the Second Non-Life Directive provides that those classes of risk defined as "large" are those which may be the subject of Community co-insurance. This provision effectively removed the discretion allowed to the Member States in the fixing of thresholds for the operation of

⁷¹Article 13 of the Second Non-Life Directive.

⁷²Article 16.

⁷³Within the meaning of the Co-insurance Directive.

Community co-insurance which was recognised by the Court of Justice in Commission v France⁷⁴.

E. THE COMPLETION OF THE SINGLE MARKET

1. Estimating the Benefits

The Single European Act of 1986 established a timetable⁷⁵ for the completion of the Single Market which envisaged adoption of all necessary measures by the end of 1992. However, until the publication of the Cecchini Report⁷⁶ in 1988, there was an absence of in-depth quantification of the economic benefits likely to be achieved as a result of the operation of the Single Market.

Cecchini estimated the net overall saving to consumers⁷⁷ from the liberalisation of financial services as being in the range ECU 11-33bn (£9-28bn) per annum, with insurance accounting for between ECU 0.7bn-2.5bn (£0.6-£2.1bn). This projected saving represents less than one percent of total insurance premiums within the Single Market.

However, those figures included only the direct ("microeconomic") gains to consumers and did not allow for the broader ("macroeconomic") benefits. Cecchini concluded that the macroeconomic gains arising from the liberalisation of capital markets, which would allow for the diversification of investment portfolios, was likely to be very substantial. If adjustment were made for this influence, it is likely that the relative benefit to the insurance market by comparison with the banking sector would be increased. A secondary macroeconomic benefit identified by Cecchini and excluded from the figures shown

⁷⁴Case 220/83, [1986] ECR 3663 (considerations 27-28).

⁷⁵This was incorporated in the new Article 8A of the EEC Treaty.

⁷⁶Commission of the European Communities, Research on the "Cost of Non-Europe" (Vol. 9 - Financial Services).

⁷⁷This was based on likely price movements in an integrated financial market.

above was the likely equalisation of interest rates among the Member States.

The inclusion of the effect of macroeconomic gains on the scale indicated by Cecchini makes it possible to envisage savings to consumers much larger than the one percent indicated above. In particular, Cecchini's conclusion that the integration of capital markets could generate substantially higher returns on investment portfolios represents a potential boost to insurers' profitability. If such returns were achieved, it is possible to envisage much larger savings being passed on to consumers. Thus, whilst the direct benefits to consumers of the Single Market in insurance may appear relatively modest, the longer-term benefits could be substantial.

2. Measures to Complete the Single Market

(a) The "Framework" Directives

(i) Home Country Control

The recent adoption of the "Framework" Directives⁷⁸ will result in the introduction of a "single licence" system under which authorisation and supervision will be the sole responsibility of the home State. This will enable an insurer authorised in one Member State to write insurance, on either a "branch"⁷⁹ or "services" basis, in any other Member State on the strength of its home state authorisation. Under the regime of the second generation Directives this right could only be exercised in respect of services business falling within the category of "large" risks in the non-life sector and "own initiative" cases in the life sector. However, where an establishment in another Member

⁷⁸Directive 92/49, OJ 1992 L228/1 (non-life) and Directive 92/96, OJ 1992 L360/1 (life).

⁷⁹A branch is defined in Article 1 of each of the Framework Directives by reference to the Second Directives which followed the ruling of the Court of Justice in Commission v Germany by treating branches (and any other permanent presence) as a form of establishment.

State is formed under the laws of that State, the principle of the "single licence" is not applicable and authorisation must be sought from the Member State of establishment⁸⁰.

(ii) Abolition of Prior Approval of Policy Conditions and Rates

In the non-life sector, the Second Directive had allowed Member States to require prior approval of premium rates and policy conditions for "mass" risks. The Third Non-Life Directive aims to abolish that discretion, although an examination of the relevant provisions suggests that some uncertainty remains as regards the legality of such systems for prior approval.

The issue is referred to in two places in the Third Non-Life Directive: the first is Article 6(3) which forms part of Title II entitled "The taking up of the Business of Insurance"; the second is Article 39 which is contained in Title IV entitled "Provisions related to the Right of Establishment and the Freedom to Provide Services". Article 6(3) provides that Member States shall not adopt provisions requiring prior approval or systematic notification of policy conditions: it goes on to say that Member States may not retain or introduce prior notification or approval of proposed increases in premium rates except as part of general price control systems. Article 39(2) provides that a host Member State shall not adopt prior approval of policy conditions or premium rates. However, unlike Article 6(3), it goes on to say that a host state may only require non-systematic notification of policy conditions or other documents. Article 39(3) restates the provisions of Article 6(3) in respect of the exceptional circumstances of general price-control systems.

Thus, it is not entirely clear whether Article 6(3) allows for the retention of systems for the control of policy conditions and other documents which are already in place. It is, however, clear from Article 39(1) that such systems will not be applicable to the

⁸⁰This would apply where a subsidiary was incorporated in a Member State other than the home State.

operations of insurers subject to the control of another Member State. The result may therefore be that non-life insurers will be subject to varying levels of prior approval of policy conditions and documentation according to the home state under whose control they fall.

A similar argument can be made in respect of the provisions of the Third Life Directive. Article 29, which is the counterpart of Article 6(3) of the Third Non-Life Directive, prohibits Member States from adopting systems for the prior approval of policy conditions or premium rates. It also makes clear that prior approval of premium rates may not constitute a prior condition for an undertaking to carry on its business, but does not make any similar provision in respect of policy conditions. Article 39, the counterpart of Article 39(2) of the Third Non-Life Directive, makes clear that a host Member State may not require prior approval of policy conditions or premium rates as a prior condition for carrying on business. Thus, as in the non-life sector, there remains some doubt as to whether existing systems for prior approval of policy conditions may be applied to insurers subject to the control of the relevant Member State⁸¹.

(iii) Technical Reserves

The provisions in respect of technical reserves in the Non-Life "Framework" Directive implement the principle of home country control by providing that supervision by the home state shall include the technical reserves in respect of an insurer's entire Community business⁸². This removes the competence left to the host Member State by the Second Non-Life Directive to control technical reserves in respect of risks other than "large" risks written on a services basis. The definition and calculation of technical reserves is left to the

⁸¹The Commission and the Department of Trade and Industry in the United Kingdom take the view that the Framework Directives create a total prohibition on prior approval of policy conditions and premium rates. See DTI Consultative Documents on the Framework Directives.

⁸²Article 9.

Insurance Accounts Directive⁸³. The conditions covering the investments represented by technical reserves, their admissibility, diversification and currency-matching are governed by the "Framework" Directive.

The principle of home country control of technical provisions is also applied to the life sector. The Life Framework Directive⁸⁴ provides for the harmonisation of actuarial principles used to determine life technical reserves but leaves considerable discretion⁸⁵ to the Member States as regards the detailed rules.

In both instances, and particularly in the case of life assurance, where Member States are keen to protect the long-term savings of their citizens, it is questionable whether the degree of harmonisation which has been introduced is sufficient to preclude a host Member State into which services are provided from requiring compliance with its own rules in respect of technical reserves. Such action would of course infringe the insurance Directives but might fall within the "judicial exception" to Article 59 if it could be established that the rules of the home Member State did not provide an equivalent degree of protection.

⁸³Directive 91/674, OJ 1991 L374/7. Article 28 provides that the provision in the balance sheet for claims outstanding, the major component of technical reserves, shall comprise:

"..the total estimated ultimate cost to an insurance undertaking of settling all claims arising from events which have occurred up to the end of the financial year, whether reported or not, less amounts already paid in respect of such claims."

Article 60 prohibits implicit discounting of claims provisions to take account of investment income likely to be earned prior to settlement: it does, however, permit Member States to allow explicit discounting subject to certain safeguards and disclosure of the process in the accounts.

⁸⁴Article 18.

⁸⁵This extends to the determination of the interest rates used in establishing technical reserves and the extent to which such reserves may be covered by resources other than premium income.

(iv) Cumulation

The "Framework" Directives abolish⁸⁶ the limited option of prohibiting cumulation which had been left to the Member States in the Second Life and Non-Life Directives. As the home member State will be responsible for all aspects of an insurer's business within the Community, irrespective of whether it is on an "establishment" or "services" basis, it is argued by the Commission⁸⁷ that there is no longer any justification for restrictions on freedom of services as consumers will be protected by equivalent measures in force in an insurer's home State. As argued by de Boissieu⁸⁸, this approach does not seem to respect the delimitation of the regimes of establishment and services developed in the case-law of the Court of Justice. Two issues⁸⁹ in particular can be regarded as contentious once the "Framework" Directives take effect. First, can an insurance undertaking which writes a transfrontier contract from its head office, covering a risk located in another Member State in which it has an establishment use this establishment for contract administration purposes? Secondly, is an insurance company entitled to conduct transfrontier business from its head office into a Member State on the territory of which it already has an establishment authorised to write the same risks? The latter is likely to be a particularly prominent issue as it gives rise to questions of reverse discrimination against establishments in the host Member States into which services are being provided, in that such

⁸⁶Article 9 of the Non-Life Directive (92/49) and Article 37 of the Life Directive (92/96).

⁸⁷See COM (90) 348 final (Non-Life) and COM (91) 57 final (Life).

⁸⁸Jean-Luc de Boissieu, "La directive libre prestation de service dommages", *l'Europe de l'assurance*, *l'Assurance* FR 16, 30 juin 1988 (extracted from CEA XII Colloquium Documents op.cit. p17) remarks: "the intentions of the drafting committee [of the Second Non-Life Directive] indeed contradict the rulings handed down by the Court: if the thinking of the Court of Justice is respected, establishments located in one country cannot be used to work in that country under freedom of services, without deviating the right of establishment from its original purpose."

⁸⁹These were raised by the German delegation at the CEA's XII Annual Colloquium: see documents, op.cit. p43.

establishments may be subject to a more restrictive regulatory regime than the provider of services.

(b) The Insurance Committee

The adoption of a Directive⁹⁰ setting up an Insurance Committee allows for the amendment of the insurance Directives by the Commission, subject to the agreement of the Committee. The latter will be composed of representatives of the Member States⁹¹, chaired by the representative of the Commission, and will operate on the basis of qualified majority voting. Areas in which the Committee will be capable of exercising its power of amendment include: changes to the list of items which can count against the solvency margin; relaxation of currency-matching rules; and modifications to the list of assets which are admissible as cover for technical reserves⁹². The establishment of the Committee can be seen as an exception to the principle of mutual recognition of the supervisory systems of the Member States in that it represents a transfer of authority to the Community, but the limited nature of the powers given to the Committee, in what are essentially technical matters, leaves the principle of mutual recognition intact⁹³.

⁹⁰Directive 91/675, OJ 1991 L374/32.

⁹¹Article 1 of Directive 91/675 governs the composition of the Committee but leaves appointment of representatives to the discretion of Member States.

⁹²These powers, inter alia, are contained in Article 47 of the Third Life Directive and Article 51 of the Third Non-Life Directive.

⁹³The Association of British Insurers (ABI) has, however, objected to the delegation to the Insurance Committee of control over the minimum guarantee fund and the composition of technical reserves on the basis that these are fundamental issues on which insurers should be consulted. See ABI Memorandum to the House of Lords Select Committee on the European Communities, Session 1990-91 12th Report, "A Single Market in Insurance".

(c) The Insurance Accounts Directive

The recent adoption of the Insurance Accounts Directive⁹⁴ marks an important step in the Single Market programme for insurance. As noted above, it contains detailed rules for the harmonisation of non-life technical reserves (which alone makes its adoption necessary for the introduction of the "single licence"), but it also serves a broader purpose. The proper functioning of the Single Market requires that insurance buyers should be able to compare the financial position of insurers from different Member States so as to reach a view as to the quality of the security which is being offered. This will be achieved through the requirement in the proposed Directive that insurers publish a profit-and-loss account and balance sheet in a standard format. Moreover, insurers will be required to publish consolidated accounts (i.e. in respect of all their operations) and not just those in respect of parent companies as is currently the case in some Member States.

(d) Intermediaries

Most insurance products are purchased through intermediaries, in the widest sense of the word, rather than directly from insurers. The preamble to the Commission Recommendation⁹⁵ on Insurance Intermediaries recognises their importance in the distribution process:

"..whereas the creation of the internal market will entail an increasing range of products as a result of the freedom to provide services; whereas the professional competence of insurance intermediaries is an essential element for the protection of the policyholders and those seeking insurance;"

As discussed above⁹⁶, the "initial phase" of liberalisation in the insurance sector saw the adoption of a Directive⁹⁷ which provided for freedom of establishment and services within the profession of

⁹⁴Directive 91/674, OJ 1991 L374/7.

⁹⁵92/48, OJ 1992 L19/32.

⁹⁶Section B.3.

⁹⁷77/92, OJ 1977 L26/14.



insurance intermediary. The main objective of the Recommendation is to ensure that intermediaries⁹⁸ are subject to professional requirements and registration. Three factors are particularly important from the perspective of consumer protection. First, it is proposed that direct legal or economic ties to insurers which might affect the intermediary's freedom of choice in placing business should be disclosed. Secondly, it is proposed that Member States require insurance intermediaries to satisfy standards of professional competence, although the determination of standards may be left to professional organisations recognised by Member States. Finally, it is proposed that adequate sanctions be applied to those who pursue the activity of intermediary without being registered or who cease to fulfill the requirements.

It is likely that further action will have to be taken by the Community to address issues arising from the different national regimes under which intermediaries operate⁹⁹. The need for action has been stated by Pool¹⁰⁰ in the following terms:

"Within the last ten years or so, there has been a proliferation of legislation in various Member States affecting the way in which intermediaries work. Most of this legislation is there ostensibly to protect the public, the policyholders, the people who might be buying insurance. No doubt, any piece of this legislation looked at on its own is admirable. The trouble is that it goes in different directions and there is a serious risk that if nothing is done there will be a fragmentation of the market at least at the intermediaries' level."

⁹⁸The definition of intermediary follows Article 2(1)(a) to (c) of Directive 77/92. This includes independent brokers, tied agents and sub-agents whose main business is not insurance.

⁹⁹The Commission has indicated that it intends to propose rules for the conduct of business by investment firms: see ISEC/B27/92 - Background Report, "Financial Services: The Single Market is Complete". In the United Kingdom, conduct of business rules introduced pursuant to the Financial Services Act 1986 include most life assurance products within their ambit.

¹⁰⁰W.Pool, "Community objectives and plans for insurance", in "1992-The Single European Market" (A collection of articles published by IFR Publishing).

F. THIRD COUNTRY INSURERS IN THE SINGLE MARKET

The scope of the right of establishment and freedom to provide services is governed by Articles 52 and 59 of the Treaty respectively. The extent to which third country insurers¹⁰¹ have access to the Single Market within the Community is dependent on whether they fall within the scope of those Treaty provisions. As discussed below, subsidiaries are in a stronger position than branches or agencies. Third country insurers are therefore likely to form subsidiaries if they wish to benefit fully from the Single Market. Alternatively, they may choose to co-operate with Community insurers in a manner which enables them to avoid becoming established within the Community.

1. Subsidiaries

Subsidiaries of insurers whose head office is in a State which is not a member of the Community have similar rights in respect of freedom of establishment and services as insurers whose head office is within the Community. This follows from the definition of the scope of those freedoms within the EEC Treaty. They apply to nationals¹⁰² of the Member States and companies or firms formed in accordance with the law of a Member State and having their registered office, central administration or principal place of business within the Community¹⁰³.

¹⁰¹This term refers to insurers with head offices outside the Community.

¹⁰²Article 52 (freedom of establishment) and Article 59 (freedom of services).

¹⁰³Article 58 (freedom of establishment) and Article 66 (freedom of services).

As subsidiaries¹⁰⁴ satisfy these criteria, they are entitled to freedom of establishment.

2. Branches and Agencies

Branches and agencies of insurers whose head office is in a State which is not a member of the Community do not have access to the Single Market in insurance in the same manner as insurers whose head office is within the Community. Restrictions exist both in respect of freedom of establishment and freedom to provide services.

(a) Freedom of Establishment

Branches and agencies of third country insurers do not fall within the scope of Article 52 in respect of nationals of a Member States or Article 58 in respect of companies or firms formed in accordance with the law of a Member State. They do not therefore have a right of establishment. This is reflected in the provisions¹⁰⁵ of the insurance Directives relating to the authorisation of branches and agencies of third country insurers: the Member States have discretion in granting an authorisation and there is no provision for an appeal against rejection of authorisation.

(b) Freedom of Services

Article 59 of the EEC Treaty provides that the Council may extend the provisions of the Treaty in respect of freedom of services to nationals of third countries who provide services and who are established within the Community. The Council has chosen not to extend freedom of services

¹⁰⁴The term "subsidiary" is defined by Article 1 of the two "Framework" Directives for the purpose of the supervision of the ownership of insurers. The definition follows that of Directive 83/349 (OJ 1983 L193/1) which defines "subsidiary" for the purposes of the preparation of consolidated accounts. The scope of the Treaty provisions on freedom of establishment and freedom to provide services is not directly related to those definitions: the essential point is that the company or firm has legal personality within the Community.

¹⁰⁵Title III of the First Life and Non-Life Directives.

to branches or agencies of third country insurers¹⁰⁶. However, it is open to such insurers to form subsidiaries, which fall within the scope of "nationals of Member States" under Article 59, in order to benefit from freedom of services. Thus, the option chosen by the Council is unlikely to deter third country insurers who are committed to competing in the Single Market.

3. Reciprocity

Reciprocity is an important issue for Community insurers in view of the ease with which third country insurers can gain access to the entire Community market. The issue is addressed in two ways by the insurance Directives. The first is the possibility of the negotiation of agreements¹⁰⁷ with third countries governing reciprocal market access. The second is the possibility¹⁰⁸ of the suspension of new authorisations for branches or agencies of third country insurers in cases where those countries discriminate against foreign insurers or do not provide effective market access. As Lohéac¹⁰⁹ has argued, the opening up of the Community market to third country insurers without any

¹⁰⁶This is achieved through the definition of "insurance undertaking" to which the second generation and "Framework" Directives apply. The definition is limited to those insurers who have been authorised under Article 6 of the First Life or Non-Life Directives: this excludes insurers authorised under Title III of those Directives (applicable to branches and agencies of insurers with head offices outside the Community).

¹⁰⁷Article 32 of the First Life Directive, Article 29 of the First Non-Life Directive. An agreement has been entered into with Switzerland: see Council Decision 91/370, OJ 1991 L205/2.

¹⁰⁸This is governed by Article 32b of the First Life Directive (inserted by Article 8 of the Second Life Directive) and Article 29b of the First Non-Life Directive (inserted by Article 4 of the Motor Services Directive (90/618)).

¹⁰⁹F. Lohéac, "A l'horizon 1992, quelle libre prestation de services pour l'assurance", *Revue du Marché Commun* no.317 (1988) 271.

reciprocal obligation on their part calls for reflection and the pursuit of a solution within the context of the GATT¹¹⁰.

G. THE SINGLE MARKET IN INSURANCE AND COMPETITION POLICY

1. Background

Historically, the transaction of insurance business has been characterised both by competition and by co-operation between insurers. Competition has resulted from the same forces at work in other sectors, namely the desire to increase market share, profits and returns to shareholders. However, co-operation has resulted largely from influences peculiar to the insurance sector. The statistical basis of premium calculation has necessitated co-operation in the compilation of claim statistics, particularly in the case of small companies who may lack a representative portfolio of risks. Moreover, limited financial resources have resulted in the development of forms of co-operation, such as co-insurance, which allow insurers to participate in markets from which they might otherwise be excluded due to insufficient capital. In both instances of co-operation, it is possible to envisage a progression towards conduct which contravenes the free market principles on which the Single Market is based, thereby raising questions as regards the relevance of the Treaty provisions on competition¹¹¹.

The potential for insurers to contravene the Community's competition rules as laid down in Article 85(1) arises mainly in relation to the fixing of prices and terms of trade. Equally, the type of co-operation

¹¹⁰The "Uruguay Round" of negotiations, launched in Sept.1986, deals, for the first time, with international trade in services. Negotiations are still continuing. The position of European insurers was set out by the Comité Européen des Assurances in "Liberalisation of Services in the GATT Negotiations", CEA Position Papers 1990.

¹¹¹Annetje Ottow, "An Internal Insurance Market before the Turn of the Century", 29 CMLRev (1992) 511, has argued that the increasing competition which will result from the liberalisation introduced by the insurance Directives will lead to a new phase in which competition rules will gain in importance.

between insurers outlined above has the potential to fall within the prohibition in Article 85(1). Article 86 is of limited relevance: despite recent consolidation, the insurance industry remains relatively fragmented¹¹², and therefore issues arising from the abuse of dominant market position are less likely to arise.

The application of the Treaty provisions on competition to the insurance industry was considered by the Court of Justice in the German Fire Insurance Case¹¹³. The Court held that the Treaty provisions on competition applied to the insurance industry and that Article 87(2), requiring the Council to adopt measures to define the scope of Articles 85 and 86 in the various branches of the economy, did not exclude insurance despite the fact that no special rules had been adopted in the field of insurance. In reaching its decision, the Court stressed that where the Treaty intended exceptions to be made to its competition provisions, express derogation was provided for, such as in Article 42 in respect of trade in agricultural products. Moreover, the Council Regulation¹¹⁴ laying down detailed rules for the implementation of Articles 85 and 86 of the Treaty had made no exception for insurance, although it had in the case of certain sectors of the transport industry.

2. The Regulation on Competition in the Insurance Sector

Since the Court's decision, several hundred notifications have been received by the Commission from insurers and their associations under Article 85(3), which provides for exemption from the provisions of

¹¹²See Research on the Cost of Non-Europe (Commission of the EC, 1988), Statistical Annex to vol.9.

¹¹³Case 45/85, Verband der Sachversicherer e.V. v Commission of the European Communities [1987] ECR 405. The case arose from the Commission's refusal to grant an exemption under Article 85(3) to an agreement between German fire insurers: this was the first occasion on which the Commission had refused an exemption to an arrangement between insurers.

¹¹⁴Council Regulation 17/62 (OJ, English Special Edition 1959-62, p87).

Article 85(1). In order to clarify the situation, the Council adopted a Regulation¹¹⁵ on the application of Article 85(3) to the insurance sector. It authorises the Commission to grant "block exemptions" specifying agreements and practices to which Article 85(1) will not apply¹¹⁶. The Council Regulation provides¹¹⁷ that "block exemptions" may cover the following areas¹¹⁸ :

(a) Common Risk Premium Tariffs

The Commission's view, based on the decision of the Court of Justice in the German Fire Insurance case, is that tariffs must satisfy two criteria: first, they must be common actuarial calculations based on loss statistics to the exclusion of any loadings for instance for commission paid to intermediaries, administrative costs or profits; and secondly, the tariffs must be purely advisory and therefore non-binding on the members of an association.

(b) Common Standard Policy Conditions

In principle, the Commission favours standard policy conditions as they provide greater transparency to the consumer, who may have difficulty in comparing differing policy wordings. However, standardisation will

¹¹⁵Council Regulation 1534/91 on the application of Article 85(3) of the Treaty to certain categories of agreements, decisions and concerted practices in the insurance sector, OJ 1991 L143/1.

¹¹⁶The Commission has published a draft Regulation providing for block exemptions in respect of the agreements specified in the Council Regulation: see OJ 1992 C207/2.

¹¹⁷Article 1.

¹¹⁸The explanatory memorandum to the (draft) Council Regulation (COM (89) 641 final) provides a broader view of the Commission's approach in the light of decisions made by the Commission in respect of exemptions under Article 85(3).

not be permitted to restrict competition and therefore any standard terms and conditions must be non-binding¹¹⁹.

(c) Co-operation on Co-insurance and Reinsurance

These forms of co-operation are viewed favourably where they open the market for companies which otherwise could not enter it alone, due to limited capacity or expertise, or if they lead to a coverage of risks which is not usually undertaken by individual companies.

(d) Accelerated and Simplified Procedures for the Settlement of Claims

This is not generally regarded by the Commission as a restriction on competition, but is likely to be included in any block exemption for the purpose of clarification.

(e) Co-operation in the Testing and Acceptance of Security Devices

Exemption of this form of co-operation will be subject to the requirements that the arrangements are open to all manufacturers and that the devices are judged on purely objective and qualitative criteria. Recommendations on how test results affect ratings or cover will only be subject to exemption if they are non-binding.

(f) Registers of Aggravated Risks

The Commission's view is that although this form of co-operation is not normally aimed at restricting competition, participation in such systems should not be obligatory and should not deprive companies of the possibility of insuring such risks on the basis of their own evaluation.

¹¹⁹ Practical examples can be seen in the Commission's decisions in the following two cases relating to proceedings under Article 85: Concordato Incendio (decision 90/25, OJ 1990 L15/25); and TEKO (decision 90/22, OJ 1990 L13/34).

3. The Impact of the Regulation on Insurers

The impact on the insurance industry of the block exemptions is unlikely to be substantial in view of the clarification of the Treaty provisions on competition provided by the German Fire Insurance case. The ruling of the Court of Justice in that case made clear that binding recommendations in respect of rates which included provision for operating costs as well as claims were not in accordance with Article 85. The other examples of co-operation to be covered by block exemptions effectively apply the principle that recommendations of industry associations must be non-binding rather than extending the boundaries of the type of activity which will be exempt from Article 85.

However, taken together, the decision in the German Fire Insurance case and the proposed block exemptions are likely to provide a spur to increased competition within the insurance sector. Whilst many companies will no doubt choose to operate within the non-binding tariffs set by their associations, the freedom to operate independently of national associations is likely to increase competition in those markets, such as Germany, where tariffs have exerted an important influence. The experience in the United Kingdom, which has over the last thirty years seen the abandonment of a series of tariffs in the insurance market, suggests that tariff-based pricing supports higher profit margins than are likely to be achieved in an environment of free and open competition¹²⁰. Thus, given that the regulatory controls within the Community are designed primarily to ensure the solvency of insurers, competition policy should result in better value being provided to the consumer without any material increase in the risk of default by insurers.

¹²⁰See Insurance, Competition or Regulation?, Institute of Fiscal Studies (1985).

H. PUBLIC PROCUREMENT IN THE INSURANCE SECTOR

1. The Regime for Public Service Contracts

The Directive¹²¹ relating to the co-ordination of procedures for the award of public service contracts includes insurance within its scope. The provisions of the Directive apply to public service contracts valued at ECU 200,000 or more. In the case of insurance contracts the value is determined by the premium. The Directive applies to central and local government and bodies governed by public law.

There are three procedures which apply to the award of public service insurance contracts. The open procedure allows all interested parties to submit a tender during a period of between 36 and 52 days. The restricted procedure limits the process to service providers invited to tender by the authority within a period of between 26 and 37 days. Under the negotiated procedure, the authority consults service providers of its choice and negotiates contract terms with one or more of them: the same time limits apply as in the case of the restricted procedure. Provision is made for a shortening of the time limits applicable to the restricted and negotiated procedures in cases where urgency renders them impracticable.

The choice of procedure for the award of public sector contracts is governed by Article 11. The basic rule is that the open or restricted procedure should be used except in the limited circumstances in which the negotiated procedure is permitted. There are two instances in which the negotiated procedure could be used in the field of insurance. The first is in exceptional cases where the nature of the services or the risks do not permit prior over-all pricing¹²². The second is where the nature of the services to be provided is such that contract specifications cannot be established with sufficient precision to permit the

¹²¹Directive 92/50, OJ 1992 L209/1.

¹²²Article 11(2)(b).

award of the contract by selecting the best tender according to the rules governing open or restricted procedures¹²³.

2. The Impact of the new Regime

The application of the Directive to the insurance sector may prove problematic. The level at which the threshold for the value of contracts has been set means that many local authority insurance policies will fall within the scope of the Directive. As regards procedure, it is the negotiated procedure, which is to apply as the exception rather than the rule, which corresponds most closely to current practice in the insurance market. Moving to the open and restricted procedures is likely to add to the costs of public authorities. Although the cost of publication of invitations to tender in the Official Journal will be met by the Community, it seems likely that additional resources will have to be committed to the process of selection.

Insurers may find the open and restricted procedures to be unattractive. The balance of price and policy conditions which are acceptable to an insurer may prove difficult to determine other than in an environment of negotiation. It may be, for example, that an uncompetitive tender can be transformed into the most competitive by the insertion of a contract term which one insurer values more than another. The need for negotiation arises particularly where the terms offered by an insurer are determined by the reinsurance cover available, which in some cases can only be determined at short notice. It is therefore likely that insurers will encourage public authorities to use the negotiated procedure other than in cases where there is little or no room for flexibility on price and contract conditions.

¹²³Article 11(2)(c).

J. CONCLUSIONS.

The success of the programme for the creation of a Single Market in insurance is best assessed by reference to the objectives which it seeks to achieve. As was made clear at the outset of this chapter, the primary objectives are the creation of a system of authorisation and supervision based on "home country control" and the extension to consumers of a wider choice in the selection of insurance products.

The first objective has met with greater success than the second. Whilst the working of the system will no doubt identify scope for improvements, the "single licence" system represents an innovative, and, in the main, coherent, approach towards the regulation of insurance business within the Single Market. Two features in particular stand out.

The first is that the "single licence" will have a de-regulatory impact on the insurance sector. The effect will be felt both in relation to the ease with which insurers can enter other Community markets and the extent to which insurance products are subject to controls. Market access will be improved by allowing the transaction of business on a branch or services basis subject only to the control of the home state. Product controls within the Community will be eased by the abolition of prior approval of policy conditions and premium rates. Although, as discussed earlier, some uncertainty may exist as regards the precise impact of the provisions of the "Framework" Directives in relation to approval of policy conditions, there is no doubt that the overall objective is de-regulation.

The second important feature of the "single licence" is that it leaves scope for competition between regulatory systems of individual Member States. This follows from the application of the principle of mutual recognition which has left many of the provisions of national regulatory systems unchanged. Lohéac¹²⁴ has argued, in relation to insurance, that competition between regulatory systems is an undesir-

¹²⁴F. Lohéac, op.cit., p273.

able by-product of the "single licence" on the basis that the Single Market is not based on such a model of competition. It is difficult to support this view. A more sustainable analysis is offered by Reich¹²⁵: this views competition between regulatory systems as an implicit objective of the principle of mutual recognition and regards it as viable so long as there is a willingness to eliminate elements of competition which are undesirable from the perspective of the Community legal order¹²⁶. However, it is important that such competition should not lead to attempts to dilute the impact of Community Directives as a means of gaining competitive advantage¹²⁷.

The objective of securing increased choice for consumers has met with less success. Two considerations are relevant in this respect. First, the Community's system of regulation has not fully addressed issues arising in relation to the role of intermediaries who play a crucial role in ensuring that a wide choice of products is available to consumers. The Court of Justice avoided the issue in the insurance cases and the Commission recommendation on intermediaries represents a limited and transitional measure. However, as the Single Market in insurance becomes a reality, differences in national regulations governing the qualifications, status and conduct of intermediaries will have to be addressed. Secondly, in contrast to the trend in trade in goods, insurers have not, in the main, responded to de-regulation by developing products to be sold on a pan-European basis or by selling their existing product range in other countries. Instead, attention has focused on expansion into other Community countries by way of establishment, with products being tailored for each individual market. This reflects a variety of influences which lie outside the regulatory

¹²⁵Norbert Reich, "Competition between legal orders: a new paradigm of EC law ?", 29 CMLRev (1992) 861.

¹²⁶Reich, *op.cit.*, concludes that insurance regulation in the Community is an example of such competition.

¹²⁷The Economic and Social Committee has recommended that the Commission study the possibility of setting up a European supervisory body designed either to replace existing national supervisory bodies or to put right their differences in interpreting and applying Directives (see OJ 1992, C14/11).

framework for the Single Market : they include the absence of fiscal harmonisation; the need to establish a local presence to service business; and differences in insurance practice and consumer preferences between the different Member States. However, as will be argued in subsequent chapters, the failure to secure increased choice for consumers can also be attributed to the manner in which the Community has approached insurance contract law. Initial efforts to harmonise insurance contract law failed and led the Community to adopt a complex system of rules governing the applicable law. The result is that insurance contracts purchased within the Single Market will be governed by differing provisions of contract law. Such differences alter the fundamental nature of insurance contracts and also limit the extent to which products lawfully marketed in one Member State can be marketed in other Member States. It will be demonstrated later in this thesis that consumer choice would be better served by a renewed effort to harmonise the essential provisions of insurance contract law.

CHAPTER 2

INSURANCE CONTRACT LAW IN THE SINGLE MARKET PROGRAMME

Introduction

This chapter analyses the way in which the programme for the creation of the Single Market in insurance has dealt with issues arising from differences in the insurance contract laws of the Member States. It begins with an overview of the relevance of contract law to the Single Market programme. The development of the Community's approach is then analysed in the context of the move to limit harmonisation measures which occurred in the early 1980's. Finally, consideration is given to the regime which will govern insurance contract law in the Single Market.

A. THE RELEVANCE OF CONTRACT LAW TO THE SINGLE MARKET PROGRAMME

1. Problems arising from Differences in Contract Law

Contract law has an impact on the operation of the Single Market in insurance both as regards establishment and services business¹. Rules governing the choice of applicable law are particularly relevant for services business as the insurer and the policyholder will normally be resident in different Member States. However, considerations relating to competition, consumer protection and conditions of insurance apply equally to establishment business.

(a) Choice of Law in respect of Services Business

In a situation in which insurance is purchased from an insurer on a services basis, it is important that the law governing the contract is clearly identified. In addition to the need to provide for certainty as regards the applicable law, there may also be considerations of

¹The scope of establishment and services, within the meaning of Articles 52 and 59 respectively of the EEC Treaty, was discussed in chap.1.

consumer protection in that Member States may wish to limit the extent to which policyholders can be deprived of the protection provided by their own national law when they purchase insurance on a services basis.

(b) Competition

Contract law has an impact on competition through its effect on insurers' claims costs and the regulatory regime with which insurers must comply in the conduct of their business². Within a single Member State, these considerations have little impact on competition as all insurers are subject to the same regime. However, in a single market in which different systems of contract law are present, competition may be distorted as some Member States may appear more attractive than others from the perspective of contract law. Whilst this may not be the most important consideration in insurers' decisions on which markets they are to operate in, it does form part of an assessment of the regulatory environment in individual markets³.

(c) Consumer Protection

Contract law is relevant to considerations of consumer protection in the context of the Single Market in insurance, as it regulates the rights and obligations of the parties to the contract. As will be discussed in greater detail in chapter 4, the Community lacks a coherent consumer policy, but the objective of protecting the consumer is nevertheless explicitly recognised by the Treaty⁴ in relation to harmonisation measures which have as their object the establishment and functioning of the Single Market.

²This includes costs such as the provision of information to a proposer for life assurance.

³See, for example, Insurance in the EC and Switzerland, a Financial Times Business Information Publication (1992).

⁴Article 100A(3). Article 129(a) of the Treaty on European Union elevates consumer protection to a formal Community policy. See chap.4, section B.

(d) Conditions of Insurance

The ruling of the Court of Justice in the case of Commission v Germany⁵ made clear that consumer protection may form a basis for restrictions on freedom to provide services. The application of this principle to conditions of insurance led the Court to the conclusion that, in the absence of harmonisation, a host state was justified in requiring compliance with its rules relating to such conditions. The Framework Directives⁶ limit the scope of controls over policy conditions by providing that prior approval cannot be made a condition for authorisation.

However, the issue of consumer protection in the field of conditions of insurance arises not only in respect of administrative control of contract terms, but also in relation to contract law as in some cases contract law governs the conditions of insurance. An example of this function of contract law can be seen in French insurance contract law where many of the requirements⁷ of the policy are laid down in a manner which precludes their amendment by the contracting parties.

2. Solutions to Problems arising from Differences in Contract Law

(a) Harmonisation

Harmonisation of the fundamental elements of the insurance contract laws of the Member States would aim to resolve the problems identified above through the elimination of the most important areas of divergence. It would not eliminate the need for choice-of-law rules in respect of services business as the national law which governed the

⁵Case 205/84, [1986] ECR 3755. See chap. 1, section C.

⁶Directive 92/49, OJ 1992 L228/1 (non-life) and Directive 92/96, OJ 1992 L360/1 (life).

⁷The Comité Européen des Assurances (CEA), EEC-Insurance Contract Law (1990) lists many of the mandatory requirements. The French law is discussed in chap. 3.

contract would still have to be identified. However, the need for restrictions on choice of law in order to ensure that policyholders benefited from the protection provided by their own national law would be reduced.

(b) Choice of Law

Choice-of-law rules seek to resolve only the issue of the contract law applicable to services business and do not address issues related to competition, the impact which contract law has on conditions of insurance or the role of contract law in consumer protection. They may provide for either a free choice of law or may impose restrictions on the contracting parties' choice.

(i) Free Choice of Law

A free choice of law may be appropriate in two situations. The first is where the parties to the contract are sufficiently well-informed as to be able to judge the consequences of any particular choice of law. The second is where the laws of the relevant Member States are sufficiently similar to ensure that the rights and obligations of the parties are not materially different irrespective of the choice of law. In this instance there is no interest to protect in a Member State attempting to apply its own law to services contracts entered into by its citizens as an equivalent level of protection is provided by other Member States.

(ii) Restricted Choice of Law

Restrictions on choice of law may be regarded as necessary where Member States feel that their citizens must not be deprived of the protection provided by their own law when they purchase insurance on a services basis. Implicit in this position is the proposition that the protection provided by the laws of other Member States is not adequate: if it were, there would be no need for restrictions as equivalent protection would be provided by the laws of other Member States.

B. THE DEVELOPMENT OF THE COMMUNITY'S APPROACH

1. The Initial Approach to Contract Law

Contract law was not a major issue in the early phase of the liberalisation of the insurance market. The emphasis on the creation of a framework for the exercise of freedom of establishment meant that the focus was on contracts concluded between an insurer established in the Member State in which the insured was resident and in which the risk was located: in most cases this did not involve questions of choice of applicable law. However, the movement towards the implementation of full freedom of services meant that the regulatory framework had to encompass issues of choice of law which would inevitably arise. An obvious example would be a situation where insurance was concluded with an insurer not established in the Member State in which the risk is located and the insured resides.

2. The draft Insurance Contract Law Directive

A draft Insurance Contract Law Directive⁸ was proposed by the Commission and later amended⁹. Although the movement towards a services regime in insurance acted as an impetus in formulating the Commission's approach, it is clear from the provisions of the draft Directive and the explanatory memorandum that the rationale for a Directive extended beyond business transacted on a services basis¹⁰. This is implied in the opening comments of the explanatory memorandum :

⁸COM (79) 355 final.

⁹COM (80) 854 final.

¹⁰The preamble to the Directive suggests a different interpretation of services business to that subsequently adopted by the Court of Justice in Commission v Germany (case 205/84) [1986] ECR 3755 but does not affect the validity of this comment as the Directive was intended to apply to all relevant business, irrespective of where the dividing line between establishment and services lay.

"The harmonisation of contract law in connection with freedom to provide services and freedom of choice of applicable law has a twofold objective. Firstly, to guarantee the policyholder that whatever the choice of applicable law, he will receive identical protection as regards the essential points of the contract. Secondly, to eliminate as competition factors for undertakings the fundamental differences between national law."

As the objectives of the draft Directive relate to the substance of contract law in each Member State, they affect establishment as well as services business.

The most important provisions of the draft Directive are in respect of the declaration of the risk¹¹ and changes in the risk. Declaration of the risk is governed by Article 3 of the draft Directive. The original terms of this article required disclosure of any circumstances of which the policyholder was aware might influence the insurer's assessment or acceptance of the risk. However, the second draft incorporated the European Parliament's view¹² that disclosure should be in relation to what a reasonable policyholder would expect to influence a prudent insurer's judgement.

Both the first and second drafts implemented the principle of proportionality. In relation to situations where the insured has not fulfilled the duty of disclosure and where a claim arises before a policy is amended or terminated, this provides that the insurer shall be liable to provide only such cover as is in accordance with the ratio between the premiums paid and the premium that should have been paid if the insured had declared the risk correctly. The second draft modified this to allow for repudiation of a claim if it were clear that the insurer would not have accepted the risk regardless of the premium rate or that acceptance would have been conditional on certain conditions. Changes in the risk were dealt with by two separate articles of the Directive dealing with increase¹³ and reduction¹⁴ in

¹¹Otherwise referred to as the duty of disclosure.

¹²Minutes of the proceedings of the sitting of 19.9 1980 (PE 66.785, p27).

¹³Article 4.

risk. The former laid down a procedure for amendment of the policy and provided the insurer with a right to terminate the contract: the latter provided that the insured was entitled to a reduced premium and could terminate the contract if this was not agreed to by the insurer.

The scope¹⁵ of the draft Directive was limited to non-life insurance, excluding certain classes which were regarded as having special characteristics: marine, aviation and transport were excluded owing to the international nature of the business and the long-established tradition of freedom of choice of applicable law, whilst credit and suretyship were regarded as requiring further examination. Deferring to the wishes of the Economic and Social Committee¹⁶ and the European Parliament¹⁷, the second draft of the Directive limited its scope in two respects: first, harmonisation was limited to contracts covering risks situated in the Member States of the Community; and secondly, sickness insurance was added to the list of excluded classes.

As regards implementation, the draft Directive provided that only the parties to the contract could agree on more favourable terms for the policyholder: the obligation of the Member States was to implement the Directive as an absolute and not a minimal standard. Some delegations had argued¹⁸ for Member States to be allowed the option to change the content of the Directive to give increased protection to policyholders on the basis that an absolute standard would have involved some Member States in reducing their level of consumer protection. However, this approach was rejected by the Commission on the grounds that it would frustrate the process of harmonisation and allow freedom of choice of applicable law to become an element of competition, which was unacceptable.

¹⁴Article 5.

¹⁵Article 1.

¹⁶See: OJ 1980, C146/1.

¹⁷See note 12, above.

¹⁸This point is made in the notes to Article 12 in the first draft of the Directive.

3. The Abandonment of Harmonisation

The draft Directive failed to secure the approval of the Council with the result that a question mark hung over the Community's commitment to harmonisation. By the time of the adoption of the Second Non-Life Directive in June 1988, the prospects for the adoption of the draft Insurance Contract Law Directive had deteriorated. This was implicit in the adoption within that Directive of rules relating to choice of law. By contrast with the preamble to the draft Insurance Contract Law Directive (above), the preamble to the Second Non-Life Directive adopts a very limited view of the significance of differences in contract law:

"Whereas the provisions in force in the Member States regarding insurance contract law continue to differ; whereas the freedom to choose, as the law applicable to the contract, a law other than that of the State in which the risk is situated may be granted in certain cases, in accordance with rules taking into account specific circumstances."

In adopting this approach, the Commission largely ignored the views of the European Parliament, which commented¹⁹ on the Commission's proposal²⁰ for a Second Non-Life Directive as follows:

"Emphasizesthe need for the Commission to submit proposals for coordinating the laws relating to insurance contracts as soon as possible and not later than three years after promulgation of this Directive, for it is only by this means that the freedom to provide services in the insurance sector within the common market can be effectively promoted."

A year after the adoption of the Second Non-Life Directive, the abandonment of the objective of harmonisation had become clearer. Sir Leon Brittan, the Commissioner responsible for insurance said²¹ in November 1989:

¹⁹Resolution of the European Parliament on a proposal for a Second Non-Life Insurance Directive: OJ 1978 C36/14.

²⁰OJ 1976, C32/2.

²¹An address to the Comité Européen des Assurances, extracted from Regulation of Insurance in the United Kingdom and Ireland (editors T.H. Ellis and J.A. Wiltshire).

"The forthcoming Non-Life Framework Directive will need to cover certain issues relating to contract law and policy conditions... but it is already certain that we will either withdraw or substantially amend the proposal for a contracts directive which has, in any case, made no progress in the Council."

By the time of the adoption of the Third Non-Life Framework Directive in June 1992, the Commission's position had been transformed into an explicit rejection of the arguments which it had previously advanced in favour of harmonisation. The preamble to this Directive²² states:

"Whereas the harmonisation of insurance contract law is not a prior condition for the achievement of the internal market in insurance; whereas, therefore, the opportunity afforded to the Member States of imposing the application of their law to insurance contracts covering risks situated within their territories is likely to provide adequate safeguards for policyholders who require special protection;"

Biancarelli²³ takes the view that the abandonment of harmonisation, contrary to the wishes of the Comité Européen des Assurances²⁴, was based on the Commission's assumption that dynamic liberation by way of provision of services in the insurance market, should lead, inevitably, to co-ordination of the different national legal systems²⁵. However, two other factors also lay behind the Commission's change of view in respect of the need for harmonisation of insurance contract law. The first, and probably the most important, was that it was not possible

²²Consideration 18.

²³Jacques Biancarelli, "Insurance Contract Law in the Single European Market - Law Applicable, Public Policy Provisions, International Conventions", XII International Colloquium of Magistrates and Insurers (Avignon 4-7 October 1991).

²⁴This is a federation of national insurance associations from Community countries which speaks on behalf of its members in international organisations.

²⁵Evidence presented to the House of Lords Select Committee on the European Communities (session 1990-91, 12th Report, A Single Insurance Market) by Humbert Drabbe, Head of the Insurance Division in DG XV makes clear that the Commission continued to favour harmonisation despite the official abandonment of its proposals:
"It would be a logical approach if contract law in the EC was harmonised so that policy conditions had the same main elements in them, which would be helpful for consumers and also for insurance companies in marketing their products. They would be bound by the same elements of contract law. This has proven to be impossible. Consequently, the Commission has taken a different approach."

to secure the agreement of the Member States to a Directive, which at that time would have required unanimity²⁶. A major consideration in the breakdown of negotiations was that the draft Directive was based largely on French law and practice and would have required fundamental changes in law in other Member States, particularly in the United Kingdom. The second influence was the absence of a formal framework within which a contract law Directive could be developed. In the absence of a fully-fledged Community consumer policy, contract law could be approached only as an adjunct of the Single Market programme, which meant that full consideration was not given to the merits of harmonisation as a measure of consumer protection²⁷.

The adoption by the Community of a new approach to harmonisation in the early 1980's also played a part in the demise of the draft Insurance Contract Law Directive by limiting the scope of harmonisation measures and stressing the principle of mutual recognition of laws and regulations of Member States. In order to place the issue of the harmonisation of insurance contract law within the framework of the Community's overall approach to harmonisation, it is helpful to examine the development of the new approach

The original Treaty basis for harmonisation (Article 100) had three essential features: its scope was measures which affected the establishment or functioning of the common market; it required unanimity in the Council; and directives were the only instrument through which action could be taken. Two influences in particular led

²⁶The Treaty basis of the draft Directive was Articles 57(2) and 66. The amendments to article 57(2) introduced by the Single European Act would probably allow for its adoption by qualified majority voting. Alternative Treaty bases are discussed in chapter 4.

²⁷The Economic and Social Committee ("Opinion on Consumer Protection and Completion of the Internal Market", OJ 1991 C339/16) referred to the draft Directive in the context of the following comment:

"Many proposals have been killed, weakened or delayed because they fell outside the remit of the Community institutions, not because they were faulty in themselves."

to changes which were eventually incorporated in the Single European Act. Each is discussed below.

(a) The Court of Justice

The first influence was the development of the case-law of the Court of Justice in a direction which gave greater force to Treaty provisions on the free movement of goods and thereby reduced the need for harmonisation. This process is best typified by the Cassis de Dijon²⁸ case, in which the Court of Justice set out the foundations of the principle of "equivalence" as a test for the legality of barriers to the free movement of goods. Prior to this case, there was some doubt as to whether measures which were indistinctively applicable to all products, whether domestic or imported, fell within the prohibition in Article 30 of measures having equivalent effect to quantitative restrictions. In Cassis de Dijon, the Court of Justice held that such measures could constitute measures having equivalent effect to quantitative restrictions within the meaning of Article 30 unless they were justified by "mandatory requirements"²⁹. This approach, which permitted the free circulation within the Community of goods lawfully

²⁸Case 120/78, Rewe-Zentral AG v Bundesmonopolverwaltung für Branntwein [1979] ECR 649. The Court of Justice held that German regulations in respect of the minimum alcohol content of potable spirits constituted "measures having an effect equivalent to quantitative restrictions on imports" within the meaning of Article 30EEC, despite the fact that they were applied without discrimination as to country of origin.

²⁹Mandatory requirements were recognised by the Court as compatible with Article 30 where they serve a purpose which is in the general interest and are the least restrictive means of achieving their objective. The list of mandatory requirements is not closed, although the Court referred specifically to four categories: the effectiveness of fiscal supervision, the protection of public health, the fairness of commercial transactions and the defence of the consumer. See Wyatt & Dashwood, The Substantive Law of the European Community (2nd edn.) p142.

produced or marketed in their country of origin, formed the basis of the principle of "equivalence"³⁰.

The impact of the development of the principle of "equivalence" on financial services can be seen in the development of the concept of "mutual recognition" of the regulatory systems of individual Member States as the basis for freedom of services. In the insurance cases, the Court held that non-discriminatory measures were illegal if they duplicated measures applied by an insurer's home state which provided equivalent protection in the host state³¹. More recently, the principle of "mutual recognition" has been incorporated into the "Framework" Directives as the basis on which the "single licence" will operate.

(b) The New Approach

The second influence was the development of a new approach to harmonisation which was advocated in the Commission's White Paper³² in 1985. Its essential feature was that harmonisation should be limited to areas regarded as essential for the operation of the Single Market and that the principle of mutual recognition of national regulations should apply in non-essential areas³³.

³⁰Oliver, Free Movement of Goods, para. 6.55, notes that it was not until later that the Court referred explicitly to the principle of equivalence.

³¹In doing so, it followed its decisions in van Binsbergen, case 33/74 [1974] ECR 1299 and Webb, case 279/80 [1981] ECR 3305.

³²Completing the Single Market, COM (85) 310 final. The draft Insurance Contract Law Directive was listed (p26) as one of several measures which were to be adopted in the process of completing the Single Market in insurance. The likely date for adoption by the Council was given as 1988.

³³The essence of the Commission's new approach was communicated to the Member States shortly after the Court's decision in Cassis de Dijon: see Communication from the Commission to the Member States, OJ 1980 C256/2. See also the Council Resolution on a new approach to technical harmonisation and standards, OJ 1985 C136/1.

The rationale for the new approach was that the recognition of the principle of "equivalence" had narrowed the scope of harmonisation measures, in that harmonisation was no longer necessary in order to ensure the free circulation of goods within the Community. The Commission, in its White Paper, emphasised the need for harmonisation in respect of mandatory health and safety requirements which may be used to justify measures having equivalent effect to quantitative restrictions.

The new approach influenced the Single European Act which modified the existing Treaty provisions on harmonisation (Article 100) through the introduction of a new Article 100A. Of most significance to the programme for the liberalisation of the insurance market is that voting under Article 100A is by qualified majority³⁴. Under the new approach, adoption of the draft Directive would be possible by qualified majority voting. However, as noted above, the Commission has made clear that it does not regard the harmonisation of insurance contract law as necessary at this stage. Instead, a solution has been sought through the medium of harmonisation of rules of private international law. This represents a major shift in the stance of the Commission which had previously regarded harmonisation as a necessary precursor of the limited freedom of services introduced by the "second generation" Directives³⁵.

C. THE PROPOSED REGIME FOR INSURANCE CONTRACT LAW

The ostensible aim of the provisions of the insurance Directives in respect of choice of law is to harmonise rules of private international law, but the influence of harmonisation of substantive law can still be seen. Indeed, the combination of provisions falling into the two separate categories under the heading of choice of law introduces an

³⁴The extension of legislative instruments to include Regulations as well as Directives has been less significant as the bulk of the Single Market programme in insurance is comprised of Directives.

³⁵The implementation date set by the draft Insurance Contract Law Directive was 1st July, 1983.

element of confusion into the approach to contract law. Harmonisation of substantive law and harmonisation of private international law rules represent different, albeit complementary, techniques: the former effectively eliminates the areas of divergence, whereas the latter ensures that different national rules can co-exist in an orderly fashion. In recognition of this distinction, it is most useful to analyse the existing provisions and proposals in respect of contract law in terms of those which represent harmonisation of rules of private international law and those which represent harmonisation of substantive (insurance contract) law.

1. Harmonisation of Private International Law

Two general principles apply to the harmonisation which has taken place in both the life and non-life sectors. The first is that the provisions³⁶ of the Community Directives are to be applied by way of derogation from a Member State's general rules of private international law³⁷: thus, the insurance Directives introduce a new layer of rules which complicate the overall structure of private international law in the field of insurance contracts. Secondly, as in the case of the "second generation" Directives, the policy of establishing a liberal regime for "large" non-life risks and a more restrictive regime for other risks has been applied to the choice-of-law rules. The effect is that freedom of choice of contract law has been substantially limited in the case of "mass" risks and life assurance.

The extent to which the choice-of-law provisions of the insurance Directives are relevant to the public law³⁸ provisions of the Member States is not clear. The issue is of importance as public law

³⁶They are set out in Annex 1 to this chapter.

³⁷Article 7(3) of the Second Non-Life Directive, Article 4(5) of the Second Life Directive.

³⁸The law of insurance regulation (authorisation and supervision of insurers) forms part of public law.

provisions in the field of insurance can have a direct bearing on the contractual relationship between insurer and policyholder, for example by fixing the terms of the contract³⁹. The Rome Contracts Convention⁴⁰, which served as the model for several of the provisions of the insurance Directives, does not provide clear guidance. Jackson⁴¹ has argued that the Rome Convention encompasses rules of public law on the grounds that there is no express exclusion and that the categorisation of laws as public or private does not represent a valid boundary within the process of conflict of laws. However, Philips⁴² has argued for the exclusion of public law rules from the scope of the Rome Convention on the basis that choice-of-law rules have traditionally been confined to private law and that public law rules are superior to choice-of-law rules, or "internationally mandatory" in the sense discussed below. Philips' argument appears to be the more convincing of the two, in that, as discussed below, both the Rome Convention and the insurance Directives contain provisions which ensure the superiority of public law rules of the forum over choice-of-law rules.

³⁹In this case, the public law provision is described as self-executing: see Kimball and Pfennigstorf, "Legislative and Judicial Control of the Terms of Insurance Contracts: A Comparative Study of American and European Practice", 39 *Indiana Law Journal* (1964) 675.

⁴⁰OJ 1980, L266/1, as amended following the accession of new Member States (OJ 1984, L146/1).

⁴¹Chap. 4, "The EEC Convention on the Law Applicable to Contractual Obligations: A Comparative Study", in Contract Conflicts: the EEC Convention on the Law Applicable to Contractual Obligations: A Comparative Study (editor, P.M. North).

⁴²Op. cit. North (editor), chap. 5, "Mandatory Rules, Public Law (Political Rules) and Choice of Law in the EEC Convention on the Law Applicable to Contractual Obligations".

(a) Non-Life Insurance

(i) Basic Principles

The regime governing choice of law is contained mainly in Article 7 of the Second Non-Life Directive: the Third Directive leaves this regime largely intact⁴³. The provisions of both Directives are limited to risks situated⁴⁴ within the Member States. A distinction is drawn between "large" risks in respect of which the parties to the contract are allowed complete freedom in the choice of law and other risks ("mass" risks) in respect of which the aim is to apply the most appropriate national law. The rules for the selection of the most appropriate national law represent a minimum level of choice: individual Member States are free to allow the parties greater freedom of choice⁴⁵.

The central principle for the selection of the applicable law for "mass" risks is the identification of the Member State with which the contract is most closely connected. Where a policyholder has his habitual residence within the Member State in which the risk is situated, the law applicable to the insurance contract shall be the law of that Member State⁴⁶. If the risk is situated in a Member State other than the home country of the policyholder, the parties may choose the law of either Member State⁴⁷. In the latter case, where the law

⁴³Earlier drafts of the Third Directive had proposed several amendments to Article 7 of the Second Directive. However the final text of the Third Directive (Article 27) contains only one change to Article 7: it extends the category of risks in respect of which the parties may choose any law to all "large" risks within the meaning of Article 5(d) of the First Directive. Article 7 of the Second Directive had limited this category to Article 5(d)(i) of the First Directive.

⁴⁴The words "situated within" are defined in Article 2(d) of the Second Non-Life Directive. See Annex 1 for the wording of this Article.

⁴⁵Article 7(1)(d) of the Second Non-Life Directive.

⁴⁶Article 7(1)(a) of the Second Directive.

⁴⁷Article 7(1)(b) of the Second Directive.

A choice of law must be expressed or demonstrated with reasonable certainty by the terms of the contract or the circumstances of the case. If this is not so, or if no choice has been made, the contract shall be governed by the law of the country, from amongst those considered in the provisions governing the applicable law in the absence of choice⁴⁸, with which it is most closely connected. Nevertheless, a severable part of the contract which has a closer connection with another country, from amongst those considered in the provisions on choice, may, by way of exception, be governed by the law of that other country (the principle of "dépeçage"). The contract shall be rebuttably presumed to be most closely connected with the Member State in which the risk is situated⁴⁹.

The Framework Directive⁵⁰ provides that, before an insurance contract is concluded, the insurer shall inform the policyholder of the applicable law, where there is no choice, or the proposed choice of law where there is a choice. The insurer must also inform the policyholder of arrangements for handling policyholders' complaints.

(ii) Limitations on Freedom of Choice

Freedom of choice in respect of "large" risks and the rules applicable to "mass" risks are qualified by certain other provisions. The most important is the possibility of the application of mandatory rules of another law. As noted by Smulders and Glazener⁵¹, Article 7 of the Second Directive refers to two categories of mandatory rules: first, those from which no derogation is possible by means of a contract⁵²;

⁴⁸Article 7(a),(b) and (g).

⁴⁹This paragraph paraphrases the provisions of Article 7(1)(h) of the Second Directive.

⁵⁰Article 31. The obligation applies only where the policyholder is a natural person.

⁵¹"Harmonization in the Field of Insurance Law through the introduction of Community Rules of Conflict" 29 CMLRev (1992) 775.

⁵²Article 7(1)(g). The French Code des Assurances contains many examples of such rules: see chap. 3.

those from which no derogation is possible by means of a contract⁵²; and secondly, rules which apply irrespective of the law applicable to the contract⁵³.

As regards the first category, Article 7(1)(g) provides that the exercise of a choice of law under the provisions of Article 7(1)(a) or Article 7(f) shall not prejudice the application of mandatory rules where all the other elements relevant to the situation at the time of choice are connected with one Member State only⁵⁴. The purpose of this provision is to ensure that, in a purely domestic situation, choice of a foreign law will not deprive a policyholder of the protection afforded by the law of his own Member State⁵⁵.

The second category⁵⁶ refers to rules that apply irrespective of the law otherwise applicable to the contract⁵⁷. The first paragraph of Article 7(2) provides a general escape from the choice-of-law rules of the Second Directive by providing for the application of such laws where they form part of the law of the forum. The second paragraph of Article 7(2) provides a discretion to a Court to apply such rules where

⁵²Article 7(1)(g). The French Code des Assurances contains many examples of such rules: see chap. 3.

⁵³Article 7(2).

⁵⁴Article 7(1)(g) refers only to a choice made under Article 7(1)(a) and Article 7(1)(f) as in other cases falling within Article 7 not all the elements are connected to the law of a single Member State.

⁵⁵It is modelled on Article 3(3) of the Rome Contracts Convention.

⁵⁶Article 7(2).

⁵⁷They are referred to as rules of immediate application or internationally mandatory rules (règles d'application immédiate or eingriffsnormen). Their origins in private international law appear to lie in the "sonderstatut" theory adopted by the Netherlands Supreme Court in the Alnatti case (BGHZ 59, 82) of 1966. Smulders and Glazener, op.cit., and Phillips, op.cit., maintain that the House of Lords adopted a similar rule in 1957 in the case of Regazzoni v K.C. Sethia Ltd. [1958] AC 301, but Richard Plender (The European Contracts Convention, p153) maintains that the principle has found no favour in English law.

they form part of the law of the Member State in which the risk is situated or the Member State imposing the obligation to take out insurance⁵⁸. The first paragraph of Article 7(2) clearly envisages the application by the forum of its own rules of public law as well as private law, but it is not clear that the discretion referred to in the second paragraph extends to the public law of another Member State⁵⁹.

Freedom of choice of law is limited in respect of compulsory insurance by the provision that a contract shall not satisfy an obligation, imposed by a Member State, to take out insurance, unless it is in accordance with the specific provisions laid down by that Member State in respect of that insurance⁶⁰. When, in the case of compulsory insurance, the law of the Member State in which the risk is situated and the law of the Member State imposing the obligation to take out insurance contradict each other, the latter shall prevail.

(b) Life Assurance

Although there are some similarities in approach, freedom of choice of applicable law is much more restricted in the life sector than in the non-life sector, reflecting the greater sensitivity with which Member States have approached consumer interests in respect of life business.

The provisions for the harmonisation of private international law in the life sector are less complex than in the non-life sector. The

⁵⁸This provision is modelled on Article 7(1) of the Rome Contracts Convention. Richard Plender, *op.cit.* p22, notes that, on ratification, the United Kingdom, Luxembourg, the FRG and Ireland exercised the option under Article 22 to declare that they would not apply the provisions of Article 7(1) of that Convention.

⁵⁹Comparison can be made with Article 7(1) of the Rome Contracts Convention (RCC) on which the second paragraph of Article 7(2) of the Second Non-Life Directive is modelled. Philips, *op.cit.* p105, takes the view that the legislative history of Article 7(1) of the RCC indicates that its scope includes public law rules. In this respect, he argues that it represents an exception to the general rule of the RCC, which he maintains to be that a choice of law does not encompass rules of public law.

⁶⁰Article 8(2) of the Second Directive.

complications in the non-life provisions resulting from the risk and the insured being in separate Member States are not generally present as the risk and the policyholder are generally the same individual. However, although the rules are less complex, the same general principles apply as in the non-life sector: first, the rules apply by way of derogation from a Member State's general rules of private international law⁶¹; and secondly, Member States are free to make provision for a wider choice of law than is prescribed by the Second Life Directive.

The basic principle⁶² is that the law applicable to contracts shall be the law of the Member State of the commitment⁶³. A wider choice may be available in two situations. First, where the law of that state so allows, the parties may choose the law of another country. Secondly, where the policyholder has his habitual residence in a Member State other than that of which he is a national, the parties may choose the law of the Member State of which he is a national⁶⁴.

As regards reference to the mandatory rules of another law, the Member States retain greater discretion than in the case of non-life insurance. The Second Life Directive makes no reference to rules from which no derogation is possible by means of contract. Thus, it appears that, unlike the position in respect of non-life risks⁶⁵, it is left to the laws of the Member State to decide whether a choice of law can

⁶¹Article 4(5).

⁶²Article 4(1).

⁶³According to Article 2(e), the Member State of the commitment: "means the Member State where the policyholder has his habitual residence, or if the policyholder is a legal person, the Member State where the latter's establishment, to which the contract relates, is situated;".

⁶⁴Article 4(2).

⁶⁵Article 7(1)(g) of the Second Non-Life Directive limits the application of rules from which no derogation is possible by contract through a requirement that the other elements of the situation must be connected with the relevant Member State.

prejudice the application of its mandatory rules⁶⁶. In the case of rules which apply irrespective of the law otherwise applicable to the contract (internationally mandatory rules), the provisions of the Second Life Directive (Article 4(2)) are similar to those of the Second Non-Life Directive (Article 7(2)).

The Third Life Directive⁶⁷ makes no material change to the choice-of-law provisions of the Second Life Directive. The explanatory memorandum⁶⁸ makes clear that the normal procedure will be for a Member State, having received notice from an insurer established in another Member State to the effect that it intends to supply insurance on a services basis, to make clear that it expects its own law to govern the contract.

2. Harmonisation of Contract Law

(a) The Consumer Contracts Directive

Before moving on to consider the specific provisions of the insurance Directives which impinge on the substance of contract law, reference should be made to the Directive on Unfair Terms in Consumer Contracts⁶⁹. The purpose of the Directive is to approximate the laws, regulations and administrative provisions of the Member States relating to unfair terms in contracts concluded between a seller or supplier and a consumer. Only terms which have not been individually negotiated (i.e. standard form contracts) are included within the scope of the Directive. Several categories of contract are excluded from the scope

⁶⁶This is the interpretation of Article 4 of the Second Life Directive adopted by Smulders and Glazener, op. cit. p787.

⁶⁷Directive 92/96, OJ 1992 L360/1.

⁶⁸This accompanied the Commission's proposal: COM (91) 57 final.

⁶⁹Directive 93/13, OJ 1993 L95/29. The Directive applies to contracts concluded after 31 December 1994.

of the Directive⁷⁰. The definition of "consumer" is intended to cover only individuals acting in a private capacity, whereas the definition of "seller or supplier" relates to individuals or firms acting in a business capacity. Unfair terms are defined by Article 3 as follows:

"A contractual term which has not been individually negotiated shall be regarded as unfair if, contrary to the requirement of good faith, it causes a significant imbalance in the parties' rights and obligations arising under the contract, to the detriment of the consumer."

The concept of good faith is clarified by the preamble⁷¹ which provides that:

".. whereas, in making an assessment of good faith, particular regard shall be had to the strength of the bargaining position of the parties.."

Article 4(2) of the Directive is of particular relevance to insurance. It provides that:

"Assessment of the unfair nature of the terms shall relate neither to the definition of the main subject matter of the contract nor to the adequacy of the price and remuneration, on the one hand, as against the services or goods supplied in exchange, on the other, in so far as these terms are in plain intelligible language."

Paragraph 19 of the preamble clarifies Article 4(2) as follows:

"... whereas it follows, inter alia, that in insurance contracts, the terms which clearly define or circumscribe the insured risk and the insurer's liability shall not be subject to such assessment since these restrictions are taken into account in calculating the premium paid by the consumer;"

Two issues arise in relation to the treatment of insurance in this Directive. First, as noted by Duffy⁷², it is possible to question the use of a preamble for the purposes of clarifying or qualifying the text of a Directive. However, there are two reasons why the exclusion of

⁷⁰These are: contracts of employment; contracts relating to succession rights; contracts relating to rights under family law; contracts relating to the incorporation and organization of companies and partnership agreements. See para.10 of the preamble.

⁷¹Para. 16.

⁷²Peter Duffy, "Unfair contract terms in the draft EC Directive", 1993 JBL 67.

the preambles to Community measures such as Directives⁷³. Secondly, it would be possible to interpret Article 4(2), even in the absence of paragraph 19 of the preamble, as leading logically to the conclusion expressed in that paragraph.

The second issue is the question of whether there are any insurance contract terms which fall within the Directive. This depends on a judgement as to the scope of the phrase "terms which define or circumscribe the insured risk and the insurer's liability" in paragraph 19 of the preamble. It is submitted that there are insurance contract terms, such as those governing claims notification, which fall outside the scope of this phrase and are therefore covered by the Directive. This leads to the unsatisfactory conclusion that the fundamental terms of an insurance contract are excluded from the Directive but that less important terms may be covered.

(b) The Insurance Directives

The provisions of the insurance Directives which represent harmonisation of contract law are those in respect of the "cooling-off" period and those which are entitled "transparency". The latter have not been generally recognised as impinging on the substance of contract law⁷⁴, but, as argued below, they can be seen in this light.

(i) "Cooling-off"

⁷³Duffy, *op.cit.*, cites case (C-106/89) Marleasing S.A. v La Commercial [1990] ECR 4135 in support of this view. In that case, the Court referred to the preamble to the First Company Law Directive (68/151).

⁷⁴Smulders & Glazener, *op.cit.* p778, take the view that: "the present insurance directives harmonise only one rule of contract law, enabling a policyholder who concludes an individual life insurance contract to cancel it within a certain time limit."

(i) "Cooling-off"

The purpose of the "cooling-off" period is to allow a policyholder a period of time in which to cancel a contract which, under the normal principles of contract law, would be binding. The Second Life Directive provides that where a contract is entered into on a services basis, a policyholder shall have a period of between 14 and 30 days from the time he was informed that the contract had been concluded within which to cancel the contract. This right is extended by the the Third Life Directive to include business transacted on an establishment as well as a services basis⁷⁵: however, where the policyholder is not in need of special protection, Member States need not allow for a right of cancellation⁷⁶.

The consequences of failure to comply with the requirement to provide the policyholder with a "cooling-off" notice are not made clear: this is left to be determined by the law applicable to the contract as defined in Article 4 of the Second Directive. Thus, it has been observed that, as far as English law is concerned, this might appear to provide the policyholder with a right, unlimited in time, to cancel the contract⁷⁷. Nevertheless, this deficiency does not change the nature of the "cooling-off" period as a modification of the substance of the normal rules of contract law which do not allow cancellation on the grounds that one party has simply had a change of mind.

⁷⁵Article 30(1).

⁷⁶Article 30(2). Member States may also decide whether or not to apply the cancellation rules to contracts of six months' duration or less.

⁷⁷This point was made by The English Law Society in its response to the Consultative Document on the Third Life Directive published by the DTI. It was also observed that there was no provision for a "cooling-off" period where a third party interest is concerned (e.g. a mortgage-linked policy).

(ii) Transparency

The second example of harmonisation of contract law within the insurance Directives is contained in the provisions of the Third Life Directive regarding "transparency". These relate to matters in respect of which the policyholder is required to receive information before he enters into a contract (such as distribution of profit participation and surrender values) and issues⁷⁸ on which he must be kept informed throughout the term of the contract (mainly changes to the initial information). Once again, the legal effect of failure to comply would be determined under the applicable law, but it seems clear that the creation of the obligation of disclosure impinges on the substance of contract law.

3. Insurance within the General Rules of Private International Law

As has already been noted, the provisions of the insurance Directives on the harmonisation of rules of private international law apply by way of derogation from the general rules of the Member States in this field. Those general rules are to a substantial degree founded on two Conventions: the 1968 Brussels Convention on Jurisdiction and the Enforcement of Judgments in Civil and Commercial Matters⁷⁹; and the 1980 Rome Convention on the Law Applicable to Contractual Obligations⁸⁰.

The Brussels Convention is based on the fourth indent of Article 220 of the Treaty of Rome. The Rome Convention has no formal Treaty basis:

⁷⁸The required items are listed in Annex 2 of the Third Life Directive.

⁷⁹OJ 1978, L304/36. The Convention is in force for all Member States. The Lugano Convention 1988 (OJ 1988 L319/9) extended the Brussels Convention to EFTA countries.

⁸⁰OJ 1980, L266/1, as amended following the accession of new Member States (OJ 1984, L146/1). The Rome Convention is in force for all Member States except Spain, Ireland, the Netherlands and Portugal. Under the terms of the Convention, the date for entry into force in the UK was 1 April 1991. See also chap. 5, part 1.

however, only Member States of the Community may sign it and there is some basis for holding that it should be interpreted in the light of the EEC Treaty⁸¹. Both Conventions are expressly subordinated⁸² to existing or subsequent acts of Community institutions which relate to particular matters within the scope of the respective Conventions, so that the provisions of the insurance Directives take precedence over the provisions of the Conventions.

(a) Jurisdiction

The insurance Directives do not deal with issues of jurisdiction (being confined to choice of applicable law). Jurisdiction is governed by the Brussels Convention⁸³, whose general rule⁸⁴ of jurisdiction is that persons domiciled in a Contracting State shall, whatever their nationality, be sued in the courts of that State. However, this is subject to special rules⁸⁵ in the case of insurance. The objective of the parties to the Treaty was to protect the insured who was seen as being in a weaker economic position than the insurer⁸⁶. The result is that the following courts have jurisdiction in respect of a defendant insurer, when the insurer is domiciled in a Contracting State:

1. Courts of the Contracting State in which the defendant insurer is domiciled;

⁸¹This contention is made by Richard Plender, op.cit. p8, on the basis of the decision of the Court of Justice in Tessili v Dunlop, case 12/76 [1976] ECR 1473: "Accordingly, the Convention must be interpreted having regard both to its principles and objectives and to its relationship with the [EEC] Treaty" (p.1484).

⁸²Article 20 of the Rome Convention, Article 57 of the Brussels Convention.

⁸³On the Brussels Convention's approach to insurance see P. Kaye, Civil Jurisdiction and Enforcement of Foreign Judgements, Part 5, Section IV(A).

⁸⁴Article 2.

⁸⁵Title II, Section 3 (Articles 7 to 12) of the Brussels Convention deals with insurance.

⁸⁶See the Jenard Report on the Convention, OJ 1979 C59/1 and 66, pp 28-33.

2. Courts for the place in which the insurer's branch, agency or other establishment is situated, as regards a dispute arising out of the operations thereof;
3. Courts of the place of the policyholder's Contracting State domicile at the date of the institution of proceedings;
4. Where the defendant is a co-insurer, courts of a Contracting State in which proceedings are brought against the leading insurer;
5. In liability insurance and insurance of immovable (and in certain cases, movable) property, courts of the place where the harmful event occurred;
6. In respect of liability insurance, courts in which the insured is sued by the injured party.

The rules governing jurisdiction in actions brought by insurers are more restrictive. They provide that the following courts have jurisdiction:

1. Courts of the Contracting State in which the defendant is domiciled;
2. Courts seised of a direct action by an injured party against an insurer;
3. A court in which an original claim is pending in accordance with Section 3 (governing insurance) on a counterclaim by a defendant insurer against the plaintiff;
4. As regards a dispute arising out of the operations of a branch, agency or other establishment, courts for the place in which the branch, agency or other establishment is situated.

Thus, even before the issue of applicable law falls to be considered, the question of jurisdiction in insurance cases raises special considerations.

(b) Applicable Law

The insurance Directives take precedence over the Rome Convention, but the latter, as part of the general rules of the Member States in relation to private international law, applies in situations not covered by the Directives: these include reinsurance and risks outside the Community. This results from the fact that the scope of the Rome Convention excludes insurance (but not reinsurance) of risks situated in the territories of the Member States⁸⁷, but not risks outside those territories, whilst the insurance Directives apply only to direct insurance risks situated within the Community.

⁸⁷Article 1(3).

Thus, insurance can be split into four different categories⁸⁸ as regards the applicable rules of private international law:

1. Direct life and non-life risks within the Community are governed by the provisions of the insurance Directives.
2. Direct life and non-life risks outside the Community are governed by the Rome Convention.
3. Reinsurance is governed by the Rome Convention.
4. Direct life and non-life risks within the Community but outside the scope of the insurance Directives⁸⁹ are excluded from the provisions of both the insurance Directives and the Rome Convention and are governed by the national choice-of-law rules of the forum. The latter also govern contracts concluded prior to the entry into force of the Rome Convention⁹⁰ or insurance Directives.

There is some similarity in approach between the Rome Convention and the provisions on choice of law in the insurance Directives. Smulders and Glazener have argued that⁹¹:

"in essence there are not so many differences between the rules of the Directives and the [Rome] Convention."

However, there are important differences. Two aspects in which they differ are particularly important. First, the Rome Convention allows greater freedom in the choice of law than do the insurance Directives, although both incorporate special measures to protect the consumer. The Rome Convention looks primarily to the contracting parties' choice of law: it protects the "consumer" primarily by ensuring that he is not deprived of the protection afforded by the mandatory rules of the

⁸⁸The alternatives are illustrated diagrammatically in Annex 2 at the end of this chapter.

⁸⁹See Article 2 of the First Life and Non-Life Directives: the scope of subsequent Directives is defined by reference to the First Directives.

⁹⁰Article 29.

⁹¹op.cit. p788.

country in which he has his habitual residence⁹². By contrast, the insurance Directives, as already noted, aim to restrict choice of law in respect of "mass" risks and life assurance. Secondly, as regards the applicable law in the absence of choice, the Rome Convention gives an important place to the doctrine of "characteristic performance"⁹³: Article 4(2) provides that, in the absence of choice, it shall be presumed that the contract is most closely connected with the country where the party who is to effect the performance which is characteristic of the contract has, at the time of conclusion of the contract, his habitual residence. This doctrine is absent from the provisions of the insurance Directives.

D. CONCLUSIONS

The Community's approach to insurance contract law within the Single Market programme shows an abandonment of the original proposals for harmonisation in favour of a complex set of rules of private international law. However, elements of the original approach through harmonisation can still be seen in the approach to cancellation rules and "transparency".

The presence of two different sets of rules governing choice of law in insurance contracts, in the form of the Rome Contracts Convention and the insurance Directives, creates a number of difficulties. First, the applicable law may vary depending on whether it is governed by the Rome Convention, the insurance Directives or national choice-of-law rules. Secondly, the problem of "parallelism", or competition between different rules of private international law within a single State, is compounded. Thirdly, the choice-of-law rules in the insurance Directives complicate the regime governing the applicable law. Where

⁹²Articles 5(2) and 5(3) of the Rome Convention. In this context "mandatory rules" has the same meaning as in Article 3(3) of the Rome Convention and Article 7(1)(g) of the Second Non-Life Directive. See Richard Plender, The Rome Contracts Convention, chap.7.

⁹³The doctrine is of Swiss origin and has attracted considerable criticism (see I.F. Fletcher, Conflict of Laws and European Community Law, chap. 5).

an agent or broker is involved in a transaction the agency relationship will be governed by the normal rules⁹⁴ of private international law of the Member State even if the contract of insurance is not subject to those rules due to the operation of the provisions of the insurance Directives. The complexity of this situation can only hinder the development of cross-border trade in insurance services, as not only "consumers" but also small and medium-sized businesses are unlikely to have the resources to provide a proper analysis of their rights and obligations.

Special rules applicable to insurance can also be criticised in the context of the Community's aim of establishing a level playing field between providers of financial services and improving the transparency of financial products. As banking is subject to the Rome Contracts Convention and insurance to the special regime of the insurance Directives, there is an additional complication introduced into the legal regime governing products which may serve similar purposes. This is to be regretted at a time when the trend towards financial conglomerates (bancassurance/allfinanz) calls for equivalence in the treatment of the providers of financial services.

⁹⁴The relationship of principal and agent is covered by the Rome Convention as is the relationship of agent and third party but the relationship of principal and third party is excluded.

ANNEX 1 to CHAPTER 2

CONTRACT LAW PROVISIONS OF THE INSURANCE DIRECTIVES

A. NON-LIFE INSURANCE

Article 2(d) of Directive 88/357 (The Second Non-Life Directive)

"Member State where the risk is situated" means:

- the Member State in which the property is situated, where the insurance relates either to buildings or to buildings and their contents, in so far as the contents are covered by the same insurance policy,
- the Member State of registration, where the insurance relates to vehicles of any type,
- the Member State where the policy-holder took out the policy in the case of policies of a duration of four months or less covering travel or holiday risks, whatever the class concerned,
- the Member State where the policy-holder has his habitual residence or, if the policy-holder is a legal person, the Member State where the latter's establishment, to which the contract relates, is situated, in all cases not explicitly covered by the foregoing indents;

Article 7 of Directive 88/357 (The Second Non-Life Directive)

1. The law applicable to contracts of insurance referred to by this Directive and covering risks situated within the Member States is determined in accordance with the following provisions:

(a) Where a policy-holder has his habitual residence or central administration within the territory of the Member State in which the risk is situated, the law applicable to the insurance contract shall be the law of that Member State. However, where the law of that Member State so allows, the parties may choose the law of another country.

(b) Where a policy-holder does not have his habitual residence or central administration in the Member State in which the risk is situated, the parties to the contract of insurance may choose to apply either the law of the Member State in which the risk is situated or the law of the country in which the policy-holder has his habitual residence or central administration.

(c) Where a policy-holder pursues a commercial or industrial activity or a liberal profession and where the contract covers two or more risks relating to these activities and situated in different Member States, the freedom of choice of the law

applicable to the contract shall extend to the laws of those Member States and of the country in which the policy-holder has his habitual residence or central administration.

(d) Notwithstanding subparagraphs (b) and (c), where the Member States referred to in those subparagraphs grant greater freedom of choice of the law applicable to the contract, the parties may take advantage of this freedom.

(e) Notwithstanding subparagraphs (a), (b) and (c), when the risks covered by the contract are limited to events occurring in one Member State other than the Member State where the risk is situated, as defined in Article 2(d), the parties may always choose the law of the former State.

(f) For the risks referred to in Article 5(d)(i) of the first Directive, the parties to the contract may choose any law.

(g) The fact that, in the cases referred to in subparagraph (a) or (f), the parties have chosen a law shall not, where all the other elements relevant to the situation at the time of the choice are connected with one Member State only, prejudice the application of the mandatory rules of the law of that Member State, which means the rules from which the law of that Member State allows no derogation by means of a contract.

(h) The choice referred to in the preceding subparagraphs must be expressed or demonstrated with reasonable certainty by the terms of the contract or the circumstances of the case. If this is not so, or if no choice has been made, the contract shall be governed by the law of the country, from amongst those considered in the relevant subparagraphs above, with which it is most closely connected. Nevertheless, a severable part of the contract which has a closer connection with another country, from amongst those considered in the relevant subparagraphs, may by way of exception be governed by the law of that other country. The contract shall be rebuttably presumed to be most closely connected with the Member State in which the risk is situated.

(i) Where a State includes several territorial units, each of which has its own rules of law concerning contractual obligations, each unit shall be considered as a country for the purposes of identifying the law applicable under this Directive.

A Member State in which various territorial units have their own rules of law concerning contractual obligations shall not be bound to apply the provisions of this Directive to conflicts which arise between the laws of those units.

2. Nothing in this Article shall restrict the application of the rules of the law of the forum in a situation where they are mandatory, irrespective of the law otherwise applicable to the contract.

If the law of a Member State so stipulates, the mandatory rules of the law of the Member State in which the risk is situated or of the Member State imposing the obligation to take out insurance may be applied if and in so far as, under the law of those States, those rules must be applied whatever the law applicable to the contract.

Where the contract covers risks situated in more than one Member State, the contract is considered for the purposes of applying this paragraph as constituting several contracts each relating to only one Member State.

3. Subject to the preceding paragraphs, the Member States shall apply to the insurance contracts referred to by this Directive their general rules of private international law concerning contractual obligations.

Article 8 of Directive 88/357 (The Second Non-Life Directive)

1. Under the conditions set out in this Article, insurance undertakings may offer and conclude compulsory insurance contracts in accordance with the rules of this Directive and of the first Directive.

2. When a Member State imposes an obligation to take out insurance, the contract shall not satisfy that obligation unless it is in accordance with the specific provisions relating to that insurance laid down by that Member State.

3. When, in the case of compulsory insurance, the law of the Member State in which the risk is situated and the law of the Member State imposing the obligation to take out insurance contradict each other, the latter shall prevail.

4. (a) Subject to subparagraphs (b) and (c) of this paragraph, the third subparagraph of Article 7(2) shall apply where the insurance contract provides cover in several Member States of which at least one imposes an obligation to take out insurance⁹⁵.

(b) A Member State which, on the date of notification of this Directive, requires that any undertaking established within its territory must obtain approval for the general and special conditions of its compulsory insurance, may also, by way of derogation from Articles 9 and 18, require such conditions to be approved in the case of any insurance undertaking offering such cover, within its territory, under the conditions provided for in Article 12(1).⁹⁶

(c) A Member State may, by way of derogation from Article 7, lay down that the law applicable to a compulsory insurance contract is the law of the State which imposes the obligation to take out insurance.

⁹⁵Article 30 of Directive 92/49 (The Third Non-Life "Framework" Directive) deletes the reference to subparagraph (b) of Article 8(4).

⁹⁶This subparagraph is deleted by Article 30 of Directive 92/49.

(d) Where a Member State imposes compulsory insurance and the insurer must notify the competent authorities of any cessation of cover, such cessation may be invoked against injured third parties only in the circumstances laid down in the legislation of that State.

5. (a) Each Member State shall communicate to the Commission the risks against which insurance is compulsory under its legislation, stating:

- the specific legal provisions relating to that insurance,
- the particulars which must be given in the certificate which an insurer must issue to an insured person where that State requires proof that the obligation to take out insurance has been complied with. A Member State may require that those particulars include a declaration by the insurer to the effect that the contract complies with the specific provisions relating to that insurance.

(b) The Commission shall publish the particulars referred to in subparagraph (a) in the Official Journal of the European Communities.

(c) A Member State shall accept, as proof that the insurance obligation has been fulfilled, a certificate, the content of which is in conformity with the second indent of subparagraph (a).

B. LIFE ASSURANCE

Article 2 of Directive 90/619 (The Second Life Directive)

(d) "commitment":
means a commitment represented by one of the kinds of insurance or operation referred to in Article 1 of the First Directive;

(e) "Member State of the commitment":
means the Member State where the policy-holder has his habitual residence or, if the policy-holder is a legal person, the Member State where the latter's establishment, to which the contract relates is situated;

Article 4 of Directive 90/619 (The Second Life Directive)

1. The law applicable to contracts relating to the activities referred to in the First Directive shall be the law of the Member State of the commitment. However, where the law of that State so allows, the parties may choose the law of another country.

2. Where the policy-holder is a natural person and has his habitual residence in a Member State other than that of which he is a national, the parties may choose the law of the Member State of which he is a national.

3. Where a State includes several territorial units, each of which has its own rules of law concerning contractual obligations, each unit shall be considered a country for the purposes of identifying the law applicable under this Directive.

A Member State in which various territorial units have their own rules of law concerning contractual obligations shall not be bound to apply the provisions of this Directive to conflicts which arise between the laws of those units.

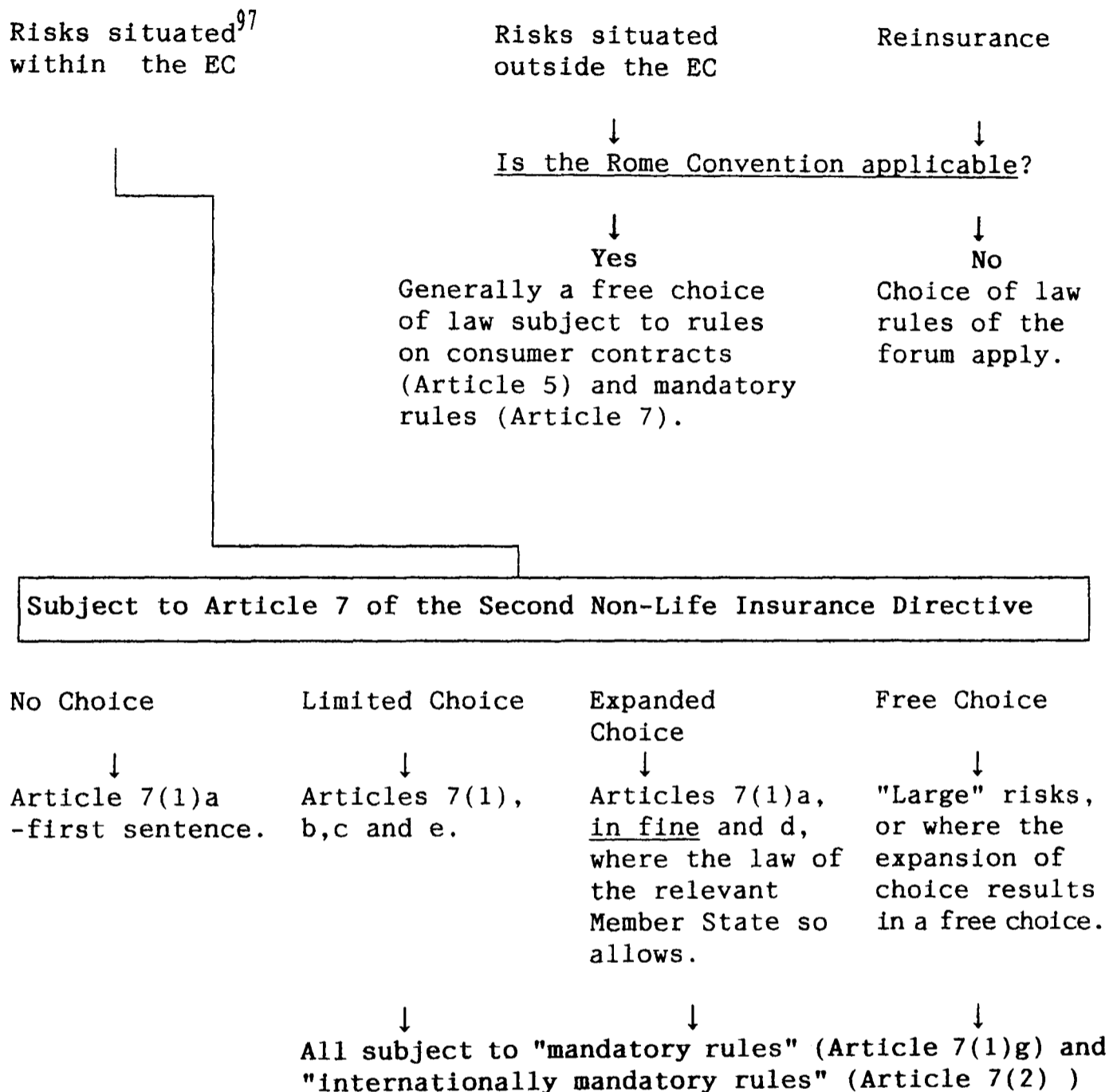
4. Nothing in this Article shall restrict the application of the rules of the law of the forum in a situation in which they are mandatory, irrespective of the law otherwise applicable to the contract.

If the law of a Member State so stipulates, the mandatory rules of the law of the Member State of the commitment may be applied if and in so far as, under the law of that Member State, those rules must be applied whatever the law applicable to the contract.

5. Subject to the preceding paragraphs, the Member States shall apply to the assurance contracts referred to in this Directive their general rules of private international law concerning contractual obligations.

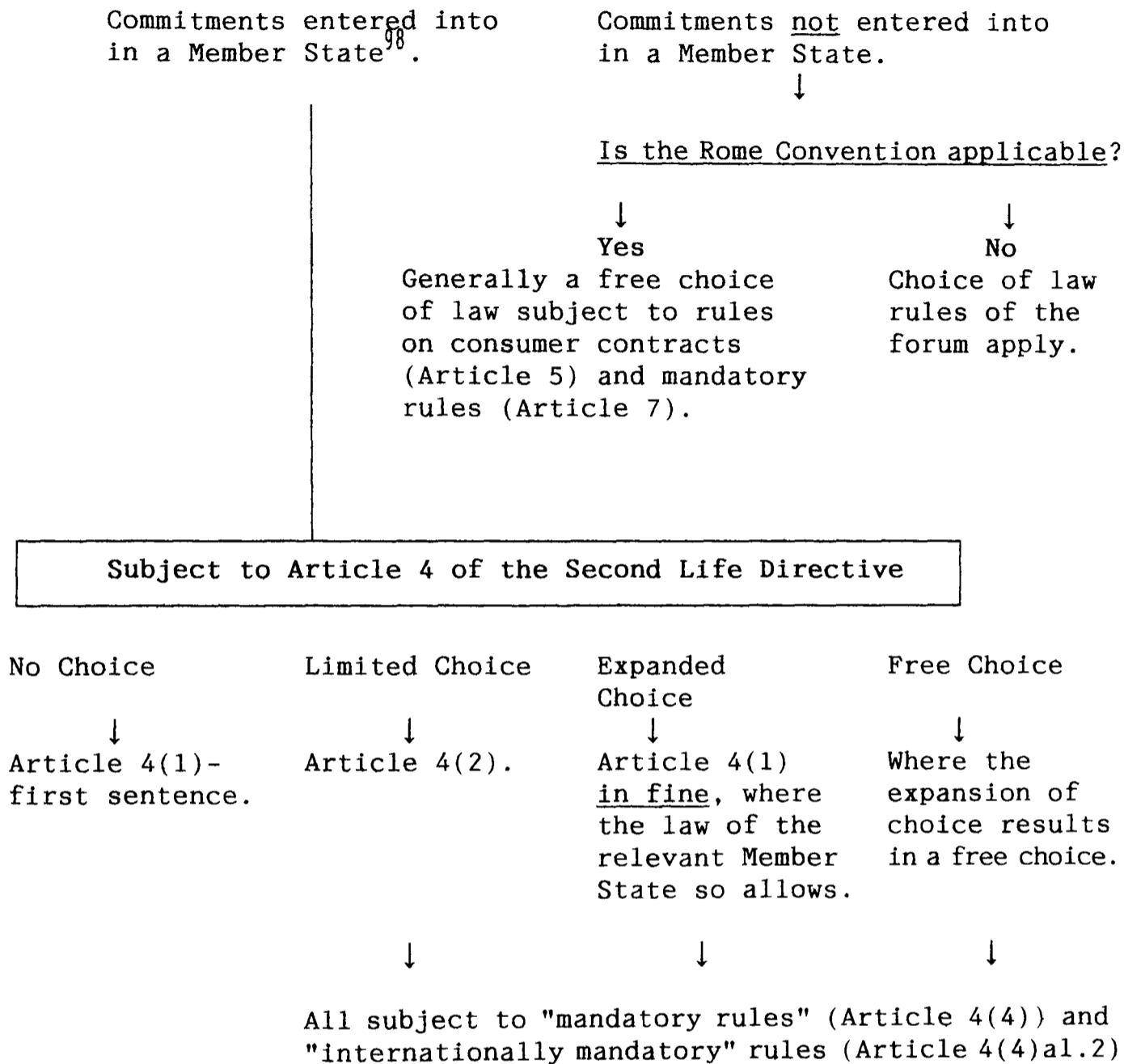
ANNEX 2 to CHAPTER 2

1. CHOICE OF LAW IN NON-LIFE INSURANCE



⁹⁷See Article 2(d) of the Second Non-Life Directive.

2. CHOICE OF LAW IN LIFE ASSURANCE



⁹⁸See Article 2(d) of the Second Life Directive.

CHAPTER 3

COMPARATIVE ASPECTS OF INSURANCE CONTRACT LAW

Introduction

The purpose of this chapter is to examine differences in insurance contract law in the context of the three largest national insurance markets in the Community - Germany, the United Kingdom and France - so as to allow an assessment to be made, in chapter 4, of their significance for the working of the Single Market. Part 1 examines two important aspects of the general body of contract law which are relevant to insurance: first, the principle of good faith and secondly consumer protection legislation. Part 2 then focuses on rules of contract law which are specific to insurance. By way of introduction to part 2 there is a brief overview of the relevant laws¹ in France, Germany and the United Kingdom. Reference is also made to the administrative control² of insurance contracts which takes place in France and Germany, but not in the United Kingdom.

PART 1: GENERAL RULES OF CONTRACT LAW

A. THE PRINCIPLE OF GOOD FAITH

For the purpose of analysis, it is convenient to approach the concept of good faith in contract law by distinguishing between the role of good faith in the formation of the contract and in its performance³.

¹See Kimball & Pfennigstorf, "Legislative and Judicial Control of the Terms of Insurance Contracts: A Comparative Study of American and European Practice", 39 Indiana Law Journal (1964) 675.

²See Kimball & Pfennigstorf, "Administrative Control of the Terms of Insurance Contracts: A Comparative Study", 40 Indiana Law Journal (1964) 143.

³This distinction is recognised by Steven Burton in "Breach of Contract and the Common Law Duty to Perform in Good Faith", 94 Harvard Law Review (1980) 369.

The two situations are different in that in the former the contract has not yet come into existence, whereas in the latter it has. In a strictly legal sense, the two situations can therefore be categorised as pre-contractual and contractual.

From an economic perspective, however, there may be similarities between the two situations in terms of the costs which have been incurred by either party⁴. The costs incurred in performance of the contract can be said to be similar to those incurred in reliance on the contract coming into existence as both are elements of the total cost of securing the benefits of the contract. This economic relationship is recognised to varying degrees by the erosion of the legal division between contractual and pre-contractual relationships, but, as outlined below, the distinction does nevertheless remain important.

1. Negotiation of the Contract

Considerations of good faith are present in many aspects of the negotiations leading up to a contract. Examples are the rights of the parties in a situation where negotiations are terminated, the status of agreements which have not yet been formalised and the abuse of the negotiating process such that a benefit is secured by one party who had no intention of concluding a contract. However, from the perspective of insurance, the most revealing aspect of good faith in the pre-contractual phase is the existence and extent of a duty to disclose information to the other party. Information is a valuable commodity in the negotiation of contracts: it forms the basis on which each party is able to assess the benefits which will flow from the contract and may in some cases only be accessible at considerable cost. The extent to which parties are obliged to share information during the negotiation of a contract therefore represents an important aspect of the way in which the law governs the economic relationship which is represented by the contract.

⁴An example would be a house survey undertaken by a prospective purchaser prior to conclusion of the contract.

The delimitation of an obligation of disclosure can be said to lie between two extremes. The first is that in which there is no obligation to provide information: this represents the most extreme form of the principle of caveat emptor and finds its economic justification in the argument that those who have incurred costs in acquiring superior skill and knowledge should be allowed to retain the benefits of their endeavours. The second is that in which a general duty of disclosure applies between the parties consistent with the principles of good faith and fair dealing: here the economic justification lies in the efficiency which results from the disclosure of information by the party which can supply it at the least cost.

The divergence between the civil and common law approach to the pre-contractual disclosure of information is less marked than these two extremes, but there are nevertheless important differences. The dominance of the principle of caveat emptor in the United Kingdom has led to a refusal to recognise any general duty of disclosure in contract law. France lacks an express formulation of such a duty in its civil code or jurisprudence, but there is some recognition that the law is gradually moving towards the formulation of such a duty. Meanwhile, Germany, through its recognition of the doctrine of culpa in contrahendo, has adopted a general system of pre-contractual liability which encompasses a duty of disclosure.

(a) United Kingdom⁵

It has been argued by Nicholas⁶ that:

"there are some signs in the later eighteenth century that the approach through a general principle of good faith might have been capable of taking root in England".

⁵The law in the United Kingdom is taken to be that of England other than where the law of Scotland differs.

⁶Barry Nicholas, "The Obligation to Disclose Information" in Contract Law Today: Anglo-French Comparisons (editors, D.Harris and D.Tallon) p168. Nicholas cites Lord Mansfield's outline of the principle of good faith in Carter v Boehm (1766) 3 Burr 1905 as evidence of such a trend.

However, the the dominance of the principle of caveat emptor in the common law approach towards good faith in contract is evident in the case-law relating to disclosure of information during the formation of the contract. In Smith v Hughes⁷ it was held that:

"whatever may be the case in a court of morals, there is no legal obligation on [a] vendor to inform the purchaser that he is under a mistake, not induced by the act of the vendor".

In Fletcher v Krell⁸, it was held that a person who applies for the post of governess is not bound to divulge the fact that she is a divorcee. More recently, in Walford v Miles⁹, the House of Lords has reaffirmed the absence of any general duty of disclosure arising from considerations of good faith:

"A duty to negotiate in good faith is as unworkable in practice as it is inherently inconsistent with the position of a negotiating party."¹⁰

The common law position is summed up by Treitel¹¹ as follows:

"As a general rule, a contracting party is under no duty to disclose material facts known to him but not to the other party".

The impact of considerations of good faith on the creation and evolution of rules which modify the strict approach of the common law has been described by O'Connor¹² in the following terms:

"The principle of good faith in English law is a fundamental principle derived from the rule pacta sunt servanda and other legal rules, distinctively and directly related to honesty, fairness and reasonableness, the application of which is determined at a particular time by the standards of honesty fairness and reasonableness prevailing in the Community which are considered appropriate for formulation in new or revised legal rules."

⁷(1871) LR 6 QB 597.

⁸(1872) 42 L.J.Q.B. 55.

⁹[1992] 1 All ER 453.

¹⁰Ibid. pp460-461.

¹¹The Law of Contract (8th edn.), p349.

¹²J.F. O'Connor, Good Faith in English Law, p102.

Several examples illustrate the extent to which good faith, whilst absent as a principle of law in the sense that it exists in many civil law systems, has nevertheless exerted an influence. Contracts uberrimae fidei, of which insurance is the prime example, have since the 18th century¹³ been regarded as an exception to the general rule in imposing a pre-contractual duty of disclosure. Where there is a fiduciary relationship between the parties, the requirements of good faith may go beyond a duty of disclosure. Effect will not be given to unduly onerous or unusual contract terms unless they are fairly and reasonably brought to the attention of the other party prior to entering into a contract¹⁴. The law relating to misrepresentation also gives rise to instances of a positive duty of disclosure¹⁵. Moreover, even in the absence of a contract, the law may recognise a claim for services rendered under the principle of quantum meruit¹⁶.

Legislation has also modified the harshness of the common law approach: in sale of goods for example, a seller acting in the course of business is subject to implied contract terms in respect of the "merchantable quality" of the goods and their fitness for the purpose for which they are bought¹⁷. The requirements for disclosure of information by an insurer to a proposer for life assurance introduced by rules adopted pursuant to the Financial Services Act 1986¹⁸ are another example of

¹³The case of Carter v Boehm (1766) 3 Burr 1905 is generally regarded as the basis of the common law rule of disclosure in insurance.

¹⁴Interfoto Picture Library v Stilleto Visual Programmes Ltd. [1989] QB 433.

¹⁵See Treitel, *op.cit.*, p352. A person may have to disclose material facts which come to his notice before the conclusion of a contract if they falsify a representation previously made by him. A person is guilty of misrepresentation, though all the facts stated by him are true, if his statement is misleading as a whole because it does not refer to other facts affecting the weight of those stated.

¹⁶Craven-Ellis v Canons Ltd. [1936] 2KB 403.

¹⁷Sale of Goods Act 1979: sections 14(2) and 14(3).

¹⁸See chap. 5, part 1.

legislative intervention. Incorporation of the Vienna Convention¹⁹ into the law in the United Kingdom would give specific recognition to the principle of good faith as it provides that it is to be interpreted having regard to the observance of good faith in international trade²⁰. However, despite its modification, the principle of caveat emptor is still sufficiently dominant to preclude any meaningful move towards a general duty of disclosure²¹ in the formation of contracts²².

The position in Scotland differs from that in England in several respects. First, it is possible to argue that Scots law imposes a general obligation of disclosure on contracting parties. This has been suggested by the Scottish Law Commission²³ on the basis that references by Scottish judges to "bona fides" in insurance cases²⁴ in the 19th century were based on a principle applicable to contracts generally and not the narrower principle of uberrima fides which was developed by the English courts. Thus, the Commission concluded²⁵ that:

¹⁹For text, see J.O. Honnold, Uniform Law for International Sales under the 1980 UN Convention, p649. The Convention is expected to become part of the law in the United Kingdom in the near future.

²⁰Article 7(1). Honnold, op. cit. para. 94, observes that the Convention rejects good faith as a general requirement and uses it solely as a principle of interpretation.

²¹For a general commentary on disclosure in contractual negotiations see: I. Brown, "The Contract to Negotiate: A Thing Writ in Water" 1992 JBL 353.

²²By contrast, it has been noted that the common law in the United States has moved closer towards a general obligation to disclose information through an extension of the notion of representation, principally in the case of sales of land. See: Nicholas, "The Obligation to Disclose Information", in Harris & Tallon (editors) op.cit. p179.

²³Scottish Law Commission Memorandum no.42, "Defective Consent", June 1978.

²⁴An example is Life Association of Scotland v Foster (1873) 11M 351 (Lord President Inglis at p359).

²⁵Memorandum no. 42, para. 3.68.

"It may well be that in Scots law there is a general duty to disclose material facts when they are specially within the knowledge of one contracting party and the other must consequently rely on him for information."

Secondly, it may be possible to claim recompense in the absence of a contract if one person has benefited from the work of another. However, the conditions which have to be met by a successful claimant are very restrictive²⁶ and do not constitute a general rule of pre-contractual liability. A third difference may exist in the law relating to error. Unlike the position in England, it has been held in Scotland that if a party knows that an offer has been made under a definite mistake in fact, that party is not entitled to accept it²⁷.

(b) France

The French civil code has no express provisions governing pre-contractual disclosure of information. The articles governing fraud (dol)²⁸ and mistake (erreur)²⁹ cover a sub-set of the circumstances encompassed by the concept of pre-contractual disclosure of information, but do not in themselves represent a general duty of disclosure.

²⁶McBryde, Contract, p37, lists the conditions as: (i) the pursuer must show a loss (ii) the pursuer must not have had the intention of donation (iii) the defender must have gained (iv) the expense must not have been incurred for the pursuer's benefit (v) reimbursement must be equitable.

²⁷Steuart's Trustees v Hart (1875) 3R 192. Gloag, The Law of Contract, (2nd edn.) p438 refers to the difficulty of applying this rule in practice. However, Steuart's Trustees was recently applied in the case of Angus v Bryden 1992 SLT 884.

²⁸Article 1109 provides that any contract is capable of annulment where the consent of one of the parties has been secured by fraud.

²⁹Article 1110 governs error. It is interpreted by Aubry & Rau (Droit Civil Français, 6th edn.) as meaning that error is a cause of nullity of the agreement only when it is certain that one or both of the parties would not undertake the obligation if the true state of things were known.

However, it has been argued that it is possible to identify a general duty to disclose information. This was asserted in 1945 by de Juglart³⁰, based on a survey of legislative provisions and judicial decisions. Ghestin³¹ contends that de Juglart's identification of the duty was premature and that, until relatively recently, it was possible to hold that there existed no pre-contractual obligation of disclosure. He then identifies in French law the elements of a developing synthesis leading to a general duty of disclosure. The first element of the synthesis is the proliferation of particular statutory or regulatory requirements of disclosure. The second element derives from the development of the droit civil through jurisprudence: Ghestin contends that cases involving defects of consent in areas such as fraudulent silence (réticence dolosive), delictual liability for pre-contractual fault, and latent defects provides a basis for holding that the law is moving towards a general duty of disclosure.

Von Mehren-Gordley³² adopts a more direct approach in arguing that an obligation of good faith has been clearly recognised by the courts and cites a case³³ which supports that view:

"..it must be recognised, in actual fact, that in the preliminary phase of negotiations, during which the conditions of the contemplated contract are studied and discussed, certain obligations of rectitude and good faith rest on the parties; these obligations clearly relate not to the conclusion of the eventual contract but to the conduct of the negotiations themselves."

Nevertheless, doubt has been expressed regarding the existence of such a rule. Aubry & Rau's view³⁴ was that:

"It is questionable whether reticence, that is to say, the silence intentionally kept as to a fact ignored by the other contracting party

³⁰de Juglart, "L'obligation de Renseignements dans les Contrats", Rev. trim. dr. civ. 1945, ppl-22.

³¹J. Ghestin, "The Obligation to Disclose Information", in Harris & Tallon (editors), op.cit., chap.4.

³²The Civil Law System, (2nd edn.), extracted from O'Connor, op.cit., p97.

³³Société Muroiterie Fraisse v Micon et Autres (Cour d'Appel de Pau, 14 Jan 1969, D&S 1969 J716(note)).

³⁴Aubry & Rau, Droit Civil Francais, 6th edn., para. 343.

and on which his consent may depend, constitutes a fraud in contracts other than insurance contracts".

This view is supported by Lambert-Faivre³⁵ who contends that there is no general obligation of disclosure outside insurance contracts.

Ghestin's view is based on developments in jurisprudence which occurred in between Aubry & Rau's analysis and that of Lambert-Faivre, and finds support from Nicholas³⁶ who concludes that recent cases have resulted in the following formula:

"Dol (fraud) can consist of the silence of one party concealing from the other a fact which, if he had known it, would have prevented him from contracting."

Moreover, in addition to this expansive interpretation of dol, Nicholas takes the view that both jurisprudence and doctrine have imported, in reliance on the general principle of delictual liability, a requirement of good faith into pre-contractual negotiations³⁷.

Recent developments in French insurance contract law cast doubt over the general rule identified by Ghestin and Nicholas. Amendment of the law in 1989 has resulted in the abolition of a positive duty of disclosure in insurance which had been one of the prime examples of a specific duty of disclosure imposed by statute.

³⁵Yvonne Lambert-Faivre, Droit des Assurances, Precis Dalloz, 7th edn., p183.

³⁶Barry Nicholas, French Law of Contract, p99.

³⁷He cites as an example a decision of the Cour de Cassation in 1972 (Cass. com 20.3.1972, JCP 1973 II 17543). The plaintiff entered negotiations with the defendant to buy a machine made by an American firm, X, for whom the defendant was the exclusive French distributor. The plaintiff went to the USA to view the machines and subsequently asked the defendant for more information. The latter made no reply and withheld an estimate supplied by X. Two weeks later the defendant signed a contract to supply the plaintiff's competitor with a machine under a contract which stipulated that the defendant was not to supply another machine in the area for 42 months. The defendant was held liable in delict for breaking off negotiations.

(c) Germany

German law in respect of pre-contractual liability has been influenced by the doctrine of culpa in contrahendo (fault in negotiating) and in particular by Jhering's³⁸ analysis of the subject. The German common law was criticised by Jhering as deficient because it did not adequately resolve problems which arose from the dominance of will theory in contract law and the requirement for a "meeting of the minds". The essence of his doctrine of culpa in contrahendo was that where one party has relied on the validity of a contract to his injury, the law should restore the status quo by reimbursing the injured party for costs incurred in reliance on the validity of the contract. Kessler and Fine³⁹ express the meaning of the doctrine in an even simpler formulation:

"The careless promisor has only himself to blame when he has created for the other party the false appearance of a binding obligation".

The German civil code does not incorporate a general theory of culpa in contrahendo but it is generally accepted⁴⁰ that case law with the aid of the legal literature began to treat individual provisions of the code as instances of a general scheme of pre-contractual liability. Particular emphasis has been placed on fair dealing and the security of transactions: each party is bound to disclose such matters as are clearly of importance for the other party's decision, provided the

³⁸Jhering's famous article on the subject ("Culpa in contrahendo, oder Schadensersatz bei nichtigen oder nicht zur Perfektion gelangten Verträgen") was published in 1861 (4 Jahrbücher für die Dogmatik des Heutigen Römischen und Deutschen Privatrechts 1)

³⁹"Culpa in Contrahendo, Bargaining in Good Faith, and Freedom of Contract: A Comparative Study" 77 Harvard Law Review (1964), 401 (402).

⁴⁰The point is made by Kessler and Fine, op.cit. p403, on the basis of several German authorities, principally 3 Larenz, Lehrbuch des Schuldrechts Chapter 4V at 38-43 (5th ed.1962). Later editions of Larenz confirm this view (see 14th edn. 1987: chap.10, "Das Prinzip von Treu und Glauben"). A similar view is taken by Foster, German Law and Legal System (1993) who says (para.5.3):
"The combination of Article 242 with 133 and 157 applies the requirement of good faith to all aspects of the law of obligations."

latter is unable to procure the information and the non-disclosing party is aware of that fact⁴¹.

2. Performance of the Contract

The duty to perform a contract in good faith is more clearly recognised in the French and German legal systems than is the duty to act in good faith during the pre-contractual phase: both the French and German civil codes have express provisions setting out a requirement of good faith in the performance of contracts. However, the law in the United Kingdom does not recognise a general duty to perform contracts in good faith: there are mechanisms which can effectively result in the application of the concept of good faith, but these fall short of providing a framework which is sufficiently broad to constitute a general rule⁴².

(a) United Kingdom⁴³

The English common law does recognise instances in which good faith is required in the performance of a contract, such as where there is a fiduciary relationship between the parties or where the contract falls, as does insurance, into the category of contracts referred to as uberrimae fidei. However, it is clear that those instances are exceptions to, rather than examples of, the general rule governing the

⁴¹Kessler and Fine, op.cit., quote an example from Larenz, op.cit. The owner of a house negotiating for its sale fails to inform a third party that it has been sold. The latter then makes a trip to view the house. The seller has failed in his duty of good faith.

⁴²This contrasts with the position in the United States where a majority of jurisdictions, the Restatement (second) of Contracts (section 205) and the Uniform Commercial Code (section 1-203) recognise a duty to perform a contract in good faith. See Burton, op.cit. note 3, above.

⁴³As in the previous subsection, English law is assumed to be that of the United Kingdom except where Scots law differs.

standards expected in performance of the contract. Powell⁴⁴ advances three reasons for this proposition:

- (i) The existence of a special class of contracts uberrimae fidei indicates the absence of a general rule⁴⁵;
- (ii) The development, in England, of the law in respect of quasi-estoppel has been necessary due to the absence of any general requirement of good faith⁴⁶;
- (iii) It is possible for "standard form" contracts to include provisions such that one party's obligations are considerably reduced even where it is clear that this was done in bad faith⁴⁷.

Powell's case can be developed further by arguing that the frequent use by the courts of the device of the "implied term" to regulate the conduct of the parties in the absence of express contractual provisions is evidence of the lack of a general rule. One example is the approach taken towards hindrance of the other party's performance of a contract. In Barque Quilpé Ltd. v Brown⁴⁸, it was stated that:

"There is an implied contract by each party that he will not do anything to prevent the other party from performing the contract or to delay him in performing it. I agree that generally such a term is by law imported into every contract."

⁴⁴Raphael Powell, "Good Faith in Contracts" 9 Current Legal Problems 16 (1956).

⁴⁵Powell regarded the use of the latin superlative as "a form of hyperbole" which failed linguistically to describe accurately the relationship between contracts "uberrimae fidei" and those that were not. The use of the term "utmost good faith" did not in his view imply the existence of a category of contract requiring ordinary good faith.

⁴⁶Powell quotes as an example the case of Central London Property Trust v High Trees House Ltd. [1947] KB 130 in which it was held that a promise to reduce the rent (set by a lease under seal) on a block of flats due to the outbreak of war bound the promisor to the extent that it would not allow him to act inconsistently with it, even although the promise was not supported by consideration.

⁴⁷Powell's article was written prior to the Unfair Contract Terms Act 1977 which has limited the use of "unfair" contract terms.

⁴⁸[1904] 2KB 264, 271 (per Vaughan Williams L.J.).

However, as Burrows⁴⁹ has observed, the use of the device of the implied term has fallen short of introducing even a general rule requiring positive co-operation in the performance of a contract: the emphasis is on what is necessary⁵⁰ for the performance of the contract rather than what is reasonable in the circumstances. As regards the future, implementation in the United Kingdom of the Consumer Contracts Directive⁵¹ will give explicit recognition to the concept of good faith in the context of the determination of unfair contract terms⁵².

(b) France

Article 1134 of the French Civil Code provides that contracts must be performed in good faith. However, the code does not define good faith or the standards by which it is to be judged. The textbook of Planiol et Ripert⁵³ suggests that Article 1134 provides for a reserve obligation of honest conduct where the duties of the parties are not laid down by their contract or by the law. Powell⁵⁴ takes the view that article 1134 has little independent force of its own but is merely ancillary to the interpretation of other provisions of the code. Nicholas⁵⁵ notes that, unlike Germany, the French courts have made little use of the obligation to perform a contract in good faith.

⁴⁹J.F. Burrows, "Contractual Co-operation and the Implied Term" 1968 32 MLR 390.

⁵⁰The law was made clear by Lord Blackburn in Mackay v Dick & Stevenson (1881) 8R (HL) 37; (1881) 6 AC 251, 263: "Where in a written contract it appears that both parties have agreed that something shall be done, which cannot effectively be done unless both concur in doing it, the construction of the contract is that each agrees to do all that is necessary to be done on his part for the carrying out of the thing, though there may be no express words to that effect."

⁵¹Directive 93/13, OJ 1993 L95/29. The Directive applies to contracts concluded after 31 December 1994.

⁵²See chap. 2 (section C.2) for an outline of the Directive.

⁵³Traité Pratique de Droit Civil Français (2nd edn., 1952) p509.

⁵⁴op.cit., p31.

⁵⁵op.cit., chap.4.

Nevertheless, Weill and Terré⁵⁶ regard the content of the obligation of good faith in the execution of contracts as being more clearly defined than the aforementioned texts. In particular, they take the view that the obligation comprises two elements: first, an obligation of fairness (loyauté) which is not rigid but takes account of surrounding circumstances; and secondly, an obligation of co-operation in the execution of the contract⁵⁷. Marty and Raynaud⁵⁸ point to the link between Article 1134 and Article 1135⁵⁹ on the interpretation of contracts and conclude that the content of a contract is determined not only by its literal sense but by reference to the principle of good faith.

(c) Germany

Article 242 of the German Civil Code provides that:

"The debtor is obliged to perform in such a manner as good faith requires, regard being paid to general practice."

Whilst the substance of the duty does not appear materially different from Article 1134 of the French Civil Code, Article 242 has developed into a much broader system of control⁶⁰. One commentary refers to the concept of good faith in Article 242 in the following terms⁶¹:

"It expresses itself in many different rules, but quite unsystematically. These rules constitute a realm of law of their own, whose function

⁵⁶Droit Civil, Les Obligations (Précis Dalloz, 4th edn. 1986 paras. 355-357).

⁵⁷It is not clear that Weill and Terré regard the obligation of co-operation as a general principle as they cite only specific instances of such an obligation rather than a general rule.

⁵⁸Droit Civil, Les Obligations (2nd edn. 1988 para 246).

⁵⁹Article 1135: Agreements are binding not only as to what is expressed, but also as to all the consequences which equity, usage or statute imposes upon the obligation according to its nature. (Translation by Berman, de Vries, Galston, French Law (looseleaf/updated)).

⁶⁰Horn, Kotz and Lesser make this point in German Private and Commercial Law, p136 as does Powell, op.cit., p37.

⁶¹Horn, Kotz & Lesser, op.cit. p145.

is typically one of control. In functional terms it is quite comparable with the role of equity vis-à-vis common law in the Anglo-American systems."

Several examples of the application of Article 242 provide some indication of the extent to which it is regarded as the dominant principle of contract law. Between 1919 and 1923, hyperinflation reduced the value of the mark to one-billionth of its 1914 value and led to disputes over the repayment of long-standing debts. In 1923 the Reichsgericht decided⁶², on the basis of Article 242, that mortgages should be revalued in terms of the value of the money at their time of creation. Good faith has also been held to prevent a landlord of several properties leasing a property adjoining a tenant to the latter's competitor⁶³ and to restrict the extent to which a standard form contract could limit the obligations of a seller of furniture⁶⁴.

B. CONSUMER PROTECTION

Consumer protection is a feature of the insurance contract laws of all three Member States under examination. There are two specific objectives which are generally pursued in the protection of the consumer in the field of insurance. The first is to ensure that a proposer for insurance has sufficient information to enable a proper decision to be made as to the suitability of the contract. The second is to ensure that, once a contract has been concluded, the insured is protected from contract terms which unduly favour the insurer, thereby causing an imbalance in the contractual relationship. However, the approach to these two issues, and their relationship with the general body of insurance contract law, varies significantly among the United Kingdom, France and Germany.

⁶²RGZ 107,78,86: extracted from Horn, Kotz & Lesser, op.cit., p140.

⁶³1931 RGZ 131,274: extracted from Horn, Kotz & Lesser, op.cit., p138.

⁶⁴1956, BGHZ 22,90: extracted from Horn, Kotz & Lesser, op.cit., p143. The General Conditions of Business Act 1976 subsequently consolidated the rules developed by the courts.

1. The Provision of Information⁶⁵

French law is most explicit as regards the insurer's duty to provide information to a proposer for insurance. Following an amendment in 1989, the Code des Assurances⁶⁶ provides that the insurer must provide the insured with details of the cover and rates prior to conclusion of the contract. There is no similar obligation of a general nature in the insurance contract laws of either the United Kingdom or Germany. However, in the United Kingdom, rules adopted by various agencies under the authority of the Financial Services Act 1986 in respect of those classes of life assurance which fall within the category "investment business" ensure that most purchasers of life assurance are provided with details of the product before committing themselves to a contract. In the case of Germany, the existence of a general pre-contractual duty of disclosure provides some measure of protection to a proposer as regards the suitability of the contract.

2. Protection from Unfair Contract Terms

In 1976, The Council of Europe adopted a resolution⁶⁷ recommending Member States:

"to create effective instruments.. in order to protect consumers from abusive contract clauses".

The United Kingdom, France and Germany all subsequently adopted laws in respect of unfair contract terms, but the impact which those laws have had on insurance contracts differs among the three Member States.

The simplest and arguably the most effective solution has been that adopted by Germany. The Law Concerning Standard Contract Terms (AGB-

⁶⁵The impact of the completion of the Single Market in insurance on the provision of information to proposers for insurance was considered in chap. 2.

⁶⁶Article L112-2.

⁶⁷Resolution dated 16.11.1976.

G)⁶⁸ of 1976 applies to standard contract terms of all kinds including insurance contracts. Moreover, the administrative control exercised by the Insurance Supervisory Authority over the standard terms of insurance contracts does not preclude judicial control under the AGB-G. However, the special nature of insurance business is recognised by the provision⁶⁹ that the courts are to consult the Insurance Supervisory Authority before reaching a decision on standard terms and the partial exemption⁷⁰ granted to insurers in respect of the rules relating to prohibited clauses, duration, tacit renewal and termination of contracts. The Insurance Contract Law 1908⁷¹ provides additional protection from unfair contract terms by providing that certain of its provisions cannot be varied by contract whilst others can only be varied to the benefit of the policyholder.

In France, the loi Scrivener⁷² of 1978, which governs contract terms, applies to insurance. However, the mechanism by which this law operates means that its impact on insurance contract law is indirect. The loi Scrivener transferred to an ad hoc body, the Commission des Clauses Abusives, the determination and sanctioning of unfair contract terms. The Commission has the power to issue "recommendations", which are publicised and exert influence over the relevant professional organisations to which they are addressed, but the courts are only able to strike down unfair contract terms if they are subsequently incorporated in a decree. Nevertheless, a recommendation issued by the Commission in 1985⁷³ was instrumental in the reform of insurance contract law which occurred in 1989. Another aspect of the control of unfair contract terms in insurance contracts in France is that many of

⁶⁸Gesetz zur Regelung des Rechts der Allgemeinen Geschäftsbedingungen. See Pfennigstorf, German Insurance Laws.

⁶⁹AGB-G, section 16.

⁷⁰AGB-G, section 23.

⁷¹See part 2 of this chapter, section C.2.

⁷²Loi no. 78-23 du 10.1.1978: J.O. 11.1.1978, p301.

⁷³Recommendation no. 85-04/CCA du 20 Sept.1985 relative aux Contrats Multirisques Habitation, RGAT 1986 p151.

the provisions of the Code des Assurance are mandatory, which means that they cannot be overridden by conflicting contract terms: the effect is to introduce a range of compulsory contract terms from which no derogation is possible.

The position in the United Kingdom is that the Unfair Contract Terms Act 1977 does not cover insurance contracts, which are subject to the self-regulatory control exercised by the Statements of Insurance Practice to which the vast majority of insurers subscribe. Thus, although it is difficult to find convincing evidence that the policyholder is less well protected than in France or Germany, it is notable that the United Kingdom is the only one of the three Member States under examination which does not have a statutory framework for the control of unfair terms in insurance contracts.

PART 2: RULES OF CONTRACT LAW SPECIFIC TO INSURANCE

C. LEGAL SOURCES

1. France

(a) Insurance Contract Law

The Insurance Contract Law of 1930⁷⁴ is the foundation of French insurance contract law. The volume of subsequent amendments to the law, as well as changes necessitated by the advent of the Single European Market, resulted in a codification of the law which was completed in 1976 and resulted in the Code des Assurances⁷⁵. The Code is divided into three parts: législative, réglementaire and arrêtés⁷⁶. This structure reflects the separation of the domains of legislation and administration contained in the French Constitution.

A revision of the law was undertaken in 1989⁷⁷. The title of the new law⁷⁸ suggests that it was mainly concerned with the conformity of French law with European Community Directives, but, as will become clear, it went far beyond this by introducing a range of amendments which strengthened the position of the consumer. The 1989 law is now incorporated in the Code des Assurances.

Much of the législative section of the Code des Assurances is mandatory in the sense that its provisions are generally not capable

⁷⁴Loi du 13 Juillet 1930.

⁷⁵J.O. 21 Juillet 1976. See Code des Assurances (L'Argus, 8th edn., 1991).

⁷⁶Reference to the provisions of each part is preceded by the prefix L, R, and A respectively.

⁷⁷Loi no.89-1014 du 31 Dec. 1989: J.O. 3 Jan. 1990.

⁷⁸"portant adaption du code des assurances a l'ouverture du marché européen".

of amendment by contract terms⁷⁹. The limitation of freedom of contract through this device is regarded as justifiable in the interests of consumer protection.

(b) Administrative Control of Insurance Contracts

In France, there is a requirement to submit copies of standard conditions and other documents which are to be issued to the public to the Ministry of Finance, who may require changes to be made according to the regulations in force⁸⁰. Premium rates⁸¹ must also be communicated to the Ministry of Finance, whose approval is required in the case of life business. In the case of "large risks" within the meaning of the Second Non-Life Directive⁸², there is no requirement of prior approval either in respect of policy forms (and other connected literature) or rates⁸³. As discussed in chapter 1, the completion of the Single Market will involve the dismantling of prior approval of policy forms and rates for all classes of business.

2. Germany

(a) Insurance Contract Law

The German law is to be found in the 1908 Insurance Contract Law (VVG)⁸⁴, as amended. It is divided into several sections: the first

⁷⁹Article L 111-2. The Comité Européen des Assurances (CEA) has published a comprehensive survey of such provisions in EEC-Insurance Contract Law (1990).

⁸⁰Code des Assurances, Articles L310-8 and R310-6.

⁸¹Code des Assurances, Article R310-6.

⁸²See chap. 1.

⁸³Code des Assurances, Articles L351-4 and R351-1 to R351-6.

⁸⁴Gesetz über den Versicherungsvertrag, hereafter referred to as the VVG. See W.Pfennigstorf, German Insurance Laws (Karlsruhe, 1986; supplement, 1991).

deals with provisions applicable to all types of insurance⁸⁵ and the remainder deal with specific categories of insurance. The VVG contains certain provisions from which no deviation is permissible through contract terms and others from which deviation is permissible if the change is in the policyholder's favour.

(b) Administrative Control of Insurance Contracts

The German authorisation procedure involves the submission of a business plan which must include standard contract terms and, in the case of life, accident and sickness insurance, the premium rates and method of calculation⁸⁶. Motor vehicle liability insurance rates are also subject to approval, though for different reasons: the relevant statute⁸⁷ provides that the considerations are the need to ensure a reasonable relation between premiums and benefits and the need to ensure that injured third parties are adequately protected. The completion of the Single Market will lead to the dismantling of the German system of prior approval of conditions of insurance and premium rates. As it has been in place for many years, it is clear that the advent of the Single Market involves a significant change in approach in Germany as regards the regulation of insurance.

3. The United Kingdom

Insurance contract law in the United Kingdom⁸⁸ was codified by the Marine Insurance Act 1906 (hereafter referred to as the MIA 1906).

⁸⁵Other than marine, which is subject to the Commercial Code: law of 10th May 1987.

⁸⁶The authorisation procedure is set out in Article 5 of the Law Governing the Supervision of Insurance Enterprises (Gesetz über die Beaufsichtigung der Versicherungsunternehmen, generally abbreviated to VAG). See Pfennigstorf, German Insurance Laws.

⁸⁷The Law Concerning Obligatory Insurance for Motor Vehicle Keepers 1965 (as amended), section 8.

⁸⁸A more detailed examination of the law in the United Kingdom is undertaken in chap.5.

Although the Act expressly excludes⁸⁹ its application to other classes, its general principles have been applied by the courts to other classes of business. As regards policyholders who have purchased insurance in a private capacity, Statements of Practice adopted by insurers modify, on a self-regulatory basis, the strict application of the law.

D. NEGOTIATION OF THE CONTRACT

An examination of the rights and obligations which arise during the negotiations for an insurance contract shows that there are substantial differences between the laws of the individual Member States.

1. The Formulation of the Duty of Disclosure

The formulation of the duty of disclosure at the inception of the contract varies in four important respects in the three Member States under examination:

- (a) The requirement of spontaneity;
- (b) Reciprocity;
- (c) The application of the disclosure rule to different policyholders;
- (d) The role of freedom of contract.

Each of these is dealt with separately below.

(a) The Requirement of Spontaneity

The formulation of the duty of disclosure in the United Kingdom requires spontaneity on the part of the insured in volunteering information to the insurer. This is made clear in the formulation of the duty in the MIA 1906⁹⁰:

⁸⁹Section 2(2).

⁹⁰Section 18(1). For a more detailed discussion of the development of the law in the United Kingdom, see chap.5.

"Subject to the provisions of this section, the assured must disclose to the insurer, before the contract is concluded, every material circumstance which is known to the assured, and the assured is deemed to know every circumstance which, in the ordinary course of business, ought to be known by him. If the assured fails to make such disclosure, the insurer may avoid the contract."

A similar approach has been followed by the Courts in respect of non-marine classes of business. As regards insurance purchased in a private capacity, the Statements of Insurance Practice limit the obligation of disclosure to what the insured could reasonably be expected to disclose⁹¹.

The formulation of the duty in Germany⁹² is similar in most respects to the United Kingdom:

"The policyholder must, at the time of the making of the contract, inform the insurer of all circumstances known to him that are material for the assumption of the risk. Circumstances of the risk are material if they are of a nature to have an influence on the insurer's decision whether to enter into the contract at all, or whether to do so under the agreed terms. A circumstance about which the insurer has inquired expressly and in writing is, in case of doubt, deemed to be material."

However, this is qualified in the case of circumstances not included in the proposal form⁹³:

"If the policyholder had to report the circumstances of the risk on the basis of written questions supplied by the insurer, the insurer may rescind on account of omitted information about a fact that was not expressly asked about only in the event that there was fraudulent concealment."

In France, the formulation of the duty of disclosure is narrower than in the United Kingdom and Germany, following amendment to the law in 1989⁹⁴. As it now stands, the formulation of the duty of disclosure

⁹¹Para 2(b)(i) of the Statement of General Insurance Practice, para 2(a)(iii) of the Statement of Long Term Insurance Practice.

⁹²VVG, section 16. Translation by Pfennigstorf, German Insurance Laws.

⁹³VVG, section 18.

⁹⁴Under the old law, spontaneity was required on the part of the proposer in bringing information to the attention of the insurer.

in France does not require spontaneity⁹⁵. A proposal form is mandatory under the new law and a proposer is required⁹⁶ only:

"De répondre exactement aux questions posées par l'assureur, notamment dans le formulaire de déclaration du risque par lequel l'assureur l'interroge lors de la conclusion du contrat, sur les circonstances qui sont de nature à faire apprécier par l'assureur les risques qu'il prend en charge;".

As regards marine insurance, the law governing such contracts in France and Germany is distinct from the law governing other classes of business. In France, the formulation of the duty of disclosure in marine insurance⁹⁷ requires spontaneity: it is closely related to the formulation of the duty in section 18 of the MIA 1906 although it refers to information which is material to the particular insurer rather than the hypothetical prudent insurer referred to in the MIA 1906. In Germany, the formulation of the duty of disclosure in marine insurance⁹⁸ is similar to that applied to non-marine classes.

(b) Reciprocity

In the United Kingdom, the duty of disclosure applies to both parties to the contract. Although the duty of the insured to disclose information material to the risk is the most obvious element of the rule of disclosure, the House of Lords has held in Banque Financière⁹⁹ that the duty is mutual and as far as the insurer is concerned extends to disclosing all facts known to him which are material either to the risk to be insured or the recoverability of a claim under the policy

⁹⁵See Christian Bouckaert, "The Declaration of Risks, the Aggravation of Risks and Relevant Sanctions", a paper presented at the Insurance and the Law Seminar, Cambridge 6-7 April 1993.

⁹⁶Code des Assurances, Article L113-2.

⁹⁷Code des Assurances, Article L172-19.

⁹⁸Commercial Code, section 806.

⁹⁹Banque Financière de la Cité SA v Westgate Insurance Co. Ltd.
[1991] 2AC 249.

which a prudent insured would take into account in deciding whether or not to place the risk for which he sought cover with the insurer.

In both France and Germany, the duty of disclosure is formulated as a duty of the insured, with no mention made of the insurer. However, this omission has to be considered within the context of the role of the principle of good faith in general contract law which was discussed in part 1. It is possible to argue that the overriding principle of good faith applied to both the negotiation and performance of contracts in Germany imposes an obligation of disclosure on the insurer during the negotiations for an insurance contract. Given the weakness of the argument in favour of a general rule of pre-contractual disclosure in France, it seems likely that there is no general rule of contract law which imposes a duty of disclosure on the insurer in pre-contractual negotiations. However, as already noted in section B above, the Code des Assurances¹⁰⁰ does impose on the insurer an obligation to provide a proposer with relevant information as to rates and cover.

(c) The Application of the Disclosure Rule to Different Policyholders

As already noted, French and German law distinguishes between marine and non-marine classes as regards the formulation of the duty of disclosure. However, all policyholders purchasing the same class of insurance are treated in a similar manner.

In the United Kingdom, the effect of the Statements of Insurance Practice is that the formulation of the duty of disclosure differs depending on whether the insurance was purchased in a "private capacity" or not. Where it has been purchased in a private capacity, the insured is required to disclose only material facts which a reasonable insured could be expected to disclose¹⁰¹. Although the law has not been amended by the Statements of Practice, the effect is that a policyholder is treated differently in respect of different purchases

¹⁰⁰Article L111-2.

¹⁰¹Para. 2(b)(i) of the Statement of General Insurance Practice and para. 3(a)(iii) of the Statement of Long-Term Insurance Practice.

of insurance within the same class of business: thus, for example, a small businessman is subject to a different rule of disclosure in respect of fire insurance for his house and his shop.

(d) Freedom of Contract

In the United Kingdom, the substance of the duty of disclosure cannot be altered to the disadvantage of the proposer in cases where insurance is purchased in a private capacity. This situation arises due to the commitment of most insurers to the Statements of Insurance Practice, which modify, on a self-regulatory basis, the strict common law duty of disclosure in favour of the insured¹⁰². However, as far as commercial insurances are concerned, it would be possible to amend the common law duty of disclosure in favour of either party¹⁰³.

The position in Germany bears some resemblance to the United Kingdom as there is limited scope to alter the duty of disclosure, which may be amended by the contracting parties in a manner which favours the policyholder¹⁰⁴.

France adopts the strictest approach in that it does not allow considerations of freedom of contract to permit modification of the duty of disclosure: in common with many other provisions of the Code des Assurances, the duty of disclosure cannot be amended¹⁰⁵ by contract terms.

¹⁰²The Statements are discussed in greater detail in chap. 5.

¹⁰³See Pan Atlantic Ins. Co. Ltd. v Pine Top Ins. Co. Ltd. [1992] 1 Lloyds Rep 101 and Court of Appeal (The Times 8.3.1993).

¹⁰⁴VVG section 34(a) provides that a contract deviating from section 16 to the disadvantage of the policyholder cannot be relied on by the insurer. Although this allows for some measure of freedom of contract, it is within the context of a system of administrative control which requires prior approval of standard contract terms.

¹⁰⁵Article L113-2 is mandatory, by virtue of Article L111-2, and therefore cannot be amended by the contracting parties.

2. The Information to be Disclosed

It is a common feature of the insurance contract laws of the three relevant Member States that the information to be disclosed by the proposer to the insurer must be "material" to the risk. However, the delimitation of information material to the risk varies between the three in several important respects, with the result that the proposer for insurance is subject to a different standard in each country.

(a) Materiality

The starting point here is that the information must be material to the insurer in respect of the risk being considered. However, it is possible to apply either a subjective test, which relates the information to the particular insurer or an objective test which relates the information to a hypothetical insurer.

In the United Kingdom, the test is objective in that materiality is judged by the standard of the hypothetical prudent insurer. The MIA 1906¹⁰⁶ provides that:

"Every circumstance is material which would influence the judgement of a prudent insurer in fixing the premium, or determining whether he will take the risk."

A similar test has been applied by the courts to other classes of business¹⁰⁷. However, this rule has been modified in respect of insurances purchased in a private capacity by the Statements of Insurance Practice¹⁰⁸ which provide that insurers will not repudiate liability for non-disclosure of information which a reasonable policyholder could not be expected to have disclosed.

¹⁰⁶Section 18(2).

¹⁰⁷Lambert v Co-operative Insurance Society [1975] 2 Lloyd's Rep 485.

¹⁰⁸See note 101 above.

In France, the test is a subjective one as the reference in Article L113-2 of the Code des Assurances is to the particular insurer. The trial courts have the sovereign power to determine whether or not non-disclosure had an influence on the insurer's appreciation of the risk. An example can be seen in a decision of the Cour de Cassation¹⁰⁹ which upheld a lower court's decision to reject repudiation of a motor policy due to non-disclosure of three minor accidents on the basis that they could not have had a bearing on the insurer's appreciation of the risk.

The German test is also subjective as section 16 of the VVG refers to "the insurer", with no mention being made of a hypothetical insurer.

(b) The Knowledge of the Proposer

It is possible to distinguish an objective and a subjective test in respect of the information which the proposer for insurance is deemed to know.

The test in the United Kingdom is objective. The MIA 1906 provides that the issue of whether any particular circumstance is material is a question of fact¹¹⁰ and the courts have taken the view that it is the actual or presumed knowledge of the proposer which is relevant¹¹¹. However, this has been modified in respect of insurances purchased in a private capacity by the Statement of General Insurance Practice¹¹² which provides that the declaration at the foot of the proposal form should be restricted to completion according to the proposer's knowledge and belief.

¹⁰⁹Première Chambre Civile, 10 Mar. 1987: RGAT 1987 p392.

¹¹⁰Section 18(4).

¹¹¹Woolcott v Sun Alliance [1978] 1 WLR 493.

¹¹²Para. 1(a).

In France, the amendment to the law in 1989 abolishing the spontaneous duty of disclosure reduces the scope for insurers to dispute the knowledge of the insured, as such issues can only now be related to questions asked by the insurer. Prior to this amendment, the proposer was obliged to disclose circumstances known to him which might influence the judgement of the insurer. Whilst this was essentially a subjective test, the courts had been prepared to take a broad view of actual knowledge. For example, the Cour de Cassation¹¹³ in 1980 upheld an appellate court decision which had found that an insured under a policy covering bodily injury could not have been unaware of the risk to which he was exposed owing to the potential reprisal of the lover of his mistress, after he had assaulted the latter and received threats from the former. The courts have also taken the view that the proposer cannot hide behind inexcusable ignorance¹¹⁴.

As noted above, the insured's duty of disclosure in Germany is framed so as to be subjective, although section 16(2) of the VVG makes clear that the proposer is in breach of the duty of disclosure if he has fraudulently avoided knowledge of circumstances material to the risk.

(c) The Judgement of the Insurer

In the United Kingdom, the MIA 1906¹¹⁵ provides that:

"Every circumstance is material which would influence the judgement of a prudent insurer in fixing the premium, or determining whether he will take the risk."

Until 1984, it was accepted that this should be interpreted as meaning that the relevant information should be of such a nature as would have resulted in different action by the insurer as regards either the

¹¹³Decision of June 4, 1980. Extracted from "The Making and Breaking of Insurance Contracts: The Duty of Disclosure under French Law", a paper presented by Christian Bouckaert and Robert Byrd II at the British Insurance Law Association Conference, July 12-14 1989.

¹¹⁴Civ. 5 avr. 1949: RGAT 1949 p161. In this case it was held that the proposer should have been aware of the pregnancy of his mare.

¹¹⁵Section 18(2).

decision to write the risk or the premium rate and terms on which it was written¹¹⁶. However, following the decision of the Court of Appeal in CTI v Oceanus¹¹⁷, it is no longer necessary to prove that the prudent insurer's decision would have been altered: it is sufficient to show that the disclosure would have had an impact on the formation of his opinion without necessarily changing the decision to accept, the premium or the terms. This decision represents an expansion of the previous duty of disclosure in the United Kingdom¹¹⁸ and distances it from the position in France and Germany.

In France, prior to the 1989 amendment of the duty of disclosure, it was necessary to prove that the particular insurer would have changed his decision¹¹⁹. The trial courts have the sovereign power to determine whether in fact the relevant information would have had this effect. Following the amendment of the duty of disclosure in 1989, questions involving the judgement of the insurer are unlikely to arise frequently as the proposer's duty is limited to answering questions posed by the insurer.

In Germany, section 16 of the VVG makes clear that the relevant information must have affected the particular insurer's decision to enter the contract or whether to do so under the agreed terms.

3. Non-Disclosure and Misrepresentation

It is not only the formulation of the duty of disclosure at the inception of the contract which varies among the three Member States.

¹¹⁶A leading case is Mutual Life Insurance Co. v Ontario Metal Products [1925] AC 344.

¹¹⁷Container Transport International v Oceanus Mutual Underwriting Association [1984] 1 Lloyd's Rep 476.

¹¹⁸The law in the United Kingdom is discussed in greater detail in chap. 5, part 2.

¹¹⁹See Georges Durry, "Assurances Terrestres", para 141 in Dalloz, Encyclopédie Juridique.

The consequences of the insured's¹²⁰ breach of the duty of disclosure also vary. The law in the United Kingdom treats the insured particularly severely although it has been modified by insurers on a voluntary basis in the case of insurances purchased in a "private capacity". In the case of both France and Germany, the insurer who wishes to avoid liability for non-disclosure is subject to several constraints which protect an insured who has acted in good faith. In contrast to the voluntary and limited modification of the law in the United Kingdom, the safeguards in France and Germany apply to all policyholders purchasing categories of insurance covered by the insurance contract law statutes¹²¹.

No material distinction is made in any of the three Member States between non-disclosure and misrepresentation. Each gives rise to the same consequences in the United Kingdom¹²². In Germany, sections 16 and 17 of the VVG, dealing with non-disclosure and misrepresentation respectively, treat each in a similar fashion. The Code des Assurances in France deals with non-disclosure and misrepresentation in the same section¹²³ and provides for similar remedies.

(a) The Relevance of Good Faith

Despite the constant reference made in case-law in the United Kingdom to uberrima fides as the guiding principle of insurance contract law, the good faith of a proposer who is in breach of the duty of disclosure is of little relevance to the remedies available to the insurer. This

¹²⁰In the United Kingdom, the consequences of the insurer's breach of the duty of disclosure are the same as those in respect of the insured. In France and Germany the insurance contract law statutes do not impose a specific duty of disclosure on the insurer: however, the general principle of good faith may apply.

¹²¹In Germany, reinsurance and marine business are not subject to the VVG (s.186). In France, reinsurance and credit insurance are excluded from the Code des Assurances (Article L111-1).

¹²²This point is discussed in greater detail in chap.5, part 2.

¹²³Article L113-8.

principle was settled at an early stage in the leading case of Carter v Boehm¹²⁴, where Lord Mansfield said:

"Although the suppression should happen through mistake, without any fraudulent intention; yet still the underwriter is deceived and the policy is void¹²⁵."

However, where the insured has acted in good faith, the premium is recoverable on the grounds that the risk never attached¹²⁶.

By contrast, the insurance contract laws in France and Germany both provide a measure of protection to the insured who has acted in good faith. As already noted, the amendment of the French law has restricted the scope of the duty of disclosure to questions asked by the insurer. Additional protection is available in the case of an insured acting in good faith. The Code des Assurances¹²⁷ provides that prior to a loss, the insurer may either demand an increased premium or, having given due notice to the insured, cancel the contract and return the unexpired premium to the insured. After a loss has occurred, the insurer is obliged to pay the claim but the principle of proportionality is applied: the payment is reduced by the ratio of the premium actually charged to that which would have been charged had the risk been properly disclosed¹²⁸. Proportionality is a mandatory provision of the Code des Assurances and cannot therefore be avoided by contract terms.

In Germany, the insurer is not entitled to avoid the contract for non-disclosure where the insured has acted in good faith¹²⁹. However, it is for the insured to prove that non-disclosure or misrepresentation

¹²⁴(1766) 3 Burr 1905.

¹²⁵This reference to void has been taken by commentators to mean voidable.

¹²⁶Feise v Parkinson (1812) 4 Taunt. 640.

¹²⁷Article L113-9.

¹²⁸The principle of proportionality does not apply in marine insurance where the non-disclosed information would have led the insurer to decline the risk (Code des Assurances, Article L172-2).

¹²⁹Sections 16(3) and 17(2) of the VVG provide for this in respect of non-disclosure and misrepresentation respectively.

was not a result of any fault on his part. An example of this can be seen in a case¹³⁰ involving a proposal for sickness insurance in which the insurer expressly requested information about any in-patient treatment, investigations, operations or out-patient treatment and whether any such had been recommended during the last five years. The proposer had given a negative and thus inaccurate answer to the last question and only a partial answer in respect of in-patient treatment. It was held that the insurer was entitled to avoid the contract ab initio according to sections 16(1) and 17(1) of the VVG.

(b) The Consequences of Bad Faith

There is no material distinction in the United Kingdom between non-disclosure made in good or bad faith as in both cases the insurer can avoid the contract. However, where the proposer has acted fraudulently, he cannot recover any premiums paid¹³¹.

A more substantial distinction is made in France between good and bad faith, in that the protection extended to an insured who has acted in good faith is not available to an insured who has acted in bad faith. The Code des Assurances¹³² provides specifically for avoidance of the contract by the insurer where a non-disclosing proposer has acted in bad faith. Moreover, the premiums paid are vested in the insurer who is entitled to payment of outstanding premiums by way of damages. In Germany, the insurer is similarly entitled to avoid the contract where there is non-disclosure accompanied by bad faith¹³³, although this remedy is subject to a requirement of causality (see below).

¹³⁰District Court, Stuttgart 23.12.1986: Versicherungsrecht 1988/398.

¹³¹Feise v Parkinson (1812) 4 Taunt. 640.

¹³²Article L113-8.

¹³³VVG, sections 16(2) and 17(1) provide for rescission in the event of non-disclosure and misrepresentation respectively.

(c) Causality between Non-Disclosure and Loss

A significant difference between the United Kingdom and France, on the one hand, and Germany on the other, relates to the issue of causality between the non-disclosure and the loss suffered by the insured. In the United Kingdom, the MIA 1906 contains no requirement of causality and the courts have followed this in respect of other classes of business¹³⁴. In France, the Code des Assurances provides specifically that causality is not required in the case of intentional non-disclosure on the part of the insured¹³⁵; nor is there a requirement of causality in the case of unintentional non-disclosure¹³⁶.

However, in Germany, section 21 of the VVG provides that an insurer who rescinds after a loss is bound to pay a claim prior to rescission if there is no causal connection between the non-disclosure and the loss.

(d) Partial Rescission

The provisions of the VVG which provide for partial rescission¹³⁷ of the contract distinguish German insurance contract law from that of the United Kingdom¹³⁸ and France. The VVG provides that where the insurer has the right to rescind for non-disclosure in respect of a part of the

¹³⁴Jones and James v Provincial 1929 Ll LRep 135.

¹³⁵Article L113-8.

¹³⁶Article L113-9. Causality is not relevant to the provisions of the article relating to the discovery of unintentional non-disclosure prior to a loss as the principle relates pre-contractual information to the occurrence of a loss.

¹³⁷Section 30.

¹³⁸Spencer Bower, Turner & Sutton (Actionable Non-Disclosure (2nd. edn.) para 14.15) state that rescission must be in toto or not at all, but recognise that where there are severable covenants or stipulations to be considered, one may be rescinded without interfering with others. However, as it is difficult to find any examples in insurance of partial rescission, the basic rule of rescission in toto appears better established than the exception, and also has support in precedent: Urquhart v MacPherson (1878) 3 AC 831.

objects or the persons covered by the insurance, the insurer has the right to rescind or to terminate with respect to the other part only if it is to be assumed that the insurer would not have made the contract for that part alone with the same provisions. The effect is that the duty of disclosure is applied to severable and discrete parts of the contract and not necessarily the contract as a whole.

Bearing in mind what has already been said regarding the insurer's right to rescind, it is clear that partial rescission in Germany can operate only in circumstances where the insured has acted in bad faith and even then the insurer may be liable for losses prior to rescission where there is no causal connection between the non-disclosure and the loss.

E. OBLIGATIONS ARISING UNDER THE CONTRACT

1. Change in Risk

(a) Increased and Excluded Risks Distinguished

A distinction can be drawn between risks covered by a policy which increase during the period of cover and those which are excluded from the cover¹³⁹. This distinction is significant in France and Germany because of the duty imposed on the insured to disclose increases in risk during the course of the contract. The formulation of the duty varies between France and Germany, but in each case the intention is to ensure that the insurer is aware of any significant changes in the risk being covered. However, the distinction between increased and excluded risk is of little relevance to the United Kingdom, where the duty of disclosure generally ends on conclusion of the contract.

¹³⁹Yvonne Lambert-Faivre, Droit des Assurances (7th edn.) p188, provides several examples of the distinction in French law: prior to 1985, the attachment of a trailer to a vehicle invalidated the insurance cover for the vehicle; failure to comply with safety measures have been categorised as both increase in risk and excluded risks depending on whether observance would have influenced the insurer's decision to accept (excluded risk) or simply have resulted in a higher premium (increased risk).

The difference in approach can be explained by the practice of tacit renewal of insurance policies in France and Germany, which allows the policy to be renewed without any action on the part of the insured. In those circumstances, difficulties would arise if the duty of disclosure were limited to inception and renewal of the contract, due to the insured's lack of involvement in the renewal process. By contrast, the general practice in the United Kingdom is for the policy to be renewed annually by the active acceptance by the insured of the insurer's offer of renewal: in these circumstances a duty of disclosure which arises only at inception and renewal provides a workable solution.

(b) The Duty to Disclose Increased Risk

In the United Kingdom, the duty of disclosure applies at inception of a new insurance contract, at renewal or at the time of a modification. It follows that there is no general duty to disclose changes in risk during the currency of the policy. However, some policies stipulate that the insured is required to inform the insurer where information provided at inception has subsequently changed in a manner which may affect the premium or terms of insurance¹⁴⁰. In the case of life assurance, the duty of disclosure extends until payment of the first premium¹⁴¹.

In Germany, the VVG provides¹⁴² that if the policyholder acquires knowledge that the risk has been increased by a change made or permitted without the insurer's approval, he must inform the insurer without delay.

In France, the duty to inform the insurer of increased risk is narrower than in Germany, following amendment of the law in 1989. The current position is that the insured is required to disclose all new circum-

¹⁴⁰See, for example, The Good Luck [1992] 1 AC 233, where the policy required notice of ships entering an "additional premium area" in the Arabian Gulf.

¹⁴¹See chap.5, part 2.

¹⁴²Section 23(2).

stances which result in either aggravating the risk or creating new risks and thus render inaccurate or void the answers given to the insurer at the inception of the contract and in particular in the proposal form¹⁴³. Prior to amendment, the duty had been to disclose circumstances specified in the policy which increased the risk. However, specific contract terms can no longer override the amended rule which is mandatory¹⁴⁴ and cannot therefore be altered by the contracting parties.

(c) The Effect of Declaration of Increased Risk¹⁴⁵

In France, the insurer's right to terminate the contract is limited to circumstances which would lead either to declinature or a higher premium at inception or renewal of the contract¹⁴⁶. No distinction is made between circumstances which do or do not result from the action of the insured.

In Germany a distinction is made between circumstances which result in an increase in risk independently of the policyholder's will and those which result from his action or which he allows to occur. The basic principle is that the insurer must consent to an increase in risk and failure by the policyholder to inform the insurer of any form of increased risk allows the insurer to terminate the contract. However, as will be seen in the next subsection, the scope for the insurer to terminate for breach of the duty to inform is qualified by several caveats which operate in favour of the insured.

¹⁴³Code des Assurances, Article L113-2.

¹⁴⁴By virtue of Article L111-2.

¹⁴⁵This subsection is not relevant to the law in the United Kingdom.

¹⁴⁶Code des Assurances, Article L113-4.

(d) The Consequences of Non-Disclosure of Increase in Risk

The consequences of non-disclosure of increase in risk vary between France and Germany. The French approach is to provide for a narrow duty of disclosure of increased risk combined with strict sanctions, whilst the German law is based on a broad formulation of the duty accompanied by restrictions on the remedies available to the insurer. In the United Kingdom, the absence of any general obligation to disclose increase in risk means that it is only where the obligation is a specific term of the contract that the insurer can avoid liability for claims following the insured's failure to disclose.

In France, the remedies available to the insurer for breach of the duty to disclose increased risk are generally the same as for non-disclosure at the inception of the contract¹⁴⁷. Thus, the issue of good or bad faith is relevant: the latter makes the contract void whilst the former results in the application of the principle of proportionality¹⁴⁸, which reduces the indemnity payable to the insured. An example of failure to inform increased risk is a case of a farmer with a public liability policy who did not disclose an increase in the area of land which he was farming¹⁴⁹. The amendment of the law in 1989, has, however, complicated the remedies available to the insurer. It provides¹⁵⁰ that, where the contract provides for repudiation of claims by the insurer due to late notice of increased risk, repudiation is only possible if the insurer has suffered prejudice. This amendment has been criticised¹⁵¹ as introducing confusion into an area of law which previously operated in a rational and equitable fashion.

¹⁴⁷ Georges Durry, op. cit. note 115 above, para 164.

¹⁴⁸ The application of the principle was set out in section D.3.a, above.

¹⁴⁹ Georges Durry, op.cit. note 115 above, "Mise à Jour 1992" para. 165, cites this case (Civ. 1re 25 Nov. 1986, D. 1987 Somm. 181).

¹⁵⁰ Code des Assurances, Article L113-2-4.

¹⁵¹ See Lambert-Faivre, op.cit., p198.

In Germany, the remedies available to the insurer vary according to whether the increase in risk has been brought about by the insured or not. Where it has (or the insured has permitted a third party to effect an increase in risk), the insurer's right to terminate is dependent on the fault of the insured¹⁵². If the latter is at fault in not disclosing the increased risk, the insurer has the right to terminate immediately. If there is no fault on the part of the policyholder, termination is only effective after the expiry of a month. Where the increase in risk does not result from the action of the insured, failure to inform¹⁵³ releases the insurer from liability for claims occurring more than one month after the insurer should have received notice (i.e. claims one month after the time the insured knew of the increase in risk). However, there are three caveats to this rule which operate in favour of the insured¹⁵⁴:

- (i) the insurer's obligation continues if it knew of the increased risk;
- (ii) the same applies if at the time of the loss the period for termination by the insurer (one month) has expired and a termination has not been effected or;
- (iii) if the increase in risk had no influence on the occurrence of the insured event or the extent of the insurer's liability (absence of causality).

(e) Decrease in Risk

Decrease in risk is a less contentious issue than increase as the probability of loss is reduced rather than increased. However, the insured has a particular interest in decrease of risk as regards his right to demand a proportionate reduction in premiums. There is no difference in substance in this respect between the three Member States

¹⁵²VVG, section 24, governs unauthorised increase in risk.

¹⁵³The policyholder must inform the insurer without delay as soon as he acquires knowledge of the increase of the risk (VVG section 27[2]).

¹⁵⁴VVG, section 28(2).

under examination but it is useful nevertheless to refer to the relevant laws in the context of the consideration of changes in risk.

In the United Kingdom, there does not appear to be a specific duty to disclose reduction in risk. However, it is possible to argue that such a duty flows from the overriding principle of good faith as the disclosure is relevant to the insurer for the purpose of calculating total values at risk and also in purchasing reinsurance. The right of the insured to demand a proportionate reduction in premium may also be regarded as flowing from the principle of good faith.

The Code des Assurances in France does not provide specifically for a duty to inform the insurer of a decrease in risk. However, specific provision is made for the right of the insured to terminate the contract if the insurer refuses a reduction in premium following a decrease in risk¹⁵⁵.

The position in Germany is similar to France in that there is no specific obligation imposed on the insured to inform the insurer of decrease in risk, but the insured has the right to demand a reduction in premium in those circumstances¹⁵⁶.

2. Compliance with Contract Terms

(a) The Categorisation of Contract Terms

A distinction can be drawn between the English and German approach to contract terms on the one hand and the French approach on the other.

In the United Kingdom, a distinction is made between warranties and other terms of the insurance contract: warranties are fundamental terms

¹⁵⁵Code des Assurances, Article L113-4-14.

¹⁵⁶VVG, section 41(a).

of the contract whereas other terms are less important¹⁵⁷. The German VVG distinguishes a particular category of obligation of the insured (obliegenheit) from other insurance contract terms (versicherungsbedingungen). An obliegenheit does not translate precisely into English¹⁵⁸ but covers many of the situations in which warranties are applied in the United Kingdom. However, unlike warranties in the United Kingdom, the main feature of the German obliegenheit is that it provides the insured with special protection in the event of breach. One commentator¹⁵⁹ has described the position as follows:

"A peculiarity of German law is the existence of 'Obliegenheiten'. These are obligations of a lesser intensity since the insured cannot be forced to comply with them and the failure to do so will not lead to a liability for damages but it may endanger his insurance coverage."

By contrast with the position in the United Kingdom and Germany, the French Code des Assurances makes no reference to the categorisation of policy terms, thereby leaving issues which in English law would be tackled under the specific law of warranties relating to insurance to be reconciled under the general principles of contract law.

(b) The Consequences of Non-Compliance

In the United Kingdom there is a strict requirement of compliance with warranties: they must be exactly¹⁶⁰ complied with and if they are not the insurer is discharged from liability as from the date of the

¹⁵⁷For a more detailed discussion of the law of warranties in the United Kingdom, see chap.5.

¹⁵⁸Pfennigstorf, German Insurance Laws, comments (p132):
 "...there is no English equivalent combining in the same way the concepts of a personal duty and of a condition and at the same time covering such a wide range of different situations."

¹⁵⁹Dr. Karl Sieg, chap. 2, Insurance Contract Law (editor M. Fontaine), published by the Association International de Droit d'Assurance.

¹⁶⁰MIA 1906, section 33(3).

breach¹⁶¹. However, the practice is modified in the case of insurances purchased in a private capacity by the undertaking¹⁶² that insurers will not repudiate liability on the ground of breach of warranty where the circumstances of the loss are unconnected with the breach (absence of causality).

The German VVG starts from the position that breach of an obliegenheit releases the insurer from liability. However, there are several safeguards which operate in favour of the insured¹⁶³:

- (i) the insurer is not released from liability if the breach has occurred without the fault of the insured;
- (ii) the insurer is only freed from liability if there is a causal connection between the breach and the occurrence of the insured event or the amount of the loss;
- (iii) an agreement under which the insurer would have a right to rescind the contract upon the breach of an "obliegenheit" is void. This last section is one of the compulsory provisions of the VVG.

An example of the importance of fault in determining a breach of warranty can be seen in a case¹⁶⁴ before the German Federal Supreme Court. It was held that, whilst by virtue of section 71 VVG, the insured was under a warranty to give notice to the insurer of any transfer of ownership of the subject-matter insured, fault must be present before the rights of the insured are forfeited and the remedy available to the insurer must not be disproportionate to the severity of the insured's breach of duty.

¹⁶¹The Good Luck [1992] 1 AC 233.

¹⁶²para. 2(b)(iii) of the Statement of General Insurance Practice and para. 3(b) of the Statement of Long-Term Insurance Practice.

¹⁶³VVG, section 6.

¹⁶⁴Federal Supreme Court decision of 11.2.1987, Versicherungsrecht 1988/398.

As already noted above, no general distinction is made in France between the different terms of an insurance contract.

3. Claims

(a) The Duties of the Insurer

In all three Member States under examination the insurer is subject to a duty of good faith during the claims process. However, in the United Kingdom, this represents a specific rule applicable to insurance, whereas in France and Germany it is the result of general rules of contract law.

In the United Kingdom, the conduct of the insurer during the claims process is subject to the duty of good faith which operates for the duration of the contract¹⁶⁵. However, the insurer does not owe the insured a separate common law duty of care, such as would be actionable in tort¹⁶⁶. Moreover, the courts have been reluctant to extend the insurer's duty of good faith to persons other than the insured¹⁶⁷.

In France, the conduct of the insurer during the claims process is subject to the overriding principle of contract law that contracts must be performed in good faith¹⁶⁸. The Code des Assurances does not provide for any similar rule to be applied specifically to insurance contracts. Similarly in Germany, the VVG does not make provision for the standard of the insurer's conduct during the claims process. The

¹⁶⁵See Boulton v Houlder Bros. & Co. [1904] 1 K.B. 784.

¹⁶⁶Banque Financière de la Cité v Westgate Insurance Co. [1988] 2 Lloyd's Law Rep 513. That decision was later affirmed by the House of Lords on other grounds: [1991] 2 AC 249.

¹⁶⁷See The Good Luck [1989] 2 Lloyd's Rep 238, 264 (per May LJ). That decision was later reversed by the House of Lords on other grounds: [1992] 1 AC 233.

¹⁶⁸Article 1134 of the Civil Code. See part 1 of this chapter.

situation is therefore governed by Article 242 of the German Civil Code concerning good faith in the performance of contracts¹⁶⁹.

(b) The Duties of the Insured

In the United Kingdom, the insured as well as the insurer is bound by the duty of good faith during the claims process:

"It is an essential condition of the policy of insurance that the underwriters shall be treated with good faith, not merely in reference to the inception of the risk, but in the steps taken to carry out the contract."¹⁷⁰

In France, the primary duty of the insured on the occurrence of a claim, as set out by the Code des Assurances, is to give notice to the insurer. The amendment of the law in 1989 limited the use of contractual terms whereby the insurer can avoid liability for claims not reported within the limits set by the policy to situations in which the insurer has been prejudiced by the delay¹⁷¹. Whilst this amendment has restricted the abuse of repudiation for delay in reporting claims, it has been criticised¹⁷² for confusing remedies available for breach of contract in the civil law with the specific contractual right of the insurer to avoid liability for late-reported claims¹⁷³.

In Germany, the provisions of the VVG¹⁷⁴ regarding the insured's duties on a claim cover both the provision of notice and the furnishing

¹⁶⁹See part 1 of this chapter.

¹⁷⁰Boulton v Houlder Bros. & Co. [1904] 1 K.B. 784,791.

¹⁷¹The provisions of Article L113-2 in respect of the reporting of claims and repudiation of late-reported claims are not applicable to life assurance.

¹⁷²See Lambert-Faivre, op. cit., p280.

¹⁷³The process by which the insured loses his right to indemnity for failure to report his claim within the time limit set by the policy is referred to as "déchéance". This is a conventional sanction which must always be contained in a policy term which is printed in a manner which draws the insured's attention to its significance.

¹⁷⁴Sections 33 and 34.

of information to the insurer. Moreover, the VVG contains a specific duty (obliegenheit) obliging the insured to act so as to minimize losses¹⁷⁵: however breach of this duty will only allow the insurer to avoid liability for a claim where the breach was intentional or due to gross negligence¹⁷⁶.

As with the duties of the insurer, the duties of the insured during the claims process in France and Germany are also regulated by the general principle of good faith in the performance of contracts¹⁷⁷.

(c) The Principle of Proportionality

The principle of proportionality distinguishes French insurance contract law from that of both the United Kingdom and Germany, neither of which adopt the approach of adjusting the claim. It has already been noted that the principle is applied in France for the purposes of reducing the claim in circumstances where avoidance of the contract by the insurer is regarded as an unduly harsh remedy. Those circumstances are first where the proposer has unintentionally breached the duty of disclosure at inception and secondly where the insured has unintentionally failed to disclose increase in risk.

The position in the United Kingdom appears less flexible in that the insurer, having discovered that there has been non-disclosure on the part of the insured, is faced with a choice of either honouring the contract and paying the claim in full or rescinding the contract and avoiding liability¹⁷⁸.

¹⁷⁵Section 62(1).

¹⁷⁶VVG, section 62(2).

¹⁷⁷See part 1 of this chapter.

¹⁷⁸Subject to the caveat in note 134 above.

In Germany, partial rescission¹⁷⁹ offers a solution which avoids the cancellation of the entire contract for non-disclosure related to a particular aspect of the coverage. However, it does not seek to adjust the claim payable to the insured. Thus, although the circumstances in which rescission can be effected vary, the position in the United Kingdom and Germany is similar in that the insured's claim will either be paid in full or not at all.

F. TERMINATION OF THE CONTRACT

1. Non-Life Insurance

The practice in France and Germany differs from the United Kingdom in that the former two Member States allow for the automatic extension of the insurance contract whereas the normal practice in the United Kingdom is for the contract to end at the expiry of the policy term in the absence of positive action by the insured to accept the insurer's offer of renewal.

The normal practice in the United Kingdom is for the policy to remain in force for one year, expiring at midnight on the last day. Where the cover is for an indefinite period, it is likely that the courts will imply a term that cover shall not last beyond a reasonable time¹⁸⁰.

In Germany, the VVG¹⁸¹ provides that where insurance is entered into for an indefinite period, the duration is deemed to be one year¹⁸². An agreement under which an insurance relationship is deemed to be tacitly extended unless notice is given prior to the expiration of the

¹⁷⁹See section D.3.d above.

¹⁸⁰Allagar Rubber Estates Ltd. v National Benefit Assurance Co Ltd. (1922) 12 Ll LR 110.

¹⁸¹Section 8.

¹⁸²VVG, section 9. The presumption does not apply if the premiums are measured by shorter intervals.

contract term is valid for extension of only one year in each case¹⁸³. Termination of the contract by either party is possible at the end of each year, subject to notice during a period of between one and three months prior to the year-end¹⁸⁴.

The French Code des Assurances provides that the duration of the contract and conditions for termination of the contract should be fixed by the policy¹⁸⁵. However, both insurer and insured have the right to terminate the contract at the end of each year, subject to the provision of two months' notice¹⁸⁶. Moreover, the policy must remind the insured of the right to cancel at the end of each year.

2. Life Assurance

Life assurance differs from non-life in that the cover is usually fixed in advance for a number of years. The concept of renewal of the policy applied in the non-life sector is not relevant as the premium and cover are based on the age and health of the individual at a point in time: at any subsequent date it is certain that the risk would be materially different.

The termination of policies prior to the end of their fixed term has therefore been approached in a different fashion in the life sector. Two issues in particular have attracted the attention of the legislature and regulators. The first is the need to provide a "cooling-off" period to the consumer who has agreed to a life contract without fully considering his position. The second is the desire to extend a measure

¹⁸³This practice is common in Germany. VVG section 8 refers to "the insurance relationship" ("versicherungsvertrag") as opposed to the "contract" ("vertrag") which is used in other contexts.

¹⁸⁴VVG section 8(2) provides that it is possible for the parties to waive their rights to terminate for up to two years.

¹⁸⁵Code des Assurances, Article L113-2 governs termination of the contract.

¹⁸⁶The annual right to terminate the contract need not be provided for in individual sickness policies and those covering commercial risks.

of protection to the insured who wishes to cancel ("surrender") the contract prior to maturity and who may face stiff penalties for doing so.

(a) Cancellation Rules

The "Cooling-Off" provisions of the Third Life (Framework) Directive¹⁸⁷ will ensure harmonisation of one aspect of insurance contract law among the Member States. The result will be that most policyholders will have a period of between 14 and 30 days from the time of intimation of conclusion of the contract in which to cancel. This represents an important step in providing equivalent protection for the policyholder in each Member State¹⁸⁸.

(b) Early Surrender Rules

The absence of specific rules in the United Kingdom in respect of the early surrender of policies distinguishes it from both France and Germany. The distinction reflects a basic difference in approach to the regulation of life assurance. France in particular, and Germany to some extent, favour product rules, that is rules which determine in detail the rights of the parties under specific forms of life policy. The United Kingdom, by contrast, adopts a marketing based approach to the regulation of the life sector with the emphasis on controlling the methods in which life policies are sold¹⁸⁹.

¹⁸⁷Directive 92/96, OJ 1992 L360/1. Article 30 extends the right of cancellation to all policyholders with two exceptions: first, those entering contracts of six months' duration or less; and secondly, those whose status or circumstances at the time of entering the contract are such that they do not require special protection. The cancellation provisions of the Second Life Directive (90/619, OJ 1990 L330/90, Article 15) apply only to "services" business.

¹⁸⁸However, as the Directive does not make clear the consequences of failure to comply with the "cooling-off" rules, they may vary between Member States.

¹⁸⁹This is achieved through the Conduct of Business Rules introduced under the authority of the Financial Services Act 1986.

In the United Kingdom, life policies generally provide the policyholder with a right to a surrender value after the expiry of a certain period. The Statement of Long-Term Insurance Practice provides¹⁹⁰:

"Life assurance policies or accompanying documents should indicate ...whether or not there are rights to surrender values in the contract and, if so, what those rights are."

However, in most cases, there is no reference to the method of calculation¹⁹¹. Instead, protection of the policyholder is pursued through a requirement that sample surrender values be disclosed to the proposer prior to entering into a contract¹⁹².

The Code des Assurances in France provides that a life policy must refer to the fact that surrender values are regulated by decree¹⁹³. The maximum proportion of policy funds which may be retained by the insurer is fixed by decree¹⁹⁴. Moreover, where the insured has requested the surrender proceeds of the policy and the insurer fails to pay within two months, the proceeds are subject to penal interest rates.

The German VVG is much less specific in its control of surrender values, providing that the insurer is entitled to a "reasonable deduction" from the policy funds which are to be returned to the insured. This is backed up by a procedure which enables the Insurance

¹⁹⁰Para. 2(b)(i).

¹⁹¹This is despite the fact that the Securities and Investments Board (SIB) has indicated that, in 1991, 37% of unit-linked endowments and 23% of with-profits policies were terminated within two years of inception. The approach to surrender values in the UK has been criticised by the Director-General of Fair Trading: see "Fair Trading and Life Insurance Savings Products" (March 1993).

¹⁹²This forms part of the "product particulars" which are required to be provided by a life insurer to a proposer for life assurance under rule 5.14 of the Rulebook of the Securities and Investments Board.

¹⁹³Article L132-21.

¹⁹⁴Code des Assurances, Article R 132-1 represents the decree and provides that the proportion may not exceed 5% of the mathematical provision. In the case of policies in force for more than ten years, no charge may be made by the insurer.

Supervisory Authority to intervene in cases where the surrender values provided by an insurer consistently fall below the industry average¹⁹⁵.

G. CONCLUSIONS

1. The importance of good faith as a general principle of contract law varies among the Member States under examination. There has been little development of the principle of good faith in the United Kingdom outside the confines of the duty of disclosure in insurance. By contrast, the duty of disclosure in France and Germany is framed within the context of a broader principle of good faith in the negotiation and performance of contracts.

2. The approach to freedom of contract varies between France, Germany and the United Kingdom. The Code des Assurances in France is largely mandatory in that its provisions cannot generally be altered by the contracting parties. The VVG in Germany also contains many mandatory provisions. By contrast, there are few mandatory provisions of insurance contract law in the United Kingdom. In France and Germany, the provisions of statutes relating to unfair contract terms apply to insurance, whereas insurance in the United Kingdom is exempt from the Unfair Contract Terms Act 1977. The Statements of Insurance Practice protect policyholders in the United Kingdom who have purchased insurance in a private capacity, but do not amend the law.

3. The substance of insurance contract law varies materially between France, Germany and the United Kingdom. Although Lohéac has argued¹⁹⁶ that the provisions of the laws of the Member States converge to a more marked degree than might have been imagined, there are important differences: as already discussed, these differences are visible at all stages of the contract from negotiation to performance of the contract and termination. Moreover, it is important to note that the common

¹⁹⁵VVG, section 81(c).

¹⁹⁶Francis Lohéac, Introduction to EEC - Insurance Contract Law (A CEA publication, 1990).

law/civil law distinction does not account for all the areas of difference. There are three important aspects on which the French and German laws differ: the first is in respect of the formulation of the duty of disclosure; the second is the principle of proportionality which is found only in France; and the third is the requirement of causality in Germany in cases of non-disclosure and breach of warranty (obliegenheit).

4. Distinctions between Categories of Policyholders

It is only in the United Kingdom that a distinction is made between different categories of policyholder. The Statements of Insurance practice "modify" the normal rules of insurance contract law in respect of individuals who purchase insurance in their "private capacity". The result is that a small businessman, for example, may be subject to different standards as regards his personal and business insurances.

The approach in France and Germany is different. Certain categories¹⁹⁷ of insurance business are exempt from the provisions of the insurance contract law statutes but no distinction is made between different types of policyholder¹⁹⁸. Thus, the approach differs from the British model in that there is equivalence of treatment between all policyholders purchasing the same policy.

¹⁹⁷In Germany, reinsurance and marine business are not subject to the VVG (s.186). In France, reinsurance and credit insurance are excluded from the Code des Assurances (Article L111-1).

¹⁹⁸A distinction is made between policyholders for the purposes of authorisation and supervision of insurers following the implementation of Community Directives 88/357 and 90/619 (the "second generation" Directives). However, the distinction does not apply within insurance contract law.

CHAPTER 4

HARMONISATION - AN ALTERNATIVE APPROACH TO DIFFERENCES IN CONTRACT LAW?

Introduction

In this chapter, consideration is given to harmonisation as an alternative to the approach adopted by the insurance Directives to differences in contract law. Part 1 sets out the case for harmonisation: this involves an examination of the Treaty basis for Community action, the functioning of the Single Market in insurance, the principle of subsidiarity and comparison of the approach in the United States with that in the Community. In Part 2, the draft Insurance Contract Law Directive is examined in order to determine if it still represents a suitable basis for action in the light of the completion of the Single Market programme.

PART 1: THE CASE FOR HARMONISATION

A. THE RANGE OF ALTERNATIVE SOLUTIONS

Alternative solutions to that adopted by the Community in the field of contract law fall into two categories: those which involve working within the choice-of-law approach incorporated in the insurance Directives and those based on harmonisation of contract law. As discussed below, the principle of mutual recognition, which forms the basis of the Community's system of prudential supervision, has only a limited contribution to make to the resolution of issues arising from differences in contract law.

1. Alternative Rules of Private International Law

Solutions falling within this category would essentially be designed to simplify the rules of private international law in the field of insurance. The most obvious approach would be to apply the Rome

Contracts Convention to insurance¹. Cousy² advances three reasons for adopting such an approach:

(i) it would avoid "parallelism"³ in the rules of private international law and bring the insurance sector into line with the banking and investment services sectors which are subject to the Rome Convention⁴;

(ii) the differences between the choice of law rules of the Rome Convention and the insurance Directives are not great⁵;

(iii) the Rome Convention strikes a better balance between free choice of law and the protection of the consumer.

However, it is highly unlikely that Member States would agree to the substitution of the provisions of the insurance Directives by those of

¹This solution was proposed by a Joint Working Party of the English and Scottish Law Commissions which reported in 1979 on the choice of law rules in the draft Second Non-life Directive: the complexity of the rules led it to the conclusion that it would be best to apply the rules of the draft Obligations Convention (which formed the basis of the Rome Contracts Convention) to "large" risks and leave "mass" risks to be governed by national rules of private international law.

²Herman Cousy, "Concluding Report", in "Insurance Contract Law in the Single Market - Law Applicable, Public Policy Provisions, International Conventions", XII International Colloquium of Magistrates and Insurers (Avignon 4-7 October 1991).

³This refers to competition among different sets of rules of private international law. Cousy takes the view that the very existence of different sets of rules gives rise to problems of this nature in relation to the demarcation of the scope of each set of rules.

⁴Cousy also notes that the disparity in treatment between the banking and investment services sector on the one hand and the insurance sector on the other gives rise to concern as regards the "transparency" of products which are sold to the same customer base and are designed to meet similar objectives. The recent rapid growth of "bancassurance" makes this issue particularly relevant.

⁵Cousy does, however, concede that the Rome Convention gives a higher priority to freedom of choice than do the insurance Directives. As argued in chap.2, this represents an important difference.

the Rome Convention: that option was available at the time of the negotiation of the Second Directives and was rejected. Moreover, alternative solutions based on choice-of-law rules which did not apply the Rome Convention would do little to reduce the complexity of the existing system and would leave the insurance sector out of line with banking and investment services as regards choice of law.

2. Harmonisation of Insurance Contract Law

The attraction of solutions involving harmonisation is that they would dispense pro tanto with the restrictions on freedom of contract and choice of law which are currently justified in the area of "mass" and life risks for the purposes of consumer protection. However, in order to make a significant contribution, the harmonisation would have to cover all the essential provisions of insurance contract law: this would ensure that equivalent protection was available to a consumer irrespective of choice of law and would therefore open the way for a simplification of the rules of private international law, as restrictions on choice of law would no longer be justified⁶.

A possible solution post-harmonisation would be the abandonment of the rules of private international law contained in the insurance Directives and the application instead of the Rome Contracts Convention. This combination would have the effect of providing a uniform standard of consumer protection throughout the Community, whilst also simplifying the rules of private international law. As discussed below, it is likely that such an approach would encourage the development of cross-border business and help in the realisation of the economic benefits identified in the Cecchini Report⁷ as likely to flow from the completion of the Single Market in insurance.

⁶The original draft of the Second Non-Life Directive (1975) provided for a free choice of law: at that time it was thought that an insurance contract law Directive would be adopted prior to the liberalisation of freedom of services in insurance: see W. Pool, "Moves Towards a Common Market in Insurance" 21 CMLRev (1984) 123,143.

⁷Commission of the EC, Research on the "Cost of Non-Europe" (1988). See chap.1.

3. The Relevance of the Principle of Mutual Recognition

As discussed in chapter 1, the regulation of the Single Market in insurance is based on the principle of mutual recognition of the rules of individual Member States. Harmonisation has been confined to those areas which have been regarded as necessary to allow the operation of a system of "home country control": these are essentially the authorisation procedure, solvency margins and the principles governing technical reserves. A different policy has been adopted in respect of conditions of insurance in that neither mutual recognition nor harmonisation has been pursued: the favoured solution has been the dismantling within the Community of all systems of prior approval of policy conditions and rates.

In approaching the issues which arise from the existence of differences in insurance contract law between the Member States, it is relevant to look to the principle of mutual recognition⁸ as the foundation of the rules governing the Single Market in insurance. Differing views have been expressed as regards the relevance of mutual recognition to differences in contract law. Roth⁹ takes the view that harmonisation of insurance contract law is not necessary and that choice-of-law rules are more in keeping with the principle of mutual recognition. However, Biancarelli¹⁰ argues that the principle of mutual recognition has little to contribute to issues of contract law within the Single Market in insurance:

"..to what extent can a financial contract, be it an insurance contract or for that matter a banking contract, be assimilated to a bottle of "Cassis de Dijon" liqueur, with regard to the freedom of circulation it is entitled to, in the Community area and in the future single market?"

⁸On the history of the principle of mutual recognition, see A. Mattera, "L'Article 30 du Traité CEE, la jurisprudence "Cassis de Dijon" et le principe de la reconnaissance mutuelle", *Revue du Marché Unique Européen* 1992 vol 4 p13.

⁹"The European Economic Community's Law on Services: Harmonisation" 25 *CMLRev* (1988) 35.

¹⁰"General Report", *CEA XII International Colloquium*, op. cit. p26.

It appears to me that the assimilation made, in this regard, by the Commission between the freedom of movement for merchandise and the freedom of movement for financial products, i.e. in the final analysis, for legal concepts, is somewhat excessive and based on a totally fictitious analogy."

Biancarelli's case is the stronger, it is submitted, as the principle of mutual recognition and contract law are separate issues: the former governs the access of products to national markets and the latter the obligations of the provider and recipient of services. Nevertheless, there is an area of common ground between the policy underlying the principle of mutual recognition and the resolution of issues arising from differences in contract law. This common ground lies in the field of consumer protection. Mutual recognition is predicated on the proposition that a consumer in one country receives an equivalent level of protection when purchasing a product from a provider of services subject to the control of a different Member State. Harmonisation has ensured that this is so as regards the prudential supervision of the business of insurers. However, as discussed in chapter 3, the relationship of insurer to policyholder varies according to the applicable law, with the result that policyholders in different Member States do not have an equivalent level of protection. This divergence limits the possibility of recognising the laws of another Member State as providing an adequate degree of consumer protection and, as will be discussed later, opens the possibility to Member States of imposing restrictions on freedom of services.

B. A TREATY BASIS FOR HARMONISATION?

1. The Legal Framework for Community Action

Article 190 of the Treaty provides that:

"Regulations, directives and decisions of the Council and of the Commission shall state the reasons on which they are based and shall refer to any proposals or opinions which were required to be obtained pursuant to this Treaty."

In order to satisfy this requirement, Community measures must include a statement of the facts and law which led the competent Institution

to adopt them¹¹. Moreover, the choice of a legal basis for a measure may not depend simply on the Institution's conviction as to the objective pursued but must be based on objective factors which are amenable to judicial review¹². Barents¹³ notes that this requirement serves two purposes: first, it allows the Community to attain the objectives set out in Article 2 of the Treaty; and secondly, it has a guarantee function as it protects Member States, institutions and individuals from acts with respect to which the Community has no powers.

2. The Treaty Basis of the draft Directive

The Treaty basis of the draft Insurance Contract Law Directive¹⁴ was Articles 57(2) and 66. The preamble to the Directive made clear that a major objective of harmonisation was the creation of a framework which would allow for the exercise of full freedom of services within the Community:

"whereas such co-ordination, by establishing a balance between the interests of the insurer on the one hand and the protection of the policyholder and insured person on the other, is likely to enable freedom of choice to be extended and thus to facilitate the exercise of freedom to provide services".

The immediate objective which the draft Insurance Contract Law Directive was intended to achieve was the adoption of the Second Non-Life Directive. As agreement was reached without harmonisation and as many of the restrictions left in place by that Directive will be removed once the Non-Life Framework Directive enters into force¹⁵, it is possible to argue that the Treaty basis of the original Insurance

¹¹Case 45/86, Commission v Council [1987] ECR 1493.

¹²On choice of legal bases see: S. Crosby, "The Single Market and the Rule of Law" 16 ELR (1991) 451; and G. Close, "Harmonisation of Laws: Use or Abuse of the Powers under the EEC Treaty" 3 ELR (1978) 461.

¹³René Barents, "The Internal Market Unlimited: Some Observations on the Legal Basis of Community Legislation" 30 CMLRev (1993) 85.

¹⁴COM (79) 355 final as amended by COM (80) 854 final.

¹⁵The implementation date is 1.7.1994 (subject to derogations).

Contract Law Directive is no longer appropriate. However, as will be demonstrated later in this chapter, there are grounds for holding that harmonisation would improve the operation of the Single Market in insurance. In particular, it will be argued that harmonisation would assist the free circulation within the Community of insurance policies lawfully marketed in any Member State. Articles 57(2) and 66 could therefore still form a valid Treaty basis for a harmonisation Directive, but, as discussed below, other Treaty provisions provide a clearer basis for action.

3. Alternative Treaty Bases

(a) Article 100¹⁶

This provides a possible legal basis for a measure harmonising insurance contract law. However, there are two reasons for arguing that it is not the most appropriate legal basis. First, it relates to measures which "directly affect the establishment or functioning of the common market". Measures which relate to the smooth operation of the Single Market, such as harmonisation of insurance contract law, fall more obviously within Article 100A which relates to measures "which have as their object the establishment and functioning of the internal market"¹⁷. Secondly, as discussed below in relation to Article 100A, the Court of Justice has made clear that the co-operation procedure¹⁸ contained in Article 100A may result in preference being given to it as the most appropriate legal basis.

¹⁶Article 100.

The Council shall, acting unanimously on a proposal from the Commission, issue directives for the approximation of such provisions laid down by law, regulation or administrative action in Member States as directly affect the establishment or functioning of the common market. The Assembly and the Economic and Social Committee shall be consulted in the case of directives whose implementation would, in one or more Member States, involve the amendment of legislation.

¹⁷However, as discussed below, there is no substantive difference between the "common market" and the "internal market".

¹⁸This is set out in Article 149 of the Treaty.

(b) Article 100A¹⁹

The introduction of Article 100A into the Treaty by the Single European Act has provided an alternative Treaty basis for the harmonisation of insurance contract law. Whilst Article 100 provides only for harmonisation of measures which directly affect the establishment or working of the common market, Article 100A provides for harmonisation of measures which have as their object the establishment and functioning of the internal market. Article 8A, which was also introduced by the Single European Act, provides that the internal market is to be established over a period expiring on the 31st December 1992 and that it shall comprise an area without internal frontiers in which the free movement of goods, persons, services and capital is ensured in accordance with the provisions of the Treaty. The Court of Justice has taken the view in the Titanium Dioxide case²⁰ that, whilst there is no substantive difference between the "common market" referred to in Article 100 and the "internal market" referred to in Article 100A, the co-operation procedure provided for in Article 100A cannot be avoided by recourse to alternative Treaty bases where it is clear that a measure falls within Article 100A. This is not to say that the choice of Article 100A as a legal basis will be influenced primarily by its requirement for co-operation. The Court's decision in Titanium Dioxide makes clear that there must be objective grounds, such as distortions in competition which affect the functioning of the Single Market, to justify the choice of Article 100A²¹.

¹⁹Article 100A.

1. By way of derogation from Article 100 and save where otherwise provided in this Treaty, the following provisions shall apply for the achievement of the objectives set out in Article 8A. The Council shall, acting by a qualified majority on a proposal from the Commission in co-operation with the European Parliament and after consulting the Economic and Social Committee, adopt the measures for the approximation of the provisions laid down by law, regulation or administrative action in Member States which have as their object the establishment and functioning of the internal market.

²⁰Commission v Council (case 300/89), [1991] ECR I 2867.

²¹See Barents, *op.cit.*, p95.

The issue of whether or not differences in insurance contract law affect the functioning of the Single Market will be examined in section C, below. However, at this point, it is worth noting that Article 100A has already been cited by the Commission as the basis for the Directive on Unfair Terms in Consumer Contracts²², the preamble of which states:

"Whereas the laws of Member States relating to the terms of contract applicable between the seller of goods or supplier of services, on the one hand, and the consumer of them, on the other hand, show many disparities, with the result that the national markets for the sale of goods and services to consumers differ from each other and that distortions of competition may arise amongst the sellers and suppliers, notably when they sell and supply in other Member States;"

Article 100A(3) provides that the Commission, in its proposals envisaged in Article 100A(1) concerning health, safety, environmental protection and consumer protection, will take as a base a high level of protection. At present, the Community has no express policy on consumer protection although many measures have been adopted which include consumer protection among their objectives²³. Three programmes for consumer protection have been adopted by the Community in 1975, 1981 and 1986 respectively. More recently, the Commission adopted a Three Year Action Plan of Consumer Policy²⁴ which concentrated policy initiatives on measures needed for the completion of the Single Market. The latter resulted in the publication in 1990 of the draft Directive on Unfair Terms in Consumer Contracts.

The failure to develop a coherent consumer protection policy has attracted criticism both from within Community institutions and from outside. McGee and Weatherill²⁵ have argued that there is a general

²²Directive 93/13, OJ 1993 L95/29.

²³For a history of the Community's involvement in the field of consumer protection see: Background Report, Consumer Policy in the European Community - An Overview, ISEC/B2/93 (1st Jan.1993).

²⁴COM (90) 98 final.

²⁵"The Evolution of the Single Market - Harmonisation or Liberalisation" 53 MLR (1990) 578.

trend for the dismantling of national barriers to take place without parallel action to create a Community regime which effectively protects the consumer and that such an approach fails to take the protective function of commercial law as seriously as its role in facilitating free trade. A similar approach has been adopted by the Economic and Social Committee which has recently proposed²⁶ that consumer policy be given greater priority as a policy in its own right rather than simply as an adjunct of Single Market proposals.

Two issues are particularly important in any consideration of consumer protection in the field of insurance. One is the necessity to ensure that any authorised insurer will have sufficient resources to pay claims: the other is the need to ensure a proper balance in contract law between the interests of the insurer and insured.

The Community's regulatory structure for insurance has ensured that the quality of security offered by insurers operating in the Community meets certain minimum standards. Thus, all policyholders are protected by provisions designed to ensure that an insurer remains solvent and can pay claims. However, as was established in chapter 3, the balance between the interests of the insured and insurer in contract law varies throughout the Community. Such a situation is incompatible with the operation of the Single Market in that the product which is delivered to the consumer (essentially a set of contingent claims against the insurer), whilst ostensibly homogeneous, varies according to the contract law which is applicable. The result is that the degree to which insurance contract law protects the consumer differs among the Member States.

Moreover, the Consumer Contracts Directive does not offer a solution to the establishment of an equivalent standard of protection for insurance policyholders throughout the Community. As noted in chapter 2²⁷, the Directive excludes insurance contract terms which clearly

²⁶Opinion on Consumer Protection and Completion of the Internal Market, OJ 1991 C339/08.

²⁷See section C.2.a.

define or circumscribe the insured risk and the insurer's liability. The exclusion can be justified on the basis that the Directive was an inappropriate²⁸ mechanism for dealing with insurance contract law but there are two unsatisfactory consequences. First, as discussed in chapter 2, fundamental terms of an insurance contract are excluded from the Consumer Contracts Directive whilst some less important terms appear to be included. Secondly, the Community's consumer protection policy has ignored the insurance sector despite it being one in which most consumers are active.

(c) Article 129A of the European Community Treaty²⁹

Within the context of Article 100A, harmonisation of insurance contract law can be considered only in terms of its impact on the functioning of the Single Market, which, at present, does not encompass general considerations of consumer protection. Ratification of the Treaty on European Union would provide greater impetus to the harmonisation of insurance contract law through its addition to the Treaty of Rome of an explicit recognition of the Community's role in consumer protection. Article 129A of the European Community Treaty provides that:

1. The Community shall contribute to the attainment of a high level of consumer protection through:
 - (a) measures adopted pursuant to Article 100A in the context of the completion of the single market
 - (b) specific action which supports and supplements the policy pursued by the Member States to promote the health, safety and economic interests of consumers and to provide adequate information to consumers.

²⁸The British Insurers International Committee opposed the Consumer Contracts Directive in a written submission to the House of Lords Select Committee on the European Community (see 6th Report 1991-92). Its opposition was based on the belief that the Directive might restrict the use of essential exclusion clauses, such as war risks, and that the definition of "unfair" contract terms was too vague.

²⁹The Treaty of Rome as amended by the Treaty on European Union is referred to as the European Community Treaty.

This article would provide an additional basis to Article 100A for a harmonisation Directive, particularly in respect of those aspects of insurance contract law such as cancellation provisions and transparency in life policies which are directly concerned with consumer protection.

C. THE FUNCTIONING OF THE SINGLE MARKET IN INSURANCE

Any attempt to justify harmonisation of insurance contract law within the Community on the basis of Article 100A must demonstrate that differences in contract law have an impact on the functioning of the Single Market. The Community's willingness to take action under Article 100A has been criticised on the basis that there are circumstances in which other Treaty provisions are more appropriate³⁰ and that Article 100A has been used as a means of escaping from the framework of specific powers attributed to the institutions by the Treaty³¹. However, it is submitted that differences in insurance contract law represent an area in which resort to Article 100A can be justified. The impact of differences in contract law on the functioning of the Single Market in insurance can be summarised as follows:

1. They distort competition by treating differently purchasers of the same product in different Member States;
2. They result in varying degrees of freedom of contract in insurance and divergence in the degree of freedom of choice of law among the Member States;
3. They allow greater reference to the "general good" as a justification for restrictions on freedom of services than would be possible with harmonisation.

Each of these points is examined in greater detail below.

³⁰See Crosby, *op.cit.*

³¹See Barents, *op. cit.* p108.

1. Competition

Harmonisation is not always the appropriate response to situations in which there is a diversity of approach between national legal systems within the Community. As argued in chapter 1³², the approach to the Single Market through the principle of mutual recognition implies some degree of competition between national systems. However, it is submitted that competition between national systems of insurance contract law produces no material benefit to the Community and that there is a clear case, based on measures already adopted by the Community, for arguing that differences in contract law represent a distortion of the Treaty rules on competition.

(a) The Impact of Differences in Insurance Contract Law

The main effect of differences in insurance contract law among the Member States of the Community is that they create distinctions between policyholders in different Member States as regards their rights and obligations in respect of an insurance contract. This can arise in two ways. First, the possibility of a claim being paid, or the amount to be paid, may vary according to the contract law which governs the contract. Secondly, the extent to which a proposer for insurance has a right to receive information from the insurer during the pre-contractual period may vary. The effect is that purchasers of the same product in different Member States are treated differently. It is not just that the policyholders rights and obligations in relation to the product differ but that the very nature of the product itself may differ in that it may or may not provide cover against the insured event.

Kitch³³ has argued, in the context of the federal system in the United States, that diversity in state legal and regulatory systems carries

³²See chap 1, section J.

³³E. Kitch, "Regulation and the American Common Market", in A. Dan Tarlock, Regulation, Federalism and Interstate Commerce (1981), pp 7-55.

with its benefits in the form of increased efficiency and consumer choice which results from competing jurisdictions. However, Porter³⁴ has argued that the potential benefits of such diversity may be eliminated where social values such as consumer or environmental protection are subject to competition between legal orders. The latter view holds good in relation to insurance contract law within the Community: competition between national systems of contract law would lower the prevailing level of consumer protection without offering any obvious benefits in terms of increased efficiency or greater product choice. This view is implicitly recognised by the Community's approach to insurance contract law which restricts competition between national systems in the case of non-life "mass" risks and life assurance. As noted by Reich³⁵, the choice-of-law rules adopted by the Community are necessary so long as insurance contract law is not harmonised in order to provide an adequate protection mechanism for the insured.

(b) The Community's approach to Competition and Harmonisation

It is clear that the Community has been prepared to take action to limit the scope for competition between national legal systems where it has a distorting impact on the operation of the Single Market. There is ample precedent in the form of measures adopted within the Community for the contention that differences in contract law represent a distortion of competition.

(i) The Consumer Contracts Directive

The preamble to the Consumer Contracts Directive³⁶ identifies the presence of a marked divergence in national laws relating to unfair contract terms as a distortion of competition in that it may deter consumers from direct purchases of goods or services in another Member

³⁴M. Porter, The Competitive Advantage of Nations (1990), p15.

³⁵Norbert Reich, "Competition between legal orders: a new paradigm of EC law?", 29 CMLRev (1992) 861.

³⁶Directive 93/13, OJ 1993 L95/29.

State. It also notes that a lack of knowledge on the part of consumers as to the rules of law of other Member States may deter them from entering into transactions with suppliers based in other Member States.

It follows from this approach that the presence of any divergence in contract law which results in consumers being treated differently in different Member States may well constitute a distortion of competition. The Consumer Contracts Directive therefore reinforces the Commission's original contention³⁷ that differences in insurance contract law represented a distortion of competition.

(ii) The Product Liability Directive

Comparison can also be made with the Product Liability Directive³⁸ which was adopted under Article 100 of the Treaty as a measure designed to cure market distortion caused by legal differences between the Member States. The preamble to that Directive states:

"Whereas approximation of the laws of the Member States concerning the liability of the producer for damage caused by the effectiveness of his products is necessary because the existing divergences may distort competition.."

The Product Liability Directive introduced only a limited form of harmonisation³⁹, but it does illustrate a willingness to treat differences in national laws as an obstacle to the functioning of the Single Market. An objective underlying the Product Liability Directive was to reduce competitive distortions arising from differences in product liability premiums which producers in different Member States would be required to pay. By way of analogy, it seems clear that if distortions arise due to differences in product liability premiums, they arise also where the law governing the insurance contract differs as in each instance producers in each Member State are in a different position.

³⁷This appeared in the explanatory memorandum to the draft Insurance Contract Law Directive.

³⁸Directive 85/374, OJ 1985 L210/29.

³⁹Article 15 allows Member States to choose whether to retain the "development risk" defence and Article 16 allows for the adoption of an aggregate limit for damage or injury caused by identical items.

(iii) The Insurance Directives

The presence of insurance contract law measures in the Second and Third Life Directives, in the form of provisions in respect of "transparency" and the policyholder's cancellation rights, is based on their impact on competition. The preamble to the Third Life Assurance Directive, referring to the "transparency" provisions, states:

" Whereas in a single insurance market the consumer will have a wider and more varied choice of contracts; whereas if he is to profit fully from this diversity and from increased competition, he must be provided with whatever information is necessary to enable him to choose the contract best suited to his needs.."

If competition is distorted by divergence in information provided to a proposer for insurance during pre-contactual negotiations, it seems a fortiori that it is also distorted by differences in the rights and obligations of policyholders who have purchased a policy, for example in respect of their rights to have a claim paid. Both have the capacity to affect the choice of policy available to the purchaser, through their influence on the insurer's decision in respect of whether to offer a policy in a particular Member State. The distinction which appears⁴⁰ to be made in the insurance Directives between measures of insurance contract law which affect competition and those that do not is therefore a false one and should be remedied by a coherent approach to harmonisation within the Community.

2. Freedom of Contract and Choice of Law

Freedom of contract and freedom of choice of applicable law are important guiding principles for the regulation of insurance within the Single Market. The latter is evident mainly in the regime applicable to "large" non-life risks, where there are no restrictions on choice

⁴⁰This distinction is not express, but is implicit in the rejection of any wide-ranging harmonisation of insurance contract law. Indeed the Second and Third Life Directives do not treat the issues of "transparency" and cancellation rights as measures related to contract law although, as argued in chap.2, they do fall into this category.

of law. The objective of freedom of contract is evidenced by the abolition of prior approval of policy forms and rates, which will result in the dismantling of much of the administrative control of insurance contracts in continental Europe.

However, the presence of differences in insurance contract law has two consequences. First, obstacles to freedom of contract may remain in place and secondly, the complex provisions governing choice of law, made necessary by the abandonment of the draft Insurance Contract Law Directive, are likely to act as an impediment to the development of services business in insurance.

(a) Freedom of Contract

Freedom of contract within the Single Market will be enhanced by two developments. The first is the abolition of prior approval of contract terms and rates and the second is the greater choice of insurers which will be available to policyholders though the introduction of full freedom of services.

Abolition of prior approval entails a substantial change in practice in Member States such as France and Germany, where administrative control of insurance contracts is well established. The current law in France⁴¹ provides for the approval, in respect of non-life "mass" risks, of not only policy forms but also proposal forms, sales literature and premium rates. In Germany, the authorisation process⁴² involves the submission of standard policy terms and, for some classes, premium rates. The dismantling of this system of administrative control clearly involves a significant change in practice for those Member States.

Full freedom of services creates the potential for a greater degree of freedom of contract accompanied by a wider choice for consumers in

⁴¹Code des Assurances, Article R310-6.

⁴²VAG, section 5.

purchasing insurance. Restrictions which have been applied in the past were well illustrated in the case of Commission v Germany⁴³, where the requirement for establishment in Germany on the part of an insurer was held to be incompatible with Articles 59 and 60 of the Treaty. The operation of the "single licence" system on completion of the Single Market will enable an insurer authorised in any Member State to write insurance business in any other Member State without the need for separate authorisation and without any need to maintain an establishment in the relevant state.

However, differences in contract law constitute a significant limitation on freedom of contract. The abolition of prior approval of policy forms and rates represents only a partial dismantling of substantive controls on the terms of insurance policies as the degree to which national insurance contract laws allow for freedom of contract varies substantially. In France, for example, much of the Code des Assurances is mandatory in the sense that it cannot be altered by contract terms. In Germany, some parts of the insurance contract law statute can be altered by contract terms whilst others cannot. Contract law in the United Kingdom imposes no substantive controls on the terms of insurance contracts. Thus, the abolition of prior approval of contract terms has the potential to enhance freedom of contract in Germany to a greater extent than in France, whilst no change will be evident in the United Kingdom.

An example illustrates that insurance contract terms can be influenced as much by insurance contract law as by administrative control. Section 33 of the VVG provides that a policyholder has to give notice to the insurer without delay as soon as he acquires knowledge of the occurrence of a loss. As this is not a compulsory or semi-compulsory section of the VVG⁴⁴, it will be open to change at the discretion of the contracting parties following the abolition of prior approval of

⁴³Case 205/84, [1986] ECR 3755.

⁴⁴Certain sections of the VVG are compulsory in the sense that no deviations are possible. Other sections are semi-compulsory in that deviations to the advantage of the insured are permitted. See chap. 3.

contract terms. However, in France, the law governing claims notification⁴⁵ is not capable of amendment by contract terms: the abolition of prior approval of contract terms will not alter French insurance contract law and therefore will have no impact on freedom of contract in this situation.

The presence of differences in contract law within the Single Market means that varying levels of control over policy conditions are likely to remain in place through the medium of contract law. The effect of this will be felt both in establishment and services business. In the former case, the extent to which freedom of contract exists in each national market will vary. In the latter case, differences in contract law may result in restrictions on access to products offered by insurers established in states other than that of the purchaser: this gives rise to considerations relating to restrictions on freedom of services which are permitted on the basis of the general good, which are considered in greater detail in subsection 3 below.

(b) Choice of Law

Differences in contract law can restrict choice of law when they fall within the category of mandatory rules⁴⁶. The choice-of-law rules⁴⁷ in respect of both the life and non-life sectors provide that such rules may override a choice of law. Two consequences follow. First, differences in mandatory rules lead to divergence in the degree of choice of law among the Member States. Secondly, issues relating to permissible restrictions on freedom of services may be triggered by the application of mandatory rules: this gives rise to considerations relating to restrictions on freedom of services which are permitted on the basis of the general good, which are considered in greater detail in subsection 3 below.

⁴⁵Code des Assurances, Article L113-2, which provides for notification within the period provided for by the policy, which must be no less than five working days.

⁴⁶In the sense in which this term was used in chap.2.

⁴⁷See chap.2.

3. The General Good

(a) The General Good and the Insurance Directives

The origins of the concept of the "general good" in Community law lie in the "judicial exception" to Article 59 of the Treaty which has been developed by the Court of Justice in its delimitation of permissible restrictions on freedom of services. The various elements⁴⁸ of the "judicial exception" were brought together by the Court in the insurance cases, but, as Chappatte has demonstrated⁴⁹, each of the individual elements were evident in the case-law of the Court prior to its decision in the insurance cases⁵⁰.

The Framework Directives follow the decision of the Court of Justice in Commission v Germany in providing that a host state can only prevent the sale of an insurance contract where it conflicts with its legal provisions protecting the general good⁵¹. The preamble to each Directive attempts to specify the conditions for the application of the principle:

"Whereas within the framework of an internal market it is in the policyholder's interest that he should have access to the widest possible range of insurance products available within the Community so that he can choose that which is best suited to his needs; whereas it is for the Member States in which the risk is situated to ensure that

⁴⁸The relevant measures must satisfy the tests of objective justification in the general interest, non-discrimination, equivalence and proportionality. See chap. 1.

⁴⁹Philippe P. Chappatte, "Freedom to Provide Insurance Services in the European Community" 9 ELR (1984) 3.

⁵⁰The "judicial exception" to Article 59 differs from the Treaty exception contained in Article 56. The latter relates to discriminatory measures which may be adopted by a Member State in order to restrict freedom of services on the basis of public policy, public security or public health. The Second Life Directive (Article 14(5)) specifically referred to the right of Member States to apply this exception. Smulders & Glazener, op.cit., take the view that Article 14(5) is purely declaratory: it is any case deleted by virtue of Article 35 of the Third Life Directive. For a more detailed discussion of Article 59, see chap.1.

⁵¹Article 28 of both Directives.

there is nothing to prevent the marketing within its territory of all the insurance products offered for sale in the Community as long as they do not conflict with the legal provisions protecting the general good in force in the Member States in which the risk is situated, and in so far as the general good is not safeguarded by the rules of the home Member State, provided that such provisions must be applied without discrimination to all undertakings operating in that Member State and be objectively necessary and in proportion to the objective pursued;"

This adds little to the delimitation of the principle of the general good by the Court of Justice. In particular, it does not address the issue of the field of application of the mandatory rules of contract law of the Member States. As discussed below, this issue is fundamental to the delimitation of the general good as applied to insurance contracts.

(b) The General Good and Contract Law

The concept of the general good in the field of insurance encompasses contract law but also extends to administrative (public law) rules which exist for reasons of prudential supervision. In relation to contract law, the issue of the general good arises in the application of mandatory rules of contract law, that is those rules from which it is not possible to derogate by way of contract. Smulders and Glazener⁵² distinguish mandatory rules and provisions relating to the general good in the following terms:

"Mandatory rules should nevertheless be distinguished from provisions relating to the protection of the general good in that the former are part of a set of Community rules of conflict, whereas the latter are essentially a 'Community filter' in order to avoid the contracting parties' freedom of choice of applicable law becoming unduly restricted."

The application of mandatory rules of contract law must be in accordance with the concept of the general good insofar as they restrict freedom to provide services⁵³. However, the extent to which

⁵²op.cit. p792.

⁵³This follows from the delimitation of the "judicial exception" to Article 59 in the insurance cases and corresponds with the view of Smulders & Glazener, op.cit. p792.

the concept of the general good permits restrictions based on mandatory rules of contract law is not entirely clear: mandatory rules are determined by each individual Member State and most of them pre-date the development of the concept of the general good in Community law. The possibility of abuse of the provisions of the insurance Directives relating to the general good has been recognised by the Department of Trade and Industry⁵⁴ in the United Kingdom:

"We would be concerned if Member States sought to construe the definition of the general good too widely and thereby justify unfair barriers to trade, but it is for the Court, not the directive, to determine what may legitimately be justified in the general good."

A similar view has been expressed within the Comité Européen des Assurances⁵⁵:

".it is not unlikely that the concept of mandatory private international law becomes a certain compensation for the form of consumer protection that, to date, the supervisory authorities ensure by way of prior approval of insurance contracts."

In framing its approach to contract law, the Commission has recognised the need to limit the field of application of mandatory rules. Sir Leon Brittan, setting out the Commission's approach to the Framework Directives, said⁵⁶:

"Our general aim will be to limit those national mandatory contract conditions whose effect is to limit consumers' freedom of choice without being justified in terms of consumer protection."

However, the absence of precise definition of the field of application of mandatory rules means that the risk of abuse of the general good arises where the law governing the contract differs from the law of the country of the establishment from which services are being provided.

⁵⁴DTI Consultative Document on the Third Life Directive, para. 4.28.

⁵⁵A view expressed by the German delegation at the CEA's 12th Annual Legal Colloquium (Avignon 4-7 October 1991). Similar views were expressed by the Spanish and Belgian delegations. See J. Biancarelli, "General Report", op.cit. p39.

⁵⁶In an address to the CEA in 1989. Extracted from Regulation of Insurance in the United Kingdom and Ireland, (Editors T.H. Ellis & J.A. Wiltshire) p.A.5.5-04.

In most cases, the law governing the contract will be that of the State in which the policyholder is resident. This provides the policyholder with the protection of his own national law. The problems likely to arise in Member States having recourse to the general good are due to mandatory provisions of the applicable law which dictate the form or contract terms of insurance policies. These may have the effect of limiting access to national markets of insurance policies lawfully marketed in other countries⁵⁷.

This is ultimately a question for the Court of Justice which, given the plethora of mandatory rules which abound within the Community, is likely to arise in the near future. It is submitted that only "internationally mandatory" rules of contract law, that is those which apply irrespective of the law otherwise applicable to the contract, should be considered as falling within the concept of the general good. If the general good were to be widened to include those rules of contract law which are mandatory only in an internal sense, the effect would be to limit severely freedom of services: in particular, it would be possible to limit or even render futile a choice of law which had been legitimately exercised under the provisions of the insurance Directives.

D. THE PRINCIPLE OF SUBSIDIARITY

1. Subsidiarity as a Principle of Community Law

Much of the recent debate regarding the future of the Community has focused on the principle of subsidiarity as a guiding principle for establishing the proper distribution of power between Community institutions and individual Member States. Two influences appear to be particularly prominent in the debate. The first is the fear, particularly evident in the United Kingdom, that the increasingly political dimension of the Community will lead to greater "interference" by the

⁵⁷See also chap. 5 part 1, section C.3, where this is discussed in the context of policies sold by way of freedom of services from the United Kingdom.

Community in matters previously left to the Member States. The second is concern within some Member States, particularly Germany, that the process of transfer of competence to the Community may distort the existing distribution of legislative authority between the central and regional government. As the principle has now been incorporated in the Treaty on European Union, it is important to consider its relevance both for the programme for the establishment of the Single Market in insurance and the approach towards insurance contract law.

The origins of the principle of subsidiarity are a matter of some dispute: various commentators have attributed it to Aristotle, Proudhon, St. Thomas Aquinas, John Stuart Mill and Pope Pius XI⁵⁸. The difficulty inherent in defining subsidiarity is encapsulated by the following comment⁵⁹:

"It is not as such a constitutional or judicial concept, rather a principle of social organisation developed to be used in combination with other principles of collective and individual action."

However, the principle is clearly evident in the constitutional law of several states with federal structures, such as Germany⁶⁰ and Canada⁶¹.

⁵⁸See Subsidiarity: The Challenge of Change, European Institute of Public Administration, Jacques Delors Colloquium, 1991.

⁵⁹Mark Wilke and Helen Wallace, Subsidiarity: Approaches to Power Sharing in the European Community, Royal Institute of International Affairs Discussion Paper no.27.

⁶⁰Article 72(2) of the Grundgesetz provides that the Federation shall have the right to legislate in matters within the concurrent powers of the Federation and the Laender where:

1. a matter cannot be effectively regulated by the legislation of individual Laender, or
2. the regulation of a matter by a Land law might prejudice the interests of other Laender or of the people as a whole, or
3. the maintenance of legal or economic unity, especially the maintenance of uniformity of living conditions beyond the territory of any one Land, necessitates such regulation. (See Blaustein & Flanz, Constitutions of the World).

⁶¹Section 92(16) of the Canadian Constitution Act 1867 (formerly known as the British North America Act) provides that the competence of the provinces extends to:

"Generally all matters of a merely local or private nature in the Province."

Within the Community, it is possible to find reference to subsidiarity as a guiding principle long before its insertion in the Treaty on European Union. The 1975 Spinelli Report on European Union⁶² referred to it in the following terms:

"The Union only acts for effecting tasks which may be undertaken in common in a more efficient way than if Member States were to act separately."

Explicit reference to the principle is made in the provisions of the Single European Act in respect of the environment⁶³ whilst the Social Charter of 1989 mentions the principle in its preamble. However, it was not until the Treaty on European Union that the principle was given a formal Treaty basis which covered all the activities of the Community. Article 3(b) of the Treaty on European Union⁶⁴ provides as follows:

"The Community shall act within the limit of the powers conferred upon it by this Treaty and of the objectives assigned to it therein.

In areas which do not fall within its exclusive competence, the Community shall take action, in accordance with the principle of subsidiarity, only if and in so far as the objectives of the proposed action cannot be sufficiently achieved by the Member States and can therefore, by reason of the scale or effects of the proposed action, be better achieved by the Community.

Any action by the Community shall not go beyond what is necessary to achieve the objectives of this Treaty."

The Commission takes the view⁶⁵ that subsidiarity encompasses two distinct legal concepts: first, the need for action; and secondly, the intensity (proportionality) of the proposed action. In areas of

⁶²Report of the Commission on European Union.

⁶³Article 130r(4) provides that the Community shall take action relating to the environment to the extent to which the objectives referred to in paragraph 1 can be attained better at Community level than at the level of the individual Member States. This specific reference to subsidiarity is deleted by the re-drafted Article 130r in the Treaty on European Union.

⁶⁴Subsidiarity is also referred to in Articles A and B of the Treaty on European Union. However, Article L of the Treaty provides that the Court of Justice does not have jurisdiction over, inter alia, Articles A and B.

⁶⁵"The principle of subsidiarity": SEC (92) 1990 final.

exclusive competence, such as the removal of barriers to free movement under Article 8A of the Treaty, the Commission's view is that the need for action cannot be limited by the principle of subsidiarity. However, it recognises that in areas where powers are shared between the Community and the Member States, there are difficulties in determining whether there is a need for Community action. In the following subsection, these issues will be considered in relation to insurance contract law.

2. Subsidiarity and the Harmonisation of Insurance Contract Law

In considering the appropriateness of harmonisation of insurance contract law, it is important to determine whether the issue falls within an exclusive or a shared competence area⁶⁶. Harmonisation of insurance contract law would fall within the area of shared competence as the Member States retain control over contract law but differences in contract law give rise to issues which affect the functioning of the Single Market⁶⁷. In areas of shared competence the Commission has proposed⁶⁸ the following approach to the application of the principle of subsidiarity:

"Each case must therefore be considered individually in the light of two tests laid down in Article 3b - the scale and the effects of the proposed action. This would involve:

- checking that the Member States have at their disposal the means - including the financial means - to the end (national, regional or local legislation, codes of conduct, agreements between employers and trade unions, etc.) - the comparative efficiency test;
- assessing the effectiveness of Community action (its scale, cross-border problems, consequences of failure to act, critical mass, etc.) - the value added test."

⁶⁶On the division of competence see: Hervé Bribosia, "Subsidiarité et répartition des compétences entre la Communauté et ses Etats membres - Commentaire sur l'Article 3B du traité de Maastricht", *Revue du Marché Unique Européen* 1992 vol.4 p165.

⁶⁷The Commission's view is that measures related to the smooth operation of the internal market and consumer protection measures related to the internal market are instances of shared powers: see COM (92) 1990 final p8.

⁶⁸"The principle of subsidiarity", *op.cit.*, p10.

On both criteria the case for harmonisation of insurance contract law seems well established. As regards the scale of the proposed action, the Member States lack the means to resolve problems which arise from differences in contract law, particularly those which relate to cross-border business. The effects of Community action would be, as discussed earlier, to eliminate distortions in competition, limit the scope for divergence in the control of conditions of insurance through contract law and restrict reference to the "general good" as a basis for restrictions on freedom of services. It follows that the value added by Community action would be the creation of a legal framework which facilitated the effective exercise of freedom of services within the insurance sector.

E. A COMPARATIVE APPROACH TO CONTRACT LAW: THE UNITED STATES

In considering the Community's approach to contract law within the Single Market programme for insurance, it is appropriate to refer to the position in the United States. This provides a model of a single market operating within a federal structure. Its approach to the regulation of insurance and differences in insurance contract law among the Member States is therefore relevant to the Community.

The regulation of insurance in the United States⁶⁹ is a matter for the individual states. Only insurers who have been authorised and become established in the relevant state are permitted to transact business. There is no right of establishment, in the sense in which that right is understood in the Community, for insurers whose main establishment is in another State : in other words, admission is at the discretion of the relevant State. The principle of mutual recognition which allows the operation of home country control within the Community is therefore absent from the United States. Of particular relevance to the issue of differences in contract law is that the United States does not

⁶⁹On regulatory requirements in the United States see: G.J. Couch, Couch Encyclopaedia of Insurance Law (Rochester, New York); K. Lenaerts, "La loi applicable et la libre prestation des services en matière d'assurance vie", Annales de droit de Louvain, Tome L 1-1/1990 145; Coopers & Lybrand, International Insurance Industry Guide.

recognise any right to freedom of services: there is nothing to prevent a customer purchasing a policy from an insurer in another State, but insurers cannot solicit business on a services basis⁷⁰ in States in which they are not authorised and established.

Looking beyond the regime governing the transaction of business by way of establishment and services, there are other important differences in the regulation of insurance. First, most States in the United States exert control over rates and policy conditions, whereas this form of control, at least as a pre-condition for authorisation, will not be present in the Single Market within the Community. Secondly, as Lenaerts⁷¹ has observed, the role of federal law in issues arising in relation to jurisdiction and choice of law is confined to imposing constitutional limits on the scope of the rights of individual States: the formulation and application of the rules relating to choice of law, subject to those constitutional constraints, remains in the hands of the individual States. By contrast, issues related to jurisdiction and choice of law in insurance within the Community are now subject to Community law⁷².

As regards their approach to the impact of differences in contract law, the Community and the United States adopt a similar approach in that neither has pursued harmonisation. Rudden⁷³ has argued that the American approach is evidence that harmonisation is not required within the Community. However, it is submitted that such a conclusion ignores the basic differences in the nature of the Single Market which is to operate in the Community by comparison with that which exists in the United States. As Lenaerts⁷⁴ has observed, conclusions in respect of the significance of the differences in contract law which exist in the

⁷⁰In the sense that this term is understood in Community law.

⁷¹op.cit. p150.

⁷²See chap.2.

⁷³Bernard Rudden, "Disclosure in Insurance: A Comparative View", British Insurance Law Association Conference Materials 1989.

⁷⁴op. cit. p150.

single market in the United States by comparison with those present in the Community are not easy to reach. The solution adopted by the Community should relate specifically to the regulatory framework within which it operates and not a model which matches neither the circumstances nor the ambitions of the Single Market within the Community.

F. FORCES FOR CHANGE

Having argued that a change in the approach to insurance contract law is necessary, it is appropriate to refer to those factors which are likely to act as forces for change.

1. Growth in Services Business

It has already been noted that the current approach towards the issue of contract law is predicated on the belief that choice-of-law issues will be largely restricted to business transacted on a services basis, which currently accounts for only a small part of the total volume of insurance business. It follows that a substantial expansion in the volume of business transacted on a services basis would threaten this stance. Expansion in the "large" risk category would be unlikely to provoke any change in approach to contract law, as freedom of choice of law already applies in this area and there is no consumer interest to protect, but expansion of the services market in "mass" risks could result in a re-appraisal of the current approach. This would follow from the increasing reference which would be required to the complex web of rules governing choice of law: it would soon be acknowledged that a better solution could be found in the harmonisation of the essential provisions of insurance contract law and a simplification of the rules on choice of law.

A substantial expansion in the volume of business transacted on a services basis can be envisaged as a result of "direct selling", which is the most rapidly growing form of distribution in the non-life sector. Insurers using this technique are able to cut costs by saving the commissions normally paid to intermediaries, by securing immediate access to the premium payments through electronic funds transfer and

by centralising their administrative functions. It is possible to envisage rapid growth in this form of distribution on a services basis, particularly in border areas, where a central office is capable of dealing directly with policyholders in several Member States. Business is already transacted on this basis in respect of UCITS⁷⁵, particularly in the Benelux region, which lends itself particularly well to this type of distribution.

2. Free Movement of Persons

On the assumption that the operation of the Single Market will result in greater labour mobility within the Community, it can be expected that the potential for choice-of-law issues to arise in business transacted on an establishment basis will increase. An example would be a household policy, issued in the United Kingdom by an "established" insurer, to a German national working in the United Kingdom, covering his holiday home in Denmark. Under the current regime⁷⁶, the applicable law would be either that of Germany or Denmark. If the same person has a motor policy governed by the law in the United Kingdom and a life policy governed by German Law, he may find it difficult to understand that the contracts are governed by fundamentally different provisions of contract law, yet all three policies have been purchased within a single market. Thus, it seems inevitable that increasing mobility of labour will create dissatisfaction with the current regime.

⁷⁵Undertakings for Collective Investments in Transferable Securities.

⁷⁶Article 7.1.(b) of the Second Non-life Directive.

PART 2: THE INSURANCE CONTRACT LAW DIRECTIVE REVISITED

G. THE HARMONISATION PROCESS

1. Harmonisation Techniques

The general approach to harmonisation within the Community, in particular the "new approach" adopted during the 1980's, has already been discussed in chapter 2. As regards the process of harmonisation, it is possible to distinguish three different techniques⁷⁷ in Community secondary legislation which covers the field of consumer protection:

(a) Minimum Harmonisation

This allows Member States to adopt or retain stricter consumer protection provisions within the limits laid down by Community law. An example of this is the Consumer Contracts Directive⁷⁸.

(b) Optional Harmonisation

In this situation a Member State may choose between several options set out in a Directive. An example is Article 15 of the Products Liability Directive⁷⁹ which allows Member States to choose whether to retain the "development risk"⁸⁰ defence.

⁷⁷See McGee & Weatherill, "The Evolution of the Single Market - Harmonisation or Liberalisation", 1990 MLR 578 and Weatherill, "Regulating the Internal Market: Result Orientation in the House of Lords" 17 ELR (1992) 299.

⁷⁸Directive 93/13, OJ 1993 L95/29. See para. 12 of the preamble.

⁷⁹Directive 85/374, OJ 1985 L210/29.

⁸⁰This allows a producer to escape liability for damage caused by a defective product if it is proven that the state of scientific and technical knowledge at the time the product was put into circulation was not such as to enable the existence of a defect to be discovered.

(c) Uniform Harmonisation

This can be said to occur where harmonisation is based on a fixed standard from which no derogation⁸¹ is possible. An example of this approach can be seen in the draft Insurance Contract Law Directive⁸².

2. Harmonisation of Insurance Contract Law

(a) Scope

Two possibilities arise in determining the scope of harmonisation measures. The first is that it could be confined to mandatory requirements of the insurance contract laws of the Member States. This would resolve many of the problems which are likely to arise in determining the extent to which mandatory rules of contract law can be used to limit the sale of insurance products on a services basis. Harmonisation of mandatory rules would limit the ability of Member States to argue that equivalent protection was not provided by the laws of other Member States. However, the scope of mandatory provisions⁸³ varies widely among Member States. Moreover, the concept of mandatory rules does not fit easily into the structure of the law in the United Kingdom, where there are very few provisions of insurance contract law which cannot be altered by the contracting parties. The alternative approach, which was adopted by the Commission at the time that it supported harmonisation, is to harmonise the essential or fundamental elements of insurance contract law. This avoids complications which arise from the variation in the scope of mandatory provisions and, subject to the technique of harmonisation, is capable of providing an

⁸¹Other than that inherent in the legislative instrument, such as the discretion permitted to Member States by Article 189 (EEC) in the implementation of Directives.

⁸²See para. 8 of the preamble to the draft Directive which is set out in Appendix 2.

⁸³See chap 3. and EEC-Insurance Contract Law (Comité Européen des Assurances, 1990).

equivalent level of protection to the consumer as regards the essential elements of the contract, irrespective of the applicable law.

(b) Technique

During the negotiations on the draft Insurance Contract Law Directive, there was a divergence in views among the Member States in relation to the way in which harmonisation should proceed. At issue was whether not only the contracting parties but also the Member States should be able to change the content of the Directive to give increased protection to policyholders. One argument put forward was that implementation of the Directive would lead some Member States to change their laws to make them less favourable to the insured⁸⁴. The Commission rejected this argument, opting instead for an approach based on a uniform implementation of the Directive by the Member States and freedom for the contracting parties to agree on more favourable terms for the policyholder, insured person or injured third party than those provided for in the Directive. The justification for this approach was that if the Directive was to be implemented as a minimal standard, it would be possible to maintain that there had been no genuine harmonisation of insurance contract law and obstacles to freedom of services could therefore be kept in place.

A similar approach to that proposed by the Commission should be adopted in respect of any future harmonisation of insurance contract law as the justification advanced by the Commission holds good in the context of the proposals for the completion of the Single Market. As noted in part 1, the Framework Directives leave the Member States discretion as to restrictions which are in the general good: in order to limit this discretion, harmonisation would need to be on a uniform and not a minimal basis.

⁸⁴See Monique Goyens, "Consumer Protection in a Single European Market: What Challenge for the EC Agenda?", 29 CMLRev (1992) 7.

H. THE DRAFT INSURANCE CONTRACT LAW DIRECTIVE

1. Scope

(a) The Exclusion of Life Assurance

The proposals for an insurance contract law Directive⁸⁵ put forward by the Commission excluded life assurance as well as several categories of direct non-life insurance⁸⁶. In adopting this approach, the Commission followed a pattern evident in several Member States by which certain classes of business falling within the grouping of "marine, aviation and transport" ("MAT") are excluded from the ambit of general insurance contract legislation⁸⁷. The rationale for this approach on the part of both the Member States and the Commission is that "MAT" is an international business, transacted between professionals, which should not be subjected to limitations on freedom of contract in the same manner as purely domestic business in which there is a consumer interest to protect. This approach was recommended by the Law Commission in its proposals⁸⁸ for the reform of the law in the United Kingdom, and has been incorporated in the Third Non-Life Directive's provisions⁸⁹ regarding freedom of choice of law. Any future proposals for harmonisation should retain this approach as regards MAT but should

⁸⁵The text of the Directive is set out in Appendix 2.

⁸⁶Article 1 provides that the draft Directive applies to certain categories of risk identified in point A of the Annex to the First Non-Life Directive (73/239) with certain exceptions which are: 4 (railway rolling-stock), 5 (aircraft), 6 (ships, sea, lake and river and canal vessels), 7 (goods in transit), 11 (aircraft liability), 12 (liability for ships, sea, lake and river and canal vessels), 14 (credit) and 15 (suretyship). Moreover, as reinsurance was excluded from the First Non-Life Directive, it is not covered by the draft contract law Directive.

⁸⁷The Code des Assurances in France has special rules for marine insurance (Title 7 of the Legislative Section). In Germany, marine insurance is excluded from the VVG. See chapter 3.

⁸⁸Cmd. 8064 para. 10.2. The Law Commission's proposals are discussed in chap. 5.

⁸⁹See chap. 2, section C.1.a.

ensure that harmonisation applies to the broader category of "large" risks⁹⁰.

The explanatory memorandum to the draft Directive contained no explanation as regards the exclusion of life assurance. This omission is odd as it is normal for many of the provisions of the type found in the draft Directive to apply equally to both life and non-life insurance within the national laws of the Member States. One explanation for the omission is that the original draft of the contract law Directive was published only four months after the adoption of the First Life Directive; at that point in time the issue of freedom of services, which prompted considerations of harmonisation of contract law, must have been regarded as a distant objective in respect of life assurance. As the programme for the creation of the Single Market in insurance is now complete, there seems no good reason why life assurance should be excluded from proposals for the harmonisation of contract law.

(b) The Relationship with other Directives

The draft Insurance Contract Law Directive excluded two important harmonisation measures which have subsequently been incorporated in the Second and Third Life Directives: first, the right of the policyholder to cancel the policy and, secondly, the obligation of the insurer to disclose information to the policyholder during the pre-contractual negotiations ("transparency"). The Life Directives may have served as a useful practical vehicle for the introduction of limited measures to harmonise contract law, particularly as it became increasingly clear that no agreement would be reached between the Member States over the draft Insurance Contract Law Directive, but they are not an adequate substitute for an insurance contract law proposal which deals with the subject in a coherent fashion.

⁹⁰This point is considered in greater detail below.

(c) Consumer Protection

Several of the provisions⁹¹ of the Directive are applied only to "consumer" insurance. Although consumer protection is an important consideration, different categories of policyholder, as opposed to different classes of business⁹², should not be treated differently. Thus, for example, a small businessman does not merit different treatment in purchasing fire insurance for his shop to that which he receives in purchasing fire insurance for his home. This is reflected in the laws of France and Germany, which have provision for consumer protection but do not treat policyholders purchasing the same class of insurance differently according to circumstance. However, as noted in chapter 3, the effect of the Statements of Insurance Practice in the United Kingdom is to create a distinction between consumers similar to that in the draft Insurance Contract Law Directive. In both instances, the distinction is at odds with the principle of securing equivalence in the standard of protection provided to policyholders.

2. The Rules relating to Disclosure (Article 3)

The duty of disclosure as it appears in the draft Directive is unduly complex. By comparison with the single paragraph of the MIA 1906⁹³ which embodies the essence of the duty of disclosure and the consequences of its breach, Article 3 extends to eighteen paragraphs. The result is a formulation of the duty of disclosure which lacks the clarity and brevity which the significance of the principle in everyday transactions demands.

⁹¹Article 3(2)(a), which deals with the duty of disclosure, and Article 7(2), which deals with costs incurred by the insured in minimising losses, distinguish risks which cover an industrial or commercial activity of the policyholder from those that do not.

⁹²Such as "MAT", as argued above.

⁹³Section 18(1). See chap. 5, part 2.

The Law Commission, in its investigation⁹⁴ into the potential effect of the draft Insurance Contract law Directive on the law in the United Kingdom, commented on Article 3 as follows:

"(i) the formulation of the Article as regards the various ways in which the duty of disclosure may be broken is inept and the ambit of each type of breach is not defined with sufficient precision;
(ii) the Article provides for complicated and uncertain procedures to be put into motion during the currency of the contract;
(iii) as a whole Article 3 seems likely to bring about undue and unnecessary increases in administrative expenses;
(iv) the Article is bound to lead to a great deal of litigation."

An examination of the role of three elements of the formulation of the duty in Article 3 - common error, subjectivity and proportionality - suggests that a simpler formulation is possible.

(a) Common Error

Article 3.2.a provides as follows:

"If circumstances existing at the time of entering into the contract which were unknown to both parties when the contract was concluded come to light subsequently, or if the policyholder has failed to declare circumstances of which he was aware but which he did not expect to influence a prudent insurer's assessment of the risk, the insurer or the policyholder shall be entitled, within a period of two months from the date on which he becomes aware of the fact, to propose an amendment to or termination of the contract."

This approach confuses the duty of disclosure in insurance with the principles of common error in the general law of contract. Circumstances unknown to both parties at the conclusion of the contract, provided they do not arise from non-disclosure, fall within the general principles of common error in the law of contract. The duty of disclosure in insurance has no particular contribution to make in these circumstances. It would therefore lead to greater clarity in the formulation of the duty of disclosure if this reference to common error was deleted.

⁹⁴ Cmnd. 8064, para. 4.31.

(b) Subjectivity

The introduction of an element of subjectivity into the duty of disclosure, through the medium of Article 3.2.a (above) runs counter to the initial formulation of the duty in Article 3.1, which provides as follows:

"When concluding the contract, the policyholder shall declare to the insurer any circumstances of which he ought reasonably to be aware and which he ought to expect to influence a prudent insurer's assessment or acceptance of the risk."

The standard of the reasonable insured, which is in essence an objective test, should not be qualified subsequently by reference to a subjective standard in determining the insured's awareness of the relevance of information to the insurer. The latter reference (in Article 3.2.a) should be deleted so as to make it clear that the test of reasonableness applies to the insured's assessment of the relevance of the information to the insurer⁹⁵.

The reference to "a prudent insurer's assessment or acceptance of the risk" in Article 3.1 should be altered so as to make clear that the relevant information would have changed either the insurer's decision to accept or the terms of the insurance. This would pre-empt implementation of the Directive in the manner followed in CTI v Oceanus Mutual⁹⁶, where the Court of Appeal held that information could be "material" within the context of the MIA 1906 without necessarily changing an underwriter's decision to accept or the terms of the insurance.

(c) Proportionality

The principle of proportionality does not fit easily into the system of open competition envisaged for the Single Market in insurance. It operates on the premise that, when there is non-disclosure on the part

⁹⁵This approach was followed by the Law Commission (Cmd. 8064) in its Insurance Law Reform Bill, section 2(1)(b). See chap. 5.

⁹⁶[1984] 1 Lloyd's Rep. 476. See chap. 5, part 2.

of the proposer, it is possible to identify the correct premium which would have applied had there been full disclosure. Where premiums are based on tariffs to which all insurers subscribe, this may be possible, but it is much more difficult in an environment in which insurers are not subject to controls over premiums or conditions of insurance. Moreover, even if the principle was not rejected outright, there are defects in its formulation in Article 3.c in respect of the conditions which must be met to enable an insurer to avoid liability for innocent non-disclosure (i.e. for proportionality to be inapplicable). Article 3.c provides:

"However, if the insurer can show that no prudent insurer would have accepted the risk regardless of the rate of premium if he had been aware of the circumstances which the policyholder should have disclosed, or if the insurer can show that a prudent insurer would not have accepted the risk unless certain conditions were complied with, he shall not be bound to pay any claim."

This provision attempts to graft elements of the (pre-CTI v Oceanus) disclosure rule in the United Kingdom onto the French principle of proportionality and incorporate the amalgam into a rule of disclosure which belongs to neither jurisdiction. The practical problems of implementing the rule would be considerable in a single market free from tariffs and administrative control of policy forms and rates: presumably reference would have to be made to the practice of all Community insurers who were authorised to write the risk, a procedure which would impose a heavy burden of proof on the insurer.

The solution of dispensing with the principle of proportionality is most appropriate for the Single Market, but, if it is to be retained, it should be in the form in which it appears in the French Code des Assurances⁹⁷. It would be better to follow the policy of that legislation in not allowing avoidance for innocent non-disclosure in any circumstances rather than allowing avoidance in certain cases which are likely to be contentious and difficult to prove.

⁹⁷See chap.3, section D.3.

3. Increase in Risk (Article 4)

The provisions of the draft Directive follow the (pre-1989) French law as regards the duty to disclose increased risk: the insured is required to declare any new circumstances or changes in circumstance of which the insurer has requested notification in the contract. There is no obligation to disclose a reduction in risk.

As noted in chapter 3, policyholders in the United Kingdom are under no general obligation to disclose increase in risk in the absence of express contract terms. However, both the French and German law impose an obligation of disclosure of increased risk on the insured irrespective of whether the matter is governed by contract terms. Article 4 of the draft Directive provides a suitable solution for the purposes of harmonisation in that it would allow for the retention of an obligation of disclosure in France and Germany whilst requiring no change in the law or practice in the United Kingdom. This would mean that there would be no necessity to disrupt the traditional practice of active renewal of non-life policies in the United Kingdom and the tacit renewal of such policies in France and Germany.

However, the comments made above in respect of the appropriateness of the principle of proportionality, as well as its formulation in Article 3.c of the Directive, apply equally here as Article 4.4 makes it clear that the principle is intended to apply to situations in which the insured is in breach of the duty to disclose increased risk.

4. Compliance with Contract Terms

The draft Insurance Contract Law Directive made no reference to this issue. Given the complexities of integrating any proposals into the general law regarding breach of contract, it is hardly surprising that no proposals were put forward. As noted in chapter 3, there are significant differences between the laws of the United Kingdom, France and Germany in this area, which result in material differences in the level of protection provided to the policyholder. It is unlikely that any future attempt at harmonisation of insurance contract law would

resolve those differences unless it were accompanied by some approximation of the general law of contract in the Community.

5. Remedies

Having been modelled closely on the (pre-1989) French law, it is hardly surprising that the draft Insurance Contract Law Directive placed a heavy emphasis on the principle of proportionality⁹⁸ in limiting the remedies available to an insurer. However, the principle, by attempting to reduce the indemnity available to the insured in relation to the premium which the insurer would have received had the insured complied with his duties, pre-supposes the existence of standard premium rates. Whilst this may have been appropriate at a time when the industry was heavily regulated as regards both rates and policy forms, it is inappropriate to the operation of a single market in which freedom of contract is an important principle. In a situation in which premium rates are free from administrative control, it will become much more difficult to establish what the "correct" premium actually should have been, with the result that the principle cannot operate with arithmetical certainty⁹⁹.

⁹⁸See chapter 3, section E.3.c.

⁹⁹The Law Commission (Cmd. 8064, para 4.5) argued against the principle of proportionality on these grounds and also on the basis that it did not deal adequately with situations in which the insurer would have reacted to the non-disclosed information other than by increasing the premium, such as declining the risk or demanding exclusion clauses or warranties.

J. CONCLUSIONS

1. The principle of mutual recognition does not form an adequate basis for addressing issues arising from differences in insurance contract law. It follows that it can be of only limited value in determining whether the Community's approach should be based on choice-of-law rules or harmonisation.

2. There is an adequate Treaty basis for harmonisation of insurance contract law in Article 100A. Differences in insurance contract law can be considered as having an impact on the functioning of the Single Market within the meaning of that Article for three reasons: first, they distort competition; secondly they permit divergence in freedom of contract and choice of law among Member States; and thirdly, they allow greater reference to the "general good" in order to restrict freedom of services than would be possible with harmonisation.

3. Harmonisation would be in accordance with the principle of subsidiarity. Action in relation to insurance contract law falls within the field of shared competence and satisfies the tests of scale and effect. It also satisfies the test of proportionality which applies to all Community action.

4. The treatment of contract law within the single market which operates in the United States is of limited value in determining the Community's approach. In particular, the absence of a right to freedom of services in the United States gives the legal framework of its market a different character to that of the Community.

5. The complexity of the rules relating to choice of law are likely to restrict the development of services business within the Community. If the Single Market in insurance is to develop in a manner in which there is a substantial flow of cross-border business, it is likely that the

Community will have to re-appraise its approach to differences in contract law and return to work on a harmonisation Directive¹⁰⁰.

6. If the Community reverts to a policy of harmonisation there are a variety of ways in which it could be implemented. The scope of a harmonisation Directive could be confined to mandatory provisions of contract law or could encompass all fundamental provisions. The harmonisation technique could be based on minimum, optional or uniform harmonisation. The original approach adopted by the Commission (uniform harmonisation of fundamental provisions) would be best suited to the objectives of the Single Market. However, the original proposals for harmonisation are likely to require substantial amendment.

¹⁰⁰Jacques Biancarelli, "General Report", CEA XII Colloquium, op.cit., goes as far as to suggest that the complexity of the system of choice-of-law in the insurance Directives is intended to provoke the Member States into agreeing a harmonisation Directive.

CHAPTER 5
INSURANCE CONTRACT LAW IN THE UNITED KINGDOM: AN ANALYSIS
IN THE CONTEXT OF THE SINGLE MARKET

Introduction

The purpose of this chapter is to analyse the operation of the choice-of-law rules of the insurance Directives in the United Kingdom. Two issues will be examined: first, the circumstances in which English or Scots law may be the applicable law; and secondly, the rights and obligations of the insurer and policyholder where English or Scots law is the applicable law.

Part 1 examines the circumstances in which Scots or English law will govern an insurance contract in the Single Market and the consequences for the insurer and policyholder. This encompasses both contracts concluded with policyholders who are resident in the United Kingdom and those with policyholders resident in other Member States. Consideration is also given to the position of Conduct of Business Rules and the Statements of Insurance Practice within the contract law regime which will operate in the Single Market.

Part 2 analyses the development of insurance contract law in the United Kingdom from the perspective of three important influences. These are the nature of the contract, the negotiation of the contract and the legal force of policy terms. Consideration is also given to rules which, strictly speaking, fall outside the field of contract law but which are nevertheless important in balancing the interests of the insurer and policyholder. Finally, reference is made to the law reform debate and in particular to the Law Commission's proposals which were prompted by the expectation that the European Community would adopt the draft Insurance Contract Law Directive.

PART 1: THE APPLICATION OF ENGLISH AND SCOTS LAW TO INSURANCE CONTRACTS
IN THE SINGLE MARKET

A. THE CHOICE OF LAW RULES

1. General Principles

English and Scots law have traditionally referred to the system of law which governs a contract as the "proper law" of a contract¹. Recently, however, there has been a tendency to use the term "applicable law"² as the rules which determine the law which governs a contract are now largely contained in the 1980 Convention on the Law Applicable to Contractual Obligations (the Rome Convention). The latter term is used in this thesis.

The common law rules of English and Scots law do not restrict choice of law in the field of insurance contracts. The general principles are as follows³:

1. An express choice of law determines the applicable law.
2. Where there is no express choice, the intention of the parties is to be inferred from the terms and nature of the contract and from the general circumstances of the case.
3. Where there is no express choice and no inference is possible from the circumstances, the contract is governed by the system of law with which it has its closest and most real connection. In the case of insurance, this test will normally result in the contract being governed by the law of the country in which the insurer carries on its

¹See Dicey & Morris, The Conflict of Laws (11th edn.) p1161, and Anton, Private International Law (A Treatise from the Standpoint of Scots Law) (2nd edn.) p262.

²See, for example, Richard Plender, The European Contracts Convention.

³See Dicey & Morris, op.cit. chap.33 and Anton, op.cit. chap 10. There is no material difference between the English and Scots common law rules.

business⁴, and if it carries on business in more than one country, by the law of the country in which the head office is located.

The Rome Convention superimposes a new set of rules on the existing common law rules governing the applicable law. The exclusion of insurance from the Convention reflected the work being undertaken by the Community in that field which resulted in the choice-of-law rules contained in the Second Life and Non-Life Directives. The common law rules remain important as the Rome Convention rules are not retrospective. The common law will continue to govern contracts within the scope of the Rome Contracts Convention and the insurance Directives which were concluded prior to the effective dates of those measures in the United Kingdom⁵.

Although the Rome Convention excludes insurance, a recent change in the law in the United Kingdom makes clear that it is of relevance in determining the law applicable to insurance contracts. The Regulations⁶ which implement the Second Life Directive in the United Kingdom provide, both in respect of life and non-life insurance, that a court in the United Kingdom shall, subject to the rules of the insurance Directives on choice of law, act in accordance with the Contracts (Applicable Law) Act 1990, which implemented the Rome Convention in the United Kingdom. The policy underlying this approach was made clear by the Department of Trade and Industry's Consultative Document on the Regulations implementing the Second Life Directive:

" We take the view... that the choice of law provisions in the Services Directives are not intended to replace the Rome Convention but are simply extra provisions which, together with the Rome Convention, form a separate code. Accordingly, where the rules of the Convention have no counterpart in the Services Directives member States can choose to apply the rules of the Convention."

⁴Greer v Poole (1850) 5 QBD 272.

⁵See below for effective dates.

⁶The Insurance Companies (Amendment) Regulations 1993 (SI 1993/174) which amend s.94B and sch.3A of the Insurance Companies Act 1982.

As discussed in chapter 2, a choice of law made under the provisions of the insurance Directives is made subject to "mandatory" and "internationally mandatory" rules⁷. The effect of the application of mandatory rules is to defeat a choice of law where all the elements relevant to the situation at the time of choice are connected with one Member State only⁸. The application of "internationally mandatory" rules also defeats a choice of law, but in this instance there is no requirement for a connection between the situation at the time of choice and the Member State which seeks to apply its own rules. The concept of mandatory rules is not one which is well defined in the United Kingdom. According to Fawcett⁹, English law has not fully developed such a concept although there are specific rules which can be cited¹⁰. Scots law does recognise the concept of mandatory rules¹¹ and a choice of law may take effect only subject to those rules.

In implementing the insurance Directives, the United Kingdom has chosen to exclude the possibility of reference being made to the "internationally mandatory rules"¹² of other Member States. Both the Second Life and Non-Life Directives¹³ allow Member States to choose whether, in certain circumstances, such rules may govern the contract. The

⁷See chapter 2 (section C.1).

⁸See Article 7(1)(g) of the Second Non-Life Directive.

⁹J.J. Fawcett, "Evasion of Law in Private International Law", 49 Cambridge Law Journal (1990) 44.

¹⁰See for example s.27(2)(a) of the Unfair Contract Terms Act 1977. This provides that the Act applies notwithstanding a choice of foreign law where that choice was imposed by a party wholly or mainly for the purpose of enabling him to evade the application of the Act.

¹¹In English v Donnelly 1958 SC 494, it was held that the Hire Purchase and Small Debt (Sc.) Act 1932 was mandatory for contracts entered into in Scotland and could not be evaded by a contract term which provided for the applicable law to be English. The choice-of-law rules of the Unfair Contract Terms Act 1977 (s.27) also apply to Scotland.

¹²In the sense in which this term was used in chap.2.

¹³Article 7(2) 2nd. para. (non-life) and Article 4(4) 2nd. para. (life). See Annex 1 to chap. 2.

combination of this approach in the United Kingdom with the relative under-development of the concept of mandatory rules suggests that there will be few instances in which issues relating to mandatory rules arise in contracts subject to the law in the United Kingdom.

2. The Contracts (Applicable Law) Act 1990

This Act implemented in the United Kingdom the Rome Contracts Convention with effect from 1 April 1991, in respect of contracts concluded after 1 July 1991. The Convention excludes contracts of insurance covering risks situated in the territories of the Community¹⁴ and provides that, in the determination of whether a risk is situated in these territories, a court shall apply its internal law. In the United Kingdom, the internal law is section 96A(3) of the Insurance Companies Act 1982 which follows Article 2(d) of the Second Non-Life Directive¹⁵.

The Rome Convention applies to reinsurance as Article 1(4) provides that the exclusion of direct insurance does not apply to reinsurance. Although not required by the Convention¹⁶, the 1990 Act makes clear that it will apply to conflicts between the laws of different parts of the United Kingdom¹⁷. Two other aspects related to the scope of the Convention are also likely to be significant in the field of insurance. First, the Convention excludes questions as to whether an agent is able to bind a principal to a third party¹⁸. This situation is likely to occur frequently within the Single Market as insurers seek to market their products through agents in other Member States. Secondly, the

¹⁴Article 1(3).

¹⁵See Annex 1 to Chapter 2 for the wording of this Article. The Regulations implementing the Second Life Directive (SI 1993/174) provide that the internal law is to be schedule 3A of the Insurance Companies Act 1982, but the definition of "situated" in that schedule is contained in s.96A(3) of the Act.

¹⁶See Article 19(2).

¹⁷Section 2(3).

¹⁸Article 1(2)(f).

rules of the Convention do not apply to arbitration agreements¹⁹, with the result that arbitration clauses in insurance contracts will be subject to common law rules in the determination of the applicable law²⁰.

3. The Contract Law Rules of the Insurance Directives

The position in the United Kingdom following the amendment of the Insurance Companies Act 1982 by the 1993 Regulations²¹ will be that the rules contained in the insurance Directives will apply by way of a lex specialis to the rules of the Rome Convention.

(a) Non-Life Insurance

As discussed in chapter 2, the choice-of-law rules are contained mainly in the Second Non-Life Directive²². The Framework Directive extends the scope for a free choice of law in respect of "large" risks but leaves the basic rules unchanged²³. The Second Non-Life Directive was implemented in the United Kingdom by the Insurance Companies (Amendment) Regulations 1990²⁴. As regards contract law, Regulation 6 implemented the provisions of the Second Directive by introducing section 94A²⁵ and schedule 3A into the Insurance Companies Act 1982.

¹⁹Article 1(2)(d).

²⁰See Plender, *op.cit.* paras 4.19-4.29.

²¹SI 1993/174. See para. 1 above.

²²See Articles 2(d), 7 and 8 which are set out in Annex 1 to chap. 2.

²³See chap. 2, section C.1.

²⁴Statutory Instrument 1990/1333.

²⁵This is renumbered as s.94B by the 1992 Regulations (SI 1992/2890) which implemented the Motor Services Directive (90/618) and Articles 8 and 9 of the Second Life Directive (Rules relating to branches and agencies of third country insurers).

The impact of the provisions of the Second Directive on choice of law varies according to whether or not the insured is resident in the United Kingdom and is considered in greater detail in sections F and G below. The position in relation to contracts in respect of which no choice of law has been made is simpler. Schedule 3A of the Insurance Companies Act 1982 provides that, in this situation, the contract shall be governed by the law of the country with which it is most closely connected, subject to the proviso that the contract is rebuttably presumed to be most closely connected with the Member State where the risk is situated. This represents a change from the common law rule that it is the legal system²⁶ and not the country with which the contract is most closely connected which determines the applicable law.

(b) Life Assurance

As in the non-life sector, the rules on choice of law are contained in the Second Directive²⁷. No changes are made by the Framework Directive. The Second Life Directive will be implemented in the United Kingdom by the Insurance Company (Amendment) Regulations 1993²⁸, Regulation 5 of which amends section 94B²⁹ and schedule 3A of the Insurance Companies Act 1982 so as to give effect to the rules contained in that Directive. As was discussed in chapter 2, the basic rule governing choice of law in life assurance is that the contract is governed by the law of the Member State of the commitment, which means the Member State in which the policyholder is habitually resident. However, there are two circumstances in which another law may be chosen. First, where the law of the Member State of the commitment so allows, the parties may choose another law. From the perspective of policyholders resident in the United Kingdom, this has the effect of

²⁶Amin Rasheed Shipping Corporation v Kuwait Insurance Co. [1984] AC 50. See also Plender, *op.cit.*, paras. 6.01-6.04.

²⁷See Articles 2 and 4 of the Second Life Directive which are set out in Annex 1 to chap. 2.

²⁸Statutory Instrument 1993/174, which takes effect as from 20th May 1993.

²⁹Previously section 94A.

allowing a free choice of law. Secondly, where a policyholder is an individual and has his habitual residence in a Member State other than that of which he is a national, the parties may choose the law of the Member State of which he is a national.

B. THE POLICYHOLDER IS RESIDENT IN THE UNITED KINGDOM

1. English or Scots Law as the Applicable Law

The insurance Directives provide explicitly for a free choice of law only in respect of "large" risks. However, the restrictions on choice of law in respect of "mass" risks and life assurance are made subject to the proviso that a wider choice may be permitted by the Member State whose law would otherwise be the applicable law. The common law principle of free choice of law in the United Kingdom therefore results in a free choice of law being open to the contracting parties in respect of all life and non-life contracts which, according to the rules of the insurance Directives, are governed prima facie by the law in the United Kingdom.

Where no choice of law has been made, it is likely that either English or Scots law will be the applicable law. As discussed above, the determination of the applicable law for non-life risks is dependent primarily on the situation of the risk. As regards life assurance, the absence of choice will result in the applicable law being that of the insured's residence (the Member State of the Commitment).

2. Conduct of Business Rules

Rules made pursuant to the Financial Services Act 1986³⁰ (hereafter "FSA 1986") impinge on certain aspects of insurance contract law in respect of those life assurance contracts which are included within the definition of "investments". The existing law is not amended in the

³⁰Chapter 3 provides for the approval of the Conduct of Business Rules of Self-Regulatory Organisations (SROs) and Registered Professional Bodies (RPBs).

strict sense as no general power of amendment is given to the relevant bodies. However, as the rules impose obligations on insurers and agents of the proposer which exceed those of the common law, the effect is that the law is amended in a hybrid fashion. The hybrid character of these rules is reinforced by the remedies available to the insured where the insurer is in breach of a rule of an SRO or RPB. The FSA 1986³¹ provides for a right of action in damages: however, the remedy is not contractual in nature but for breach of a statutory duty³².

The provisions of the insurance Directives in relation to choice of law are not relevant to Conduct of Business Rules. The Directives do not refer to Conduct of Business Rules. Both the Department of Trade and Industry and the European Commission take the view that a choice of law does not encompass such rules³³. Thus, Conduct of Business Rules will apply to all relevant business concluded with policyholders resident in the United Kingdom irrespective of whether the insurer is subject to the supervision of the regulatory authority in the United Kingdom³⁴ or not. This leaves considerable discretion in the hands of the authorities in the United Kingdom as regards the conduct of all business transacted in the United Kingdom, including cases where

³¹Section 62. The right of action was subsequently limited to "private investors" by an amendment introduced by section 193 of the Companies Act 1989. However, the term "private investor" has not yet been defined by Statutory Instrument.

³²Defences to an action for breach of statutory duty include the exercise of reasonable care in instances where the duty is not absolute: see Re The Bristol and North Somerset Railway Company (1877) 3 QBD 10.

³³See House of Lords Select Committee on the European Communities, 12th Report (1990-91), A Single Insurance Market.

³⁴The Department of Trade and Industry is responsible for the authorisation and supervision of insurers.

insurance is sold on a services basis³⁵ from a location outside the United Kingdom³⁶.

The major areas in which Conduct of Business Rules are relevant to insurance contract law are "best advice", the duty of disclosure before and after conclusion of the contract and the rules setting out the insured's right to cancel the contract after it has been concluded. In the following analysis of these three areas, reference will be made to the Conduct of Business Rules³⁷ of the Securities and Investments Board, the body charged with primary responsibility for ensuring implementation of and compliance with the Act³⁸.

(a) "Best Advice"

The principle of "best advice" is central to the SIB's Rulebook³⁹:

"A firm shall not make a recommendation to a person...unless it has reasonable grounds for believing that the transaction is suitable for that person having regard to the facts known, or which ought reasonably

³⁵In the sense in which this term was used in chap. 1.

³⁶However, Article 31(3) of the Life Framework Directive provides that the Member State of the commitment may require assurance undertakings to furnish information in addition to that listed in Annex II of the Directive (Information for Policyholders) only if it is necessary for a proper understanding by the policyholder of the essential elements of the commitment.

³⁷The Financial Services Conduct of Business Rules 1990, most of which came into effect on the 1st November 1990.

³⁸Strictly speaking, the Conduct of Business Rules of the SIB do not apply to members of SROs and persons certified by RPBs who are subject to the rules of their own SRO or RPB (FSA 1986 s.48). The FSA 1986 originally required the rulebooks of SROs and RPBs to provide a level of protection to investors equivalent to that of the rulebook of the SIB. This was amended by the Companies Act 1989 (s.203) which requires the rulebooks of SROs and RPBs simply to provide an adequate level of protection. However, it is appropriate to use the rulebook of the SIB as a general source for two reasons: first, it applies to firms directly authorised by the SIB in respect of investment business; and secondly, the old test of equivalence means that it has exerted a major influence on the rulebooks of SROs and RPBs.

³⁹SIB Conduct of Business Rule 5.01.

to be known, to the firm, about that investment, scheme or agreement and as to that persons's other investments and his personal and financial situation."

Prior to this, the rule of "best advice" was limited to situations in which it was part of the fiduciary duty of an agent to act in the best interests of his client⁴⁰. In other cases, such as where a policy is purchased from a salesman employed by an insurer, good business practice might well call for the application of the principle, but it was not required by the law. The SIB's rulebook makes clear that the principle of "best advice" applies to virtually all situations in which investments are recommended to individuals in their private capacity, irrespective of whether the person making the recommendation is acting as a principal (including instances where the person making the recommendation is the agent of the insurer) or agent of the proposer.

(b) Disclosure of Commissions, Charges and Expenses

The SIB's Rulebook includes a general disclosure requirement⁴¹ applicable to all firms making recommendations in respect of life policies which requires the provision of such information to the proposer as is necessary for an informed decision and notice of the right of cancellation. As discussed below, this rule expands the common law duty owed by an insurer to a proposer for life assurance. In the case of an agent acting for the proposer, the disclosure rules are even more stringent than the general rule and once again represent an extension of the common law.

(i) The Insurer

Under the common law, the insurer is subject to the general duty of good faith which applies to the contract of insurance⁴². However,

⁴⁰The duty to act bona fide follows from the agent's designation as a fiduciary: Cooks v Deeks [1916] 1 AC 554 (PC).

⁴¹SIB Conduct of Business Rule 5.12A.

⁴²Banque Financière de la Cité S.A. v Westgate Insurance Co. Ltd. [1991] 2 AC 249.

despite the lack of precedent, it seems likely that the insurer's common law duty of disclosure in life assurance does not extend as far as the obligations imposed by the SIB's Rulebook.

The disclosure provisions of the SIB's Rulebook⁴³ require the insurer to issue to the proposer a "statement of product particulars" which includes details on matters such as bonus expectations, liability to taxation, surrender values and the effect of charges and expenses. They therefore expand the insurer's common law duty of disclosure into areas in which most proposers for life assurance have little or no expertise.

(ii) The Agent of the Proposer

The common law fiduciary duties of the agent require disclosure of his commission on request to his principal, a position implicitly recognised by the Code of Conduct of the Insurance Brokers Registration Council⁴⁴, which includes this disclosure requirement.

The SIB's Rulebook introduces a more extensive disclosure requirement in respect of the agent of the proposer than is required by common law⁴⁵. It requires disclosure, prior to the recommendation of a transaction, of⁴⁶:

- (a) the basis of the remuneration of the intermediary payable by the customer; and
- (b) the fact, if relevant, that commission will be paid by a person other than the customer and that information relating to the commission will follow from that person in due course.

⁴³SIB Conduct of Business Rule 5.14.

⁴⁴Insurance Brokers Registration Council (Code of Conduct) Approval Order 1978, SI 1978/1394.

⁴⁵"Independent intermediary" is a term used to describe an agent of the proposer as opposed to a "tied agent" which is the term generally applied to an agent of the insurer.

⁴⁶This section paraphrases rule 5.13 of the SIB's Conduct of Business Rules.

(c) Cancellation Rights

The FSA 1986⁴⁷ gives the SIB power to make rules to enable a person who has entered into an investment agreement with an authorised person to rescind the agreement within such period and in such manner as the Board prescribes. The rules⁴⁸ adopted by the Board generally allow a cancellation period of fourteen days from receipt of the notice of cancellation. As rescission of the contract would not be open to the proposer under the common law⁴⁹, the right of cancellation is an example of a fully-fledged amendment of the common law introduced by the FSA 1986. In this respect, the cancellation rules differ from the rules relating to "best advice" and disclosure which, as noted above, do not alter the common law of contract in the sense that the term "amendment" is generally used.

However, a choice of applicable law other than English or Scots will not prevent the application of the United Kingdom cancellation rules. The Regulations⁵⁰ implementing the cancellation rules of the Second and Third Life Directives make clear that a cancellation notice⁵¹ must be sent or given to policyholders resident in the United Kingdom where the policy is sold by a Community insurer on either an establishment or services basis. In implementing the cancellation rules of the

⁴⁷Section 51.

⁴⁸The Financial Services (Cancellation) Rules 1989 (as amended) govern the cancellation procedure for investment business. Other long-term contracts are governed by sections 75-77 of the Insurance Companies Act 1982. The Insurance Companies (Cancellation) and (Cancellation no.2) Regulations 1993 will implement Article 15 of the Second Life Directive (as amended by Article 30 of the Third Life Directive) in respect of contracts falling under the Insurance Companies Act 1982. It is intended that a separate review of FSA Cancellation Rules will be undertaken by the SIB (see DTI Consultation Document on Article 15).

⁴⁹Although he would have the right to withdraw up until payment of the first premium which represents the conclusion of the contract.

⁵⁰See note 48 above.

⁵¹The form of the notice is set out in the Insurance Companies (Cancellation no. 2) Regulations 1993.

insurance Directives, the United Kingdom has opted for the minimum cancellation period of 14 days which is provided for in the Life Directives⁵².

3. The Statements of Insurance Practice

The scope of the Statements of Practice is defined as follows:

(a) Statement of General Insurance Practice (1986);

"The following Statement of normal insurance practice applies to general insurances of policyholders resident in the UK and insured in their private capacity only."

(b) Statement of Long-Term Insurance Practice (1986);

"The following Statement of normal insurance practice applies to policies of long-term insurance effected in the UK in a private capacity by individuals resident in the UK."

In both instances, the definition of the scope of the Statements raises issues regarding the law applicable to the contract as determined by the insurance Directives⁵³. Two sets of circumstances are possible:

(i) The insurer is based in the United Kingdom. In this situation, the Statements of Practice apply to policyholders resident in the United Kingdom where the insurer has subscribed to the Statements.

(ii) The insurer is based outside the United Kingdom. In this situation, the insurer will not have subscribed to the Statements of Insurance Practice. Therefore, policyholders resident in the United Kingdom who purchase such policies are not covered by the

⁵²Article 15 of the Second Directive provided policyholders purchasing policies on a services basis with a cancellation period of between 14 and 30 days from the time of intimation of conclusion of the contract. Article 30 of the Third Directive extends this right to all policyholders purchasing individual life assurance from Community insurers. See also chap. 2, section C.2.

⁵³The position of policyholders not resident in the United Kingdom is considered in section G below.

Statements even if the contract is subject to the law in the United Kingdom.

It follows that policyholders in the United Kingdom purchasing policies on a "services" basis do not have a similar level of protection to those purchasing policies within the domestic market, who benefit from the Statements of Practice.

C. THE POLICYHOLDER IS NOT RESIDENT IN THE UNITED KINGDOM

1. English or Scots Law as the Applicable Law

A choice of English or Scots law as the applicable law is dependent, in this situation, on the rules of the insurance Directives and the laws of other Member States. It is particularly important to identify whether the laws of other Member States provide for a wider choice of law than the rules of the insurance Directives. Several situations can be identified in which a choice of English or Scots law will be available to the contracting parties.

Three instances can be cited in the non-life sector. First, "large" risks, where a free choice is always available. Secondly, where a Member State in which the risk is situated and in which the insured has his habitual residence allows a free choice of law. Thirdly, where a risk is situated in the United Kingdom, the parties may take advantage of the freedom of choice of law available in the United Kingdom.

In the life sector, a choice of English or Scots law will be possible where the Member State of the commitment allows a free choice of law. It will also be possible where the policyholder is a United Kingdom national, irrespective of the law of the Member State of the commitment. This means that, in respect of "expatriate" policies sold from the United Kingdom by way of freedom of services⁵⁴ into other Member States, a choice of English or Scots law is always available.

⁵⁴In the sense in which this term was used in chap. 1.

Where no choice has been made, the applicable law is likely to be English or Scots law if the risk is situated in the United Kingdom (the country of the closest connection). In the case of life assurance, the applicable law in the absence of choice will be that of the Member State in which the insured is habitually resident (the Member State of the commitment).

2. Conduct of Business Rules

As noted above, a choice of law does not encompass Conduct of Business Rules. Thus, where a policyholder is resident in a Member State outside the United Kingdom, he will be subject to that Member State's Conduct of Business Rules, if such rules exist⁵⁵. The application of those rules will not be prejudiced by a choice of English or Scots law as the applicable law⁵⁶.

3. The Statements of Insurance Practice

Where a policy is sold on a services basis into another Member State and is made subject to the law in the United Kingdom, it is clear that the Statements do not apply. It follows that the rights and obligations of a policyholder⁵⁷ whose contract is subject to the law in the United Kingdom will vary according to whether or not he is resident in the United Kingdom. This gives rise to considerations of mandatory rules of contract law which may be justified in the "general good" which were discussed in chapters 2 and 4. In particular, it might be argued that the failure of the United Kingdom to extend an equivalent level of protection to policyholders in other Member States whose policies are

⁵⁵Not all Member States have Conduct of Business Rules. See the evidence of the DTI to the House of Lords Select Committee on the European Communities (12th Report, session 1990-91, A Single Insurance Market).

⁵⁶The Regulations implementing the cancellation rules of the insurance Directives (see note 48 above) provide that they do not apply where the policyholder is habitually resident in another Member State.

⁵⁷The Statements can only apply to policyholders purchasing in a private capacity.

subject to English or Scots law justified the retention of mandatory rules of contract law which impaired the free access of United Kingdom policies to another country in the Community. The law on warranties can be cited as an example. The Statements of Practice require a causal link between breach of warranty and a loss if the insurer is to avoid liability, but the law in the United Kingdom requires no such causal link. Member States such as Germany⁵⁸, which require a causal link as part of their law may regard a contract or a choice of law which evades this requirement as being contrary to the "general good" and seek to apply the rule of causality as a mandatory rule.

⁵⁸See chap. 3 for more details on German law.

PART 2: THE DEVELOPMENT OF INSURANCE CONTRACT LAW IN THE UNITED KINGDOM

It is proposed to use the Marine Insurance Act 1906 (hereafter MIA 1906) as the basis of the statement of current insurance contract law in both England and Scotland. The MIA 1906⁵⁹ makes express provision regarding its application to other classes:

"..except as by this section provided, nothing in this Act shall alter or affect any rule of law applicable to any contract of insurance other than a contract of marine insurance as by this Act defined."

However, an approach based on the MIA 1906 can be justified on two grounds. Firstly, a tendency to extrapolate from marine to other classes of business was evident long before the introduction of the MIA 1906: the early case-law related mainly to marine insurance, but the principles were extended to other classes. Secondly, the act was itself largely a codifying statute and its provisions have subsequently, whether rightly or wrongly, been applied to non-marine classes of business. Categorical support for this extension to other classes can be found in the House of Lords decision in the case of Thomson v Weems⁶⁰: "I think that on the balance of authority the general principles of insurance law apply to all insurances, whether marine, life or fire."

D. THE NATURE OF THE CONTRACT

1. Definition of Insurance

The MIA 1906⁶¹ provides the following definition:

"A contract of marine insurance is a contract whereby the insurer undertakes to indemnify the assured, against marine losses, that is to say, the losses incident to marine adventure."

The definition contained in the Insurance Companies Act 1982⁶² is less ambitious in that it simply provides that the term "insurance business", for the purposes of the Act, includes certain common

⁵⁹Section 2(2).

⁶⁰(1884) 9 AC 671.

⁶¹Section 1.

⁶²Section 95.

categories of business. As neither statutory definition is exhaustive, common law definitions remain important. However, attempts on the part of judges and commentators to reach a more wide-ranging definition, which would cover non-marine classes and encompass the fact that the principle of indemnity is of limited relevance to life assurance, appear to have had only limited success. Ivamy's definition⁶³ is challenged by Colinvaux⁶⁴ on the basis that the law does not prescribe the form which indemnity is to take, nor does it require a premium, although the general principles of English contract law require some form of consideration, unless the policy is under seal. Clarke⁶⁵ resorts to the observation that:

"The English courts know an elephant when they see one, so too a policy of insurance".

Within the relevant case-law, the best definition is probably in Prudential Insurance Co. v Inland Revenue Commissioners⁶⁶:

"When you insure a ship or a house, you cannot insure that the ship shall not be lost or the house burned, but what you do insure is that a sum of money shall be paid on the happening of a certain event. That I think is the first requirement in a contract of insurance. It must be a contract, whereby, for some consideration, usually, but not necessarily, for periodical payments called premiums, you secure to yourself some benefit, usually, but not necessarily, the payment of a sum of money upon the happening of some event."

These essential elements were relied on in DTI v St. Christopher's Motorists Association⁶⁷, although it was stressed that they did not

⁶³General Principles of Insurance Law (4th edn.) p3:

"A contract of insurance in the widest sense of the term may be defined as a contract whereby one person, called the insurer, undertakes, in return for an agreed consideration called the premium, to pay to another person, called the assured, a sum of money or its equivalent on the happening of a specified event."

⁶⁴The Law of Insurance (4th edn.) p4.

⁶⁵Malcolm Clarke, The Law of Insurance Contracts, pl.

⁶⁶[1904] 2K.B. 658, 663.

⁶⁷[1974] 1 Lloyd's Rep 17. It was held that the provision of a chauffeur service by the Association to members in the event of their being unable to drive through accident or disqualification amounted to insurance.

constitute an exhaustive definition. Indeed, the judge in that case cast doubt over the desirability of an exhaustive definition, saying⁶⁸ that the legislature had not defined insurance as:

"no difficulty has arisen in practice, and therefore there has been no all-embracing definition, and the probability is that it is undesirable that there should be, because definitions tend to obscure and occasionally to exclude that which ought to be included".

A similar approach was followed in Medical Defence Union v Dept. of Trade⁶⁹. No definition of insurance was attempted in that case, but it was stressed that the payment of money or money's worth on the occurrence of the insured event was fundamental to the contract of insurance⁷⁰.

Among the Scots sources, Bell⁷¹ offers a definition which does not limit the form of the indemnity in the manner indicated by the cases cited above:

"Insurance is a contract to indemnify against possible or probable loss, in consideration of a sum or premium paid, or held to be paid."

However, a contemporary definition of insurance in Scots law would probably follow the English model⁷².

2. Insurable Interest

Insurable interest operates to limit access to insurance to parties who have a financial interest in the occurrence of the insured event. In its early years, the transaction of insurance was seen as analogous to gambling, in that the element of speculation appeared to be one of the

⁶⁸Ibid. p18.

⁶⁹[1980] Ch. 82.

⁷⁰The court concluded that the benefits provided by the Medical Defence Union to its members were not of such a nature as to constitute insurance.

⁷¹Principles, s.457.

⁷²As discussed below, Scots law has tended to follow the English approach to insurance contract law although there are points on which the two legal systems differ.

major characteristics of the contract. The practice of insurers, who, in the formative years of the industry, were concerned mainly with marine risks, no doubt reinforced the analogy: ships were often insured after they had sailed and subject to the "lost or not lost" provision, which meant that the insurance was valid whether or not the ship had already been lost at sea. It was against this background and in order to distinguish insurance from gambling that the requirement that the insured have an "insurable interest" in the subject matter of insurance developed.

The MIA 1906⁷³ defines insurable interest in relation to marine insurance as follows:

"In particular a person is interested in a marine adventure where he stands in any legal or equitable relation to the adventure or to any insurable property at risk therein, in consequence of which he may benefit by the safety or due arrival of insurable property, or may be prejudiced by its loss, or by damage thereto, or by the detention thereof, or may incur liability in respect thereof."

The Act further provides that where the insured does not have an insurable interest or the expectation of acquiring such an interest, the contract is deemed to be a gaming or wagering contract and therefore void⁷⁴. This represents the current law as regards marine insurance in both England and Scotland, but, as discussed below, the development of the law in each jurisdiction was substantially different.

(a) England

The English common law recognised the validity of wagering contracts⁷⁵, although where it was clear that the contract was one of indemnity, proof of interest was required⁷⁶. The Marine Insurance Act 1745 made marine policies lacking interest, or no further proof of

⁷³Section 5(2).

⁷⁴MIA 1906, section 4.

⁷⁵Jones v Randall (1774) Cowp. 17.

⁷⁶Lucena v Craufurd (1802) 3 B&P 75, 101.

interest than the policy itself, void. It was later repealed in toto by the MIA 1906. The rather misleadingly titled Life Assurance Act of 1774 extended the requirement of insurable interest to insurances "on the Life or Lives of any Person or Persons, or on any other Event or Events whatsoever", but excluded from its ambit insurances "on Ships, Goods, or Merchandises".

This apparent gap in statute law concerning insurable interest in respect of "goods or merchandises" was later resolved by the Marine Insurance Act 1788, which required the insertion of the name of an interested party for "insurances, on ships and on goods, merchandises or effects", and the Gaming Act 1845 which declared "That all Contracts or Agreements, whether by Parole or in Writing, by way of gaming or wagering shall be null and void."

The key point appears to be that the contingency in respect of which insurance is effected must relate to the insured's legal rights: thus, a shareholder, even a substantial one, has no insurable interest in the company's property⁷⁷, although he does have an insurable interest in his shares in the company⁷⁸.

The issue of when insurable interest must exist was clarified in the case of Mark Rowlands Ltd. v Berni Inns⁷⁹, which held that insurance policies on buildings and land do not require interest at the outset. It had previously been argued that the Life Assurance Act 1774 had imposed a requirement of interest at the outset.

(b) Scotland

The abuse of insurance as a method of gaming or wagering was not present in Scotland as gambling contracts were void at common law⁸⁰.

⁷⁷Macaura v Northern Assurance Co. [1925] AC 619.

⁷⁸Wilson v Jones (1867) L.R. 2Exch. 139.

⁷⁹[1985] 3 All ER 473.

⁸⁰Bruce v Ross (1787) M 952.

The Marine Insurance Act 1745 and the Life Assurance Act 1774 both applied to Scotland as did the Marine Insurance Act 1788. However, the Gaming Act of 1845 did not apply to Scotland, and it has been suggested⁸¹ that it is not at all clear that the requirement of the 1788 Act regarding the insertion of the name of an interested party creates a requirement for insurable interest in respect of property (i.e. "goods and merchandises" under the 1774 Act) insurances in Scotland.

Nevertheless, Bell⁸² refers to insurable interest as an accepted principle of Scots law:

"It is essential to the contract of insurance that there shall be a subject in which the insured has an interest, a premium given or engaged for, and a risk run".

He goes on to define the scope⁸³ of insurable interest as being:

"every real and actual advantage and benefit arising out of or depending on the thing to which it refers".

Case-law supports a requirement of insurable interest in the case of all property insurances in Scotland. In Arif v Excess Insurance Group⁸⁴, it was held that one partner in an hotel business was not entitled to recover under a fire policy covering the building and its contents as the title to the building was in the other partner's name⁸⁵.

(c) A wider definition of insurable interest?

It has been noted⁸⁶ that the recognition of insurable interest has expanded with time:

⁸¹J.J. Gow, The Mercantile and Industrial Law of Scotland, p335.

⁸²Principles, s.457.

⁸³Principles, s.461.

⁸⁴1987 S.L.T. 473.

⁸⁵There was also non-disclosure as the partnership interest had not been disclosed.

⁸⁶Moran Galloway v Uzielli [1905] 2 K.B. 555, 563.

"The definition of insurable interest has been continuously expanding and dicta in some of the older cases, which would tend to narrow it, must be accepted with caution."

Wolffe⁸⁷ has argued that the delimitation of insurable interest in Arif v Excess, which followed the approach of the House of Lords in Macaura v Northern Insurance Co.⁸⁸, is unduly restrictive. He bases his argument on the decision of the Supreme Court of Canada in Constitution Insurance Company of Canada v Kosmopoulos⁸⁹ where, on the basis of facts⁹⁰ similar to those in Arif v Excess, it was decided that the insured could recover under the policy. The rationale of Kosmopoulos followed that of Bell (above) in that it extended insurable interest to anyone who could show a pecuniary loss from the insured event. As argued by Wolffe, the adoption of such an approach in the United Kingdom would widen the category of person with insurable interest without increasing materially the risk of fraud⁹¹.

⁸⁷W.J. Wolffe, "Insurable Interest: Time for a Change" 1989 SLT 103.

⁸⁸[1925] AC 619.

⁸⁹(1987) 34 D.L.R. (4th) 208.

⁹⁰Kosmopoulos was sole shareholder and director of a limited company, Kosmopoulos Leather Goods Ltd., through which he carried on a business known as Spring Leather Goods. He insured the business assets against fire damage in the name of "Andreas Kosmopoulos O/A Spring Leather Goods". The insurer repudiated a claim for fire damage on the basis of lack of insurable interest. The Ontario Court of Appeal found for Kosmopoulos by lifting the corporate veil. The Supreme Court also found for Kosmopoulos but on the basis that he had an insurable interest: in reaching this view it disregarded the approach of the House of Lords in Macaura v Northern Assurance [1925] AC 619.

⁹¹The main risk identified in Kosmopoulos was that of shareholders in small companies destroying assets insured in their own names so as to defeat creditors. This was counterbalanced by the consideration that criminal sanctions provided a deterrent to fraudulent destruction of property. Moreover, it was noted that it was open to creditors to satisfy themselves as to the adequacy of insurance in the company name.

3. The Requirement of Good Faith

The nature of the contract of insurance is the foundation of the separation of insurance from the normal rules of contract law. Insurance, along with several other contracts⁹² is designated a contract uberrimae fidei⁹³, that is a transaction whose nature requires good faith in both the negotiating process and performance. Such contracts can be distinguished from those which require good faith due to the relationship which exists between the parties at the time they enter into a contract: examples are the relationships of agency and trusteeship. Thus, the requirement of good faith in contracts uberrimae fidei can be regarded as transaction-based, whereas other examples of a requirement of good faith in the negotiation of contracts are relationship-based⁹⁴.

4. Insurance as an Investment

The past thirty years have seen fundamental changes in the nature of life assurance, with the emphasis switching away from provision for dependants in the event of death to investment products which are intended to provide a return to the insured during the course of his lifetime⁹⁵. This process has been most obvious in the development of unit-linked life assurance, whereby an investment bond and life

⁹²Spencer Bower, Turner & Sutton, Actionable Non-Disclosure (2nd edn), para 5.01, list the following as contracts uberrimae fidei (in addition to insurance): (i) contracts for the sale of land (ii) contracts of suretyship (iii) releases and compromises (iv) contracts for partnership (v) contracts to marry and separation deeds.

⁹³The use of the latin superlative "Utmost Good Faith" is superfluous as contracts either require good faith or do not. See chap. 3, part 1, section A.

⁹⁴This distinction is recognised by Spencer Bower, Turner & Sutton, op.cit. chap.1.

⁹⁵See "The Marketing and Sale of Investment-Linked Insurance Products" (A Report by the Director General of Fair Trading to the Chancellor of the Exchequer, March 1993) and "Fair Trading and Life Insurance Savings Products" (A Report by the Director General of Fair Trading, March 1993).

assurance are linked together to form one contract in which the bulk of the premium is generally in respect of the investment element rather than the life assurance. However, the trend has also been evident in conventional life assurance products, where "with-profit" endowment policies have for a long time acted as regular savings plans designed to provide a lump-sum during the lifetime of the assured.

It was against this background that Professor Gower, in his Review of Investor Protection⁹⁶ recommended that:

"all forms of bonds, whether or not linked to life policies, should be treated as 'securities'.. and so should all life policies, for investment is what they undoubtedly are."

That recommendation was accepted by the government and incorporated in the Financial Services Act 1986. The result is that life assurance is included within the definition of "investment" for the purposes of the Act, except where the insurance is one which provides no lifetime savings element⁹⁷. The Financial Services Act imposes obligations on insurers in relation to their investment business in the form of Conduct of Business Rules adopted by self-regulatory bodies under the authority of the Act. The relationship of those rules to contract law and their relevance to the rules which govern the applicable law within the Single Market were considered in part 1 of this chapter.

E. NEGOTIATION OF THE CONTRACT

Two influences can be identified in the law relating to the negotiation of insurance contracts. The first is a reliance on freedom of contract which results in a legal framework in which there are few limitations on contract terms. The second is an emphasis on the relative bargaining positions of the contracting parties. In the formative years of insurance contract law, the prevailing view was that the advantage of information as to the risk lay with the insured. This formed the basis of the insured's duty of disclosure at inception of the contract.

⁹⁶ Cmnd. 9125 (1984), Part 1.

⁹⁷ The most important categories of exemption are contracts, such as term or whole life insurance, which provide benefits only on death.

Recent developments, however, indicate a divergence of approach in the law relating to disclosure as between commercial and personal insurances. On the one hand, the Statements of Insurance Practice⁹⁸ have, through self-regulation on the part of insurers, strengthened the position of the policyholder who purchases insurance in a private capacity. On the other hand, the law relating to disclosure in relation to commercial insurances has developed in a manner which imposes a heavy duty on the insured.

1. Freedom of Contract

There are few substantive limitations on freedom of contract in the field of insurance in the United Kingdom. As noted in chapter 3, the United Kingdom, unlike other Member States such as France and Germany, does not exercise administrative control over either the terms of insurance contracts or premium rates. Standard forms of contract are common in relation to risks where insurance is compulsory⁹⁹ but this arises from the obligation to insure rather than from control over contract terms. As noted in chapter 2, contract terms relating to jurisdiction are governed by the Brussels Convention and those relating to choice of law primarily by the Second Life and Non-Life Directives. The Statements of Insurance Practice modify, on a self-regulatory basis, the rights of the insurer and policyholder in relation to insurances purchased in a private capacity: as will be discussed below, this has the effect of limiting the use of certain contract terms.

Formal limitations on freedom of contract in the United Kingdom arise mainly where there is an obligation on the part of the insurer to bring certain matters to the attention of the proposer. There are three main instances of such an obligation. The first arises at common law: in Interfoto Picture Library Ltd. v Stiletto Visual Programmes Ltd.¹⁰⁰,

⁹⁸These are discussed in greater detail in section G below.

⁹⁹An example is third party motor cover under the Road Traffic Act 1988.

¹⁰⁰[1989] QB 433.

the Court of Appeal held that effect will not be given to particularly onerous or unusual contract terms unless they are fairly and reasonably brought to the attention of the other party prior to entering into the contract. The second instance is the requirement for life assurers to issue certain notices to a proposer under rules adopted pursuant to the Financial Services Act 1986¹⁰¹. Finally, the Statements of Insurance Practice contain several requirements regarding the form of insurers' documentation¹⁰².

2. Good Faith

The MIA 1906 codified the common law duty of good faith as follows¹⁰³:

"A contract of marine insurance is a contract based upon the utmost good faith and, if the utmost good faith be not observed by either party, the contract may be avoided by the other party."

The principle of good faith applies equally to both parties to the contract. Whilst the substance of the principle is most readily identifiable in relation to the insured's duty of disclosure, the insurer has also been held to owe a duty of disclosure to the insured¹⁰⁴. Moreover, both parties are bound to act in good faith in the settlement of claims¹⁰⁵.

As regards the period during which utmost good faith operates, it has been said¹⁰⁶ that:

¹⁰¹These were discussed in more detail in part 1 of this chapter.

¹⁰²For example, para. 1(d) of the Statement of General Insurance Practice requires proposal forms to contain questions on matters which insurers have found generally to be material.

¹⁰³Section 17.

¹⁰⁴Banque Financière de la Cité SA v Westgate Insurance Co. Ltd. [1991] 2 AC 249.

¹⁰⁵This has developed in the United States into the principle of "reverse bad faith" under which there have been numerous cases of damages awarded to the insured where the insurer has acted in bad faith during the claims settlement process. See Clarke, *op.cit.* chap.27.

¹⁰⁶Boulton v Houlder Bros. [1904] 1KB 784, 791-2.

"It is an essential condition of the policy of insurance that the underwriters shall be treated with good faith, not merely in reference to the inception of the risk, but in the steps taken to carry out the contract".

In particular, the duty revives whenever the insured has an express or implied duty to supply information to enable the insurer to make a decision¹⁰⁷. Thus, although most frequently referred to in the context of the duty of disclosure prior to the formation of the contract, the principle of good faith continues to operate throughout the policy term but with varying levels of obligation as to disclosure and conduct placed on the parties.

It was noted in chapter 3 that the notion of good faith as a general principle of contract law varies between Scotland and England, but there does not appear to be any material distinction between the two jurisdictions as regards the application of the principle to insurance contracts.

3. The Duty of Disclosure

The legal basis of the duty of disclosure has been disputed over the years by both judges and commentators. The MIA 1906¹⁰⁸ adopted the common law requirement of disclosure in insurance but did not make clear the nature of the duty. The dominant view in the late nineteenth and early twentieth centuries was that that the duty was an implied term of the contract¹⁰⁹. Recent case-law, however, has rejected an implied term as the basis of the duty¹¹⁰. In Banque Financière de la

¹⁰⁷The Litsion Pride [1985] 1 Lloyd's Rep 435,511.

¹⁰⁸Section 18(1).

¹⁰⁹This interpretation is supported by the majority view in Blackburn Low & Co. v Vigors (1887) 12 AC 531, and by Arnould's Law of Marine Insurance (2nd edn. 1850 to 12th edn. 1939).

¹¹⁰Merchants & Manufacturers Ins. Co. v Hunt [1941] 1KB 215,313; March Cabaret v London Assurance [1975] 1 Lloyd's Rep 437,518; and Bank of Nova Scotia v Hellenic Mutual War Risk Associates [1989] 2 Lloyd's Rep 238. See H.Y. Yeo, "Of reciprocity and remedies - duty of disclosure in insurance contracts" 11 Legal Studies (1991) 131.

Cité S.A. v Westgate Insurance Co.Ltd.¹¹¹, the Court of Appeal favoured the dissenting view of Lord Esher in Blackburn Low & Co v Vigors¹¹² and held the duty to be a condition¹¹³ precedent to the right of a party to insist on performance. As such, breach of the duty of disclosure did not give rise to a remedy in damages. This view was followed in "The Good Luck"¹¹⁴ when the Court of Appeal relied on the ruling in Banque Financière in holding that breach of the duty of good faith after conclusion of the contract did not support a claim in damages.

(a) England

In areas other than insurance, the common law does not recognise a general duty of disclosure of information¹¹⁵. However, it is fundamental to the contract of insurance as failure to fulfil the duty means that the contract is voidable at the option of the insurer¹¹⁶. The duty is the same each time the policy is renewed as at the outset¹¹⁷. Following the general principles of contract law, the presence of fraud gives rise to a claim for damages.

¹¹¹[1988] 2 Lloyd's Rep 513. The decision was affirmed by the House of Lords on different grounds: [1991] 2 AC 249.

¹¹²(1887) 12 AC 531.

¹¹³The reference to a "condition" is confusing within the context of a rejection of the duty as an implied contract term. However, it was made clear in Banque Financière (Court of Appeal, p548) that the reference to a condition was in the sense of a contingent condition, the non-fulfillment of which gives no right of action for breach but merely suspends the obligations of one or both parties. See Chitty on Contracts (25th edn.) paras 752-3.

¹¹⁴The Bank of Nova Scotia v Hellenic Mutual War Risks Association (Bermuda) Ltd. [1989] 2 Lloyd's Rep 238. The decision was reversed by the House of Lords on other grounds: [1992] 1 AC 233.

¹¹⁵See Treitel, The Law of Contract (8th edn.) p349, and chap. 3 of this thesis.

¹¹⁶MIA 1906, section 18(1).

¹¹⁷Lambert v Co-operative Insurance Society [1975] 2 Lloyd's Rep. 485.

English common law did not allow avoidance of a contract in cases of innocent misrepresentation¹¹⁸, but insurance cases were an exception to this rule¹¹⁹. As regards other contracts, the courts of equity might grant rescission for innocent misrepresentation, but at law the contract stood unless the representation amounted to a condition¹²⁰. It has been observed that it is doubtful whether an action for non-disclosure can be brought under section 2(1) of The Misrepresentation Act¹²¹, although such actions would, in most cases, be precluded by the Statements of Practice¹²² adopted by the industry.

(i) The Scope of the Duty of Disclosure

The MIA 1906 codified the common law in respect of disclosure as follows¹²³:

"Subject to the provisions of this section, the assured must disclose to the insurer, before the contract is concluded, every material circumstance which is known to the assured, and the assured is deemed to know every circumstance which, in the ordinary course of business, ought to be known by him"

¹¹⁸Redgrave v Hurd 1881 20 Ch.D. 1.

¹¹⁹Graham v Western Australian Insurance (1931) 40 Lloyd's Rep 64.

¹²⁰Implying fundamental term of the contract.

¹²¹This provides:

"Where a person enters into a contract after a misrepresentation has been made to him by another party thereto and as a result thereof he has suffered loss, then, if the person making the representation would be liable to damages in respect thereof had the representation been made fraudulently, that person shall be so liable notwithstanding that the representation was not made fraudulently, unless he proves that he had reasonable grounds to believe and did believe up to the time the contract was made that the facts represented were true."

¹²²Para. 2(b)(ii) of the Statement of General Insurance Practice and para. 3(a) of the Statement of Long-Term Insurance Practice limit repudiation of claims to deliberate or negligent misrepresentation of a material fact. The Statements apply only to policies purchased in a private capacity.

¹²³Section 18(1).

These principles were first recognised by Lord Mansfield in Carter v Boehm¹²⁴:

"Insurance is a contract upon speculation. The special facts, upon which the contingent chance is to be computed, lie more commonly in the knowledge of the insured only: the underwriter trusts to his representation, and proceeds upon confidence that he does not keep back any circumstance in his knowledge, to mislead the underwriter into a belief that the circumstance did not exist, and to induce him to estimate the risk as if it did not exist. The keeping back in such a circumstance is a fraud and therefore the policy is void¹²⁵. Although the suppression should happen through mistake, without any fraudulent intention; yet still the underwriter is deceived and the policy is void."

However, the same judge in the following year directly contradicted this famous passage, holding that:

"It must be a fraudulent concealment of circumstances, that will vitiate a policy"¹²⁶.

It has been argued¹²⁷ on the basis of this decision and the weight of the duty of investigation placed on the insurer in Carter v Boehm¹²⁸, that Lord Mansfield framed the duty of disclosure in a much narrower form than that in which it subsequently developed. However, the formulation of the duty of disclosure in Carter v Boehm makes it difficult to accept that Lord Mansfield intended that there must be fraud if the insurer is to avoid the policy for non-disclosure.

As regards the duration of the insured's duty of disclosure, it continues until the conclusion of the contract. In the case of life assurance, the contract is not concluded until the first premium has been paid, and the duty of disclosure therefore continues until the

¹²⁴(1766) 3 Burr 1905.

¹²⁵This has been taken by commentators to mean voidable.

¹²⁶Mayne v Walter (1787). Report in Park, The Law of Marine Insurances (1787), p220.

¹²⁷R.A. Hasson, "The Doctrine of Uberrima Fides in Insurance Law - A Critical Evaluation" 1969 32 MLR 615.

¹²⁸The decision was in favour of the insured largely due to the fact that the insurer had failed to investigate "the condition of the place" (Fort Marlborough on the island of Sumatra) in respect of the risk of French attack which was insured by the policy.

insured tenders the first premium¹²⁹. There is no legal duty to disclose changes in risk during the period of cover, although such an obligation may arise in the case of non-life insurance in the form of a specific contract term.

The insurer may, however, waive disclosure of material facts¹³⁰. Although the proposer's duty of disclosure is not discharged by completion of a proposal form, the formulation of questions in the proposal form may be indicative of the insurer having waived the right to further information¹³¹.

(ii) "Material" Information

The MIA 1906¹³² provides that:

"Every circumstance is material which would influence the judgement of a prudent insurer in fixing the premium, or determining whether he will take the risk".

A concise outline of the potential meaning of "material" was provided in Lambert v Co-operative Insurance Society¹³³, where four possible interpretations of prior case-law were advanced:

1. to disclose such facts as the particular assured believes to be material
2. to disclose such facts as a reasonable man would consider to be material
3. to disclose such facts as the particular insurer would regard as material
4. to disclose such facts as a reasonable or prudent insurer would regard as material.

It was explained that the last alternative was the correct interpretation of the law and that the insurer was entitled to avoid the policy

¹²⁹Looker v Law Union & Rock Ins. Co. [1928] 1 K.B. 554.

¹³⁰MIA 1906, section 18(3)(c).

¹³¹In Roberts v Plaisted [1989] 2 Lloyd's Rep 667 the insured did not disclose that a discotheque was occasionally run in his hotel but the insurer was taken to have waived this information by the nature of the questions in the proposal form.

¹³²Section 18(2).

¹³³[1975] 2 Lloyd's Rep. 485.

on the grounds that the insured had failed to disclose a conviction when renewing the policy.

The MIA 1906¹³⁴ provides that the "materiality" of any particular circumstance is a question of fact. Some guidance is available from Woolcott v Sun Alliance¹³⁵, where it was held that the insurer was entitled to avoid the policy on the grounds that the insured had not disclosed a twelve-year-old conviction for robbery. This decision was reached despite the fact that the insurance was ancillary to a mortgage agreement as it was held to be within the insured's actual or presumed knowledge that the building society would effect the insurance of his property on his behalf as well as on their own.

It is not necessary for an insurer to demonstrate that a prudent insurer would have altered his decision if he were in possession of a material fact which has not been disclosed. Following the decision of the Court of Appeal in Container Transport International Inc. v Oceanus Mutual Underwriting Association¹³⁶ it is clear that the relevant information, considered in isolation, need have made no difference to the acceptance of the risk or the terms of the contract. This decision has been criticised¹³⁷ as being inconsistent with precedent and placing an unduly onerous burden on the insured, but it now represents the law in England. The test of materiality in CTI v Oceanus is of general application and not limited to marine insurance¹³⁸. It was

¹³⁴Section 18(4).

¹³⁵[1978] 1 WLR 493.

¹³⁶[1984] 1 Lloyd's Rep 476,510.

¹³⁷See M. Clarke, "Failure to Disclose and Failure to Legislate: is it Material?", 1988 JBL 206, 298.

¹³⁸Highlands Insurance Co. v The Continental Insurance Co. [1987] 1 Lloyd's Rep 109.

recently applied in Pan Atlantic Ins. Co. Ltd. v Pine Top Ins. Co. Ltd¹³⁹.

(b) Scotland

The substance of the current Scots law in respect of disclosure in insurance is probably not different to England¹⁴⁰. The definition of the duty of disclosure advanced by Bell¹⁴¹ is less onerous than that indicated by the case-law and appears to be no more than a general principle of Scots contract law, in that it focuses on representations and not on the duty of disclosure. The provisions of the MIA 1906 apply to both jurisdictions and the courts have generally followed the English common law in relation to non-marine classes of business. In Life Association of Scotland v Foster¹⁴², the facts of the case resulted in the insurer being bound by the contract but it was recognised that:

"uberrima fides is part of Scots law and that without any fraudulent intent and even in bona fide, the insured may fail in the duty of disclosure".

However, it is possible that the test of materiality may differ between Scotland and England. In Gifto Fancy Goods Ltd. v Ecclesiastical Insurance Office¹⁴³ the court reserved its opinion on the question of

¹³⁹[1992] 1 Lloyd's Rep 101. However, the decision of the Court of Appeal in this case ([1993] 1 Lloyd's Rep 496) makes clear that CTI v Oceanus has not adequately resolved the law on materiality in that it is not clear if it is necessary for the relevant information to have had the effect of increasing the risk in the judgement of the prudent insurer.

¹⁴⁰However, as noted in chap. 3,(part 1 section A), the general law on disclosure in pre-contractual negotiations may differ between Scotland and England.

¹⁴¹Principles, s.474:
"Insurance is a contract of good faith, in which the insurer, in calculating the risks to be run, greatly relies on the statement of the insured. The statement is called a Representation which, whether fraudulent or innocent, if material to the risk, must be 'substantially' true, or complied with, otherwise there is in the option of the insurer no insurance."

¹⁴²(1873) 11M 351.

¹⁴³1991 GWD 2-117.

whether the appropriate test of materiality in establishing non-disclosure in relation to a non-marine risk was that of CTI v Oceanus. This stands in contrast to the position in England where, as discussed above, the test of CTI v Oceanus has been extended to non-marine risks.

The complications arising from innocent misrepresentation in England do not apply in Scotland as it is well established that a contract is voidable on those grounds¹⁴⁴.

F. THE LEGAL FORCE OF POLICY TERMS

The process of balancing the interests of the insurer and policyholder extends beyond the rules governing the negotiation of the contract. As discussed below, the effect which the law gives to policy terms has important consequences for the insured's ability to secure payment of a claim and for the insurer's ability to limit the scope of cover.

1. The Categories of Policy Term

This area presents something of a terminological nightmare. In English law, a warranty is a stipulation which is not fundamental to the contract, breach of which gives rise to a claim for damages but does not justify rescission of the contract, whereas a condition is a fundamental stipulation, something guaranteed, for non-implementation of which the contract can be rescinded and damages claimed. This usage appears in the Sale of Goods Act 1979. Scots law, however, does not follow the English approach, although there are cases in which the English terminology has been used. Instead, Scots law looks at the nature of the breach, distinguishing between "material" and "non-material" breaches: the former gives the innocent party the right to rescind the contract, whereas the latter does not¹⁴⁵.

¹⁴⁴Tulloch v Davidson (1860) 22D (H.L.) 7. The Misrepresentation Act does not apply to Scotland.

¹⁴⁵McBryde, Contract, chap.14.

Confusingly, the term "warranty" in insurance in England corresponds to condition in contracts other than insurance: in other words, it is a fundamental term, breach of which justifies rescission. The term is used in a similar sense in insurance policies applicable to Scotland, but the concept of "material breach" is not dependent on the classification of the terms of the contract¹⁴⁶.

2. Warranties

The MIA 1906¹⁴⁷ codified the common law on warranties in respect of marine risks as follows:

"A warranty, as above defined, is a condition which must be exactly complied with, whether it be material to the risk or not. If it be not so complied with, then, subject to any express provision in the policy, the insurer is discharged from liability as from the date of the breach of the warranty, but without prejudice to any liability incurred by him before that date."

Even before the MIA 1906 this principle was well established in relation to all classes of business. In Thomson v Weems¹⁴⁸, the House of Lords held that an insurer was entitled to avoid a life policy on the basis that a warranty provided by the assured in relation to his health was not true, and that once a representation becomes a warranty, the issue of materiality is not relevant. However, an insurer cannot reject a claim for breach of warranty without at the same time repudiating the policy¹⁴⁹.

The issue of whether or not a provision of the contract constitutes a warranty is one of intent not form: it is not essential that words such as "warranty" or "warranted" are used¹⁵⁰. Warranties may appear on the face of the policy or may be incorporated by reference to another document, usually the proposal form. The extreme position adopted in

¹⁴⁶Ibid.

¹⁴⁷Section 33(3).

¹⁴⁸(1884) 9 AC 671.

¹⁴⁹West v National Motor Insurance Union Ltd. [1955] 1 All ER 800.

¹⁵⁰Dawsons Ltd. v Bonnin [1922] 2AC 413, 428-9.

marine insurance, whereby any statement of fact bearing upon the risk contained in the policy is construed as a warranty¹⁵¹ is not applicable to other classes of business¹⁵². However, as Birds¹⁵³ has pointed out, problems may nevertheless be encountered in distinguishing between contract terms which are warranties and those which are merely descriptive of the risk, breach of which does not justify avoidance of the policy but relieves the insurer of liability if the term is not being complied with at the time of loss. An example can be seen in the case of Farr v Motor Traders' Mutual Ins. Soc. Ltd.¹⁵⁴: the plaintiff insured his two taxi-cabs and answered "Just one" to a question in the proposal form asking whether the vehicles were driven in one or more shifts per 24 hours. Following an accident to one of the taxi-cabs, it was discovered that the same vehicle had been driven in two shifts one day three months previously. The Court of Appeal held that the insurer could not avoid the policy as the clause did not constitute a warranty¹⁵⁵.

There is no requirement of a causal link between the breach of a warranty which gives rise to the right to avoid the contract and the actual loss sustained by an insurer. In Jones and James v Provincial¹⁵⁶, it was held that the failure of the insured to maintain his vehicle in an efficient condition was a breach of warranty which allowed the insurer to avoid a claim for theft.

¹⁵¹MIA 1906, section 35.

¹⁵²Thomson v Weems (1884) 9AC 671.

¹⁵³J. Birds, "Warranties in Insurance Proposal Forms" 1977 JBL 231.

¹⁵⁴[1920] 3 K.B. 669.

¹⁵⁵The incorporation of answers to questions in proposal forms into a policy as warranties has been limited by the Statements of Insurance Practice. See section G below.

¹⁵⁶1929 35 Ll L Rep 135. However, where a reinsurance contract subject to English law is made on a back-to-back basis with an original policy which is subject to a requirement of causality if the insurer is to avoid liability for breach of warranty, the reinsurer's liability is controlled by the original insurance unless there is an express clause to the contrary: see Forskringsaktieselskapet Vesta v Butcher and Others [1989] 1 AC 852.

The consequences of a breach of warranty have recently been clarified by the House of Lords in The Good Luck¹⁵⁷. The Court of Appeal¹⁵⁸ had held that breach of warranty did not automatically bring the policy to an end: the insurer had the right to avoid the policy but also had the right to waive the breach. Thus, the Court took the view that the insurer could only be discharged from liability by a positive decision. However, the House of Lords held that section 33 of the MIA 1906 operated to discharge the insurer from liability automatically as from the date of breach, as compliance with the warranty was a condition precedent to the attaching of the risk. Waiver of the breach by the insurer was held by the House of Lords to remain a possibility, but in a different manner to that envisaged by the Court of Appeal:

"When, as section 34(3) contemplates, the insurer waives a breach of a promissory warranty, the effect is that, to the extent of the waiver, the insurer cannot rely upon the breach as having discharged him from liability. This is a very different thing from saying that discharge of the insurer from liability is dependent on a decision by the insurer."¹⁵⁹

Provisions of the policy which are not warranties in the insurance sense fall under the general principles of contract law, which in both Scotland and England provides that the aggrieved party may claim damages or withhold performance but not rescind the contract.

3. "Basis of Contract" Clauses

The "basis of contract" clause is a technique which has been used by insurers to transform all statements made by an insured into "warranties", thereby avoiding the test of "materiality" which normally applies to the duty of disclosure. The most common example was where a proposal form, completed by the insured or an agent, contained a clause making the proposal form the "basis of the contract", thereby

¹⁵⁷ Bank of Nova Scotia v Hellenic Mutual War Risks Association (Bermuda) Ltd. [1992] 1 AC 233.

¹⁵⁸ [1990] 1 Q.B. 818.

¹⁵⁹ p263 (H.L.)

satisfying the requirement outlined above that there be a clear intention to create a warranty.

The first reported case dealing with such a clause was Ducket v Williams¹⁶⁰, in which it was held that, where a "basis of contract" clause was operative, the insurer could avoid the policy due to an innocent misrepresentation made by the insured. Although it was a life reinsurance case, it was subsequently followed as an authority for cases of ordinary insurance. In Thomson v Weems¹⁶¹, an applicant for life assurance was asked the following question:

"Question 7 (a) Are you temperate in your habits? (b) and have you always been strictly so?".

His answer was (a) "Temperate" (b) "Yes" and he subsequently signed a declaration to the effect that the foregoing statements were true, that he agreed that the declaration should be the basis of the contract and that any untrue statement would result in the policy being void. The House of Lords held that this declaration constituted an express warranty and that the insurer was entitled to avoid the policy, having proved that the answer to question 7 was false.

In Dawsons Ltd. v Bonnin¹⁶² a firm of contractors in Glasgow, in applying for motor insurance, wrongly stated the garaging address of the vehicle which was subsequently destroyed by fire. The policy provided that the proposal should be the basis of the contract and held as incorporated in the policy, and it was expressed to be granted subject to the conditions at the back thereof. The fourth condition provided that "material misstatement or concealment of any circumstance by the insured material to assessing the premium herein, or in connection with any claim, shall render the policy void". The court held:

(1) that the misstatement in the proposal was not material within the meaning of condition 4 ; but

¹⁶⁰ (1834) 2 Cr.&M 348.

¹⁶¹ (1884) 9 AC 671.

¹⁶² [1922] 2AC 413.

(2) that the recital in the policy that the proposal should be the basis of the contract had the effect of turning the garaging address into a warranty and that the effect of the recital was not diminished by the special conditions on the back of the policy.

The wide-ranging protection which this mechanism provided to insurers subsequently attracted criticism from several quarters and, as will be examined in greater detail below, has been an important feature of recent discussions regarding law reform.

G. THE LAW REFORM DEBATE

1. Background

The law relating to disclosure and contract terms met with criticism on the basis that there was an imbalance in the rights and obligations of the parties to the contract. Two factors seem particularly influential in the development of the case against the existing law. First, the conditions under which insurance was transacted were becoming substantially different to those applicable in the industry's formative years. Most of the early cases involved marine insurance and framed the duty of disclosure on the basis of the knowledge of the risks to be run being weighed heavily in favour of the insured. As insurance expanded into areas such as life, fire, motor and liability and the expertise and experience of insurers increased, the circumstances in which the law relating to disclosure had been framed became unrepresentative of the conditions which actually prevailed. Secondly, the increasing erosion of the principle of caveat emptor through legislation such as the Supply of Goods (Implied Terms) Act 1973 and the Unfair Contract Terms Act 1977 made the duty of disclosure in insurance seem particularly harsh and strengthened the case for law reform.

Dissatisfaction with the law was evident in judicial circles. In Joel v Law Union and Crown Insurance¹⁶³, Fletcher Moulton J. said in relation to "basis of contract clauses":

¹⁶³[1908] 2 K.B. 863.

"..I wish I could adequately warn the public against such practices on the part of insurance offices."

In Glicksman v Lancashire and General Assurance Co.¹⁶⁴, Lord Atkinson described as "lamentable" the continued failure of insurance companies to put questions "in clear and unambiguous language". Academic criticism was evident both in respect of the law in the United States and in England. Harnett¹⁶⁵ argued that the doctrine of concealment in the United States served no useful social function and should be abandoned in favour of the application of the ordinary rules of contract law to insurance. Hasson¹⁶⁶ proposed that the American courts¹⁶⁷ had correctly interpreted the classical doctrine outlined in Carter v Boehm and that it had been misunderstood by the English courts.

The case for leaving the law as it stood was based more on the contention, which appears from the limited case-law to have some justification, that insurers rarely used the full force of the law in their dealings with insureds other than when they suspected fraud: in most situations insurers claimed¹⁶⁸ to demand less from the insured than the law strictly demanded. This standard of conduct on the part of the insurers, together with the absence of any significant number of cases in which there was seen to be injustice resulting from the strict application of the law, formed the basis for the industry's claim that the potential for abuse could be solved by self-regulation and that there was no need for law reform. In the end, it was this view

¹⁶⁴[1927] AC 139.

¹⁶⁵B. Harnett, "The Doctrine of Concealment: A Remnant in the Law of Insurance", 15 *Law & Contemporary Problems* (1950) 391.

¹⁶⁶R.A. Hasson, "The Doctrine of Uberrima Fides in Insurance Law - A Critical Evaluation", 32 *MLR* (1969) 615.

¹⁶⁷The American courts applied the English rule of disclosure only to marine risks. In non-marine insurance, the insurer can avoid the contract only if there is non-disclosure in bad faith. See F. Achampong, "Uberrima Fides in English and American Insurance Law: A Comparative Analysis" 36 *ICLQ* (1987) 329.

¹⁶⁸See Law Reform Committee 5th Report, Jan. 1957: Cmnd.62.

which won the day, with the result that insurance contract law in the United Kingdom is now, as far as policies purchased in a private capacity are concerned, largely an irrelevance in terms of the practice of the industry. As discussed below, self-regulation has supplanted, though not changed, the existing law in several important areas.

2. Early Proposals for Law Reform

Growing concern regarding the state of insurance contract law led to a review being undertaken by the Law Reform Committee in 1957¹⁶⁹. The Committee's observations on its role and the effect of reforming the law had a major influence on its final recommendations. First, it observed that the mere fact that a branch of the law was theoretically open to criticism and susceptible to abuse did not justify a recommendation that it should be changed, especially where the prejudice to the insured arose from express contractual provisions rather than from rules of law as such. Secondly, it took the view that legislation to alleviate the position of the insured would involve interference with the liberty of contract of the parties and that the desirability of such legislation was a broad question of social policy outside its competence.

However, the Committee was still able to make three proposals for law reform:

(i) that, for the purposes of any contract of insurance, no fact should be deemed material unless it would have been considered material by a reasonable insured;

(ii) that notwithstanding anything contained or incorporated in a contract of insurance, no defence to a claim thereunder should be maintainable by reason of any misstatement of fact by the insured, where the insured can prove that the statement was true to the best of his knowledge and belief;

(iii) that any person who solicits or negotiates a contract of insurance should be deemed, for the purposes of the contract, to be the agent of the insurers, and that the knowledge of such person should be deemed to be the knowledge of the insurers.

¹⁶⁹Law Reform Committee 5th Report, Jan. 1957: Cmnd.62.

The limited scope of the recommendations can be attributed to the initial observations, outlined above, which the Committee made in respect of its review¹⁷⁰. However, despite their limited scope, the recommendations failed to make further progress and it was not until the introduction of the Unfair Contract Terms Bill¹⁷¹ that the issue of legislation regarding insurance contract law was once again subjected to serious consideration.

3. Law Reform versus Self-Regulation

The Unfair Contract Terms Act 1977 was designed, *inter alia*, to introduce a test of "reasonableness" in respect of terms in "standard form" contracts. The Act does not apply to insurance contracts¹⁷². The "consideration" for this exemption was the agreement by the insurance industry to draw up and implement "Statements of Practice". These were published in 1977: the Non-Life Statement was subscribed to by the British Insurance Association and Lloyd's, whilst the Life Statement was subscribed to by the two dominant industry associations¹⁷³. Although the Statements are not applicable to insurers who are not members of these bodies, the Department of Trade and Industry has indicated that it expects all insurers to comply with the spirit and letter of the Statements¹⁷⁴.

¹⁷⁰R.A. Hasson, *op.cit.*, observed that "The analysis of the doctrine [of *uberrima fides*] is extremely superficial and the proposals for its reform timid and confusing".

¹⁷¹Which became the Unfair Contract Terms Act 1977.

¹⁷²Schedule 1(1)(a) disapplies ss.2-4 for the purposes of English law and s.15(3)(a)(i) disapplies ss.16-18 for the purposes of Scots law.

¹⁷³The Life Offices Association and the Association of Scottish Life Offices (now superseded by the Association of British Insurers).

¹⁷⁴See R. Lewis, "Insurers' Agreements not to Enforce Strict Legal Rights", 48 MLR (1985) 275. The vast majority of insurers belong to the Association of British Insurers which is now the industry association for both life and non-life insurers.

The Statements remedied, on the basis of self-regulation, several of the problems which had been identified over the years; they are applicable only to individuals who insure in a private capacity. The following provisions of the (1977) Non-Life Statement were particularly important:

Clause 1. Proposal Forms

(a) The declaration at the foot of the proposal form should be restricted to completion according to the proposer's knowledge and belief.

(c) Those matters which insurers have found generally to be material will be the subject of clear questions in proposal forms.

This gave effect to the second of the Law Reform Committee's recommendations (above). However, the 1977 Statement of Practice did not follow the Committee's recommendation in respect of the definition of "material", opting instead for a formula based on the judgement of the insurer. Nevertheless, the introduction of a requirement, in cases of repudiation of liability by the insurer, of a causal connection between a breach of warranty and a loss went beyond the Committee's recommendations:

Clause 2. Claims

(b) Except where fraud, deception or negligence is involved, an insurer will not unreasonably repudiate liability to indemnify a policyholder:

(i) on the grounds of non-disclosure or misrepresentation of a material fact where knowledge of the fact would not materially have influenced the insurer's judgement in the acceptance or assessment of the insurance;

(ii) on the grounds of a breach of warranty or condition where the circumstances of the loss are unconnected with the breach.

The emergence of self-regulation as the primary means of controlling the relationship of the parties to an insurance contract did not escape criticism. Professor Gordon Borrie remarked in 1982¹⁷⁵:

"I do not think the balance between legal regulation and self-regulation is right at present because the basic law about disclosure

¹⁷⁵In an address to the Insurance Institute of London. Extracted from Regulation of Insurance in the United Kingdom and Ireland (editors T.H. Ellis and J.A. Wiltshire).

and warranties is unsatisfactory and only legislation can alter that. But there is scope for self-regulation to complement the law because there are many matters of good insurance practice that are simply not suitable for legal regulation."

Professor Gower, the architect of the Financial Services Act 1986, referring to insurance in his Review of Investor Protection in 1984 said:

"There is a growing habit, both in this field and elsewhere for regulators, whether governmental regulators or self-regulators, to promulgate Codes of Conduct rather than rules or regulations. In the course of my preliminary discussions, disquiet has been expressed about this practice - a disquiet that I share."

However, these criticisms were to have little or no impact on the subsequent development of the insurance law reform debate.

4. The Outcome of the Law Reform Debate

The industry's desire for self-regulation was clearly vindicated by the acceptance of the Statements of Practice as adequate protection for the insured, but the issue of law reform was not dead. The publication of the European Commission's draft Insurance Contract Law Directive¹⁷⁶ in 1979 served not only to illustrate the divergence of approach within the Community, but also the gap in the United Kingdom between law and practice. The draft Directive was referred to the Law Commission, which subsequently published its findings in a Command Paper¹⁷⁷.

From the outset, the Law Commission made clear that it regarded the existing law on non-disclosure and breach of warranty as in need of reform, and that the Statements of Insurance Practice were not adequate:

"The mischiefs in the present law cannot be cured by voluntary matters of self-regulation by the insurance industry such as Statements of

¹⁷⁶COM (79) 355 as amended by COM (80) 854.

¹⁷⁷Cmd. 8064, Insurance Law: Non-Disclosure and Breach of Warranty (Law Commission Report 104).

Insurance Practice. In the absence of effective administrative control of underwriting, reform of the law is therefore required."¹⁷⁸

However, it was also acknowledged by the Law Commission that the proposed Directive would do little or nothing to remedy the defects and would freeze the law in the United Kingdom permanently in an unsatisfactory state¹⁷⁹. The recommendations for law reform were made in the knowledge that the future of the draft Directive was uncertain and that there was some possibility of any immediate change to the law in the United Kingdom being subsequently amended by legislation implementing the Directive.

The key recommendations of the Law Commission were as follows¹⁸⁰:

(i) Non-disclosure. The duty of disclosure should be retained but modified along the lines suggested by the Fifth Report of the Law Reform Committee (i.e. the test of the "reasonable insured"). The adoption of special rules for those who apply for insurance as consumers was rejected.

(ii) Proposal forms. The duty to volunteer information in addition to answering the questions in the proposal form should be retained. The duty would be the same as the duty of disclosure when there is no proposal form.

(iii) Warranties. A term of a contract of insurance should only be capable of constituting a warranty if it is material to the risk. Where the insured is in breach of warranty the insurer should prima facie be entitled to reject claims in respect of all losses which occur after the date of the breach. However, where the insured shows that the breach was not material to the loss, he should be entitled to recover.

(iv) "Basis of contract" clauses. Such clauses should be ineffective for the purposes of the creation of warranties as to past or present fact. However, the present law should be allowed to remain effective as regards the creation of warranties relating to the future ("promissory warranties").

(v) Non-fraudulent misrepresentation. The insurer should be limited to his rights and remedies for non-disclosure where the insured has made an actionable misrepresentation and has by doing so acted in breach of the modified duty of disclosure outlined in (i) above.

¹⁷⁸ Cmnd. 8064, para. 10.5.

¹⁷⁹ Ibid., para. 1.21.

¹⁸⁰ Ibid., part 10. This section paraphrases the recommendations.

These recommendations, *inter alia*, were incorporated into a draft Insurance Law Reform Bill, which was subsequently introduced to Parliament. However, the bill failed to reach the statute book. Once again a solution was reached by means of self-regulation. The 1977 Non-Life Statement¹⁸¹ was amended to include the following provision in respect of "basis of contract" clauses:

"Neither the proposal form nor the policy shall contain any provision converting the statements as to past or present fact in the proposal form into warranties. But insurers may require specific warranties about matters which are material to the risk."¹⁸²

A similar change was made to the 1977 Life Statement¹⁸³, although warranties may still be created through "basis of contract clauses" where the warranty relates to a statement of fact concerning the life to be assured under a life of another policy. Furthermore, the test of "materiality" in clause 2(b)(i) of the 1977 Non-Life Statement was changed to that of a reasonable insured, in line with the recommendation of the Law Commission¹⁸⁴. The latter's recommendation in respect of remedies for innocent misrepresentation was also introduced into the revised Statements¹⁸⁵.

With the demise of the Law Reform Bill and the draft Directive, the result is that insurance contract law in the United Kingdom applies in its entirety only to commercial insurances. The principles set out in the early legislation and case-law are far removed from those incorporated in the industry's Statements of Practice. In relation to policies purchased in a private capacity, the Statements have largely

¹⁸¹Its name was also changed to the Statement of General Insurance Practice.

¹⁸²This became para.1(b) of the revised Statement.

¹⁸³Para. 1(b) of the revised Statement, now referred to as the Statement of Long-Term Insurance Practice.

¹⁸⁴A similar amendment was made to the Life Statement of Practice (new para. 3).

¹⁸⁵Generally on the revised Statements, see A. Forte, "The revised Statements of Insurance Practice: cosmetic change or major surgery?" 49 MLR (1986) 754.

remedied the abuses which arose from the application of the existing law.

However, the heavy reliance placed on self-regulation is open to criticism on two grounds. The first is that it should not be the primary means of regulating economic relationships into which most people at some time in their life will enter¹⁸⁶. Contract law should provide a framework to govern the rights and obligations of the parties to an insurance policy. There is a role for self-regulation in relation to the working practices of insurers but not, it is submitted, in matters as fundamental as the law on disclosure and warranties. Secondly, self-regulation is not an appropriate mechanism for law reform in the context of the Single Market. As was made clear in part 1 of this chapter, the Statements of Practice give rise to problems in situations in which either English or Scots law is the applicable law for policyholders resident outside the United Kingdom or for policyholders resident in the United Kingdom who purchase insurance on a services basis from insurers in other Member States.

H. CONCLUSIONS

1. The Determination of English or Scots Law as the Applicable Law

The rules governing the determination of the applicable law for insurance contracts in the Single Market are to be found primarily in the Second Directives which now form part of the law in the United Kingdom. However, these rules are to be applied subject to the more general rules governing the law applicable to contracts found in the Rome Contracts Convention which has also been incorporated in the law in the United Kingdom

Where a policyholder is resident in the United Kingdom, a free choice of law will generally be available. Where no choice has been made, the applicable law will normally be that of England or Scotland. The

¹⁸⁶In the United Kingdom, life assurance often constitutes an individual's largest or only means of discretionary saving.

Conduct of Business rules in the United Kingdom will apply irrespective of any choice of law and policyholders purchasing insurance in a private capacity will normally benefit from the Statements of Insurance Practice.

Where a policyholder is not resident in the United Kingdom the insurance Directives ensure, in the case of "large " risks, that a free choice is available. However, in other cases, the availability of the law in the United Kingdom as the applicable law depends on the law of the Member State whose law is prima facie the applicable law. A choice of English or Scots law will not prejudice the application of local Conduct of Business Rules and will not allow the the insured to benefit from the Statements of Insurance Practice.

2. Substantive Aspects of the Law in the United Kingdom

Several considerations should be taken into account when a choice of English or Scots law as the applicable law is under consideration. First, there are few restrictions on freedom of contract in the United Kingdom. The control of contract terms, whether through administrative control or mandatory provisions of contract law has been rejected in the United Kingdom. The Framework Directives aim to abolish prior approval of contract terms throughout the Community but mandatory provisions of contract law will remain in place in other Member States. Secondly, a narrow approach towards insurable interest has been adopted, at least in English law, although there is no requirement for interest at inception for non-life contracts. Thirdly, the test of materiality in CTI v Oceanus imposes a heavy duty of disclosure on a proposer for commercial insurances. Finally, as regards insurances purchased in a private capacity, the Statements of Insurance Practice, although not part of the law, considerably strengthen the position of the insured.

There are two areas in which Scots and English law may diverge: insurable interest and the test of materiality. As regards insurable interest, there are grounds for arguing that Scots law adopts a wider definition than does English law. As regards the test of materiality

for the purposes of establishing non-disclosure, the test of CTI v Oceanus has been neither adopted nor rejected in Scotland, with the result that there is some uncertainty as to the Scots test of materiality.

CONCLUSIONS

Conclusions have already been reached in respect of the topics discussed in each individual chapter. However, it is now appropriate to bring them together so as to reach an overall assessment of the treatment of insurance contract law within the Single Market.

1. Objectives of the Single Market in Insurance

The creation of the Single Market in insurance is intended to achieve two objectives. The first is the operation of a "single licence" which enables an insurer authorised in one Member State to do business elsewhere in the Community without the need for separate authorisation. This involves the Member State in which an insurer has its head office assuming responsibility for the supervision of its entire business. The second is that purchasers of insurance in the Community should be offered the widest possible choice. This is achieved by improving access to national markets through the operation of the "single licence" and by prohibiting the prior approval of policy conditions and premium rates as a condition for authorisation.

The first objective has met with greater success than the second. Whilst the working of the system will no doubt identify scope for improvements, the "single licence" system represents an innovative, and, in the main, coherent approach towards the regulation of insurance business within the Single Market. Two aspects of the "single licence" system are particularly important. First, it is de-regulatory in that it improves access to national markets and reduces the extent to which insurance products are subject to prior approval. Secondly, it leaves scope for competition between national regulatory systems by applying the principle of mutual recognition to those national laws and regulations which have not been harmonised by the insurance Directives.

The objective of securing increased choice for consumers has met with less success. Two considerations are relevant in this respect. First, the Community's system of regulation has not fully addressed issues arising in relation to the role of intermediaries who play a crucial role in ensuring that a wide choice of products is available to consumers. The Court of Justice avoided the issue in the insurance cases and the Commission recommendation on intermediaries represents a limited and transitional measure. However, as the Single Market in insurance becomes a reality, differences in national regulations governing the qualifications, status and conduct of intermediaries will have to be addressed. Secondly, in contrast to the trend in trade in goods, insurers have not, in the main, responded to de-regulation by developing products to be sold on a pan-European basis or by selling their existing product range in other countries. Instead, attention has focused on expansion into other Community countries by way of establishment, with products being tailored for each individual market. This reflects a variety of influences which lie outside the regulatory framework for the Single Market : they include the absence of fiscal harmonisation; the need to establish a local presence to service business; and differences in insurance practice and consumer preferences between the different Member States. However, the failure to secure increased choice for consumers can also be attributed to the manner in which the Community has approached insurance contract law. The failure of initial efforts to harmonise insurance contract law led the Community to adopt a complex system of rules governing the applicable law. The result is that insurance contracts purchased within the Single Market will be governed by differing provisions of contract law. Such differences alter the fundamental nature of insurance contracts and also limit the extent to which products lawfully marketed in one Member State can be marketed in other Member States. For the reasons set out in paragraphs two to four below, consumer choice would be better served by a renewed effort to harmonise the essential provisions of insurance contract law.

2. The Regime for Insurance Contract Law

Differences in insurance contract law among the Member States give rise to several issues which affect the functioning of the Single Market. First, there is a need to identify the applicable law in the case of services business. Secondly, the impact which differences in contract law have on competition should be considered. Thirdly, the extent to which national laws safeguard consumer interests is relevant if consumers in one Member State are to enter into a contract governed by the laws of another Member State. Finally, consideration must be given to provisions of insurance contract law which contain restrictions which are not compatible with the EEC Treaty or the provisions of the insurance Directives.

The solution adopted by the Community addresses only the first of these issues. The rules in the insurance Directives are intended to govern choice of law, where a choice is allowed, and to identify the applicable law where no choice is allowed. In addition to the failure to address the broader issues which arise from differences in contract law, the provisions of the insurance Directives can be criticised on several other grounds. First, the complexity of the rules is likely to hinder the development of cross-border insurance business. Many policyholders are likely to be unfamiliar with the rules which determine whether the applicable law is governed by the Rome Contracts Convention, the insurance Directives or national choice-of-law rules. Secondly, the rules applicable to insurance differ from those applicable to banking, despite the declared objective of the creation of a "level playing field" in financial services within the Community. Thirdly, in cases where a broker acts for the insured, the choice of law rules which apply to the insured/broker relationship differ from those applicable to the insurer/insured relationship.

3. Differences in Insurance Contract Law

The Community's approach to contract law within the Single Market programme means that fundamental differences between the Member States remain in place. A comparative analysis of the insurance contract laws in the United Kingdom, France and Germany leads to the following conclusions:

(a) There are differences in the overall approach to the regulation of insurance contracts. Some Member States, such as France and Germany, control contract terms and rates through administrative procedures, whilst others, such as the United Kingdom, do not.

(b) The interaction of the general law controlling the terms of contracts with insurance contract law varies between Member States.

(c) The extent to which provisions of the insurance contract laws of individual Member States can be overridden by specific agreement of the contracting parties varies. Some Member States, such as the United Kingdom, have few mandatory requirements of contract law, whilst others, such as France, adopt an approach in which the bulk of their contract law is mandatory. The result is that freedom of contract in the field of insurance varies significantly throughout the Community as a result of differences in contract law.

(d) There are important differences in the substance of insurance contract laws relating to the negotiation of the contract, its performance and its termination.

The effect of these differences is that the rights and duties which attach to the insurer/policyholder relationship vary substantially according to the law which governs the contract. The regulatory framework within which contracts are concluded also differs materially. Even with the abolition of prior approval of contract terms and rates which will follow implementation of the Framework Directives,

administrative controls will remain in place in markets such as France and Germany. Moreover, mandatory requirements of contract law have the effect of limiting the impact of the abolition of prior approval of contract terms as certain contract conditions remain compulsory.

4. Harmonisation as an alternative to Choice-of-Law Rules

Harmonisation of insurance contract law should be considered as an alternative to the approach adopted by the Community. This would allow the broader issues which arise in relation to differences in contract law - competition, consumer protection, freedom of contract - to be addressed.

Article 100A of the EEC Treaty provides an adequate legal basis for a harmonisation measure. Differences in insurance contract law can be regarded as having an impact on the functioning of the Single Market for three reasons. First, they distort competition. Policyholders and insurers in different Member States have different rights and obligations with the result that purchasers of the same product in different Member States are treated differently. Secondly, they permit divergence in freedom of contract and freedom of choice of law among Member States whereas the objectives of the Single Market Programme are to harmonise the regime governing control of policy conditions and choice of law. Finally, differences in insurance contract law allow greater reference to the "general good" in order to restrict freedom of services than would be possible with harmonisation. Moreover, harmonisation of insurance contract law would be in accordance with the principle of subsidiarity. Although it falls into an area of shared competence, the scale and effect of such a harmonisation measure suggests that Community action is appropriate.

If the Community reverts to a policy of harmonisation, there are a variety of ways in which it could be implemented. The scope of a harmonisation Directive could be confined to mandatory provisions of contract law or could encompass all fundamental provisions. The

harmonisation technique could be based on minimum, optional or uniform harmonisation. However, the original approach adopted by the Commission (uniform harmonisation of fundamental provisions) would be best suited to the objectives of the Single Market even if the original proposals for harmonisation are likely to require substantial amendment.

5. United Kingdom Law in the context of the Single Market

The rules governing the determination of the applicable law for insurance contracts in the Single Market are to be found primarily in the Second Directives which now form part of the law in the United Kingdom. However, those rules are to be applied subject to the more general rules governing the law applicable to contracts found in the Rome Contracts Convention which has also been adopted as law in the United Kingdom.

Where a policyholder is resident in the United Kingdom, a free choice of law will generally be available. Where no choice has been made, the applicable law will normally be that of England or Scotland. The Conduct of Business rules in the United Kingdom will apply irrespective of any choice of law and policyholders purchasing insurance in a private capacity will normally benefit from the Statements of Insurance Practice.

Where a policyholder is not resident in the United Kingdom the insurance Directives ensure, in the case of "large " risks, that a free choice is available. However, in other cases, the availability of the law in the United Kingdom as the applicable law depends on the law of the Member State whose law is prima facie the applicable law. A choice of English or Scots law will not prejudice the application of local Conduct of Business Rules and will not allow the insured to benefit from the Statements of Insurance Practice.

Several considerations should be taken into account when a choice of English or Scots law as the applicable law is under consideration.

First, there are few restrictions on freedom of contract in the United Kingdom. The control of contract terms, whether through administrative control or mandatory provisions of contract law has been rejected in the United Kingdom. The Framework Directives aim to abolish prior approval of contract terms throughout the Community but mandatory provisions of contract law will remain in place in other Member States. Secondly, a narrow approach towards insurable interest has been adopted, at least in English law. Thirdly, the test of materiality in CTI v Oceanus imposes a heavy duty of disclosure on a proposer for commercial insurances. Finally, as regards insurances purchased in a private capacity, the Statements of Insurance Practice, although not part of the law, considerably strengthen the position of the insured.

APPENDIX 1

SUMMARY OF RELEVANT COMMUNITY MEASURES

DIRECTIVE (OJ Ref.)	SUBJECT	TITLE	STATUS
64/225 (OJ Spec. Ed. 1963/131)	Reinsurance	Council Directive of 25.2.1964 on the abolition of restrictions on freedom to provide services in respect of reinsurance and retrocession.	In force
72/166 (OJ 1972 L103/1)	Motor Insurance	Council Directive of 24.4.1972 on the approximation of the laws of the Member States relating to insurance against civil liability in respect of the use of motor vehicles, and to the enforcement of the obligation to insure against such liability. (Referred to as the First Motor Directive)	In force
73/239 (OJ 1973 L228/3)	Direct Non-Life Insurance	First Council Directive of 24.7.1973 on the co-ordination of laws, regulations and administrative provisions relating to the take up and pursuit of direct insurance other than life assurance. (Referred to as the First Non-Life Directive)	In force
73/240 (OJ 1973 L228/20)	Direct Non-Life Insurance	Council Directive of 24.7.1973 abolishing restrictions on freedom of establishment in the business of direct insurance other than life assurance.	In force
77/92 (OJ 1977 L26/14)	Insurance Intermediaries	Council Directive of 13.12.1976 on measures to facilitate the effective exercise of freedom of establishment and freedom to provide services in respect of activities of insurance agents and brokers and, in particular, transitional measures in respect of those activities.	In force
78/473 (OJ 1978 L151/25)	Co-insurance	Council Directive of 30.5.1978 on the co-ordination of laws, regulations and administrative provisions relating to Community co-insurance.	In force

79/267 (OJ 1979 L63/1)	Direct Life Assurance	First Council Directive of 5.3.1979 on the co-ordination of laws, regulations and administrative provisions relating to the taking up and pursuit of the business of direct life assurance. (Referred to as the First Life Directive)	In force
84/5 (OJ 1984 L8/17)	Motor Insurance	Second Council Directive of 30.12.1983 on the approximation of the laws of the Member States relating to insurance against civil liability in respect of the use of motor vehicles. (Referred to as the Second Motor Insurance Directive)	In force
88/357 (OJ 1988 L172/1)	Direct Non- Life Insurance	Second Council Directive of 22.6.1988 on the co-ordination of laws, regulations and administrative provisions relating to direct insurance other than life assurance and laying down provisions to facilitate the effective exercise of freedom to provide services and amending Directive 73/239. (Referred to as the Second Non-Life Directive or the Non-Life Services Directive)	In force subject to derogations
90/232 (OJ 1990 L129/33)	Motor Insurance	Third Council Directive of 14.5.1990 on the approximation of the laws of the Member States relating to insurance against civil liability in respect of the use of motor vehicles. (Referred to as the Third Motor Directive)	In force subject to derogations
1534/91 (OJ 1991 L143/1)	Competition	Council Regulation of 31.5.1991 on the application of Article 85(3) of the Treaty to certain categories of agreements, decisions and concerted practices in the insurance sector.	In force

90/618 (OJ 1990 L330/44)	Motor Insurance	Council Directive of 8.11.1990 amending particularly regarding motor vehicle liability insurance, Directive 73/239 and Directive 88/357 which concern the co-ordination of laws, regulations and administrative provisions relating to direct insurance other than life assurance. (Referred to as the Motor Services Directive)	In force
90/619 (OJ 1990 L330/90)	Direct Life Assurance	Second Council Directive of 8.11.1990 on the co-ordination of laws, regulations and administrative provisions relating to direct life assurance, laying down provisions to facilitate the effective exercise of freedom to provide services and amending Directive 79/267. (Referred to as the Second Life Directive or the Life Services Directive)	In force subject to derogations
91/674 (OJ 1991 L374/7)	Insurance Accounts	Council Directive of 19.12.1991 on the annual accounts and consolidated accounts of insurance undertakings.	In force 1.1.1994
91/675 (OJ 1991 L374/32)	Insurance Committee	Council Directive of 19.12.1991 setting up an Insurance Committee.	In force
92/48 (OJ 1992 L19/32)	Insurance Intermediaries	Commission Recommendation of 18.12.1991 on insurance intermediaries.	In force
92/49 (OJ 1992 L228/1)	Direct Non- Life Insurance	Council Directive of 18.6.1992 on the co-ordination of laws, regulations and administrative provisions relating to direct insurance other than life assurance and amending Directives 73/239 and 88/357. (Referred to as the Third Non-Life "Framework" Directive)	In force 1.7.1994 subject to derogations
92/96 (OJ 1992 L360/1)	Direct Life Assurance	Council Directive of 10.11.1992 on the co-ordination of laws, regulations and administrative provisions relating to direct life assurance and amending Directives 79/267 and 90/619. (Referred to as the Third Life "Framework" Directive)	In force 1.7.1994 subject to derogations

APPENDIX 2

COM(80) 854 final; 16th December, 1980

Amendment of the proposal for a Council Directive on the co-ordination of laws, regulations and administrative provisions relating to insurance contracts.

(Submitted to the Council by the Commission pursuant to the second paragraph of Article 149 of the EEC Treaty)

THE COUNCIL OF THE EUROPEAN COMMUNITIES,

Having regard to the Treaty establishing the European Economic Community, and in particular Articles 57(2) and 66 thereof;

Having regard to the proposal from the Commission;

Having regard to the opinion of the European Parliament¹;

Having regard to the opinion of the Economic and Social Committee²;

Whereas, pursuant to the Treaty, any discrimination in relation to the provision of services which is based on the fact that an undertaking is not established in the Member State in which the service is provided has been prohibited since the end of the transitional period; whereas this prohibition applies to services provided from any establishment in the Community, whether it is the head office of an undertaking or an agency or branch;

Whereas the second Council Directive³ of [22nd June 1988] on the co-ordination of laws, regulations and administrative provisions relating to direct insurance other than life assurance and laying down provisions to facilitate the effective exercise of freedom to provide services, granted the parties freedom to choose the law applicable to the contract, firstly in the case of risks classified as transport, primarily on account of their frequently international character, and secondly in the case of certain risks which are defined by precise criteria;

Whereas co-ordination of laws relating to insurance contracts would facilitate the provision of services in a Member State by those providing them in another Member State;

Whereas in co-ordinating the laws relating to insurance contracts it

¹Minutes of proceedings of the sitting of 19.9.1980 (PE 66.785, p.27).

²OJ 1980 C146/1.

³Directive 88/357, OJ 1988 L172/1. The reference to this Directive was left blank as it had not been adopted.

is necessary to maintain the fairest balance between the interests of the insurer on the one hand and the protection of the insured person on the other; whereas such co-ordination is likely to facilitate an extension of the freedom of choice of the law applicable to the choice of the law applicable to the contract;

Whereas it was considered advisable to exclude from the scope of the Directive, marine, aviation and transport insurance because of their widely international character and the freedom traditionally allowed to the parties in concluding such contracts, and sickness insurance which in some cases is operated in a manner similar to life assurance and has special technical features; whereas the credit and suretyship insurance classes display peculiarities which, pending subsequent co-ordination, justify not making them subject to the provisions of this Directive as they stand;

Whereas among the problems posed by legislation on insurance contracts are the consequences resulting from the conduct of the policyholder at the time of the conclusion and in the course of the contract concerning the declaration of the risk and of the claim, and with regard to the measures to be taken in the event of a claim;

Whereas it is also desirable to co-ordinate the law relating in particular to the existence of cover depending on the payment of the premium, the duration of the contract, and the position of insured persons who are not policyholders;

Whereas, as regards the problems regulated in this Directive, Member States may be authorised to adopt different solutions only where this is expressly provided for in the text of the Directive; whereas any other approach would call into question the objectives of the Directive; whereas, however, there is nothing to prevent the parties from derogating from the provisions adopted pursuant to the Directive, provided that such derogations favour the policyholder, insured person or third party;

HAS ADOPTED THIS DIRECTIVE:

Article 1

The object of this Directive is to co-ordinate the important laws, regulations and administrative provisions governing insurance contracts covering risks situated in Member States of the Community and relating to one of the classes contained in point A of the Annex to Directive 73/239/EEC of 24 July 1973 on the co-ordination of laws, regulations and administrative provisions relating to the taking-up and pursuit of the business of direct insurance other than life assurance⁴, with the exception of the classes contained in points 2 (sickness), 4 (railway rolling stock), 5 (aircraft), 6 (ships (sea, lake, river and canal vessels)), 7 (goods in transit), 11 (aircraft liability), 12 (liability for ships (sea, lake and river and canal vessels)), 14 (credit) and 15 (suretyship).

⁴OJ 1973, L228/3.

Article 2

1. Every insurance contract shall give rise to the issue to the policyholder of a document containing at least the following information:

(a) the name and address of the policyholder; name and registered office of the insurer or co-insurers; address of the establishment to which the policyholder is to send his declarations and pay the premiums;

(b) the subject matter of the insurance, any exclusions and a description of the risks covered;

(c) the amount insured or the method of calculating it;

(d) the amount of the premium or contribution or the method of calculating it;

(e) the dates on which premiums or contributions fall due;

(f) the duration of the contract and the times at which cover commences and expires and, where it applies, the time of automatic renewal.

2. Pending the issue of such a document the policyholder shall be entitled to receive, without delay, a document which attests to the existence of an insurance contract and contains at least the information referred to in paragraph 1(a), (b) and (c).

3. If, after the contract has been concluded, any agreed change occurs that affects the information referred to under paragraph 1(a) to (f), the insurer shall furnish the policyholder with a document containing information as to such change.

4. If provisional cover is provided, the policyholder shall be entitled to receive a document which contains the information that such cover has in fact been provided and which contains at least the information referred to in paragraph 1(a), (b), (c) and (f).

5. The documents referred to in paragraphs 1, 2, 3 and 4 shall be drafted in the language of the Member State whose law is applicable according to the second Council Directive 88/357 of 22nd June 1988⁵.

However, the policyholder shall be entitled to stipulate as a condition precedent to the conclusion of the contract that all documents relating to the conclusion, amendment and performance of the insurance contract be drafted in the language of his habitual residence, provided such language is an official language of the Community.

6. The documents referred to in the above paragraph shall have only a probative value.

⁵The reference to this Directive was left blank as it had not been adopted.

7. Notwithstanding the provisions of this Article, the laws of the Member States may authorise a simplified form for insurance contracts concluded for a period of less than six months and for bearer policies.

Article 3

1. When concluding the contract, the policyholder shall declare to the insurer any circumstances of which he ought reasonably to be aware and which he ought to expect to influence a prudent insurer's assessment or acceptance of the risk. The policyholder shall not be obliged to declare to the insurer circumstances of which the latter is already aware because he has already covered the risk. In the case of a corporate policyholder, circumstances of which it ought reasonably to be aware means circumstances of which the appropriate officer of the corporation ought reasonably to have been aware. Any circumstances in respect of which the insurer has asked specific questions in writing shall, in the absence of proof to the contrary, be regarded as influencing the assessment and acceptance of the risk.

2.(a) If circumstances existing at the time of entering into the contract which were unknown to both parties when the contract was concluded come to light subsequently, or if the policyholder has failed to declare circumstances of which he was aware but which he did not expect to influence a prudent insurer's assessment of the risk, the insurer or the policyholder shall be entitled, within a period of two months from the date on which he becomes aware of the fact, to propose an amendment to or termination of the contract.

- Where one of the parties proposes an amendment to the contract, the insurer shall be entitled to a period of fifteen days and the policyholder to a period of one month from the date of the receipt of the proposal in which to accept or reject it. In the event of rejection of the proposal or failure to reply within the above time limit, the party proposing the amendment may terminate the contract within a period of eight days.

Termination shall not take effect until a period of fifteen days has elapsed from the date on which notice of termination is given, as the case may be, to the insurer or to the policyholder at his last known address.

The abovementioned periods shall be extended to three weeks and one month where they are to the policyholder's benefit and the contract covers a risk which is not connected with a commercial or industrial activity of the policyholder.

- Where one of the parties proposes that the contract be terminated, termination shall not take effect until a period of fifteen days has elapsed from the date on which notice of termination is given to the insurer or to the policyholder at his last known address.

- The abovementioned period shall be extended to one month where the insurer terminates the contract and the contract covers a risk which is not connected with a commercial or industrial activity of the policyholder.

(b) If the contract is terminated, the insurer shall refund to the policyholder the proportion of the premium in respect of the period for which cover is not provided.

(c) If a claim arises before the contract is amended or before termination of the contract has taken effect, the insurer shall provide the agreed cover.

3.(a) If the policyholder has failed to fulfil the obligation referred to in paragraph 1, the insurer may, within two months from the date on which he becomes aware of such fact, propose an amendment to the contract or terminate it.

- Where the insurer has proposed an amendment to the contract, the policyholder shall be entitled to accept or reject it within one month from the date on which he receives the proposal for an amendment. If the policyholder refuses the proposal or fails to reply, the insurer may terminate the contract within eight days. Termination shall not take effect until a period of fifteen days has elapsed from the date on which the policyholder is notified thereof at his last known address.

- Where the insurer terminates the contract, termination shall take effect fifteen days after the date on which the policyholder is notified thereof at his last known address.

(b) If the contract is terminated, the insurer shall refund to the policyholder the proportion of the premium in respect of the period for which cover is not provided.

(c) If a claim arises before the contract is amended or before termination of the contract has taken effect, the insurer shall pay the policyholder a proportion of the compensation which would have been payable had the policyholder not failed to fulfil his obligations under paragraph 1 equal to the ratio between the agreed premium and the premium which a prudent insurer would have fixed if the policyholder had fulfilled his obligations under paragraph 1. However, if the insurer can show that no prudent insurer would have accepted the risk regardless of the rate of premium if he had been aware of the circumstances which the policyholder should have disclosed, or if the insurer can show that a prudent insurer would not have accepted the risk unless certain conditions were complied with, he shall not be bound to pay any claim.

4.(a) If the policyholder has failed to fulfil the obligation referred to in paragraph 1 with the intention of deceiving the insurer, the latter may terminate the contract within two months from the date on which he becomes aware of such fact.

(b) By way of damages, premiums shall be retained by the insurer who shall be entitled to the payment of all premiums due, without prejudice to the payment of damages in respect of any additional losses he has incurred by reason of the intention to deceive.

(c) The insurer shall not be liable in respect of any claim.

5. In the cases referred to in paragraphs 3 and 4, the burden of proof of failure to fulfil the obligation referred to in paragraph 1 or of intention to deceive on the part of the policyholder shall rest on the insurer.

Article 4

1. From the time when the contract is concluded, the policyholder shall declare to the insurer any new circumstances or change in circumstance of which the insurer has requested notification in the contract. Such declaration shall be made not later than the time when the risk increases where this is attributable to an intentional act of the policyholder; in all other cases, it must be made immediately the policyholder becomes aware of the increase.

2. The insurer may, within two months of the date on which he became aware of the increase of risk, propose an amendment to or terminate the contract in accordance with the provisions covering such circumstances set out in Article 3(2).

3. If the policyholder has failed to fulfil the obligation referred to in paragraph 1, such failure to give notice shall not give rise to any sanction where it relates to a new circumstance or change in circumstances which is liable neither to increase the risk appreciably or permanently nor lead to an increase in the premium.

4. If the policyholder has failed to fulfil the obligation referred to in paragraph 1, the insurer may, within two months of the date on which he becomes aware of such fact, propose an amendment to the contract or terminate it in the manner provided for in Article 3(3). However, in respect of the application of the proportionality provided for in Article 3(3)(c) account shall be taken only of the portion of premium corresponding to the period subsequent to the increase.

5.(a) If the policyholder has failed to fulfil the obligation referred to in paragraph 1, with the intention of deceiving the insurer, the latter may terminate the contract within two months from the date on which he becomes aware of such fact.

(b) By way of damages, any premiums paid shall be retained by the insurer who shall be entitled to the payment of all premiums due without prejudice to the payment of damages in respect of any additional losses he has incurred by reason of the intention to deceive.

(c) The insurer shall not be liable in respect of any claim arising after the increase of the risk.

6. In the cases referred to in paragraphs 4 and 5, the burden of proof of failure to fulfil the obligation referred to in paragraph 1 or of intention to deceive on the part of the policyholder shall rest on the insurer.

7. The provisions of this Article shall not apply to circumstances which form the subject of an express exclusion of cover in the contract.

Article 5

If, while the contract is in force, the risk has diminished appreciably and permanently because of circumstances other than those covered by the contract the policyholder may ask for the premium to be reduced. The policyholder shall be entitled to terminate the contract without compensation if the insurer does not consent to reduce the premium proportionately.

The right to terminate the contract shall arise immediately the insurer refuses to reduce the premium or, where he fails to reply to the policyholder's proposals, after a period of fifteen days following such proposal.

Where the contract is terminated, the insurer shall refund to the policyholder a proportion of the premium corresponding to the period for which cover is not provided, less the administrative costs involved.

Article 6

Failure to pay a premium or part thereof shall be penalized only after a period of grace of at least fifteen days has elapsed from the date on which the policyholder is notified, in writing and after the date on which payment is due, of the penalty.

This provision shall not apply to any failure to pay the first premium or the single premium of an annual contract where the contract or the law provides that commencement of cover shall be conditional upon payment of such premium.

Article 7

1. If a claim arises, the policyholder shall take all reasonable steps to avoid or reduce the consequences. In particular, instructions from the insurer or compliance with specific provisions on this point contained in the contract shall be considered reasonable.

2. Any costs incurred by the policyholder in performing the obligation referred to in paragraph 1 shall be borne by the insurer.

Notwithstanding this, where the policyholder carries on a commercial or industrial activity and the contract covers a risk connected with such activity, they shall be defrayed only in so far as, when combined with the amount of the damage suffered, they do not exceed the sum

insured.

3. If the insurer is required, under the contract, to pay in respect of only part of the loss, he shall be obliged to refund only a proportion of the costs referred to in the preceding paragraph unless the policyholder acted on his instructions.

4. If the policyholder fails to comply with the provision laid down in paragraph 1, and may be considered to have acted improperly, the insurer may claim compensation for the loss which he has suffered.

5. If the insurer proves that the policyholder's failure to fulfil the obligation laid down in paragraph 1 was intended to cause him loss or to deceive him, he shall be released from all liability to make payment in respect of the claim.

Article 8

1. If a claim arises or if an event occurs which may result in a claim arising, the policyholder shall declare it to the insurer in accordance with the conditions and time limits laid down in the policy. The time limit must be reasonable. Such time limit may be fixed by national laws for certain classes of insurance.

2. The insurer may require the policyholder to provide all the necessary information and documents on the circumstances and consequences of the claim.

3. If the policyholder fails to fulfil the obligations referred to in paragraphs 1 and 2, and may be considered to have acted improperly, the insurer shall be entitled to claim compensation for the loss he has suffered.

4. If the insurer proves that the policyholder's failure to fulfil one of the obligations laid down in paragraphs 1 and 2 was intended to cause him loss or to deceive him, he shall be released from all liability to make payment in respect of the claim.

Article 9

Any unjustified payment made by the parties pursuant to the foregoing Articles shall be refunded.

Article 10

1. The circumstances and conditions in which the contract may be denounced or terminated shall be set out in the contract either directly or by reference to the law applicable to the contract.

2. The contract may be terminated without notice only where one of the parties has failed to fulfil one of its obligations with the intention of deceiving the other. The policyholder may also be granted a right under national law to terminate the contract without notice in other circumstances.

3. Without prejudice to the circumstances referred to in paragraph 2:

(a) Save where the parties have agreed to a shorter period in the case of war, insurrection or civil war, premature termination on the part of the policyholder or the insurer shall not take effect until a period of fifteen days has elapsed from the date on which notice of termination is given, as the case may be, to the insurer or to the policyholder at his last known address.

(b) If provision is made in the contract for automatic renewal, such renewal shall take effect in each case for a period not exceeding one year, unless one of the parties gives notice of termination at least two months before the date of expiry of the current insurance period.

(c) If the contract is for a period of more than three years, the policyholder may terminate it at the end of the third year or of any subsequent year by giving at least two months' notice, provided that the premiums were not agreed for a fixed period.

Article 11

If the insured person is not the policyholder, he shall have the same rights against the insurer as Article 8(2) grants to the policyholder. He shall be treated in the same way as the latter for the purposes of Articles 3(1), 4(1), 8(1) and 9(1) and (2) as regards the obligations referred to in those Articles where he has knowledge of the contract and is able to fulfil such obligations⁶.

Article 12

The parties to the contract may agree on more favourable terms for the policyholder, insured person or injured third party than are provided for in this Directive.

Article 13

Member States shall bring into force the measures necessary to comply with this Directive before 1 July 1983. They shall inform the Commission thereof immediately.

Article 14

After notification of this Directive, Member States shall ensure that the Commission is informed, in sufficient time for it to submit its comments, of any new laws, regulations or administrative provisions which they intend to adopt. They shall also inform the other Member States thereof.

⁶The references are reproduced as they appear in the (amended) draft Directive. However, following re-arrangement of the Articles, the reference to Article 8(1) should be to Article 7(1) and the reference to Articles 9(1) and (2) should be to Articles 8(1) and (2).

Article 15

This Directive is addressed to the Member States.

APPENDIX 3

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