The Optional Application of the Principles of European Insurance Contract Law

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1. Introduction

The work conducted by the Project Group on a Restatement of European Insurance Contract Law since 1999 is by no means the first attempt to harmonise insurance contract law in Europe. The European Commission had initially proposed the harmonisation of substantive insurance contract law in 1979 as part of its internal market programme.

However, discussions on this item turned out to be very difficult because of the large divergences that existed between the laws of the Member States in those years. While some jurisdictions such as the United Kingdom and the Netherlands would not interfere with the freedom of contract in insurance matters, others like France and Germany had enacted a heavy load of mandatory provisions for the protection of policy holders. A compromise between these two schools of thought appeared to be impossible when the European Community ran out of time in the second half of the 1980s as the 1992 deadline for the implementation of the internal market approached. Moreover, contract law was not the only impediment to the implementation of the single insurance market. Other issues related to the admission of insurance companies to the market, their supervision, their investment policies etc. were held to be more important and to deserve closer attention.

Therefore, the Community institutions finally agreed not to pursue the idea of an approximation of substantive contract law and to enact common conflict rules instead.

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At best, they would provide for the application of one and the same law to a given insurance contract irrespective of the Member State where a claim would be lodged. As a result the insurance Directives of the second generation enacted in 1988 and 1990 contained choice of law provisions for insurance contracts in the non-life and life sectors.

However, these conflict rules were extremely complex and could not even achieve uniformity in this field, since they gave some effect to divergent national conflict rules. What is even more important, they do not allow for the free choice of the applicable law and basically refer to the law of the policyholder, as far as small and medium risks are concerned; therefore insurers will generally abstain from transborder business since they would have to design their products in accordance with foreign law and, if they want to sell them in several national markets, with several national laws. Given the mandatory character of divergent national insurance contract laws, a policy which complies with all these different provisions is almost impossible to draft. The conflicts solution of the Directives of the second generation has recently been transposed into the Rome I-Regulation on the law applicable to contractual obligations. Yet, it has essentially remained unchanged in substance. The internal insurance market therefore can still not be said to be implemented as far as the freedom to provide services is concerned. It is still subject to significant restrictions as far as the conclusion of transborder insurance contracts on small and medium risks is concerned. The conflicts solution therefore has correctly been criticised as a failure.

This was the general feeling of members when the Project Group on a Restatement of European Insurance Contract Law set out to work in 1999. But it is probably correct to say that members had only very vague ideas about what should replace the conflicts solution. A second attempt at harmonisation was probably what most had in mind. This perspective changed when the Commission published its action plan on a more coherent European contract law in 2003 where it contemplated, for the first time, an optional instrument on European contract law. While the advantage of such optional application was not obvious in respect of other types of contract, the Project Group was soon convinced that it was the appropriate solution for insurance contracts. It would have the great advantage of not interfering with national insurance contract law which has been subject to far reaching reform in many Member States throughout the last twenty years and therefore will be defended by vested interests at the national level. At the same time the optional instrument would create a common legal framework for insurance policies sold across Europe. It would thus enable insurers to form all-European risk pools being subject to one and the same contract law.

It is well known that the idea of an optional instrument encountered much criticism in the political discussions ever since 2003. The Commission has therefore watered down its plans to what is called a Common Frame of Reference. The amended plans are difficult to attack since the designation is new and obscure. What would be its role for insurance contract law?

2. Functions of the Common Frame of Reference and its Part on Insurance Contract Law

The role of the future Common Frame of Reference is far from clear until now. The verbosity of the Commission Communication of October 2004 cannot obscure the

poor substance in this respect. The main role of the CFR is said to be a “toolbox” which the Commission can use, “where appropriate when presenting proposals to improve the quality and coherence of the existing *acquis* and future legal instruments in the area of contract law. At the same time it will serve the purpose of simplifying the *acquis*.”

The simplification and consolidation function is limited to the internal use of the Commission and the Council. In so far there appears to be political consensus. Inconsistencies of the *acquis communautaire* in contract law shall be detected in the expectation that the European legislator will avoid them in the future and will amend the existing acts in order to restore consistency. Other functions of the CFR are characterised only as “possible”. According to the Commission Communication the CFR could be used by national legislators as a model for new statutes, by arbitration tribunals looking for balanced solutions, by business associations drafting all-European standard contract terms, by the Commission itself incorporating it into its own contracts or by the European Court of Justice when interpreting the *acquis communautaire*. It is thus left to the single actors of legal life whether they make use of the CFR or not. As a consequence, the CFR has very little in common with traditional legislation. Quite understandably the Commission therefore considers “at this stage” that the CFR would be a non-binding instrument.

According to the Commission’s 2004 Communication the CFR should include a part on insurance contracts. In the light of the CFR functions set forth above, what would be the role of this part? It may be said from the outset that its significance can only be marginal. Insurance contract law is either absolutely mandatory or may not be derogated from to the detriment of the policyholder in most Member States. Neither leave conflict rules much room for a free choice of the applicable law as far as small and medium risks are concerned. Therefore the application of the applicable national law must in the first place aim at the consistency of the solutions in the respective national framework. There is little leeway for the interpretation of that law in the light of a European Frame of Reference.

Standard insurance conditions must in the first place comply with the binding benchmark of mandatory national law; their consistency with the European Frame of Reference does not clear up inconsistencies with mandatory national provisions. It can therefore be taken for granted that the Commission will not incorporate the Common Frame of Reference into the insurance contracts which it concludes itself for example for the cover of fire risks of its own buildings. Just like the insurance contracts of private policyholders the Community’s insurance contracts are governed by the law applicable under the Directives. As long as it is unclear whether they allow parties to chose provisions other than the law of a Member State as the applicable law, the Commission will want its contracts to be governed by the national law of a Member State for reasons of legal security. Since the existing *acquis* only contains very few rules on the substantive insurance contract law, the Court of Justice will hardly ever have an opportunity to interpret the existing Community insurance law in the light of the Common Frame of Reference. It is also doubtful whether national legislators will tailor their insurance statutes on the model of a European Common Frame of Reference. When it comes to the adoption of mandatory rules, the antagonistic interests of suppliers and customers usually lead to grim negotiations; as they proceed the significance of intellectual models

provided by comparative law or by a Common Frame of Reference diminishes more and more.

The remaining function is that of simplification and consolidation. But the *acquis communautaire* does not contain many provisions on substantive insurance contract law. Therefore, conceptual or other inconsistencies or contradictions are very rare in this area. An example is however given by the divergent information duties laid down in Annex 3 of the Life Assurance Directive and Article 3 of the Directive on the Distant Marketing of Financial Services. It would appear however that such isolated overlaps and tensions do not require a comprehensive Frame of Reference. Moreover, it should be kept in mind that some of the inconsistencies are due to the conscious adoption of divergent solutions on related issues by different Directorates General within the European Commission; the policy choice advocated by the Commission, of an amendment of the existing Directives which would address these problems does not appear to be very realistic under such circumstances. There are finally some issues where a coordination of insurance contract law with other parts of the *acquis* should be excluded. Thus, the scope of application of European insurance law extends to small and medium risks, i. e. also to a great number of commercial risks; for objective reasons discussed at length both at the European level and in many Member States, this scope cannot be narrowed to consumer contracts.

To sum up, the need for a special part of the Common Frame of Reference dedicated to insurance contract law is very low. That part would hardly perform the functions attributed to the Common Frame of Reference. It would probably serve as a kind of thesaurus of ideas which may be useful in the drafting process of future legislative acts on single issues of insurance contract law.

3. The Significance of the General Parts of the CFR for Insurance Contract Law

It is one thing to look at the specific part of the CFR on insurance and it is another thing to look at the CFR as a whole including its many general rules and their role in insurance. The significance of the whole structure of the CFR for insurance contract law could of course be much greater than that of the specific insurance contract part.

In fact, the Project Group on a Restatement of European Insurance Contract Law has based its considerations upon the Principles of European Contract Law which are meant to fill gaps of the PEICL, see Article 1:105 (2). Insofar as these general principles and rules contain a satisfactory solution also for insurance contracts, there is no need for special provisions in the part on insurance contract law. Thus, there is no need for the latter to repeat what has been laid down in the former. Where such repetitions occur by way of exception, they are motivated by the Group's decision that a certain rule of the general part has to be immunised against contractual derogations. For example, most of the provisions on prescription contained in the Principles of European Contract Law are very well suited to the needs of insurance, but derogations should only be allowed to the benefit of the policyholder, beneficiary or insured.

This coordination between insurance contract law and general contract law may however confer practical significance to the general part of CFR for its insurance contract part only if this part acquires some practical significance in itself. As pointed

out before, this is largely excluded by the mandatory character of national substantive law and of the conflict rules in this area. The coordination between the insurance contract part and the general parts of the CFR therefore remains an essentially academic exercise. This will only change if the CFR may be chosen by the parties to an insurance contract as an alternative to the national insurance contract law that would be applicable under the conflict rules of the EC Directives.

4. An Optional Instrument

This takes us to the development of the CFR into a so-called optional instrument. Already in its action plan of 2003 the Commission has considered the adoption of a European contract law that would be placed on the same footing as the national contract laws and that would be susceptible of being elected by the parties if this choice makes sense in their eyes. The choice of this 28th model would have the character of a choice of law just like in private international law; for this choice would replace the national law that would be applicable under the conflict rules of the EC Directives or the Rome I-Regulation otherwise. Thus, the choice of the optional instrument would at the same time derogate the mandatory provisions of the national law that would otherwise be applicable, in most cases, the law of the policyholder. The derogation from mandatory provisions of national law explains that the insurance section of the CFR must aim at a high level of policyholder protection. Otherwise the optional instrument would not be a realistic alternative to national insurance contract law. Consumer organisations would recommend not to take out insurance on the basis of the optional instrument, and the single insurance market would still not be implemented.

There are examples for this type of Community legislation in other sectors, in particular in the areas of company law and intellectual property law; think of the European Economic Interest Grouping and the European Company (*Societas Europaea*), and of the Community Trademark. It was in 2005 that the Commission has for the first time hinted at the possibility of such a legislation in the field of financial services contracts. According to the first annual progress report on European contract law a study on the feasibility of an optional instrument has been commissioned for certain life assurance products. The adoption of an optional instrument would in fact be a promising project for the area of insurance contract law. In particular, it would create a common European legal basis for cross-border insurance contracts which would allow for the implementation of the freedom to provide services with regard to the insurance of small and medium risks. Of course, such an instrument will only be accepted if it provides for a high level of consumer protection. This view is shared by the Project Group on a Restatement of European Insurance Contract Law. On the occasion of presentations of its work in London and Paris in 2007, representatives of the insurance industry also stressed the need for an instrument which in the case of choice by the parties is binding and supersedes national law. The integration of the work of the Project Group in the network put together by the Commission to draft a Common Frame of Reference only makes sense in view of such an optional instrument.

In this context, the Rome I-Regulation on the law applicable to contractual obligations could gain some significance. According to Article 3 (2) of the Commission pro-

posal for this Regulation, the contracting parties “may also choose as the applicable law the principles and rules of the substantive law of contract recognised internationally or in the Community.” The Rome I compromise agreed in late 2007 has deleted this provision. But Recitals 13–14 of the agreed text of the Regulation explicitly point out that Rome I does not exclude an agreement of the parties of that kind.

While this compromise solution does not close the door to the recognition of a choice of the PEICL at the level of private international law, it does not provide the legal security which is required by insurers to actually embark upon this road. To this effect a clear-cut rule like that of Article 1: 102 of the PEICL is certainly to be preferred:

“The PEICL shall apply when the parties, notwithstanding any limitations of choice of law under private international law, have agreed that their contract shall be governed by them ...“

In line with the examples cited from company law and intellectual property law, a regulation containing this rule could be based upon Article 308 EC. In that case, the solution implemented by Article 1: 102 would be of a hybrid nature, it would be both a substantive rule and a conflict rule. A substantive rule since it presupposes that the law of the European Union or of any of its Member States is applicable under the conflict of laws; thus, choice of law rules and in particular Rome I must determine at a first stage whether Community law (or the law of one of its Member States) or the law of a third State applies. In the latter case it would be up to the third State’s law to determine the effect of the PEICL. As far as the conflict between the national laws of different Member States is concerned, Article 1: 102 has an additional significance in private international law, however. It would supersede the conflict rules of the insurance Directives which have been consolidated in Article 7 Rome I and in particular the limitations imposed on the free choice of law laid down therein.

Article 1: 102 PEICL is not limited to cross-border contracting situations. The demand for an insurance policy based upon PEICL may not only occur if insurer and applicant are domiciled in different Member States. Parties may also want to agree on the application of PEICL in view of a future change of residence into another Member State which would turn a domestic contract into an international one. If the PEICL could be chosen only by parties residing in different Member States it would be out of reach of those citizens of the Community who, at the time of contracting, live in the same country where the insurer is established but who are planning to go abroad. Moreover, Article 1: 102, allowing the choice of the PEICL also in internal fact situations, may trigger a competition between different contracting models, i. e. the PEICL and the national law. In the long run this may bring about a spontaneous assimilation of national laws.

5. Conclusion

The Common Frame of Reference is largely insignificant for insurance contract law if it remains a non-binding instrument as outlined by the Commission. Under the national laws of many Member States the parties to an insurance contract are not

allowed to derogate from a great number of legal provisions or may do so only to the benefit of the policyholder or applicant. Since the conflict rules of the EC Insurance Directives (and Article 7 of the Rome I-Regulation) essentially refer to the law of the policyholder as the applicable law of the contract, the cross-border insurance contracts concluded by a single insurer within the Community would be subject to a great number of different laws many of which contain mandatory provisions. This is a serious impediment to the formation of all-European risk pools which are however required for the implementation of the freedom to provide services. This freedom could be implemented if the Community succeeds to draft an insurance contract law as an optional instrument which could be chosen by the parties instead of one of the 27 national laws. It would have the great advantage of allowing insurers to maintain their forms and practices developed under national law to the extent they believe useful. As far as they want to get involved in transborder business the PEICL provide a platform which they may use if they wish to. The PEICL would finally allow to make use of the freedom to provide services. Therefore, the future work of the Community in this area must be directed towards the elaboration of such an optional European Insurance Act. This reminds of the most recent resolution of the European Parliament of 12 December 2007 which has equally called on the Commission to consider the different possible forms of a CFR including an optional instrument.

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