

## THE HARMONIZATION OF EUROPEAN CONTRACT LAW: THE CASE OF INSURANCE CONTRACTS

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*The harmonization of European Contract Law for consumers and businesses continues to progress; however, without some standardization of the insurance contract, it will be difficult to achieve a true single market. This Article chronicles the European Union's activities towards this goal, including the role of the Principles of European Insurance Contract Law, which provides a set of model rules for European legislators. The Article also analyzes: (i) the appropriate legal nature of the instrument of European Contract Law; (ii) the scope of that legal instrument (e.g., whether the instrument should cover both cross-border and domestic contracts, and whether it should include contracts between businesses and consumers or only those between businesses); and (iii) the most appropriate scope to answer the needs to be served.*

*The Article argues for the use of optional instruments as a key step towards a harmonized system and offers that the best way forward is to construct a regulatory system whose ultimate objective is to be globally applicable. Lastly, the Article concludes that the law of insurance contracts is a constituent part of contract law, and as such, the best legislative practice for the regulation of insurance contracts is to restrict its scope to those issues that differentiate insurance from the general theory of obligation and contract.*

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I. THE GREEN PAPER ISSUED BY THE COMMISSION ON  
OPTIONS FOR PROGRESS TOWARDS A EUROPEAN  
CONTRACT LAW FOR CONSUMERS AND BUSINESSES

A. INTRODUCTION

The European Union activity in the insurance sector must be directed, as indicated in Article 2 of the Treaty establishing the European Community, to the achievement of a single market. However, a quick overview of the status of the Community rules on its three branches – the supervision of insurance companies and the market, the insurance intermediary and, as a central element, the insurance contract – shows developments with relevant differences. On the one hand, monitoring-based entities have enacted generations of directives, which have led to a uniform method of authorization across the entire Community ("European passport"). Such authorization must be sought from the supervisory authorities of the home Member State.<sup>2</sup> Similarly, Directive 2002/92/EC of the European Parliament and the Council on insurance mediation also establishes a single license for insurance intermediaries. By contrast, the harmonization of contract law has been less successful – except in the area of insurance automobile liability, as only there has there been a harmonization of conflict rules, regardless of the proposed Directive that failed.

This uneven development of regulation is not the result of a differentiated assessment of the role that the various elements of the insurance law are called to play in the achievement of a single market. Clearly, the rules of supervision and mediation, such as regulating access conditions, exercising insurance activity and distributing contracts in the market, is of paramount importance in this process, but the product offered is another pillar on which building any market rests. However, without some standardization of the insurance contract, it seems difficult to achieve a true single market. The current situation ultimately leads to a certain isolation of markets. Therefore it is easy to deduce that the state of European regulations has generated more criticism than adhesions.

So, on July 1, 2010, the Commission published the Green Paper on Options for Progress Towards a Uniform European Contract Law for

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<sup>2</sup> See Directive 2009/138/EC of the European Parliament and of the Council of 25 November 2009 on the Taking-Up and Pursuit of the Business of Insurance and Reinsurance (Solvency II), 2009 O.J. (L 335) (EU).

Consumers and Businesses. This marks another milestone on the road to the elusive, but eagerly awaited, European Contract Law – a project on which great intellectual efforts are being expended.<sup>3</sup>

The internal European Union market, we note, consists of a multitude of contracts, which are subject to various different national contract laws. The differences between these national contractual laws can both add to the costs of transactions and cause considerable uncertainty for businesses about their exact legal position. This, in turn, undermines consumer confidence in the internal market. The differences in the regulations governing Contract Law can even force businesses to alter their conditions of contract. Furthermore, national legislation is rarely translated into other European languages, and hence those entering the market require the services of a lawyer who is familiar with the legislation of the legal jurisdiction under which they propose to operate.

Partly for these reasons, consumers and businesses, particularly small and medium enterprises (SMEs) whose resources are limited, are frequently reluctant to undertake cross-border transactions. This reluctance, in turn, inhibits cross-border competition – to the general detriment of society. Consumers and businesses in the small Member States can be at a particular disadvantage. The process that culminated in the Green Paper sought to address these concerns.

## B. BACKGROUND

The origins of this process are found in “The Principles of European Contract Law” (Lando Commission), which was initiated in the 1960s, although it was not until the 1980s that it began to operate.<sup>4</sup> This project prepared the ground for further academic works: Study Group for a European Civil Code<sup>5</sup>/ Research Group on EC Private Law (Acquis

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<sup>3</sup> JOINT NETWORK ON EUR. PRIVATE L. (COPECL), <http://www.copec.l.jura.uni-osnabrueck.de/copec/dms/copec/dms.php> (last visited Dec. 27, 2014).

<sup>4</sup> PRINCIPLES OF EUR. CONTRACT LAW, PARTS I AND II (Ole Lando & Hugh Beale eds., 2000); PRINCIPLES OF EUROPEAN CONTRACT LAW, ART. III (Ole Lando et al. eds., 2003).

<sup>5</sup> STUDY GROUP ON A EUR. CIV. UNION, <http://www.sgecc.net> (last visited Dec. 27, 2014).

Group),<sup>67</sup> European Contract Code (the Pavia Group),<sup>8</sup> and “Restatement of European Insurance Contract Law.”<sup>9</sup>

However, this is more than just an academic project, as is demonstrated by the interest shown by Community institutions. First, the European Commission has played an important role, as evidenced by: the Communication from the Commission to the Council and to the European Parliament on a European Contract Law,<sup>10</sup> which was followed by the Communication by the Commission to the Council and to the European Parliament, on Greater Consistency in European Contract Law, an Action Plan,<sup>11</sup> and finally the Communication from the Commission to the Council and to Parliament, on a European Contract Law and an Assessment of Existing Community Law: Perspectives for the Future.<sup>12</sup>

Secondly, the European Social and Economic Committee has also played a part by issuing the following reports: the first on “European Insurance Contracts”<sup>13</sup> and the second with the title, “The 28th Regime: An Alternative to Allowing Less Lawmaking at Community Level.”<sup>14</sup> Nor should we overlook mentioning the European Parliament Resolutions.

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<sup>6</sup> ACQUIS GROUP: EUR. RES. GROUP ON EXISTING EC PRIVATE L., <http://www.acquis-group.jura.uniosnabrueck.de/> (last visited Dec. 27, 2014).

<sup>7</sup> PRINCIPLES, DEFINITIONS AND MODEL RULES OF EUROPEAN PRIVATE LAW: DRAFT COMMON FRAME OF REFERENCE (DCFR) (Christian von Bar & Eric Clive Sellier eds., 2009).

<sup>8</sup> EUROPEAN CONTRACT CODE PRELIMINARY DRAFT (Universita Di Pavia ed., 2004).

<sup>9</sup> *Project Group: “Restatement of European Insurance Contract Law”*, UNIVERSITÄT INNSBRUCK, <http://www.uibk.ac.at/zivilrecht/restatement/> (last visited Dec. 27, 2014); PRINCIPLES OF EUROPEAN INSURANCE CONTRACT LAW: A MODEL OPINION INSTRUMENT (Helmut Heiss & Mandeep Lakhan eds., 2011).

<sup>10</sup> *Communication from the Commission to the Council and the European Parliament On European Contract Law*, COM (2001) 659 final (Nov. 7, 2001).

<sup>11</sup> *Communication from the Commission to the Council and the European Parliament a More Coherent European Contract Law An Action Plan*, COM (2003) 68 final (Dec. 2, 2003).

<sup>12</sup> *Communication from the Commission to the Council and the European Parliament European Contract Law and the Revision of the Acquis: The Way Forward*, COM (2004) 651 final (Nov. 10, 2004).

<sup>13</sup> Opinion of the European Social & Economic Committee on ‘The European Insurance Contract’ (EU) No. 157/2005 of 26 June 2005, 2005 O.J. (C 157) 1.

<sup>14</sup> Opinion of the European Economic and Social Committee on ‘The 28th Regime – An Alternative Allowing Less Lawmaking at Community Level’ (EU), 2011 O.J. (C 21).

The next step of this process crystallized these policies into the Green Paper from the Commission on Policy Options for Progress Towards a European Contract Law for Consumers and Businesses.<sup>15</sup>

### C. PUBLIC CONSULTATION

The main long-term objective of the Green Paper was to define possible ways to strengthen the internal market, develop proposals for European Contract Law, and initiate public consultation on these proposals.

Public consultation has focused on deciding three important issues. The first problem is to elucidate what juridical form the new legal instrument for contract law should take. The proposed options range from a simple statement of the results, to the promulgation of a regulation to create a European Contract Law. Intermediate options center on using the results as a model to follow in future reforms of European legislation, but without implementing it; a simple recommendation to Member States that they should incorporate into their respective legislation a regulation which would adopt Contract Law as an optional instrument; or a regulation on European Contract Law.

The second issue is limited to defining the scope of the legal instrument. Here there are two separate issues: first, whether the instrument would be applicable just to contracts between businesses, or whether contracts between businesses and consumers should also be included; second, whether it should govern only cross-border transactions, or whether it would also extend to domestic transactions.

Finally, we come to the decision as to which is the most appropriate scope to answer the needs to be served. Consequently, should we opt for recommending a legal instrument which would be restricted to what would be (more or less) a general theory of obligations and contracts; or, slightly more broadly, should we also seek to regulate extra-contractual responsibility, the restitution, acquisition and loss of assets, and the guarantee of property ownership rights; or even go a step further, to include specific contracts.<sup>16</sup>

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<sup>15</sup> *Commission Green Paper on Policy Options for Progress Towards a European Contract Law for Consumers and Businesses*, COM (2010) 348 final (Jan. 7, 2010).

<sup>16</sup> Including Liability and Life insurance, as a first step.

## II. THE CASE OF INSURANCE CONTRACTS: THE CONTRIBUTION OF THE “RESTATEMENT OF EUROPEAN INSURANCE CONTRACT LAW” RESEARCH GROUP

Within this process of progress towards a European Contract Law, in 2009 the “Restatement of European Insurance Contract Law”<sup>17</sup> project group published “Principles of European Insurance Contract Law” (PEICL),<sup>18</sup> the fruit of more than ten years’ work. These principles encompass the general provisions applying to all insurance contracts (except reinsurance) and the special provisions applicable to indemnity insurance and insurance of fixed sums.

The Principles of European Insurance Contract Law (PEICL) are designed to provide European legislators with a set of model rules, which have been developed by building on a comparative law analysis of the various national regulations, as well as existing Community insurance law. They have been drawn up as an “optional instrument,” which allows insurers and policyholders to choose these principles, including mandatory rights, instead of national insurance contract law. Adopting the principles of European insurance contract law would enable insurance companies to offer their services throughout the internal market using a single, standard set of rules, which provide a high level of protection to policy holders, and at the same time enable European citizens to purchase non-national insurance products. In short, there has been an attempt to establish the basis for what we might call a EUROPOLICY.

### A. WHAT IS AN OPTIONAL INSTRUMENT?

An optional instrument is so called because its application is dependent on the wishes of the parties in the contract.<sup>19</sup> Its purpose is not to provide a regulation to replace national laws covering insurance contracts, but rather to make an alternative available which could be incorporated as a new regime, distinct from those that already exist in European Union Member States.

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<sup>17</sup> Project Group: “Restatement of European Insurance Contract Law”, *supra* note 9.

<sup>18</sup> PRINCIPLES OF EUROPEAN INSURANCE CONTRACT LAW, *supra* note 4.

<sup>19</sup> D. Staudenmayer, *Ein optionales Instrument im Europäischen Vertragsrecht?*, ZEITSCHRIFT FÜR EUROPÄISCHES PRIVATRECHT, 2003, at 828, ff.

There are two types of optional instruments. In the first type, known as opt-in, the instrument's applicability is dependent on the express willingness of the contracting parties to be subject to its provisions; the second type, the opt-out instrument, applies unless the parties expressly state their wish not to be bound by it. In other words, with an opt-in instrument, the absence of any mention of its applicability means that the national regulations are automatically in force; meanwhile, with the opt-out, the opposite is true: the instrument, not the national rules, is in force.

One example of an opt-in instrument that is rather famous in commercial circles, even though it does not fall within Contract Law, may be found in the Regulation of European trade mark or in the Regulation on European industrial design. On the other hand, the Vienna Convention on International Sales of Goods, whose Article 6 allows the parties to a contract to declare that the Convention does not govern their particular contract, is an example of the second type of instrument.

Which model to choose has been the subject of some debate, although those who argue for the advantages of the opt-in instrument appear to be winning, and this is especially true within the insurance community. In effect, the opt-out type of instrument is more suitable for wholly non-mandatory regulations, while, as we know well, insurance contracts generally do – in fact must – contain a mandatory guarantee of at least some minimal rights for the insured. In turn, it has been pointed out that if an instrument is constructed on the opt-in model, then there is a risk that such an instrument could remain side-lined and completely marginal to the insurance market, since as a regulation it would appear artificial and entirely foreign in the eyes of those in the national legal systems. In my view, this latter argument is not a conclusive basis for a decision, since an optional instrument may play an extremely important role in the European Union insurance sector through the advantages it brings to those engaged in it.<sup>20</sup>

#### B. CHARACTERISTICS OF AN OPTIONAL INSTRUMENT

An optional instrument replaces national law once the parties have decided, by means of the contract, that it is the legal framework that will govern their legal relationship. In consequence, when the parties to an insurance policy decide to place themselves under its scope, the contract is governed exclusively by the optional instrument and by clauses of the

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<sup>20</sup> J. Basedow, *Ein optionales Europäisches Vertragsgesetz – opt-in, opt-out, wozu überhaupt?*, ZEITSCHRIFT FÜR EUROPÄISCHES PRIVATRECHT, 2003, at 1, ff.

contract, as is natural in contract law. Here, it is essential to clarify that national law ceases to provide a minimum standard of universal protection in this State. Incorporation of the optional instrument through the contract does not concede to the regulation's contractual nature. National law does not pre-empt the optional instrument when the latter provides lower protection. The parties' choice decides that one of the two regulatory frameworks will be applied wholly and hence, exclusively. Consequently, accepting the authority of the optional instrument entails displacing national law, thus incorporating all the mandatory rules that this instrument contains. To act otherwise would severely compromise the central function of an optional instrument, which is to achieve uniformity of application throughout the territory of the European Union.<sup>21</sup>

The derogation of the mandatory right that was promulgated in national legal regime for the protection of the insured needs to be accompanied by the institution of new regulations to provide a high standard of protection to those insured.<sup>22</sup> An optional instrument must never become an easy escape route for insurance companies. The alternative of the two types of regulation must guarantee that there is a lowest common denominator: a high level of protection. However, once these protective rules for policyholders' rights are established, the remaining issues remain subject to free choice by the contracting parties; the optional instrument cannot interfere with the development of new products, nor restrict the freedom of the parties to determine for themselves the remaining clauses of any contract.<sup>23</sup>

Optional instruments have to be independent, so that they do not become enmeshed with the national law of the different states. As we shall now see, their interpretation, incorporation, and integration cannot be accomplished through the different national legal regime. What is needed is a set of rules that is completely independent of the regulation of the different states of the European Union. This is the only way to accomplish the desired objective of harmonization. To act differently would be to recreate the very problems that we have set out to avoid.

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<sup>21</sup> Jürgen Basedow, *Insurance Contract Law as a Part of an Optional European Contract Act*, 4 ERA-FORUM 56, 61, 62 (2003), available at <http://link.springer.com/article/10.1007%2Fs12027-003-0007-0>.

<sup>22</sup> Opinion of the European Social & Economic Committee on 'The European Insurance Contract', *supra* note 13, at 6.2.

<sup>23</sup> Malcolm A. Clarke & Helmut Heiss, *Towards a European Insurance Contract Law? Recent Developments in Brussels*, J. BUS. L., Sept. 2006, at 605.



## C. ADVANTAGES OF OPTIONAL INSTRUMENTS

The first advantage of an optional instrument lies precisely in the fact that there is no detriment to the different national legal systems. There would be no need to modify the contracts that are already in use, thus eluding this high cost for insurers. In the same way – and this is not to be scorned – the continued existence of the various separate national regimes also means that another set of problems (of major importance in the failure of the Directive on insurance contracts) is avoided: the great difficulty that is encountered when attempting to reconcile different judicial philosophies or principles, particularly with common law and civil law.<sup>24</sup> This is by no means an idle argument if we consider the economic implications of reform, the inevitable result of a confrontation between two highly developed markets (Continental industry vs. British industry),<sup>25</sup> where a change in the product available – the insurance contract – (which is precisely the implication of a change in the regulatory framework governing insurance contracts) could lead to a competitor gaining a competitive edge of an unpredictable financial magnitude.<sup>26</sup>

The second contribution relates to achieving a uniform regulatory framework throughout the European Union. In my judgement, it is precisely here, with the enormous practical usefulness of such a development, that the real benefit of implanting the optional instrument in the insurance market lies – rather than in the intrinsic benefit of the move towards harmonization. These benefits are of three different types.<sup>27</sup>

1) A harmonized system would allow insurance companies to devise marketing strategies for the whole of the European Union. Let us

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<sup>24</sup> Patrick Pearson, Opening Address to International Insurance Contract Law in the EC: Proceedings of a Comparative Law Conference Held at the European University Institute, Florence 1, 3 (Fritz Reichert-Facilides & Hans Ulrich Jessurun d'Oliveira eds., 1993) (explaining the impossibility of negotiating a restatement between the different legal systems in Europe).

<sup>25</sup> Colin Crody & Rob Merkin, *Doubts About Insurance Codes*, J. BUS. L., Nov. 2001, at 587; Malcolm Clarke, *Doubts from the Dark Side - The Case Against Codes*, J. BUS. L., Nov. 2001, at 605; Patrick Griggs, *Insurance Codes - A Middle Way*, J. BUS. L., Nov. 2001, at 616.

<sup>26</sup> If a regulatory change compelled British insurers to change their policies – and therefore change their legal system – continental insurers would have a relevant competitive advantage in the market, the consequences of which would be difficult to foresee.

<sup>27</sup> E.g., Basedow, *supra* note 21, at 62.

consider, for example, the possibilities that an optional instrument would open up marketing via Internet sites. This new set of rules would mean that it would be possible to draw up insurance contracts that would be available to clients in any Member State of the European Union.

2) Exchange of all types (commercial, sporting, cultural, etc.) is becoming more and more common in frontier areas. Overcoming the compartmentalization that comes with separate national legal systems would allow insurance brokers to offer their policies on either side of a frontier. This is a possibility that insurance companies do not currently allow, since policies are written in conformity to a single legal regulation. Similarly, this would bring a solution to the difficulties encountered by numerous citizens who live in one country but frequently travel to another – for example, to work or engage in business – with the insurance coverage problems that this inevitably brings.

3) European Union citizens who frequently change their country of residence suffer great inconvenience since they are continually obliged to change insurance policies. This implies not only difficulties of a legal nature, but also increased premiums. Insurance companies would be able to design policies to cover the entire territory of the European Union if there were a single regime.<sup>28</sup>

There then arises the crucial question of whether the optional instrument should apply only to cross-border business, or whether it should be presented as an alternative to national law, and therefore generally available for all types of contract. As I have already argued, the second option would seem preferable.<sup>29</sup> It seems to me rather difficult to justify the limitation of applicability to only cover cross-border business. If the continuity of coverage is itself a positive value – and that is the view I take – it would not be correct to deprive the policyholder of coverage simply on the criterion of whether the contracting is cross-border or internal. The decision as to which law applies must reside in the freedom of choice of the contracting parties.

All in all, with an optional instrument, national legal rights are untouched, and it is left to the market to decide how useful the new regulatory regime is. Only those insurance companies which decided, of

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<sup>28</sup> Helmut Heiss, *Mobilität und Versicherung*, in *VERSICHERUNGSRECHT* 448 (Gerlinde Weilinger ed., 2006).

<sup>29</sup> Bataller Grau, *¿Hacia la Unificación de la Normativa del Contrato de Seguro en Europa? Tópicos para un Debate*, *supra* note 1, at 63, ff.

their own free will, to place themselves under its scope would need to underwrite the associated transaction costs.

#### D. THE SOURCE OF THE MOST APPROPRIATE LEGAL FRAMEWORK

The Commission's Communication to the Council and to the European Parliament on a more coherent European contract law: An action plan,<sup>30</sup> dated 12 February 2003, signalled the difficult choice of whether an optional instrument should take the form of a recommendation or of a regulation. In the subsequent debate on this question it was claimed that the non-binding nature of a recommendation would make its designation as a regulation very unclear, and cause the problems in international law that selecting a recommendation as the applicable law might entail. For all these reasons it seems most appropriate to incline towards a regulatory framework which contains alternative regulation to national laws.<sup>31</sup>

It has also been suggested that the PEICL could be useful without having to be promulgated as a regulatory act by Community institutions. As is the case with other texts drawn up by international institutions to be used in international contracts (e.g. UNIDROIT), the simple fact of acceptance of the authority of its articles, on the part of contracting parties, could be sufficient for it to be in force. However, this idea conflicts with the regulation contained in article 7<sup>32</sup> of the Regulation (EC) no. 593/2008

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<sup>30</sup> *Communication from the Commission to the European Parliament and the Council, a More Coherent European Contract Law, an Action Plan*, at 61, COM (2003) 68 final (Dec. 2, 2003).

<sup>31</sup> Jürgen Basedow, *Der Versicherungsbinnenmarkt und ein optionales europäisches Vertragsgesetz*, in *KONTINUITÄT UND WANDEL DES VERSICHERUNGSRECHTS*, Festschrift für Egon Lorenz 101, 102 (Egon Lorenz ed., 2004).

<sup>32</sup> Commission Regulation 593/2008, of the European Parliament and of the Council of 17 June 2008 on the Law Applicable to Contractual Obligations (Rome I), art. 7, 2008 O.J. (L 177) (EU):

1. This Article shall apply to contracts referred to in paragraph 2, whether or not the risk covered is situated in a Member State, and to all other insurance contracts covering risks situated inside the territory of the Member States. It shall not apply to reinsurance contracts.

2. An insurance contract covering a large risk as defined in Article 5(d) of the First Council Directive 73/239/EEC of 24 July 1973 on the coordination of laws, regulations and administrative provisions relating to the taking-up and pursuit of

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the business of direct insurance other than life assurance (2) shall be governed by the law chosen by the parties in accordance with Article 3 of this Regulation.

To the extent that the applicable law has not been chosen by the parties, the insurance contract shall be governed by the law of the country where the insurer has his habitual residence. Where it is clear from all the circumstances of the case that the contract is manifestly more closely connected with another country, the law of that other country shall apply. 3. In the case of an insurance contract other than a contract falling within paragraph 2, only the following laws may be chosen by the parties in accordance with Article 3:

(a) the law of any Member State where the risk is situated at the time of conclusion of the contract;

(b) the law of the country where the policy holder has his habitual residence;

(c) in the case of life assurance, the law of the Member State of which the policy holder is a national;

(d) for insurance contracts covering risks limited to events occurring in one Member State other than the Member State where the risk is situated, the law of that Member State;

(e) where the policy holder of a contract falling under this paragraph pursues a commercial or industrial activity or a liberal profession and the insurance contract covers two or more risks which relate to those activities and are situated in different Member States, the law of any of the Member States concerned or the law of the country of habitual residence of the policy holder.

Where, in the cases set out in points (a), (b) or (e), the Member States referred to grant greater freedom of choice of the law applicable to the insurance contract, the parties may take advantage of that freedom

To the extent that the law applicable has not been chosen by the parties in accordance with this paragraph, such a contract shall be governed by the law of the Member State in which the risk is situated at the time of conclusion of the contract.

4. The following additional rules shall apply to insurance contracts covering risks for which a Member State imposes an obligation to take out insurance:

(a) The insurance contract shall not satisfy the obligation to take out insurance unless it complies with the specific provisions relating to that insurance laid down by the Member State that imposes the obligation. Where 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) By way of derogation from paragraphs 2 and 3, a Member State may lay down that the insurance contract shall be governed by the law of the Member State that imposes the obligation to take out insurance.

5. For the purposes of paragraph 3, third subparagraph, and paragraph 4, where the contract covers risks situated in more than one Member State, the contract shall be considered as constituting several contracts each relating to only one Member State.

of the European Parliament and the Council, dated 17 June 2008, on the law applicable to contractual obligations (Rome I).<sup>33</sup>

#### E. MANDATORY CHARACTER

The regulations found in the PEICL are on some occasions mandatory, and on others semi-mandatory. Indeed, the first paragraph of its Article 1:103 establishes the mandatory nature of some PEICL Articles. Such Articles can never be altered by any party, because they are substantive. However, at the present time, these rules have yet to be specified.

The second paragraph of the same Article establishes the semi-mandatory nature of the remaining precepts. In other words, the PEICL guarantees a minimum standard of protection, meaning that their Articles can only be derogated from when the resulting contractual clause is of greater benefit to the policyholder, insured, or beneficiary. This is all without prejudice to the necessary primacy of freedom of choice with respect to large risks (such as commercial lines).

The affirmation of its mandatory (or semi-mandatory) status may at first blush appear somewhat shocking, since it appears to contradict the very nature of an optional instrument. But these doubts disappear when a distinction is drawn between the different planes in which option and mandate, respectively, are located. The optional nature here alludes to the parties' freedom to be governed by the PEICL or by national law; the mandatory character, meanwhile, is predicated on the actual precepts that constitute it.

In my view, the mandatory nature of the precepts is essential if the object is to give legitimacy to an optional instrument whose purpose is to

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6. For the purposes of this Article, the country in which the risk is situated shall be determined in accordance with Article 2(d) of the Second Council Directive 88/357/EEC of 22 June 1988 on the coordination 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 (1) and, in the case of life assurance, the country in which the risk is situated shall be the country of the commitment within the meaning of Article 1(1) (g) of Directive 2002/83/EC.

<sup>33</sup> Helmut Heiss, *The Common Frame of Reference (CFR) of European Insurance Contract Law*, in *COMMON FRAME OF REFERENCE AND EXISTING EC CONTRACT LAW* 244, 245 (Reiner Schulze, ed., 2008).

install a regulatory structure governing insurance contracts within the European Union. It would be difficult to justify the different states' national laws providing a high degree of protection to policyholders, insureds and beneficiaries using precisely this legislative technique, while by contrast providing non-mandatory Community regulations whose purpose is to regulate risk for the many.<sup>34</sup> Certainly, the freedom of the parties is limited to the choice between an optional instrument and national law, but in both cases a high degree of protection is provided, since both sets of regulations are drawn up with precepts of a mandatory nature that accord some minimum rights to the insured.

The next unknown to be answered is how to be sure which of the two regulatory regimes provides the greater protection. It is reasonable to think that if the insurer has the choice of national law or the PEICL in each market, when the insurance company draws up the policy – it is they who in practice decide this matter – then the less protective regulatory regime will always be chosen. This equation does not have a single solution because the variable is unknown, so the different national laws need to be taken into consideration. However, I would confidently affirm that, for the majority of national laws, the difference in levels of protection between the two would not be substantial. It must be clearly understood that we are not asserting that in each of the subjects customarily considered in insurance contract law, that equidistance has been achieved between the PEICL and national law. The different alternatives that the various national laws contain for each subject mean that this is an unattainable goal. This assertion goes no further than the observation that in an overall evaluation of the two systems, we cannot escape the fact that we will find examples working in both directions. In some areas national law will offer greater protection, and in others the PEICL will provide a superior set of rules for defending the rights of the insured.

In the Spanish case, I would anticipate that certain precepts offer less protection than the Spanish laws. A first example is constituted in the admission, albeit restricted to clauses relating to termination of contract after damage or loss has occurred, that our Supreme Court has declared null and void. And the same occurs with precautionary measures, which allow the insurer to include clauses that prescribe specified behaviour on the part of the insured before any occurrence of an insured event; this can go so far as to even remove the insured's indemnity. (This is subject to the clause conforming to the stipulations laid down in article 4:103.)

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<sup>34</sup> *E.g.*, Basedow, *supra* note 31, at 101–02; Heiss, *supra* note 33, at 247–48.

On the other hand, other PEICL precepts go further than Spanish insurance contract law, as is evidenced in the chapter devoted to the duties of the insurer to provide information before contract, and especially Article 2:202 of the PEICL, which includes the insurer's duty to warn about the inconsistencies that it observes in the coverage provided. In fact, as is specifically provided for in the aforementioned precept, at the moment of conclusion of the contract, the insurer must advise the applicant of any inconsistencies that may exist between the coverage offered and the applicant's needs of which the insurer is or ought to be aware, taking into account the circumstances and mode of contracting, and in particular, if the applicant was assisted by an independent intermediary. In the event of a breach of this duty, either the insurer must indemnify the policyholder against all losses resulting from the breach of this duty to warn, unless the insurer acted without fault, or the policyholder shall be entitled to terminate the contract by written notice given within two months after the breach becomes known to the policyholder. An additional example of regulation offering higher protection is found in Article 5:104, in which the principle of divisibility of premium is explicitly recognized; this obliges insurance companies to reimburse the premium in the event of early termination of the contract.

#### F. SUBSTANTIVE SCOPE OF APPLICATION

Article 1:101 of the PEICL lays down that the principles we have mentioned apply to private insurance in general, including mutual insurance. However, reinsurance is specifically excluded. As far as types of insurance which are governed by special sets of regulations, such as maritime and aviation insurance, are concerned, these do fall within its scope, although since these are classified as large risks (i.e., commercial risks), freedom of choice will take primacy given the relatively equal bargaining power of the two contracting parties.

#### G. STRUCTURE

##### 1. The Sections of the PEICL

The PEICL are structured in four main sections: the first sets out the general regulations which apply to all insurance contracts; the second covers the general regulations applying to indemnity insurance; the third relates to the general regulations for insurance of fixed sums; and the fourth

contains the regulations which will apply to specific branches of insurance. The sections are divided into chapters, and these are subdivided into rules.

We begin by pointing out that in this first version of the PEICL, there is as yet no detail in the fourth section mentioned above. The Commission's suggestion that the document should be delivered as a work-in-progress, together with the belief that the general regulations (in the first three sections) are in themselves substantive, are behind the decision to publish the PEICL without the fourth section. At a later date a second, complete version of its principles will be delivered, containing the completed fourth part – and perhaps some minor amendments to the general regulations.

## 2. The PEICL Rules

The rules, a very brief document which contains the text of the regulations, have a different structure from that of a national regime. The scientific rather than political origin of the current text means that the simple regulatory mandate that we are accustomed to encounter in regulations issued by our national legislatures is completed by the addition of comments and notes. Consequently, each rule consists of three parts: the rule itself, which is completed with a brief commentary and some endnotes.

The purpose of the commentaries is to clarify the rules' content, to make their interpretation easier by those who use them. The aim is, by this means, to consolidate juridical certainty in a text which poses two obvious difficulties: first, the fact of its novelty – which means that there is no legal precedent, no previous judgment to guide decision; second, the fact that it is conceived as of universal application, which is to say that it intended to be applied by those working in quite different legal traditions. The comments are, then, complementary to the rules: although they do not carry statutory force, they nevertheless must play a key role in ensuring that a uniformly consistent interpretation of the PEICL is arrived at.

The notes provide the reader with information about the different regulatory stances that have been adopted in relation to this problem in national law. Thus, the PEICL make a major positive contribution to comparative insurance contract law. Furthermore, the notes also contribute to the interpretation of each rule; by locating it in the specific context of a legislative solution, this helps us to understand its meaning and extent of applicability. We should remember that the rules were drawn up using the results of a comparative study of bodies of legislation relating to insurance contracts currently in force in Europe, and also – where it exists on this particular issue – existing Community Law.



## H. LANGUAGE AND TERMINOLOGY

The PEICL are written in English. There are now translations available in several languages, but the only version that has official status, and that continues to be updated, is the one in English (all this, it goes without saying, is without prejudice to any future developments within Community institutions).

However, the terminology employed is not that used in English Law. Quite the contrary, the intention has been to use terminology of an international nature as much as possible. In particular, the PEICL have been drawn up with the intention that in the drafting of the rules, the authors should draw on terminology that has already been devised and established within the Principles of European Contract Law and in other existing Community Law.<sup>35</sup>

Moreover, Articles 1:201 and 1:202 of the PEICL provide an index of the most commonly used terms in each set of regulations governing insurance contracts, specifying them conceptually, in order to achieve greater clarity. In this way, terms such as the insured, beneficiary, and the sum insured are defined, such that in any subsequent use of the terms the user understands all their connotations precisely and fully.

## I. INTERPRETATION

The usefulness of the PEICL when it comes to achieving its objectives is not assured by the text of the regulation itself, but rather rests additionally on its uniform application by the courts. For this purpose, Article 1:104 of the PEICL lays down the principles of interpretation to be observed in the following terms:

The PEICL shall be interpreted in the light of their text, context, purpose and comparative background. In particular, regard should be had to the need to promote good faith and fair dealing in the insurance sector, certainty in contractual relationships, uniformity of application and the adequate protection of policyholders.

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<sup>35</sup> *E.g.*, Heiss, *supra* note 34, at 239.

We see, then, that these criteria are to play an important role in the uniform application of the PEICL, providing a precept which will determine which of them should be used for all involved with these legal matters, especially the courts. So, the rules are not only accompanied by comments and notes to assist in their interpretation, but, in a further effort to ensure consistent application of the PEICL, there are also explicit hermeneutic criteria that should be used in connection with them. In relation to this, it should be emphasized that the PEICL establish consistency of its application as the interpretative rule, and in this way makes the related objective itself a principle.

In relation to issues of a different order, the appropriateness of the participation of the European Court of Justice in drawing up these criteria for consistency of interpretation has been posited. Article 234 of the European Union Treaty authorizes the interpretation of legal orders issued by European institutions to be submitted to the Court as a pre-judicial matter. Consequently, such participation requires prior promulgation of the PEICL by the Community's legislature.<sup>36</sup> However, the resolution of this pre-judicial issue would help to achieve greater uniformity in the application of optional instruments.

#### J. THE LAW OF INSURANCE CONTRACTS AS A CONSTITUENT PART OF CONTRACT LAW: PROBLEMS OF INTEGRATION

An insurance contract, though it is covered by extensive sets of regulations in the majority of national laws, is not an independent document peripheral to Contract Law. Furthermore, I consider the best legislative practice for the regulation of insurance contracts is to restrict ourselves to those issues and characteristics that differentiate insurance from the general theory of obligation and contract. Nothing can be gained by interfering with the numerous areas that are already subject to general regulation, and where insurance is simply another contract.<sup>37</sup>

This proposition caused another set of problems when it came to drawing up the PEICL, created with the intention of being a text whose application should be consistent across the whole territory of the European Union. In truth, although the PEICL provide uniformity of regulation for the particular features applying only to insurance contracts, the remaining issues of general theory could not be settled by recourse to the different

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<sup>36</sup> *Id.*

<sup>37</sup> *E.g.*, Basedow, *supra* note 21, at 58–59.

national legislation, because then the risk would again arise of a distinct implementation of optional instruments in each Member State. On the contrary, devising a text that would be all encompassing, such that on its own it could also resolve questions of general theory, was an enormous and overly-ambitious undertaking. The way out of this dilemma was to draw up the PEICL, limiting the coverage to those aspects pertaining specifically to insurance, and to take as a general principle the theory that is already written in the Principles of European Contract Law. As a result, the PEICL are located as a particular contract within the Principles of European Contract Law, which means that their incorporation is by recourse to this further regulatory text which also was devised to be uniformly applied throughout the territory of the European Union.

In Article 1:105 of the PEICL, the regulations covering issues related to their incorporation is where this idea is expounded: it is forbidden to have recourse to national law in order to restrict or to complement the PEICL, while at the same time the Principles of European Contract Law are invoked to cover any gaps which need to be reconciled with the general theory of obligations and contracts. However, this mandatory instruction does not entirely resolve the problems associated with the incorporation of the PEICL. In order to achieve this, two more references are introduced to the process.

First, however scrupulously one attends to detail when drawing up insurance contracts, there always remain issues that require regulation. Furthermore, there is an essential role played by freedom of choice in the insurance market when it comes to offering new products. However, these issues, which are proper to insurance law precisely because they are a special case, cannot be resolved by recourse to general theory. For this reason, Article 1:105 of the PEICL explicitly allows an exception to the general principle of omission of national law: it is permitted to apply national regulations if they are mandatory and specifically devised to apply to the branch of insurance in question – always supposing that there are no special rules contained in the PEICL.

Second, playing a similar role to that played by general principles in Spanish Law, a final closure to the system is provided by means of the reference to the general principles which are common to the Law of the Member States. The previous recourses now being exhausted, incorporation takes place through inferring the existence, in the different legislation of the member states of the European Union, of a general principle which permits a judge to resolve the question that is placed before him or her. This last rule is hermeneutic, designed to play only a residual role.

## III. A CONSISTENT OPINION ABOUT THE GREEN PAPER

Let us next look at the arguments from the perspective of the insurance market.

## A. WHAT SHOULD BE THE LEGAL NATURE OF THE INSTRUMENT OF EUROPEAN CONTRACT LAW?

The directives route needs to be supplanted by the use of optional instruments: this would be a step towards a harmonized system, which can never be achieved with directives. Adopting the harmonization approach offers the advantage that it is supported by a more solid history of practice, since this solution has been adopted for other types of contract, which will at least go some way towards building consensus – which in itself is a difficult thing to achieve. However, as the Commission's Communication to the Council and to the European Parliament on European Contract Law pointed out, the use of abstract terminology in Community legislation may give rise to inconsistent administration of Community Law and of national measures. Moreover, purely internal legislation enacted by Member States to apply European Union directives is based on internal national understanding and definitions of those abstract terms. In the light of what has been expounded here, it is easy to deduce that the most desirable option to adopt, from a technical point of view, is harmonization, since this is the solution that comes closest to the objective, namely standardized application of the product being sold.

The Commission's Communication to the Council and to the European Parliament, dated 12 February 2003, proposed a more consistent European Contract Law: an action plan pointed to the difficulty over whether optional instruments should take the form of recommendations, or alternatively of regulations. In the subsequent debate on this question, it was claimed that the non-binding nature of a recommendation would be deleterious to its being considered as having regulatory force – to say nothing of the problems in international private law that might be entailed by the choice of a recommendation as the law to be applied. For all these reasons, the most appropriate course would seem to be to opt for a set of rules that contains an alternative regulation to national laws.

I do not believe, either, that it is feasible to advance towards a regulation that would impose a European Contract Law in all the territories of the European Union, because of the problems this would bring and the resistance that it would meet. I believe that the voluntary character of the

optional instrument is a positive aspect that should be taken into consideration.

All in all, I consider that the best course to adopt is to promulgate a regulation which would create an optional instrument, and preferably in opt-in form. Thus, the different national laws would remain unchanged, and a new one would be created, whose authority would be accepted voluntarily by the parties.

B. SHOULD THE INSTRUMENT COVER BOTH CROSS-BORDER AND DOMESTIC CONTRACTS?

One option that recurs in this debate is that of limiting the use of European Contract Law to cross-border business. Thus, when all the elements of the insurance are linked together by a single legal regime, national law would be applied, allowing each State's regulations to remain unchanged, whereas in the other case, a contract that included a foreign element would be subject to international regulations. Such a model, it can be said, protects the autonomy of the parties in an international contract, and ensures fair and equal competition, since a single law would govern all international contracts, as well as providing a uniform level of protection in the different Member States. This means that a party could act without fear in foreign markets, knowing that the level of protection would be similar to that enjoyed under the laws of the home country. Furthermore, those who defend such an approach understand that actual harmonization just of the rules of international insurance contracts would mean enhanced legal security thanks to the establishment of an actual law specifically for this type of insurance, thus avoiding all the problems arising out of a contested project for harmonization.

However, as even those who would seek to advance this thesis must recognize, the problem will then shift to the question of how to organize and express the relationship between the two regulations. This problem, in our view, is impossible to resolve. In the first place, if the nationality of the insurance company were to be the determining criterion, there would be great uncertainty regarding the governance regime that would in the end be applicable. And without saying that in member states like Spain, where there is a marked presence of foreign insurance companies, it would be the exception, not the rule, to apply Spanish law. It would be equally problematic if the policyholder were the defining criterion, since if the level of protection depended on the policyholder's nationality, then grievances of a comparative nature would inevitably arise. A final proposal, that is more nuanced than the preceding ones, would be to

start from the regulations relating to directives, but introducing the possibility of being governed by supranational regulation where there is no obligation to be governed by the law of the State in which the risk is incurred or the commitment formalized. An objection to this thesis is that the creation of a system of regulation for the making of supranational contracts would be another available possibility, but it would neither reduce diversity nor enhance legal certainty, while it would give rise to discriminatory treatment. Perhaps the dysfunction resides in the difficulty in reconciling the concept of a single market with a transnational space.

In conclusion, it seems to me that the best way forward, at least in terms of desirability, is to undertake the construction of a system of regulation whose ultimate objective is to be globally applicable, in this way avoiding the drawbacks that have been pointed out.

C. SHOULD THE INSTRUMENT COVER BOTH BUSINESS-TO-CONSUMER AND BUSINESS-TO-BUSINESS CONTRACTS?

It is well known in the insurance market that there is a well-established distinction between large risks and mass risks. The first category is strongly internationalized because of the nature of the contracted risk itself, insurance companies themselves having been engaged in developing standard contract clauses based on the principle of the pre-eminence of freedom of choice. Because of this, we can already talk of a *lex mercatoria* which has been developed through the general conditions that are employed in the making of international contracts. Two examples will suffice: reinsurance and marine insurance.

The next step to be taken if we wish to progress further in this direction is to establish a European insurance contract law that would apply to mass risk. This would lead to the positive effects that have already been set out, and would give consumers the benefits of the system, especially those benefits which would be generated by a marketplace that would be more competitive as a result of its greater integration.

D. WHAT SHOULD BE THE MATERIAL SCOPE OF THE INSTRUMENT?

The solution to this final problem has almost already been answered by what we have set out so far. It is only possible to achieve the desired objectives if regulation of insurance contracts is included. The necessarily mandatory nature of such a set of regulations, if it is to provide the standard of protection that is required for mass insurance contracts,

requires a set of rules governing insurance contracts. This governance should at least consider the mechanisms for the protection of the insured, since it is not appropriate to be subject to contractual freedom, a provision which would leave the door open for insurance companies to infringe the different national regulations. Neither do I recommend remission to the different national regulations for contracts in specific branches of insurance, because we would then be creating a bigger problem than the one we are trying to solve. We would not achieve uniform consistency; and what is more, by trying to interpret European Contract Law and the respective laws concerning insurance contracts together, we would simply end up with greater legal uncertainty by trying to make two rules proceeding from differing origins and principles appear just and reasonable.

#### IV. CONCLUSION

The “Restatement of European Insurance Contract Law” project group is working on a 2nd edition of their “Principles of European Insurance Contract Law.” This 2nd edition adds regulation of liability insurance and life insurance.

The harmonization of European contract law has continued its way. The Commission created an Expert Group relationship with previous academic studies. On 3 May 2011 the Expert Group's feasibility study was published and interested parties were invited to give feedback.

Within this process of progress towards a European Contract Law, on October 11, 2011, the Commission adopted a proposal for a Regulation on a Common European Sales Law. The proposal facilitates cross-border trade for business and cross-border purchases for consumers by establishing a self-standing uniform set of contract law rules including provisions to protect consumers. Nowadays, the proposal proceeding continues as a co-decision procedure.

However, the main change at the heart of current insurance contracts has been the European Commission's initiative to establish the “Commission Expert Group on European Insurance Contract Law.”<sup>38</sup>

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<sup>38</sup> Commission Decision (EU) of 17 January 2013 on Setting up the Commission Expert Group on European Insurance Contract Law, 2013 O.J. (C 16/6) 6.

The Expert Group's task shall be to carry out an analysis in order to assist the Commission in examining whether differences in contract laws pose an obstacle to cross-border trade in insurance products.

If the Expert Group finds that differences in contract laws may pose obstacles to cross-border trade in insurance products, it shall identify the insurance areas which are likely to be particularly affected by such obstacles.

It is difficult to predict the future, but I believe that this beginning of the legislative process must lead to a future regulation of insurance contracts, as happened with the aforementioned Regulation on a Common European Sales Law. By the end of 2013, the Expert Group shall deliver to the Commission a report on its findings. Then we will appreciate the reactions of institutions, the industry and consumers and perhaps we can know then if this goal is attained.