

EU CONSENSUS ON APPLICANT'S PRE-CONTRACTUAL INFORMATION DUTY AND SANCTIONS FOR ITS BREACH

- SOME ISSUES FROM THE RESTATEMENT OF EUROPEAN INSURANCE CONTRACT LAW COMMON FRAME OF REFERENCE -

INTRODUCTION – HARMONISATION OF EUROPEAN INSURANCE CONTRACT LAW

EU legislation was so far mostly limited to the implementation of EU directives related to the supervision of insurance companies within the European market. The next step in a true integration of the European insurance market – following the liberalisation of European insurance markets under standardised supervision, development of cross-border insurance and international insurance also facilitated by the Internet and Euro Monetary Union - is harmonisation of insurance contract law.

Over the last years the European Commission has undertaken a series of initiatives aimed at increasing the overall coherence of European contract law. The Common Frame of Reference (the CFR) is a long-term project which aims at providing the European Legislators with a tool to be used for the revision of existing and preparation of new legislation in the area of contract law.

The Project the Restatement of European Insurance Contract Law has produced the Principles of European Insurance Contract Law (PEICL)¹, which aim to establish a voluntary insurance contract law regime across the EU. Once selected, the PEICL will apply as a whole. There is some flexibility, however, in that any provision not designated mandatory can be receded from, as long as it is not to the detriment of the policyholder, the insured or beneficiary. And in the case of certain risks derogation is allowed for the benefit of either party.

This paper shall focus on the CFR regulation of the applicants' obligation to inform the insurer and within this context, particularly on the sanctions pertaining to the breach of this obligation. The solutions used in the CFR exist in this or similar form in legislations of different jurisdictions and have been used in practice.

Chapter two of the CFR deals with the initial stage and duration of the insurance contract. The first section of this Chapter, articles 2:101 to 2:105, regulate the Applicant's Pre-Contractual Information Duty. There is no need to stress especially the importance of providing the relevant information the applicant possesses for the estimation of the risk by the insurer, at the time of conclusion of an insurance contract. "Insurance is a contract upon speculation. The special facts, upon which the contingent chance is to be computed, lie most commonly in the knowledge of the insured only: the under-writer trusts to his representation, and proceeds upon the confidence that he does not keep back any circumstance in his knowledge, to mislead the underwriter into a belief that the circumstance does not exist, and to induce him to estimate the risk as if it did

¹ see www.reinstatement.com

not exist.² This obligation is clearly regulated in insurance contract laws in other jurisdictions as well. The difference lies in details and the CFR intends to provide unified solutions and consensus.

DUTY OF DISCLOSURE

The first article of this Chapter establishes the duty to disclose, determines the subject of disclosure, imposes the obligation to the insurer to prepare the questionnaire and to the applicant to perform a research before providing information.

Article 2:101 of the CFR - Duty of Disclosure

- (1) When concluding the contract, the applicant shall inform the insurer of circumstances of which he is or ought to be aware, and which are the subject of clear and precise questions put to him by the insurer.*
- (2) The circumstances referred to in para. 1 include those of which the person to be insured was or should have been aware.*

The time, when the information is obtained, is of essence to an insurer regarding his decision on whether to accept the application for insurance and on what terms. All the relevant information, must be disclosed before the concluding of the contract so that the insurer can estimate the risk and provide the terms and the amount of the premium. The relevant information about the risk to be insured lies mostly in the knowledge of the applicant and not with the insurer. Full and honest disclosure is of the essence for the insurer's decision on concluding of an insurance contract and its terms.

The CRF has opted to pass the burden of selecting the right questions to the insurer, who possesses the knowledge of what circumstances are relevant for the estimation of the risk, rather than leaving the freedom to the applicant to choose among the information that is at his disposal and the burden of deciding on their materiality.

The wording "is or ought to be aware" that is chosen in the CRF, implies a duty to check facts of which he is uncertain or to search for the facts which are not, but for some reason, these should be within his actual knowledge. The duty to check includes asking and checking these questions of the future insured in cases that the applicant and the future insured are not the same person.

A similar provision in Serbian law, article 907 of the Law on Obligations, provides an obligation of a person concluding the insurance to report to the insurer all circumstances "which are material in assessing the risk and which were known or could not have been unknown to him". The Greek Insurance Contract Law³ includes both solutions: providing of the relevant information by the policyholder and answering relevant questions posed by the insurer, thus covering the possibility that the insurer does not have a questionnaire for the policyholder and the fact that the applicant is the one who is aware of all the facts that may affect the insurance risk such as in the case of his own assets. However, if the insurer poses a questionnaire with exclusive questions it shall be considered that the applicant is not obliged to provide additional information to those requested in the questionnaire. The law provides that "It shall be presumed that the information and circumstances, in relation to which the insurer has set clear written questions, constitute the sole grounds on which the insurer based its assessments and acceptance of such risk". This presumption may, however, be disputed and the insurer may evi-

² Lord Mansfield in *Cater v. Boehm* (1766) in the leading case which established the duty of disclosure in insurance contracts in England; see John Birds: *Modern Insurance Law* (1997), p. 101

³ Greek Insurance Contract Law no. 2496/97, article 3 Description of Risk

dence that he was not in the position to pose certain questions to the applicant and that the applicant intentionally failed to disclose certain facts known to him⁴.

BREACH OF THE DUTY TO DISCLOSE

The second article regulates the sanctions for negligent and unintended breach of duty to disclose the procedure of termination and variation of the insurance agreement and duty to pay insurance money in case of an insured event occurring before the termination of this procedure.

Article 2:102 of the CFR – Breach

- (1) When the policyholder is in breach of Article 2.101, subject to paras. 2-5, the insurer shall be entitled to propose a reasonable variation of the contract or to terminate the contract. To this end the insurer shall give written notice of its intention, accompanied by information on the legal consequences of its decision, within one month after the breach of Article 2:101 becomes known or apparent to it.*
- (2) If the insurer proposes a reasonable variation, the contract shall continue on the basis of the variation proposed, unless the policyholder rejects the proposal within one month of receipt of the notice referred to in para. 1. In that case, the insurer shall be entitled to terminate the contract within one month of receipt of written notice of the policyholder's rejection.*
- (3) The insurer shall not be entitled to terminate the contract if the policyholder is in innocent breach of Article 2.101, unless the insurer proves that it would not have concluded the contract, had it known the information concerned.*
- (4) Termination of the contract shall take effect one month after the written notice referred to in para. 1 has been received by the policyholder. Variation shall take effect in accordance with the agreement of the parties.*
- (5) If an insured event is caused by an element of the risk, which is the subject of negligent non-disclosure or misrepresentation by the policyholder, and occurs before termination or variation takes effect, no insurance money shall be payable if the insurer would not have concluded the contract had it known the information concerned. If, however, the insurer would have concluded the contract at a higher premium or on different terms, the insurance money shall be payable proportionately or in accordance with such terms.*

The option on whether to propose a reasonable variation or to terminate is on the insurer's side with only one exception in case of innocent non-disclosure or misrepresentation of non material information when the insured is obliged to offer a variation of the contract. The right of the insurer to maintain the insurance agreement by proposing relevant amendments of the insurance agreement is common in the jurisdictions of different countries. Serbian law provides the same, with a similar procedure and also partial payment of insurance money in case "the case covered by insurance take place prior to finding the incorrectness or incompleteness of the application, or after that but prior to the rescission, or prior to reaching an agreement on the premium increase"⁵. Greek Law provides for the same possibilities in case of negligent failure to comply with the duty to disclose and "if the insured risk occurs prior to the amendment of the insurance contract pursuant to paragraph 3, or before the termination comes into effect, the insurance com-

⁴ Vasileiou D, Kiantou: Insurance Law, 2003.

⁵ Article 909 of the Serbian Law on Obligations

compensation shall be reduced in proportion to the difference between the premium payable and the premium which would have been demanded if the failure to disclose had not occurred"⁶. This, however, does not apply to life and health insurance. The French Insurance Code regulates that if the insured's bad faith has not been proved, the insurer is not entitled to nullity of the insurance contract. If the misrepresentation or omission was recorded before the occurrence of the insured event, the insurer may either increase the premium or terminate the agreement with a notice period of 10 days and return the premiums received for the period not covered by the insurance. If the event took place and loss has occurred, the compensation shall be reduced in proportion to the rate of the premiums paid relevant to the rate of premiums that would have been owed if the risks had been truthfully and exhaustively declared. It also provides for a possibility to agree additional compensation in certain cases⁷.

According to the CFR, only if there is an innocent, non material breach the insurer will not have the right to terminate. He will only have the right to propose variations. An innocent breach does not include any negligence. English law and practice recognises innocent material breach but does not provide for different treatment from negligent breach. It provides that an insurer can avoid an insurance contract, if he was induced to enter into it by a misrepresentation of fact made by the applicant, which was false in a material particular, whether or not the applicant acted negligently or quite innocently⁸. Greek law also regulates innocent breach in the same manner as negligent breach "if, for any reason whatsoever beyond the control of the insurer or the policyholder, information or circumstances which are objectively essential for the assessment of risk did not become known to the insurer, the insurer shall be entitled to terminate the contract, or to request that it be amended, within a period of one month following the insurer's discovery of such information or circumstances." This however does not apply to life and health insurance. In regard to innocent breach there is clearly a distinction between an innocent misrepresentation, where the applicant does not know the truth, and an innocent non disclosure, where the applicant knows the truth but does not appreciate that he should disclose the fact in question. The consequences are, however the same.

Negligent non-disclosure or misrepresentation has in the CFR the same consequences. A misrepresentation is a positive statement of fact, which is made or adopted by a party to the contract and which is untrue⁹. Half truths may be regarded as half misrepresentation or half non-disclosure by the answer which is false, as it carries an untrue implication that it is a complete answer to the question concerned. For example, in response to a question about the existence of other life insurance, an applicant mentions only one life insurance policy and fails to mention the existence of a second life insurance policy. In the case of non-disclosure, the basic rule is that the applicant is obliged to disclose all material information affecting the risk; and there is also the breach of this duty or concealment. In practice, a distinction between incomplete information (non-disclosure) and inaccurate information (misrepresentation) may be difficult to draw. There is a tendency in national laws to deal with the misrepresentation and non-disclosure in the same way, and this approach has been adopted in the CFR. "Cases have frequently failed to distinguish between the

⁶ article 3.5 of the Greek Insurance Contract Law no. 2496/97

⁷ The French Insurance Code, article L113-9 (as updated up to 27.07.2005)

⁸ see: John Birds, Professor of Commercial Law, University of Sheffield,; *Modern Insurance Law* 1997, p. 99.

⁹ In English marine insurance, a "representation as to a matter of fact is true, if substantially true, if it be substantially correct, i.e. if the difference between what is represented and what is actually correct would not be considered material by a prudent insurer". It has been suggested that a similar rule applies to non-marine insurance. For example a material misstatement is made by the applicant of motor cover, who has been convicted of a motoring offence, but states that he has not. But if he states his conviction for speeding, but understates his speed or the amount of his fine by 5%, it might be that the representation was material, but the untruth (5%) was not and hence the statement as a whole is not false. See Malcolm A Clarke: *the Law of Insurance Contracts*, 1997, p. 575.

two defences taken by an insurer and indeed it appears to be standard practice for an insurer, where possible, to plead both defences¹⁰.

The information about the risk to be insured forms the basis of the insurer's calculations when concluding the contract of insurance. If the insurer discovers that the information was inaccurate it should be entitled to reconsider whether and on what terms it wishes to continue to cover the risk. It may propose a reasonable variation of the contract of insurance.

However, the policyholder must not be kept in a position of indefinite doubt and uncertainty, so the RFC requires the insurer to select between the remedies available to him within a month and to inform the policyholder. If the insurer fails to reach the decision within one month, the insurance agreement and cover continues as before the discovery. If the insurer proposes within the one month time frame the variation of the contract, the RFC provides that the policyholder is not obliged to accept the variation. He may reject the proposal within one month from the receipt of the proposal. If he does not reject it, the contract continues to be valid with the variations proposed by the insurer included. If the policyholder rejects the proposal, the insurer may terminate the agreement. Failing to do so within the required time frame would have as a consequence that the original contract continues to be valid. If the insurer decides to terminate the contract, the policyholder must have enough time to obtain alternative insurance cover, if available.

The consequences when the insured event, which is subject of negligent breach, occurs before the termination or the agreement in the RFC are:

- a) if the insurer would not have concluded the insurance contract had it known the information, no insurance money would be payable;
- b) if the Insurer would have concluded the insurance contract under different terms or for a different premium, the insurance money should be payable proportionately.

EXCEPTIONS TO THE ARTICLE 2:102

This article protects the applicant from termination or variation of the insurance contract in specific cases in which he acted honestly and the non-disclosure or misrepresentation may be or should be considered as approved by the insurer.

Article 2:103 – Exceptions

The sanctions provided for in Article 2.102 shall not apply in respect of

- a) *a question which was unanswered, or information supplied which was obviously incomplete or incorrect;*
- b) *information which should have been disclosed or information inaccurately supplied, which was not material to a reasonable insurer's decision to enter into the contract at all, or to do so on the agreed terms;*
- c) *information which the insurer led the policyholder to believe did not have to be disclosed; or*
- d) *information of which the insurer was or should have been aware.*

There should not be a negative effect of non-disclosure, if the insurer gave its consent to that. If consent is induced by incomplete or inaccurate information, as it decided to conclude the insurance contract, although certain information a) has not been supplied or was obviously incomplete or inaccurate, b) was objectively immaterial or c) has been waived or d) was already known to the insurer, in all these cases

¹⁰ Ibidem

the insurer shall not be entitled to terminate the insurance contract or to propose its variations and clause 2:102 will not apply.

First exception: Insurers, in order to reduce transaction costs commonly require applicants to complete standard forms of questions drafted with no particular applicant or even sub-class of insurance cover in mind. These forms often contain more questions than strictly necessary for an insurer to reach a decision on a particular risk/s. It is common in practice that applicants submit incomplete or blank answers because they are unable to supply the information required or they rightfully consider the required information obviously immaterial. But the insurer concludes the contract nevertheless. In these cases the only logical conclusion is that the answer was not material to the decision or that the insurer was willing to assume that, if supplied, the information would not have been material.

Second exception: An insurer may apply clause 2:102 claiming that certain information is material to him although not material to most other insurers of that kind of risk. This provision is a consequence of the rule found in many countries that applicants are obliged to disclose only information that is objectively material to the risk in question. In many countries, material is interpreted as sufficiently significant so that if it had been disclosed, the insurer would have refused to conclude the contract at all or would have done so only on different terms. In many countries the presumption lies on the insurer's side based on the assumption that since the insurer has requested the information, it is material for that risk, unless proved otherwise.

Third exception: The third paragraph refers to an applicant who answers the insurer's questions with the assistance of an employee or representative of the insurer. Often such a representative clarifies and interprets the questions and explains their significance for the insurance risk and cover, provides examples of answers of other applicants and generally advises on the kind of information that is necessary to be supplied. If he wrongly advises the applicant that some information does not have to be mentioned, while the insurer (and the insurance market) would regard the same information as material, and the applicant relies on such information of the insurer's representative, this insurer may not apply the provisions of the clause 2:102 i.e. terminate or propose a variation of the insurance contract. It would be considered that the insurer has waived the disclosure of the information in question.

Forth exception: If the particular information is already known to the insurer, the assumption is that he concluded a contract relying on his own knowledge rather than on what the applicant provided. Similar to the information of the applicant – i.e. making an investigation in order to find the answers to the insurer's questions, as provided in the clause 2:101- the insurer should conduct a research in order to check the material questions. However, the insurer's research should not extend to a search in different public records or other investigations which would be too expensive and time consuming. It should be limited to information already available and retrievable such as in-house computer data and data collected in cooperation with other insurers.

Similarly, Greek law provides that if the contract was based on written questions, the insurer cannot later rely on the fact that specific questions remained unanswered, circumstances which were not the subject matter of a questions have not been disclosed, or an obviously incomplete answer was given to a general question, unless the other contracting party has made such a response with an intention to deceive the insurer. Knowledge of the insurer of the facts and information that should be provided by the applicant does not release the applicant from the obligation to actually provide this information. However, if the policyholder evidences that the insurer possessed the information, he may prevent the occurrence of the legal consequences for his misrepresentation or non-disclosure. This applies in cases when the insurer acquired this relevant knowledge within its contractual relations with the applicant. For example in case that the insurer sent an ex-

pert to perform the relevant expertise before the conclusion of the agreement and these relevant facts were included in the expert opinion. On the other hand this would not apply if an employees of the insurer had this knowledge from his personal relations with the applicant.¹¹ Serbian law provides for two exceptions: if the insurer was aware or could not have been unaware of the facts in question and if the insurer fails to use his legal rights once when he become aware.

FRAUDULENT BREACH

The sanctions for fraudulent breach are heavier and the time limits of the procedure are longer. This article regulates the right of the insurer to avoid the contract and to retain the premium received and due if the breach of Article 2:101 was fraudulent.

Article 2:104 Fraudulent Breach

Without prejudice to the sanctions provided for in Article 2:102, the insurer shall be entitled to avoid the contract and retain the right to any premium due, if it has been led to conclude the contract by the policyholder's fraudulent breach of Article 2:101. Notice of avoidance shall be given to the policyholder in writing two months after the fraud becomes known to the insurer.

The avoidance of contract should be understood as ex tunc retroactive rescission of a contract. The general rule regarding the legal consequences of avoidance are regulated in article 4:115 of the Principles of European Contract Law which provide that "On avoidance either party may claim restitution of whatever he has supplied under the contract or the part of it avoided, provided he makes concurrent restitution of whatever he has received under the contract or the part of it avoided. If restitution cannot be made in kind for any reason, a reasonable sum must be paid for what has been received." The general rule for avoidance of an insurance contract would be that the insurer is entitled to receive any payment made under the insurance contract, while the policyholder would receive back any premium paid. However, in the case of fraudulent breach of the applicant's obligation to disclose information the insurer shall be entitled to receive any payment given but the policyholder shall not be refunded the premium and the insurer will be entitled to request the premiums not paid yet.

Furthermore, the time limit in which the insurer may send notice of avoidance is longer than in cases of innocent or negligent breach and starts from the moment when the insurer has acquired the knowledge that the misrepresentation or non-disclosure was fraudulent.

In Greek law, the insurer may terminate the insurance contract and request damages for any loss he suffered¹². Serbian law provides for a similar solution as CFR including the declaring of the insurance agreement as null and void, keeping the premium and requesting the unpaid premiums for the period within which he has requested the declaration of the contract to be null and void, all in case of fraudulent non-disclosure or misrepresentation of a material information¹³. In French Insurance Code, the insurance contract shall be null and void in the event of reluctance or intentional false statement of the insured, when such omission or fraudulent misrepresentation changes the subject of the risk or decreases the insurer's assessment thereof, even if the risk that the insured concealed or distorted has had no impact on the loss. The insurer shall then be entitled to the premiums paid. It shall be entitled to payment of all due premiums by way of damages. These provisions do not apply to life insurance. The insurance agreement may also provide for in these cases, that the insurer shall be entitled

¹¹ I.K Rokas, Professor of Commercial Law at the Economic Faculty of Athens: Insurance Law, 2008.

¹² Article 3.6 of the Greek Law on Insurance Contract

¹³ Article 908 of the Serbian Law on Obligations

to take action to recover losses paid by mistake, apart from payment of the compensation provided for the above¹⁴.

ADDITIONAL INFORMATION

This article refers to situations when the applicant voluntarily supplies information not in the questionnaire at the time of concluding of an insurance contract.

Article 2:105 Additional Information

Articles 2:102 – 2:104 shall also apply to any information supplied by a policyholder at the time of concluding the contract in addition to that required by Article 2:101.

This provision deals with situations in which the information were not supplied in response to the insurer's questions, but still had a similar effect on the insurer's decision to conclude the insurance contract and to his estimation of the risks and thus his calculation of the premiums.

The reason for which the CFR proposes that an insurer in this case is entitled to terminate a contract of insurance or to propose its variation on the grounds of breach of the information duty provided in Article 2:101 (although the information provided was above this duty to inform) is that the insurer's agreement to the contract and its terms was based on misrepresentation of facts or omission of information by the applicant.

RETROACTIVE COVER IN REGARD TO THE BREACH OF THE APPLICANT'S DUTY TO DISCLOSE

This provision regulates the situation when an insurer and an applicant agree to an insurance cover that includes or covers the period of time before the conclusion of the insurance agreement. It refers to the applicants' duty to inform and the breach of this duty in case that the insured had the knowledge that the insured event actually occurred before the conclusion of the agreement.

Article 2:401 Retroactive Cover

- (1) If in the case of cover granted for a period before the contract was concluded (retroactive cover), the insured knows at the time of the conclusion of the contract that no insured risk has occurred, the policyholder shall owe premiums only for the period after the time of conclusion.*
- (2) If, in the case of retroactive cover, the policyholder knows at the time of the conclusion of the contract that the insured event has occurred, the insurer shall subject to Article 2:104, provide cover only for the period after the time of the conclusion of the contract.*

By definition, an insurance contract must cover a risk which implies a future event. In case of a retroactive cover, objectively, there is no risk since the time period in which it could have occurred has passed, but there should be a subjective uncertainty of the occurrence of the insured event. Thus, the CFR al-

¹⁴ Article L113-8 of the French Insurance Code (Act no. 81-5 of 7 January 1981, Article 32, Official Journal of 8 January 1981, corrigendum, Official Journal of the French Republic of 8 February 1981).

allows retroactive cover as long as the parties, at the time of contracting, were unaware of whether an insured event occurred or not.

If the policyholder at the time of contract conclusion knew that the insured event has already occurred, article 2:104 should apply since there is a fraud and the insurer should not be bound by this agreement. However, if the insurer also knew about the occurrence of the insured event, the contract may be valid by application of a relevant institution of general contract law (e.g. settlement). In practice, insurers occasionally cover passed insured events for commercial reasons, such as to gain a customer for the future by covering a past event.

If the policyholder did not know about the insured event, but should have known about it, there is no fraud, but there may be place for breach of the pre-contractual obligations of the applicant and articles 2:102 – 2:105 would apply.

SUMMARY

The expressed need for unified insurance contract rules and consensus on these rules resulted in drafting of the PEICL. The PEICL are proposed to apply when the parties have agreed that their contract is governed by them.

The applicant's information provided before conclusion of an insurance contract is essential for the insurer's estimation of the risk and his determining of whether he will enter the agreement, under what terms and for what amount of premium.

The draft PEICL, propose the following regulation of the applicant's obligation to inform and sanctions for the breach of this obligation:

- *The applicant should honestly answer the insurer's questionnaire, consult the person that should be insured for the answers he does not know and investigate the facts that he, or the person to be insured, should have been aware.*
- *In case of a negligent breach of the above obligation, the insurer would have the right either to propose a variation of the insurance contract, or to terminate it. In case of an innocent non-disclosure or misrepresentation of non-material information, the insurer would have only the right to propose an amendment of the insurance contract.*
- *If the insurer fails to use the above right in the prescribed time limit, the policyholder should not be kept in a position of indefinite doubt and uncertainty; therefore the insurer will lose the said right. If the insurer decides to terminate the agreement, the policyholder shall have the right to search for an alternative insurance cover, if available.*
- *In certain cases, such as obviously incomplete or inaccurate information provided by the applicant, objectively immaterial information, a question waived by the insurer or its representative or the answer known to the insurer, the insurer's consent to the contract shall be presumed.*

In case of fraudulent breach, the insurer may avoid the contract and retain the premiums paid and due.