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Significance of the Principles of European Insurance Contract Law for the pre-contractual information duty: Experience of the Baltic States

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Abstract

The provision of cross-border insurance services to consumers in the European Union is problematical as the existence of 27 different contract laws both complicates the cross-border activity and renders it expensive. The currently drafted Principles of European Insurance Contract Law, which will presumably be implemented as a '2nd regime', should change this situation in principle. This article explores the differences between the Estonian Law of Obligations Act, the Latvian Insurance Contract Law and the Lithuanian Civil Code in comparison with the Principles of European Insurance Contract Law with regards to the policyholder's pre-contractual information duty as the rights and obligations of the policyholders do change where the optional instrument is applied. The authors believe that the Principles of European Insurance Contract Law will significantly change the scope of the policyholders' rights and obligations in the Baltic States. Compared with national laws, the relevant regulation provided in the Principles of European Insurance Contract Law is more favourable and consumer-friendly for policyholders both as regards the information duty and the consequences of breaching the duty.

Keywords: insurance law, insurance contract, principles of insurance law.

Europos draudimo sutarčių teisės principų reikšmė informacijai suteikti sudarant draudimo sutartį: Baltijos valstybių patirtis

Anotacija

Tarpvalstybinių draudimo paslaugų teikimas Europos Sąjungoje kelia daug problemų, nes 27 skirtingų sutarčių teisės formų taikymas ne tik komplikuoja tarpvalstybinę veiklą, bet ir didina jos kaštus. Šiuo metu rengiami Europos draudimo sutarčių teisės principai (angl. PEICL), kurie turbūt bus įgyvendinti kaip „2-asis režimas", turėtų iš esmės pakeisti situaciją. Šis straipsnis nagrinėja skirtumus tarp Estijos Respublikos prievolių teisės įstatymo, Latvijos Respublikos draudimo sutarčių įstatymo ir Lietuvos Respublikos civilinio kodekso. Šie teisės aktai lyginami su Europos draudimo sutarčių teisės principais, nagrinėjama informacijos suteikimo sudarant draudimo sutartį pareiga, nes draudėjų teisės ir pareigos keičiasi taikant neprivalomą priemonę. Autoriai mano, kad Europos draudimo sutarčių teisės principai turės reikšmingos įtakos draudėjų teisių ir pareigų apimčiai Baltijos valstybėse. Lyginant su valstybių narių teisės aktais, atitinkamos Europos draudimo sutarčių teisės principų nuostatos yra palankesnės draudėjams kaip vartotojams tiek pačios informacijos pateikimo pareigos, tiek šios pareigos nevykdymo pasekmių atžvilgiu.

Reikšminiai žodžiai: draudimo teisė, draudimo sutartis, draudimo teisės principai.

Introduction

Induced by the desire to harmonise European Union contract law, the Principles of European Insurance Contract Law (PEICL) are currently being drafted, to be presumably implemented as a '2nd regime', i.e., consumers and companies will be able to freely choose whether to apply these principles to their contractual relations or not. The '2nd regime' would be preferable in those areas where international private law (Rome I) prohibits or restricts the parties' free choice of law, such as in the case of contracts of carriage (Rome I, Article 5), consumer contracts (Rome I, Article 6), insurance contracts (Rome I, Article 7), and contracts of employment (Rome, Article 8). Similar voluntary regimes already exist at both the international and European levels: at the international level, the United Nations Convention on Contracts for the International Sale of Goods (1980), UNIDROIT conventions on international factoring and international leasing; at the EU level, European company regulations, e.g., the regulation on *societas europaea* (SE) (this is the option which insurers in the Baltic States and in Europe have used the most), the regulation on a European order for payment procedure, the regulation on the European Economic Interest Grouping or on the Statute for a European Cooperative Society, and the

regulation establishing a European Small Claims Procedure. Such a freedom of choice granted to the parties of an insurance contract is particularly relevant in an open market situation where foreign insurers can provide cross-border services in other member states.

Though in the case of the single European insurance market it was presumed that liberalisation of the market would facilitate a broader international distribution of the insurance portfolio of insurers, which would allow for lower costs and, consequently, lower prices, while local insurers could make their products available to all the consumers in the EU with a more effective marketing of special products (Hess, Trauth, 1998), the authors do not believe this has materialised to date. Many insurance products are still not provided, or are provided to a limited extent on smaller markets, such as the Baltic States. Yet even in the cases where the provider is internationally active, business is typically carried out through subsidiaries or branch offices, and the products sold in different countries are not the same as those on offer in the country of the insurer's domicile. This leads to insurance providers being restricted by variations in national laws, consumers being prevented from having access to a full range of products, and the internal market consequently remaining incomplete (Lakhan, Heiss, 2010). The provision of cross-border insurance services to consumers is currently problematical as the existence of 27 different contract laws both complicates the cross-border activity and renders it expensive. With services and goods directed to consumers, companies need to consider the specific features of each country, *inter alia*, different legal systems, and this adds costs to business, for example, in terms of legal costs (e.g., different legal systems require different standard terms and conditions of contracts, etc.). The idea of the PEICL is to overcome this barrier by providing the parties with an alternative body of law which replaces and supersedes (mandatorily) national insurance contract laws. If chosen by the parties, the insurer would be able to sell a uniform European policy based on the PEICL, regardless of the national insurance law which would otherwise be applicable according to the conflict of law rules (the authors consider that if there is no uniform EU private law, application of the PEICL will still result in 27 different practices, because insurance contract law is coherent with provisions of the general contract law of each country). Thus, the PEICL may *grosso modo* be compared to the United Nations Convention on Contracts for the International Sale of Goods (CISG), although they are based on an 'opt-in' (see Article 1:102 PEICL) rather than 'opt out' scheme (see Article 6 CISG) (Brömmelmeyer, 2011). The PEICL is also expected to intensify the conclusion of cross-border insurance contracts.

It may bring along new insurance products for Estonian, Latvian and Lithuanian consumers and, what is more important, a greater competition amongst the provided services (enhanced competition normally causes prices to drop).

This article explores the differences between the Estonian Law of Obligations Act (LOA), the Latvian Insurance Contract Law (ICL) and the Lithuanian Civil Code (CC), and the PEICL as regards the policyholder's pre-contractual information duty. The three Baltic States have been chosen for comparison purposes, because investors often treat the region as a single homogeneous and similar market (e.g., the insurance companies ERGO, IF and BTA, which operate in all the three countries, have one pan-Baltic management board). However, the insurance products and regulations provided in these countries are very different. The authors of the article believe that the implementation of the PEICL will eventually result in large insurance corporations (in Estonia, Latvia and Lithuania, for example, the German insurance group ERGO, Finnish insurers IF and Seesam (Pohjola Group), the Norwegian insurance company Gjensidige, the British insurance company RSA, the Latvian insurance company BTA, the Austrian insurance company Vienna Insurance Group can be mentioned in this context), which operate in several EU countries, unifying their products using optional instruments (the authors believe, hence, that the term 'optional' does not necessarily guarantee the freedom of choice to all the parties, because in a situation where large corporations unify their products they may discontinue the products based on national law, and thus the PEICL-based products will be the only 'option' for the consumer (should they prefer dealing with an international corporation)) into pan-European insurance products, and thus the PEICL can be expected to be predominantly implemented in some countries.

Implementation of the PEICL is expected to intensify cross-border activities. Today, the cross-border activity is commonplace mostly in the case of exposure to significant business risks. However, a retail customer often cannot use the services of a cross-border service provider.

The pre-contractual information duty is essential with respect to the insurance contracts which, being speculative contracts, place the parties to the contract in a very unequal situation in terms of knowledge about the properties of the object being insured. The pre-contractual information duty can be regulated in a variety of ways and the consequences of a breach of this duty are also different. The authors of the article attempt to find an answer to the question whether or not the PEICL is more favourable for Baltic consumers as regards the pre-contractual information duty and the consequences of its breach and whether the optional instrument as such will bring about drastic changes.

1. Policyholder's pre-contractual information duty

It is one of the fundamental obligations of the policyholder to notify the insurer of all circumstances known to the policyholder which are relevant to the insurer in order to take over the risk. This obligation is related to the principle of *uberrimae fidei* ('the utmost good faith'). The principle was originally formulated in England back in 1766 in the case of *Carter v Boehm*. Generally, only the insurer knows the specific data used to calculate the probability of occurrence of an insured event. The insurer relies on the claims made by the policyholder, believing firmly that the policyholder is not withholding any circumstances known to the policyholder which might mislead the insurer and instil in the latter a belief that there are no such circumstances. The utmost good faith prohibits one party to withhold circumstances which only that party knows by involving another party in a transaction and taking advantage of that other party who believes that the circumstances are different (Belich, Krivosheev, 2001). The principle of utmost faith in the context of insurance is a special case of the principle of good faith central to civil law (Belich, 2009). If the policyholder has better knowledge about his risk level than the insurer, it is difficult for the latter to assess the risk level (high or low) of a particular policyholder. The insurer has to set the premium somewhere in between the premium for a high-risk policyholder and a low-risk policyholder. Consequently, the high-risk policyholder will pay less and the low-risk policyholder will pay more. Due to the increase in insurance premiums, low-risk policyholders will decide not to purchase insurance at all; they will leave the market. This phenomenon is called *adverse selection* (Kontautas, 2010).

There are two ways to address the pre-contractual information duty in the case of insurance contracts: the insurer presents a questionnaire to the policyholder, who proceeds to answer all of the questions (i), or the policyholder is required to inform the insurer about all relevant circumstances (ii). These two potential regulations are different primarily in that which party should bear the risk that all the circumstances relevant to the insurance contract have been clarified. Today's insurance practice leans towards the questioning method and not the rule of own initiative, which, until quite recently, was the law in the majority of European countries (Basedow *et al*., 2009). While classical law presumed that, according to the principles of liberalism, individuals should be capable of making the right decisions and taking responsibility for their consequences, modern law no longer presupposes the parties' competence to take account of all the risks involved with the contract and thus the rule of own

initiative used to be predominant in insurance law. Postmodern law presumes that insurers, as professionals, are capable of predicting the risks adequately and thus can prepare relevant questionnaires.

Pursuant to Article 2:101 (1) of the PEICL, when concluding the contract, the policyholder must 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. The PEICL purports to entitle the insurer to request information about all circumstances of risk and, depending on such information, decide whether to enter into an insurance contract or refuse to do so (Basedow *et al*., 2009). The chosen wording 'is or ought to be aware' implies the duty to check the facts of which he is uncertain or to search for the facts which are not, but for some reason should, be within his actual knowledge. The duty to check includes asking and checking these questions of the future insured in cases when the applicant and the future insured are not the same person (Todorović-Symeneonides, 2009). The choice of the method of questioning as set out in Article 2:101 is mainly motivated by the fact that generally it is significantly more difficult for policyholders to decide which information is relevant in terms of assessing the risk insured. Placing the burden of asking clear and precise questions on the insurer considerably reduces the likelihood of unnecessary transaction costs and precludes disputes between the insurer and the policyholder at a later date. The authors of the PEICL took the continental approach to the duty of disclosure. Thus, under the PEICL it is sufficient that the policyholder fills in a questionnaire prepared by the insurer. A traditional argument was used – the insurer as a professional should prepare a thorough questionnaire which would enable him to obtain all the needed information from the policyholder (Kontautas, 2010).

In Estonia, pursuant to § 440 (1) of the LOA, upon entering into a contract, the policyholder must inform the insurer of all circumstances known to the policyholder which, due to their nature, may influence the insurer's decision to enter into the contract or enter into the contract on agreed terms (material circumstances). At the same time, the cited section presumes that material circumstances are those about which the insurer has directly requested information in a format which can be reproduced in writing. The scope of the word 'material circumstances' depends upon the individual circumstances of each individual case. Estonian legal literature concludes that the LOA has chosen a middle ground between two extreme regulations: on the one hand, the policyholder must, on his own initiative, inform the insurer about all the material circumstances relevant to the contract, on the other hand, in any

case information which the insurer has separately requested must be provided (Lahe, 2007). In Estonia, the presumption is that any circumstance concerning which the insurer has not separately required information is immaterial (Varul *et al*., 2007). The authors of this article find this contradictory. If one is to claim that any circumstance about which the insurer has not separately requested information is immaterial, one cannot, according to the authors, also take the stance that the LOA has chosen a middle ground and that the policyholder must, in addition to information requested by the insurer, inform the insurer about everything material on his own initiative. The greatest difference between the PEICL and the LOA is that the LOA deals just with the information known to the policyholder, while under the PEICL the information of which the policyholder ought to be aware is material. However, this is just an ostensible difference as under the LOA only knowledgeable behaviour causes adverse consequences (LOA § 441). In their practice, too, Estonian insurers expect the policyholders to inform about all material circumstances on their own initiative. For instance, the insurance company Gjensidige, which operates in Estonia, stipulates in clause 9.1 of its home insurance terms and conditions that, upon concluding an insurance contract, the policyholder is required to provide true information regarding all issues related to the insurance contract and disclose all material circumstances affecting the risk insured which he is aware of. Clause 12.1.1 of the terms and conditions specifically highlights the rule of own initiative, stressing that upon concluding an insurance contract the policyholder is required to inform the insurer about all the material circumstances known to him which affect the insurer's decision to enter into the insurance contract or to enter into it subject to additional conditions as agreed upon (AAS Gjensidige…, 2005).

In Latvia, however, under § 5 (1) of the ICL, the policyholder and the insured are obliged to provide all the information requested by the insurer regarding the conditions which the insurer needs for assessing the likelihood of occurrence of the insured risk and which is essential for concluding an insurance agreement. Under § 5 (2) of the ICL, the policyholder and the insured are responsible for the truthfulness of the information provided (The Insurance Contract Law of the Republic of Latvia, 2007). Pursuant to the General Insurance Terms and Conditions of the insurance company BTA operating in Latvia (hereinafter – the "BTA Terms"), prior to signing the insurance contract, the policyholder is obliged to provide the BTA with a genuine and complete information requested by the BTA that is related to the insurance object and is necessary for the BTA to evaluate the probability of the occurrence of

the insured risk (BTA Insurance Company SE; General Insurance Terms and Conditions No. 2, 2011). The terms and conditions of the insurance company Seesam operating in Latvia (hereinafter – the "Seesam Terms") require that the policyholder and/or the insured provide all the information requested by the insurer for assessing the insured risk. The policyholder and/or the insured is responsible for truthfulness and completeness of the information provided (Joint Stock…, 2011). Thus, the regulations of the ICL and the PEICL are compatible already at the current stage, and the rule of own initiative does not apply to Latvian policyholders.

In Lithuania, under clause 1 of Article 6.993 of the CC, prior to entering into the insurance agreement, the insured must provide to the insurer all the held information (i) about the circumstances which can have material effect on the probability of occurrence of the insured event and (ii) the amount of potential loss in respect of such event if the insurer does and should not know such circumstances. Pursuant to clause 2 of the same article, material circumstances about which the insured must inform the insurer are deemed to be the circumstances indicated in the standard conditions of the insurance agreement, as well as the circumstances on which the insurer has requested the insured in writing to provide information (The Civil Code of the Republic of Lithuania, 2000). The regulation provided in the CC is essentially the same as the one laid out in the Russian Civil Code (§ 944 (1)), which provides that only such information as set out in an insurance contract or concerning which written questions have been asked is deemed to be material (Protas, 2010). Zaveckas asserts that the CC has been influenced by the Civil Code of the Russian Federation (Zaveckas, 2008). Russian jurisprudents believe that there is a certain asymmetry of information when concluding the contract. The policyholder knows everything about his own risks while the insurer knows just those that have been disclosed to the insurer. However, all material circumstances are needed to be known in order to assess the risks. These are such circumstances of a risk which may affect the insurer's decision to enter or not to enter into a contract as well as the amount of the premium. There are two methods available to the insurer to obtain the necessary information, namely, direct questions in the form of an application and provisions in the insurance terms to the effect that the customer must independently inform the insurer about the circumstances that are material for assessing the risk (Arkhipov, Adonin, 2008). The central law and economics problem in the area of insurance law is avoidance of consequences of asymmetric information. Asymmetric information can be understood as the situation where 'some par-

ties know more than the others'. In the case of insurance, the policyholder has more information about the risk which he wants to insure, and the insurer hardly can monitor the post-contractual behaviour of the policyholder (Kontautas, 2002). For example, pursuant to the personal accident insurance terms and conditions of the insurance company RSA operating in Lithuania (under the business name *Lietuvas draudimas*) (hereinafter – the "RSA Terms"), in order to conclude a contract, the policyholder must, if so required by the insurer, fill in an application/questionnaire (hereinafter – the "application") and submit it together with the additional documents considered by the insurer necessary in order to conclude the contract. Prior to concluding the contract, the policyholder must also provide to the insurer all information available to it on the circumstances that may possibly have an essential influence on the insurance risk. Such essential circumstances of which the insured must notify the insurer are provided in the application or as requested in writing by the insurer (Accident Insurance…, 2011). The CC is different from the PEICL in that additionally to the questionnaire, the policyholder must also be familiar with the insurer's standard terms and conditions. The authors believe that such a regulation is essentially similar to the rule of own initiative as the presumption that a consumer is capable of adequately and thoroughly exploring complicated and often long standard terms is not necessarily compatible with standard practices (the authors believe that although the tenor of Article 6.993 of the CC supports the inference, Lithuanian insurers consider filling in the questionnaire sufficient). Moreover, a person with no legal knowledge is likely not to identify in the standard terms the issues that the insurer considers particularly relevant (for instance, this is why modern insurance law holds that in order to protect the policyholder, certain regulations must be written in bold in the text of the policy, see Article 4:103 (2) of the PEICL). In legal literature, too, it has been specifically highlighted that although standard terms and conditions are very helpful, there is a risk that the parties do not wholly comprehend their content, and thus EU law specifically protects consumers in terms of separate non-negotiated consumer contracts. Some member states have acknowledged the presence of the very same problem in relation to contracts between companies and the DCFR controls corporate contracts, although it is not as extensive as for consumer contracts (Von Bar *et al*., 2009).

Under the insurance laws of the three analysed Baltic States, prospective implementation of the PEICL will affect policyholders the least in Latvia, whose pre-contractual information duty is similar to the optional instrument. However, the situation of Estonian policyholders will improve significantly as

policyholders no longer must adhere to the so-called rule of own initiative or the standard terms and conditions of the insurer in an insurance contract entered into under the PEICL.

2. Consequences of breach of the policyholder's pre-contractual information duty in the absence of an insured event

Article 2:102 of the PEICL entitles the insurer, in the case of a breach of the policyholder's information duty, to either (i) propose a reasonable variation of the contract or (ii) to terminate the contract within one month. Under the PEICL, the policyholder may reject the proposed variation of the contract within one month of receipt of the notice to that effect (Article 2:102 (2) first sentence). In that case, the insurer is entitled to terminate the contract within one month (Article 2:102 (2) second sentence), whereas termination takes effect one month after the notice has been received by the policyholder (Article 2:102 (4)). As a rule, the PEICL limits the right of termination to wrongful breaches alone. It should be noted that according to 'what is expected to be the rule within the market', the PEICL accepts as presumption (*prima facie*) that the contract will continue on the basis of the variation proposed by the insurer. However, the policyholder will always have the right to reject the proposal 'which is expected not to be the rule within the market' only if he does it within one month of the receipt of the relevant written notice of the insurer. In that case, the insurer can terminate the contract, but only within one month from the written rejection of the policyholder (Rokas, 2010).

However, Article 2:102 (3) of the PEICL also provides for the right of termination in the case of a no-fault breach if the insurer proves that it would not have concluded the contract if it had known the information not disclosed to it.

Under the LOA, giving untrue information about the circumstances of risk yields two consequences: (i) if the policyholder has wrongfully breached the information duty, the insurer may withdraw from the contract, i.e., the insurer has the right to avoid the contract *ab initio* (LOA § 441 (1)); (ii) if the policyholder's breach of the information duty is a no-fault breach, the law provides for the insurer's design right to increase the premium (LOA § 460). Thus, there are two key differences between the LOA and the PEICL. Firstly, unlike the PEICL, the LOA does not allow the insurer to demand alteration of the insurance premium (including modification of the contract) if the policyholder has wrongfully breached his information duty. Secondly, the LOA

does not provide for an option to cancel the contract in the case of a no-fault breach if the insurer can prove that it would not have concluded the contract if it had known the undisclosed information. The regulation of standard terms and conditions of Estonian insurers matches that of the LOA (e.g., clause 14 of the General Insurance Conditions of the ERGO Kindlustuse AS, 2011). The authors find the LOA's inflexible and cancellation-favouring regulation is absolutely unjustifiable (especially in a situation where under similar circumstances the LOA prefers continuation of the obligation to its termination; see § 97 of the LOA). The insurer should be able to choose, in each individual case, whether to terminate the contract or to continue with the contract with increased premiums depending on the gravity of the policyholder's breach. Preclusion of the option to change the premium where a wrongful breach is involved inevitably results in the cancellation of the contract. The authors hold that the law should rather direct the parties to continue the contract in an altered form, and resorting to cancellation should be *ultima ratio*. The PEICL, however, allows this. For that reason, the PEICL should be preferred in this issue insofar as it allows the insurers to address circumstances of risk more adequately. The new Swiss Insurance Contract Act also incorporates an amendment which allows the insurer to choose, depending on the circumstances, whether to cancel the contract or to increase the premiums and to carry on with the contract under new conditions (Hasenböhler, 2008).

Article 9 of the ICL sets out that if the insurer has been misled in respect of facts necessary to assess the likelihood of occurrence of the insured risk through negligence of the policyholder, the insurance contract stays in effect. Then, within a 15-day period as from the day when the insurer learns about the actual conditions, the insurer proposes amendments to the terms and conditions of the insurance contract to the policy holder. If the policyholder refuses to accept the insurer's offer or if 15 days have elapsed since the date of forwarding the insurer's offer, the insurer may unilaterally withdraw from the insurance contract. The insurer may exercise this right within a 15-day period after the receipt of the refusal or the expiration of the time limit for the offer. If the insurer proves that, had it known about the actual conditions of the risk, it would not have concluded the insurance contract, the insurer may terminate the insurance contract by notifying thereof within a 15-day period as from the day the insurer learns about such conditions. If, however, the insurer neither terminates the insurance contract nor proposes amendments within 15 days, the insurance contract stays in effect and, in the future, the insurer may not terminate the insurance contract or amend its terms. The BTA Terms set out:

'If the information on the insurance object and the insured risk initially submitted to BTA changes and due to this the insured risk increases, as well as in cases where BTA is misled due to insignificant oversight of the Policyholder, BTA is entitled to offer the Policyholder to make amendments to the insurance contract, including the proposal to increase the insurance premium, within 15 (fifteen) calendar days. If the Policyholder declines the amendments to the insurance contract offered by BTA, or does not give any reply to BTA within the 15 (fifteen) day notification period, BTA is entitled to unilaterally terminate the insurance contract. If BTA can prove that in knowing the increased insured risk it would not have concluded the insurance contract, BTA is entitled to terminate the insurance contract by notifying the Policyholder thereof in writing'. Hence, the main difference between the PEICL and the ICL is the deadline, which is 15 days in Latvia, or one month under the optional instrument. In Lithuania, the insurer must respond to the insured's negligence in fulfilling the information duty within two months. If the insured fails to submit the required information, the insurer may, not later than within two months from becoming aware of the breach, propose to the insured to change the insurance agreement. If the insured refuses to change the insurance agreement and does not respond to the proposal within one month (in the case of life insurance – within two months), the insurer is entitled to claim termination of the insurance agreement (clause 5 of CC Article 6.993). Thus, if the insured does not fulfil his information duty through negligence and the insurer would not have concluded the insurance agreement if it had known the actual circumstances, the insurer is, within two months from its becoming aware of the breach, entitled to claim termination of the insurance agreement. Consequently, the difference between the PEICL and the CC lies in the deadline until which the insurer must respond to a breach after becoming aware of it. Pursuant to the comments to Article 2:102 of the PEICL (p. 83; C4), the insurer must reach a decision within a reasonable period of time, which is one month. In Lithuania, the deadline is two months.

The authors highlight another significant difference between the provisions of the PEICL and those of the LOA, the CC and the ICL regulating the insurer's right to cancel a contract. Namely, the PEICL sets out that termination of the contract takes effect one month after the related notice is received by the policyholder. This ensures that the policyholder has insurance coverage from his soon-to-be former insurer during one month while he searches for a new insurer to provide him equivalent coverage. The CC, the ICL and the LOA do not provide for such an option. Subsection 442 (1) of the LOA does provide for

a one-month deadline for the insurer as of the time when the insurer becomes or should have become aware of the violation of the notification obligation, however, this deadline merely limits the period during which the insurer can exercise its right of withdrawal. Conversely, it is not impossible for the policyholder to withdraw from the contract within one month so that the contract is terminated upon receipt of the related notice or within an unreasonably short period after that. This would create a situation where the policyholder is prevented from insuring his risks so that he is guaranteed continuous coverage. The new Swiss Insurance Contract Act likewise deprives the insurer of the unilateral right to retroactively cancel a contract. Instead there is the right to cancel the contract at a certain date in the future. Should the insurer wish to exercise that right, it must notify the policyholder about its desire to cancel the contract in writing in advance (Hasenböhler, 2008).

Under the insurance law of the three analysed Baltic States, the most significant change upon the potential implementation of the PEICL will be that if the insurer withdraws from a contract, it terminates within one month after receipt of a notice to that effect. In addition, the deadline by which the policyholder must respond to a breach of the information duty will be shortened to one month in Lithuania. In Latvia, this deadline will be extended to one month; instead of the current period of 15 days, the policyholder will also have one month to agree to change the contract.

3. Consequences of breach of the policyholder's pre-contractual information duty in the case of an insured event

The *onus probandi* of non-disclosure is always on the insurer and a breach can never be presumable. As often as not, the insurer discovers a breach of the information duty only after an insured event (*ex post*). There is also a possibility that an insured event occurs at the time when the insurer has already discovered the breach and proposed a variation of the contract under the PEICL or notified about the cancellation of the contract, however, the mandatory one-month period has yet not elapsed after the receipt of the variation proposal or the termination notice by the policyholder. In both cases the degree of fault of the policyholder and whether or not the risk was uninsured (i.e., the insurer would not have concluded the contract) should be considered under the PEICL. In other words, the general rule enshrined in Article 2:102 of the PEICL should be observed when deciding on the fate of the contract (Cousy, 2008). If the policyholder

commits a breach without a fault, Article 2:102 (5) allows that even in the case of an uninsured risk, i.e., even in the case where the insurer would not have concluded the contract, if it had known the circumstances. Upon breaching the information duty (at least) through negligence, one must distinguish between (a) uninsured risk and (b) a situation where the insurer would have concluded the contract and insured the risk, but would have done so under different terms or at a greater premium. No insurance indemnity is payable in the case of an uninsured risk (Article 2:102 (5) first sentence). In the second case, the indemnity is paid, but in accordance with the terms that would have been agreed between the parties if the insurer had known the incompletely disclosed circumstances proportionately to the difference in the insurance premium (Article 2:102 (5) second sentence). What is also very important is the requirement that the occurrence of an insured event should be causally connected with the incompletely disclosed circumstances (Cousy, 2008), i.e., the insured event has to be caused by an element of risk which was the subject of negligent non-disclosure or misrepresentation by the policyholder (Delfos-Roy, 2011).

Pursuant to § 442 (2) of the LOA, the insurer may withdraw from a contract on the basis specified in § 441 of the LOA also after the occurrence of an insured event. The insurer is not released from the obligation to perform the obligations if the circumstances about which information had not been provided had no bearing on the insured event and do not preclude or restrict the validity of the insurer's performance obligation. In deciding on the preclusion or restriction in the meaning of the second sentence § 442 (2) of the LOA one must, *inter alia*, consider the proportion of the paid insurance premiums to the amount of premiums which should have been paid if the circumstances had been disclosed (Varul *et al.*, 2007). One must concede, in comparing § 442 and 460 of the LOA to the relevant provision of the PEICL (Article 2:102), that provisions dealing with the withdrawal of the insurer from the contract and the obligation to pay indemnity due to the policyholder's breach of the information duty in a situation where an insured event has occurred are virtually identical in both texts.

Where a Latvian policyholder commits an act of negligence and an insured event occurs before the termination of an insurance contract or its amendment, the insurer is obliged to pay insurance indemnity in such a proportion as exists between the paid insurance premium and the insurance premium to be paid by the policyholder with a difference in premiums that matches the actual circumstances of risk. However, if the insurer is able to prove that if it had known about the actual conditions of the occurrence of the insured risk,

it would not have concluded the insurance contract, the insurance indemnity does not exceed the insurance premium paid (Article 9 (6) and (7)).

In Lithuania, too, the insurer must pay, in a situation where the insured has breached the information duty through negligence, a portion of the insurance indemnity proportionate to the difference between two insurance premiums. Upon occurrence of the insured event, the insurer is entitled to refuse to pay the insurance indemnity only if it proves that not a single insurer, being aware of the circumstances not indicated by the insured through negligence, would have executed the insurance agreement (Article 6.993 (6) and (7)).

There is also the question of the time frame in relation to which the insurer may claim a higher insurance premium. Pursuant to § 460 (1) of the LOA, the insurer may demand payment of a reasonably higher insurance premium by the policyholder as of the beginning of the current period of insurances if the insurer does not have the right to withdraw from the contract. Under § 453 of the LOA, the period of insurance is a period of time based on which insurance premiums are calculated. It is presumed that the period of insurance lasts for one year. Hence, if the insurer and the policyholder have agreed upon a one-year insurance period for which the insurance premium is paid in four quarterly instalments, the insurer may retroactively increase the instalments. Let us suppose that the breach of the information duty is discovered in the middle of the fourth quarter entitling the insurer to demand, in addition to the already paid three instalments, the fourth instalment and multiply all of the instalments by a certain coefficient. The authors believe that such a retroactive increase of the premium is not justified insofar as it puts on the policyholder a consideration obligation without any counter-consideration (better insurance coverage). In view of the nature of the insurance contract, punishment of the policyholder for a breach of the information duty by increasing the premiums cannot be seen to be reasonable. The adverse consequences of a breach of the information duty should apply only to subsequent payments (as of becoming aware of the breach) and not to the payments already made. In keeping with the ICL (Article 9 (2)), the CC (clause 5 of Article 6.993) and the PEICL, Estonian insurers should also be entitled to increase only subsequent (*in posterum*) insurance premiums (the insurance premium is divisible and can be calculated as *pro rata temporis*) and do that also in the case where the policyholder agrees to the increase, i.e., if the policyholder notifies within one month that he does not agree to the increase, the insurer may withdraw from the contract within one month after which the insurance contract will terminate within one month of the receipt of the withdrawal notice by the policyholder.

Pursuant to Articles 2:101 and 2:102 of the PEICL, the policyholder may present the following objections to an alleged breach of the information duty:

- the policyholder was not aware and did not have to be aware of the actual circumstances of risk;
- the questions posed by the insurer were not clear and precise;
- the notice of the insurer regarding the termination or variation of the contract arrived too late or did not contain all the required information;
- the policyholder was not negligent as the breach was without a fault;
- the insured event was not causally connected with the incompletely disclosed circumstances.

Article 2:103 of the PEICL also allows the policyholder to rely on four potential options if the exercise of the insurer's rights (i.e., the application of the sanctions specified in Article 2:102) is precluded. Therefore, in certain cases there are no adverse consequences for the policyholder even if he fails to properly reply to the insurer's questions (Cousy, 2008).

Pursuant to Article 2:103 (a) of the PEICL, the sanctions do not apply in respect of a question which was unanswered, or the information supplied which was obviously incomplete or incorrect. In the comments to the PEICL, this provision is justified by the fact that as insurers develop standard questionnaires to save transaction costs, such questionnaires tend to be overly long and include the questions unnecessary for the assessment of an individual policyholder. The insurer often gets back a questionnaire with incomplete or omitted replies (Basedow *et al.*, 2009). However, if the insurer concludes the contract irrespectively of unanswered questions or incomplete information, it means that this factor did not affect the insurer's decision or if it did, the impact was so negligible that the insurer was willing to cover the risk irrespectively of the answer (Cousy, 2008). The authors agree with this conclusion. If, for instance, the insurer asks in its standard questionnaire about the existence of a fire alarm in a building and the policyholder omits the question, but the contract is nevertheless signed, one may conclude that the insurer considered this element so insignificant that it did not affect its decision to enter into the contract. If this is the case, the insurer cannot reproach the policyholder for the lack of a fire alarm should an insured event occur. The authors hold that if the installation of a fire alarm is prescribed by legislation (e.g., an automatic fire alarm system must be installed in a building to ensure automatic transmission of a fire call received by the automatic fire alarm system to the alarm centre), any *ex post* reproaches made by the insurer are disputable. On the one hand, upon noticing that the relevant question has been omitted and accepting

the transfer of the risk, the insurer knowingly assumes the risk *ex ante*, on the other hand, the insurer is entitled to expect that the policyholders meet the safety requirements prescribed by law. An exclusion similar to Article 2:102 (a) of the PEICL is provided for in § 441 (2) 1) of the LOA. In the comments to the LOA, it is noted that if the insurer knew that the information was untrue or knew the circumstances which had not been provided to it, the insurer is unworthy of the withdrawal right as it had the opportunity to request true information from the policyholder or, if the insurer knew the circumstances it could have taken them into account in concluding the contract (Varul *et al*., 2007). The provision does not explicitly specify that the insurer has no withdrawal right if the policyholder answers the questions incorrectly or incompletely, however, this is what is implied taking account of the meaning and purpose of the provision. Under the CC and the ICL, too, the insurer is prevented from withdrawal if the policyholder gives incomplete information but the contract is nevertheless entered into. However, the ICL allows the insurer to withdraw from the contract where the information is incomplete by reasons of the policyholder's gross negligence or bad faith.

Article 2:103 (b) provides for an exception as regards the information which should have been disclosed or the information which has been inaccurately supplied, which is not material in respect of the insurer's reasonable decision to enter into the contract, or to do so on the agreed terms. Let us recall Article 2:101, which provides for the presumption that if the insurer asks about some circumstances in the questionnaire, such circumstances are material. This is also how it is understood for the purposes of Article 2:103 (b). In other words, it is presumed that the circumstances included in the questionnaire affect the insurer's decision to conclude the contract (on agreed terms), and where any circumstances had not been included in the questionnaire, they could not have affected the insurer's decision to enter into contractual relations with the policyholder. Consequently, Article 2:103 (b) precludes a situation where the insurer withdraws from the contract due to circumstances about which it had failed to pose a clear and precise question, but in some way gained knowledge of such circumstances. Pursuant to Article 2:103 (c), the insurer is deprived of the right to apply sanctions if this leads the policyholder to believe the information did not have to be disclosed. What is meant here is a situation where the policyholder is assisted in replying by an employee or a representative of the insurer, and the latter mistakenly suggests that a question should be omitted due to its irrelevance. Should it emerge later that the question was essential for the insurer's decision, the insurer has no right to invoke the right insofar it forwent

it due to its representative having given ill advice to the policyholder (Cousy, 2008). Subsection 441 (2) of the LOA does not, once again, explicitly provide for a preclusion similar to that of Article 2:103 (c), though it is covered by § 441 (2) (2), pursuant to which the insurer cannot withdraw from a contract if the failure to provide information or the provision of incorrect information was not the fault of the policyholder. Pursuant to § 104 (1) of the LOA, the types of culpability are carelessness, gross negligence and intent. Insofar as the insurer has no right to withdraw from the contract in the case of the negligence of the policyholder, the insurer should prove the gross negligence of the policyholder's failure to exercise necessary care to a material extent (Varul *et al*., 2007). The insurer is unlikely to fulfil its *onus probandi* in proving gross negligence of the policyholder where the latter did not answer the questions following the recommendations of the insurer's representative. There is no need for further regulation as § 441 (2) 2) covers it. Article 2:103 (d) precludes sanctions in respect of the information of which the insurer was or should have been aware. The drafters of the PEICL proceeded from the idea that if the insurer was aware of this information, it would rely on its knowledge and not on the information disclosed by the policyholder in the questionnaire (Cousy, 2008). However, in assessing what the insurer knows or should know, one must proceed from the presumption that the insurer's knowledge obligation (it would be more precise to use the phrase 'scope of knowledge'; however, the PEICL prescribes an insurer's 'knowledge obligation') extends, in addition to information provided in writing, also to cover the information stored in the servers and computers of the insurer and to information gathered in the course of co-operation with other insurers (Basedow *et al*., 2009). The provisions of § 440 (2) and § 441 (2) 2) of the LOA are similar to Article 2:103 (d). Then again, five insurers with the largest market share in Estonia have precluded the application of § 440 (2) in their standard terms and conditions and thus, in practice, policyholders are still required to inform the insurer about any circumstances that the latter may be aware of. However, such an approach is unreasonably burdensome for the policyholder, also in light of the provisions of the PEICL incorporation of § 440 (2) into the list of § 427 (1) of the LOA (catalogue of restrictions on freedom of contract or imperative provisions) should be considered. The potential implementation of the PEICL does not significantly affect the situation of the policyholder in respect of breach of the information duty in the case of an insured event. However, the PEICL specifies the catalogue of possible objections of the policyholder to the alleged breach (Article 2:103) and defines clearly the insurer's 'knowledge obligation'.

Under the insurance law of the three analysed Baltic States, the potential implementation of the PEICL will bring along only minor changes to the situation related to the policyholder's breach of the pre-contractual information duty *ex post* after an insured event. In case of an insured risk, indemnity will continue to be paid in proportion to the difference in the insurance premiums, i.e., the proportionality rule will be applied. If the risk is uninsured, the insurer is released from the obligation. The situation of Estonian policyholders will improve insofar as, under the PEICL, the insurer may increase only subsequent insurance premiums and even then it is subject to the policyholder's consent.

4. Fraudulent breach of the policyholder's pre-contractual information duty

Article 2:104 of the PEICL regulates a situation where the policyholder concludes a contract as a result of a fraudulent breach of the policyholder's pre-contractual information duty. The PEICL does not explicitly define fraud and the comments refer to Article 4:107 (2) of the PECL pursuant to which a party's representation or non-disclosure is fraudulent if it was intended to deceive the other party (Basedow *et al*., 2009). Pursuant to Article 2:104, the insurer has as many as three options to respond to a fraudulent breach. The first one is to do nothing and to let the contract continue. The second and third options arise out of Article 2:102 which allows the variation of the contract (and termination of the contract if this proves unfruitful) or termination of the contract. It should be highlighted that the PEICL does not require invalidity of the contract, but grants the insurer the choice of whether to terminate the contract or to increase the premium. If the insurer wishes to terminate the contract, this will have a retroactive effect and entitle the parties to demand reversal (the relevant right arises from Article 4:115 of PECL). Nevertheless, as far as the reversal is concerned, Article 2:104 of the PEICL deviates from the PECL and entitles the insurer to retain any premium already paid and to demand payment of any premium due (Cousy, 2008). The underlying reasoning of this right is the need to prevent fraud and hinder the planting, in policyholders' minds, of the idea that 'I'll benefit if the fraud succeeds and if not, I won't lose anything (save there is an insured event)'. 'Fraud which has no effect to an insurer's decision to conclude the contract, whether because the false information was inherently immaterial or because the insurer was aware that the in-

formation was false, does not carry consequences adverse to the policyholder' (Basedow *et al*., 2009).

In Estonia, § 94 of the General Part of the Civil Code Act allows annulment *ab initio* of the contract due to fraud (Tsviilseadustiku üldosa seadus, 2010).

With regards to the insurer, this has been specifically highlighted in § 441 (5) of the LOA. The legislator obviously considered it necessary to emphasise the right of annulment on the basis of the references made in § 442 (Term for insurer to withdraw from contract) to § 441 (Withdrawal of insurer from contract upon violation of notification obligation) to regulate the insurer's performance obligation in a situation where the insurer annuls a contract due to fraud. However, the presumptions set out in § 442 (2) have been fulfilled (the circumstances about which information had not been provided had no bearing on the occurrence of the insured event and do not preclude or restrict the validity of the insurer's performance obligation), and thus the insurer must perform the obligations arising out of the contract. Comments to the LOA point out that in construing § 441 (5) of the LOA, one might conclude that the insurer has no right to annul a contract due to mistake (Varul *et al*., 2007). It must be conceded that the provision is ambiguous in this respect. The insurer's performance obligation becomes especially questionable in a situation where it annuls the contract precisely on the grounds of a mistake as this does not constitute 'withdrawal from a contract on the basis specified in § 441 of the LOA' and therefore should not cause the consequences set out in § 442 (2). Legal literature recommends applying the consequences of withdrawal also in the case of annulment by way of analogy (Varul *et al*., 2007). In Estonia, the insurer cannot retain the premiums, and the amounts paid must be repaid. Insofar as insurance contracts belong to a special type of contracts based on mutual trust and reliance (*contractus intuitae personae*), where the principle of *uberrimae fides* ('utmost good faith') is applied (Kontautas, 2002), the authors hold that the principle of reasonability is contradicted in a situation where there are no financial consequences for the policyholder who intentionally ignores the principle of good faith and behaves *mala fide*; the insurer would be justified in retaining the premiums in such a situation because *ex iuniuria ius non oritur*.

Pursuant to Article 8 of the ICL, if the insurer is misled in respect of the facts necessary to assess the likelihood of occurrence of the insured risk due to bad faith or gross negligence of the policyholder or the insured, the insurance contract is deemed to be null and void as of its conclusion. The insurer does not have to refund the insurance premium paid. Clause 3.1 of the BTA Terms and clause 9.1 of the Seesam Terms reiterate almost verbatim the provision of

Article 8 of the ICL. The major difference between the PEICL and the ICL is that, in addition to bad faith, gross negligence also invalidates a contract *ab initio*. The authors hold that the Latvian regulation is overly rigid as the insurer cannot continue (for example, if the insurer considers it feasible under the circumstances) or change the contract.

In Lithuania, if after execution of the insurance agreement it is established that the insured furnished to the insurer a knowingly misleading information about the circumstances of risk, the insurer is entitled to claim the recognition of the insurance agreement as void, except for the cases when the circumstances which had been concealed by the insured disappeared prior to the insured event or had no effect on the insured event (CC Article 6.933). It is significant that if the insured fails to give a written answer to the inquiry by the insurer, and the insurance agreement is concluded anyway, the insurer has no right to claim the recognition of it as void.

Under the insurance law of the three analysed Baltic States, the potential implementation of the PEICL will introduce major changes in the regulation of the policyholder's fraudulent breach of the pre-contractual information duty. As far as the insurer is concerned, the PEICL is much more flexible and allows more options for action in a situation where the policyholder has committed fraud in relation to the insurance contract. The situation of Latvian policyholders will become less burdensome, because if the PEICL is implemented, the insurers will no longer be able to invoke gross negligence in providing information in the pre-contractual negotiation phase.

Conclusions

The authors believe that the current differences of the Estonian, Latvian and Lithuanian insurance legislation as regards the pre-contractual obligations of the policyholder and the consequences of a breach of these obligations preclude the introduction of pan-Baltic insurance products. Implementation of the PEICL would allow cross-border insurers to provide consumers cross-border services on the Baltic insurance market as the barriers caused by different legal systems would be removed. The authors hold that the PEICL will significantly alter the scope of the policyholder's obligations in the Baltic States. As regards the pre-contractual information duty, potential implementation of the PEICL will affect Latvian policyholders the least. However, the situation of Estonian policyholders will improve significantly as policyholders no longer must adhe-

re to the so-called rule of own initiative or the standard terms and conditions of the insurer if the insurance contract is entered into under the PEICL. The most significant change upon the potential implementation of the PEICL will be that if the insurer withdraws from a contract, it terminates within one month after receipt of a notice to that effect. In addition, the deadline by which the policyholder must respond to a breach of the information duty will be shortened to one month in Lithuania. In Latvia, this deadline will be extended to one month, instead of the current 15 days, the policyholder will also have one month to agree to change the contract. Under the insurance law of Estonia, Latvia and Lithuania, the potential implementation of the PEICL will bring along only minor changes to the situation related to the policyholder's breach of the pre-contractual information duty *ex post* after an insured event. The regulation of the fraudulent breach of the policyholder's pre-contractual information duty will change significantly. As far as the insurer is concerned, the PEICL is much more flexible and allows more options for action in a situation where the policyholder has committed fraud in relation to the insurance contract. The situation of Latvian policyholders will become less burdensome because, if the PEICL is implemented, the insurers will no longer be able to invoke gross negligence in providing information in the pre-contractual negotiation phase.

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