Verslo ir teisės aktualijos / Current Issues of Business and Law
ISSN 1822-9530 print / ISSN 2029-574X online
2012, 7(1), 85–107
doi:10.5200/1822-9530.2012.06

TEISĖS AKTUALIJOS / CURRENT ISSUES OF LAW

Does the insurance premium payment regulation as stipulated in the Principles of European Insurance Contract Law protect policyholders sufficiently enough?

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Received 14 March 2012; accepted 10 May 2012

Abstract

The topic of insurance premiums is of a central and crucial relevance in insurance matters as the payment of the insurance premiums corresponds to the assumption of insurance risk by the insurer. An insurance premium is the price of risk – *pretium periculi*. Non-payment of insurance premiums may, in certain cases, cause the insurer to be released from the obligation to perform. Hence, it is the most important principal obligation of the policyholder. Currently, the regulation concerning the payment of insurance premiums varies significantly across the EU Member States and there are different approaches to the protection of the rights of the policyholder. However, such a situation renders it difficult to provide cross-border insurance services. Moreover, the citizens of the European Union may have difficulties in understanding the obligations arising out of the legislation of the country they plan to move to for employment. This article explores the differences between the Estonian Law of Obligations Act, the Latvian Insurance Contract Law and the Lithuanian rules contained in the Civil Code and the Insurance Law in comparison with the Principles of European Insurance Contract Law with regards to the insurance premium payment regulation. The authors believe that, compared with national laws, the relevant regulation provided in the Principles of European Insurance Contract Law to a certain extent is more favourable and consumer-friendly for policyholders than the domestic law of the Baltic States. Notwithstanding the fact, it may be argued that the Finnish insurance law is even more consumer-friendly when it comes to the issue of insurance premiums.

Keywords: insurance law, insurance contract, insurance premium, Principles of European Insurance Contract Law, Draft Common Frame of Reference.

Reference: Luik, O.–J.; Kontautas, T. (2012). Does the insurance premium payment regulation as stipulated in the Principles of European Insurance Contract Law protect policyholders sufficiently enough? *Current Issues of Business and Law*, 7(1), 85–107.

Ar draudimo įmokos mokėjimo reglamentavimas, įtvirtintas Europos draudimo sutarčių teisės principuose, pakankamai apsaugo draudėjus?

Anotacija

Draudimo įmokų tema turi didžiulę reikšmę draudimo teisės srityje, nes draudimo įmokų mokėjimas yra lygus draudimo rizikos prisiėmimui, kurį įgyvendina draudikas. Draudimo įmoka yra rizikos kaina, arba *pretium periculi*. Draudimo įmokų mokėjimų nevykdymas tam tikrais atvejais gali reikšti draudiko atleidimą nuo pareigos vykdyti sutartį, todėl įmokų mokėjimas yra svarbiausia ir pagrindinė draudėjo prievolė. Šiuo metu draudimo įmokų mokėjimas reglamentuojamas labai skirtingai įvairiose ES valstybėse narėse, egzistuoja skirtingi požiūriai į draudėjų teisių apsaugą. Vis dėlto tokia situacija lemia, kad kyla sunkumų teikiant tarptautines draudimo paslaugas. Be to, Europos Sąjungos piliečiams gali būti sudėtinga suprasti savo prievoles, kylančias iš teisės aktų toje šalyje, į kurią jie planuoja persikelti siekdami įsidarbinti. Šiame straipsnyje nagrinėjami Estijos Prievolių teisės įstatymo, Latvijos Draudimo sutarčių įstatymo ir Lietuvos Civilinio kodekso bei Draudimo įstatymo nuostatų skirtumai lyginant jas su Europos draudimo sutarčių teisės principais draudimo įmokų mokėjimo reglamentavimo kontekste. Autorių nuomone, lyginant su nacionaline teise, atitinkamos Europos draudimo sutarčių teisės principų nuostatos tam tikra apimtimi yra palankesnės ir labiau orientuotos į draudėjus kaip vartotojus nei Baltijos valstybių nacionalinė teisė. Nepaisant šio fakto, galima teigti, kad Suomijos draudimo teisė yra net dar palankesnė vartotojams draudimo įmokų atžvilgiu.

Reikšminiai žodžiai: draudimo teisė, draudimo sutartis, draudimo įmoka, Europos draudimo sutarčių teisės principai, bendros principų sistemos projektas.

Introduction

It was already back in the 17th century that Scacciae stressed that *nam assecuratio est contractus emptionis et venditionis, in quo assecuratus emit periculum, et assecurans illud vendit* (Scacciae, 1664), i.e., insurance means the purchase and sale of risk where the policyholder sells and the insurer buys such risk. An insurance premium is the price of risk – *pretium periculi*. Insurance is a risk management technique used to hedge against the risk of an uncertain loss by transferring it to another party, namely, an insurance company, against a premium. The people who buy insurance are those who value the "ease of mind" that insurance provides much more than those that prefer to self-insure. They prefer to pay a premium to transfer a possible loss to the insurer rather than living with uncertainty. The amount of the premium that they would pay depends highly on their degree of risk aversion and the way they evaluate the risk they represent (Dimitriyadis *et al.*, 2011).

The topic of insurance premiums is of central relevance in non-life insurance matters, as the payment of the insurance premiums corresponds to the assumption of the insurance risk by the insurer. Notwithstanding the fact that a life assurance premium nowadays is mostly meant to cover capital accumulation, equal importance also exists in the sphere of life assurance contracts. Thus, the substance of the subjective rights of the policyholder and the insurer can be determined by way of analysing their corresponding obligations. At this point, it is important that the contractual obligation of the policyholder to make payments towards insurance premiums is reflected in the law and is not dependent on the policyholder being the insured person or the policyholder's right to indemnity (Norio-Timonen, 2010).

Currently, the regulation concerning the payment of insurance premiums varies significantly across the EU Member States, and there are different approaches to the protection of the rights of the policyholder. However, such a situation renders it difficult to provide cross-border insurance services. Moreover, the citizens of the European Union may have difficulties in understanding the obligations arising out of the legislation of the country they plan to move to for employment. The European Commission is currently in the process of preparing a European Common Frame of Reference (CFR) concerning Europe's general contract law wherein one part focuses on insurance contracts (Principles of European Insurance Contract Law, hereinafter – the PEICL). The PEICL presumably will be 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. Basedow mentions that there is a risk that insurers would prefer the PEICL only if this does not significantly deteriorate their legal status compared to the domestic law (Heiss, 2011).

This article explores the differences between the Estonian Law of Obligations Act (LOA), the Insurance Contract Law of the Republic of Latvia (ICL), the Civil Code and the Law on Insurance of the Republic of Lithuania (CC and IL) and the PEICL as regards the policyholder's insurance premium payment duty. The article purports to identify whether or not the regulation of insurance premiums as contemplated in the PEICL is more beneficial to policyholders than the domestic laws of Estonia, Latvia, or Lithuania.

1. First or single premium

One of the distinct features of an insurance contract is that the insurer assumes the risk of an insured event solely subject to the policyholder's payment of insurance premiums. The payment of the premiums and the acceptance of such payments is the paramount evidence of the transfer of risk from the insured person to the insurer.

Article 5:101 of the PEICL sets out that when the insurer makes payment of the first or single premium a condition of formation of a contract or of the beginning of cover, that condition shall be without effect unless (a) the condition is communicated to the applicant in writing using a clear language and warning the applicant that he lacks the cover until the premium is paid, and (b) a period of two weeks has expired after receipt of an invoice which complies with the requirement (a) without payment having been made. Hence, the PEICL does not require that the insurance premium be paid in advance as a condition of the entry into force of the insurance contract. However, this provision does not preclude any agreements to the effect that the payment of the insurance premium is a condition of the activation of the insurance cover. It does, however, mean that the insurer meets certain conditions upon entering into the insurance contract. Basedow highlights that such a condition is looked upon as a means to deter fraudulent contracting by the policyholder (Basedow *et al.*, 2009). In particular, it makes it impossible for them to enjoy the cover, at least for a certain amount of time, under a contract which was concluded knowing that they were not going to pay premium – whether they were unable or simply unwilling to do so (Basedow *et al.*, 2009). The authors agree that, presumably, in order to avoid fraudulent behaviour, it would be reasonable for insurers not to provide the insurance cover for all the policyholders who do not immediately pay the first or single premium. On the other hand, even if the premium is not immediately paid it would be reasonable to provide the insurance cover where the policyholder and the insurer have prolonged contractual relations and where the payment history shows overall regularity. Pursuant to Article 5:103 of the PEICL, the non-payment of the first or single premium entitles the insurer to terminate an insurance contract by giving a prior notice thereof. The contract shall be deemed to be terminated if, as the case may be, the insurer does not bring an action for payment of the first premium within two months after expiry of a period to pay an invoice (two weeks after receipt of the invoice).

Pursuant to para. 454 (1) of the Estonian LOA, the policyholder pays an insurance premium (or the first insurance premium) immediately after entry into a contract. Nevertheless, under para. 454 (2) of the LOA, the policyholder may refuse to pay the insurance premium until the policy has been issued to the policyholder. In Estonia, the legal consequences of failing to make a timely payment of the first insurance premium by the policyholder are set out in para. 457 of the LOA. Under the said provision, if the policyholder fails to pay the first premium within fourteen days after entry into the insurance contract, the insurer has the right to withdraw from the contract. The insurer is presumed to have withdrawn from the contract if the insurer does not file an action to collect the insurance premium within three months after the premium becomes collectable. Consequently, not unlike the PEICL, the advance payment of the insurance payment is, as a rule, not required under the Estonian law. The insurer's right to implicitly withdraw from a contract is set out in para. 457 (1) of the LOA. If the first insurance premium which has become collectable has not been paid by the time an insured event occurs, the insurer is, under para. 457 (2) of the LOA, released from its performance obligation. In this context, it is important that the insurance payment must become collectable by the time the insured event occurs, i.e., the payment deadline must have matured already *ex ante*. The insurer's release from the performance obligation means that the insurance contract continues to be valid; however, irrespective of the occurrence of the insured event and the validity of the contract, the insurer has no obligation to perform. However, the insurer cannot rely on the rights set out in para. 457 (1) and (2) of the LOA if the insurer did not inform the policyholder of the consequences of delaying the payment of the first premium prior to entry into the contract, i.e., the insurer must communicate such legal consequences to the policyholder via the insurance contract (either in the policy or in the general terms and conditions). The mentioned edition of the Law of Obligations Act notes that, as this is an undesired consequence for the insurer, who bears the burden of proving the fact of provision of such information, it is recommended that insurers obtain a signature regarding the communication of information (Varul *et al.*, 2007). The authors of this article believe that communication of information through documents of the insurance contract (either the policy or the general terms and conditions) is sufficient and appropriate while the requirement of an additional signature is excessive, because normally insurers would have: a) already obtained a signature on the insurance contract (the policy and the general terms and conditions which are an integral part thereof) and the general terms and conditions include information about the consequences of delaying the payment of the first premium, i.e., the *caveat subscriptor* rule applies here, or b) the insurance contract bears just the signature of the insurer; however, the insurance contract sets out that by paying the premium the policyholder is deemed to have consented to and read the terms and conditions of the insurance contract (also if the general terms and conditions include information about the consequences of delaying the payment of the first premium), i.e., the payment of the premium proves that the policyholder has read the policy (a reasonable person would normally check the documents supporting the invoice, i.e., the insurance policy). However, in a situation where an insured event occurs within fourteen days, the insurer's performance obligation depends on whether or not the policyholder has paid the premium within this period. If not, the insurer is deemed to have withdrawn from the insurance contract and is therefore not obligated to pay damages.

In Latvia, para. 7 (2) of the ICL sets out that an insurance contract takes effect on the day following the payment of the insurance premium or a part thereof specified by the insurance policy, in the manner, time limit and amount specified by the insurance contract. The insurance contract may contain other procedures for effecting the contract. Thus, in Latvia an insurance contract enters formally and without a special agreement into force on the day following the payment of the premium, i.e., the principle *no premium, no risk* or *no premium, no cover* applies. Hence, the insurer will have no obligation to perform due to the delay in paying the premium as the insurer does not have such an obligation until the payment and the insurance contract takes effect on the day following the payment. But if the policyholder pays the first premium in part (less than the required amount), the insurer may, pursuant to ICL para. 19, suspend the insurance contract until the insurance premium is paid in full and when suspending the insurance contract, the insurer temporarily suspends its obligations.

The regulation contained in Article 6.996 of the Lithuanian CC is essentially much stricter and insurer-centred than the PEICL. Namely, the relevant provision of the CC sets out that an insurance agreement, unless it provides for otherwise, comes into force from the moment of payment by the insured of full insurance contribution (premium) or the first instalment thereof. If the premium is not paid, the contract is terminated unless otherwise agreed. This raises questions whether the insurance contract is a consensual (*contractus consensualis*) or real contract (*contractus realis*). Protas (2010) notes that though formally an insurance contract would be consensual (i.e., it is deemed signed after reaching an agreement regarding its fundamental conditions), in many instances for a contract to be deemed valid it is required that, besides agreeing upon important conditions, the first premium must also have been paid for the contract to turn from a consensual into real contract (Protas, 2010). Nevertheless, even an insurance contract has some features of real contracts, the prevailing view in Lithuania perceives an insurance contract as a consensual contract (*contractus consensualis*). Usually in insurance practice the payment of a premium is a condition for the insurance cover to come into force, while all other obligations of the insurer commence from the moment the contract is treated as concluded.

Under the Finnish law, the payment of the first premium is subject to an even milder regulation than that of the PEICL. Under para. 38 of the Finnish Insurance Contract Act (FICA), a premium for an insurance contract is payable within one month from the dispatch of an invoice for the premium by the insurer to the policyholder. The first payment, however, need not be made before the commencement of the cover, unless payment of the premium is a condition for the commencement of the cover pursuant to the terms and conditions of the insurance policy, and later payments need not be effected before the commencement of the agreed premium period or the insurance period. On the other hand, para. 11 of the FICA allows that according to the nature of insurance or another particular reason, the terms and conditions of an insurance policy may include a provision to the effect that the cover commences only after an insurance premium has been paid. However, such a provision requires under the Finnish law that the policyholder must be informed about it on the invoice issued for the premium.

Pursuant to the insurance laws of the three Baltic States analysed by the authors, the potential introduction of the PEICL and the regulation of the first payment will mean significant changes for policyholders in Estonia, Latvia and Lithuania. However, taking into account the dispositivity of Article 5:101 of the PEICL, insurers will be able to lay down rules in their standard terms which are analogous to the domestic law. However, the authors feel that this may complicate the achievement of the key objective of the PEICL – facilitation of the policyholder's understanding of an insurance contract in a situation where the policyholder concludes contracts in different countries.

2. Subsequent premium

Similarly to laws of a number of countries, Article 5:102 of the PEICL sets out an exception regarding the payment of subsequent premiums. Specifically, several conditions apply to the release of the insurer from the performance obligation in the case where payment of a subsequent premium is not made on time: (a) the policyholder must receive an invoice stating the precise amount of the premium due as well as the date of payment; (b) after the premium falls due, the insurer sends a reminder to the policyholder of the precise amount of the premium due, granting an additional period of payment of at least two weeks, and warning the policyholder of the imminent suspension of the cover if the payment is not made; and (c) the additional period in the requirement (b) has expired without the payment having been made. Thus, the policyholder is granted an additional two-week period of grace if the policyholder fails to pay any subsequent premiums in a timely manner. Heiss notes that if the period of grace has ended and the cover has been suspended, the policyholder still has the option to resume the cover by paying the premium; see the second sentence of Article 5:102 paragraph 2. The cover will, however, be resumed only for the future. As a consequence, insured events occurring between the end of the period of grace and the payment of the premium remain uncovered under the policy (Heiss, 2008). Where an insurance contract is not cancelled and the policyholder does make the subsequent payment, albeit with a delay, the cover will be resumed. Pursuant to 5:103 of the PEICL, the insurer may terminate the contract by a written notice if a subsequent premium is not paid. The contract shall be deemed to be *lapsed* (terminated) if, as the case may be, the insurer does not bring an action for the payment of the subsequent premium within two months of expiry of the period of grace (at least two weeks).

Under the Estonian law, there is also a substantial difference between the policyholder's delaying the payment of the first or second (or subsequent) premium. LOA para. 458 (1) sets out that if the policyholder fails to pay the second or subsequent premium in time, the insurer may, in a format which can be reproduced in writing, set a term of at least two weeks or, if a structure is insured, one month for the policyholder to pay. If the policyholder fails to pay *de integro* the second or subsequent insurance premium within the specified term, the insurer may cancel the insurance contract without prior notice (LOA para. 458 (3)). The insurer may state in the notice specified in LOA para. 458 (1) that it will consider the contract as having been cancelled upon expiry of the term if the policyholder fails to pay premiums within the term.

This represents a potential legal consequence of the failure to pay a subsequent premium, namely, the insurer's right to cancel the contract. Thus, the rules of the LOA and the PEICL are very similar, except for the insurance of a structure where the Estonian law is more insurer- and mortgagee-centred. Where, however, an insured event occurs during the period of grace granted for the payment of the second or subsequent premium (i.e., before the elapse of the period of grace) but the policyholder has not paid the second or subsequent premium by the time of the insured event, the insurer is required to perform its obligation, but may, subject to LOA para. 456, set off an insurance premium which has become collectable against the insurer's performance obligation. If the insurer has set an additional term for the payment of an insurance premium and an insured event occurs after the expiry of the term and if at the time of occurrence of the insured event the policyholder is in default with the payment of the insurance premium, the insurer is released from its performance obligation, unless the failure to pay the insurance premium was due to circumstances beyond the control of the policyholder (para. 458 (2) of the LOA). Lahe has concluded that the last sentence of para. 458 (2) of the LOA allows for the interpretation that the policyholder may excuse his default on the ground of, e.g., the presence of *force majeure* under para. 103 of the LOA. It is questionable whether such a situation covers also the insolvency of the policyholder due to the failure of his debtors to meet their obligations (Lahe, 2007).

For comparison purposes, under para. 39 (3) of the FICA, if a failure to pay a premium has resulted from the financial difficulties encountered by the policyholder as a result of an illness, unemployment or another particular circumstance not primarily caused by the insured, the insurance policy is not *lapsed* (terminated), even if a notice of termination has been given, until 14 days after the impeding circumstance has ceased to exist. Notwithstanding the foregoing, the insurance policy is *lapsed* (terminated) three months after the closing of the period of notice provided. The notice of termination also includes a mention of this option to extend the validity of the insurance policy temporarily. Hence, the Finnish insurance law essentially provides for a maximum of three months of free insurance cover to an unemployed or sick person in a situation where the policyholder cannot make premium payments. Such a period of cover is not subject to the consent of the insurer and neither is the policyholder required to notify the insurer (Norio-Timonen, 2010). However, the policyholder cannot rely on this "social protection" where he himself is to be blamed for his situation. For instance, where the policyholder has fallen ill due to alcohol consumption, participation in a fight or due to any other such culpable reasons

(Hoppu *et al*., 2006). If we compare the regulation of subsequent payments in the Law of Obligations Act and in the PEICL, it becomes apparent that the current Estonian system is formally more liberal for the insurer. Specifically, Article 5:102 (1) of the PEICL states that, as the first operation, the insurer issues an invoice stating the precise amount of the premium due as well as the date of payment and the place for payment. The Law of Obligations Act, on the other hand, puts no obligation to issue an invoice on the insurer. In practice, there are cases where the insurer indicates all the instalments on one invoice without a separate invoice concerning the instalments. Nevertheless, the Estonian Supreme Court concluded in its judgement regarding case 3-2-1-51-06 that it is reasonable to presume in an insurance relationship that the insurer is obliged to notify the policyholder of the obligations the policyholder must meet under the contract before the expiry of the current policy, and issue a related invoice and warning to that effect to the policyholder.

Subsection 39 of the Finnish FICA and para. 38 of the German Insurance Contract Act (hereinafter – VVG) are similar to the PEICL and the LOA on this issue, granting a two-week period of grace to the policyholder. Neither the Latvian nor the Lithuanian law provides for an automatic period of grace to the policyholder in the case of subsequent premium payments.

Pursuant to Article 19 of the Latvian ICL, if the payment of an insurance premium is not made in full, the insurer may suspend an insurance contract until the insurance premium is paid in full. When suspending the insurance contract, the insurer temporarily suspends its obligations. Before suspending the insurance cover (subject to the existence of a precise agreement regarding the payment of subsequent premiums), the insurer is required to make a proposal to the policyholder regarding the payment of the premium, and the insurance cover is suspended on the day following the date of the letter. If the policyholder does not pay the premium during the period of suspension, which cannot be shorter than 15 days, the insurer may cancel the insurance contract. If the premium is paid by the specified date, the suspension on the cover is lifted. Hence, the ICL does not allow Latvian policyholders the “enjoyment” of at least 15 days of the insurance cover should they fail to pay a subsequent premium. In the same vein, clause 2.7 of Insurance Terms and Conditions No. 2 of the BTA General operating in Latvia (hereinafter – the BTA Terms) sets out that if an insurance premium is paid after the insurance premium payment date indicated in an insurance contract and the insured risk occurs before the insurance premium is paid, insurance protection is not valid and the BTA is obliged to notify the Policyholder of the invalidity of insurance protection within 10 (ten) calendar days and pay back the delayed insurance premium.

Pursuant to Article 6.1004 of the CC, when an insurance contribution (premium) is paid regularly, an insurance agreement provides for the legal consequences of a failure to make a regular contribution within the established term. The said provisions are detailed in Article 94 of the IL. If the policyholder fails to pay the second or any other subsequent premium in time, the insurer must inform the policyholder in writing stating that if the premium is not paid within 15 days (for non-life insurance contracts) or 30 days (for life assurance contracts) from the moment the insurer's notification is received, the insurance cover will be suspended. Suspension of the insurance cover exists till the premium is paid or the insurer terminates the contract. Notably, the insurer's right to terminate the contract arises if suspension of the cover lasts at least 3 months (for non-life assurance contracts) or at least 6 months (for life assurance contracts). The same provision is replicated in the majority of general terms and conditions. For instance, clause 32.1 of Accident Insurance Regulations No. 048 of the Lithuanian-based insurance company AB Lietuvos draudimas (hereinafter – the RSA Terms) (2011) sets out that the insurer grants the policyholder 15 days to pay an unpaid subsequent premium before suspending the policyholder's insurance cover. If the subsequent premium payment is not effected during these 15 days, the insurance cover is discontinued and the insurer has no obligation to pay damages. In the event that an insured event (or, if liability insurance is construed on claims made basis, wrongful act which subsequently becomes a basis of the claim) occurs during suspension of the cover, the insurer is released from the duty to pay insurance indemnity.

Lithuanian rules raise few practical questions: i) when the insurer's notification is treated as received ii) whether the insurer is entitled to charge an insurance premium for the suspension period, iii) whether regulation is not too burdensome for non-life insurers.

During a discussion regarding the draft IL 2003, the wording proposed by AB Lietuvos draudimas (RSA) was accepted – "if the contract does not provide other means of notification, it is presumed that notification is received when a reasonable period passes after dispatch of the notice by post". Therefore, the insurer has to prove not the fact that the policyholder has received the notice, but the fact that that the insurer has dispatched the notice. Courts are rather harsh protecting the policyholder in such a situation. Thus, Vilnius District Court in its decision (case No. 2A-957-623/2010) states that the facts that insurer has engaged the third party (logistics company) which has i) confirmed the receipt of the notification from the insurer ii) confirmed that it handed in the notification to the Lithuanian Post are not sufficient to prove that the notice has been dispatched.

Several Lithuanian insurers were charging a premium for the suspension period. However, in a position rendered on 22 November 2005 the insurance supervisor criticized such a practice as being illegitimate and contractual clauses stipulating such a right of the insurer as unfair. Such a position was also upheld by court decisions; therefore, in case the policyholder breaches the premium payment obligation, insurers may claim only losses (e.g., costs of notification, etc.), but not the premium corresponding to the suspension period.

During discussions regarding the draft IL 2012 (which not only aims at implementing Solvency II directive, but, among other issues, also amends some rules on insurance contracts), Lithuanian non-life insurers were successful in arguing that in case of non-life insurance if the second or any other subsequent premium has not been paid, it is sufficient that the non-life insurer notifies about non-payment, gives a 30-day period after which, in case the premium is still due, the contract expires. In case such a provision is upheld by the legislator, life of non-life insurers would be easier, but their policyholders will have considerably less protection.

Under Estonian, Latvian and Lithuanian insurance laws, as analysed by the authors, the potential introduction of the PEICL will bring most changes to Latvian policyholders in connection with the failure to make a subsequent premium payment as they will be entitled to the automatic right of a grace period. In Lithuania, introduction of the PEICL might reverse achievements of non-life insurers regarding non-applicability of the suspension period. In Estonia, on the other hand, the grace period will shorten from the minimum 30 days to the minimum 15 days for the insurance of structures. However, the authors point out that compared with the PEICL, the Finnish FICA has gone even further in protecting policyholders in the case of non-payment of subsequent premiums, granting them additional coverage in the case of an illness or unemployment. Whether or not the Finnish regulation is justified and just is open to discussion, as ultimately the consequences of the problems encountered by some policyholders (illness, unemployment) have to be indirectly borne by the rest of the policyholders who will have to guarantee their obligations through the insurance premiums they pay. Finnish jurisprudents believe that, as the level of protection granted to policyholders in the Nordic countries has always been high, it is likely that the harmonisation of the EU insurance contract law would result in less favourable terms both for policyholders and insured persons (Lehtipuro *et al.*, 2010).

3. Practical problems related to premiums in insurance legal relationships

One of the critical issues related to the payment of premiums is the precise moment at which a premium should be deemed to have been paid: whether a premium is deemed paid as from the moment the policyholder makes a bank transfer to pay the premium or whether it is the moment when the premium is collected in the insurer's bank account? There is also the question of who bears the risk in a situation where, for instance, a bank goes bankrupt after a transfer is made, but *ex ante* it is collected in the insurer's bank account. The PEICL does not provide direct answers to this question. The mentioned edition of the PEICL clarifies that questions of performance, such as the place, time and mode of payment of a premium, are left to general rules as contained in the Principles of European Contract Law (Basedow *et al.*, 2009). Pursuant to para. 44 of the FICA, in Finland a premium is deemed to have been paid as from the moment the money is debited from the policyholder's account or, in the case of a postal payment, as from the moment the receipt is stamped in the post office. Hence, under the Finnish law it is irrelevant that the premium be collected in the insurer's bank account. The regulation of an insurance contract under the Estonian LOA does not specify the moment which should be regarded as the payment of a premium. It can be derived from the general regulation concerning the performance of obligations, i.e., performance of an obligation is deemed to be conforming if the obligation is performed at the right time, at the right place and in the right manner for the benefit of the person who is entitled to accept performance. However, in Estonia quite a few insurers have laid down in their standard terms and conditions that a premium is deemed paid as from the moment it is collected in the insurer's account. For example, clause 4.1 of the General Insurance Terms and Conditions of the Estonian-based Salva Insurance AS (hereinafter – the Salva Terms) sets out that the policyholder is required to ensure that premiums are received by the insurer by the deadline specified in an insurance contract. In Germany, para. 36 (1) of the VVG provides that the policyholder must transfer an insurance premium to the insurer at his own risk and at his own cost. Hence, the German law affirms that the payment of the insurance premium (collection by the insurer) is at the risk of the policyholder. For instance, in Lithuania, clause 32.3 of the RSA

Terms similarly presumes that an insurance premium must be collected in the insurer's bank account. On the other hand, clause 4.3 of General Insurance Terms and Conditions No. 2 of the Latvian-based insurer BTA (hereinafter – the BTA Terms) sets out that if an insurance premium is paid by transfer, the moment of payment is the moment when the Policyholder submits an order to a credit institution to transfer the respective amount to a BTA bank account. Accordingly, in practice both Estonian and Lithuanian insurers often presume that a premium can be deemed as paid when it is collected in the insurer's bank account, whereas in Latvia it may be sufficient, as the practice shows, to give a bank an order to transfer the premium to the insurer.

There is another practical issue related to insurance premiums, namely, to which extent should a premium be returned by the insurer if an insurance contract is terminated prematurely for reasons other than the fraud of the policyholder? For instance, para. 459 of the Estonian LOA, which is imperative in its nature, provides that if an insurance contract is terminated prematurely during a period of insurance by cancellation or withdrawal or for any other reason, the insurer is entitled to an insurance premium only for the period of time up to the termination of the contract. At the same time, many Estonian insurance companies provide for the so-called administrative expenses in their general terms and conditions. Clause 9.6 of the General Terms and Conditions of Insurance Contracts of the Estonian-based ERGO Insurance AS (hereinafter – the ERGO Terms) sets out that if an insurance contract is cancelled, the policyholder is entitled to a refund of the premium paid for the time remaining until the end of the insurance period, less the administrative expenses of the insurer (15% of the annual premium). Article 5:104 of the PEICL provides that if an insurance contract is terminated before the contract period has ended, the insurer is entitled to premiums in respect of only the part of the period prior to termination. In the annotated edition of the PEICL (Basedow *et al.*, 2009), it is pointed out that if an insurance premium has been prepaid, returning of the money takes place on the *pro rata* principle, since modern information technology enables virtual expenseless calculation on the principle of *pro rata temporis* (a), and due to lessening of the peril, an insurance premium is no longer necessary from the point of view of the insurer's solvency (b), the insurance risk is divisible on the basis of days/months/years in an economic sense (c), 'preservance' of an insurance premium is not justifiable as a 'contractual penalty' (d) and keeping such premium could be viewed as punishing of the policyholder, which is unjustifiable (e). Heiss (2008), too, stresses that indivisibility is, first of all, no longer required for reasons of practicability. Modern information technology enables the calculation of *pro rata* premiums at virtually no charge. Secondly, the argument that the insurer needs the premium to fund the relevant risk pool, as originally conceived, is unfounded. Following early termination of the contract, the overall exposure of the insurer to risk decreases and the unearned premium is no longer needed to maintain the solvency of the insurer. Thirdly, the risk covered is not indivisible itself. Insurance practice shows that a premium for risk can be calculated on a daily, monthly or yearly basis. Clearly, premiums for the cover of a shorter period are lower in absolute terms than premiums for cover of a longer period. Therefore, at least from the economic point of view, risks are divisible in time. There is, of course, the argument that risk is not even throughout a given period, such as one year. For example, in the case of flood insurance risk is higher in some seasons than others. However, insurers could tackle this problem by calculating and charging premiums on a monthly basis instead of an annual basis. The principle of divisibility of a premium neither prevents nor interferes with such a calculation and charging of the premium. Fourthly, the right of the insurer to retain unearned premium cannot be justified as a provision for liquidated damages (Heiss, 2008). Article 45 of the Finnish FICA similarly provides that any excess payment must be refunded to the policyholder; however, if the refundable premium is less than EUR 8 it need not be returned. The authors believe that if one was to take the stance that insurers may impose administrative fees at their own discretion and without restrictions, it would result in it being technically possible to lay down in general terms and conditions that the administrative expenses are equal to the potential refund, i.e., the amount of the insurance premium until the end of the insurance premium, it would therefore be situation *ab absurdo*. This might create a situation where the policyholder must pay premiums for the entire insured period despite of having the contract cancelled. The authors note that the policyholder pays a premium for the risk assumed by the insurer and should a contract be terminated due to cancellation, the risk no longer transfers to the insurer and thus the insurer is not entitled to any more premiums. Compensation for the costs of concluding the contract is open to debate. One may assert that an insurance contract and its termination is not, by nature, so special as to afford to the compilers of general terms and conditions an additional outlet for managing the costs. At the same time, in Latvia, for instance, the so-called fee for the termination of an insurance contract is provided for in law. Thus, the ICL (para. 9 (3), 9 (4), 11 (4), 15 (2), 16 (2) and (3), 27 (1), 30 (3)) sets out that the insurer is entitled to expenses (evidenced) arising from the conclusion of an insurance contract, which do not exceed twenty five per cent of an insurance premium. Similarly, clause 2.9 of the BTA Terms sets out that in the event that: a) the Policyholder fails to pay the insurance premium within the period of time indicated in the insurance contract, which confirms that the Policyholder is not willing to enter into a contractual relationship with BTA; b) the Policyholder notifies of the will thereof to terminate the insurance contract; the insurance contract is terminated and BTA is entitled to request the Policyholder to compensate expenses of BTA related to the conclusion of the insurance contract amounting to 25% (twenty five per cent) of the insurance premium calculated in accordance with the respective insurance contract, unless stipulated otherwise by the parties. The Insurance Terms of the Finnish-based insurance company Pohjola (hereinafter – the Pohjola Terms) expressly set out that when determining the amount of a returnable premium, the validity is calculated in days according to the insurance period to which the premium pertains. In Lithuania, the *pro rata temporis* rule is set in Article 98 of the IL which specifies that provisions of an insurance contract on refund due to premature termination take into account i) the degree of the policyholder's fault (in case of a breach of the contract), ii) the insurer's administrative expenses related to conclusion and performance of the insurance contract, iii) the insurance premium paid for the remaining period of the contract when the insurance cover was not provided, iv) the premium due and other important circumstances. Therefore, in an ideal situation, if a contract is terminated in the middle of its term (say after 6 months in case of an annual contract) the good faith policyholder who has paid the full annual premium should get back 50 per cent of it minus insurer's administrative expenses corresponding to the first six months when the contract was valid.

In Germany, para. 39 of the VVG provides that the insurer is entitled only to a share of a premium for the period of insurance which corresponds to the period in which the insurance cover existed, except in the case where the first premium is not paid on time. In such a case, if the insurer withdraws, he may demand an appropriate fee. Some regulations prescribe the option of not refunding a premium upon the termination of an insurance contract due to the policyholder's fraudulent behaviour (e.g. Article 8 of the ICL in Latvia and Article 2:104 of the PEICL), invoking the policyholder's breach of the *fraus omnia corrumpit* rule.

Another practical question is whether or not an insurance contract transfers to the acquirer upon the transfer of the insured thing and until which time the previous owner has to pay insurance premiums and from which moment this obligation befalls the new owner. The Estonian Law of Obligations

Act gives preference to the continuance of the obligation in the case where an insured thing is transferred. Thus, para. 494 (1) of the LOA sets out that if the policyholder transfers an insured thing, all the policyholder's rights and obligations arising from the insurance contract transfer to the acquirer of the thing. By acquiring a thing, the acquirer becomes a party to the insurance contract, i.e., the policyholder. Subsection 494 (2) of the LOA provides that the transferor and the acquirer of the thing are solidarily liable to the insurer for payment of an insurance premium for the period of insurance during which the transfer takes place. The LOA allows the insurer to cancel an insurance contract within one month after becoming aware of the transfer. The logic behind this is that the new owner may be a person of a heightened risk for the insurer with whom the insurer would normally not enter into a contract under such conditions. The policyholder, i.e., the new owner may cancel the contract only at the end of the current insurance period. Pursuant to para. 494 (3) of the LOA, the policyholder's rights and obligations arising from an insurance contract are not be deemed to have been transferred with respect to the insurer until the insurer becomes aware of the transfer of an insured thing. If the insurer is not notified of the transfer of the thing in time, i.e., promptly, the insurer is released from its performance obligation if an insured event occurs more than a month after the time when the insurer should have received the corresponding notice. Hence, under the Estonian law, if a thing is transferred there is a certain period of time when both the transferor and the acquirer of the thing are solidarily liable for the payment of insurance premiums. Likewise, pursuant to Article 6.1011 of the Lithuanian CC, it is preferred that an insurance contract remains valid upon transfer and that the obligations of the policyholder, including the obligation to pay premiums, are also transferred to the acquirer. However, this is a dispositive provision, i.e., an insurance contract may prescribe otherwise. Pursuant to Article 44 of the Latvian ICL, upon the transfer of an immovable an insurance contract terminates after one month; for movables, an insurance contract terminates as from the moment of the transfer, unless otherwise agreed with the insurer. Article 12:102 of the PEICL provides that an insurance contract is terminated one month after the time of the transfer, except in the case of inheritance or if the parties agree otherwise.

An analysis of various aspects of insurance premiums as undertaken in this chapter allows for a conclusion that, in general, the regulation provided in the PEICL is more policyholder-centred that that of the Estonian, Latvian and Lithuanian law.

4. Legitimate interest of a third party

There may be persons other than the policyholder who are interested in the validity of an insurance contract and insurance cover. For instance, the mortgagee has a clear interest in the validity of the insurance cover where a structure is being insured; leasing companies may be interested in a valid insurance cover as may be other persons who are not direct parties to an insurance legal relationship. Article 5:105 of the PEICL expressly provides for the right to pay insurance premiums and correspondingly the insurer is obliged to accept the relevant insurance premium portion provided that (a) the third party acts with the assent of the policyholder; or (b) the third party has a legitimate interest in maintaining the cover and the policyholder has failed to pay or it is clear that he will not pay at the time payment is due. The mentioned edition of the PEICL emphasises that this is usually the case when the third party benefits from the cover, for example, either directly as the insured, or indirectly as the pledgee. In other cases, payment by a third party intended as a gift to the policyholder, for example, when a mother keeps paying health insurance premiums for her bankrupt son (Basedow *et al.*, 2009).

Similarly, para. 455 (1) of the Estonian LOA provides that an insurance premium which has become collectable or another amount payable pursuant to an insurance contract may, rather than by the policyholder, be paid by the insured person or the beneficiary or a pledgee in whose favour the claim of the policyholder against the insurer arising from the insurance contract is pledged. The payment of an insurance premium by a third party can be viewed as the performance of an obligation by the third party, i.e. *eo nomine*. It is significant that pursuant to the second sentence of para. 455 (1) of the LOA, the insurer must not refuse to accept payment from the above-mentioned person even if the insurer could refuse to accept the payment pursuant to the provisions of the General Part of the LOA (pursuant to para. 78 (2) of the LOA, the obligee may refuse to accept performance of an obligation by a third party if the obligor objects to the performance of the obligation by the third party). Pursuant to para. 455 (2) of the LOA, the insurer's claim for payment of an insurance premium against the policyholder is transferred to the person who has made the payment. A similar regulation exists in Germany too, where para. 34 of the VVG sets out that the insurer must accept insurance premiums due to him or other payments to which he is entitled from the insured person on the basis of the contract if insurance is taken for the account of a third party from the beneficiary who has acquired the right to the insurer's benefits, as well as from the lien creditor even if he could refuse to accept the payment in accordance with the provisions of the German Civil Code. The regulation of an insurance contract in the Latvian ICL and Lithuanian the CC (except as regards the beneficiary) has no special provisions regarding the insurer's obligation to accept insurance premiums from third parties, but in practice payment from the third parties is not precluded.

The Estonian Law of Obligations Act includes a regulation which differs from that of the PEICL, the CC and the ICL – the rights of the mortgagee, *inter alia*, the regulation concerning insurance premiums upon procuring the insurance cover for structures. In Estonia, the insurer is required to notify the mortgagee separately of a period of grace granted to the policyholder for the payment of an insurance premium, as well as of any occurrences of insured events. Subsection 499 (2) of the LOA sets out that if, upon the insurance of a structure, the immovable on which the structure is located is encumbered with a mortgage, the insurer immediately notifies the mortgagee known to the insurer in a format which can be reproduced in writing of the setting of a term for the policyholder to pay the insurance premium if the policyholder has failed to pay the premium and of the cancellation of the contract. The Law of Obligations Act does not directly set out the legal consequences for the insurer should he be in breach of the notification obligation. The general ideology on which the Law of Obligations Act is built upon is the principle that a remedy of the violation and continuation of the obligation should be preferred to the termination of the obligation by one party on the ground of the violation of the obligation. Based on this general principle, one cannot but assume the position that in Estonia, the insurer cannot cancel an insurance contract on the basis of para. 458 (3) of the LOA if the insurer has failed to inform the mortgagee about the policyholder's arrears and has not granted to the latter a period of grace to pay a premium. Moreover, the relevant regulation in the Law of Obligations Act grants Estonian mortgagees a broader protection than the actual insurance cover. Based on para. 501 of the LOA, if the policyholder violates an obligation arising from an insurance contract and, as a result thereof, the insurer is released from its performance obligation with respect to the policyholder, the insurer shall still perform the obligation to the mortgagee, unless the insurer is released from its performance obligation with respect to the policyholder, because the policyholder has failed to pay insurance premiums or intentionally caused an insured event. The claim of the mortgagee against the insurer for the payment of the insurance indemnity in a situation where the insurer has been released from the obligation to pay the indemnity to the policyholder is treated as the right of claim created under law, which should replace the mortgagee's right of security in respect of the indemnity to be paid. In Germany too, the insurer must, under para. 142 and 143 of the VVG, notify the mortgagee of the non-payment of a premium so that the latter can make the payment. The Latvian ICL and the Lithuanian CC do not put such a notification burden on the insurer. Notably, Article 6.1007 of the Lithuanian CC establishes that in the event that the policyholder does not perform an insurance contract, the insurer may request the beneficiary (the mortgagee falls into this category) to perform the contract *if the beneficiary submits a claim for insurance indemnity*. However, the provision does not establish the legal duty for the insurer to notify the beneficiary about the breach of contract; moreover, the provision applies only in a situation after an insured event has occurred. Therefore, it may be argued that this provision merely entitles the insurer to set off the premiums due from the indemnity payable to the beneficiary. During the financial crisis, the situations when debtors failed to pay insurance premiums significantly affected mortgagees. Banks reacted by establishing an umbrella type of insurance arrangements (i.e., the insurance cover under policies of banks would come into force in case the primary cover for which the debtor was responsible was terminated). This is a good example of how players in the market economy find fast solutions to cure the deficiencies of legislation.

Hence, it is very likely that Estonian and German mortgagees would not be motivated to accept the application of the PEICL to insurance contracts, as this would put them in a less favourable situation. In view of the fact that the majority of homes have been bought with bank financing, which always involves the establishment of a mortgage for the benefit of a bank, including the obligation to insure a structure as stipulated in the loan agreement, it is obvious that this would be a situation to affect huge numbers of policyholders.

The authors believe that as far as the protection of the interests of third parties is concerned, the PEICL would not predominantly come to be applied to the insurance of structures, as the national law (e.g. in Estonia) provides a better protection of the interests of third parties. With regard to Latvian and Lithuanian policyholders, however, insurers will have no legal ground to reject the payment of a premium by third parties as proper performance.

Conclusions

The authors believe that the introduction of the "2nd regime" of the PEICL would certainly facilitate the opportunities of consumers to find suitable insurance products in other countries. The part of the PEICL dealing with insurance premiums is, in certain aspects, stricter than the national law. The potential implementation of the PEICL regarding the regulation of the payment of the first premium would bring along major changes for Estonian, Latvian and Lithuanian policyholders. Currently in Estonia, if the policyholder fails to pay the first premium within fourteen days after entry into an insurance contract, the insurer has the right to withdraw from the contract. The insurer is presumed to have withdrawn from the contract if the insurer does not file an action to collect the insurance premium within three months after the premium becomes collectable. In Latvia, an insurance contract enters formally and without a special agreement into force on the day following the payment of the premium. In Lithuania, an insurance agreement, unless it provides otherwise, comes into force from the moment of payment by the insured of full insurance contribution (premium) or the first instalment thereof. In Finland, a premium for an insurance contract is payable within one month from the dispatch of the invoice for the premium by the insurer to the policyholder. However, as Article 5:101 of the PEICL is dispositive, insurers will be able to lay down rules in their standard terms which are analogous to the domestic law, although this may complicate the achievement of the key objective of the PEICL – facilitation of the policyholder's understanding of an insurance contract in a situation where the policyholder concludes contracts in different countries.

Currently in Estonia, if the policyholder fails to pay the second or subsequent premium in time, the insurer may, in a format which can be reproduced in writing, set a term of at least two weeks or, if a structure is insured, one month for the policyholder to pay. If the policyholder fails to pay *de integro* the second or subsequent insurance premium within the specified term, the insurer may cancel the insurance contract without prior notice. The Finnish FICA and the German VVG are similar to the PEICL and the LOA on this issue, granting a two-week period of grace to the policyholder. In Lithuania, the period of grace for non-life insurance contracts is 15, and for life assurance contracts – 30 days. The Latvian law does not provide for an automatic period of grace to the policyholder in the case of subsequent premium payments. The potential introduction of the PEICL will bring most changes to Latvian policyholders in connection with the failure to make a subsequent premium payment as they will be entitled to the automatic right of a period of grace. In Estonia, on the other hand, the period of grace will shorten from the minimum 30 days to the minimum 15 days for the insurance of structures. It is also doubtful that Estonian mortgagees would be willing to accept insurance contracts for structures based on the PEICL as the PEICL does not guarantee them the same rights as the LOA: Hence, in the context of insuring structures, mortgagees may hinder the application of the PEICL in Estonia as they might not accept insurance contracts based on the PEICL. However, the PEICL would be more favourable for the insurers who operate in Estonia, as it would release them from several extra obligations imposed on them under the current LOA.

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