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In the Member States of the European Union, civil law is one of the remaining sets of rules relevant in day-to-day and commercial legal relations which – despite decades of work in the European Union – are still largely fragmented and dominated by national particularities. Harmonization has so far only been achieved in - albeit important - marginal areas.¹ It is not unrealistic to suspect that this situation could constitute an essential reason for the fact that the pursued European Single Market, even 14 years after its inauguration in 1992, has not yet made a real stunning progress. The divergence in the civil law of Member States as well as a lack of coherence of individual European acts of law, which becomes already apparent from the fact that legal terms are not used in a homogeneous way, constitute an obstacle to the conclusion of cross-border contracts and the establishment of cross-border legal relations.

The insurance industry being an industry which sells legal (incorporeal) products is suffering from this especially: up to this very day, it is not possible to offer uniform insurance products developed in a centralized way on the basis of a homogeneous legal framework throughout the European Union. Because of the differences in both general law and insurance contract law between Member States policy conditions have to be developed from top to bottom or to be adjusted at great expense for each target market. To do so, specialists with detailed knowledge of the legal system of each target market are required. Naturally, the same is true for subsequent administration and claims handling. The theoretical possibility of a choice-of-law agreement in favour of the contract law applicable country where the head office of the insurer is situated usually does not solve the problem. Apart from the fact that for mass risks it is mostly not even possible or severely restricted,² it is in practice prevented mainly by psychological barriers on the part of the policyholder and – in the case of large risks – often by the superior bargaining power of the policyholder. Moreover, it would only help if the insurer succeeded in enforcing it without exception, which is improbable as well. Furthermore, necessary intervention and adjustments due to consumer protection

¹ Examples of these are (regardless of the official titles): the Directive on unfair terms in consumer contracts (OJ L 95, 21. 4. 1993, p. 29), the Directive on doorstep canvassing (OJ L 372, 31. 12. 1985, p. 31 et seq.), the Directive on product liability (OJ L 210, 7. 8. 1985, p. 29), the Directive on consumer credit (OJ L 61, 10. 3. 1990, p. 14), the Directive on default in payment (OJ L 200, 8. 8. 2000, p. 35 et seq.), the Directive on purchase of consumer goods (OJ L 171, 7. 7. 1999, p. 12 et seq.) and the Directive on distance marketing of financial services (OJ L 271, 9. 10. 2002, p. 16 et seq.).

² Arts. 7 and 8 of the 2nd Non-Life Insurance Directive, Art. 32 of the Life Insurance Directive.

regulations (Art. 5 of the European Convention on Contract Law)³, mandatory law (Art. 7 of the European Convention on Contract Law)⁴ and public-policy (Art. 16 of the European Convention on Contract Law)⁵ prevent the creation of uniform European products even where choice of law agreements are permitted and valid. These conclusions are so obvious that they are openly expressed even by the European Commission.⁶ The consequence is that in practice even today suppliers with cross-border ambitions are more likely to acquire an insurance company in the target market than to offer their products on a cross-border basis by using the freedom of services under the EU-treaty, although the former administrative obstacles to this have been eliminated as early as the early nineties through implementation of the Directives on insurance.⁷

The question what the insurance industry may expect from the work undertaken by the European Commission and what framework would be appropriate for it is difficult to answer. The actual problems begin rather beyond what the Commission currently admits to be the official objective of its work, namely the establishment of the CFR or a review of the consumer acquis. There are no objections to its establishment as an instrument to achieve a standardized legal terminology in the European Union and to promote greater coherence ('toolbox'). Everybody working in a juridical environment could only profit from this.

Given the impossibility to market identical insurance products in different Member States and the resulting economic and administrative expense for cross-border insurance business, it is to be expected that the sector will basically benefit from harmonization of civil law in the Community since 'production costs' will tend to decrease as a result of it. In this respect, it may be assumed that the benefit, which may also be to policyholders via declining premiums, will be the greater the farther this harmonization goes. Maximum harmonization conceivable to this effect, namely the creation of a European Civil Code, is not likely to be expected, at least in the medium term, because the opposition from Member States and a

³ In insurance contract law, this usually results from Art. 7 (1) (g) and (2), Art. 8 (2) of the 2nd Non-Life Insurance Directive.

⁴ In insurance contract law, this roughly corresponds with Art. 7 (1) (g) and (2), Art. 8 (2) of the 2nd Non-Life Insurance Directive.

⁵ In insurance contract law, this usually results from Art. 7 (3) of the 2nd Non-Life Insurance Directive.

⁶ Report from the Commission to the Council and the European Parliament on the state of the internal market for services, 30. 7. 2002 (COM (2002) 441 final), p. 39).

⁷ Second Council Directive on the coordination of laws, regulations and administrative provisions relating to direct insurance other than life assurance and laying down provisions to facilitate the effective exercise of freedom to provide services and amending Directive 73/239/EEC, OJ L 172, 4. 7. 1988, p. 1 et seq.

Council Directive 92/49/EEC of 18 June 1992 on the coordination of laws, regulations and administrative provisions relating to direct insurance other than life assurance and amending Directives 73/239/EEC and 88/357/EEC (third non-life insurance Directive), OJ L 228, 11 .8. 1992, p. 1 et seq.

Directive 2002/83/EC of the European Parliament and of the Council of 5 November 2002 concerning life assurance, OJ L 345, 19. 12. 2002, p. 1 et seq.

For reasons of space a list of the Directives in the motor insurance area is dispensed with here.

number of industries to this is all-too obvious. Therefore, the question concerning the usefulness of conceivable harmonization currently focuses on the optional instrument (26th regime).

So far, it is open whether the application of the optional instrument will depend on the express intention of the parties (opt-in), thus presupposing a choice-of-law agreement of contracting parties, as known in private international law, or whether it is to be applied automatically (and perhaps only in the case of cross-border contracts), unless the contracting parties have expressly agreed on its non-application (opt-out). Ultimately, the predictable success in practice and hence the usefulness of the optional instrument will depend on this preliminary question, which at first glance may appear to be a mere technical one.

If the optional instrument is installed in the opt-in version, the insurer is, first of all, faced with the hurdle that he has to convince his contract partner that he should rather agree with the insurer on application of supra-national law instead of national law, the application of which is provided for as the usual case. There may be psychological aspects (private customers) and/or aspects of bargaining power (industrial customers) which stand in the way of this: the suggestion alone that applicability of a certain legal system should be agreed on will be felt to be an exceptional case and will therefore possibly arouse suspicion. Policyholders will be more inclined – though perhaps not for rational reasons – to trust in their national law. If they have some knowledge of law, this will usually be limited to national law, and – at least for a transitional period, which should not be underestimated – it will presumably be much easier to obtain competent advice on this law rather than on a supra-national legal system which is more likely to be unimportant for day-to-day practice. Apart from such aspects, it is possible that customers having the required bargaining power are inclined not to bear the costs caused by the adjustment of existing internal know-how, of their own specimen contracts and processes by themselves, but to shift them to the insurer and, therefore, to require the maintenance of familiar and well-established legal bases.

The second hurdle for the insurer consists in the fact that it is more or less improbable that after the introduction of the optional instrument contracts will be concluded solely on the basis of this instrument. Therefore, as a minimum prerequisite on the part of the legislator, it would be necessary that the optional instrument is not only applicable to cross-border situations (interstate), but that its application may also be agreed on in domestic situations. It is not until this is possible that there would be the opportunity, at least in theory, that the optional instrument can be transformed - on the basis of a choice of law agreement – into a factual law which may thus lead to synergistic effects within companies. But even if this was the case, for the above-mentioned reasons concerning psychology and bargaining power of policyholders, it is not to be expected that the replacement of the national legal system as contract basis will be completely successful. For company practice this means that the

required competence and products will have to be held available both for the national legal system (perhaps even in the first place) and for the supra-national legal system.

If the optional instrument is introduced in the opt-out version, the psychological hurdle described, which forms an obstacle to its use, will presumably be smaller because possibly only a few contract partners are aware of the fact that if they want to avoid application of the optional instrument, they have to agree on its express exclusion as a contract basis. Moreover, it is rather improbable that policyholders take active steps to avoid any contractual agreement on the legal system, at least in normal cases, because there are deep-rooted human habits which form an obstacle to this. Also, maintaining the decreed normal case certainly meets with much less suspicion on the part of the contract partner than altering it. However, already in the case of contract partners with great bargaining power, this is not likely to be decisive because as a rule, especially when it comes to costs, customers in the industrial sector actively pursue their interests. On the whole, under an opt-out regime, the proportion of contracts concluded according to national law is likely to be significantly lower than it would be if the opt-in solution was chosen. However, since it will not decline to zero, it is to be expected that the other disadvantages described will be maintained with a system of multiple legal bases in contract law.

From the technical point of view, choosing the optional instrument as a legal basis for the insurance contract will only be possible if the Rome-I-Regulation, which is being worked on, allows the choice of a supra-national legal system by the parties.⁸ Since the optional instrument will be the best of all conceivable civil laws, under its applicability, there will logically no longer be any need for intervention and adjustments due to consumer protection regulations (Art. 5 (2) of the European Convention on Contract Law/Art. 5 of the Rome I Regulation), mandatory law (Art. 7 of the European Convention on Contract Law/Art. 8 of the Rome I Regulation) or public policy (Art. 16 of the European Convention on Contract Law/Art. 20 of the Rome I Regulation). Rather, the choice of the optional instrument would logically have to lead to unrestricted application of this set of rules since it claims to reflect the standard to be recognized in the European Union. If this should be ensured, this would represent real progress as compared with the existing possibilities of choice of law. Currently, rules to this effect are still lacking in the draft Rome I Regulation. Moreover, if the optional instrument is considered to be the best of all civil laws, no restriction of the freedom of choice of law whatsoever depending on the status of the contract partner, as is the case today in the insurance sector,⁹ would be justified because by choosing this law the contract partner can only win, but not lose.

⁸ We are grateful, this is provided for by Art. 3 (2) of the draft (doc. COM (2005) 650 final, 15 .12. 2005).

⁹ Consumers, mass risks, large risks.

Any breakthrough with respect to the pan-European distribution of insurance products could not be expected from the CFR. The creation of the optional instrument would go farther in this direction and solve certain problems which cannot be coped with by means of the CFR alone. This breakthrough cannot be achieved until at least the law of contractual obligations and the general part of civil law have been harmonized on a European scale. Only when this has been done, the obstacles to enforcing a choice of law by the insurer, which are due to psychological reasons or based on bargaining power, will cease to exist. However, the homogeneity of the legal bases of contracts, which cannot foreseeably be achieved to a sufficient degree within the scope of the optional instrument, is the prerequisite for companies for no longer having to hold available competence and products according to supra-national law along with those according to national law. Of course, this is currently not on the agenda of the European Union. The objective of realizing a European Civil Code would certainly be – apart from the opposition from Member States, which fear a loss of identity – much too ambitious for the time being. Therefore, the CFR is a step forward which is to be welcomed. After its realization there will probably be more clarity as to whether the next steps are worthwhile at all.