City of London Law Society
Financial Law Committee
Insurance in Rome 1

Introduction

We welcome the opportunity to respond to the HM Treasury and Department for Constitutional Affairs consultation on insurance under the Rome Regulation. We have sought to provide brief responses to the questions raised. We would be happy to elaborate further should this be of assistance to the Government.

In responding we have considered the position in respect of non-life insurance only. We recognise that the issues on party autonomy discussed in this response may be less significant in the life sector given that it is predominantly retail in nature. This submission is not confidential and we have no objection to its contents being made public.

We recognise that the current treatment of insurance in private international law is not ideal with insurance of risks within the territory of the EU subject to the rules in the Insurance Directives while risks located outside of the EU are governed by the Rome Convention. The result is complex and adoption of a single set of rules in the Regulation would promote legal certainty as well as providing greater transparency in European legislation. However, the Presidency text is deficient and if adopted in its current or a similar form could be detrimental to the interests of UK insurers and insureds.

The Committee favours the application of the general rules in the Regulation to insurance subject to two points. Firstly, consumer insurance contracts should, generally, be governed by the law applicable to consumer contracts. Secondly, in the case of compulsory insurance Member States should be permitted (but not required), subject to proportionality, to continue to demand the application of local law in relation to policies insuring purely domestic risks (but not for any policy covering risks arising in more than one jurisdiction, as this will produce conflict between different national laws and restrict trade between Member States, causing additional expense, particularly for transport businesses). Further, the creation of new rules of this sort at national level appear contrary to the Treaty rules, which include an obligation not to create new barriers to the provision of services across frontiers.

Given the political difficulty in securing significant changes at this stage in the negotiations our fall back position is to retain the existing approach in the Convention and the Insurance Directives. In this case, we would invite the Commission to publish a green paper on reform of the rules in the Insurance Directives with a view to simplifying the treatment of insurance and, if appropriate, to amend the Regulation to cover all cases of insurance. We consider it important that any legislative proposal complies with better regulation principles and contains a proper cost-benefit analysis.

The Presidency Text

We regard the presidency text as potentially harmful to the interests of UK insurers and possibly also to the position of London as a centre for international litigation and arbitration.

As highlighted in the consultation document, the proposal will restrict party autonomy for small businesses and also for mass risks located outside of the EEA. In our experience commercial parties do make use of the possibility of choosing the governing law in the non-life sector. This is particularly important in the insurance of maritime and transport risks where it is common for parties without any other connection to the United Kingdom to choose English law or New York law. Maritime risks are generally insured on standard terms that have evolved over time and are very often subject to English law and practice. The same applies to risks insured through Lloyds. Many/most policies subject to English law also select English jurisdiction or arbitration, thereby enhancing the position of London as a forum for the resolution of international insurance disputes. By undermining this practice, this insurance business and related dispute resolution is likely to be driven outside the EU altogether to jurisdictions that recognise party autonomy and will give effect to the parties' own choice of law and jurisdiction (even where not permitted by the Regulation).

English law is seen by commercial parties as attractive for many reasons including:-

(1) Legal certainty. The law of insurance is well established compared with many other EEA and third country states.

(2) Fairness. English law generally strikes an appropriate balance between the interests of insurers and policyholders (although we are aware that there are areas where the Law Commission is likely to recommend reform).

Insurers also find English law attractive because of the requirement of utmost good faith. This is not the case for most primary insurance in the United States or in many EEA states, although it applies in some other markets (e.g. Australia). The requirement of utmost good faith enables insurers to price cover efficiently and assists policyholders through making the writing of certain classes of business possible that could not be done economically if the insurer had to bear the consequences of non-disclosed material risks. In particular, we are aware of UK insurers writing classes of business in the United States that US insurers are unwilling to write due to the different legal framework within which they operate.

Specific Questions Raised by the Consultation

1. Should the UK support the Commission's original proposal which would preserve the present rules in the Directives, leaving Rome I to deal with all other insurance contract situations?

Our preferred option is to have a single set of rules in the Regulation that distinguishes between consumer contracts and business-to-business contracts. However, should this not prove possible we would support retention of the existing division between the Convention and the Insurance Directives. The existing rules, although complex, have operated reasonably satisfactorily for the past 15 years and we are not aware of any major difficulties having arisen in practice. Most of the criticisms appear to us to be mainly academic in nature.

However, retention of the existing rules should not preclude a future review of the rules in the Insurance Directives. We would therefore invite the Commission to publish a green paper on options for reform. This could include analysis of a major simplification of the rules together with the possibility of applying a single set of rules regardless of where the risk is situated.

2. Should the UK propose a rule to deal with situations where a contact of insurance covers risks partly inside and partly outside the Community?

If the rules in the Insurance Directives remain in place then there will be different regimes depending on whether the risk is located inside or outside of the EEA. As the Convention/Regulation provides more flexibility to businesses than the Insurance Directives, we oppose any extension of the rules in the Directives to mass risks that are located outside of the EEA. We do not consider that the restriction of party autonomy in this way will benefit UK or EU insurers or that it is "necessary for the proper functioning of the internal market" as required by Article 65 EC.

If a policy covers risks situated inside and outside the EEA we consider that the most practical solution is severability. A test based on connecting factors, such as the closest and most real connection, or the preponderance of cover, would be productive of uncertainty and we have been unable to come up with any better solution.

3. Should it only be individuals acting outside of their trade or profession that enjoy consumer protection by virtue of their consumer status?

The European Court of Justice held in *Société Bertrand v. Paul Ott K.G.* [1978] E.C.R. 1431 that the consumer provisions in the Brussels Convention apply only to private final consumers and not to those who are engaged while buying the product in trade or professional activities. Neither do they apply to a contract which an individual has concluded with a view to pursuing a trade in the future (*Benincasa v. Dentalkit Srl* [1997] E.C.R. I-3767) nor to an assignee of a claim from a consumer (*Shearson Lehman Hutton Inc. v. TVB* [1993] ECR I-139).

In *Gruber* [2005] E.C.R. I-439 the European Court of Justice held that the consumer provisions "cannot, as a matter of principle, be relied on by a person who concludes a contract for a purpose which is partly concerned with his trade or profession and is therefore only partly outside it. It would be otherwise only if the link between the contract and the trade or profession of the person concerned was so slight as to be marginal and, therefore, had only a negligible role in the context of the supply in respect of which the contract was concluded, considered in its entirety" para [39]. In para [40] the Court stated that "inasmuch as a contract is entered into for the person's trade or professional purposes, he must be deemed to be on an equal footing with the other party to the contract, so that the special protection reserved by the Brussels Convention for consumers is not justified". In our view this consistent case law is correct and demonstrates that only consumers acting outside their trade or profession require special protection. This is also supported by Article 2(b) of the Unfair Terms in Consumer Contracts Directive 93/13/EEC (which defines a consumer as "any natural person who, in contracts covered by this Directive, is acting for purposes which are outside his trade, business or profession") and Article 1(2)(b) of the Consumer Credit Directive 87/102/EEC .

There is no justification for treating individuals who contract in the course of carrying on a trade or profession differently from those who act through a legal person. Treating sole traders as consumers introduces an unprincipled distinction between persons who choose to incorporate and those who do not, and may make insurers less likely to provide cover to sole traders. We consider that such discrimination might contravene Article 43 EC insofar as it discriminates between different forms of establishment.

Nor do we see any reason for regarding small and medium size businesses generally as a category requiring protection from insurance companies. No evidence has been provided of market failure in this area. Abusive practices by insurers, should they be found to exist, are properly addressed by the relevant insurance supervisor. Anti-competitive practices are prohibited by Articles 81 and 82 EC.

We would also refer to the difficulty of properly defining a category of "small businesses" that does not inadvertently pick up other commercial entities that are not SMEs. When the rules on administrative receivership were reformed in the United Kingdom it was necessary to provide a large number of exceptions to avoid including special purpose vehicles that may have no employees and a low turnover. The same could apply to single ship companies, for example.

4. If so, should the limitations placed on SMEs' choice of law in insurance be removed? If so, how would you alter the present rules?

We do not understand the rationale for a set of rules that distinguish based on the *type* of risk rather than on the *identity* of the policyholder (e.g. a consumer). Our preferred solution is to replace mass risks with a rule that provides protection to consumers only but otherwise permits party autonomy. If this is not possible then consideration should be given to expanding the class of risks that are treated as large risks. We believe that the insurance sector is best placed to advise the Government where relaxation would be most beneficial.

5. Should there be any changes to the Directives' definition of large risks that currently limits choice of law by some SMEs?

We defer to the views of the insurance sector as to any specific changes that are desirable.

6. Does the removal of Article 1(3) of the Rome Convention pose any problems?

If the rules in the Insurance Directives continue to exist alongside the Regulation then Article 1(3) is necessary to define the relationship between them. As the Regulation will not apply in Denmark and may not apply in the EEA States (Iceland, Liechtenstein and Norway) an overlap will remain regardless of whether the UK opts in to the Regulation.

7. Should insurers excluded from the Directives who conduct intra-EU business be covered by Rome Regulation?

Yes. Such insurers should have the benefit of Article 3 in choosing the applicable law. In other cases Article 4 should apply or, if they are dealing with consumers, Article 5. If such insurers are not covered by the Regulation then determination of the applicable law will either be subject to the Rome Convention (if it continues to exist) or be determined in accordance with national choice of law rules. Either approach is sub-optimal.

8. Should the UK support the Presidency's proposed rules?

For the reasons set out above we disagree with the Presidency's text.

9. If not, why not?

We refer to our general comments above. We stress the importance of the principle of party autonomy in non-consumer cases. In addition:-

(1) We do not understand the rationale for restricting party autonomy in the case of compulsory insurance *where the state imposing the requirement does not regard it as necessary.* Where compulsory insurance seeks to achieve a specific social purpose, for example, ensuring that persons injured in the course of commercial or leisure activities recover compensation, and do become a burden on public welfare, the state imposing the requirement may consider that having the contract governed by local law is necessary to achieve that object. Subject to proportionality, we consider that Member States should continue to be able to impose a choice of local law. Where, however, achievement of the particular social purpose does not require a restriction on party autonomy we see no reason for reducing the choice available in a business-to-business context.

It is common in cases of liability insurance for legislation to require a minimum level of cover but not to include stipulations in respect of the governing law of the contract or the nationality of the insurer. For example, articles 7 and 8 of the Capital Adequacy Directive 2006/49/EC requires certain investment firms to hold initial capital, professional indemnity cover, or a combination of both but has no requirement in respect of the governing law of such cover. The Employers' Liability (Compulsory Insurance) Act 1969 and the Employers' Liability (Compulsory Insurance) Regulations 1998 SI 1998/2573 require businesses to have insurance covering their potential liability to their employees for work-related claims. The regulations specify the minimum amount of cover (not less than £5 million) and prohibit certain terms that would reduce the scope of cover. However, neither the Act nor the regulations require the policy to be governed by English law.

The mandatory imposition of local law for compulsory cover is likely, in practice, to favour domestic insurers against insurers incorporated in other EEA states, and might therefore constitute a form of indirect discrimination on the grounds of nationality. We fear this may negatively affect UK insurers given the differences between substantive insurance law in the UK and other EEA States that make English law attractive. It may also make non-EEA insurers less likely to insure such risks thereby potentially reducing customer choice. Such a rule also makes

the development of master policies covering such risks across the EEA, or world-wide, more difficult.

2) We see difficulties in a rule that applies the law of the place where the risk is situated (paragraph 3 of the Presidency text). This is most apparent with transport risks which, despite being large risks, appear to be subject to paragraph 3. A ship may pass through many different territorial waters, as well as the high seas. Applying the law of the place where a vessel is situated at the time of a collision seems arbitrary. The same problems arise with carriage of goods by air or road, or with multi-modal transport. Applying the law of the place of the risk will also make the development of master policies more difficult. In the case of third party/public liability and reinsurance, the concept of situs of risk is elusive and unhelpful.

10. What practical economic impact would the Presidency's proposed rules have?

As the proposals reduce choice and impose new restrictions on business-to-business insurance we would expect the proposals to have a negative economic effect. They would also adversely affect competition and trade between Member States, contrary to Treaty objectives. It may also restrict the ability of third country insurers to provide services in the EU contrary to the EU's obligations under the WTO agreement. However, we defer to the insurance sector as to what the size of this effect would be.

11. Is it important to preserve the rule for mass risks that allows Member States the option to allow parties to choose the applicable law to their contracts?

We believe party autonomy is important in a business-to-business context and oppose any change that reduces flexibility under the existing rules

12. In relation to mass risks to what extent do insurers make use of their ability to choose the law applicable to insurance contracts?

We defer to the judgment of the insurance sector on this question. In case of transport and liability insurance this freedom is exercised. Based on our experience of examining contracts, we suggest that the applicable law is also frequently chosen expressly in reinsurance of a treaty nature - but very rarely for facultative reinsurance contracts. Facultative reinsurance is normally one of a specific, known insurance risk or risks, in which the reinsurer has a choice about whether or not to accept by contrast. In a treaty or obligatory reinsurance, the contract prescribes risks which must then be offered by the insurer/reinsured and accepted by the reinsurer.

13. Would consultees prefer a specific consumer/business distinction to replace the existing mass risk/large risk division?

Yes.

14. Is it a problem to apply the protective rules to contracts for "mass risks" situated outside of the EU?

We can see no justification for restricting party autonomy for mass risks outside of the EEA. Imposing requirements in this area could possibly conflict with the legal or regulatory framework in the relevant non-EEA market. If the supervisor of the relevant non-EEA market chooses not to impose restrictions we consider the EU should not second guess that decision. Further there may be a breach of the EU's duties under the WTO agreement on freedom to provide services, even in relation to their activities outside the EEA.

15. Should Member States continue to be able to allow compulsory insurance policies to have choice of law, or should they always be governed by the law of the country imposing the compulsory insurance requirement?

Such policies should not automatically be governed by the law of the country imposing the requirement. States should, however, have the power to require local law if the risks are purely domestic and this is necessary for reasons of social policy and satisfies the requirement of proportionality. It is, however, questionable that the Treaty rules on freedom to provide services would allow any new rules of this sort to be introduced.

16. Do you make use of the current freedom to choose the applicable law available as a result of the UK's implementation of the Insurance Directives?

This question is not relevant to the Committee.

17. If so, would your business be adversely affected by the removal of these freedoms? What would be the scale of the impact on your business?

This question is not relevant to the Committee.

18. What rules do you suggest that the UK propose to govern global choice of law in reinsurance, direct insurance and compulsory insurances?

In consumer cases, the basic rule for consumer contracts in the Regulation should apply. There will need to be a set of exceptions to cover e.g. insurance of immovable property. If the risk is not located at the place of the consumer's habitual residence we would favour permitting the choice of the country where the risk is situated as an alternative governing law. Nationality could also be used for life assurance; for example, where an individual is habitually resident in one country but intends to return to his home country on retirement. The same could apply to pension contracts.

For all other insurance contracts we consider that the basic rules in the Regulation should apply. In the absence of choice, the governing law should be the law of the country in which the insurer or re-insurer has its habitual residence. This should be capable of displacement if it appears, from the circumstances as a whole, that the contract is manifestly more closely connected with another country.

19. What material impact would your proposed rules have on your businesses?

This question is not relevant to the Committee.

Additional Question - Habitual Residence (Article 18)

We are attracted to replacing the reference to "central administration" by "centre of main interests". The latter concept is derived from the EC Insolvency Regulation 1346/2000 and has been the subject of helpful national and ECJ case law. The problem is that the place of central administration could be artificial whereas the centre of main interests cannot be.

Financial Law Committee of the City of London Law Society

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The Members of the Committee's working party are:

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