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## **PROVISIONS OF THE CIVIL CODE OF THE REPUBLIC OF SERBIA**

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### **Abstract**

The paper deals with the application of the principle of utmost good faith in insurance and the extent to which this principle is adopted in the Preliminary Draft of the Civil Code of Serbia. In addition, the protection of consumers in the capacity of insureds is considered together with the impact of this protection on the application of the principle of utmost good faith in insurance. Furthermore, the impact of EU directives in this area is analysed and, eventually, the question is raised whether the utmost good faith is still applied in insurance industry.

**Key words:** *civil code, good faith in insurance, protection of consumers in the capacity of insureds*

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## 1. Introduction

One of the vital principles in insurance is the principle of utmost good faith (*uberrima fides*). An eighteenth-century British judge concluded that good faith forbids either party by concealing what he privately knows, to draw the other into a contract from his ignorance of that fact, and believing the contrary. Parties to insurance thus have a duty they owe each other. It would not be right to ask from the underwriter to estimate the risk without the information he can obtain only from the policyholder. Otherwise, policyholders would not be on an equal footing. The utmost good faith represents the basis for fulfilment of all contractual obligations.

## 2. Application of the Principle of Utmost Good Faith

Insurance transactions and mutual relationships of the parties to insurance involve candour, honesty and integrity. This principle is adopted in the interpretation of the European Contract Law. The principle of fairness and diligence is accepted in many countries. If the policyholder intentionally misrepresents or conceals material circumstances, the underwriter may cancel the insurance contract. The same applies to the gross negligence of the policyholder (relative nullity of insurance contract). Due to increased protection of consumers, who appear as policyholders and insureds, the foregoing situation has considerably changed.

It was pointed out that the duty to disclose material facts to the insurer, based on which the insurer can decide whether to enter into a contract and under what circumstances, may operate as a trap for consumers. Consumers are usually unaware that this duty exists, and may be denied claims despite acting honestly and reasonably.

According to the Unfair Terms in Consumer Contracts Directive 93/13/EEC, the contractual terms that are found unfair are not binding for consumers. This Directive forbids unfair business-to-consumer commercial practices.

The principles of this Directive should also be applied to the insurance contract, which was taken into account when drafting the working paper of the Civil Code of the Republic of Serbia. Namely, Article 1419 stipulates that “when concluding the contract, the Policyholder shall report to the Insurer any circumstances relevant for risk assessment, which are known or could not have stayed unknown to him and which are the subject of clear and precise questions asked by the Insurer.”

Nevertheless, in our opinion, the said Article of the Civil Code should be modified.

*Proposed solution:*

When providing answers to the questions asked by an underwriter, the consumer acting as a policyholder has a duty to take reasonable care. Answers must be correct and complete and must not be misleading for the underwriter.

The right of underwriters to terminate the insurance contract is limited only to the cases when the answers of the policyholder were intentionally incorrect, concealed, or provided with gross negligence.

In addition, the right of the underwriter to deny a claim should be limited so that:

- no fact will be considered relevant if such fact is not material for a prudent insurer;
- no misrepresentation of fact should affect the right of the insured to indemnity if the policyholder can prove that he has acted in good faith.

The principle of good faith and fairness will still apply to the insurance contract, however, to the limited extent.

### **3. Insurance (Preliminary Draft Code)**

The systematization of stipulations should be changed, so that the stipulations on the rights and obligations of the policyholder and insured are grouped into one group, whereas the stipulations on the rights and obligations of the insurer are grouped into another. The stipulations relating to life insurance should be omitted from general stipulations.

In the beginning of this Title, Article 1.390 defining the term “insurance contract” **should be amended** to read:

“The insurance contract is a contract by which, upon the occurrence of the insured event, the Insurer undertakes to pay out a certain amount of money to the Insured or Insurance Beneficiary and the Policyholder undertakes to pay the premium or contribution to the Insurer.”

*Explanation of the proposal:*

In mutual insurance, variable contributions are paid in place of premium.

Article 1391, which defines the risk, should remain unchanged, except for the fact that **the words in brackets „(insured event)” should be deleted**, to read:

“The risk covered by insurance must be future, uncertain and independent of the sole will of the Policyholder or the Insured.”

*Explanation of the proposal:*

In Article 1392 on the insured event, the first paragraph, which reads:

“Insured event is an event which occurs by the occurrence of the risk insured against”, **should be amended** to read:

“Insured event occurs by the occurrence of the risk insured against.”

*Explanation of the proposal:*

The word „event“ should be omitted from the text because “loss event” is a narrower term than the “insured event”.

Article 1393, paragraph one, which reads:

“The provisions of this Title shall not be applied to marine and other insurance lines which are subject to the provisions on marine insurance, as well as to the insurances in air transport and insurance of accounts receivable”, **should be rephrased** to read:

“Provisions of this Title shall not be applied to marine and credit insurance lines.”

*Explanation of the proposal:*

Marine insurance lines include sea, river and air navigation. Insurance of accounts receivable cannot be excluded in its entirety (e.g. the claim of a mortgage creditor against the house of a debtor). Credit insurance should be regulated having in mind the specific nature of risks and limited options for reinsurance.

Article 1400, paragraphs one and two, which read:

“The insurance contract is concluded after the applicant has received the statement of the insurer that he accepts the application.

A written application sent to the insurer for the conclusion of the insurance contract binds the applicant to the period of eight days from the date when the application has been received by the insurer, unless shorter period is determined by him, and if the medical examination is required, to the period of thirty days”, **should be amended**.

*Proposed solution:*

The insurance contract shall be concluded after the insurer has accepted the application. The insurer shall promptly deliver to the contracting party duly made out insurance policy or other insurance document.

*Explanation of the proposal:*

The solution provided in the working paper of the Civil Code, according to which the contract becomes effective if the Insurer does not reject the application within eight days, is not acceptable since the insurer is able to neither analyse the risks nor conclude the reinsurance treaty within the given period.

To Article 1407, which defines insurance policy, first paragraph should be added to read

“Policy is an insurance document confirming the existence of insurance contract.”

**The second paragraph of this Article should be amended** to read:

“The policy should contain all provisions of the insurance contract stipulating the liability of the insurer for insurance indemnity.”

*Explanation of the proposal:*

Despite the fact that the insurance contract is consensual, it is usually concluded in writing.

Article 1408, which reads:

Insurance policy may be temporarily replaced by a cover note when, at the moment of its issue, all material elements of the contract are unknown.

In the event when the cover note is replaced by a policy, the contract shall take effect upon the issue of a cover note and not upon the issue of a policy.

In addition, the cover note may be issued as the evidence of provisional cover with limited term, without an obligation of the insurer to deliver to the insured general insurance terms and conditions and without the right to cancel the provisional cover contract”, **is unnecessary and should be omitted.**

*Explanation of the proposal:*

This should be left to the standard business practice.

A new Article should be introduced to the Civil Code to regulate insurance intermediaries, which requires a careful approach with a view to the manner in which they are regulated in the European Union (*Insurance Distribution Directive*) and considering their importance in insurance business.

*Proposed solution:*

“Insurance intermediary must act fairly, conscientiously and professionally, in the best interests of the client. He is obliged to inform the client of the nature in which he intends to collect its services and of its identity.

The fee for intermediary services is paid by the client.

*Explanation of the proposal:*

The intermediary works for the client. It would not be appropriate to allow the insurer to pay for intermediary’s services, due to possible abuses which should be excluded.

Article 1419, dealing with the duty to report, which reads:

“When concluding the contract, the Policyholder shall report to the Insurer any circumstances relevant for risk assessment, which are known or could not have stayed unknown to him and which are the subject of clear and precise questions asked by the Insurer.”

If, upon the request of the Insurer, the Policyholder reports the circumstances relating to data secrecy according to the law governing personal data protection, the insurer shall keep and use the received data in accordance with the regulations on the manner of collection, keeping and submitting personal data”, **should be partly amended.**

In addition, first paragraph of this Article should remain unchanged, and a

new paragraph should be inserted to read:

“If the Policyholder is also a Consumer (user of an insurance service), he shall be obliged to answer the questions asked by the Insurer by providing accurate and complete answers which may not be misleading for the Insurer.”

The second paragraph of this Article should remain unchanged.

Solution provided in Article 1429, relating to the duty to report to the insurer any changes in the risk, in particular, the duty to report an aggravated risk, where the first paragraph reads:

“In property insurance, the Policyholder shall inform the Insurer of any change in the circumstances which may be relevant for the risk assessment and, in personal insurance lines, only if the risk is aggravated due to the fact that the insured person has changed his/her occupation”, **we consider obsolete in the part of property insurance and it should be amended.**

*Explanation of the proposal:*

The solution laid out in property insurance was stipulated in the Law on Contracts and Torts. We consider it obsolete. The change of risk, which has occurred after the conclusion of insurance contract and beyond the will of the insured, should not affect the insurance validity. Such changes are considered an integral part of the risk covered by the insurance. Any risk aggravation, which has occurred beyond the will and influence of the insured, should be borne by the insurer.

Article 1432 on the obligation to report the occurrence of the insured event, which reads:

“Except for life insurance, the insured shall inform the insurer of the occurrence of the insured event, not later than within three days from his knowledge thereof.

If he fails to meet this obligation within a particular period, he shall indemnify the insurer for the loss the insurer would have sustained due to such fact”, **text should be deleted and the following should be inserted:**

“In the event of the occurrence of the covered risk, the Insured shall:

- a) when possible, and with the approval of the Insurer, take all reasonable measures necessary to avoid and/or minimise the loss;
- b) inform the Insurer of the loss, as soon as he becomes aware thereof;
- c) ensure the right to indemnity from the person responsible for the loss.

If the insured fails to meet any of the foregoing obligations intentionally or out of gross negligence, he shall be liable to the insured for the loss the insurer has sustained.”

In connection with the above, see Article 1444 on the prevention of occurrence of the insured event and salvage. The second and third paragraph should be inserted from this Article to regulate the costs of the insured, which read:

“The insurer shall indemnify the costs, losses and other damages caused by

reasonable attempts to eliminate immediate danger from the occurrence of the insured event and the attempts to limit harmful consequences thereof, even when such attempts remained unsuccessful.

The insurer shall pay such indemnity even when such indemnity, together with the indemnity for the loss occurred due to the occurrence of the insured event, exceeds the sum insured.”

To Article 1435 on exclusion of insurer’s liability in the event of intent and fraud, which reads:

“If the Policyholder, Insured or Beneficiary has caused the occurrence of the insured event intentionally or by fraud, the Insurer shall not be obliged to any payments, and any contractual provision to the contrary shall have no legal effect”, after the word „intentionally”, **the words „by gross negligence” should be added.**

*Explanation of the proposal:*

The insurer cannot be expected to indemnify the insured for the loss which has been caused by the insured’s gross negligence.

Article 1442 on insured interest, which belongs to the section of General Provisions and reads:

“Property insurance may be concluded by any person or it may be concluded to the benefit of any person who has an interest in preventing the occurrence of the insured event since, otherwise, such person would have sustained a material damage.

Rights arising under insurance may have only those persons who, at the moment of the occurrence of the insured event, had legally allowed material interest in the insured object to prevent the occurrence of the insured event”, **first paragraph should be replaced by the following text:**

“Property insurance may be written by or on behalf of any person who has an interest in the subject matter of insurance to prevent the occurrence of the insured event.”

The second paragraph should remain unchanged.

Article 1449 on losses caused by warlike operations, which reads:

“The insurer shall not indemnify the losses caused by warlike operations or rebellions, unless agreed otherwise.

The insurer shall prove that the loss was caused by war risks”, **in the first paragraph, after the word „loss” the word „directly” is to be added, and after the word „operations” , the word „by terrorism” should be added.**

*Explanation of the proposal:*

Consequential losses from terrorist attacks may be huge. After the terrorist attack on the two buildings of the World Trade Centre in New York, a shop at the Florida airport was closed because of the danger of a terrorist attack. The shop owner claimed from the insurer the indemnity for the loss.

Article 1453, which relates to coinsurance, and stipulates the following:

“When the insurance contract is concluded with more than one insurer who have agreed to jointly carry and distribute the risk (coinsurance), each insurer named in the insurance policy shall be liable to the insured for full indemnity.”

However, in practice, this is not always the case. Thus, **after the word „indemnity“ it is necessary to add the words „unless agreed otherwise“.**

The above solution limits coinsurance business. There is no reason for the coinsurer to assume the risk of another insurer which may become insolvent.

#### **4. Conclusion**

The principle of utmost good faith and fairness (utmost good faith) is adopted in the Law on Contracts and Torts. The insurer has the right to cancel the insurance contract if the policyholder failed to observe this principle. The application of principle of utmost good faith and fairness is limited when the consumer is both the policyholder and the insured.

The consumer has an obligation to provide answers to the questions of the insurer in a conscientious and honest manner. The answers must not be misleading for the insurer. The insurer has the right to cancel the insurance contract only in the event when the policyholder has provided incorrect information, either intentionally or out of gross negligence.

The question is raised whether the insurer should trust that the policyholder has observed the principle of utmost good faith and fairness and indemnify the policyholder even if he is not assured that the policyholder has observed this principle. In providing answers, the following arguments should be taken into consideration:

- A distinction should not be made between the policyholder, who intentionally provided incorrect information, and the policyholder who was negligent. In both cases, the policyholder is obliged to give the information to the insurer.
- The policyholder has no right to allege that the principle of utmost good faith and fairness was not observed by the insurer considering that on the conclusion of the insurance contract, he did not observe this principle.

The right of the insurer to cancel the insurance contract should be limited as follows:

- no information will be considered the information of material relevance if a prudent (conscientious) insurer did not consider it to be of importance;
- no misrepresentation of data provided to the insurer may prejudice the right of the insured to indemnity if the policyholder can prove that he



acted conscientiously, believing to the best of his knowledge, that the information was correct.

The principle of utmost good faith and fairness will continue to be applied in insurance. To increase the safety of the insureds, particularly the consumers, this principle will be applied partially. It remains to be seen if this will cause the costs of insurance to go up, as some predict.

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