Duties and remedies in the Principles of International Commercial Contracts (PICC) and the Principles of Reinsurance Contract Law (PRICL): notes for a comparison

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Abstract

I. Reinsurance in the global landscape: risks of legal uncertainty and the case for an optional law; II. Relation between the Principles of International Commercial Contracts (PICC) and the Principles of Reinsurance Contract Law (PRICL); III. Contractual duties in the PICC and PRICL; IV. Remedies; V. Conclusion.

I. Reinsurance in the global landscape: risks of legal uncertainty and the case for an optional law

In 2016, scholars from several European Union (EU) and non-EU States began work on a "model" or "optional" law for reinsurance contracts: the Principles of Reinsurance Contract Law (PRICL). Since then, the project has been jointly supported by legal practitioners and insurance and reinsurance companies. The basic goal of the working group has been to elaborate on a set of rules to be used globally as an optional law instrument for reinsurance transactions.[1]

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1 For a broader view on the goals and aims shared by the project group see H. Heiss, 'From contract certainty to legal certainty for reinsurance transactions: the Principles of Reinsurance Contract Law (PRICL)', in *Scandinavian Studies in Law*, vol. 64 (2018) 92–114, especially at § III. On the idea of optional laws and restatements to be used in commercial contracts, see M. Fontaine, Les Principes pour les contrats commerciaux internationaux élaborés par UNIDROIT, in Revue de droit international et de droit comparé, 1991, p. 25 ff ; M. J. Bonell, *An international*

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The first volume of the PRICL will soon be published.[2]

One might be questioning this level of attention to a contract that, historically, has largely remained behind the scenes. Market strategies and contract details as well as the inner mechanisms of the reinsurance policies and treaties have not only remained 'unexplored' by most national legislations but also often appear to be unknown even to many players within the insurance and reinsurance market.[3] The reason can be easily explained by taking into consideration the contrast between the real economic and social importance of reinsurance and the 'shadow' role it often plays.[4] It would be impossible to recall all of the inner reasons for such a contrast, but let us remember just a few of them.

First, reinsurance operates exclusively between professional subjects of the financial market: insurance companies on the one side and reinsurance companies on the other side.

Second, reinsurers do not have any direct factual or contractual link with final insured parties—in other words, people are often unaware of the existence of reinsurance.[5] That explains why, traditionally, reinsurers have not been really interested in mass advertising or in highlighting their position in the broader society to get portfolios (as insurers, on the contrary, are called to do).

However, reinsurance provides the inner, but inevitable, hedge needed by insurance companies to limit or better manage their risks. It is no exaggeration to assert that, in most cases, insurance for certain types of risks would be unavailable without the backing of reinsurance coverage.[6] Without the reinsurer, there

restatement of contract law. The UNIDROIT *Principles of International Commercial Contracts*, III ed., 2005, p. 9 ff.

[2] See in particular the website of the Working Group: <http://www.ius.uzh.ch> (December 2019); here the reader can find all materials of the working group as well as the last available edition of PRICL.

[3] As Eugene Wollan observed: '*Even among sophisticated, experienced business people, including many insurance professionals, the term reinsurance has a way of evoking unenthusiastic reactions ranging from disinterest to bewilderment. The world of reinsurance is generally considered, by those not part of it, to be an isolated corner of the universe devoted to a subject that is at once arcane and parochial*' (in Handbook of Reinsurance Law, Aspen Publishers, 2003, supplement, §1.02).

[4] Direct insurance itself is often said to work like a 'phantom', standing behind most activities and relationships between individuals and companies, but seldom perceived, even by its ultimate beneficiaries, if no accident occurs. This assumption is even more apt for reinsurance for several reasons. On the "phantom metaphor" applied to insurance, see M. Clarke, *Policies and perceptions of insurance* (Cambridge University Press, 2005) ch 1. Much has been written on the economic and social roles of insurance -see M. Albert, 'Le role économique et social de l'assurance', in F. Ewald and J.H. Lorenzi (eds.), *Encyclopédie de l'assurance* (Paris, 1998) 18–24; M. Clarke, *Policies and perceptions of insurance* (Cambridge University Press, 2005); see also the summary by H. Heiss, 'Insurance Contract Law Between Business Law and Consumer Protection', in *General Reports of the XVIIIth Congress of the International Academy of Comparative Law/ Rapports Généraux du XVIIIème Congrès de l'Académie Internationale de Droit Comparé* (2011) 335–53- whereas reinsurance has received little attention.

[5] This is true since the origins of reinsurance; even today the position of the reinsurer is only exceptionally directly linked to the insured, as in case of insolvency of the direct insurer. See *infra* for further comments and examples in actual legislations concerning this solution.

[6] This is the case, for example, regarding catastrophic risks which is highly discussed in the actual economic and strategic scenario: see on the topic OECD, *The Contribution of Reinsurance Markets to Managing Catastrophe Risk* (2018), <http://www.oecd.org/finance/the-contribution-of-reinsurance-markets-to-managing-catastrophe-risk.pdf>; S. Dahlen - G. von Peter, Natural catastrophes and global reinsurance: exploring the linkages, Bis Quarterly Review, December

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would not be insurance as we know it. As will be further explored later, this explains why reinsurance is called the 'silent regulator' of the insurance market.[7] Altogether, this explains the more recent role of reinsurance plans in the evaluation of the solvency ratio of insurance companies and the growing interest of supervisory authorities and legislators in reinsurance plans of undertakings.

The essential role of reinsurance is mirrored by its historical roots, inextricably tied to insurance schemes. Since their appearance, reinsurance coverages have allowed insurance activities to grow and spread into different areas of risk, including those that were, and still are, most dangerous. In fact, the first examples of reinsurance-structured contracts can be traced back to 1370, just a few decades after the appearance of direct insurance, which was moving its path in the direction of differentiating from unprofessional mutual aid.[8] At that time, reinsurance was mostly an alternative to co-insurance (where insurers decide to cover a risk, jointly or partially, together). The idea was to enable an insurer having second thoughts about their 'bet' to pass on the risk to another and profit from the difference of premiums applied for direct and indirect insurance. In addition, the scheme of 'insurance for insurers' proved to be quite useful in allowing insurers to cover more and greater risks that would never have been covered without a second level of protection.

As a contract for professionals of the insurance market, reinsurance has developed in a more liberal legal landscape than that of insurance, which—at least, since the 17th century—has been the subject to increasingly strict regulation by States, as the French Ordonnance de la Marine of 1681 clearly exemplifies.[9] Reinsurance, for centuries, has been based on the relationship between insurers and reinsurers in a context of gentlemen's duties, in which reputation counts more than written rules. The often confidential context with a limited number of actors for such chambers of negotiation, together with the use of international customs, are all factors that have allowed reinsurance to be managed extremely flexibly while considerably reducing disputes, which, when they arise, were and still are mainly discussed and resolved through arbitration.

The inner *laissez faire* attitude of legislators and regulators towards the rules governing reinsurance contracts appeared more surprising during the 20th century in Europe and in many other countries when, by contrast, insurance

2012, p.24 ff. More in general on the essential role of reinsurance especially with reference to the coverage of catastrophic risks (either related to natural disasters, hyper terrorism, or technological risks) see Lambert-Faivre, Droit des assurance, XII ed., 2007, Paris, p. 47.

7 Abramovsky, *Silent regulator*, quoted; see also Heiss, 'From contract certainty', quoted, particularly 107.

8 See A. La Torre, *L'assicurazione nella storia delle idee. L'assicurazione come risposta giuridica al bisogno economica di sicurezza: ieri e oggi* (2nd ed, Milano, 2000); B. Caizzi, 'Assicurazione ed economia nell'età moderna', in AA. VV., L'assicurazione in Italia fino all'unità (Milano, 1975); G. Fanelli, 'Le assicurazioni', in A. Cicu and F. Messineo (eds), *Trattato di diritto civile e commerciale*, vol. 36 (Milano, 1973) 65–136.

9 This same Ordonnance merely mentioned reinsurance, but it did not provide stringent rules. See Ordonnance de la Marine (1681), Article XX, Titre Sixième, and comments by J.M. Thiveaud, 'La naissance des assurances maritimes et Colbert', (1988) 4 *Revue d'économie financière*, p. 151.

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activities and contract rules were regulated by a series of extremely rigorous provisions covering not only the exercise of the business but also, in particular, how policyholders should be protected, with close attention to all of the so-called mass risk contracts (which, according to the EU legal language, comprehend both coverages offered to consumers and non-consumers).[10] The fact that, of all activities related to the insurance business, reinsurance had been the first to form the subject of a European Community directive (that is to say Council Directive (EEC) 64/225 of 25 February 1964) does not contradict this assumption—in fact, these provisions aimed solely to allow the freedom of establishment and services for reinsurers in the single market in order to facilitate a larger risk pooling within the European Member States.[11] Only later (in 2009–10) were further EU provisions introduced in order to regulate the exercise of reinsurance as an economic activity, with little or no interference with the applicable contract rules.[12]

In recent years, the rising attention devoted by the EU legislator to companies exercising the reinsurance activity testifies to the existence of a process of slowly unveiling the role and function of reinsurance in society. The more and more frequent experience of catastrophic events, together with the financial crisis, have put the focus on the fragility of even big insurance companies and banks. This has contributed to proving that reinsurance and retrocession schemes not only serve as a form of risk allocation for the insurer but also play an essential role in the solvency evaluation process, with a direct impact on reserve requirements of insurance companies.[13]

In other words, reinsurance is now fully considered as a loss stabilizer that ultimately benefits the market overall, overpassing the 'privity of contract' of the single economic transaction between the single insurance company and its reinsurer. Where insurance is a private tool often used by legislators and policymakers to realize public goals, it is the existence of the insurance market itself that relies on the presence of a well-functioning reinsurance market.[14] Being reinsured may consequently not only be qualified as a duty of the prudent

[10] R. Capotosti, *La riassicurazione. Il contratto e l'impresa*, Torino, 1991, p.15; A. La Torre, *L'assicurazione nella storia delle idee: l'assicurazione come risposta giuridica al bisogno economica di sicurezza: ieri e oggi*, (2nd ed., Milano, 2000); Fanelli, 'Le assicurazioni', quoted; B. Caizzi, 'Assicurazione ed economia', quoted *supra*. On the social role of insurance, see Albert, 'Le role économique' (n 2); H. Heiss, *Insurance Contract Law*, quoted.; D. Drechsleri and J.P. Jutting, *Private Health Insurance in Low and Middle-Income Countries: Scope, Limitations, and Policy Responses* (OECD Development Centre 'Le Seine St Germain', March 2005); J. P. Platteau and D. Ugarte Ontiveros, *Understanding and information failures: lessons from a health microinsurance program in India*, ILO Research paper no.29, 2014, *passim;* D. Cerini, *Micro in Macro: the role of private health insurance in BRICS*, in *Federalismi.it*, 2/2014.

[11] See B. Labilloy, *European Insurance regulation. New opportunities for insurers and consumers, ed. C.E.A., 2010, p.31.*

[12] See in particular Directive 2005/68/EC and Directive 2009/138/EC.

[13] See R. Capotosti, quoted, especially at p. 34 and p. 280; A. Abramovsky, 'Reinsurance: The silent regulator?' quoted, at Connecticut Insurance Law Journal Vol. 15 Iss. 2 (2009) p. 345 – 406.

[14] R. Capotosti, quoted, p. 254.

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insurer but also, in some cases, is a requirement by law,[15] and the policy adopted in reinsurance transactions may have a deep impact on the final insurers, even if it is well known that the insurance and reinsurance coverage do not have a direct contractual link.[16]

Although insurance and reinsurance activities are now following increasingly parallel patterns of supervision, significant differences persist between insurance and reinsurance in terms of contract law. In fact, while reinsurance is substantially regulated as a type of insurance activity, its purpose of increasing financial security and stability in the insurance market continues to coexist with flexible laws governing reinsurance contracts: in addition, these contracts are subject to few national mandatory rules. The 'rules' of reinsurance are more to be found not in written acts but, rather, in international customs and industry usage, often following the lead of the London market. The balance between the rights and duties of professional parties is based more on reputation and fairness than on detailed rules.[17] While insurance is subject to increasingly tighter regulations requiring extended, standardized, pre-contractual information as well as more and more complex contractual documentation sets,[18] reinsurance continues to be based on quite 'synthetic and slim' contracts to which the general principles of international markets based mostly on trust usually apply.

The major role played by the industry (mainly international) customs is good for some purposes—not least for allowing the parties to keep unskilled lawyers and legislators apart! At the same time, this might create inefficiencies, decreasing fair competition and introducing higher operational risks, especially in cases of contractual pathologies and controversies that are required to address arbitrators or courts. This implies that there is an increasing demand by professionals of the insurance markets—reinsurance and as well as insurance companies—to have a higher degree of legal certainty.[19]

[15] In fact, according to EU legislation in order to get authorization to start their business insurance companies are required to present to supervisory authorities a program of activity for the risk management that implies connection to reinsurance strategies and coverages. The Solvency II regime has increased the role of reinsurance in the financial evaluation of the insurance company stability and specific technical provisions are set at national level.

[16] R. Capotosti, quoted, p. 293.

[17] See V. Ehrenberg, *Rückversicherung*, Hamburg, 1885; A. Graziani, *La riassicurazione* (Perugia 1924); J. Hemard, *Assurances terrestres* (Parigi 1925) n. 601; E. Bruck, *Privatversicherungsrecht*, Mannheim 1930, p. 77; C. Persico, La riassicurazione (Città di Castello, 1931); Wollan, *Handbook of reinsurance law* (n 1) § 1.02: '*It is also true, however, that reinsurance is still a specialized world that can often seem ingrown. It has been said, not entirely facetiously, that "in the reinsurance business, sooner or later you meet yourself coming around the corner"*'.

[18] Especially to protect the weak party to the contract, meaning the clients (both consumer or professionals, there is no difference) in all *mass insurance contracts*, in contrast to the so called *large risks* where a lower level of protection of the policyholders is provided. The EU regulations introduced the distinction between large risks and mass risks, in order to set different level of protections of policyholders. The subsequent couples of Directives regulating life and non life insurance link the separation on the basis of both qualitative and quantitative criteria. Some branches of activities, i.e. transport and credit and suretyship risks, are always considered to be large risks to the extent they relate to the industrial and commercial activity or the liberal profession exercised by the policyholder. For other branches of activity, as property and liability insurance, the quantitative separation is based on criteria taken from the Fourth Company Law Directive, the Accounts Directive. See at this proposal Cerini, *Insurance law*, 2019, especially Chapter VII.

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The legal uncertainty risk that characterizes reinsurance contracts seems to clash with the stringent rules on the activity increasingly imposed on all companies; it quite often creates inefficiencies, especially in a globalized world where new players and new models of contracting and negotiating reinsurance contracts appear.[20]

This raises the need to establish clear rules applicable to reinsurance that properly consider the specific characteristics of these contracts. Such rules cannot be easily found in insurance law by way of analogy, as reinsurance is not simply a larger-scale 'clone' of insurance or a financial exchange of money (a premium in exchange for the promise to pay for a financial loss). Reinsurance, instead, entails in its contract rules for the complex reality of the relationship between the reinsured—the insurance company—and its thousands of clients seeking coverage for damages (non-life insurance) or for events connected to life (life insurance branches).

This position of reinsurance combines with the deep evolution in the technical creation of reinsurance contracts, as confirmed by the proliferation of structured reinsurances (prospective or retrospective) in the market and the creation of extremely specialized contract terms, such as 'back-to-back coverage' clauses or 'follow-the-fortune' or 'follow-the-settlement' clauses.

To understand the risks of such legal uncertainty—which is amplified in the international context—it may be useful to consider the Italian legal system, where reinsurance is covered by a few dedicated rules in the Civil Code (Articles 1928, 1929, and 2952 comma II). These rules do not really go to the core of the contractual relationship between reinsurer and reinsured.[21] The same light legislative treatment of reinsurance was also apparent in the superseded Commercial

[19] See L. Kuitunen, *Principles of reinsurance contract law project- enhancing the value of reinsurance cover. Viewpoint of an industry practitioner*, *infra*, in this Review.

[20] See H. Heiss, 'From contract certainty to legal certainty for reinsurance transactions', quoted.

[21] Among the few rules devoted to reinsurance is Article 1928 CC, which requires a contract of reinsurance (often qualified as a "treaty") to be proved in writing. The treaty records a commitment by the reinsurer to assume part of the risk of the ceding insurer, either on a *pro rata* basis or an excess basis. Article 1929 CC prevents a reinsurance contract from creating a direct connection between the reinsurer and the insured. This rule applies the more general principle that the contract cannot have any effects on third parties, as enshrined by Article 1372 CC. Reproducing this principle in the rules on reinsurance has the special aim of avoiding a connection between the insurance and reinsurance contracts and of rejecting the complex contract theory once proposed to create legal duties of the reinsurer towards the insured. In other words, Article 1929 CC is intended to maintain complete independence between the insurance and the reinsurance contracts. The importance of this independence is confirmed by Article 1929 CC being mandatory. In fact, the contract of reinsurance does not create any relationships between the insured and the reinsurer, except in circumstances where the special laws concerning privileges favouring a policyholders group become applicable. Should the insurance company be compulsorily liquidated, Article 1930 CC protects the final insureds by establishing that the reinsurer shall fully pay the sums due to them, within the limits of their right to compensate that duty to pay with the premiums and other credits due by the insurer. This increases the possibilities for the insured to obtain satisfaction of their credit by derogating from the general rule set by Article 1929 CC, which excludes direct action of the insured against the reinsurer. The reinsurer's right to obtain payment of the premiums is subject to the general prescription term of one year set by Article 2952, 1st paragraph. For all other aspects, the legislation leaves concrete discipline to the freedom of contract between the parties.

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Code of 1882; more recently, it is found in the provisions of the Code of Private Insurance adopted in 2005, which dedicates specific attention to the activity of reinsurance as a consequence of implementing Council Directive (EC) 2005/68, realized through Legislative Decree 29.2.2008 no. 56 and Council Directive (EC) 2009/138.[22]

Reproduced in the Code of Private Insurance, the EU provisions define reinsurance thus: 'Reinsurance business consists in accepting risks ceded by an insurance undertaking or by another reinsurance undertaking and shall be reserved to reinsurance undertakings.' It is quite clear that this definition mainly focuses on defining the activity for supervisory purposes rather than on defining reinsurance contracts. Ultimately, from the Italian perspective, there is no set of contractual rules unequivocally applicable between reinsurance parties, as the rules of general contract law and those of insurance are, from time to time, applied by analogy, leaving great uncertainty for the parties, especially in crucial areas such as interpretation, application of utmost good faith requirements, and cooperation duties.

The Italian position is not unique among civil law as well as common law countries, as the reinsurance contract seems commonly prone to legal uncertainty and consequent operational risks.[23] The absence of specific rules (even in the form of default rules) has been often justified by the existence of a set of usages accepted and known by the parties involved, from one side, and from the absence of a serious need to protect one party to the contract. This confirms that the legislator had nothing much to say not only to protect one party (and there would be, in fact, no need) but also in the direction of reducing the transactional costs of negotiation, which is completely left to market rules.[24] In some

[22] This Code regulates the conditions for accessing and exercising reinsurance activities and the aforementioned EU provisions were mainly introduced with an eye to reinsurance as an economic activity. In particular, the law requires the exclusive object of reinsurance activity: '*Reinsurance undertakings shall limit their objects to the pursuit of reinsurance business and related or instrumental operations. These operations may include a holding company function and activities with respect to financial sector activities within the meaning of Article 2 (8) of Directive 2002/87/EC70*'. Article 57 of the Code of Private Insurance also prohibits the establishment in the territory of the Italian Republic of companies with the exclusive purpose of pursuing reinsurance business abroad. Finally, insurance undertakings that simultaneously operate insurance and reinsurance business shall be subject to special provisions. Regarding reinsurance activity, it is important to note that the pursuit of this business in Italy is allowed under the freedom to provide services and the freedom of establishment to both EU and non-EU companies. In particular, Article 61 of the Code of Private Insurances provides that authorization shall not be required for undertakings with their head office in another Member State or in a third State to operate a reinsurance business in the territory of the Italian Republic under the freedom to provide services. However, such an undertaking may not use branches, agencies, or any other permanent presence in the Italian territory, even if that presence consists merely of an office managed by the undertaking's own staff or by a person who is independent.

[23] Y. Lambert-Faivre and L. Leveneur, *Droit des assurance*, 43, 47.

[24] J. Bigot, Chapitre III, *Traité de droit des assurances*, Tome 3, Le contrat d'assurance, 217: '*L'exclusion de la réassurance [from the application of the Code des Assurances] est justifié : les parties sont l'une et l'autre des assureurs professionnels et n'ont pas besoin de la protection instaurée par la loi régissant l'assurance directe.*' See also Hagopian M., « La nature juridique de la réassurance », *Mélanges Jean Bigot*, Paris, L.G.D.J., 2010, p. 165. This perspective is quite surprising, implying that legislators should only act to support a weak party, whereas, in practice, many well-known default rules have been introduced to reduce negotiations costs.

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cases, in the absence of a statutory definition of reinsurance and a set of rules dedicated to the contract, case law provides the best guidance.[25]

Nevertheless, it seems to be the market itself that can, less and less, rely solely on established usages. This is a consequence of the role of reinsurance as a fundamental factor for determining the stability and solvency ratio of insurance companies as well as in the light of the higher regulation impacting on the reinsurance companies, as described above; the existing operation risks and legal traps connected to legal uncertainty seem to appear as unbearable factors for the same actors of the market involved.

This is why, considering the global scenario, which makes it more difficult to identify without doubt the international customs and the growing importance of reinsurance, a uniform set of rules to be optioned by the parties as their special legislation (optional law) can contribute to reducing legal uncertainty, especially given the common application of some uses and customs such as the 'deal now, detail later' culture.[26] This explains the motivation for the PRICL project, which proposes a soft law to be optioned by the parties in the reinsurance transaction.[27]

II. Relation between the Principles of International Commercial Contracts and the PRICL

The PRICL working group decided to identify a set of rules dedicated to reinsurance contracts, to be applied in conjunction with the Principles of International Commercial Contracts (PICC), drafted by the International Institute for the Unification of Private Law (UNIDROIT). In fact, the specific characteristics of reinsurance appear to require a limited number of special rules, each of them of significant importance, that deviate from general contract law as well as from insurance contract law. This is the reason for which the PRICL will not be linked to the Principles of European Insurance Law—that is to say, the Principles elaborated in order to offer a restatement of rules on insurance contract.[28] In this way, reinsurance parties gain access to two complementary sets of rules to fully cover their contractual arrangements, working in conjunction and reducing gaps in the discipline. This is clearly stated by Article 1.1.2 of the PRICL, which gives an option in favour of such a uniform set of rules.

[25] This is the case for the USA: see J. Stempel, *Stempel on insurance contracts* (3rd ed, Aspen Publishing, 2011). In the USA, even a tentative definition of reinsurance is proposed by case law: '*Reinsurance occurs when one insurer (the "ceding insurer" or reinsured) cedes all or part of the risk it underwrites, pursuant to a policy or group of policies, to another insurer. The purpose of reinsurance is to diversify the risk of loss, and to reduce required capital reserves*' (*Unigard Security Insurance Co. v. North River Insurance Co*, 4 F. 3d 1049, 1053 (2d Cir. 1993)).

[26] London Market Group's website mentions the traditional 'deal now, detail later' culture of the London market: <https://www.londonmarketgroup.co.uk/contract-certainty>.

[27] See E. Mostacci, *La soft law nel sistema delle fonti. Uno studio comparato*, Padova, 2008.

[28] For the choice to apply a specific set of rules, rather than merely referring to the Principles of European Insurance Contract Law (PEICL) developed as an optional law for insurance contracts, see Heiss, *From contract certainty to legal certainty for reinsurance transactions: the Principles of Reinsurance Contract Law (PRICL)*, quoted.

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It is evident that the PICC imply a choice that includes general rules of contract law. Therefore, the PICC will apply unless the PRICL provide special solutions for problems and aspects typical of the reinsurance contract (see also Article 1.1.6(3)). The basic idea is that the PICC and the PRICL together will provide a relatively comprehensive and uniform soft law on reinsurance in order to simplify operations for market actors.

In particular, the PRICL proposes specific rules in those areas where reinsurance practitioners, together with scholars, have identified a higher need to have legal certainty. To this end, in a first instance, the Principles propose a definition of contract of reinsurance (Article 1.2.1) as 'a contract under which one party, the reinsurer, in consideration of a premium, promises another party, the reinsured, cover against the risk of exposure to insurance and/or reinsurance claims'.

The Principles then try to set the framework to combine the rules more often used by the market and detailed in usually adopted contract clauses (such as the 'follow-the-fortune clause'), with underlying general principles commonly accepted by the same industry, even if not always clearly expressed, such as the one to act according to utmost good faith. This hybrid approach is mirrored by the language used and explained to the readers in each comment and note in the proposed rules, thus reducing the risk of opacity that could ultimately be judged by an arbitrator or a court.

It is useful to remember that the PRICL, like the PICC, is a soft law solution, and, as is usual for all model contract laws, its application depends on the choice of the parties. This is clearly stated in the preamble of the PRICL: 'The PRICL shall apply to contracts of reinsurance where the parties have agreed that their contract shall be governed by them.' This implies a voluntary decision by the parties to derogate from national contract law for practical purposes as well as the cultural idea that reinsurance needs special provisions.[29]

Deviation from the PICC is required and adopted for issues that go to the core of unique reinsurance arrangements. This is particularly needed when setting the duties and remedies, which we consider below.

The need for special rules may be explained by several reasons. First, one should consider the already mentioned role of reinsurance in the dynamic process of market securitization and the highly specific actuarial rules that govern the contractual relationship: this approach is shared by reinsurance and direct insurance.[30]

[29] At the same time, the PRICL incorporates uniform rules on general contract law by virtue of a reference to the PICC 2016. Both the PRICL and the PICC are accompanied by comments that explain the principles and illustrate their application to typical cases. Thus, the outcomes of legal debates on the meaning of reinsurance contract terms and the contents of the (soft) law governing such contracts should become more predictable. See for further comments Heiss, 'From contract certainty', quoted, *passim.*

[30] See E. Bellizzi, 'Accesso ed esercizio dell'attività di assicurazione', in S. Amorosino and L. Desiderio (eds), *Il nuovo codice delle assicurazioni. Commento sintetico* (Milan, 2006) 195.

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Another special feature of reinsurance in the scenario of business-to-business contracts is rather surprising for the most rigorous lawyers. In many jurisdictions, reinsurance is not subject to insurance contract law, despite the apparent resemblance between the two domains;[31] most surprising, however, is that it is often unknown, even to insurance market specialists, which rules should apply to reinsurance, due solely to legal uncertainty.

Besides uncertainty over which law and rules apply, it is also often difficult to find them even in the absence of codification, even within a single jurisdiction. Finding the applicable rules is in some cases a 'fishing expedition'. This is evidently the case in Italy, as raised by scholars and reflected in the very scarce case law on this matter.[32]

To remedy this situation, specific rules have been elaborated in order to identify duties and remedies for both the pre-contractual and the contractual stage. For these aspects of the life of reinsurance contracts, general contract rules are a poor fit.

III. Contractual duties in the PICC and the PRICL

1. From the paramount duty of good faith to the utmost good faith standard

As is globally known, contracts (with limited exceptions) create duties for both parties. This applies equally to reinsurance, despite being an aleatory contact, as is the case for direct insurance. When dealing with the parties' duties, the PICC confirms the importance of both relation duties and substantial duties. Unsurprisingly, we find a core role for the duty to act in good faith, which is sanctified by many articles of the PICC, starting from Article 1.7, which applies the duty of good faith and fair dealing to pre-contractual negotiation.[33] As the comment to that rule clearly explains, 'the parties' duty to act in accordance with good faith and fair dealing is of such a fundamental nature that the parties may not contractually exclude or limit it'.[34]

A number of provisions throughout the PICC directly apply the duty of good faith. This confirms that adherence to a standard of good faith is raised to the

[31] See the references to different legal systems in the PRICL Comments added to the 2019 draft by J. Stempel, in course of publishing together with the version of the Principles approved until now by the working group.

[32] Case law is equally extremely scarce, as are arbitration procedures ruled by civil law (and Italian law) rules: for comments on the law of arbitration, see J. Stempel, 'Notes from a Quiet Corner: User Concerns about Reinsurance Arbitration—and Attendant Lessons for Selection of Dispute Resolution Forums and Methods' (2017) *Scholarly Words* 1068.

[33] M.J. Bonell, 'The law governing international commercial contracts and the actual role of the Unidroit Principles' (2018) 23 *Uniform Law Review* 15. Article 1.7 PICC imposes a duty of good faith and fair dealing. Significantly, this provision has not been changed in subsequent versions.

[34] For specific applications of the general prohibition to exclude or limit the principle of good faith and fair dealing between the parties, see Articles 3.1.4, 7.1.6, and 7.4.13.

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status of a fundamental principle (see comment under Article 1.7).[35] The general reference to good faith is applicable to reinsurance contracts, and it continues to apply to duties that are less typical of reinsurance contracts and common to all contract law and transactions. For example, Article 1.1.6 requires good faith and fair dealing in interpreting the proposed PRICL rules. This reference to interpretation according to good faith is necessary to ensure uniform application of the PRICL and, ultimately, legal certainty.[36]

Although the PICC raises the duty of good faith to an imperative general provision, thereby trying to unify the solutions applied and recognized in both civil law and common law countries,[37] it never imposes a standard of utmost good faith. Instead, parties are given freedom to agree to such higher behavioural standard within their contract (see, for example, Article 5.3.3). Should the parties choose to apply the PRICL, then this higher standard will apply: in fact, as will be later examined, the PRICL mirrors the idea that, in reinsurance, parties have to act and behave in utmost good faith, as detailed in Chapter 2.

This result is obtained thanks to two main provisions. First, Article 2.1.1 (Duties in general) provides that throughout the negotiation, formation, operation, termination, or avoidance of the contract, the parties owe one another (at least) the duties set forth in Chapter 2, which refers to all duties of both the insurer and reinsurer.[38] In Article 2.1.2 (Duty of utmost good faith), it provides that the performance of those duties has to be evaluated under the standard of utmost good faith ('[t]he parties owe one another the duty of utmost good faith'). The systematic position of this provision confirms that the standard of utmost good faith is consequently fundamental and must be applied even when, with reference to specific duties, it is not expressly recalled: the duty to act according to utmost good faith, thus, might be considered a supplementary rule.

Given its importance, the parties cannot derogate from, or exclude, the duty to act in utmost good faith, as it affects all steps in the relationship between the

[35] On the notion of principle (*principio*) in contract law, see G. Alpa, 'CESL, Diritti fondamentali, principi generali, disciplina del contratto', in *NGCC* (2014) *parte seconda*, 147–55.

[36] Article 1.1.6 (Interpretation and internal gaps): '(*1) In the interpretation of the PRICL, regard is to be had to their international character and to their purposes including the need to promote the observance of good faith and fair dealing in the reinsurance sector and uniformity in the application of the PRICL. (2) Issues within the scope of the PRICL but not expressly settled by them are as far as possible to be settled in accordance with their underlying principles.*' As in the PICC, the idea is not to refer to a national or local concept of good faith, but to construe it from the perspective of international trade. For a critical view on the problem of interpreting uniform rules and the drag of national interpretation rules, see O.C. Giles, *Uniform commercial law. An essay on international conventions in national courts*, especially p. 27 ff, which points out the risk of a national approach to supranational (uniform) laws.

[37] The PICC proposes its application in all jurisdictions, even if some common law countries do not generally recognize good faith as a general rule.

[38] As clarified in the comments to the article, "subject to judicially imposed limits on the alteration of default rules, the duties set out in this Chapter may be altered by the parties to the contract of reinsurance – provided that the alteration of the default rule is knowing and voluntary and not the product of fraud, misrepresentation, duress, undue influence, or other conduct that would make the alteration of the default rule unenforceable pursuant to the PICC" (See Comment under Article 2.1.2, draft edition).

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parties and in both directions, 'on a two-way street between cedant and reinsurer'.[39] Once again, and consistent with market practice, the duty is set bilaterally and reciprocally rather than only as a burden for the reinsured company.[40] In addition, the duty to act according to utmost good faith applies in the pre-contractual phase as well as during the performance of the contract.[41]

Utmost good faith is generally considered to require something more than the ordinary or 'regular' good faith obligations prevailing in some jurisdictions for contracts that do not involve reinsurance or marine insurance;[42] however, there is no univocal definition, which is why one is proposed by the PRICL. Quite ambitiously, the same Article 2.1.2 also provides for a definition of utmost good faith thereto: '[H]onesty and transparency as well as fairly taking into account the interests of the other party.' It should be considered that the definition of utmost good faith, like that of good faith, is neither univocal nor easily found in legislative acts or statutes. Referring to the common reference source of a legal dictionary, we find that utmost good faith is defined as 'most abundant good faith; absolute and perfect candor or openness and honesty; the absence of any concealment or deception, however slight'.[43] In other words, it is obvious that utmost good faith is not something genetically different from the good faith requirement for all contracts but that it is, instead, a reminder to the parties (and to the judges) to apply the standard of fairness and good faith in the most rigorous way. In fact, this general notion has been better detailed in the series of case law dealing with this matter. The presence of a definition in term of utmost good faith, consequently, has to be read in this direction, and it undoubtedly contributes to spreading a common culture and language.

It is important to focus once again on the fact that the PRICL accepts the idea of a reciprocal duty of utmost good faith. This seems to become a supplementary rule under the general assumption that the special relationship between the reinsurance company and the reinsured justifies a rise in the standard contractual duties. Setting a bilateral duty to act in utmost good faith seems to reflect

39 Quoting Wollan, Handbook of reinsurance law, at § 3–5.

40 Jerry, *Understanding Insurance Law* (n 35) § 142[c], 1060: '*Utmost good faith contracts of any kind are so delicate in character and so susceptible of abuse that unusual precautions must be observed by both parties in their implementation. The business of reinsurance often involves considerable oral exchange of information between primary insurer and reinsurer, and the reliability of this information is very important. The resemblance of the customary practices to how business used to be conducted at the Lloyd's Coffee House of old is unmistakable. The strict law of warranty which applied to the old transactions at Lloyd's probably has something in common with the duty of "utmost good faith" which applies in reinsurance. Both doctrines have the effect of ratcheting up the expectations contracting parties can reasonably possess with regard to the accuracy of information shared by the other party.*'

41 It is enough to think about the course of subsequent policies and in the application of the so-called 'follow the fortune' clause. Several examples are mentioned in the comment to the article, see PRICL, draft 2019.

42 For example, in non-marine insurance matters in some jurisdictions (including most of the USA), an applicant or policyholder is usually is required only to answer questions truthfully and generally need not volunteer adverse information unless this amounts to impermissible concealment. See Stempel, Swisher and Knutsen, 478; Stempel and Knutsen, §§ 3.07–3.11.

43 *Black's Law Dictionary* (6th ed, 1990) 1520.

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the market expectation, as it is already considered bilateral in business practice.[44] For the avoidance of doubt, comments to the rule clarify that it is impossible to exclude the reference to utmost good faith. This specific comment is crucial as the parties who opt for the Principles can exclude or partially limit their application (as per Article 1.1.3) apart from rules that are considered to be the essence of the reinsurance relationship.[45]

This deviation from the general standard of good faith is justified by more than one reason. First, there are specific aspects of the negotiation that require such a high standard. For example, reinsurance is often characterized by the 'deal now, detail later' culture: this implies that the parties generally agree on the basic aspects of their contracts and treaties before then recording the details and verifying the notions and clauses of the underlying insurance contracts and treaties (specifically, the direct insurance contracts). It is essential that both parties act in utmost good faith.

Equally, an utmost good faith rule is justified by the economic reasons for ceding the insured risks.[46] It is also consistent with more recent trends in insurance and the need to mirror these in reinsurance, particularly given the special clause in reinsurance contracts concerning 'back-to-back' coverage.

As it was pointed out:

> Historically, the reinsurance market has relied on a practice of the exercise of utmost good faith to decrease monitoring costs and ex ante contracting costs. Reinsurance works only if the sums of the reinsurance premiums are less than the original insurance premium. Otherwise, the ceding insurers will not reinsure. For the reinsurance premium to be less, reinsurers cannot duplicate the costly but necessary efforts of the primary insurer in evaluating risks and handling claims. [t]hey are protected, however, by a large area of common interest with ceding insurers and by the tradition of utmost good faith, particularly in the sharing of information.[47]

The reasons for such special rules and the higher standard of fairness are so easily explained. The mutual perspective that characterizes insurance contracts also

[44] It should, though, be noted that the standard is more often debated in courts and arbitrations with reference to the position of the reinsured party, rather than that of the reinsurer. See also Wollan, *Handbook of reinsurance law* (n 1) §3.02: '*The duty is generally perceived and articulated as running in both directions, on a two-way street between the cedent and the reinsurer. As a practical matter, however, at least as far as treaty reinsurance is concerned, the reality is that the cedent's duty of utmost good faith figures far more prominently in the relationship than does that of the reinsurer, for the very simple and self-evident reason that the reinsurer must rely on the information furnished by the cedent to a much greater extent than the reverse*'; see also P.T. O'Neill-J.W. Woloniecki, *The law of reinsurance in England and Bermuda*, London, Sweet and Maxwell, 2004.

[45] Comment under Article 1.1.3 of the PRICL clarifies this solution: "Individual rules contained in the PRICL may bear a mandatory element following from the content and purpose of the rule. For example, parties will not be allowed to exclude the application of the duty to observe" (PRICL, edition with comments, in course of publishing); similarly, PICC comments clarify that the parties cannot exclude the good faith requirement.

[46] Abramovsky, *Silent regulator*, quoted, 382–3.

[47] *Unigard Sec. Ins. Co. v. N. River Ins. Co.*, 4 F.3d 1049, 1054 (2d Cir. 1993)); see for further comments M.M. Mendoza, *Reinsurance as governance: governmental risk management pools as a case study in the governance role played by reinsurance institutions*, in *Connecticut Law Journal*, 2015, 21.1, p. 54 et seq.

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dominates reinsurance in the sense that what happens in one reinsurance contract impacts on all reinsured companies. In addition, reinsurers are remote from the direct risk (especially in aggregated forms of reinsurance coverage). This is clearly expressed in Comment C6 in the PRICL.[48]

In fact, utmost good faith allows the costs of negotiations and due diligence to be reduced. This lowers the costs of the opaque acquisitions that often characterize reinsurance contracts.[49] From an economic perspective, reduced due diligence activities allow the reinsurer to apply a lower premium than that applied to direct insurance, thereby making the operation profitable for the insurer and thus marketable.

On the other hand, applying the concept of utmost good faith to reinsurers is justified by their expertise and experience in global markets, which equip them with more data about major issues than is held by direct insurers (reinsurance companies often have large research departments). In this case, a reinsurer could not hold against the reinsured its failure to declare a fact that was already available to the reinsurer through its own research.[50]

Deviating from general rules applying to ordinary commercial contracts, the doctrine of utmost good faith—or *uberrimae fidei*—was elaborated in the area of insurance centuries ago and then underlying the qualification of insurance contracts as of utmost good faith in most legal systems.[51] Despite its long history, the notion of utmost good faith is not univocal and sometimes creates

[48] See Comment C6 under Article 2.1.2 to PRICL: '*Reinsurance underwriters tend to be considerably more removed from risks than non-marine insurance underwriters and are thus more dependent upon receiving adequate disclosure of material information from reinsureds. As a result, reinsurance law has long imposed more rigorous duties upon parties to a reinsurance agreement, particularly as respects the reinsured's disclosure obligations, than are imposed upon insureds outside the context of marine insurance. The PRICL embrace the traditional view that because of the nature of reinsurance and the degree to which it differs from primary insurance, the reinsurer should be permitted to rely completely on the degree of material disclosure provided by the reinsured. Although the duty of utmost good faith is primarily stated in terms of duties of disclosure imposed upon a prospective reinsured, the duty applies throughout all aspects and stages of a reinsurance agreement. Although most discussion of the duty of utmost good faith in judicial decisions involves alleged breach by the reinsured, the duty is reciprocal and applies to reinsurers as well as reinsureds, even if the circumstances in which breach by the reinsurer is alleged may be comparatively less frequent than situations in which it is alleged that the reinsured failed to provide required information during the contracting process*'.

[49] See R.H. Jerry, *Understanding Insurance Law* (4th ed., 2007) § 142(d) 1021; S. Plitt and others, *Couch on Insurance* (3rd ed., 2008) § 9:17: '*Duties of good faith and fair dealing run between the reinsurer and the reinsured much as they do between the initial insured and his or her insurer. This duty originates from the reinsurer's need to rely upon and not duplicate the reinsured's efforts in properly evaluating risks and handling claims, reducing costs for both parties to the reinsurance contract. Accordingly, this duty requires the reinsured to disclose to the reinsurer all material facts which may affect the subject risk. The extension of this duty of good faith is the related concept that reinsurers are generally bound by the reinsured's good faith decision to pay a claim, commonly referred to as the "follow the settlements" doctrine.*'

[50] See also Wollan, *Handbook of reinsurance law* (n 1) §3.01 (b).

[51] A.D. Candian, Contratto di assicurazione e clausole vessatorie, in G. Alpa and S. Patti (eds) Le clausole vessatorie nei contratti con i consumatori (Milano, 1997) t. II, 955; A. Monti, Buona fede e assicurazione (Milano, 2002); M. Gagliardi, *Il contratto di assicurazione. Spunti di atipicità ed evoluzione del tipo* (Giappichelli, Torino, 2009); with reference to German law see H. Geiger, *The comparative law and economics of reinsurance*, Baden-Baden, 2000, especially at p. 85 ff..; Gerathewohl, *Reinsurance principles and practice*, vol. I, Karlsruhe, 1980 and vol.II, 1982.

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difficulties; we can, nevertheless, rely on the notion developed at least since *Carter v Boehm* (1766),[52] especially referring to the duty of disclosure, which was later codified in both common law and civil law jurisdictions. For example, the Maritime Insurance Act 1906 contributed to more precisely delimiting the notion.

Under current English law, the duty of utmost good faith requires the party to devote their best efforts to helping the other adopt an informed decision and perform. It consequently implies a duty of avoiding misrepresentation even when full disclosure may have a negative effect on the party.

Recall that not only the definition but also the concrete application of an utmost good faith rule is not univocal in all jurisdictions and legal systems for reinsurance.[53] Nevertheless, most countries allow it either as a consequence of applying insurance contract rules to the reinsurance contract or for the analogy process. In this regard, the PRICL represents an important tool for harmonization and legal certainty.

Let us consider, in this respect, the case of Italian law. Here, the paramount obligation on the parties to a contract is to act and behave according to the principle of good faith (Articles 1175 and 1375 of the Italian Civil Code),[54] and it is commonly accepted for this standard to be raised in both insurance and reinsurance. This applies to both the pre-contractual disclosure duties and activities and the execution of the contract throughout its duration. Nevertheless, even in a civil law country like Italy, there are no rules to clarify what implies an utmost good faith behaviour, which in insurance is often applied by the courts, while no case law exists with reference to reinsurance.[55]

As utmost good faith thus becomes a general standard of behaviour for the parties,[56] clearly stipulating that the contractual relationship is governed by utmost good faith reduces the risk of the parties underestimating their obligations and, thus, risking an adverse judgment by a rigorous judge or arbitrator. However, a duty of 'utmost' good faith requires the party seeking reinsurance

[52] Carter v Boehm (1766) 97 ER 1162, 1164.

[53] See Comments under Article 2.1.2 to the PRICL, drafting edition 2019; Capotosti, *La riassicurazione, quoted*, p. 247–248.

[54] The rule does not apply to contracts having as their object securities, financial instruments, and other products or services whose price is connected with the floating of quotations and of a stock exchange index or a financial market rate that is not controlled by the professional, or the purchase and sale of foreign currency, travellers cheques or international money orders issued in foreign currency.

[55] Stempel, *Stempel on insurance contracts*, quoted, passim; with reference to insurance, see A. Monti, *Buona fede e assicurazione*, Milano, 2002. More specifically, on reinsurance contract see A. Boglione, *La riassicurazione*, Milano, 2012, pp.184–200.

[56] Clarke, *Policies and perceptions* (n 2) 80; J. Birds, *Modern insurance law* (4th ed.) 101. Albeit that the distinction between good faith and utmost good faith often depends more on the standards of evaluation of the parties' behaviour, rather than in the substance of the same good faith. This is also the reason why, in some comments, scholars refer to mere good faith despite parties' behaviours being evaluated in practice against the highest standard of utmost good faith. In other words, it is well known that establishing a duty of utmost good faith makes the judgment of this duty more rigorous, and it is perfectly coherent in both civil law systems and common law systems, particularly in English case law.

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cover to inform the reinsurer of all facts material to the risk, even if the reinsurer poses no specific questions on a particular topic.

In outlining the duties, it is necessary to distinguish between pre-contractual duties, especially the duty of disclosure, and other duties of the parties. During the life of the reinsurance contract, utmost good faith is required from both parties with respect to a number of duties. When not specified, it is also the default rule. This is in line also with the solution applied in many States—for example, some jurisdictions that do not require such a high a standard for primary insurance (for example, the USA) nonetheless require utmost good faith in the context of reinsurance.[57]

To grant legal certainty, the PRICL identifies a minimum set of duties governed by the utmost good faith standard. The first example is the duty of confidentiality (Article 2.1.3): the practical consequence is that both parties should take care to avoid unauthorized disclosure of sensitive information to third parties.[58] As the standard of care is that of utmost good faith, each party must maintain the highest respect for the other party's interests, with deviation from the confidentiality rule only justified in exceptional cases (for example, where a specific law requires the information to be disclosed or when it is demanded by regulators or supervisory entities).

Another bilateral duty under the utmost good faith principle is the duty to provide and disclose documents (Article 2.3.2): 'The parties shall cooperate regarding documentation of any agreement and shall seek reasonably prompt documentation of the contract.' This mainly targets the 'deal now detail later' culture of reinsurance contracts. It might be argued that, as a practical solution often followed by reinsurance parties, this culture should not be challenged, particularly with the application of such a high standard. However, this situation is a primary cause of conflict, so a clear default rule imposing a duty to deliver documents that fully define the contractual terms would seem to be appropriate.

It should also be considered that many legislations are already targeting increased contract certainty, in line with results coming from the market codes of conduct. For instance, since 2007, the London market has utilized a Contract Certainty Code of Practice, which was created by its Market Reform Group and is now maintained by the London Market Group. Although this Code is aimed

[57] See Comment to the PRICL, drafting edition 2019, quoting *Travelers Indem Co v Scor Reinsurance Co*, 62 F3d 74, 76 (2d Cir 1995) (applying New York law): '*Reinsurers depend on ceding insurers to provide information concerning potential liability on the underlying policies*'; see also *Unigard Sec Ins Co, Inc v North River Ins Co*, 4 F3d 1049, 1054 (2d Cir 1993) (applying New York law). '*Historically, the reinsurance market has relied on a practice of utmost good faith to decrease monitoring costs and ex ante contracting costs ... [R]einsurers cannot duplicate the costly but necessary efforts of the primary insurer in evaluating risks and handling claims.... They are protected, however, by a large area of common interest with ceding insurers and by the tradition of utmost good faith, particularly in the sharing of information*' (Mendoza, (n 33) 15).

[58] See Article 2.1.3: '*The parties shall treat information provided by one another as confidential. Absent permission, they shall not disclose it to third parties except where required by law and except as necessary to provide information to professional advisers, statutory auditors, regulatory authorities and retrocessionaires.*'

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primarily at insurance, it logically sets industry standards for reinsurance placement and documentation.

Another crucial stage in the life of a reinsurance arrangement is that of claims handling. Even at this stage, the PRICL proposes the rule of utmost good faith (Article 2.4.4). This mirrors the idea of what happens in direct insurance. Consequently, reinsurance parties must find the right balance between the duty of the insurance company (reinsured party) to best support its insured clients and its duty towards the reinsurance company. Besides, although the reinsurance company has no direct link with the final insured, its actions cannot prejudice them. Some duties are specifically imposed on the reinsurance company, such as the 'follow-the-fortune rule' (Article 2.4.3) and provisions on payment of claims, both of which are subject to the standard of utmost good faith.

Here, the PRICL makes an important deviation from the PICC that warrants discussion.

2. *Utmost good faith in the pre-contractual stage: the duty of disclosure*

In cooperating towards concluding the contract, the parties must navigate a complex scenario involving disclosure activities by the insurer; this disclosure is to be based mainly on insured contracts offered and in connection with its insurance strategies.

This duty especially requires some specification. As in the process of forming insurance contractual relations, respect for the duty of utmost good faith is needed in the pre-contractual stage of reinsurance, mainly with reference to the process of contract formation.

Here, we identify a relevant difference from the general principles of contract law and of the PICC. The first application of the rule of utmost good faith relates to the pre-contractual duty of declaration.[59] The issue of information

[59] According to Italian legal provisions, the declaration of risk must be complete, true, and correct. These elements can be inferred by the combined letters of Articles 1892–3 CC that sanction fraudulent, incorrect, and incomplete declarations, with a specific distinction between cases in which the declarations are made with fraud or gross negligence (Article 1892 CC) and cases in which declarations are made without fraud or gross negligence (Article 1893 CC).

The Italian legal system does not apply the model of guided declaration, which would limit the extent of the duty of declaration on the charge of the insured. In fact, the combined application of Articles 1892–3 CC builds a system where the insured must know what a prudent insurer would wish to know about the risk, and so must specify every element relevant to evaluating the risk. In principle, this rule aims to reduce the knowledge imbalance between the parties, but it is easy to recognize how many practical problems it creates, especially when applied to the consumer, who may not know which elements should be declared to the insured at the time of concluding the contract. Consequently, the national courts have tried to limit the extent of the duty of disclosure by placing the burden of proof on the insurer. When the insured was required, prior to concluding the insurance contract, to complete a questionnaire prepared by the insurer, then the insurer is required to prove that any elements not covered in the questionnaire were nonetheless relevant for evaluating the risk and the non-disclosure by the insured consequent to the insurance contract.

In a case of non-disclosure or wrongful declaration by the insured, two different types of consequences apply, depending on the intent/gross negligence or simple negligence of the insured. If the omission or wrongful declaration was intentional or the result of gross negligence by the insured, then the insurer can ask the court to declare the contract null and void if,

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asymmetries in insurance contracts has recently been read with more attention to the real knowledge and contractual power of the applicant. If one now moves from the duty of disclosure as an application of the utmost good faith rule, one should observe that, in principle, this duty is mutual and thus imposed on both insurer and insured.

Historically, though, the obligation has rarely been applied to the insurer in practice. Emphasizing the duty's bilateral application is a recent development, following a long period in which it was considered solely applicable to the insured. In fact, we can now confirm that the doctrine of utmost good faith, as formally accepted in the statutes or court decisions of some jurisdictions, requires both parties to mutually and positively volunteer information and passively refrain from misrepresentation.

The insurance relation already imposes the duty of good faith on the insurer, who is obliged to provide suitable information to the policyholder. This should be seen as an application of the general duty to act in good faith, which finds several applications in the regulations in question and in specific provisions adopted by the supervisory body over the years (that is, the regulation regarding pre-contractual information and information arising during the contract that must be provided by the company to a party to a life insurance contract).[60] According to many, this is, in fact, stressed to the utmost good faith duty—for example, where the insurer must inform the insured about the lack of policies or any inadequacies in the offered contracts with respect to the position of the prospective insured.

knowing the true circumstances, they would not have entered into the contract or would only have done so on different terms. The insurer forfeits their right to annul the contract if, within three months from the day they discover the omission or wrongful declaration, they fail to notify the contracting party of their intention to do so. The insurer is entitled to premiums covering the period of insurance up to the date of the declaration of annulment, and in all cases to agreed premiums for the first year of the contract. If an accident occurs before the expiration of this period, the insurer is not bound to pay (Article 1892 CC).

By contrast, if the insured has acted without fraud or gross negligence, then a misrepresentation or failure to disclose are not grounds for annulment of the contract but the insurer can terminate the contract within three months from the day they discover the misrepresentation. If an accident occurs before the insurer discovers the falsity or failure to disclose, or before the term for notification has expired, then the amount due is reduced in proportion to the difference between the agreed premium and the premium which would have been payable had the true situation been known (art 1893 CC).

60 The Court of Cassation has endorsed this approach, holding in particular that the primary duties of insurers and brokers '*arise from Articles 1175, 1337 and 1375 Civil Code; and that violation thereof amount to negligence, pursuant to Article 1176, para 2, Civil Code*' (24 April 2015, n. 8412). In this case, the Court of Cassation discussed how the general duties of conduct according to good faith and fairness, as set out in Articles 1175, 1337 and 1375 Civil Code, impact on the conduct of professionals in an insurance contract. Following an interesting line of reasoning, the Court held that the primary duties of the insurer and their brokers or promoters included providing 'thorough, clear and complete information and of offering the contracting party insurance policies that are actually useful for the insured party's needs', i.e. 'consistent with the profile of risk or pension needs' manifested thereby. These duties, continued the Court, 'are general in nature' and 'prevail over regulatory standards, such as the supervisory authority's rules and, *a fortiori*, over the indications given in supervisory authority's rules and, *a fortiori*, over the indications given in documents with no regulatory power, such as a memorandum from the supervisory authority': see S. Nitti, in D. Cerini and S, Nitti, chapter 'Italy', in P. Marano- I. Rokas (eds.), *Distribution of insurance-based investment products*, 2019, p. 197.

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IV. Remedies

Even in the best families, things can go wrong: when this happen within the boundaries of a contractual relation, the parties can exercise remedies for the protection of their interests. Finding the proper remedies is a complex matter, as the parties are no more in a peaceful state of mind within the process of managing their relation: the law is called to set, from a general and *ex ante* point of view, ideally the right balance between (violated) rights and remedies available, which might eventually have to be reviewed in a judicial or arbitration *siège*.

The core point of the *ex ante* regulation lies in finding the balance between freedom of contract (which also implies at its ultimate steps to the possibility for a party to not perform and accept the consequence) and the respect to the principle of *pacta sunt servanda*. In international contracts, problems of domestic cases of breach of contracts seem amplified by the necessity to combine different cultural approaches referring to contractual malfunctioning.[61]

In proposing rules for the case of a breach of contractual remedies, the PRICL seeks to respect this need while taking into consideration the customs of the market and the systematic relevance given to the utmost good faith standard of conduct—so crucial for all that has been said above.[62] As a consequence, the available remedies provided by the PRICL primarily aim at the persistence of the contract and the application of the proportional rule; avoidance is a possible solution only in exceptional cases. In a few words, the relevant rules confirm the goal of maintaining the contract, from one side, combined with the negative incentive for all type of violations of contractual duties, without an excessive penalization of the party on the infringement State.

In order to see how this solution is expected to function, let us first remember that Chapter 3 of the PRICL generally refers to the traditional 'breach-of-contract' terminology mostly used in common law systems. This terminology differs from the PICC, where the relevant remedies are identified under the consequences for 'non-performance'. The substance, anyway, does not change as the comment to the PICC, as well as the systematic structure of the project, clearly confirms the overall approach to all pathologies of the contract as it is in the PRICL. In fact, the broader reference to the notion of breach of contract

[61] L. Chengwei, *Remedies for non-performance. Perspectives from CISG, Unidroit Principles and PECL*, CISG on line publishing, 2003, in particular p. 28 ff. On different approaches and solution for breach of contracts, see O.W. Holmes, Jr, *The common law*, 1881, p. 299 seq.; H. Collins, *Regulating contracts*, Oxford, OUP, 1999; R. Hyland, Pacta sunt servanda: a Meditation, 34 Va. J. Int. L., 2003; p. 405 ff.; P. Malaurie. L. Aynès- P. Stoffel-Munck, *Les obligations*, Paris, 2003, 594 seq.; R.L. Weaver, (ed.), *Comparative Perspectives on Remedies. Views from Four Continent*, Global Papers Series, Volume V; Y.M. Laithier, *Etude comparative des sanctions de l'inexécution du contrat*, LGDJ, Paris, 2007; G. Treitel, *Remedies for breach of contract. A comparative account*, OUP, 2008.

[62] In the reinsurance relations, those complexities coexist with the further need to take into consideration not only the positions of the two parties involved in the transaction, but also the impact that reinsurance is supposed to have on the final insured parties (even if not directly connected from a contractual point of view to the reinsurer).

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adopted by the PRICL includes non-performance, late performance, and partial non-performance (Articles 3.1–3.2).

Second, with reference to the types of available remedies, the PRICL respects the trilogy between specific performance, termination, and avoidance, all eventually combined with the payment of damages. This is in line with the PICC.

More substantial are the differences in the treatment and consequences of non-performance/breach of contract. In fact, deviations from the general rules provided by the PICC apply, and solutions vary a lot according to the type of duty violated: not surprisingly, the PRICL isolates the breach of pre-contractual duties—mainly, the duty to disclose—from the violation of other contractual duties. This solution mirrors the crucial relevance of the duty of disclosure in the pre-contractual phase that leads to the conclusion of the reinsurance contract.

In light of what has been said, it is now time to look at the rules proposed by the PRICL. In the analysis of the solution provided, let us first consider the rules proposed for violation of all pre-contractual and contractual duties (Article 3.1) and, second, the special solution for the violation of the duty of disclosure (Article 3.2.).

1. Remedies for violation of contractual duties (with the exception of the duty of disclosure)

Article 3.1 sets remedies for violation during the pre-contractual or contractual stage, with the exclusion of the duty of disclosure. Article 3.1 displaces remedies provided by the PICC with regard to breaches of duties during the contract term in a broad sense. As a general rule, the PRICL is in line with the PICC where they provide for specific performance as a preferred remedy (according to the civil law tradition and especially in line with the cultural model proposed by the French and German legal systems).[63] The principle of specific performance is simplified in the PICC in Article 7.2.1 for monetary obligations, and it is further sanctified in actual Article 7.2.2, which sets the specific performance also for non-monetary obligation as the general rule.[64]

[63] Traditionally, German and French contract law tend to give preference to specific performance for dare obligations, being debt for monetary duties or other duties of dare and culturally confine damages to more limited situations. See Markesinis, V.B.S. Markesinis- H. Unberath- A. Johnston, *The German law of Contract. A comparative treatise*, II ed., Hart Publishing, Oxford-Portland, 2008, pp. 348 ss; A. A. Levasseur, *Comparative Law of contracts, Cases and materials*, Caroline Academic Press, 2008, pp. 167 ss. With reference to the PICC edition of 1994, see in particular I. Schwenzer, p. 292; on the following editions of the Principles, see Vogenauer, *The Unidroit Principles of International Commercial Contracts at twenty: experiences to date*, the 2010 edition, and future prospects, Uniform Law Review, Volume 19, Issue 4, December 2014, p. 481–518,

[64] This general rule is in fact criticized by some authors for not being always the most efficient, especially in the perspective of a uniform (model) law; consequently, general priority to the right to require performance is considered not always justified especially in international contest, where award of damages may be enough. Taking into consideration those comments, PICC mitigate the rule in specific situations (see Article 7.2(a) to (e)). This solution is reinforced from the analysis of other articles, as Article 3.2.4 (Remedies for non-performance) which states that '*a party is not entitled to avoid the contract on the ground of mistake if the circumstances on*

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Specific performance is, nevertheless, combined with the right of the party who suffered the breach with the possibility of adjustment, which can operate retroactively. Avoidance of the contract is allowed in extreme cases. Payment of damages, if not already covered by other previous solutions (in particular as the effect of adjustment) can be added.

In fact, Article 3.1 (Remedies for breach of contract) provides that:

> (1) If a party breaches the contract, an aggrieved party is entitled to claim: (a)performance in accordance with Chapter 7 Section 2 PICC; (b)damages in accordance with Chapter 7 Section 4 PICC. (2) An aggrieved party may terminate the contract if it cannot reasonably be expected to uphold the contract.

As the rules clearly show, the provision grants the right to performance and thereby refers directly to Chapter 7, section 2, of the PICC. This is not a surprise: in reinsurance contracts, a large number of the parties are of a monetary nature. Accordingly, Article 7.2.1 of the PICC (Performance of monetary obligation) fits perfectly as it grants a claim for payment.

Non-monetary obligations (such as, for example, the duty to allow inspection of records provide by Article 2.3.4 of the PRICL) will be governed by Article 7.2.2 of the PICC (Performance of non-monetary obligation). At the same time, the main idea being to maintain the contract while respecting the economic balance of the transaction,[65] Article 3.1.1. provides that, in case of breach, there is a proportionate reduction of eventual payment to be made by the reinsurer or the reinsured (in terms of premiums). In other words, there is ground for contractual adjustment that can also operate retroactively. In practical terms, this possibility will be mainly applied to the position of the reinsured, with the right to demand a higher premium or to reduce the amount due for the coverage, in line with the respect of actuarial bases of the reinsurance contracts. The alternative remedy of avoiding the contact is set only for exceptional circumstances—that is to say, in case of a fraudulent breach of pre-contractual or contractual duties.

which that party relies afford, or could have afforded, a remedy for non-performance'. In the comment to the clause, it is clarified that '*This Article is intended to resolve the conflict which may arise between the remedy of avoidance for mistake and the remedies for non-performance. In the event of such a conflict, preference is given to the remedies for non-performance since they seem to be better suited and are more flexible than the radical solution of avoidance*'. And, continues the explanation, an actual conflict between the remedies for mistake and those for non-performance arises whenever the two sets of remedies are invoked in relation to what are essentially the same facts". See the illustration to the rule as proposed by Unidroit: '*A, a farmer, who finds a rusty cup on the land sells it to B, an art dealer, for EUR 10,000. The high price is based upon the assumption of both parties that the cup is made of silver (other silver objects had previously been found on the land). It subsequently turns out that the object in question is an ordinary iron cup worth only EUR 1,000. B refuses to accept the cup and to pay for it on the ground that it lacks the assumed quality. B also avoids the contract on the ground of mistake as to the quality of the cup. B is entitled only to the remedies for non-performance. It may be that the conflict between the two sets of remedies is only potential, since the mistaken party could have relied upon a remedy for non-performance, but is actually precluded from doing so by special circumstances, for example because a statutory limitation period has lapsed. Even in such a case this Article applies with the consequence that the remedy of avoidance for mistake is excluded*'.

65 This does not clash with the qualification of aleatory contract of reinsurance as the balance refers to what the parties have agreed upon.

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Some other solutions provided by the PICC remain applicable: this regards the right to set off as provided by Article 8.1ff of the PICC. Hence, the reinsurer may set off claims for payment resulting from Article 3.1.1(1) and (2) against the reinsured's claim for performance under the reinsurance contract. This is in line with the idea that the PICC constitute the general contract law also governing reinsurance contracts. Some examples may clarify the functioning of these rules:

- if the reinsured party does not cooperate in utmost good faith, or he acts negligently while setting claims with the finale insureds, the reinsurer – who is generally bound by the follow the settlement rule, may nevertheless reduce the amount to be paid according to the contract.
- If the reinsurer fails to pay the claims in due terms, the insurance company (reinsured) will be entitled to the get the payment, plus damages.

2. *Breach of duty of disclosure*

As anticipated, the PRICL give a crucial role to the duty of disclosure in line with the overall relevance of the duty of utmost good faith.

While solutions for the violation of pre-contractual and contractual duties, as seen before, may generally refer to both parties to the contract, consequences for the breach of the duty of disclosure are set with specific reference to the position of the reinsured. In this direction, Article 3.2 of the PRICL is specifically dedicated to the violation of duty of disclosure of the prospective reinsured, and it provides for the alternative remedies of adjustment (Article 3.2.1), as a general rule, and avoidance in most extreme cases (Article 3.2.2).

In particular, if the prospective reinsured breaches its duty of disclosure as set forth in Article 2.2.1 and if the reinsurer, had it known the undisclosed information, would have entered into the contract on different terms and conditions other than the premium, the reinsurer is entitled to retroactively adjust the contract to these different terms and conditions. As a consequence, if the reinsurer, had it known the undisclosed information, would have entered into the contract on a higher premium, the reinsurer is entitled to (i) proportional reduction of the amount to be paid on any claim arising from a loss that occurred before the reinsurer became aware of the breach and (ii) claiming the higher premium for the remaining contract period while providing full coverage according to the adjusted contract for all claims arising from a loss that occurred after the reinsurer became aware of the breach.

In limited cases, the breach of the duty of disclosure, as set forth in Article 2.2.1, entitles the reinsurer to avoid the contract retroactively: this happens solely if the duty was breached fraudulently (Article 3.2.3(a)) or the reinsurer would not have entered into the contract at all had it known the undisclosed information (Article 3.2.3(b)). As the aim of the PRICL is to uphold the contract whenever it is possible, comments to Article 3.2 clarify that the requirements of the

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remedy are to be interpreted restrictively.[66] For example, the reinsurer will be entitled to avoid the contract according to Article 3.2.3(b) only where he proves that he categorically refuses to cover a certain risk that the insured company has not disclosed. In all cases, the reinsurer may claim additional damages.[67]

As can be seen, Article 3.1.2 is designed in a threefold structure. Paragraphs (1) and (2) determine the consequences of a breach of the pre-contractual duty of disclosure in cases where the reinsurer would have entered into the contract, albeit on different terms and conditions. In principle, paragraphs (1) and (2) allow for an adjustment, whereas paragraph (3) allows for the avoidance of the contract. Paragraph (4) grants additional damages that are not already covered by paragraphs (1) to (3).

This solution deviates from the PICC as the reinsurer is not entitled to avoid the contract for mistakes pursuant to Article 3.2.2 of the PICC or even for fraud as specified in Article 3.2.5 of the PICC.[68] The solutions proposed by the PRICL also deviate from solutions traditionally applied in some legal systems, where the violation of the duty of disclosure always leads to the possibility of the reinsurer to avoid the contract: in the direction of proposing a more innovative position to better balance the position of the parties and to allow the reinsurance contracts to develop their effect.[69]

V. Conclusion

It appears quite clear that the PRICL may be a useful tool for the specialists of the reinsurance markets in order to reduce legal uncertainty and operational risks.

At the same time, the PRICL also represent a comprehensive compilation of knowledge regarding a sector of contractual law that is extremely relevant from an economic point of view but, at the same time, quite unexpectedly unknown by scholars and often by others (regulators, legislators, and attorneys) active in the basic insurance markets.

This practical usage of the PRICL may be particularly beneficial with reference to aspects of the contract relationship that require specific deviations from general contract law rules—more specifically, duties of cooperation between the parties, the duty to act according to utmost good faith standards, and the consequent remedies in case of violation of said duties, as we have tried to outline

66 See PRICL, under C27, draft 2019, p.96.

67 For other comments and examples see the PRICL drafting 2019, under Article 3.2.3, p.100 seq.

68 See also further comments under Article 3.1.2 PRICL.

69 The 'lose all' approach applied in some jurisdictions is well simplified by the words of Robert W. Strain, 'A defining characterization of quality of some (contractual) relationships, of which reinsurance is universally recognized to be one. Among other differences from ordinary relationships, the nature of reinsurance transactions is dependent upon mutual trust and a lively regard for the interest of the other party even if inimical to one's own. A breach of the utmost good faith, especially in regard to full and voluntary disclosure of the element of risks of loss, is accepted as grounds for any necessary reformation or redress, including rescission' (R. Strain, *Reinsurance*, 665 (1980). For examples of jurisdictions where this solution is applied see notes under Article 3.2.3, PRICL draft 2019, p. 103 ff.

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above. From a more theoretical approach, one may consider the importance that the PRICL can have as a tool to create a better knowledge of the reinsurance contract in the market.

The dual goal to approach the 'experts' of the reinsurance market as well as 'third parties' (lawyers, arbitrators, and judges) can be better reached thanks to the fact that the PRICL have put their fundamentals in the PICC and have tried to combine them with more specific rules, where the language and the solutions of the traditional contract law (breach of duties and utmost good faith) are mixed with the terminology specific to the reinsurance market.

Examples are that expressions like 'follow the fortune' or 'back-to-back' coverage, which deeply seep into the everyday and long-consolidated uses and practices of the international market but are unknown to the legislators and even sometimes to the many people in apical positions of insurance companies, are now easily accessible. This language and terminology are often taken from the English language because the tradition of reinsurance is mainly dealt with in the global market and commercial law, especially the common law and London rules, as it is a minor part for direct insurance. This simplifies problems of translation, as the PRICL are written in English.

At the same time, they appear to be extremely innovative as the language of the practice becomes the rule, in the soft law model of the PRICL. Comments on the proposed rules, at the same time, recall the (unwritten) market praxis and have become extremely useful not only for granting a sort of 'educational function' but also for facilitating a uniform future application, which is to be read in line with the good faith interpretation rule set by Article 1.1.6. In the end, this will substantially increase legal certainty even if such certainty cannot be fully guaranteed.[70]

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[70] Basedow J., 'International economic law and commercial contracts: promoting cross-border trade by uniform law conventions', in *Uniform Law Review*, Volume 23, Issue 1, March 2018, p. 1–14, <https://www.doi.org/10.1093/ulr/uny007>.