# Failure to pay successive premiums and its effects on the Extraordinary Risk coverage by the Consorcio de Compensación de Seguros

The judgment in discussion refers to the effectiveness in relation to the Consorcio de Compensación de Seguros (CCS) of agreements between the policyholder and their insurer in cases where the premium is not paid in the one-month grace period and the insurance contract between the parties has been suspended pursuant to article 15.2 of the Insurance Contracts Act.

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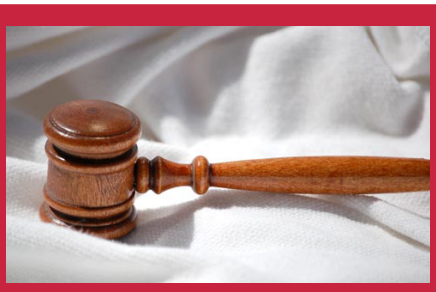
## Judgment by the Civil Law Chamber of the Supreme Court of 30 January 2017

### Judge rapporteur: Mr. Sancho Gargallo

It is not uncommon for delays to occur in paying premiums, especially in the case of major risks where an insurance broker usually intermediates as well. Such delays in payment often originate from the circumstance of successive premiums where there is a late start to negotiating the renewal of the insurance contract, or renewal entails problems, and the premium is paid only after the one-month grace period following annual expiration of the policy.

When such delays to payment concern the contracting parties (the insurer and the policyholder) there do not tend to be problems, given that insurers are familiar with them and accept them, even if, on the date of a loss, the successive premium has still not been paid. It is commonplace for many insurance brokers to have agreements with the insurers whereby they pay the premiums after one, two or even three months, without taking into account when the policies expire. This is why, on some occasions, payment takes place after the one-month grace period is over, when, according to article 15.2 of the Insurance Contracts Act (the LCS for the Spanish) the cover between the contracting parties has fallen into suspension for legal purposes.



As regards the case we are concerned with here, and with respect to CCS extraordinary risk cover, we shall discuss the legal effects that arise from the situation where the successive premium is only paid to the insurer on a date after the loss event (involving flooding) and when the contract was legally in a state of suspension given that the premium had not been paid within the month following the expiration thereof.

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The facts that have given rise to this court decision concern an insurance contract which was to run from 1 July 2005 to 1 July 2006 and which was extended from year to year.

Over the days from 4 to 7 November 2011, as a result of heavy downpours of rain, the River Urumea burst its banks where it runs through Hernani (Gipuzkoa). This was at a place where the premises of Selak, Savera Services and Savera were located, which suffered serious damage. The flooding was rated as an extraordinary risk and CCS assumed the loss according to the provisions of the relevant legislation.

When these events occurred the insurance contract had been extended on 1 July 2011, although, even after over four months had passed since the expiration thereof, the pertinent premium had still not been paid. Payment of the premium was made and accepted by the insurer after the loss event. Consequently, when the events took place the contract was in suspension of legal effects pursuant to article 15.2 of the Insurance Contracts Act. In such cases, as jurisprudence has indicated, the contract is ineffective between the parties. On this point, the Judgment by the Civil Law Chamber of the Supreme Court of 30 June 2015 provides that:

> *"From the month following non-payment of the premium and for the next five months, while the policyholder continues to fail to pay the premium and the insurer has not cancelled the contract, insurance cover remains suspended. This means that it has no legal effects between the parties in the sense that if the loss event takes place within this time, the insurer does not cover it for its insured party. Nonetheless, suspension of insurance cover is not legally operative in relation to a third party that brings the direct action mentioned in art. 76 of the Insurance Contracts Act to the extent that this same precept envisages that "direct action is not affected by any defence that the insurer might be entitled to against the insured".*

Given that what we have is an extraordinary risk that is guaranteed by CCS, this is first party insurance and not third party liability insurance. Thus, as the judgment cited suggests, since the contract has been suspended, it has no legal effects between the parties, for which reason CCS refused to cover the loss mentioned.

The judgment by the court of first instance accepted the complaint. The judge from the original lower court understood that the insurer was aware and accepted that the premium would be paid beyond the established deadline and that CCS both could and should have been aware of this fact. He moreover reasoned that said public body had contradicted its own actions, because in the case of a loss that had occurred the previous year, the insured party (Funvera) had been in the same situation with delayed payments of the premium yet CCS still covered the risk.

On appeal, the judgment of the provincial court upheld the claims of CCS, arguing that we are under the regime in art. 15.2 of the Insurance Contracts Act in that there has been non-payment of the premiums following the first premium, for which reason, after one month has passed since the expiration of the premium, coverage of the risk was left suspended under the legal provisions and the loss event took place during this suspension.

Faced with the appeal judgment, the three claimant companies filed an extraordinary appeal on the grounds of breach of the procedural rules and an appeal to quash the decision, where their main claim was that the insurer had been aware of the delays in payment of the premium and that there was an agreement between the policyholder and the insurer to the effect that the delay in payment of the premium did not imply suspension of cover under the contract. They also claimed that this agreement affected coverage of extraordinary risks by CCS too in that CCS's surcharge should have been collected jointly with its premiums by the insurer, pursuant to article 18.2 of the Legal Charter of CCS.

The Chamber of the Court dismissed the appeal to quash the decision, stating that since this concerned failure to pay the successive premium, the provisions of article 15.2 of the Insurance Contracts Act should apply whereby, after the one-month grace period is over and the premium not having been paid by the policy holder, the contract is suspended and has no legal effects between the contracting parties, as indicated in the Supreme Court Judgment of 30 June 2015, which was ratified by the recent SCJ of 3 June 2016.

As regards the claim by the appellants that there was an agreement between the policyholder and the insurer to delay payment of the premium, the judgment maintains that there is nothing to accredit this and, while it is true that in the case of the annual payment for the previous year the premium was paid six months after expiration, it cannot be inferred from this that any agreement might exist between both contracting parties to leave the legal consequences which are envisaged in article 15.2 of the Insurance Contracts Act null and void in the event of failure to pay the successive premium.

The judgment moreover adds that *"Were such a nullifying agreement to have existed between the insurer and the policy holder, this would not be effective as to the Insurance Compensation Fund, the legal relation of which with the policy holder and the insured is different from that of the insurer, even though they both emanate from the same policy"*.

As may be seen, in the view of the Chamber of the Court, any potential agreement between the policyholder and their insurer to avoid the suspension of the legal effects of the contract where the premium has still not been paid one month after the expiration thereof cannot affect CCS, which stands outside the relationship that exists between the former two parties.

On the other hand the judgment also alludes to the provisions of section (k) of article 6 of the Regulations on Extraordinary Risk Insurance, endorsed by Royal Decree 300/2004, of 20 February, which specifically establishes that any losses are excluded from coverage by CCS which *"relate to loss events occurring prior to payment of the first premium or when, pursuant to Law 50/1980 of 8 October, the Insurance Contracts Act, coverage by the Insurance Compensation Fund has been suspended or insurance is terminated owing to failure to pay premiums"*.