Jurisprudence about the Consorcio de Compensación de Seguros

Non-payment of successive premiums and instalment payments. Review of the ruling of the First Chamber of the Supreme Court of 30 June, 2015

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1. The Problem

The insurance contract is a reciprocal and mutually binding contract that gives rise to different obligations for the contracting parties. The main obligation of the insurer is the restitution or payment of compensation in the event of a loss, while that of the policyholder is to pay the premium.

Article 14 of the Insurance Contract Law (LCS) regulates the payment of premiums, while the first part of Article 15 deals with the legal consequences of non-payment of the first Premium and the second part deals with the non-payment of successive premiums. In practice, this regulation is quite controversial, especially in liability insurance where there are injured third parties who have nothing to do with the legal relationship between insurer and insured. The law grants special protection to such injured parties, which is primarily manifested in the possibility of taking direct action against the insurer according to the provisions of Article 76 of this Law.

Added to this is the problem of premium instalment payments. In order to facilitate the payment of the premium, insurance companies often allow policyholders to pay the premium in instalments. All too often, after making the first instalment payment the insureds fail to pay one or more of the subsequent instalments.

In such cases, it is our understanding that the insurer must maintain the coverage for the time agreed in the contract, regardless of the fact that the policyholder, after making the first instalment payment, fails to make the subsequently payments, due to the unique and indivisible nature of the premium. This cannot result in the termination or suspension of the contract.

Since the Insurance Contract Law says nothing about the unique and indivisible nature of the premium, most of the legal doctrine and jurisprudence has set about the task of justifying these characteristics, although there is a current of jurisprudence coming from the provincial courts that does not see it that way.

The only reference to premium instalment payments is found in the Draft Commercial Code of June 2014. The fourth paragraph of Article 581-14 titled *"Non-payment of the premium", states* that *"in case of premium instalment payments, the insurer may deduct the amount of any unpaid instalments from the settlement".*

Therefore, aside from attempting to regulate this issue for the first time, this wording could be interpreted to mean that the insurance coverage exists for the agreed period of time and that in cases of

default on any of the subsequent instalment payments, the insurer should bear the consequences not only of the liability claims but the claims for damages as well, where the only legal relationship is between the insurer and the insured. Hence, the mention in this case that the insurer may deduct from the settlement paid – presumably to the insured – the amount of any unpaid instalments.

This regulation, if included in the future Insurance Contract Law, would support the thesis of the indivisibility of the premium, which we defend.

For Garrigues[1], indivisibility means that the premium is paid in full at the beginning of each insurance period and cannot be reduced or refunded if the risk exists, even if the contract is terminated during the period. The rationale for this rule lies not so much in the equity or individualization of the risk, but rather in the technical requirements for the operation of the insurance. In other words, in the fact that the accident statistics that serve as the basis for premium pricing typically refer to annual periods. We believe that the premiums set by the insurer are calculated for a particular period of time and, indeed, for the whole period, that is, considering the probability of a loss occurring at any time during that period.

Our high court has clarified the indivisibility of the premium in the Supreme Court Ruling (STS) (First Chamber) of 16 September 2004 (RJ 2004/5477), wherein it states that: "*The obligation to pay the premium may mean a one-time payment or periodic payments when the duration of the contract includes several periods (Article 22). The one-time or periodic premium may be paid in instalments. This possibility would seem to be contrary to the principle of the indivisibility of the premium. However, this is not the case as the parties may agree to the payment of the unique premium in instalments. The agreed terms only become relevant as an ancillary mode of delivery which does not affect the obligation itself, but rather its fulfilment. The provision continues to refer to the insurance period, even if the execution thereof takes the form of instalments paid by the policyholder".*

Subsequently, in the Supreme Court ruling (First Chamber) of 22 October 2008 (RJ 2008\5785), while alluding to this problem tangentially, the court repeats the argument we have just seen in the previous paragraph, adding that *"it is also true that doctrine and jurisprudence have held that the premium is indivisible, which was deduced from article 388 of the Commercial Code where it states that 'any premium paid in advance will be retained by the insurer, regardless of the duration of the insurance'. Although there is no similar provision in the current Insurance Contract Law, the very random nature of insurance makes this the logical conclusion. Indivisibility, however, has nothing to do with the agreement on premium instalment payments, the total of which is intended the cover total claims that occur during the term of the contract."*

What we see in these rulings is the Supreme Court upholding the indivisibility of the premium, despite the fact that the parties may agree to instalment payments, this being an accessory to the delivery mode. According to this interpretation, it is our understanding that if any of the instalment payments after the first one is not made, the insurer may not cancel the contract until the insurance period expires and may not apply to this breach the rules for non-payment of subsequent premiums provided for in art. 15.2 LCS.

Based on this hypothesis, the insurer is actually agreeing to provide annual, indivisible coverage, i.e., coverage that cannot be used separately by the insured at different times during the annual period. In return, the policyholder undertakes to pay an annual premium, although there may be an option to pay the premium in instalments. However, each of the instalment payments is not applied to separate periods of coverage provided by the insurer. Rather, it is simply a payment facility offered by the in-

[1] Vid GARRIGUES J, *Contrato de seguro terrestre*, 2nd edition. Madrid, 1983, p. 104.

surer. Consequently, the division of payments does not affect the term of the insurance, which is still one year, as this was presumably the period used by the insurance company to run the actuarial calculations needed to set the premium. This understanding of the nature of the periodic benefits of deferred payment of the premium was accepted by the Supreme Court (TS) in the ruling of the second chamber of 22 March 1991 (RJ 1991/2354), noting that "*the fact that the premium is divided into quarterly payments for the sake of convenience does not conflict with the unity of the contract in terms of its duration"* and that a clear distinction can be drawn between *"the annual premium, which corresponds the agreed duration, and quarterly payments".*

As for the consequences of non-payment of any of the instalments into which the annual premium is divided, the alternative interpretation mentioned above implies that insurer is unable to benefit from the provision contained in art. 15.2 LCS because even if payment is split into instalments, the different instalments still refer to the first premium. On the contrary, the successive premiums to which this article refers are those for successive periods of coverage, whether or not the payment is deferred[2].

Similarly, yet from a different point of view, because of the indivisible nature of the premium, the insurer cannot refund the unused portion of the premium due to questions such as the cessation of the risk, the disposal of the object of the insurance, the invalidity of the insurance due to bad faith on the part of the policyholder or insured, etc.

In this regard, the ruling of the third chamber of the Supreme Court of 4 March 2002 (RJ 2002/2612) is a case in which the insurer included a clause in the policy providing for the possibility of terminating the contract and refunding the unused premium after the declaration of a loss. The Directorate General of Insurance required the insurer to remove from Article 8 of the "Multi-risk Home" insurance policy the power to rescind the insurance following a claim.

Nevertheless, there is a minority jurisprudential trend that equates the second and subsequent premium instalments to successive premiums. As a result, the courts have applied the rules of LCS 15.2 to these cases.

As mentioned at the beginning of this section, while this is not the doctrine we can extract from the Supreme Court – particularly following the ruling of the First Chamber of the Supreme Court of 16 September 2004 (RJ 2004/5477), the fact is that advocates of this position base their argument not only on the criteria used by certain provincial courts, but also on certain high court rulings that seem to support the second hypothesis.

Among these is the ruling of the First Chamber of the Supreme Court dated 9 March 1996 (RJ 1996/1938), which applies the sanctions provided for in art. 15.2 LCS for non-payment of premium instalments, on the understanding that once the one-month grace period has elapsed without the policyholder paying the next instalment, the contract is suspended. However, in our opinion, the application of art. 15.2 in this case is based on the fact that this was agreed by the parties in general terms.

2. The Supreme Court Ruling of 30 June 2015

Although there are many lower court rulings on this subject, it is not common to find the high court's ruling on matters concerning the non-payment of premiums, which makes the ruling of the First Chamber of the Supreme Court of 30 June 2015 (RJ 2015 \ 2555) even more significant.

[2] Cfr. REGLERO CAMPOS, L.F (Director) / BADILLO ARIAS, J.A. (coord.), *Accidentes de Circulación: Responsabilidad Civil y Seguro*, Cizur Menor (Navarra), Aranzadi, 3rd edition, 2013, p. 829.

2.1. Proven Facts

The facts have to do with liability insurance. The insured company took out a liability policy with Mapfre on 14 March 2000, which was ultimately renewed in subsequent years, the parties having agreed that the payment of the annual premium would be made in two instalments. In the one-year period from between 14 March 2005 and 14 March 2006, the policyholder failed to pay the first bill, which was returned in mid-March 2005. In December of that year there was an incident when employees of the insured entity caused damage to Telefonica's premises.

Obviously, since the loss occurred eight months after the non-payment of the 2005-2006 premium, the insurer was under the impression that the contract was terminated pursuant to the provisions of Article 15.2 of the Insurance Contract Law.

Telefónica, not satisfied with the insurer's refusal to cover the loss, sued the company that caused the damages and the insurer. The lower ruled in Telefónica's favour and after the decision was appealed by Mapfre, the Provincial Court upheld ruled against the insured who had caused the damages and absolved the appellant, in this case the insurance company. The Provincial Court considered that when the accident occurred the policy was not in force since the insured had expressed its desire to discontinue the contractual relationship prior to the loss by ordering that the first invoice for the premium instalment payment be returned to the bank.

Following the insurer's acquittal, the injured party filed a cassation appeal calling for Mapfre to be found guilty, citing the infringement of Article 15 of the LCS in connection with the beginning of the period of suspension of the policy coverage provided for in paragraph 2 and noting that the insurance contract may not be cancelled for non-payment of the premium until six months have elapsed. In the appellant's opinion, the termination does not take place when the insured fails to pay one of the premium instalments but only the last of the instalments. Hence, until that time it cannot be understood that the payment has not been paid.

2.2. Legal argument

The Supreme Court rejected the appeal and established how the non-payment of successive premiums must be interpreted, which is the question that concerns us here.

After quoting Article 15.2 LCS, the Court states that *"starting the month after the non-payment of the premium and for the next five months, if the policyholder still does not pay the premium and the insurer does not terminate the contract, the insurance coverage is suspended. This means that the agreement between the parties is ineffective so that if the insured sustains a loss during this time it will not be covered by the insurer. However, the suspension of the insurance coverage does not apply to third parties taking direct action pursuant to article 76 LCS, to the extent that this provision states that «Direct action is immune to the exceptions that may apply to the insurer against the insured»."*

In keeping with this argument, the court adds that if the insurer does not demand payment within six months of non-payment of the premium, the contract will be terminated automatically as mandated by laws, without either part having to request the termination. Obviously, any loss that occurs after the contract is terminated, as in this case, is not covered by the insurance and therefore not only will the insurer not be liable for the damages sustained by the insured, but it will not be liable for direct actions taken by third parties.

Thus far, then, the Supreme Court has upheld the practically unanimous interpretation maintained in both the doctrine and the jurisprudence regarding the legal consequences of non-payment of successive insurance premium payments, which is regulated in Article 15.2 LCS.

However, and this is where the controversy may arise, the high court concludes its arguments stating that *"in cases such as this one, where the premium payment has been split up and the insured fails to pay the first instalment on the due date, then the provision contained in art. 15.2 LCS takes effect, without having to wait until the due date of the last instalment, as claimed by the appellant. For the purposes of article 15.2 LCS, it must be understood that the premium is unpaid as of that moment, at which time the one-month grace period begins, after which the insurance coverage is suspended until the termination of the contract six months after the non-payment, provided that at no point during this time does the insurer request payment of the premium".*

This could be interpreted to mean that the Supreme Court understands that the provisions of Article 15.2 should apply to unpaid premium instalments. If this were the case, the problem could be resolved by terminating the contract while it is suspended, right after the one-month grace period, as the Court itself has previously mentioned when interpreting Article 15.2 LCS, in order to render the contract ineffective once one of the premium instalments is not paid.

In our opinion, the high court alludes to the question of splitting the premium payment because it was one of the arguments put forward by the appellant in the cassation appeal. The issue of splitting the premium into instalment payments suited the appellant's argument, which held that until there is a default on the last instalment payment, it cannot be understood that the premium has not been paid. Therefore, this allusion in the ruling to splitting the premium into instalments would still be an *obiter dictum*, something which we are accustomed to in the high court's rulings.

However, it is our understanding that the facts analysed in this case does not refer to the non-payment of one premium instalment but rather the non-payment the successive premium, which was also split into instalments. What the insured failed to pay was the premium for the annual period from 14 March 2005 to 14 March 2006. Since the loss occurred eight months after the non-payment of the successive premium, it is not covered by the insurer, as clearly argued by the court in its interpretation of 15.2 of the Insurance Contract Act, which is the one that applies to the facts of this case.

3. Conclusions

As mentioned in the foregoing paragraphs, it can be concluded that in the opinion of the high court, according to the provisions of Article 15.2 of the Insurance Contract Law the non-payment of successive premiums by the policyholder has the following effects:

a. One-month grace period: for a period of one-month after the non-payment of the successive premium the contract remains in force and thus the insurance, so that if a loss occurs during this period of time, the company is obligated to indemnify the insured in the terms agreed in the contract and is also liable to third parties taking the direct actions referred to in article 76 LCS.
b. Suspension of the contract's effects: one month after non-payment of the premium and for the next five months, if the policyholder still does not pay the premium and the insurer does not terminate the contract, the insurance coverage is suspended. This means that the agreement between the parties is ineffective so that if the insured sustains a loss during this time it will not be covered by the insurer. However, the suspension of the insurance coverage does not apply to third parties taking direct action pursuant to article76 LCS, to the extent that this provision states that *«Direct action is immune to the exceptions that may apply to the insurer against the insured».*
c. Termination of contract: if the insurer does not demand payment within six months of non-payment of the insurance premium, the insurance contract will be terminated automatically pursuant to the terms of the law, without the need for either party to request the termination.

> Obviously, any loss that occurs after the contract is terminated, as is the case analysed in the ruling under study, is not covered by the insurance and therefore not only will the insurer not be liable for the damages sustained by the insured, but it will not be liable for direct actions taken by third parties.

On the other hand, as we have argued, we do not think that the Supreme Court intends to apply this doctrine when the policyholder fails to pay one of the instalment payments, since this was not the problem in the case under study. The non-payment referred to a successive premium rather than a single premium instalment.