DEFINITION OF INSURANCE CONTRACT
de lege lata - de lege ferenda

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Abstract
The contract of insurance is an important term to define for the purpose of specifying the binding and legal meanings of this term. Expressing its specific features and distinguishing it from all other binding agreements shall determine its significance in the context of the legal obligation rights.
The Law on Obligations clearly and distinctively defines the contract of insurance which refers to both the property insurance contracts and personal insurance contracts. No matter how clearly explained the definition of the contract of insurance seems to be by the Law of Obligations, and how well the execution of these contracts is, it may find any person by surprise in their ordinary practise with many issues, which sometimes require more than a simple and easy reply. The reason for this is a rather conservative and classical definition which, on the other hand, is not surprising given that it is taken from the 1978 Law on Obligations.
In the meantime, the insurance industry has been developing rapidly and new classes of business have been introduced. It is questionable whether this definition may refer to ever emerging new classes of business, or may it favourably affect the development of new lines of insurance, and whether it is in line with the contemporary market demands. This is especially the case in the Republic of Macedonia where a new Civil Code is being prepared, and is expected to entirely regulate the matters in the context of the Civil Law, including therein the contract of insurance.

Keywords*: contract of insurance; insurer; insured, insurance premium; compensation; claim indemnity; sum insured; insured event.*

I. General notes on definition of the insurance contract

The numerous types and forms of insurance, as well as their legal characteristics, make every attempt to provide a precise and simple definition of the insurance contract very complex and difficult. Therefore, there is not a universal definition of the insurance contract. There are only definitions of some legal system for terms "insurance" and "insurance contract". Difficulties arise from the fact that some types of insurance provide compensation for specified losses or damages (property insurance, marine insurance, liability insurance), while other insurances guarantee payment of benefits (life insurance). Accordingly, the existing definitions of the term "insurance contract" are incomplete and unclear in relation to the elements constituting this contractual relation.

The definition of the insurance contract will be more precise if the property insurance contract and the life insurance contract are defined separately, as are the marine insurance contract or the property insurance contract defined separately by some legal systems. Relying on this standpoint, it is more likely that a new definition for liability insurance contract is needed as well. However, the specific character of some types of insurance does not make those contracts different to the extent to which they could be treated as separate contracts by the Obligation Law.

All types of insurance contracts share the same common important features, and consequently, having one definition which applies to all insurances that are regulated by a single legal act is the proper practice. This especially applies to the countries where the insurance system is highly developed. Especially the marine insurance, where legal regulations for the insurance contract are not included in one legal act or a law, and therefore in every legal act which regulates a certain type of insurance, there is a definition for that type of insurance. When the legal systems are compared, there are separate definitions for marine, property, and personal insurance because these types of insurances are not regulated by the same legal act.

The legal theory sets two groups of definitions of the insurance contract: compensation and prestation theory. The first one outlines the aspect of remuneration in the insurance contract regarding both the property and the personal line of business. The latter defines the insurance contract as an equal obligation which imposes reciprocal prestations upon parties. However, both theories are based on the same understanding of the insurance contract as being a contract which provides compensation. Although, this characteristic of the contract refers only to property insurances.

How the recent and modern laws of some developed countries define the insurance contract and what definition thereon our law gives?

II. Definition of insurance contract by law in developed countries

The following definitions are extracted from their native language, and I had them translated accordingly for the purpose of this text.

The Civil Code of Quebec (CQLR c CCQ-1991) gives a concise definition of the insurance contract:

"The insurance contract is a contract whereby the insurer undertakes to pay compensation to the user or to a third party, on the basis of a paid premium or other amount of money, if an event (loss event) covered by the insurance policy incur[1]*."*

This Civil Code, which is part of the Common Law, divides the insurance into marine and non-marine. The non-marine refers to personal insurance and insurances that provide compensation for specified losses or damages, which also contains the liability insurance.

The Belgian Land Insurance Contract Act 1 (1992) defines the insurance contract as:

"A contract on the basis of which, by paying a fixed or variable premium, one party, the insurer, undertakes to pay compensation to the other party under the insurance contract, should an uncertain event (accident) incur which, according to the circumstances of the occurrence, is not in the interest of the insured or the policyholder or beneficiary (Art. 1)[2]*."*

This definition is neither simple nor concise, though it applies to more types of insurance that are used worldwide.

The Civil Code of the Russian Federation (1996) defines the contract of property insurance as follows:

"Under the contract of property insurance one part (insurer) shall undertake, for the charge stipulated by the contract (insurance premium) and upon the onset of an event (insured accident), stipulated by the contract, to reimburse to the other party (insurant) or another person in favour of whom the contract has been concluded (beneficiary) the losses inflicted in consequence of this event in the insured property or the losses sustained in connection with other property interests of the insurant (to pay insurance compensation) within the amount specified by the contract (insured sum)[3]*."*

This is how the Insurance Contract Act of Germany defines the insurance contract:

"By making a contract of insurance the insurer undertakes to cover a certain risk of the policyholder or a third party by paying a benefit upon

[1] Art. 2389 of the Civil Code of Quebec (CQLR c CCQ-1991).
[2] Loi du 25. juin 1992 sur le contrat d'assurance terrestre.
[3] Article 929 of the Civil Code of the Russian Federation.

occurrence of the agreed insured event. The policyholder is obligated to pay the agreed contribution (insurance premium) to the insurer[4]*."*

Speaking of the definitions of insurance contract, I think that it is important here the definitions for marine insurance to be mentioned. Historically, this is the first type of insurance that occurred and has gone under the greatest development. This is because the development of the insurance contract, in its true sense of the word, begins with the marine insurance (Pavic, 2006) This process began to take place in the 14th century. The oldest insurance contract was found at a notary archive in Genoa and dates back to 1347 (the ship Santa Clara was insured for a journey from Genoa to Mallorca). Pisa found an insurance contract for goods on a ship transport that dates back to 1347 (Victor, 1975).

Of the definitions on marine insurance, it is necessary to mention the one governed by the English Marine Insurance Act[5]:

"A contract of marine insurance is a contract whereby the insurer undertakes to indemnify the assured, in manner and to the extent thereby agreed, against marine losses, that is to say, the losses incident to marine adventure."

The Canadian Marine Insurance Act (1993) is based on the English Marine Insurance Act, and defines the marine insurance contract as follows:

> *"A contract of marine insurance is a contract whereby the insurer undertakes to indemnify the insured, in the manner and to the extent agreed in the contract, against:*
>
> *(a) losses that are incidental to a marine adventure or an adventure analogous to a marine adventure, including losses arising from a land or air peril incidental to such an adventure if they are provided for in the contract or by usage of the trade; or*
>
> *(b) losses that are incidental to the building, repair or launch of a ship*[6]*."*

The Merchant Shipping Code of the Russian Federation (1999) defines the marine insurance contract as follows:

> *"Under the contract of marine insurance, the insurer undertakes, against a specified payment (insurance premium), if the perils or accidents covered by the contract of marine insurance occur, to which the object of insurance is exposed (insured event), to indemnify the insured or other person, to whose benefit the contract was concluded (beneficiary), for losses incurred."*

[4] Versicherungsvertragsgesets, VVG. (2007). Art.1.
[5] Article 1 of the Marine Insurance Act. (1906).
[6] Article 6 (1) of the Marine Insurance Act. (1993).

III. Definition of insurance contract by laws in the Republic of Macedonia and the Former Yugoslav Republics

The definition of the insurance contract by the legal system of the Republic of Macedonia is given under the new Law on Obligations (Off. Gazette no. 18/2001 and no. 84/2008) and this definition is almost identical to the definition that existed in the former Federal Law on Obligations (Off. Journal of SFRY 29/78; 39/85 and 57/89). The definition is as follows:

> "*By the insurance contract, the policyholder shall be bound, under the principles of joint and solidary obligation to join a definite amount in the insurance company, i.e. in the risk company (insurer), and the company shall be bound under the occurrence of insured event to pay the insured or any other third party the reimbursement, i.e. the agreed amount or to do something else*[7]*."*

From legal, economic and contextual point of view, this definition is rather old to a certain extent. The principles on joint and solidary obligations have been significantly modified and updated by adoption and implementation of new principles by the current insurance companies. As the operation regulations for the insurance companies are governed by another legal act, the Law on Insurance Supervision, it is no longer necessary for the joint and solidary obligations to be a part of the definition of the insurance contract. Furthermore, the last part of the definition, where the insurance company has an obligation "to do something else", is unneeded or superfluous. In my opinion, it is an obligation of the insurance company to pay indemnity for the claim, or pay the sum insured. This is because no type of insurance contract does oblige the insurer to do something else other than to compensate the damage or pay the sum insured. This is the argument why the part of the definition which states that the insurance company is bound to do something else is superfluous.

Following the foregoing explanation, the former Yugoslav Republics, after the independence, introduced changes to the definition of the insurance contract. The Croatian Civil Obligations Act of 2005 gives a new definition of the insurance contract in the Art. 921, which states:

> *"Under the insurance contract, an insurer undertakes to a policyholder to pay the indemnity to the insured person or insurance beneficiary upon the occurrence of an insured event, while the policyholder undertakes to pay insurance premiums to the insurer."*

The Slovenian Obligations Code, Art. 921 gives the following definition:

[7] Article 953 of the Law on Obligations.

"Through an insurance contract the policyholder undertakes to pay an insurance premium or contribution to the insurance agency, and the insurance agency undertakes in the event of a development entailing an insurance case to pay out the insurance pay out or compensation to the policyholder or a third person or do something else."

The Serbian Law on Contracts and Torts in Art. 897, defines the insurance contract in the following manner:

"By a contract of insurance, a negotiator of insurance shall assume the obligation to pay a specific amount to an insurance organisation (insurer), while the organisation shall assume the obligation, should an event take place which represents the case covered by insurance, to pay to the insured person, or to a third party, compensation, the stipulated amount, or to do something else."

IV. Definitions of insurance contract in legal literature

Apart from the legal definitions, there are a number of definitions given by theoreticians who have been engaged in insurance. They were driven by the fact that there was no legal definition or that the existing definitions are not comprehensive and acceptable.

I will mention the definitions that I think deserve special attention:

Nikola Nikolich: *"An agreement whereby one party (insured), who has an interest to protect the property against the risk, undertakes to pay premium, and the other party (insurer) undertakes to provide that protection on a mutual satisfaction* (Nikolich, 1954)*."*

Mihajlo Konstantinovich: *"By the insurance contract, the policyholder undertakes to pay the insured a certain premium, and the other party undertakes, should a loss event covered by the insurance policy incur (insured event), to pay the policyholder or any other third party, a certain amount of money or to do something else* (Mihajlo, 1969)*."*

Branko Jakasa: *"Insurance contract is a contract whereby one party (insurer), by setting a certain price (insurance premium), undertakes to a contractee (policyholder) to pay upmost amount (sum insured) to a certain person (the insured) as a compensation of a damage or loss to property or indemnity for personal injuries (subject of insurance) caused by perils (risks) insured against under the insurance contract* (Jakasa, 1984, p. 37)*."*

MacGillivray on Insurance Law: *"An insurance contract is a contract whereby one party (insurer), in exchange for payment of a certain amount (premium), undertakes to pay the other party (insured) money or procure other*

benefit, in case of one or more loss occurrences covered under the insurance contract (MacGillivray, 2003, p. 3)*."*

Jean Bigot: *"The insurance contract may be defined as an agreement whereby one party, called insurer, undertakes to the other party, called policyholder or insured, in exchange for the paid premium, to provide protection against some risk and pay indemnity to the insured or to a third party for a claim arising from a loss or damage caused by that risk* (Bigot, 2002, p. 29)*"*

Yvonne Lambert-Faivre: *"An insurance contract is such an agreement whereby the policyholder obtains compensation, for themselves or for a third party, in case of occurrence of an insured event by paying a premium; the compensation is paid by the insurance company which compensates analogous risks using statistical methods* (Lambert-Faive, 2001, p. 237)*."*

The American Risk and Insurance Association gives the following definition: *"Insurance is aggregation of accidental losses or damages by transferring the risks to the insurer, who agrees to compensate those damages to the insured, to pay the costs related to the loss event or compensate the damage in any other way, if it is consequential to the occurrence of an insured event* (Reida, 1999, p. 21)*."*

V. Definition of the insurance contract – De Lege Ferenda

All definitions of insurance contract given above express the important characteristics of the insurance contract. In all of them the contract is described as two-party binding agreement, stating the contracting parties and their main obligations, and the insurer's obligation to pay compensation for damages or pay sum insured is related to the occurrence of an insured event.

These definitions are unique in relation to the question what the important elements of the insurance contract are, as well. And, they are: subject of insurance, insured risks, insurance premium and the obligation for compensation of damages or payment of sum insured in case of a loss occurrence.

The definitions given above and the important insurance contract elements and characteristics stated therein, may lead us to a general and comprehensive definition:

By the insurance contract, the policyholder undertakes to pay the insurer an insurance premium, and the insurer undertakes to pay the insured or the beneficiary the compensation for the damage or an agreed sum insured, in accordance with the provisions of the contract in case of a loss occurrence giving rise to a claim.

This definition covers insurance contracts for compensation of damages and insurance contracts that guarantee payment of benefits. It also contains the important

features and characteristics of the insurance contract as a binding document. Let's consider each element of this definition.

Payment of insurance premium. The insurance contract is a binding agreement. The premium is the amount of money that the policyholder must pay as a fee for underwriting the risk by the insurer. Paying the premium is an essential element of the insurance contract because free insurance does not exist. The obligation to pay the premium lays with the policyholder because the policyholder functions as the contracting party in the insurance contract. The collected premiums are then put into funds, from which the claims are indemnified to insureds who have suffered losses or damages. The premium amount is a fixed amount determined at the conclusion of the insurance contract, it is stated in the insurance contract/policy and cannot be changed.

The insurer undertakes to pay. By the insurance contract, the insurer must take the obligation that, should the agreed circumstances occur, the compensation is to be paid under this contract. The insurer's obligation to pay compensation is the legal and economical purpose for signing an insurance contract. The insurer is liable to pay the compensation arising from the insurance contract. The insurance contract must guarantee the compensation for damages that the insured suffered in case of a loss event occurrence. That is the essence of the insurance contract. If, for example, it was agreed that the insurer will consider the damages claim and, according to its discretion, decide on the payment of a fee, such an agreement would not be an insurance contract. In the insurance contract, the insurer does not pay compensation for damages based on his discretion, but on the basis of a contractual obligation taken with a concluded insurance contract (if, by the contract, the insurer undertakes to consider the claim and decides upon its discretion to indemnify the claim, this agreement does not fall under the category of insurance contracts). We should note that, according to our legislation and the structure of the insurance industry, the insurer may be any insurance company.

***Insured or insurance beneficiary*.** The insured person is any person who is entitled to claim indemnity for a loss or damage or claim payment of sum insured from the insurer, with the right to claim the insurer's damage compensation or the insured amount. It is a person who at the moment of the loss occurrence has a reasonable material interest this insured event not to occur. Here one of the basic principles of the insurance contract comes to the fore, which is the principle of interest for insurance. An insurer or insurance contractor concludes an insurance contract because they have an interest in not having the insured event, otherwise they would have suffered some material loss. These are, for example, the owners of objects or other persons having some other right that arises of their interest in concluding an insurance contract. Without an insurance interest there can be no insurance contract at all. Also, when an insured event occurs, the rights of the insurance contract can only apply to those persons who at the time of the occurrence

of the damage had material interest not to have the insured event arising. The persons who had interest at the moment of concluding the contract for insurance, but no longer have it at the time of the occurrence of the damage, have no rights to the insurance contract. For example, the seller, who has alienated the object that he previously secured, has material interest only until the object is alienated, and after the object is alienated, that material interest ends with it. However, it continues with the buyer, and therefore the buyer has the rights from an insurance contract in respect of the damage arising of an insured event that has arisen since the object was received by the buyer. The policyholder is also the insured person, if the insurance was concluded for their own account. There is a difference between the policyholder and an insurance beneficiary where the insurance contract is concluded on another's behalf. The insurance beneficiary, as a special term, appears in property insurance and personal insurance. In that case, the term insurance beneficiary is any third party to whom the insurer undertakes to pay compensation for the damage or sum insured, and that person is different from the policyholder. The policyholder of the insurance is the beneficiary from the agreement in favour of a third party.

***Claim indemnity or sum insured*.** The use of these two terms, compensation for damage and the agreed sum insured make the definition complete, comprehensive, and applicable to all types of insurance (insurances that provide compensation of damages and insurances that guarantee payment of benefits). The payment of the claim indemnity or the sum insured is the insurer's obligation. In the case of compensation of damages under the insurance contract, the insurer will indemnify the claim amount or up to the agreed limits and arranged criteria, and in regard with the insurance contracts that guarantee the payment of benefits, the agreed sum insured will be paid irrespective of the claim value.

In accordance with the provisions of the agreement. The compensation is determined according to the provisions of the insurance contract, not according to the rules of the Obligation Law for paying the material damage. The parties in the insurance contract may, within their discretionary rights, agree on the manner (the form) of repairing the damage, the amount of compensation, as well as the manner in which the compensation amount will be determined (criteria, claim settlement procedure, etc.). These criteria, apart from the insurance contract, can be stated in the insurance terms and conditions or in the standardised claims handling guidelines. Often, the actual loss or damage is only one of the criteria for claim indemnity. The insurance contract or the insurance terms and conditions may limit the amount of compensation to the real claim value. The contract of insurance or the insurance terms and conditions can arrange different forms of participation of the insured into the claim in the form of deductible or self-retention. Deductible means that the insured participates in every claim indemnity with a certain amount of money, that is, the insured bears the payment of claims to a certain amount. Also, a contract may be concluded at a lower value than the actual value of the insured property

(underinsurance) or the value of the insured property may be covered under insurance only partially (insurance at first risk). The amount of claim indemnity depends on all these previously arranged terms and not on the real claim value. The rule states that in insurance, the policyholder should make insurance in the amount corresponding to the value of the insured property. In the case of underinsurance, at the time of concluding the insurance contract, the value of the insured property was higher than the sum insured determined in the insurance contract. The underinsurance is determined during the calculation of the claim and, therefore the compensation decreases proportionally. Various insurance exclusions or restrictions can also be arranged. Therefore, in determining the right to compensation and the amount of compensation, it is of utmost importance for the contracting parties to reach an agreement.

If an event representing an insured event occurs. The insured event is a legal requirement for the liability of the insurer to compensate the insured for the suffered damages or pay the insured sum. Unless the insured event occurs, the insurer does not have an obligation towards the insured. The insured event is an event caused by the insured risks defined in the insurance contract or by the insurance conditions, the consequences of which are loss or damage of the insured property, the injury or death in personal insurance. And in life insurance are when the assumptions made by the contract are met, for e.g. living to a certain age or death. Only the event caused by the insured risk is insured. The risks which the insured property is insured against are strictly stated in the contract or in the insurance terms and conditions. The amount of premium depends on the number of risks which the insured property is insured against. The more risks included in the insurance, the higher the premium. In determining the circumstance whether there is an insured event, as well as determining the insurer's liability, the insurance contract should be considered.

Conclusion

The definition of insurance contract in the Law on Obligations is outdated and irrelevant because it is based on the principles of the former socialist environment. From a legal point of view, it is correct that there is no joint and solidary relation between the policyholder and the insurer. The insurers are joint-stock companies that work for profit.

The proposed definition of the insurance contract defines a contractual relationship between two contracting parties, from which relationship rights and obligations arise for the contracting parties. The First Contracting Party, the insurer, has an **obligation** under the agreed terms to pay to the Second Contracting Party, *or to a third party in whose favor the contract is concluded*, compensation for the damage caused by the predetermined risks-hazards in the insurance of the property,

i.e. to pay an amount of insurance if with the contract arises a predicted insurance case in the insurance of persons and the **right** to claim a payment of a premium. The Second Contracting Party is **obligated** to pay the insurance premium. Regarding the right of the Second Contracting Party to claim payment of compensation or payment of insurance amount, one specificity arises in this contract.

Namely, since the insurance contract is a contractual relationship, it is assumed that, as with all other obligatory relations, the rule for the relative effect of these relations applies, i.e. that this relationship only acts as inter partes.

However, from the very definition of the insurance contract and from the obligation of the insurer given by the definition, one specific feature is noted - the characteristic of the legal relationship created with this contract is the fact that this agreement can provide rights in favor of the third party. The very fact that this element has found a place in the definition of an insurance contract shows how strong and frequent this feature of this agreement is.

The above-mentioned features (the action of the inter parties and the incorporation of rights in favour of a third party) given in the definition of an insurance contract at first glance appear to be mutually excluded. This is because the principle of the relative effect of the contract only between the contracting parties should be respected towards the First, and according to the Second, it indicates the absence of this priciple.

Because the aforementioned, it follows that in the definition of the insurance contract there is a deviation from the principle of the relative effect (inter parties) of the contractual relations under which the agreement for all non-contractual parties is res inter alios acta. The definition of an insurance contract where a person who is not a contracting party is given the right to claim payment of a fee or an insured sum constitutes a deviation from the relative effect of the contract. In this agreement, the contracting parties, the insurer and the insured, agree to provide protection to a third party, which is not a contracting party, and the payment of the compensation for damage or the insured sum is agreed upon for that party.

With the given definition it is possible to cover all types of insurance, that is, those types when the insurer is obligated to pay the fee or sum of insurance, which fulfills the purpose of the insurance, not to the other party, but to a third party which is not a contracting party.

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