

# MARKET BULLETIN

**From** Julian James

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**Date** 12 December 2006

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**Reference** Y3921

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**Subject** Update on French MAT decree

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**Subject areas**

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**Attachments** Leboeuf legal advice

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**Action points** **Managing Agents and Underwriters to note:**

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## Update

In Market Bulletin Y3882, we announced that Decree no. 1202-2006, dated 29 September 2006, had been accepted by the Conseil d'Etat (French State Council) and was officially published on Saturday 30 September 2006. This decree amends the relevant provisions of the Terrorism Act and confirms that:

- Property insurance contracts covering damage to the hulls of railway rolling stock, aircraft, marine, lake and inland waterway vessels, as well as goods in transit, will be exempt from the provisions of article L.126-2 of the Terrorism Act.
- The following will, however, remain subject to the provisions of article L.126-2:
  - insurance contracts covering damage to the hulls of aircraft used for non-commercial activities or for non-lucrative purposes, where the unit value of each hull declared in the contract is less than €1 million;
  - insurance contracts covering damage to the hulls of marine, lake and inland waterway vessels used for pleasure sailing / yachting, where the unit value of each hull declared in the contract is less than €1 million.

Further to this decree, Lloyd's as well as other insurers sought clarification on a number of issues relating to the scope of the exemption.

The French Insurers' Association (FFSA) released a circular on the subject, which should be regarded as the only valid interpretation for French and foreign insurers on the French market:

**Free and non-committal translation:**

*The decree concerns all "transport" risks as defined in article L.111-6-1\*, paragraph (a) and (b) of the French Insurance code.*

*The exemption applies as follows:*

- *marine insurance : all "hull" insurance contracts covering all vessels, including vessels under construction, fishing vessels and lake and inland waterway vessels.*
- *"cargo" insurance: all insurance contracts covering goods carried by land, air, sea, river or lake transport. Please note that goods whilst "stationary", or while "in transit" are covered by "cargo" insurance policies concerned by this exemption. This applies to goods carried by sea that can stay for a maximum of 60 days after being unloaded from the last sea vessel. The exemption also applies to "transport-exhibition" guarantees included in "cargo" policies which cover goods for up to 30 days while they are exhibited. Finally, please note that all "exhibitions" policies, as well as policies covering "stocks of goods" remain subject to the provisions of the legal extension of terrorism coverage.*
- *"aviation" insurance: all insurance contracts covering the hulls of air vessels. Please note that those contracts cover air vessels, whether they are on the ground or in flight, as well as all spare parts, engines, equipment and any other components that are an integral part of the aircraft.*

**\* Article L111-6**

*(transferred by Act n°. 94-5 of 4 January 1994, Article 6, II, Official Journal of 5 January 1994 in force on 1 July 1994)*

The following shall be regarded as major risks :

1 Those that fall within the following categories:

- a) hulls of rail, air, marine, lake and inland waterway vehicles or vessels as well as public liability for said vehicles,
- b) goods in transit,

c) credit and guarantee when the policyholder, in a professional capacity, carries on an industrial, commercial or professional activity, provided that the risk relates to such activity,

2 Those relating to fire and natural elements, other damage to property, general public liability, various pecuniary losses, hulls of non marine motor vehicles and public liability, including that of the carrier relating to said vehicles, when the policyholder carries on an activity where the extent thereof exceeds certain thresholds defined by decree in *Conseil d'Etat*.

**Legal advice from Leboeuf:**

Following a number of queries received from the Market, the Lloyd's French office commissioned Leboeuf to consider the implications of the new exemption decree. Their legal advice is attached to this market bulletin for your reference.

In particular, Leboeuf studied the consequences of the decree on existing contracts for large risks "by size" (as opposed to large risks "by nature", i.e. MAT risks). The decree does not stipulate any transitional arrangements for existing contracts.

Except for the large risks by nature, the option to sub-limit the terrorism coverage for this type of risk is retained. However, the sub-limits and deductibles allowed for such risks are no longer assessed on the basis of the Property Damage cover but on the basis of the Fire cover. Therefore, Leboeuf recommends that underwriters issue an endorsement to existing contracts to comply with the new decree.

Details and guidelines for this endorsement can be found in the attached legal advice.

**Further information**

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**MEMORANDUM**

*Date*           6 December 2006

*To:*            Anne-Gaëlle Leillard, Cécile Peyrade – Lloyd’s France

*From:*       Jean Alisse, Caroline Vigneaux

*Subject:*     ***Questions on Decree No. 2006-1202 of 29 September 2006 defining the dispensations and exclusions applicable to property insurance contracts concerning large risks in the insurance cover of damage caused by terrorist attacks and modifying the French Insurance Code***

In addition to our memorandum dated 21 September 2006, we have analyzed Decree No. 2006-1202 of 29 September 2006, which defined the dispensations and exclusions applicable to Large Risk insurance contracts with regard to cover for damage caused by terrorist attacks.

This Decree was published in the *Journal Officiel* on 30 September 2006 and came into force on 1<sup>st</sup> October 2006.

It modifies the French Insurance Code as follows (our translation):

***Article 1***

*Article R. 126-1 of the French Insurance Code is repealed.*

## **Article 2**

*Article R. 126-2 of the French Insurance Code is drafted as follows:*

*"Art. R.126-2. - I. – Property insurance contracts covering damage sustained by the hulls of rail, air, marine, lake and inland waterway vehicles or vessels, as well as goods in transit, are excluded from the scope of article L. 126-2.*

*However, the following remains subject to the application of article L. 126-2:*

*1° Property insurance contracts covering damages sustained by the hulls of aircrafts intended for a non-commercial or non-profit activity, if the unit value of the hulls declared in the contract is less than one million Euros;*

*2° Property insurance contracts covering damages sustained by the hulls of marine, lake and inland waterway vessels intended for yachting, if the unit value of the hulls declared in the contract is less than one million Euros;*

*II. – Where property insurance contracts mentioned in the first paragraph of article L. 126-2 are concerning the large risks defined in 2° of article L. 111-6, the wording may allow for the compensation of damages caused by terrorist attacks, limits on deductibles and cover limits different from those set in the contract for fire cover, under the following conditions:*

*1° the amount of the cover, net of deductible, for damages caused by terrorist attacks may not be lower than 20% of the amount of the cover, net of deductible, provided for in the contract for fire cover and, in any case, lower than 20 million Euros;*

*2° the amount of the deductible for damages caused by terrorist attacks may not be higher than twice the deductible provided for in the contract for fire cover."*

As of 1<sup>st</sup> October 2006 (section 1), MAT (*Maritime, Aviation, Transports*) risks are henceforth excluded from the scope of article L. 126-2 with certain exceptions (section 2).

The new drafting of article R. 126-2 provides for cover limits applicable to Large Risks, without providing for transitional provisions for contracts currently in force (section 3).

It is therefore necessary to modify the clauses limiting cover (deductibles and limits) included in contracts currently in force to ensure their compliance with the provisions of the new drafting of article R. 126-2 (section 4).

## **1. Coming into force of the Decree of 29 September 2006**

The Decree of 29 September 2006 does not contain any provisions concerning its coming into force.

Therefore, article 1 of the French Civil Code applies, which provides that "*statutes and, when they are published in the Journal Officiel de la République Française, administrative acts shall come into force on the date specified in them or, in the absence thereof, on the day after their publication.*"

The Decree of 29 September 2006 was published in the *Journal Officiel* on 30 September 2006. It therefore came into force on 1<sup>st</sup> October 2006.

## **2. Exclusion of MAT (Maritime, Aviation, Transports) risks from the scope of article L. 126-2**

### **2.1 Repeal of article R. 126-1 of the French Insurance Code**

Article 1 of the Decree of 29 September 2006 repeals article R. 126-1 of the French Insurance Code.

This repeal was necessary in order to allow for the exclusion of MAT risks from the scope of article L. 126-2 of the French Insurance Code.

Indeed, the former drafting of article R. 126-1<sup>1</sup> expressly subjected MAT risks (branches 4 to 6) to the provisions of article L. 126-2 of the French Insurance Code.

### **2.2 Exclusion in principle of MAT risks from the scope of article L. 126-2**

The first paragraph of the new drafting of article R. 126-2 excludes all MAT risks from the scope of article L. 126-2.

The following are expressly mentioned:

- the hulls of rail vehicles,
- the hulls of air vessels,

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<sup>1</sup> Former drafting of Article R126-1: "*the property insurance contracts referred to under article L.126-2 are those connected to the insurance operations listed under sections 3 to 9 of article R. 321-1 or which cover the business interruption resulting from the losses on the insured property.*"

- the hulls of marine vessels,
- the hulls of lake and inland waterway vessels,
- goods in transit.

Insurance contracts covering such property will therefore not be subject to the obligation to cover damages caused by terrorist attacks.

However, the second paragraph of the new drafting of article R. 126-2 of the French Insurance Code provides for two exceptions to this principle.

### **2.3 Exceptions to the principle of excluding MAT risks**

The new drafting of article R. 126-2 includes the hulls of air, marine, lake and inland waterway vehicles in the scope of article L. 126-2 when they fulfill two cumulative conditions:

- a) their unitary value declared in the contract must be lower than one million Euros;
- b) their use must satisfy the following criteria:
  - hulls of aircrafts must be intended for non-commercial or non-profit purposes (R. 126-2, paragraph I, 1°), or
  - hulls of marine, lake and inland waterway vehicles must be intended for yachting (article R. 126-2, paragraph I, 2°).

All boats and planes that satisfy these two criteria are therefore covered against damage caused by a terrorist attack if they are on French national territory when the damage is sustained.

We stress the fact that the hulls of rail vehicles are never subject to the provisions of article L. 126-2 of the French Insurance Code.

### **3. Adapting the application of article L. 126-2 to Large Risks**

Paragraph II of the new drafting of article R. 126-2 addresses Large Risks.

Its provisions are relatively close to those of paragraph 2 of the former drafting of article R. 126-2 of the French Insurance Code.

The new drafting of this article does, however, entail certain consequences concerning the definition of the large risks addressed (3.1), the cover limits applicable to them (3.1.3) and contracts currently in force.

### 3.1 The definition of Large Risks

As indicated in our memorandum of 26 September 2006<sup>2</sup>, paragraph 7 of article L. 126-2 of the French Insurance Code provides for possible limits to its application to Large Risks in the following terms:

*" A Decree in Conseil d'Etat determines the possible dispensations or exclusions applicable to contracts covering large risks defined in **article L. 111-6** with regard to the insurability of such risks."*

This article therefore expressly mentions article L. 111-6 of the French Insurance Code.

#### 3.1.1. The Large Risks mentioned in the new drafting of article R. 126-2

The former drafting of article R. 126-2 also referred to article L. 111-6:

*"However, when they concern **large risks, as defined by article L. 111-6**, the property insurance contracts mentioned in article R. 126-1 may depart from the provisions of the first paragraph within the limits set by order of the Minister of Finance."*

The dispensation and/or exclusions therefore applied to large risks "by nature" and "by size", as defined in article L. 111-6 of the French Insurance Code.

However, concerning the dispensations for Large Risks defined in 2° of article L. 111-6, the new drafting of article R. 126-2 (paragraph II) provides:

*The property insurance contracts mentioned in the first paragraph of article L. 126-2, when they concern the large risks defined in **2° of article L. 111-6**, may set forth (...)*

The dispensations therefore no longer applies to the Large Risks "by nature" mentioned in 1° of article L. 111-6

This modified drafting is, however, of no consequence to insurers.

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<sup>2</sup> Memorandum of 26 September 2006 page 2 (French version)



The Large Risks mentioned in 1° of article L. 111-6 are:

*"1) those that fall within the following categories:*

- a) hulls of rail, air, marine, lake and inland waterway vehicles or vessels as well as public liability for said vehicles,*
- b) goods in transit,*
- c) credit and guarantee when the policyholder, in a professional capacity, carries on an industrial, commercial or professional activity, provided that the risk relates to such activity"*

Let us analyze each of these categories of Large Risks "by nature":

**a) Hulls of rail, air, marine, lake and inland waterway vehicles or vessels as well as the civil liability related to said vehicles or vessels;**

These MAT risks were expressly excluded from the scope of article L. 126-2 by paragraph I of the new drafting of article R. 126-2 (see 2.2 above).

Furthermore, liability does not fall within the scope of article L. 126-2, as this article only refers to material damage or immaterial damage.

**b) Goods in transit;**

The cover for goods in transit was also excluded from the scope of article L. 126-2 by paragraph I of the new drafting of article R. 126-2 (see 2.2 above).

**c) Credit and guarantee when the policyholder, in a professional capacity, carries on an industrial, commercial or professional activity, provided that the risk relates to such activity;**

Credit and guarantee do not fall within the scope of article L. 126-2, which only refers to material damage or immaterial damage

Thus, the absence of Large Risks "by nature" in the definition of Large Risks for which it is possible to provide cover limits is of no consequence.

Indeed, whereas Large Risks "by nature" were completely excluded from the scope of article L. 126-2 of the French Insurance Code, the large risks "by size" mentioned in 2° of article L. 111-6 of the French Insurance Code still fall within the scope of the new drafting of article R. 126-2.

These risks are:<sup>3</sup> *"2) those relating to fire and natural elements, other damage to property, general public liability, various pecuniary losses, hulls of motor vehicles and public liability, including that of the*

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<sup>3</sup> 2° of Article L111-6 of the French Insurance Code

carrier relating to said vehicles, when the policyholder carries on an activity where the extent thereof exceeds certain thresholds defined by Decree in Conseil d'Etat<sup>4</sup>"

### **3.1.2. The contracts mentioned in the new drafting of article R. 126-2**

The former drafting of article R. 126-2 referred to article R. 126-1 in order to determine the property insurance contracts covered by the dispensations applicable to Large Risks:

*"However, when they concern large risks, as defined by article L. 111-6, **the property insurance contracts mentioned in article R. 126-1** may depart from the provisions of the first paragraph within the limits set by order of the Minister of Finance."*

The new drafting of article R. 126-2 refers to article L. 126-2 of the French Insurance Code:

***"The property insurance contracts mentioned in the first paragraph of article L. 126-2,** when they concern the large risks defined in 2° of article L. 111-6, may set forth, for the compensation of damages resulting from terrorist acts or attacks, "*

Once again, this modified drafting is of no consequence. As article R. 126-1 was repealed by the Decree of 29 September 2006, the legislator provided for an explicit reference to the first paragraph of article L. 126-2 of the French Insurance Code.

The following are therefore referred to by the new drafting of article R. 126-2 (paragraph II): *"Insurance contracts covering damage caused by fire to property located on the national territory as well as damage to the hulls of motor vehicles (...).<sup>5</sup>"*

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<sup>4</sup> The Decree in Conseil d'Etat referred to under Article 111-6 of the French Insurance Code has been codified under Article R111-1, which provides:

*"An operation relevant to the branches mentioned in 3, 8, 9, 10, 13, and 16 of Article R321-1 is considered as covering a large risk for the application of Article L.111-6 if the underwriter meets at least two of the following three conditions:*

- 1) The total of its latest balance sheet is more than 6.2 million units of account of the European Economic Community;*
- 2) The amount of its turnover of the latest tax year is more than 12.8 million units of account of the European Economic Community;*
- 3) The average number of people that it has employed during the previous tax year is more than 250.*

*If the underwriter belongs to a group of companies which is subject to compulsory financial reporting on a consolidated basis, the thresholds mentioned in points 1, 2, and 3 above are applied on consolidated accounts."*

<sup>5</sup> Paragraph 1 of Article L. 126-2 of the French Insurance Code

### 3.1.3. Cover limits applicable to Large Risks

As was the case with the former drafting of article R. 126-2, the new drafting of article R. 126-2 specifies that insurance contracts must expressly provide for cover limits applicable to Large Risks in order for them to be opposable to the policyholders.

However, the nature of these limits has been modified.

The Decree brought about an important change: it now refers to fire cover;

As indicated in our memorandum of 26 September 2006<sup>6</sup>, article L. 126-2 of the French Insurance Code uses the limits of "fire cover" as a reference, whereas article R. 126-2, in its former drafting, used the limits of "cover for damage of the same nature" as a reference.

Indeed, paragraph 2 of article L. 126-2 of the French Insurance Code specifies that:

*"Repair of material damage, including the costs of decontamination and the repair of immaterial damage caused by such damage are covered within the limits of the deductible and the limit **for fire damage** set by the contract."*

The former drafting of article R. 126-2 of the French Insurance Code specified:

*"However, when they concern large risks, as defined by article L.111-6, the property insurance contracts mentioned in article R. 126-1 may depart from the provisions of the first paragraph within the limits set by order of the Minister of Finance. These dispensations may in no case lead to the reduction in the amount of the cover, free of deductible, for damage resulting from terrorist attacks, to an amount inferior to the following amounts:*

- 1. For transported merchandise, 20% of the amount of the cover, free of deductible, provided for by the contract **for damage of the same nature** but not caused by terrorist attacks;*
- 2. For other risks, 20% of the amount of the cover, free of deductible, provided for by the contract **for damage of the same nature** but not caused by terrorist attacks and, whatever the circumstances, 20 million Euros."*

Likewise, the decree of 28 December 2001<sup>7</sup> provided that the insurance contracts covering property may not stipulate *"a deductible higher than twice of that provided for by the contract **for damage of the same nature** which would not be caused by terrorist attacks."*

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<sup>6</sup> Memorandum of 26 September 2006 page 7 (French version)

<sup>7</sup> Article 1, 2 of the decree of 28 December 2001 establishing the minimal conditions of cover for damage to property resulting from terrorist attacks.

This difference generated certain ambiguities, as well as some incompatibilities.

The Decree of 29 September 2006 suppresses any ambiguity as paragraph II of the new drafting of article R. 126-2 henceforth mentions, as article L. 126-2, fire cover:

*" The property insurance contracts mentioned in the first paragraph of article L. 126-2, when they concern the large risks defined in 2° of article L. 111-6, may set forth, for the compensation of damages caused by terrorist attacks, limits on deductibles and cover limits different from those set in the contract **for fire cover**, under the following conditions:*

*1° the amount of the cover, free of deductible, for damages caused by terrorist attacks may not be lower than 20% of the amount of the cover, free of deductible, provided for in the contract **for fire cover** or, in any case, lower than 20 million Euros (...).*

*2° the amount of the deductible, for the damage resulting from terrorist attacks, cannot be higher than twice that provided for in the contract **for fire cover**."*

The insurer therefore has the possibility to limit the terrorism cover to 20% of the amount of the fire cover, provided that it is not lower than 20 million Euros.

The contract may also contain deductibles, which should not exceed double the deductible applicable to fire cover.

We must, however, highlight the fact that goods in transit are no longer mentioned in the new drafting of article R. 126-2. This does not have any real impact because, as we pointed out, goods in transit have been completely excluded from the scope of article L. 126-2 of the French Insurance Code.

### **3.2 The consequences of applying the Decree of 29 September 2006 to contracts currently in force**

We would like to draw your attention to the complexity of applying the new drafting of article R. 126-2 to contracts currently in force. It is indeed impossible to establish with certainty whether this article will apply or not to contracts currently in force, and if so, how.

Two questions arise:

- Does the new drafting of article R. 126-2, which came into force on 1st October 2006, apply to contracts currently in force?
- If so, what are the modalities for applying this article to contracts currently in force?

**3.2.1. Does the new drafting of article R. 126-2 apply to contracts currently in force?**

The Decree of 29 September 2006 does not specify whether the provisions of the new drafting of article R. 126-2 apply to contracts currently in force.

One must therefore interpret the new drafting of article R. 126-2 in light of article L. 126-2, as the former is an implementation measure of the latter.

As you know, article R. 126-2 is expressly referred to in article L. 126-2:

*"A Decree in Conseil d'Etat [the Decree of 29 September setting forth the new drafting of article R. 126-2] determines the possible dispensations or exclusions applicable to contracts concerning large risks defined under article L. 111-6 with regard to the insurability of such risks."*

The act of 23 January 2006 creating article L. 126-2 (currently in force) provides that the provisions of this article apply to contracts currently in force as of the date of the act's publication.

Consequently, the new drafting of article R. 126-2, which is an implementation measure of article L. 126-2, also applies to contracts currently in force as of its coming into force, i.e. as of 1<sup>st</sup> October 2006.

The *Cour de Cassation*<sup>8</sup> has validated the application of legislative provisions to existing insurance contracts when said provisions come into force after the conclusion of the insurance contract. In the case in point, the *Cour de Cassation* considered that the act modifying the modalities for settling losses was immediately applicable to existing insurance contracts.

It is therefore our opinion that the new drafting of article R. 126-2 applies to contracts currently in force.

**3.2.2. The modalities for applying article R. 126-2 to contracts currently in force**

Firstly, the limits and covers of contracts currently in force were established in light of the applicable provisions at the time of their conclusion, i.e. of article R. 126-2 in its **former** drafting.

It is therefore probable that, for a certain amount of these contracts, the deductibles and limits will not comply with the provisions of the **new** drafting of article R. 126-2.

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<sup>8</sup> *Cour de Cassation* 1<sup>st</sup> Civ., 29 February 2000

The table below summarizes the differences between the former drafting and the new drafting of article R. 126-2:

	<b>Former drafting</b>	<b>New drafting</b>
<b>Deductibles</b>	Article 1 paragraph 2 of the decree of 28 December 2001: 2. A deductible higher than twice that provided by the contract <i>for damage of the same nature</i> which would not be caused by terrorist attacks.	II - 2° the amount of the deductible for damages caused by terrorist attacks may not be higher than twice the deductible provided for in the contract for fire cover
<b>Cover Limits</b>	1. For goods in transit, 20% of the amount of the cover, net of deductible, provided for by the contract <i>for damage of the same nature</i> but not caused by terrorist attacks; 2. For other risks, 20% of the amount of the cover, free of deductible, provided for by the contract <i>for damage of the same nature</i> but not caused by terrorist attacks and, in any case, 20 million Euros.	II - 1° The amount of the cover, free of deductible, for damages caused by terrorist acts or attacks may not be lower than 20% of the amount of the cover, free of deductible, provided for in the contract <i>for fire cover</i> and, whatever the circumstances, lower than 20 million Euros

We must distinguish between two situations:

- a) the contractual provisions comply with the amounts set by the new drafting of article R. 126-2
- b) the contractual provisions do not comply with the amounts set by the new drafting of article R. 126-2

**a) the contractual provisions comply with the amounts set by the new drafting of article R. 126-2**

In this case, the contractual provisions shall apply.

Two cumulative conditions must be fulfilled:

- 1) the deductible provided for in the contract in force must be **lower** than the deductible resulting from the new drafting of article R. 126-2.

Example: the deductible provided for in the contract is 100. Due to the new drafting of article R. 126-2, the deductible provided for in the contract may not be higher than 120. It is therefore the deductible of 100 that applies.

- 2) the cover limit provided for in the contract in force must be **higher** than the cover limit resulting from the new drafting of article R. 126-2.

Example: the cover limit provided for in the contract is 300. Under the new drafting of article R. 126-2, the deductible provided for in the contract may not be lower than 250. It is therefore the deductible of 300 that applies.

This will not be the case in the event that the amount of the "cover for damage of the same nature" that will serve as the basis of calculation for the amount of the cover is lower than the amount of the fire cover. This case is probably rare as, in most property insurance contracts the highest cover is for fire damage.

Thus, if the provisions of the contract currently in force are more favorable for the policyholder than the new provisions of article R. 126-2 of the French Insurance Code, then the contractual provisions shall apply.

**b) The contractual provisions do not comply with the amounts set by the new drafting of article R. 126-2**

1) Possible situations

This will probably be a more common situation:

- Either the contractual deductible is higher than the maximum provided for in the new drafting of article R. 126-2,

Example: the deductible provided for in the contract is 100. Under the new drafting of article R. 126-2, the deductible provided for in the contract may not be higher than 90.

- Or the contractual cover limit is lower than the minimum provided for in the new drafting of article R. 126-2.

We may legitimately consider that, in most property insurance contracts currently in force, the fire damage cover is the highest cover. In this case, the minimum cover limit set by the new drafting of article R. 126-2 will usually be higher than the cover limit provided for in the contract (20% of the cover for damage of the same nature).

Example: the cover limit provided for in the contract is 300. Under to the new drafting of article R. 126-2, the cover limit of the contract may not be lower than 500.

## 2) The consequences

In these two situations, the contractual clauses limiting the cover for Large Risks do not comply with the provisions of the French Insurance Code.

The question therefore arises as to the consequences of such an incompatibility. Two scenarios are conceivable:

- The clauses limiting cover provided for in the contract (deductible and cover limit) could be deemed unwritten. The contract would then be considered as having no deductible or cover limit.

### Or

- The principle of the deductible and the cover limit remains, but the applicable amounts will be those required by the new drafting of article R. 126-2:
  - i. For the deductible, the applicable amount will be the maximum deductible provided for in the new drafting of article R. 126-2, i.e. twice the deductible for the fire cover;

Example: the deductible provided for in the contract is 100. Under the new drafting of article R. 126-2, the deductible provided for in the contract may not be higher than 90. The deductible of 90 applies.

- ii. For the cover limit, the applicable amount will be the minimum provided for in the new drafting of article R. 126-2, i.e. 20 % of the amount of the fire cover and, in any case, 20 million Euros.

Example: the cover limit provided for in the contract is 300. Under the new drafting of article R. 126-2, the cover limit of the contract may not be lower than 500. The cover limit of 500 applies.



We do not feel that the solution according to which clauses limiting cover would be deemed unwritten could convince a judge. Indeed, this solution would create too high a level of legal uncertainty for insurers<sup>9</sup>.

We therefore consider it is as much more likely that the maximum deductible and the minimum cover limit required by the new drafting of article R. 126-2 will apply, even if the contractual clauses do not comply with them.

In order to comply with our analysis, we propose that you modify your contracts currently in force (See 4 below).

#### **4. The modification of contracts currently in force**

##### **4.1.. The need for an endorsement to the contract**

In order to limit the legal uncertainty linked to the application of the new drafting of article R. 126-2 to contracts currently in force, it is recommended to modify these contracts by sending an endorsement to the policyholders.

The purpose of this endorsement would be to make the deductibles and cover limits comply with the new drafting of article R. 126-2.

##### **4.2. The form of the endorsement**

Paragraph 5 of article L. 112-3 provides that, "*the parties must draw up and sign an endorsement in respect of any addition to or amendment of the previous insurance contract.*"

It will therefore be necessary to draft an endorsement in writing, which must then be sent to the policyholder by registered mail with acknowledgement of receipt. The policyholder must then sign the endorsement and return it as proof of explicit acceptance. If one remains true to the letter

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<sup>9</sup>In any event, if such a position were upheld before a court, it could be possible for us to request that the Decree be declared null and void.

By way of a judgment of 24 March 2006, the Conseil d'État annulled a decree for not containing transitional provisions, which resulted in its implementation excessively disturbing the execution of contracts entered into before its coming into force. In accordance with this case law, the Decree of 29 September 2006 could be null and void. This would be due to the fact that, in the absence of any transitional provisions, the requirements of the Decree would create excessive disturbances in contractual relationships legally entered into before its coming into force, requirements which would therefore be in breach of the principle of legal certainty.

We must point out, however, that this would entail extensive proceedings with little chance of success, as we would have to request that the court through which the policyholder issued us a subpoena submit the case to the relevant administrative court by way of a preliminary ruling ("*question préjudicielle*"), in order to obtain the nullity of the Decree.

If the Decree of 29 September 2006 were to be annulled, then the former Article R126-2 would be considered as having remained in force. Clauses providing for limits and deductibles that comply with the former Article R126-2 would therefore continue to apply.

of article L. 112-3, in the absence of the written acceptance of the policyholder, the modification could not, in principle, be considered as accepted.

This principle must, however, be tempered.

The relevant case law generally deals with situations in which the modification to the contract requested by the insurer is, in some way or another, unfavorable to the policyholder.

However, the *Cour de cassation* considered in a recent judgment<sup>10</sup> that:

*"modifications to insurance contracts that lead to a restriction of cover may only be established by the signature of the policyholder prior to the loss "*.

This decision could be interpreted as having eliminated the need for written approval in the event that the modification to the contract does not restrict the policy's cover.

This analysis would confirm the French law principle according to which acceptance of an offer must be explicit, unless the offer was made in the sole interest of the person to whom it was addressed<sup>11</sup>.

It is therefore essential that the modifications proposed in the endorsement always be favorable to the policyholder. In this way, even in the event the policyholder does not sign the endorsement, and referring to the aforementioned case law and principle, one could consider the endorsement as accepted.

In addition, the policyholder could hardly argue in front of a court that the unsigned endorsement has not been accepted. Indeed, it would not be in the policyholder's interest to contest the application of an endorsement extending the cover.

The only conceivable interest in claiming that, in the absence of the policyholder's signature, the endorsement has not been accepted, would be to attempt voiding the clauses limiting cover (limits and deductibles) contained in the contract in view of their non-compliance with the new drafting of article R. 126-2 of the French Insurance Code.

Although this risk cannot be eliminated, it remains marginal. Indeed, the insurer would have demonstrated its good faith in proposing an endorsement containing an increase in cover in accordance with the new drafting of article R. 126-2 of the French Insurance Code for signature by the policyholder.

Finally, one must not forget that the policyholder will have signed a contract containing deductibles and/or cover limits. It would therefore be of particularly bad faith to argue that no

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<sup>10</sup> *Cour de Cassation* 3<sup>re</sup> Civ., 17 June 2003

<sup>11</sup> *Cour de Cassation*. Req. 29 March 1938.

deductibles and/or cover limits could be opposable to him, simply because their amount has changed – in order to comply with more favorable legal provisions.

#### **4.3. The content of the endorsement**

The endorsement must allow the policyholder to determine which deductible and cover limit amounts will apply, between the contractual amounts on the one hand and the amounts imposed by the new drafting of article R. 126-2 on the other hand. As discussed above, the applicable deductible and cover limit amounts should always be those which are the most favorable to the policyholder.

The endorsement must therefore contain several options (for deductibles and limits) and specify each time which applies.

##### **4.3.1. Regarding deductibles**

The endorsement will specify that the amount of the deductible will be the lowest of the following amounts:

- Amount of the deductible currently provided for in the contract for cover for damages caused by terrorist attacks concerning Large Risks;
- Twice the amount of the deductible currently provided for in the contract for fire cover (article R. 126-2 paragraph II 2°).

##### **4.3.2. Regarding cover limits**

The endorsement will specify that the amount of the cover limit will be the highest of the following amounts:

- Amount of the cover limit currently provided for in the contract for cover for damages caused by terrorist attacks concerning Large Risks;
- 20 % of the amount of the cover, free of deductible, provided for in the contract for fire cover (article R. 126-2 paragraph II 1°)
- 20 million Euros (article R. 126-2 paragraph II 1°).

## 5. Additional Questions

### 5.1. Exclusion of MAT risks

**Question:** *Could you confirm that the exclusion clauses concerning terrorism are again valid in the MAT insurance contracts (with the exception of the MAT contracts specified in 1° and 2° of Section I of the new article R. 126-2?)*

As indicated in Section 2.2 above, the first paragraph of the new article R. 126-2 of the French Insurance Code excludes all the MAT risks<sup>12</sup> within the scope of the application of article L. 126-2.

The exclusion clauses for damages resulting from terrorist attacks are thus valid in the insurance contracts for property covering the damages caused to:

- the hulls of rail vehicles,
- the hulls of air vessels,
- the hulls of marine vessels,
- the hulls of lake and inland waterway vessels,
- goods in transit.

These clauses are thus also valid for contracts currently in force as well as for contracts entered into after 1 October 2006.

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<sup>12</sup> Except the MAT contracts as specified in 1° and 2° of Section 1 of the new Article R 126-2

5.2 **The MAT contracts specified in 1° and 2° of Section I of the new article R. 126-2**

*Question: The MAT contracts defined in 1° and 2° of Section I of the new article R. 126-2<sup>13</sup>, remain subject to the obligation of cover for terrorism.*

- a. Must they contain the LMA 5061 clause?*
- b. Do they benefit from any possibility of limits on insured amounts or deductibles with regard to cover for terrorism?*

**a) Must they contain the LMA 5061 clause?**

The contracts specified in 1° and 2° of Section I of the new article 126-2 remain subject to article L. 126-2 of the French Insurance Code and the exclusion from the cover for damages resulting from a terrorist attack is therefore not possible.

They are thus also subject to the provisions of article L. 126-3 of the French Insurance Code which provides that:

*"The insurance companies must include in the contracts, which are specified in article L. 126-2, a clause extending their cover for damages specified in said article."*

Consequently, the LMA 5061 clause must be included in these contracts.

**b) Do they benefit from any possibility of limits on insured amounts or deductibles with regard to cover for terrorism?**

Article L. 126-2 lays down the principle according to which:

*"Repair of material damage, including the costs of decontamination and the repair of immaterial damage caused by such damage are covered within the limits of the deductible and the limit for fire damage set by the contract."*

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<sup>13</sup> Section I of the new Article R 126-2: the following remains, however, subject to the application of Article L 126-2:

1° Property insurance contracts covering damages sustained by the hulls of aircrafts intended for a non-commercial or non-profit activity, if the unit value of the hulls declared in the contract is less than one million Euros;

2° Property insurance contracts covering damages sustained by the hulls of marine, lake and inland waterway vessels intended for yachting, if the unit value of the hulls declared in the contract is less than one million Euros;

The limits of the deductible and cover limit will thus be those of the fire cover.

Therefore, it will not be possible to include any cover limit or deductible in these contracts other than those applicable to the fire cover.

Indeed, they do not fall within the scope of large risks "by size"<sup>14</sup> referred to under Section II of the new article R126-2, which excludes branches 5 (hulls of air vessels) and 6 (hulls of lake and inland waterway vessels).

### **5.3. Large Risks by size**<sup>15</sup>

*The large risks "by size" can now limit the amounts insured and the deductibles under terrorism cover as specified by Section II of the new article R. 126-2.*

**Questions: Regarding new contracts:**

- a. Must they really contain the LMA 5061 clause?**
- b. If the clause remains compulsory, how should the section concerning the cover limit of 20% / 20 million of the contract be drafted in order for this limitation to**

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<sup>14</sup> See next question for a reminder of the definition of large risks "by size"

<sup>15</sup> The large risks "by size" referred to by Article R. 126-2 are those specified under 2° of Article L. 111-6 of the French Insurance Code: *"those relating to fire and natural elements, other damage to property, general public liability, various pecuniary losses, hulls of non marine motor vehicles and public liability, including that of the carrier relating to said vehicles, when the policyholder carries on an activity where the extent thereof exceeds certain thresholds defined by Decree in Conseil d'Etat."*

The Decree in Conseil d'Etat refers to 2° of Article L. 111-6 of the French Insurance Code has been codified under Article R. 111-1, which provides for the following:

*"An operation relevant to the branches mentioned in 3, 8,9,10,13,and 16 of Article 321-1 is considered as covering a large risk for the application of Article L. 111-6 if the underwriter meets at least two of the following three conditions:*

- 1° The total of its latest balance sheet is more than 6.2 million units of account of the European Economic Community;*
- 2° The amount of its turnover of the latest tax year is more than 12.8 million units of account of the European Economic Community;*
- 3° The average number of people that it has employed during the latest tax year is more than 250.*

*If the underwriter belongs to a group of companies which is subject to compulsory financial reporting on a consolidated basis, the thresholds mentioned in points 1, 2, and 3 above are applied on consolidated accounts."*

The branches referred to under Article R. 111-1 correspond exactly to the different cases referred to under 2° of Article L. 111-6:

- fire and natural elements corresponding to branch 8
- other property damage corresponding to branch 9
- general public liability corresponds to branch 13
- various financial losses correspond to sector 16
- non marine motor vehicles correspond to sector 3
- Public liability [of non marine motor vehicles], including that of the carrier relating to said vehicles, corresponds to sector 10

*be opposable to the LMA 5061 clause which stipulates that the compensation should be limited to the fire cover?*

**a) Must they really contain the LMA 5061 clause?**

The property damage insurance contracts applicable to "Large Risks" remain subject to article L. 126-2 of the French Insurance Code and the exclusion of the cover of damages resulting from terrorist attacks is therefore not possible.

They are thus also subject to the provisions of article L. 126-3 of the French Insurance Code which provides the following:

*"The insurance companies must include in the contracts mentioned in article L. 126-2 a clause extending their cover for the damages mentioned in said article."*

The LMA 5061 clause must hence be included in these contracts.

**b) If the clause remains compulsory, in which manner should the section concerning the limit cover of 20% / 20 million of the contract be drafted in order for this limitation to be opposable to the LMA 5061 clause which stipulates that the compensation should be limited to the fire cover?**

It is not necessary to modify the LMA 5061 clause, as it expressly makes reference to the large risk exceptions provided:

*"...A Decree in Conseil d'Etat determines the possible dispensations or exclusions applicable to contracts covering large risks defined in article L. 111 6 with regard to the insurability of such risks."*

On the other hand, it is essential that the contract includes a clause on cover limits which determines the amount of the coverage limit and the deductible, so that these are opposable to the policyholder. These limitations must of course respect the minimum cover and the maximum deductible set by the new article R. 126-2 II 1° and 2°<sup>16</sup>.

**6. Goods in transit and motor vehicles**

***Question: The new Decree R. 126-2 implies that the terrorism cover is no longer compulsory for goods in transit. Could you confirm that this applies to all types of goods in transit?***

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<sup>16</sup> II- 1° The amount of cover, free of deductible, for damages resulting from terrorist attacks, cannot be lower than 20% of the amount of the cover, free of deductible, provided for by the contract regarding fire cover and, in any event, 20 million Euros."

2° The amount of deductible, for damages resulting from terrorist acts, cannot be higher than twice than that provided by the contract regarding fire cover.

Section I of the new article R. 126-2 excludes goods in transit from the scope of application of article L. 126-2:

*"I. The following are excluded from the scope of application of article L. 126-2: property insurance contracts covering damages to the hulls of rail vehicles, the hulls of air vessels, the hulls of marine vessels, the hulls of lake and inland waterway vessels as well as **to goods in transit...**"*

Branch 7 is defined under article R. 321-1 7° in the following manner:

*"7. Goods in transit (including the merchandise, luggage and any other goods): any damage suffered by the goods in transit or by the luggage, **regardless of the means of transportation.**"*

The exclusion referred to in article R. 126-2 of the French Insurance Code thus applies to the goods in transit regardless of the means of transportation.

***Question: And more specifically, how should the case of goods transported by land be interpreted, as the motor vehicles remain subject to the obligation of terrorism cover?***

article L. 126-2 indeed specifies the following:

*" Insurance contracts covering goods located on national territory damaged by fire as well as **damages to the hulls of motor vehicles** entitle the policyholder to cover for direct material damages to insured property caused by terrorist acts..."*

According to article L. 126-2, insurance contracts covering damages to motor vehicles are thus subject to compulsory terrorism cover, whereas insurance contracts covering damages to goods in transit are not subject to such compulsory cover.

As such, in the case of goods transported by a motor vehicle damaged by a terrorist attack, it seems to us that it will be necessary to analyze the insurance contract in order to determine whether it is a motor insurance contract (which ultimately covers goods in transit), or whether it is a transport insurance contract (the purpose of which is to cover goods in transit).

**Transport insurance contracts** for "goods in transit" do not fall within the scope of the application of article L. 126-2 of the French Insurance Code.

**Motor vehicle insurance contracts** are subject to the obligation of terrorism cover. If the cover of goods in transit is an "accessory" to the main cover, the goods could be subject to compulsory cover against terrorist attacks as long as they qualify as "insured property" ("*bien assuré*").



Article L. 126-2 indeed provides the following:

*"Insurance contracts covering damage caused by fire to property located on the national territory as well as damage to the hulls of motor vehicles, give the insured the right to cover for direct material damage caused to the insured property by a terrorist attack...."*

In the case of damage sustained by a motor vehicle and caused by a terrorist attack, it is the nature of the insurance contract which will determine whether the compulsory terrorism cover applies<sup>17</sup>.

## **7. Goods in storage**

***Question: Some insurance policies covering goods in transit also provide for periods of storage (i.e. in a warehouse). Although these contracts are considered as transport policies, are the insurers obliged to cover terrorism while the goods are stored and therefore static?***

Section I of the new article R. 126-2 of the French Insurance Code specifies that:

*"I. The following are excluded from the scope of application of article L. 126-2: the property insurance contracts covering damages to (...) goods in transit..."*

Insurance contracts covering "goods in transit" against fire damage can therefore legitimately exclude the cover of damages resulting from terrorist attacks.

The definition of the term "goods in transit" is therefore essential.

The French Insurance Code, however, does not give any definition.

Legally, the term "goods" ("*merchandise*") means tangible moveable property which is the object of a commercial contract (e.g. sale, transport, pledge, etc.).

Goods in transit are tangible moveable property, and are therefore the object of a transport contract.

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<sup>17</sup> We would, however, draw your attention to the fact that Article R126-2 is very badly drafted.

It provides that: "*Art. R. 126-2 - I. The following are excluded from the scope of application of Article L. 126-2: the property insurance contracts covering damages to (...) goods in transit..."*

Under a purely literal analysis of this text, it could be deduced that any property insurance contract which covers goods in transit is excluded from the scope of Article L126-2 of the French Insurance Code.

As branch 7, defined under Article R321-1 7°, also refers to luggage, one could conclude that any motor vehicle insurance also covering transported goods (whether goods in transit or luggage) are not subject to the compulsory terrorism cover.

Such analysis cannot be retained, as it is not consistent with the legislator's intention. We are nevertheless mentioning it to you as it may serve as a basis for argumentation in case of litigation.

Insurance contracts referred to under article R. 126-2 of the French Insurance Code hence cover the damage to goods which are the object of a transport contract.

In order to determine whether the insurance contracts covering goods in storage are indeed excluded from the scope of article L. 126-2 of the French Insurance Code, it is necessary to analyze the nature of the contract covering the goods whilst in storage.

If these goods in storage are covered by a **"classic" property insurance contract** (e.g. by the property insurance contract covering the buildings in which they are stored), they will be subject to compulsory terrorism cover: article L. 126-2 of the French Insurance Code will apply.

On the other hand, if these goods in storage are covered by a **transport insurance contract** which also covers this temporary storage, they will not be subject to compulsory terrorism cover.

The goods in storage, covered by a transport insurance contract, which ultimately covers the periods of storage, will therefore qualify as "goods in transit" pursuant to the new article R. 126-2. The contract could therefore legitimately exclude from their cover the damages to these goods resulting from terrorist attacks.