COLLEGE OF INSURANCE

Driven by distinction

PROGRAMME: DIPLOMA IN INSURANCE

LEGAL ASPECTS OF INSURANCE

CODE: DIP 103

AUTHOR: BEATRICE ONDUSO

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LEGAL ASPECTS OF INSURANCE

5.1.1 Introduction

This module unit is intended to equip the trainee with knowledge, skills, competences and attitudes that will enable you to apply various legal principles in the practice of insurance.

5.1.2 General Objectives

At the end the module unit, you should be able to:

a) recognize the importance of law in the practice of insurance
b) apply the principles and practice of law to insurance practice
c) comprehend legislation governing insurance
d) comply with the laws governing insurance practice

5.1.3 Module Unit Summary and Time Allocation

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LECTURE ONE

1.0 INTRODUCTION TO LAW

LECTURE OUTLINE

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1.2 Learning outcomes
1.3 Meaning of law
1.4 Importance of law
1.5 Classification/branches of law
1.6 Sources of law
1.7 Structure and jurisdiction of the courts
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1.1 INTRODUCTION

Welcome to Legal Aspects of Insurance unit for Diploma in Insurance Module one. I am glad that you chose to pursue a career in insurance. Note that insurance business cannot be effectively transacted unless there are established rules some of which are based on legal practice. One of the main reasons that will cause interest in insurance business is the confidence that the transactions are legally binding just like all the other contracts. This unit will therefore give you insights on various aspects and principles of law that affect the practice of insurance. However, let me give you an overview of what the entire unit entails before going into specific lectures.

- In this unit, you will examine the importance, classification and sources of law. The unit also provides you with details on the structure and powers of courts;
- It also discusses the application of principles of insurance in insurance contracts;
- There are also laws, rules and regulations that govern insurance operations and practice which are explained in this unit. As a student of insurance, you should comprehend these legislations and ensure they are complied with them when engaged in various insurance transactions.

The unit will cover the following topics:

- Introduction to Law;
- The law of contract;
- The Insurance contract;
- Principles of Insurance;
- The law of tort;
- The law of agency;

- Company law;
- Other legislation affecting insurance operations;
- Dispute resolution mechanisms; and
- Legal challenges facing insurance operations.

This is your first lecture in this unit. In this lecture, you will cover the meaning, importance, classification and sources of law. You will also have the ability to demonstrate the structure and jurisdiction of Kenyan Courts.

1.2 LEARNING OUTCOMES

By the end of this lecture, you will be able to:

- Explain the meaning of law
  - Identify the importance of law
  - Explain various classification/branches of law
  - Discuss the sources of law
- Describe the structure and jurisdiction of the courts

1.3 MEANING OF LAW

What do you understand by term law?

Almost everything that we do in life is governed by some set of rules. There are rules for religious institutions, sports, social clubs, learning institutions, work place environments and other business transactions. It is important to note that the law is part of everyone's life, a living part, a controlling part, a determining part, a giving part and that it concerns people. The term law has been given various definitions by different schools of thought. Law refers to rules that regulate and control the behaviour of people in society. Law may also be defined as a collection of rules binding on specific persons, made and authored by certain institutions and enforced by the machinery of government. There is need for everyone to have basic understanding of the law as it is generally said that ignorance of the law is not a defence in a court of law. Simply stated:

- Law is a collection of rules which say do this or do not do this;
- Laws are applicable to a community;
- Law is binding and must be obeyed by everyone in the community;
- Law is made and authored by certain institutions; and
- Law is be enforced by government machinery.

1.3.1 What is the Origin of Law?

Law is not a recent phenomenon as it has been many years before the birth of Christ. The bible teaches about the ten commandments and consequences for disobedience are clearly spelt out. The biblical Moses advised the Israelites to give inheritance to daughters if one dies without a son. This is echoed in Article 27 (3) of the Kenyan Constitution which provides for equal treatment to men and women in political, economic, cultural and social spheres. The law of contract has its origins in the bible as is illustrated when the biblical Abraham was purchasing a piece of land to use as a burial ground and the requirement for witnesses and payment of the full price arose. This is still the practice under the law of contract relating to conveyances in land which requires that the contract must be in writing, signed and witnessed.

1.3.2 What are Laws Based on?

Laws can only be acceptable to people in a society if they reflect the feelings of the community as to what is right and what is wrong. Is there a relationship between morality and legality? The concern of this unit is mainly legal rules that is, the law of the state. Legal rules unlike moral rules are backed by legal sanctions meaning that there are adverse consequences for non-compliance. Rules of morality are not enforced by courts of law unless they are tied to or are not part of the law of the state. Examples of moral wrongs may be infidelity in a marriage and the manner of dressing. The issue morality relates to the behavior, attitude and character of a person may also arise in insurance contracts. In Introduction to Insurance, you have covered moral and morale hazards and their place in insurance practice. Note that part of our law and particularly criminal law is based on morality. Some moral wrongs may also be legal wrongs for example incest, theft and rape among others. Laws of morality differ from one society to another. Some countries have legalized issues that may be considered immoral in other countries for example prostitution and sale of alcoholic drinks in retail outlets.

How are Laws Enforced?

Whatever the basis of legal rules may be, there must obviously be mechanisms to enforce them. Otherwise they may be ignored, leading to disorder and confusion. Thus every society has put systems in place to ensure justice is not only done but seen to be done. This includes courts that hear civil disputes and try suspects in

criminal cases, the police service and other mechanisms in place to enforce court judgments. If a person fails to honour a decree issued by the court, an order may be issued for attachment and subsequent sale of their property or one may be sent to civil jail.

1.4 PURPOSE OF LAW IN SOCIETY

Think

What would happen in a society where there are no laws?

Questions abound as to what would have happened if man lived alone. The simple answer is that if man lived alone, there could be no friction and no disputes can arise and law will therefore not be necessary. However, mankind has a natural desire to live together with others. The consequence of this is social friction as people trespass to each other's property, kill one another, defame each other and generally violate rights belonging to other people. The law therefore becomes a necessary tool to regulate and ensure that life generally is orderly and civilised.

In the absence of rules that dictate on what we can do and what we cannot do, what is right and what is wrong, people in society would simply do as they please, with little regard for others. Laws have therefore been the glue that has kept society together. Without laws, chaos will reign as individuals will trespass into other people's property without care and drive dangerously on the roads among other violations. Laws regulating business affairs help to ensure that people keep their promises. Laws against criminal conduct help to safeguard our personal property and lives. When disputes arise in society, the law must provide a way to resolve them in a peaceful way. The need for law to ensure a safe society in which individuals' rights are respected is paramount. Rule of Law must be embraced in every orderly society. The Rule of Law entails equal treatment to all, access to justice by everyone, fair hearing by an impartial court, public officers conducting their affairs within the law and that the law be reasonable, certain and predictable.

The purpose of law in society can thus be summarised as follows:

- Regulating the conduct and behaviour of people in society;
- Providing justice, promoting fairness and equality;
- Governing affairs among nations;
- Protecting fundamental human liberties and rights enshrined in the Constitution;
- Establishing procedures to be followed in conducting certain matters;
- Maintaining peace, order and stability in society; and

- A tool used in resolving disputes which are unavoidable in any society.

1.5 CLASSIFICATION OF LAW

Classification refers to the different branches of law, some of which overlap with each other. Law may be classified in a number of ways. You should be able to distinguish the different classifications. They include:

- Public and private law;
- International and municipal law;
- Civil and criminal law; and
- Procedural and substantive law.

1.5.1 Public Law and Private Law

a. Public Law

This is the class of law concerned with the legal structure of the state, the relationship between the state and its citizens and the relationship between one state and another. It consists of branches of the law where the state has interest and includes constitutional law, criminal law and administrative law. Below is a discussion on each of these three branches.

(i) Constitutional Law

Constitutional law refers to law that is derived from the constitution. It deals with the structure of the main institutions/organs of government which include the executive, the legislature and the judiciary and how the institutions relate to each other. These institutions are created under The Kenya Constitution 2010 and derive their mandate from the constitution. The constitution also provides for the making of treaties with other foreign states. Article 2 (6) of the constitution provides, 'Any treaty or convention ratified by Kenya shall form part of the law of Kenya under this constitution'.

(ii) Criminal Law

The concern of criminal law is controlling of behaviour which is harmful to the community.

What is a crime? A crime has been defined as an act, default or conduct prejudicial to the community the commission of which, by law, renders the person responsible liable for prosecution and punishment. Can you think of some of these crimes? Examples of crimes include theft, arson, murder, manslaughter, burglary among others. Crimes such as murder obviously affect individual victims but the stability of the society is threatened if such acts go unchecked. The wrongs are therefore committed against the state and they are punishable by the state. This branch of law creates crimes and prescribes punishment for them under the Penal Code Chapter 63 of the laws of Kenya. The cases filed against the offenders are styled as republic against the accused person. It is the duty of the state to ensure peace, order, good governance and protection of its citizens. The

remedy provided for in criminal law is punishment which may be in form of a term of imprisonment, a fine or community service.

(ii) Administrative Law

Administrative law governs the relationship between private citizens with the local/county and central/national government. Issues dealt with under this branch includes grant of licenses to traders and professionals, land rates, compulsory acquisition of land, health and education among others.

b. Private Law

Point to note

Private law is commonly known as civil law. It is concerned with violation of private rights belonging to an individual in his/her capacity as an individual. It thus governs the relationship between individuals. The aim of civil law is to compensate the aggrieved individual. Branches of civil law include the law of contract, the law of torts, succession law, the law of property, family law, and the law of trust among others. The scope and content of some of these branches will be considered later. However, a brief outline of these branches is provided.

(i) The Law of Contract

A contract is an agreement between two or more persons that is intended to be legally binding. It creates rights and obligations which the law recognises and courts can enforce. Breach of the terms and conditions that govern the relationship between the parties in a contract constitutes a civil wrong and entitles the innocent party to compensation. The remedies available for breach will be discussed in detail in lecture two.

(ii) The Law of Tort

A tort is a civil wrong. A tort results from breach of duties primarily fixed by the law breach of which entitles the aggrieved party to claim compensation. A person who drives carelessly and injures another commits the tort negligence. Examples of torts include defamation, negligence, strict liability, breach of statutory duty, nuisance and trespass. Each of these will be discussed in detail in lecture five.

(iii) Law of Succession

This is the law that governs succession matters in Kenya and is contained in the Law of Succession Act Cap. 160 of the laws of Kenya. It is a branch of law that deals with matters of inheritance. It determines how property (both real and personal) passes to the heirs/survivors upon the death of a

person. A person can die testate (leaving a will) or intestate (without a will). In insurance, where a policyholder or a third party dies, letters of administration are requested for to assist the insurer in determining the person entitled to payment following a claim by the legal representatives of the estate.

(iv) The Law of Trust

This arises where a person known as a settlor establishes/creates a trust by transferring property to another called a trustee for the benefit of the person(s) called the beneficiary. This is governed by the Trust Act Cap.67 of the laws of Kenya. There are obligations and responsibilities imposed on the trustee which obligations are enforceable by courts of law. Where the trustee is in breach of trust, this amounts to a civil wrong. A trustee in property insurance is among the categories of persons recognized as having insurable interest. In life assurance, the assured having purchased a policy with a named beneficiary, the life office acts as a trustee holding the policy money on behalf of the beneficiary.

(v) The Law of Property

The term property refers to that which belongs to a person. It includes movable, immovable, tangible and intangible property. Examples of property include buildings, money, trademarks among others. Property is part of the subject matter in insurance. The law of property therefore addresses the rights which a person has over use of his property. The extent of a person's rights over property in respect of which he has a claim may at times depend on whether he is the owner or possessor. A person who is temporarily entrusted with another property otherwise known as a bailee is said to have insurable interest in property and such persons include garages, drycleaners and warehouses. A person's rights in property may be limited by other factors for instance, in cases of joint ownership where the property may be owned by spouses or partners in business.

(vi) Family Law

This branch of civil law deals with marriage, divorce, matrimonial property rights and custody of children upon divorce among other issues. There are a number of Acts of parliament that address these issues among them the Kenya Constitution 2010, the Marriage Act 2014, Matrimonial Property Act of 2013.

In private law, the person whose rights are violated may sue the wrongdoer for compensation. The person who files a suit is known as the plaintiff whereas the person who the suit is filed against is the defendant. Some of the remedies available in civil law include damages, injunctions, specific performance among others. They will be explained in detail in the next lecture.

Activity

Distinguish between private law and public law?

1.5.2 International Law and Municipal Law

Let us now understand the difference between international law and municipal law.

(i) International Law

International law is divided into public international law and private international law. Public international law contains rules which govern relations between states. Kenya is a signatory to various international treaties and conventions. What law then governs violations arising out of these treaties? Article 2(5) of the Constitution of Kenya, 2010 provides that the general rules of international law shall form part of the law of Kenya. The treaties address issues of trade, human rights among others.

Private international law on the other hand, determines which national law governs a case where there is a foreign element. A contract entered between a Nigerian national and a Kenyan citizen whose performance is to take place in Tanzania requires a clause that provides for resolution of disputes arising under the contract to avoid forum shopping. This is usaully the jurisdiction clause that provides for the national law that will be applied to resolve the dispute where there is breach of such contract. This is also applicable to insurance contracts and the policy document contains the jurisdiction clause.

(ii) Municipal Law

Municipal law may also be termed as domestic law and refers to the law of the state. The law of the state can be widely classified into public and private law which classifications have been discussed in detail above.

1.5.3 Procedural Law and Substantive Law

These are explained below.

(i) Procedural Law

Procedural law lays down the rules in detail to guide courts in regulating the manner in which proceedings in civil and criminal trials are conducted. It creates and controls the process of enforcing rights and duties provided for under substantive law. Examples include the Law Reform (Limitation of Actions) Act of 1954, the Evidence Act Chapter 80, the Civil Procedure Act Chapter 21, and the Criminal Procedure Code Chapter 75.

(ii) Substantive Law

Substantive law creates and controls rights and duties of legal persons. It lays down the actual rules of law. This branch of law defines civil and criminal wrongs and provides remedies for them.

Examples of substantive law include the law relating to torts, contracts and crimes. The Penal Code of Kenya creates crimes and prescribes punishment for them and is an example of substantive law.

Activity

Where would legal principles that that govern insurance be classified?

The legal rules which govern insurance are part of civil law many of which are drawn mainly from the law of contract and the law of torts.

1.6 SOURCES OF LAW IN KENYA

What is a source? The Businessdictionary.com defines a source as a place from which things originate. In the legal context, a source of law means the origin of the rule, which constitutes a law, or legal principle. The phrase `sources of Kenyan law' therefore means the origin of the legal rules which constitute the law of Kenya. N.A. Saleemi in his book 'General Principles of Law Simplified' defines a source of law as that which may be pointed out as forming the basis of law that is, what gives law its force and validity. The sources of Kenyan law consists both written and unwritten law. They are set out in section 3(1) of the Judicature Act Chapter 8 of the laws of Kenya and include the following:

- The Constitution of Kenya, 2010;
- All other written laws including Kenyan Acts of parliament and those of the United Kingdom;
- Subsidiary legislation which for time being is in force;
- The common law, the doctrines of equity and statutes of general application in force in England on 12/08/1897;
- African customary law;
- Islamic law; and
- Judicial Precedents (Case law).

Let us discuss each of these sources.

1.6.1 The Constitution

What is a constitution?

It is a document having legal sanctity which sets out fundamental principles or established precedents on how a state is to be governed. Chapter nine (9) of the Constitution of Kenya, 2010 creates the executive arm of the government which generally administers the laws enacted by the legislature and also makes policies on how people are governed; chapter eight (8) creates the legislature that consists of the national assembly and the senate, which organs are mandated to make laws; chapter ten (10) creates the judiciary which determines the validity of the laws made and enforcement of the laws. Article 159 provides for the principles that guide courts and tribunals in exercising their authority. They include:

- Justice shall be done to all**,** irrespective of status;
- Justice shall not be delayed;
- Alternative forms of dispute resolution including reconciliation, mediation, arbitration and traditional dispute resolution mechanisms shall be promoted; and
- Justice shall be administered without undue regard to procedural technicalities.

Constitutions are classified into written and unwritten. When the principles are written down into a single document or set of legal documents, those documents may be said to embody a written constitution; if they are written down in a single comprehensive document, it is said to embody a codified constitution. The Kenyan constitution is an example of written constitutions. The supremacy of the constitution is clearly reiterated in Article 2(4) of the Constitution which provides that any law, including customary law that is inconsistent with the Constitution is void to the extent of the inconsistency, and any act or omission in contravention of the Constitution is invalid.

Note that every constitution must have an amending clause as society is dynamic and the law must continuously develop to reflect changes in society. Article 255 of the Kenya constitution, 2010 allows for the alteration of the constitution and provides that a proposed amendment shall be approved by a referendum if;

(*a*) At least twenty per cent of the registered voters in each of at least half of the counties vote in the referendum; and

(*b*) The amendment is supported by a simple majority of the citizens voting in the referendum.

1.6.2 Legislation/Acts of Parliament

Legislation refers to the law that has been created in a formal way and set down in writing. The institution that has been mandated to make laws in Kenya is the legislature/parliament. The legislature consists of the National Assembly and the Senate at national level and county assemblies at county level. These institutions are created under the Constitution and derive their powers from the Constitution. Parliamentary legislation takes the form of Acts of Parliament or statutes. Law made by parliament can be direct or indirect. This is due to the fact that parliament sometimes delegates its law making powers to lesser but competent bodies including government ministries and local authorities. Direct legislation, also known as primary legislation is where the rules are made in parliament and are contained in a statute/Act of parliament. Indirect legislation is also known as delegated or subsidiary legislation. The laws made by ministers are known as statutory instruments,

rules or orders where as those made by local authorities are known as by-laws. Note that parliament in exercising their authority may create entirely new law, modify or extend existing law or repeal existing statute.

What is Entailed in the Legislative Process in Kenya

An outline of the law making process is explained. The procedure of law making is contained in chapter eight (8) of the Constitution. The process begins with drafting of a bill.

What is a bill?

A Bill is draft legislation for consideration by Parliament or County Assembly. There are two main categories of bills: public bills and private bills. Public bills deal with questions of national interest that is those relating to matters affecting the general public and usually introduced by a minister in which case they are referred to as "government bills". They may also be initiated by private members, in which case they are called "private Members' bills. Private bills are concerned with a specific section of the society and grant powers, special rights or exemptions to a person or persons, including corporations.

In the national assembly, the bill goes through the following stages:

- Publication of the bill in the Kenya Gazette: This is to allow for dissemination of information before the bill is introduced into the national assembly. This must be done within 14 days before the bill is formally introduced in parliament;
- First reading: This is the formal introduction of the bill into the national assembly and no debate takes place at this stage. This is intended to draw the bill to the attention of both the members of parliament and the general public. If the bill is approved, it is circulated and a date is set for the second reading;
- Second reading: The bill is reread for the second time. The person concerned explains the purpose and issues involved. This is the debating stage where the merits of the bill are discussed and amendments proposed. A vote is then taken;
- Committee stage. Here the bill is committed to a selected committee of Members of Parliament or the national assembly can act as a committee for critical analysis. The select committee has the power to propose amendments;
- Reporting stage. The chairperson tenders the committee's report to the national assembly. If adopted, then the bill proceeds to the third reading;
- Third reading. The bill is read out to members for the third time and members are free to make contributions but no debate takes place. If the bill gets the requisite votes the bill is passed on to the president for assent;

- Presidential assent. A bill passed by the national assembly must be presented to the president for assent. The president must signify his assent or refusal to the speaker of the national assembly within 21 days o the presentation of the bill. If the president refuses to signify assent, he must within a further 14 days deliver to the speaker a memo of all the provisions which in his opinion ought to be reconsidered including his recommendation of the same. Then, the national assembly must either pass the bill incorporating the president's recommendations with or resubmit it for assent or they could re-pass the bill in its original form ignoring the president's recommendations;
- Publication of the law in the Kenya Gazette: For a law to come into effect, it must be published in the Kenya Gazette; and
- Commencement of the law: A statute comes into force either on the date of publication in the Kenya gazette or it may be taken in a retrospective aspect except for criminal laws. And thus a bill shall now be a law.

1.6.3 Subsidiary Legislation

This arises where parliament delegates its law making authority to subordinate bodies. These bodies include government ministries and county governments. The laws made by parliament are referred to as direct/primary legislation while those made by other bodies are known as delegated/subsidiary legislation. Direct legislation is superior and binding as courts may not question their validity. Indirect legislation on the other hand is binding only if it is intra vires meaning if it is within the powers given. Where delegated legislation is inconsistent with an Act of parliament, the provision in the Act of parliament will prevail.

The Doctrine of Ultra Vires

This arises where institutions that have been empowered to make indirect legislation acts beyond (outside) the powers contained in the statute/the enabling Act. Ultra vires doctrine is used to defeat those rules which are offending to the general law. Courts therefore control subordinate bodies exercising legislative, administrative and judicial powers to ensure that they do so within the powers (intra vires) given by statute. Delegated legislation can be declared null and void if:

- It is unreasonable or uncertain;
- Has a retroactive or retrospective effect that is affecting acts done or rights acquired before the law was passed;
- It infringes fundamental rights such as the right of personal liberty; and
- They are rules on levying taxes.

Reasons for Delegated Legislation

The complexities of the modern world are such that the law itself must be extensive and very detailed. Parliament may not have the time to lay down all the intricate rules which are necessary in the field of, say, medicine, insurance, stock exchange, road traffic, social security or taxation. For this reason, Acts of Parliament often lay down only a general framework of rules, leaving the details to be filled in by civil servants working in the appropriate ministry. However, detailed rules of this sort cannot

be made unless the persons in question have been given the power to make law by Parliament itself. Some of the reasons that lead parliament to delegate their legislative role include:

Lack of Parliamentary Time

Parliament does not have the time to deal with the precise details of all the legislation as they have other mandates under the constitution.

Urgency

In time of emergency, parliament may not be able to pass law quickly enough thus delegated legislation is preferred because it can easily be amended or revoked when necessary.

Technicality of the Subject Matter

Parliament may not have the necessary technical expertise or knowledge required for the needs of certain industry or local people for instance in the field of medicine, engineering and insurance among others.

Flexibility

The process of passing an act of parliament can take a considerable amount of time. It is a rigid process as all the stages must be followed. Delegated legislation is not bound by these steps.

Statutory Interpretation

The term statutory interpretation refers to the action of a court in trying to understand and explain the meaning of a piece of legislation. Legislative bodies take a lot of care in the drafting of legislation so as to ensure that there is no room for doubt as to the meaning and intention of the Act or regulation. Nevertheless, disputes arise quite frequently about the meaning of words used in both primary and subsidiary legislation. To find the meanings of statutes, judges use various tools and methods of statutory interpretation. The following are some of the rules which courts follow when interpreting and applying certain provisions of the statutes.

(i) The Literal Rule

When writing statutes, the legislature intends to use ordinary English words in their ordinary senses. According to the rule, words and phrases should be construed by the courts in their ordinary, precise and plain sense, and the ordinary rules of grammar and punctuation should be applied. In the **Case: Whitely v. chapel,** the defendant had voted in the name of a person who had died. A provision of a statute made it an offence to impersonate a person who is entitled to vote. The accused was set free because going by the literal interpretation, the person impersonated was not entitled to vote as he had died. In other words, there was no person to be impersonated.

(ii) The Golden Rule

The golden rule is an exception to the literal rule and is be used where the literal rule produces the result where Parliament's intention would be avoided rather than applied. Again, where the literal interpretation is used, it at times leads to absurdity and inconsistency. Under the golden rule, the literal meaning is modified by being given a reasonable meaning to avoid absurdity. One example of the application of the golden rule is the UK case of **R v Allen** where the defendant was charged with bigamy**,** an offence prohibited in Offences Against Persons Act 1861 which reads "whoever is married, marries commits bigamy." The court held that the word marries need not mean a contract of marriage as it was impossible for a person who is already married to enter into another valid contract of marriage. Hence, the court interpreted it as "going through marriage ceremony". The intention of the draftsmanship was: a person who purports to marry another while that person's wife/husband is still alive is guilty of bigamy.

(iii) The Mischief Rule

Under this rule, a judge attempts to determine the legislator's intention i.e. what is the mischief and defect that the statute in question was set out to remedy**,** and what ruling would effectively implement this remedy. The judge or magistrate will consider the meaning of the words in the Act in light of the abuse/mischief/defect which parliament had intended to eradicate. In the **Case: Smith v. Hughes,** The Street Offences Act of the UK made it an offence for a prostitute to solicit men 'in a street or a public place. The defendant stood on a balcony and hissed at men in order to attract their attention. The issue before the court was whether she was acting in contravention of the provision of the Act and secondly, which defect had the draftsman intended to eradicate. The court applied the mischief rule holding that the activities of the defendants were within the mischief the Act was aimed at.

In the case of **New Great Company of India v. E Cross (1966) EALR,** the insurer refused to pay a claim for a person who had been injured in a road accident because the driver did not have a valid driving licence at the material time. The court had to determine the mischief that parliament intended to solve by the enactment of the Insurance (Motor VehicleThird Party Risks) Act Chapter 405 of the laws of Kenya. The court held that the insurers were liable as the intention of the draftsman was to protect injured persons in road accidents.

1.6.4 Rules of English Common Law and the Doctrines of Equity

These are imported to the Kenyan Law under section 3 (c) of the Judicature Act. Their application however is limited to the extent to which courts find them compatible with the needs of the Kenyan people.

(a) The Common Law

The common law refers to a unified system of law that developed from the local customs of the people of England. The system developed through selection of the best customary rulings from the local courts in addition to general rules developed by central royal courts to create a uniform body of rules applicable in the whole of England. Originally, common law was used to refer to English law as a

whole but it is currently used to signify the unwritten law originating from ancient customs and also developed by judges guided by the principle of stare decis (let the decision stand) which principle is the origin of judicial precedents. Stare decis refers to the policy of courts to abide by or adhere to principles established by decisions in earlier cases. The common law system was rigid and technical in application leading to injustices. Those who felt that justice had not been done would petition the crown who would then refer the cases to the Lord Chancellor. This led to the development of equity. The common law system had a number of defects some of which are explained below.

The System of Writs was Inflexible and Expensive

A person seeking a remedy from the common law courts was required to obtain/purchase a document known as the original writ from the main Royal office. The writ served two main functions that is to ensure that the defendant appeared at the trial and secondly it outlined the cause of action. There were no writs for breach of trust. For one to get a remedy, the cause of action had to fit within the framework of the existing writ or show that it was similar to an existing writ. This system was therefore inflexible and the price of purchasing a writ was expensive.

Limited Remedies

The only remedy available at common law courts were an award of damages only that is, the financial compensation. The courts could not grant other orders for instance injunctions or specific performance (these will be explained in the next lecture).

Corruption

The rich and the powerful were able to bribe witnesses and the jury thus escaping justice and causing injustice to the parties who deserved it.

Procedure

There were elaborate rules governing the procedure to be followed hence any technical breach of the procedure would leave the claimant without a remedy even if they had a substantially good case.

(b)Equity

Equity in simple terms means fairness. It is a collection of rules which were developed to remedy some of the shortcomings of the common law. It is also referred to as a supplement of the common law. Those who were not satisfied at the common law would petition the king for a relief. The king passed over the petitions to the Lord Chancellor who was his spiritual advisor. This led to the establishment of the court of Chancery and the principles of equity were therefore administered through the court of chancery under the Lord Chancellor. In the case **The Earl of Oxford (1616),** it was held that whenever there was a conflict between common law and equity, equity should prevail. The two legal systems were later amalgamated into a single system. The principles and remedies of both systems were now being administered in any of the courts.

Contribution made by equity

- Granted other remedies not available at common law for example injunctions, specific performance among others;
- Recognized trusts hence a trustee would be compelled to administer the trust property in accordance with the terms of the trust;
- Recognized equitable doctrine of part performance;
- Introduced the principles of subrogation and contribution; and
- Recognized the doctrine of promissory/equitable estoppel.

These contributions will be explained in lecture two and four.

Principles of Equity

Equity was meant to create fairness and justice. It developed some of the following principles:

- Equity shall not suffer a wrong to be without a remedy;
- Equity follows the law i.e. equity will not allow a remedy that is contrary to law;
- Where there is equal equity, the law shall prevail (common law);
- Where there are two equities, the first in time prevails;
- He who seeks equity must do equity: This requires those seeking an equitable relief to complete all of their own obligations as well;
- He who comes to equity must come with clean hands;
- Delay defeats equity meaning that a person who has been wronged must act relatively swiftly to preserve their rights. The Limitations of Actions Act provides for time limits for seeking to enforce their rights in courts of law;
- Equality is equity (no one is superior before the law);
- Equity looks at the intent rather than the form; and
- Equity looks on that as done which ought to be done.

Reference of these principles will be made in subsequent lectures.

1.6.5 African Customary Law

Customary law may be defined as consisting of the unwritten norms, traditions and practices of the different communities in Kenya which dates back from pre-colonial times. Customary, religious and statutory laws operate within the same social context and cover similar ground, particularly in the areas of personal law, which include marriage, divorce, inheritance, custody and guardianship of children and land tenure. Some of the conditions for customs to be recognized and applied by courts include continuity, reasonableness, certainty, peaceful user, compulsion and should not contrary to written law. African customary law was only qualified to apply to civil matters as it was argued that it may create a different line of justice if applied in criminal cases for instance wife beating and incest. African customary law would only be allowed to apply if it is not repugnant to justice and morality. The parties involved must be either be subject to or affected by the law.

The Kenya Magistrates Courts Act defines customary law to refer to the following:

- Land held under customary law;

- Marriage, divorce, maintenance or dowry;
- Seduction or pregnancy of unmarried woman or girl;
- Enticement of or adultery with married woman;
- Status of women, widows and children; and
- Succession matters unless where there is a will.

The magistrates' courts have been given jurisdiction to hear disputes arising under customary law.

In the case HCCC no. 4873 of 1986 at Nairobi, a case involving Virginia Edith Wambui Otieno (the plaintiff) on the one hand, and the deceased's younger brother, Joash Ochieng Ougo (1st defendant) with a clan member and distant nephew of the deceased, Omolo Siranga (2nd defendant), concerning who had the legal right to bury the remains of the deceased and as to his place of burial. The presiding judge stated inter alia, ''The plaintiff, a Kikuyu by birth, chose to be married by a man who was not of her tribe. She knew she was marrying a Luo. He at no time, at least according to the evidence renounced his tribe or declared that, apart from marriage, he would not be bound or be subject to customary law where its application is permissible, and is not in conflict with a written law or repugnant to justice and morality.'' The plaintiff by virtue of her marriage to the deceased became subject to the Luo customs and traditions.

1.6.6 Islamic Law

The applicable rules emanate from the Quran. Its application is limited to the Kadhi's courts and parties to the dispute must be those professing the Muslim faith. Islamic law only applies to personal matters, marriage, divorce and inheritance.

1.6.7 Case law (Judicial precedents)

What is a precedent?

A precedent is defined as a decision in a previous legal case where the facts were similar to the case before the court. It is a judgement or decision of a court, normally recorded in law reports, used as an authority for reaching the same decision in subsequent cases. It is the legal principle which the judge relied on in determining the outcome of a case. The decision in the current case will be guided by the doctrine of stare decis i.e. let the decision stand (do not unsettle what is already established). The purpose of stare decis is to encourage fairness and create certainty in the law. However if the whole of the case is reported, the judge who is required to follow it must choose which parts of the earlier decision are binding on them, since some of the things said in the earlier decision may not be relevant to the case in hand. In fact the 'precedent' which the judge is bound to follow is not the earlier case as such but the principle established in it. This principle is known as the ratio decidendi.

The ratio decidendi consist of the facts of the case, the decision and reasons for the decision. When deciding a case, the judge or judges may say a number of things in passing. The comments may concern hypothetical situations (meaning situations which have not arisen in this particular case but which might occur), or concern questions which it is unnecessary to decide for the purposes of settling the dispute in question. Statements made by a judge which are not essential to the decision that is, things said as a by the way are known as obiter dicta and do not create binding precedents. They may however be persuasive. Persuasive precedents are influential but non-binding decisions. Examples of persuasive precedents include:

- decisions made in lower courts or courts of equal standing;
- decisions of courts outside the Kenyan judicial system; and
- textbooks, learned treaties and the law of other jurisdictions.

Where an existing principle is applied to a current case, this is referred to as a declaratory precedent. Where no legal principle exists, courts create new rules of law which acts as future precedents. Decisions of the High Court and Court of Appeal are recorded in annual volumes known as law reports. Magistrate's courts do not create binding precedents and their judgments are not reported in the Law reports.

Advantages of Case Law

Judicial precedents (case law) have advantages which are explained below.

Certainty

If judges were free to decide each case without any regard to principles laid down in previous similar cases, no person could be certain as to their rights or liabilities. Precedent therefore introduces a strong element of certainty as people know the law and what is likely to happen. This allows people their affairs with reasonable confidence.

Possibility of growth with changing needs

The system of precedents allow for the possibility of development and growth. Although the courts cannot create entirely new rules the scope of existing precedents can be extended to new situations which arise.

Rich in Detail

The system of precedent gives Kenyan law a wealth of detailed decisions and rulings. All the rules of Kenya case law derive from real situations which have come before the courts, the decisions deal with practical matters.

Flexibility

Where a judge is able to effectively distinguish a current case with an earlier decision, the court will not be compelled to follow the past decided case. The law can also change since the highest courts can overrule cases. Distinguishing cases also give all courts some freedom to avoid past decisions and develop the law thus creating some flexibility in the realm of precedents.

Disadvantages of Case Law

Precedents have various disadvantages some of which are explained below.

Rigidity

Precedents are rigid since lower courts must follow decisions of higher courts due to the binding nature of precedents. Bad decisions made in the past may be thus be perpetuated. Changes in the law will only take place if parties have the courage, persistence and money to appeal their case and subsequently a decision is overruled by a higher court.

Slow in Development

The growth of the law through precedents is dependent entirely upon litigation. Judges and magistrates may be aware that some areas of law are in need of reform, but they cannot make a decision unless there is a case before the courts to be decided.

Bulk and Complexity

With the increase in decided cases, it may be difficult to find all the relevant case law even where there is data in the computers. The risk of lawyers failing to draw to the court's attention to an important previous decision is likely to arise because of the bulkiness of a past decided case.

Creation of Artificial Distinction to Avoid Following the Earlier Decision

This may lead to injustice as one may be a winner in a case that they would have lost defeating the purpose for which the judiciary is established.

Obscurity

This arises where more than one judge sits hears and determines a case before the court. The judges may arrive at the same decision but with different reasons for the decision. The question arises as to which of the reasons forms part of the ratio decidendi.

1.7 THE STRUCTURE OF COURTS IN KENYA

The judiciary is one of the three most important institutions of the state, along with the executive and the legislature. The judiciary consists of judges, magistrates and staff to assist them in their judicial work and in administration. The Kenya Constitution 2010 creates an independent judiciary consisting of the courts of law and tribunals. The Chief Justice is the head of the judiciary, and is appointed by the President on the recommendation of the Judicial Service Commission. The appointment is subject to the approval of the National Assembly. The judiciary's role is determining disputes and ensuring justice is given. It is the institution that interprets and enforces the law. There are various levels of courts and a discussion of the powers of each is given hereunder.

1.7.1 The Supreme Court

Under the Kenya constitution, the Supreme Court is the highest court in Kenya. The Chief Justice is the President of the Supreme Court. This court also comprises the Deputy Chief Justice and five other judges. Prior to the enactment of the Constitution of Kenya, 2010, the Court of Appeal had assumed this position. The Supreme Court is the only court that can hear and determine a case challenging the election of the President. The court also attends to appeals from the Court of Appeal, the High Court and other courts and tribunals. It is created under Article 163 of the constitution which article also provides its mandate. The Supreme Court has the following powers:

- Exclusive original jurisdiction to hear and determine disputes relating to election to the office of the president;
- Appellate jurisdiction on appeals from the court of appeal;
- Disputes on the interpretation of the constitution;
- Matters of national importance.

Original jurisdiction refers to the power of a court to hear a case at first instance. Appellate jurisdiction will arise where one is not satisfied with the decision of a court hearing their case and files a petition (appeals) to a higher court.

1.7.2 The Kenya Court of Appeal

The Court of Appeal is established under Article 164 (1) of the Constitution which provides for the establishment of the court of appeal consisting of the number of judges, being not fewer than twelve and headed by a president of the Court of Appeal who shall be elected by the judges of the Court of Appeal from among themselves. The Court of Appeal is the second highest court in Kenya for both civil and criminal matters. It was established in October 1977 through the Constitutional Amendment Act 1977. The establishment of the Court of Appeal was due to the collapse of the East Africa Community. Prior to this, the E.A. court of Appeal was the final appellate court in Kenya, Uganda and Tanzania.

The court of appeal does not have original jurisdiction hence cannot hear a matter at first instance. However, it has appellate jurisdiction in criminal, civil, constitutional and political matters. Appeals are normally heard by three (3) judges and decisions are by majority and are brought by way of petition. The Court of Appeal has jurisdiction to hear appeals from the High Court and any other court or tribunal as prescribed by an Act of parliament. Appeals must be filed within 14 days.

The Court of Appeal has power upon hearing an appeal to:

- Uphold the decision of the lower court;
- Reverse the decision;
- substitute another judgment;
- Overrule the decision; and
- Order a new trial.

1.7.3 The High Court

The High Court of Kenya is created under article 165 of the Constitution. It is the third highest court in Kenya. The High Court has unlimited original jurisdiction in criminal and civil matters. The court also has supervisory powers over the subordinate courts. The Constitution provides that there shall be a Principal Judge of the High Court, who shall be elected by the judges of the High Court from among themselves. The High Court has divisions which include Family, Commercial and Admiralty, Constitutional and Judicial Review, Land and Environment, Criminal and Industrial Court. There are at least 20 High Court stations countrywide. The high court has unlimited original jurisdiction in both civil and criminal matters and has the following powers:

- Determining the question whether a right or fundamental freedom in the Bill of Rights has been denied, violated, infringed or threatened;
- Hearing appeals from a decision in lower courts and tribunals;
- Hearing any question relating to the interpretation of this Constitution including the determination of the question whether any law is inconsistent with or in contravention of the constitution;
- Determining any matter relating to constitutional powers of State organs in respect of county governments and any matter relating to the constitutional relationship between the levels of government;
- Hearing any question relating to conflict of laws;
- Jurisdiction over matters arising on the high seas, territorial waters or other navigable inland waters in Kenya. The law applicable is English law and jurisdiction shall be executed in conformity with international law; and
- Supervisory jurisdiction over the subordinate courts and over any person, body or authority exercising a judicial or quasi-judicial function, but not over a superior court.

The Constitution provides that in exercising its supervisory powers, the High Court may call for the record of any proceedings before any subordinate court or person, body or authority and may make any order or give any direction it considers appropriate to ensure fair administration. The court may issue orders, writs, summon or directions. One can only invoke supervisory jurisdiction after exhausting all other remedies and rights of appeal. The order it can issue are discussed below.

Writ of Habeas Corpus

This relates to where one has been arrested and detained in custody without justification contrary to freedom of liberty guaranteed in the constitution The Constitution provides that where a person has been arrested, he/she is to be brought before a court as soon as reasonably possible, but not later than twenty-four hours after being arrested. If such person continues to be held, any person on his behalf may request the High Court to obtain his release by issuing the writ of habeas corpus. The High Court will direct that the person be released or be produced in court.

Certiorari

This is an order issued by a superior court, directing an inferior court, tribunal, or other public authority to send the record of a proceeding for review. The order is issued by the high court to an inferior court or body exercising judicial or quasi judicial functions calling for the record of the proceedings in a given case. Intervention of the High Court may be sought by a person through a petition to the High Court due to the following:

- To secure an impartial trial;
- Review excess jurisdiction;
- Challenge an ultra vires act; and
- Quash a judicial decision that contradicts the rules of natural justice.

Prohibition

This is a court order preventing an inferior court from hearing a case or stopping the inferior court from continuing to hear a case that is before it due to the reasons cited above under certiorari.

Mandamus

This is an order from the high court to any subordinate court, state corporation, or public authority compelling them to do (or forbear from doing) some specific act which that body is obliged to do (or refrain from doing) under the law. It cannot be issued to compel an authority to do something against statutory provision. Mandamus may be a command to do an administrative action or not to take a particular action, and it is supplemented by legal rights. A person can be said to b,e aggrieved only when he is denied a legal right by someone who has a legal duty to do something and abstains from doing it.

Other Powers of the High Court

The high court has power to pass any sentence ranging from capital punishment to a fine. Decisions of High Court judges are binding on magistrates and Kadhi's courts. They however do not bind other judges of the same court although in practice, they follow the decisions unless they have strong reasons for not following them. The Attorney General files cases for acquittals in the High Court. Election petitions, defamation cases and divorce petitions are also heard in the High Court.

The constitution mandates Parliament to establish special courts to determine disputes related to employment and labour relations, land and environmental matters. These special courts have equal status with the High Court. The High Court does not have any jurisdiction over matters handled exclusively by these special courts.

Qualifications of a High Court Judge

For one to be appointed as a judge of the High Court, the must meet the following criteria:

- He/she has been a judge of a court having unlimited jurisdiction in civil and criminal matters in some part of the commonwealth; and
- An advocate of the High Court of not less than 7 years standing.

Removal of a Judge from Office

Article 168 of the constitution provides for the circumstances under which a judge may be removed from office. They include:

- Inability to perform the functions of office arising from mental or physical incapacity;
- A breach of a code of conduct prescribed for judges of the superior courts by an Act of Parliament;
- Bankruptcy;
- incompetence; or
- Gross misconduct or misbehaviour.

The constitution makes provision for retirement age of a judge at the age of seventy (70) years.

1.7.4 Kadhi's Court

The Kadhi's courts are established under Article 170 of the Constitution which provides that parliament shall establish Kadhi's courts each of which shall have jurisdiction and powers conferred on it by legislation. Their jurisdiction is limited to matters of personal status, marriage, divorce and inheritance. Parties to the dispute must be those who profess the Muslim faith and submit to the jurisdiction of these courts. The Chief Kadhi hears a case is assisted by other Kadhis not being fewer than three. The Kadhis are appointed by the Judicial Service Commission.

Qualifications of a Kadhi

For one to be appointed a Kadhi, the following are the requirements:

- Must profess the Muslim faith;and
- Must possess knowledge of Muslim Law applicable to any sect or sects of Muslims.

1.7.5 Magistrates' Courts

These are established under article 169 (1) of the constitution which also provides that Parliament shall enact legislation conferring jurisdiction, functions and powers on the courts. The Magistrates Courts Act No. 26 of 2015 provides for the jurisdiction of these courts. A magistrate's court is subordinate to the High Court and is presided over by a chief magistrate, a senior principal magistrate, a principal magistrate, a senior resident magistrate or a resident magistrate.

The Magistrates Courts can hear cases all over Kenya and are empowered to exercise original jurisdiction at first instance. They have unlimited powers to hear matters relating to customary law. Their jurisdiction is limited in terms of the value of the subject matter. In civil matters for instance, their jurisdiction is as follows:

(a) twenty million shillings, where the court is presided over by a chief magistrate;
(b) fifteen million shillings, where the court is presided over by a senior principal magistrate;
(c) ten million shillings, where the court is presided over by a principal magistrate;
(d) seven million shillings, where the court is presided over by a senior resident magistrate; or
(e) five million shillings, where the court is presided over by a resident magistrate.

Their mandate in criminal cases is conferred under the Criminal Procedure Code Cap. 75 of the laws of Kenya and other written laws. A Magistrate's Court has the authority to hear all criminal cases

except murder, treason and crimes under international criminal law. They can hear cases of manslaughter, robbery with violence, arson, rape and offences whose sentence is life imprisonment or death. In criminal cases, there are limitations in terms of the maximum jail terms, fine or corporal punishment they can impose. Magistrates' courts have also been given power to punish a person for contempt of court both in civil and criminal matters.

A magistrate's court has limited jurisdiction to hear and determine:

- Applications for redress of a denial, violation or infringement of, or threat to, a right or fundamental freedom in the Bill of Rights;
- Claims relating to employment and labour relations; and
- Land and environmental cases.

Appeal must be done within 14 days from the date of the decision. The Appeal does not operate as a stay of execution. Even if an appeal has been lodged, and all parties served, the decree holder can proceed and apply for execution. However the judgment debtor can apply for a stay of execution on the ground that an appeal is intended or that an appeal has been filed

1.7.6 Court Martial

The Court Martial is established under section 84 of the Armed Forces Act. The court has jurisdiction to hear cases of indiscipline within the armed forces. Jurisdiction is penal or disciplinary and designed to ensure discipline in the Armed Forces. Some of the cases that can be tried by the court include insubordination, cowardice, fraud, theft, aiding an enemy and neglect of duty. Appeals from the decisions of the court martial lie with the High Court, which must grant leave before the appeal is heard. The court is presided over by a senior officer of the armed forces and two soldiers and are assisted by a judge/advocate who gives opinions on matters of fact and law

1.7.7 The Industrial Court

The Industrial Court is created under Article 162 (2) of the Constitution of Kenya 2010 with the mandate of settling employment and Industrial relations disputes. This Court is also given power to further, secure and maintain good employment and labour relations in Kenya. The Industrial Court is a superior court of record with the status of the High Court and shall and exercise jurisdiction throughout Kenya. The court has exclusive original and appellate jurisdiction to hear and determine all employment and labour related disputes referred to it in accordance with the provisions of the Constitution and those of the Industrial Court Act or any other written Law. The court is headed by a principal judge and other judges appointed by the president with the recommendation of the Judicial Service Commission. Some of the disputes heard in the Industrial Court include but not limited to the following:

- Those relating to or arising out of employment between an employer and an employee;
- Between an employer and a trade union;
- Between an employer's organisation and a trade union's organization;
- A trade union against another trade union;

- Between an employer's organisation and trade union;
- Between a trade union and a member; and
- Disputes relating to the registration and enforcement of collective agreements.

The Industrial Court can issue the following orders:

- An injunction in cases of urgency (either prohibits or commands a person)
- A prohibitory order (prevents a person from doing)
- An order for specific performance (compels one to do something they are bound to do)
- A declaratory order
- An award of damages (monetary compensation)
- An order for reinstatement of any employee within three years of dismissal, subject to such conditions as the court thinks fit to impose

1.7.8 Tribunals

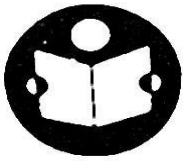
Article 169 of the Constitution establishes subordinate courts which includes tribunals. The tribunals derive their mandate from the specific Act of parliament which creates them. Tribunals in Kenya are institutions created to help courts in the administration of justice. The main intention of creating tribunals is to ease the burden in the courts. The tribunals, however, do not have penal/criminal jurisdiction. They are set up by law to adjudicate disputes that arise out of the statutes creating them. They deal with the administration and enforcement of the Act concerned. For example, the Rent Tribunal determines questions arising out of the Administration and Rent Restriction Act and the Business Rent Tribunal, which deal with controlled commercial tenancy. Tribunals, like the courts, have to respect the Bill of Rights in their decisions and not be repugnant to justice and morality or be inconsistent with the Constitution or other laws of the land. Most tribunals are subject to the supervision of the High Court.

Section 169 (2) of the Insurance Act Cap. 487 of the laws of Kenya creates a tribunal consisting of a chairman, a vice-chairman and a minimum of two and a maximum of four other members appointed by the Minister and shall hold office for such period and upon such terms and conditions as the Minister may determine. The main mandate of the tribunal is to hear appeals arising under the Act.

Powers of Tribunals

- On hearing appeals, the tribunal has all the powers of a Resident Magistrate's Court of the first class to summon witnesses, to take evidence upon oath or affirmation and to call for the production of books and other documents;
- have power to award the costs of any proceedings before it; and
- Where it considers it desirable for the purpose of avoiding expenses or delay or any other special reason so to do, it may receive evidence by affidavit and administer questions.

1.8 SUMMARY



In this lecture, you have learned that;

- The law is important in regulating business activities and controlling the behavior of people in society;
- The law is has various classifications namely private and public, civil and criminal, procedural and substantive and international and municipal ;
- There are different sources of law in Kenya and they include the constitution, legislation(acts of parliament), customary law, Islamic law, common law and doctrines of equity from England, judicial precedent (case law);
- The supreme law making authority is parliament which may delegate such functions to other competent bodies county governments(by-laws) and ministries (rules and regulations); and
- There are various courts with distinctive jurisdiction (powers) to carry out their mandates. Such courts include the Supreme Court, the Court of Appeal, the High Court and Magistrates courts.

1.9 ACTIVITY

1. Outline the sources of law of Kenya.
1. Describe the stages in the law making process.
2. Explain the difference between legal rules and moral rules.
3. The High Courts in Kenya exercise supervisory powers over subordinate courts and tribunals. Explain the orders that such courts may issue.
4. Describe the features of civil law.
5. Explain the reasons why the parliament may delegate their legislative authority.
6. Outline the principles of equity.

1.10 READING LIST

i. The Constitution of Kenya of Kenya, 2010
ii. General Principles and Commercial Law of Kenya by Ashiq Hussain
iii. General Principles of Law Simplified by N.A. Saleemi
iv. Past papers

LECTURE TWO

2.0 THE LAW OF CONTRACT

LECTURE OUTLINE

2.1 INTRODUCTION

In lecture one, you covered the purpose, classification and sources of law. You also learnt about the structure and powers of the courts.

In this second lecture, you are expected to understand the requirements of a valid contract and circumstances under which such contracts may be brought to an end. You will be able to interpret the terms used in contracts, factors that affect the validity of a contract and the remedies available to the aggrieved party in case of breach of a contract.

2.2 LEARNING OUTCOMES

By the end of this lecture, you should be able to:

a) Explain the nature of contracts;
b) Explain ingredients of a valid contract;
c) Explain terms of contracts;
d) Describe vitiating factors;
e) Explain the methods of discharging a contract;
f) Explain the doctrine of privity of contract;
g) Discuss assignments in contracts; and
h) Describe the remedies available for breach of contract.

Competence
The trainee should have the ability to identify the elements of a valid contract in business

Content
Let us now start by explaining the nature of contracts

2.3 NATURE OF CONTRACTS

What is a contract?

A contract is a legally binding agreement, that is, one which the courts will recognize and enforce. A contract creates rights and obligations to the parties. Contracts are made for many purposes besides insurance e.g. contracts for the sale of goods and land, contracts of carriage of goods, contracts of hire, contracts of employment and many others. The law of contract is applicable to insurance practice and is handled in the next lecture. This lecture therefore concentrates on various aspects general contracts.

2.3.1 TYPES OF CONTRACTS

There are three types of contracts and they include the following;

(i) Specialty Contracts/Contracts Under Deed

A specialty contract is a formal agreement which must be in writing, signed, witnessed, sealed and delivered. Delivery can be actual (mere handing over) or constructive (formal). Such a contract is also referred to as a contract under seal or deed. Where delivery takes place at a future date, the deed is known as escrow. Examples of contracts under seal include conveyances of land, leases of over three years and conditional bills of sale, among others. Such contracts will still be binding even in the absence of consideration.

(ii) Simple Contracts

Simple contracts are informal in nature and can be made orally, in writing, partly oral and partly written rather a contract made under seal. A simple contract can be implied by conduct of the parties. For simple contracts to be valid, they need to be supported by consideration. Insurance contracts are mainly simple contracts.

(iii) Contracts of Record

A contract that is declared by a court and entered into the court's record is known as a contract of record. The records are conclusive proofs of the facts appearing thereby and could be formerly enforced by action of law as though they had been put in the shape of a contract. Examples include court judgments in civil matters and personal cognizances in criminal cases. They are not true contracts since the obligations are imposed by the courts.

2.3.2 Other Terminologies used to describe Contracts

There are certain terms that are used when describing contracts. An explanation of each of them is given below.

Unilateral Contracts

Unilateral contracts refer to those where only one party makes promises and the contract is only binding to one party. For example, where one promises a reward for whoever finds their lost property, this will only bind the party who makes such a promise if the property is found by another.

Bilateral Contracts

In bilateral contracts, each party makes promises and both are legally bound by their promises and an example is in insurance contracts where the insured promises to pay premiums and comply with policy terms and the insurer undertakes to pay claims that may arise.

Void Contracts

A void contract is one which has no binding effect on either party. A void contract is no contract at all since neither party can fully enforce it in a court of law. A contract is void when:

- A basic ingredient is lacking for example offer and acceptance;

- It is made under mistake;
- It is made with minors and disallowed under the Infant's Relief Act; and
- Its consideration or the object is unlawful

Voidable Contracts

Voidable contracts on the other hand are binding and enforceable on either one party or both parties. The parties however may insert a term to allow either party to avoid a contract. A contract may be voidable because of misrepresentation, insanity among other reasons. It may be set aside at the option of the aggrieved party. The aggrieved party must however do this within a reasonable time.

Unenforceable Contracts

Unenforceable contracts are generally valid contracts. If one party refuses to keep the agreement, the contract cannot be enforced against the other party. An example is where the insured fails to pay the premium and suffers a financial loss, the court cannot compel the insurer to honour the claim. Such a contract can be useful for other purposes for example, it can be used as a defence to a claim.

Contracts that must be in writing Otherwise they will be declared Void.

Examples of these contracts include:

- Those that require to be stamped for example bills of exchange and promissory notes;
- Acknowledgment of statute barred debts;
- Transfer of immovable property; and
- Representation of character of creditworthiness.

There are also Contracts that must be supported by written evidence otherwise unenforceable. Examples include:

- Contracts of guarantee;
- Contracts for sale of land;
- Contacts for sale of goods;
- Hire purchase agreements;
- Contracts of employment; and
- Money lending contracts.

A written contract must contain some of the following details:

- Details of the parties;
- Description of the parties;
- Description of the subject matter;
- Signature of the parties; and
- Consideration.

2.4 INGREDIENTS OF A VALID CONTRACT

Since the meaning and types of contracts has already been explained, let us now explain the essentials of a valid contract. A valid contract has all the ingredients of a contract and is therefore binding and enforceable in law. The essentials (ingredients) of a valid contract are the key elements which must be present in such a contract for it to be legally enforceable. They are:

- The must be offer and acceptance (agreement);
- The parties must have intention to create legal relations;
- There must be consideration;
- The parties must have capacity to contract;
- The contract may be in a certain form; and
- The objects of the contract must be legal.

2.4.1 Offer and Acceptance

For a legally binding agreement, there must be a party making an offer and another party accepting the offer.

a. Offer

What then is an offer?

It is a proposal made by one party known as the offeror to another party known as the offeree to buy or sell goods or services. It can be made orally, in writing or implied by conduct. Note that an offer can be made to one person, a group of persons or to the public as a whole. An offer has to be accepted unconditionally for an agreement to be come into existence. In procurement processes, invitations to tender may be made through advertisements. The party who submits tenders makes an offer for the supply of goods or services and acceptance takes place once the tender is accepted and effective communication done. In auction sales on the other hand, invitations are made by the auctioneer, the bidders make the offer and acceptance is at the fall of the hammer.

Offer and Invitation to Treat

We need to distinguish between offers from an invitation to treat. An invitation to treat is a statement made during negotiations while an offer is a proposal to buy or sell. Acceptance of an invitation to treat does not amount to an agreement while an offer is legally binding.

Case example

Carlill vs. Carbolic Smoke Ball Co. (1893)

Facts: the defendants were manufactures of smoke balls, a medicine which they claimed would prevent all sorts of illnesses. They promised in an advert to pay 100 pounds to anyone who caught influenza after using the smoke ball. The plaintiff relied on the advert, bought the smoke ball, and used it as prescribed but caught influenza. The defendants argued that they did not make an offer to

anyone specifically and secondly that their advert amounted to an invitation to treat. It was held that the advertisement amounted to an offer made to the whole world and the defendants were therefore liable.

Case example

Fisher v. Bell (1960)

Facts: This is a criminal case where a shopkeeper was charged with offering for sale a flick knife contrary to the Restriction of Offensive Weapons Act. It was held that displaying the knife in his shop window was not an offer but a mere invitation to treat. He was not found guilty and set free.

Essentials of a Valid Offer

Note that for an offer to be valid, it must have certain essentials which are:

- The terms of the offer must be clear;
- It must be communicated so as to make the other party aware;
- The offer must contemplate to give rise to legal relations;
- The offeror can not bind the offeree without his consent; and
- The offeror may attach any conditions to the offer but must communicate them to the offeree before they bind him by his acceptance of the offer.

Point to note

You should note that an offer does not remain open indefinitely and once it comes to an end, it can no longer be accepted. An offer can come to an end in the following ways:

A Time Limit or a Reasonable Time

Where the offeror imposes a time limit for acceptance and the offeree does not accept within that time, the offer terminates. Example is an offer to buy shares in a stock exchange market which remains open for a stipulated period of time. Where the offer is silent about time, it lapses after a reasonable time and this will depend on the nature of the contract and the circumstances of each case.

Death

The death of either party before acceptance will terminate the offer. Death after acceptance will not affect most contracts except contracts for personal services.

Acceptance of Offer

Acceptance of an offer will complete the contract and bring the offer to an end. An offer lapse by not being accepted in the manner prescribed.

Revocation of Offer

An offer may be revoked (withdrawn) by the offeror at any time before acceptance. This can be done even where the offeror has promised to keep the offer open for a definite period of time. However, where the offeree has paid money or given something of value in return for the promise to keep the offer open (known as the buying option), the offeror will be liable to pay damages. Revocation of an offer is governed by certain rules and they include the following:

- Revocation of an offer must be communicated to the offeree either by words or conduct. It can be made to the offeree directly or through a reliable source.
- Revocation by post does not take effect until it is received by the offeree
- Where the offeror promises to keep the offer open for a specified time (option) either orally or in writing, he is not bound unless there was acceptance, the promise is supported by consideration or the promise was made under seal.

Case example

Dickson vs. Dodds (1876)

Facts: The defendant offered to sell his house to the plaintiff but sold it to another person before acceptance. It was held that the offer had been duly revoked since revocation had been communicated to a friend to the plaintiff whom the court stated was a reliable source.

Counter Offer or Rejection

If an offeree rejects the offer, it automatically terminates. If the offeree later changes and makes a counter offer, and then the offeree becomes the offeror. If the acceptance is subject to conditions, then it amounts to a counter offer which has the effect of destroying the original offer. A counter offer operates as a rejection as well as a fresh offer. **In Hyde v. Wrench** the defendant offered to sell his farm to the plaintiff at 1000 pounds. The plaintiff made a counter offer of 950 pounds which the defendant refused. The plaintiff tried to accept the original offer which the defendant rejected. The defendant was held not liable as his counter offer had terminated the original offer.

b. Acceptance

Acceptance is willingness to be bound by the terms of the offer. For acceptance to be valid requires certain conditions to be fulfilled and they include the following:

- Acceptance can either be through words either spoken or written or can be implied by conduct;
- Acceptance must be unqualified meaning that it must exactly match the terms of the offer. If the offeree tries to vary or add conditions of their own, it is ineffective as acceptance. A qualified acceptance of this nature operates as a rejection of the original offer or takes the effect of a counter offer. Trivial variations from the original terms of the offer will not affect the validity of acceptance;
- There must be some positive act of acceptance. Acceptance cannot be by silence or doing nothing;
- Acceptance must be made in the manner prescribed and the time stipulated by the offeror; and
- Acceptance is not effective until it is communicated by the offeree or their authorized agent.

However, there are two exceptions to this rule:

(i) Where the offer dispenses with communication that is, the terms of the offer indicates that the other party can accept by carrying out their part of the agreement; and
(ii) Where the offer is made through the post.

What is the posting rule?

The offeror may specifically require that acceptance of an offer be made through the post office. Acceptance will be governed by the posting rule which provides that a letter of acceptance is effective the moment it is posted and a binding agreement entered into from that time. Note that a contract can be made even where the letter of acceptance never arrives. For the posting rule to apply, the letter must be properly addressed, stamped and posted. It must also be reasonable to use the post unless the offeror has stated that it be by other means.
There are exceptions to the posting rule and these are:

- The offeror may make it clear that the acceptance be actually communicated to them that is acceptance must be heard; and
- Offers made to the world at large, acceptance is by some act without notification of acceptance as illustrated in the case of **Carlill v. Carbolic Smoke Balls.**

Note that acceptance once made cannot be revoked as this will amount to breach of agreement.
There are certain instances where parties do not intend to be bound until a formal contract has been agreed. This is referred to as acceptance subject to the contract. Agreement to agree in future refers to where it is not open for parties to reach an agreement on most of the main terms and leave others to agree in future. This will amount to a contract to making another contract. In contracts, there may be provisional agreements where parties intend a document to be evidence of an agreement binding from the outset but to be replaced by a fully legalised document. An example is cover notes which are later replaced by the policy document (already discussed in Principles and Practice of Insurance).

2.4.2 Intention to Create Legal Relations

It is important to note that there may be no contract if the parties did not intend their arrangements to be legally binding and enforceable. Courts will also not enforce agreements coming before them unless there is sufficient evidence to prove existence of intention to create legal relations. Whether or not parties intend to create legal relations is a question of fact to be inferred from the circumstances of the case. In a situation where the parties insert an express term of the agreement to the effect that it is not legally binding, courts may not enforce but this will depend on the nature of the contract and the intention of the parties.

Case example

Rose & Frank v. J R Crompton & Bros ltd (1925)
Words in the agreement, 'this arrangement is not entered into……..as a formal or legal agreement and shall not be subject to the legal jurisdiction of the courts.' The court held that the agreement was not legally enforceable.

Will the courts enforce the following agreements?

(i) Social and Domestic Arrangements

It is assumed that social arrangements and day to day family matters are not intended to have legal consequences. They are not legally binding unless strong evidence of contractual intention can be found.

Case example

Balfour vs Balfour (1919)
It was held that the husband's promise to pay monthly allowance to the wife was not legally binding even though his work had taken him abroad. It would not be implied from the circumstances that it was meant to be legally binding

Case example

Simpkins vs Pays
Facts: The defendant, her grand-daughter and the plaintiff agreed to submit in the defendant's name a weekly coupon in the newspaper and share the prize. When the defendant received the prize, she refused to share. It was held that the arrangement was intended to be legally binding.
(ii) Collective agreements between trade unions and employers are assumed not to be legally binding unless there is a written contract stating the contrary

(iii) Contracts of engagement (promise to marry) are not intended to create legal relations

(iv) Commercial or business agreements, courts assume them to be legally binding unless there is strong evidence to the contrary.

2.4.3 Consideration

What is Consideration?

You are required to understand the concept of consideration and its significance in transactions.

Consideration has been defined in the case Currie vs. Misa (1875) as some right, interest or profit accruing to one party, or some forbearance, detriment, loss or responsibility given, suffered or undertaken by the other. A contract should be seen as a promise and courts will not enforce a promise not supported by consideration. We have seen that simple contracts, they are not binding unless they are supported by consideration. Consideration is therefore the price which supports a promise.

Consideration signifies some benefit or advantage going to one party or some loss or detriment going to another party. It may be a benefit or a profit to the promisor and a detriment to the promise. However, in many cases the detriment to the promisee is also a benefit to the promisor and vice versa- each party gains a benefit and suffers a detriment. Note that consideration in simple contracts may either be executed meaning that the value has already been given by the promise for example in sale of goods on credit or can be executory meaning a promise to do something in future. However, a legally binding agreement may come into effect before the benefit of the consideration is conferred on the other party provided there is a firm promise to do so.

Rules That Govern Consideration

Let us now look at the rules that have been established by courts to help in resolving disputes relating to consideration. These rules are described below.

Consideration Must be Real or Genuine

This means that courts will not enforce vague promises or where there is no real benefit or detriment at all. The consideration sought need to be capable of financial valuation.

Case example

White vs. Bluett (1853)

Facts: The plaintiff sued the executors for a promise by his father to pay him some money to cease complaining that he was not treated well as his brothers. The father had made the promise while he was alive but died before fulfilling the promise. The court held that the promise was too vague for a real consideration.

Consideration Need Not Be Adequate

This means that the value given need not be worth or equivalent to what is given in exchange. If one makes a bad bargain, courts will not step in to help.

Consideration Must Not Be Past

Consideration must be given in exchange for the promise which it supports that is, the two must be linked from the beginning. It follows that when services have already been given for free, a promise to pay for them made afterwards is not good consideration. However, there are exceptions to this rule which are:

(i) If the act was done at the request of the promisor and the understanding was that payment was to be made;and

(ii) When a debt the payment of which is statute barred is revived by a fresh promise in writing.

Consideration Must Move From the Promisee

A contract is an agreement between two or more persons. Under the doctrine of privity of contract (it will be discussed later in this lecture), the duties arising under a contract can only be enforced by or against the original parties to the contract. This rule therefore provides that a third party cannot enforce a promise if he was not a party to the contract. Consideration can only move from the promisee. However, there are circumstances under which a third party may enforce a contract and these may include the following:

- Under the law of trust, a beneficiary may enforce a contract entered into by a trustee;
- The Insurance (Motor Vehicle Third Party Risks) Act Cap. 405 of Kenya makes provisions that allows authorised drivers and injured third parties to enforce motor insurance contracts;
- The doctrine of assignment allows an assignee of a debt to enforce a contract as provided for under statute or under equity; and
- A holder of a bill of exchange can also sue if the drawee fails to pay for example an insurance agent who receives premium payment in form of cash from the insured and issues a cheque to the insurer. If the cheque is returned unpaid, the agent can be sued.

A further discussion of these exceptions will be detailed later in this lecture and the next one.

Consideration Must Be Legal

The purpose for which the consideration is being given must not one prohibited by the law or against public policy. If one contracts another to commit a crime and fails to pay, the other party cannot enforce such an agreement in a court of law.

Consideration Must Not be Something Which the Promisee is Already Bound to Do

The purpose of this rule is to prevent extortion by people who threaten to break their contracts unless they are paid extra**. In the case of Stilk vs. Myrick (1809),** employees were unable to enforce a promise by the employer to the effect that salaries for there colleagues who deserted work would be shared among those who remained after completion of work.

The Doctrine of Equittable/Promisory Estoppel

This is used by courts to minimise the harsh effects of the requirement in simple contracts that they must be supported by consideration.The doctrine means that where one has made a promise and the other acts on the basis of the promise, the court will treat the promise as binding upon the promisor though not supported by consideration.The doctrine can be used as a defence. However, the defendant will not be allowed to claim unless they acted fairly.

Case example

Central London Property Trust vs. High Trees House

Facts: The plaintiffs who were landlords rented out a block of flats at 2,500 pounds a year. When the Second World war broke out, they agreed to reduce the rent to 1,250 pounds a year from 1941. After the war in 1945, they moved to court seeking full rent from 1941 arguing that there was no fresh consideration for their reduced rent. The court held that it would be inequitable to allow them go back on their promise. They were only entitled to full rent from 1945.

Point to note

Equitable estoppel operates as a shield (defence) and not a sword (a weapon of attacking the other party). For one to plead equitable estoppel, the following must be proved:

(i) That there existed an original agreement between the parties;

(ii) There arose a new agreement out of the original agreement and there was no consideration given by the promisor; and

(iii) The promisee relied on the promise and acted to his detriment.

2.4.4 Contractual Capacity

Who can enter into contracts?

The law presumes every person to be competent to enter into contracts. However, some persons are subject to special rules that restrict their capacity to contract. Note that lack of contractual capacity renders a contract void, voidable or unenforceable. Certain legal persons have limited contractual capacity. The affected class of persons includes minors, insane and drunken persons. A discussion of each is given below.

(i) Minors

The Age of Majority Amendment Act of 1974 places the age of majority (for one to be considered an adult) at 18 years. The Infants' Relief Act of 1874 of England governs contracts entered into by minors in the UK. The purpose of the Act is to protect minors from being exploited by traders and money lenders who may take advantage of their inexperience. The Act also protects adults from hardships caused to them when they deal with minors. Contracts entered into with minors fall into four categories as discussed below.

Contracts which are Binding (valid)

A minor is bound by contracts for necessaries and beneficial contracts. Necessaries are goods and services that are suitable to the condition in life of the infant and his actual requirements at the time of sale and delivery. Necessaries include food, clothing, shelter, education, legal advice and the like. A minor is liable to pay for necessaries but the burden of proof will be on the plaintiff to prove the quality and condition of the goods. A money lender can recover money lend to a minor if he can prove that the money was for the purchase of necessaries. The law requires that a minor only pay a reasonable price for the goods.

Point to note

The necessaries that a minor may purchase must be appropriate to their station in life. In the case of **Clyde vs. Hargreaver (1898**), a racing bicycle was held to be a necessary.

Beneficial contracts on the other hand refer to those entered into for purposes of education and training. However, such contract is binding on the minor provided it is as a whole beneficial to the minor.

Case example

Doyle vs. White City Stadium

Facts: An under age boxer was held to be bound to a clause in his contract which stated that he would loose his prize money if for certain reasons he was disqualified. It was held that the contract was whole for his benefit and therefore binding.

Note that a minor can successfully sue for his salary for services rendered though he was limited in capacity to enter into employment contracts.

Contracts not Binding on the Minor (void)

Examples of contracts not binding on the minor include:

- Contracts to buy goods which are not necessaries;
- Contracts to lend or borrow money;
- Accounts stated with infants i.e. acknowledgement of debts;
- Where a minor orders for goods but subsequently refuses to take them; and
- Trading contracts where infants buys goods on credit for sale.

Case example

Merchantile Union Ltd vs. Ball (1937)
Facts: A minor obtained a lorry on hire purchase terms but failed to pay. It was held that trading contracts whether beneficial to the minor or not are not binding on the minor.

Voidable Contracts (those binding unless repudiated)
These are contracts of continuing nature on both parties for example lease, partnership or holding of shares in a company. The minor may repudiate the contract during minority or within a reasonable time thereafter. Repudiation frees the minor from further liability under the contract but existing liabilities are not removed for example rent owing. A minor can also not claim money already paid under contract if he received something of value (consideration).

Case example
Valentini vs. Canali (1890)
Facts: A minor leased a house together with the furniture therein at a price of £102. He made a down payment of £68 and gave a promissory note for the balance and took occupation of the house. He moved to court after several months to avoid the contract. The court held that he was entitled to avoid the contract but would not recover money paid since he had received something of value in return.

Unenforceable Contracts on Minors
Note: All other contracts except for necessaries, beneficial and voidable contracts are unenforceable against a minor. This is because a minor cannot be compelled to honour obligations in a contract which is not binding on them. The law does not allow a minor to ratify contracts made during infancy even where fresh consideration is given

Case example
Smith vs. King (1892)
Facts: The defendant, a minor owed the plaintiff money. After he attained age of majority, he acknowledged that he owed the money and the court held that he was not liable since the act amounted to ratification of a void contract. If the minor makes fresh promises on attaining the age of majority, he will be held liable.

Case example
Dicham vs. Worrall (1880)
Facts: The defendant, a minor was engaged to the plaintiff. On attaining the age of majority, he requested the plaintiff to fix a fresh wedding date. He then refused to marry the plaintiff. It was held that the renewal of the promise amounted to a new contract and was enforceable.
Think

What happens to an adult who transacts with a minor innocently and in good faith and the minor takes advantage in contracts that cannot bind a minor?

A minor may acquire property from another under a contract either with a honest or fraudulent intent. The other party cannot enforce the contract because it is void for example, goods bought on credit which are not necessaries. Equity will however come to the aid of those who have traded with the minor and demand that the minor restores the property to the owner because it is just and equitable to do so.

What is the position of a third party who purchases items from the minor?

Generally a contract entered into with minors that is not for necessaries is void. The right of ownership is however passed to the minor. A third party who buys the property from the minor in good faith gets a good title.

(ii) Insane Persons

Can a person with mental disability enter into contracts?

Generally, contracts made by insane persons other than those for necessaries are voidable Contracts entered into by insane persons during lucid moments are also valid. They should however be charged reasonable price. What then must an insane person prove in a court of law for the contract to be repudiated?

- That they had a mental disability but with relevant supporting evidence;
- That at the material time of entering the contract, they were unable to understand the nature of the contract; and
- That the other party was aware of their condition and took advantage of the same.

(iii) Drunken Persons

Contracts that are entered into by drunken persons are given similar treatment as those with mental patients. However, partial or ordinary drunkenness is not a sufficient ground to render a contract voidable. Just like the case of insane persons, drunken persons should be charged a reasonable price. For a contract to be avoided by the person, one must prove that he did not understand the implication of the contract and that the other party was aware of their condition and took advantage.

2.5 TERMS OF CONTRACTS

2.5.1 What are terms?

Terms are provisions, requirements, rules, specifications and standards that form an integral part of an agreement or contract. They refer to detailed provisions contained in an agreement that governs the rights and obligations of parties to a contract. The law was originally based on the theory of freedom to contract. This is because it is primarily upon the parties to negotiate and agree on the terms to a contract. However, courts and parliament have increasingly stepped in to regulate and control contracts through implied terms. The intention is to protect consumers and those whose bargaining position is weak.

2.5.2 Classification of Terms

Contracts contain both express and implied terms.

Implied Terms

What are implied terms? Implied terms relates to something which is so obvious that 'it goes without saying' Implied terms to a contract must be certain and not ambiguous. The main purpose of these terms is to implement the presumed intention of the parties to give business efficacy to the contract. This is because the contract will not make sense without the terms.

Case example

British School of Motoring vs. Simms (1971) where it was held that a contract for driving lessons was subject to an implied term that the vehicle provided would be covered by insurance and that it was the driving school to insure the vehicle.

Note: The implied terms must be reasonable for them to be enforced by a court of law.

What are the sources of implied terms in contracts?

(i) Terms may be implied by custom or trade depending on the market in which the parties to the contract operate or the usages of a particular trade. Terms however must not be inconsistent with the rest of the contract.

(ii) Terms may also be implied by statute. The aim of this is to create certainty by standardising a particular type of contract and protect weaker parties from exploitation and restore balance where one party is in a stronger bargaining position. Some of the Acts of parliament include the Sale of Goods Act and the Hire Purchase Act.

Examples of implied terms under the Sale of Goods Act are:

- An implied condition that the seller has a right to sell the goods;
- Where goods are sold by description, there is an implied condition that the goods will correspond with the description; and
- There is also an implied warranty that the buyer has and will enjoy quiet possession of the goods.

Express Terms

Express terms, on the other hand, arise from the words used by the parties in reaching or recording their agreement whereas implied terms are those which form part of the agreement even though the parties never put them into words.

Terms in contracts can also be classified as either warranties or conditions. Contracts also contain exclusion/exemption clauses. Some terms in contracts are so fundamental that a contract may be ineffective in the absence of the vital terms.

What is a Warranty?

A warranty is a term in a contract that affects only some relatively minor aspects of the agreement and where it is broken, the aggrieved party can only claim damages but not avoid the contract. Such terms are not vital but do not go to the root of the contract.

Conditions

This is a term that affects an important aspect of the contract as it goes to the root. Where such a term is broken, one can claim for damages and also avoid the contract. A condition may be precedent or subsequent. A condition precedent is an express provision that a contract will not be binding unless the condition is fulfilled whereas a condition subsequent is a provision in the contract that the contract will cease to be binding upon the happening of a certain event.

In the next lecture, we will learn that the term warranty, as used in insurance contracts refers to a major term of the contract.

Exemption/Exclusion Clauses

Most contracts made are usually on standard terms contained in printed forms for example, insurance policies and contracts to borrow money from a bank. The intention is to save time and simplify dealings of day to day nature. The printed forms normally contain exclusion clauses which exclude or reduce liability to the customer. The main disadvantage of this is that the consumer may not negotiate the terms or read the contents and if things go wrong, they have no redress. Because of the abuse that may arise from exclusion clauses, courts and parliament have developed rules to control the use of these restrictive clauses.

Note the following about exclusion clauses

- Courts will enforce the exclusion clause if it was part of the written document and the other party signed;
- Courts will also enforce the clause where reasonable care was taken to bring the clause to the attention of the other party during negotiations and at the time the contract is being entered. Where the obligation was so fundamental that liability cannot be excluded, courts will not allow their application. In the UK, Section 2 of the Unfair Contract Terms Act of 1977 provides that no one acting in the course of business can by means of contractual terms or by any notice given or displayed exclude his liability for death or bodily injury arising from negligence;
- An exclusion clause on the reverse of the paper is not valid if it was not brought to the attention of the other party;
- Where the party relying on the clause misrepresented the contents, the clause will not bind the other party;
- Courts will not enforce a clause if it was brought to the attention of the other party after the contract has been entered into; and
- Exceptionally, the courts may also allow an exclusion clause to be incorporated in a contract as a result of past dealings between the parties in which the exclusion clause was regularly used. In such cases, the party who alleges that he is prejudiced by the clause may be held to be 'fixed with knowledge' of it even though it was not included in the transaction in question.

2.6 VITIATING FACTORS

These are factors that may destroy the validity causing them to be defective. This sub-topic discusses these factors and the effect they have on contract. They include the following:

- Illegality;
- Mistake;
- Misrepresentation;

- Non-disclosure; and
- Improper pressure.

Let us let us discuss each of them.

2.6.1 Illegality

Although people are generally free to make whatever agreements they wish, contracts which directly involve the commission of a legal wrong should obviously be discouraged. In this sub-topic, we use the term 'illegality' in a broader sense to include those agreements which are against public policy, that is, agreements which do not involve the commission of a distinct legal wrong but which the courts refuse to enforce because of their tendency to harm society and those contrary to statutory provisions. They cannot therefore be enforced in law. Illegal contracts have been classified into three and they are discussed below.

(i) Contracts Contrary to the Law

These are contracts which involve commission of a crime or a tort e.g. forging bank notes, agreement to steal or kill, wagering or gaming contracts among others. Note that some contracts may be prohibited by the law but making such contracts does not amount to a criminal act.

(ii) Contracts Contrary to Public Policy

A contract may not involve the commission of a legal wrong, or be forbidden by a statute, but may still tend to bring about results which are in some way harmful to the public or socially undesirable. A considerable number of examples exist, including those which follow. Such contracts are outlined below.

a. Those tending to Sexual Immorality for example those in furtherance of prostitution.

In the case of **Pearce vs. Brooks (1866),** a prostitute bought a carriage for use in attracting customers on hire purchase terms but failed to keep up payments. The owner knew the purpose for which it was bought. It was held that the contract was illegal and therefore void and the owner could not recover the outstanding balance.

b. Those affecting sanctity of marriage

Examples are those agreements between a husband and a wife for future separation and those where promises to marry are made by one who is already married. In the case of **Wilson vs. Carnley,** the defendant promised to marry the plaintiff after the death of his wife. The wife was seriously ill at the time. He married somebody else after the wife died and the court held The contract was void.

c. Contracts in restraint of marriage for example agreements not to marry. If it is a partial restraint, it may be held to be reasonable.

d. Contracts to commit a crime so as to benefit from the act as was in the case of **Berseford vs. Royal Ins. Co. (1937),** where the insured took out a life policy with the defendant. He shot himself dead with intent that the insurer will pay his estate. The court held the contract was void as suicide was a crime in the UK at the time.

e. Contracts to commit fraud on public revenue for example an employer and an employee agreeing to make false returns to the tax master.
f. Contracts to break laws of a friendly state. In the case of **Foster vs. Driscoll,** an English partnership formed to smuggle whisky into the USA when alcoholic drink was prohibited in the US held to be illegal
g. Contracts to trade with an enemy for example a Kenyan citizen trading with a person regarded as an enemy.
h. Contracts to corrupt public life for positions of honour or title for example giving a bribe to be given a title by the Head of State.
i. Contracts which pervert the course of justice. These are contracts that hinder prosecutions for example paying someone not to report an offence or not to co-operate with the prosecution
j. Contracts to oust jurisdiction of the courts. In the case of, **Bennett vs. Bennett,** n agreement for maintenance between a husband and a wife contained a clause that prevented the wife from seeking maintenance for her son through the courts. The same was declared void.
k. Contracts that abuse the legal process and there are two types of agreements. They are:

- **Maintenance:** that is promotion of litigation through financial assistance where one has no financial interest where one finances a person to take another to court. There are exceptions where this arrangement can be held to be legal. These are:
  - ✓ Where one is related, they can recover the money;
  - ✓ If one lends money on humanitarian grounds; and
  - ✓ Where one has common interest.
  - **Chamberty**: This refers to where a person assists another with money or evidence in a court case with intent to share the proceeds.

(iii) Contracts in restraint of trade

These are contracts entered into that prevent one from exercising a lawful profession, business or trade. They are prima-facie void but can be upheld if they are reasonable. There are two examples of contracts where restraint of trade may apply and they are explained below.

Contracts of Employment

These are contracts where an employee is restrained from working for a competitor on termination of employment or setting up a competing business. If the restraint is reasonable, courts will allow it for example, restraints relating to the employer's trade secrets or confidential information. Certain factors are taken into consideration to determine whether a restraint is reasonable or unreasonable. They include:

- The nature of the business;
- The position of the employee;
- The area; and
- The duration covered by the restraint.

In the case of **Mason vs. Provident Clothing & Supply Company (1913),** an employee of a firm of tailors agreed that he will not become employed in a similar business within 20 miles of London. It was held that the restraint was unreasonable because the skills acquired were for the employee's own benefit even though he learnt them at the employer's business.

Restraints on the Seller of Business Contracts

These are constraints that restrain a seller of business from starting a similar business since the purchaser buys even the goodwill. Courts do not interfere on this since parties are assumed to be of equal bargaining position.

Effects of Illegality

- Illegality renders contracts void and unenforceable; and
- Any money paid or goods transferred cannot be recovered.

However, recovery is possible in the following circumstances:

- Where both parties are not in pari delicto (equal wrong doing);
- Where the illegal purpose of the contract has not been performed and one party honestly repents;
- Money paid under a marriage brokage is recoverable where the marriage does not take place; and
- Money or goods paid in pursuance of an illegal contract is recoverable where the statute intends to protect a given class of persons.

2.6.2 Mistake

A mistake in a contract can either be a mistake of fact or a mistake of law. A mistake of law is not a ground for avoiding a contract. A mistake of fact however renders a contract void if it is so fundamental and goes to the root of the contract and undermines the entire contract. Mistakes affecting the validity of the contract include the following:

- Common mistakes regarding the existence of the subject matter: This occurs where both parties assume the existence of the subject matter which, unknown to them, has ceased to exist.
- Mutual mistake regarding the identity of the subject matter: This is where there is no consensus ad idem (meeting of the minds).

Case example

Raffles vs. Wichelhas (1864)

Facts: A contract made for the sale of cotton. Two ships carrying cotton had left Bombay in October and December respectively. While the seller intended to sell the consignment on the second ship, the buyer expected to buy the consignment of the first ship. It was held that the contract was void.

- Mistake regarding the quality of the subject matter. However, this does not render the contract void. This is because the doctrine of caveat emptor that is, buyer be aware will apply to sale of goods

contracts. It can only render the contract void if the mistake is such that to lender the contract impossible to perform. However, if one proves misrepresentation, the contract can be avoided.

- Mistake as to the identity of the other party: This is where the other party impersonates or uses false identity with the intention of persuading the other party into a contract. This will render the contract void.

  Case example

  Cundy vs. Lindsay (1878)

  Facts: A fraudulent person (Blenkarm) ordered for handkerchiefs from the defendant (Lindsay) using the name of a reputable firm which he had no association with. Lindsay delivered the goods to him on credit. The fraudster resold the goods to the plaintiff. It was held that the original contract was void for mistake and the defendant remained the owner of the goods

  - Unilateral mistake: This is where only one party is mistaken. This does not render the contract void unless the other party is aware of the erroneous belief.
  - Mistake of signing written documents. Where one party who is illiterate signs a written document, this does not relief the party from the consequences of signing the document. The party may, however raise the defense of non est factum (this is not my act) where he was induced to sign a document through fraudulent misrepresentation. The defense will succeed even where he was negligent.

  Case example

  Carlisle & Cumberland Banking Co. vs. Bragg (1911)

  Facts: The defendant was \fraudulently induced to sign a document which he was told was an insurance document. The document was however a guarantee for his overdraft with the plaintiff. It was held that he was not liable even though he was negligent

- Mistake in typing/recording agreements: Where there is a typing error, the court may rectify the document to reflect the true agreement. However, the mistake must be for both parties
  Where rectification is not available, courts may declare the contract void of mistake or enforce it the way it is.

  Equitable remedies for mistake are:

  - ✓ Rectification where there are fundamental terms omitted due to a typing error;
  - ✓ Rescission (cancellation) that is, setting aside the terms; and
  - ✓ Refusal to grant specific performance that is, where one party makes a mistake of fact and the other party is aware of it.

2.6.3 Misrepresentation

What is a misrepresentation?

A misrepresentation is a false statement of fact made by one party to induce the other party to enter into the contract. The effect of a misrepresentation in a contract is to render the contract voidable. During negotiations, representations (statements) are made with intent to persuade the other party to buy. Some representations become part of the contract while others do not. Some are true while others are false.

Types of Misrepresentations

Misrepresentations are of three types namely fraudulent, negligent and innocent. A brief explanation of each is given below.

Fraudulent misrepresentation: It is one which the maker knows to be false, does not belief in its truth or makes it recklessly.

Innocent misrepresentation: It refers to one which the maker honestly believes to be true.

Negligent misrepresentation: It is one that is made without reasonable care being taken.

Conditions Necessary for a Misrepresentation to Have Effect

For a misrepresentation to affect the validity of a contract, the following conditions must be present:

- The statement must be untrue;
- It is one of material fact and not law or opinion;
- It must be meant to induce the other party to enter into the contract;
- That the other party relied on it and entered into the contract;
- The statement must be made before or at the time of entering into the contract; and
- That the person relying on the statement suffered damage.

Remedies for Misrepresentation

Where one party misrepresents material facts, the aggrieved party is entitled to the remedies explained below.

(i) Rescission (cancellation)

This remedy is available in all types of misrepresentations. The contract is declared voidable at the option of the aggrieved party. The court may award damages in lieu of rescission if the misrepresentation was minor or innocent. However, in innocent misrepresentation, one may avoid

the contract by proving that the statement was untrue and it induced him to enter into the contract. The right to seek for the remedy of rescission may be lost in the following circumstances:

- Where it is not exercised promptly and delay may imply affirmation. The option is to claim damages;
- Where the aggrieved party cannot be restored to their original position; and
- Where a third party has acquired rights.

(ii) Damages

This is a common law remedy. If the misrepresentation is fraudulent, action is based on the tort of deceit and not on breach of contract. One can therefore bring an action for rescission in addition to damages. With innocent misrepresentation, damages are given in lieu or instead of rescission. Damages and rescission are alternatives where there is no fraud.

(iii) Refusal to Further Performance

This remedy is given where one has not performed. One can also use refusal to further performance and use it as a defence.

(iv) Affirmation

This is where the aggrieved party opts to treat the contract as binding. One cannot seek rescission after affirmation.

Think

Are there situations in the course of transacting business where misrepresentations are likely to occur?

2.6.4 Non-Disclosure

In contracts generally, parties are under no positive duty to disclose. In a contract for sale of goods, the caveat emptor (buyer be aware) rule applies. However, a positive duty to disclose exists in the following circumstances:

- A true statement made in the course of negotiations but becomes untrue due to a major change in circumstances as in the Case: **With vs. O' Flanagan** where the defendant who was a doctor wanted to sell his business and his monthly income was high at the commencement of negotiations but declined when he become sick. He did not disclose the decline to the buyer. The buyer sued and the contract was rescinded.
- Where a statement is literally true but with a misleading impression. In **R vs. Kylsant**, a statement was made to the effect that the company pays dividends every year creating an impression that the company only makes profits.

- A honest statement made in the believe that it was true but discovered to be untrue later by the maker.
- Contracts of *uberrimae fidei* (utmost good faith): The duty to disclose exists where one party is likely to know more than the other about the subject matter. Examples include:
    - ✓ Insurance contracts where one party is deemed to know more about the subject matter;
    - ✓ Family arrangements where there is a disagreement property;
    - ✓ Sale of land contracts where there is a defect in title;
    - ✓ Partnership agreements;
    - ✓ Issuance of a prospectus inviting members of the public to subscribe for shares; and
    - ✓ Also in contracts of guarantee where an employer is required to disclose previous dishonest acts of the employee.

2.6.5 Improper Pressure

Improper pressure can either be where duress or undue influence is used to cause one to sign a contract.

Duress

This is actual or threatened physical violence by one of the parties causing the other to agree to enter into a contract against their will. It can also be threats to one party's family member, to one's property or business interests or threats to own life. Contracts entered into under these circumstances render them voidable at the option of the aggrieved party.

Undue Influence

This is a product of equity where there are indicators of more than persuasion. It occurs where one party holds a dominant position over the other and takes unfair advantage of the relationship of trust to influence the other. The transaction will therefore be substantially unfair. It renders the contract voidable and the burden of proving undue influence is on the party alleging it. Delay in seeking a remedy may imply that the other party has affirmed. Undue influence is presumed in the following relationships:

- Parent/child: In the case of **Ottoman Bank vs Mawani,** a son signed a contract of guarantee in favour of a company owned by the parents. The court held that although the son was an adult, he was still under the father's authority and immature and therefore and the defence of undue influence stood;
- Doctor/patient;
- Advocate/client;
- Trustee/beneficiary;
- Teacher/pupil; and
- Religious leader/follower.

Think

Find out the circumstances under which undue influence may arise in the above relationships?

2.7 DISCHARGE OF CONTRACTS

Discharge of contracts refers to bringing an agreement to an end. You have now gained an understanding on requirements of valid contracts and factors that may cause contracts to have defects. You also need to know the circumstances that may lead to termination/discharge of contracts that is, bring them to an end.

A contract may be discharged by any of the methods discussed below.

2.7.1 By Performance

This is where the parties have fulfilled their obligations under the contract. However, each party has to completely and exactly do what they were required to do. If a party fails to perform or does anything different, it will amount to a breach. Note that liability in contract is often strict. For example, requirements under the Sale of Goods Act as to quality, quantity, description among others must be complied with.
Case example

Moore & Co. vs. Landauer & Co. (1921)
Facts: The defendant entered into a contract with the plaintiff for the supply of tins of fruit packed in crates of thirty. The plaintiff delivered the goods packed in crates of twenty four and the plaintiff refused to take delivery. The plaintiff sued for breach of contract. It was held that Performance was not within the strict terms of the contract and the defendant was therefore entitled to refuse.

However, there are exceptions to the rule of strict performance in circumstances discussed below.

- Where there is substantial performance with minor details. Where there is substantial performance, the contractual price is recoverable. In the case of **Shipton, Anderson & Co. vs. Weil Bros. (1912),** the contract was for the supply of 4950 tons of wheat. Delivery was made less 55 tons and the court held that this did not amount to a breach as;
- Where a party voluntarily accepts partial performance and pays for work done (quantum meriut);
- Where one party refuses to perform, the contract will be declared discharged;
- Where performance by one party is prevented by the other party to the contract;
- In contracts where a party promises to take reasonable care in the execution of their duties under the contract, for example, a doctor carrying out surgery in a patient undertakes to do their best or lawyers representing clients in court do not guarantee to win;

- If there is a clause excusing non-performance due to illegality or impossibility, then non-performance will be pardoned;
- In divisible contracts where execution is carried out in piecemeal, performance is deemed to have taken place after each agreed portion is carried out; and
- Where one party performs and the other party refuses to accept, courts will hold that performance has taken place.

Period of Performance

Note that time of performance may be agreed in the contract. Time may be of essence as expressed in the contract or implied from the circumstances. Failure to adhere to the time lines may lead to an award of damages. Where no time limit is set, performance will be within reasonable time decided by the court.

2.7.2 Agreement

A contract is created by mutual agreement and can be terminated by agreement. Note that a further agreement must be made to discharge each other from the obligations of the original agreement. Discharge by agreement may take three forms as explained below.

(i) Waiver

The agreement can be by waiver where parties mutually release each other from their rights and obligations. The new agreement can take any form although the original contract was in writing.

(ii) Accord and Satisfaction

Agreement can also be by accord and satisfaction where a party accepts less than what was due under the contract and agrees to release the other party from their obligations. Accord is the new agreement to discharge and satisfaction is the new consideration.

(iii) Novation

This is where an existing contract may be discharged when a new one substitutes it. This is known as novation which can either between same parties or different parties and the terms of the new agreement may be different.

Note that money debts cannot be discharged by paying less unless there is a change in the time of payment, mode of payment or something extra of value is added.

Case example

Foakes vs. Beer

Facts: Miss Beer obtained a judgment against Mr. Foaks. They agreed that the amount be liquidated by way of installments. After full payment had been made, Beers sued for interest. It was held that she was entitled to interest as this was the consideration for agreeing to be paid in installments.

2.7.3 Discharge by Operation of the Law

There are circumstances where the law may apply in such a manner so as to discharge a contract. Some of these situations are now explained.

Merger: This is where an existing simple contract is replaced by a specialty contract (under deed) with existing terms. The original contract is automatically terminated.

Death: Contracts for personal services are automatically terminated by death of one party. If an employee dies, the employment contract is automatically terminated. However, other contracts survive the benefit for example, an insurance contract is not automatically discharged by the death of the policyholder.

Bankruptcy: When one obtains a bankruptcy order against himself, a trustee in bankruptcy is appointed to run his affairs and any contract they may have entered into stands automatically discharged in favour of the trustee in bankruptcy.

Unauthorised alterations: Where there is unauthorised material alteration to the terms of the contract by one party without the knowledge and consent of the other, this will discharge the contract.

2.7.4 Discharge by Breach

Breach occurs where there is failure by one party to perform their obligations under the contract. For the contract to be discharged, the breach should be one that goes to the root of the contract for example where there is breach of a condition. If it is breach of a warranty, the innocent party will be entitled to damages. Breach may occur in a various ways which are discussed below.

Failure to Perform: Either there is no performance at all or the performance is inadequate

Anticipatory Breach: Anticipatory breach is one that takes place before the time of performance. One can do this by expressly renouncing the contract or disabling themselves by doing something that makes performance impossible. An example is where a seller disables himself by selling the goods to another person before the time of delivery. In the case of Frost **vs. Night,** the defendant promised to marry the plaintiff after the death of his father. He however married somebody else while his father was alive. It was held that the defendant had disabled himself as English law allowed a person to take only one wife.

However, one may ignore the anticipatory breach and keep the contract alive until the time of performance in the hope that the other party may perform their obligations. However, there is a risk in doing this as the right to sue may be lost if the contract is discharged by some unexpected turn of events. The right to sue in anticipatory breach should be exercised promptly.

Exercise

Search the case of Avery vs. Bowden (1855) and find out the principle established therein.

What effect does breach have in a contract?

Generally, breach of a condition gives right to the aggrieved party to avoid the contract whereas breach of a warranty gives rise to the right to sue for damages. As will be explained in the next lecture, in insurance, breach of a warranty brings a contract to an end.

The Remedies for Breach of Contract

Where there is breach of contract by one party, the aggrieved party is entitled to the remedies discussed below.

(i) Rescission

This is an equitable remedy and refers to the cancellation of the contract. As discussed under misrepresentation, the injured party on rescinding the contract is freed from his duties and entitled to recover any property that they have transferred. Such party can however lose the right to rescind the contract if:

(i) They cannot be restored back to their original position;
(ii) A third party has acquired rights under the contract;
(iii) They knew the misrepresentation and affirmed; and
(iv) They take unreasonable delay in seeking rescission.

Under breach of contract, if the breach is serious, parties will be entitled to rescind. They can do this by either refusing to perform or refusing to further performance. If the breach is not serious, the court will give the claimant an award damages.

(ii) Specific performance

This is an equitable remedy where the court orders a party do something they are obliged to do under the contract. Failure to obey an order of specific performance constitutes contempt of the court, which is punishable by a fine or imprisonment. As an equitable remedy, it is granted at the discretion of the court. It is also commonly granted in the following circumstances:

- Where the contract is for the sale of debentures in a company;

- Where the contract is for the sale of rare goods which are not easily available in the market or the value of such could not be measured in money;
- When damages are an inadequate remedy; and
- In contracts for the sale of land. With such contract the buyer will hardly be compensated by an award of damages as they require the land.

Specific performance will not be granted where:

- Damages would be an adequate remedy for example most contracts for sale of goods;
- The contract is one for rendering of a personal service;
- The order would cause undue hardship to the defendant for example, if the cost of performing is out of all proportion to the benefit to the plaintiff;
- The contract was not supported by consideration (even if it had been under seal);
- There has been undue delay on the plaintiffs part in seeking the remedy; and
- The plaintiff is himself guilty of having acted unfairly.

(iii) Quantum Meruit

Quantum meruit means as much as they have earned or deserved. This is a claim based upon the amount, which has been earned under a contract. It arises when the plaintiff has performed their contractual obligations under a contract and the defendant has repudiated the contract, thereby preventing the plaintiff from further Performance. Hence the plaintiff can sue upon a quantum meruit to recover the amount earned by their partial performance of their contractual obligation. This is different from damages as it is in effect a claim for restitution for work done. In ***Planche -v- Colburn* (1831)** there was a contract for the writing of a book for which the plaintiff was to be paid 100 pounds by the publisher and the latter repudiated after the plaintiff had done the necessary research and written part of the book. A sum of 50 pounds was awarded on a *quantum meruit.*

(iv) Damages

This is an award for financial/monetary compensation and can be claimed as of right where a contract is broken. The purpose of damages in contracts is to place the claimant to the position they would have been in had the contract been performed fully. They are not expenses incurred by the defendant in performing the contract. If no real loss was suffered, nominal damages will be awarded. Damages are meant to compensate the claimant and not to punish the defendant. Note that punitive damages cannot be awarded for breach of contract

What are the factors that guide/govern the award of damages?

Damages may be assessed by courts or may be agreed upon by the parties in an out of court settlement. Where they determined by courts, the guiding factors discussed below will be taken into consideration.

- Damages are assessed based on the nature of loss. The common types of losses include personal injury, property damage, financial loss, distress, injury to feelings among others;
- The amount of damage will also vary depending on the circumstances giving rise to the loss. An example may be where an unpaid seller fails to deliver the goods and the buyer has not paid, the court will award based on the cost of substitute goods whereas if the seller is paid and fails to deliver, the court will give an award based on the market value of substitute goods;
- Mitigation of loss: The aggrieved party in breach of contract is under duty to take reasonable steps to minimise the loss suffered. Failure to do this, the court will not award the extra costs;
- Action for breach of contract is usually for unliquidated damages (not agreed on in advance). There may be instances where the parties make provisions in advance regarding the amount payable and in case of a breach, courts will allow them if they are reasonable;
- Remoteness of damage: Damages will not be awarded for losses that are considered too remote to the original contract that is, they are not foreseeable. In the case of **Hadley vs. Baxandale**, a mill operator requested a common carrier to deliver a crankshaft to the manufacture and they took too long to deliver it back. The plaintiff sought to recover loss of income and profits from the defendant. It was held that the defendant was not liable for loss of profits because it would not be reasonably considered as arising naturally from the breach and that it would not be reasonably be supposed to be in the contemplation of the parties of the parties at the time they made the contract; and
- Causation: Damages can also be recovered if there is a direct causal connection between the wrongful act/breach and the loss (proximate cause) with no intervening causes.

2.7.5 Discharge by Frustration

A contract is discharged by frustration when it becomes impossible to perform, illegal or futile due to unexpected change of events. The effect is to release the parties from their obligations. For courts to allow discharge, the event must have been unforeseen. What are the circumstances which may be deemed to frustrate a contract?

- Change of law/operation of law;
- Destruction of the subject matter of the contract for example a house that was the subject of a lease agreement is completely damaged by fire;
- Non-occurrence of an event which the contract depends: this may arise where one pays for a space to watch a football match and unforeseen reasons, the match fails to take place;
- Government interference for example where the government orders a stop to a building under construction; and
- Death or personal incapacity of either party to the contract. However, the incapacity must be serious and should not be self inflicted.

2.8 THE DOCTRINE OF PRIVITY OF CONTRACT

This is a doctrine that restricts the rights and duties created by a contract to the persons who originally made it. The contract cannot therefore confer any legally enforceable benefit or duty on a third party. In the case of Dunlop **vs. Selfridge,** the plaintiff sold tyres to A.J. Dew & Co. subject to the condition that the tyres were not to be sold except at a fixed minimum price. The company sold the tyres to the defendant subject to the same conditions. The defendant sold the tyres at less than the minimum price and the plaintiff moved to court. The court held that only a person who is a party to a contract can sue upon it.

Activity

Find the case of Tweddle vs. Atkinson and establish the facts and the principle that were established in the case.

2.8.1 Exceptions to the Doctrine of Privity of Contract

Strict application of the doctrine of privity of contract hinders useful and sensible commercial transactions. Because of this, a number of exceptions have become established over the years either by statute or common law. They are discussed below.

(i) Assignment

This refers to the transfer to another of the rights that exist under a contract and in some cases transfer of duties/obligations. Think of a scenario where A & B enters into a contract and A is required to pay B Kshs.1000. B may transfer his rights to receive the money to C. This confers benefits to a person who was originally not a party to the contract. The common law did not allow assignment but this is now provided for under equity and statutes.

(ii) Agency

A third party can gain the right to claim on an insurance policy under the rules of agency. A mercantile agent (explained in lecture six) acquires insurable interest on the property of the principal. An agent may also be given the power of attorney to run the affairs of another and acquire rights. The principal however may enforce a contract entered into by an agent on their behalf.

(iii) Trust

A trustee may insure the trust property. The beneficiary may enforce the contract of insurance and enjoy the benefits payable under an insurance policy.

(iv) Insurance (Motor Vehicle Third Party Risks) Act Cap.405

This Act protects injured third parties in road accidents when vehicles are being driven on public roads. Third parties and authorised drivers may benefit from motor policies yet they were not parties to the original contract.

2.9 THE DOCTRINE OF ASSIGNMENT

As explained above, assignment occurs where an original party to a contract transfers their rights and liabilities under the contract to another (a third party who is not a party to the original contract) who stands in their place. A contractual right is a chose in action (a valuable but intangible piece of property) and it cannot be physically seized but can be enforced through an action in court. Originally, under the common law system, one could not transfer rights/benefits under a contract but equity and statute has allowed assignment. The person who assigns is known as the assignor whereas the one who is assigned is known as the assignee. Note that the assignor cannot recover anything more than they themselves posses. Assignment is subject to all liabilities and equities existing between the original parties to the contract.

2.9.1 Types of Assignment

Assignment may take place through various ways which are discussed below.

(i) Legal/Statutory Assignment

The Indian Law of Property Act section 130 provides that all debts and other legal choses in action for example patents, copyrights may be assigned. Rights and obligations can therefore be assigned. For a statutory assignment to be effective, the following essentials must be present:

- The assignment must however be absolute/unconditional;
- It must also be in writing and signed by the assignor;
- A written notice must be given to the debtor; and
- Consideration is not necessary to support a statutory assignment.

In legal assignment, the assignee can enforce the contract against the debtor in his name without involving the assignor. However, in equitable assignment, the assignee must join the assignor as a party to any action against the debtor. Where a notice has been given, payment to the original party will not discharge the debtor.

(ii) Equitable Assignment

This will be possible if an assignment does not comply with all the requirements for a statutory assignment. It may therefore take effect as an equitable assignment provided the intention to assign is clear from the circumstances. No formality is followed or notice given. Equitable assignment, unlike legal assignment, must be supported by consideration. If the assignee wishes to enforce the contract, the assignor must be enjoined into the case as a co-plaintiff and in the absence of consideration, the assignee cannot compel the assignor to join him.

(iii) Assignment by Operation of the Law

This will arise where an event occurs and the law operates in such a way as to automatically cause assignment. Assignment through operation of the law is also known as involuntary assignment occurs. The events that may lead to involuntary assignment are death and bankruptcy. Death of a party to the contract does not discharge the contract as rights and liabilities will be vested in the personal/legal representatives of the deceased. Voluntary assignment also takes place where one is declared bankrupt through a court order. A trustee in bankruptcy takes the place of the original party as the assignee.

Contracts that Cannot be Assigned

There are two types of contracts which due to certain reasons cannot be assigned. They are:

- Under contracts for personal services for example in employment contracts, an employee cannot assign their salary/wage to another person; and
- Insurance contracts are personal in character and cannot be assigned. This will be discussed further in the next chapter.

2.9.2 Assignment of Obligations

Note that obligations under a contract can also be transferred. However, this cannot be possible without the consent of the other party and the assignee. The transfer of obligations may occur in the ways explained below.

By Novation

This is where the original contract is rescinded/cancelled and substituted with a new one. The new contract will indicate the parties and the obligations of the parties.

By Vicarious Performance

This will occur where a contract entered into by one party can be performed by another provided there is no provision requiring personal performance by one party. An example is where a contractor delegates their duties to a sub-contractor but shoulders responsibility for the acts and omissions of the sub-contractor though vicarious liability (to be discussed further in lecture five).

In the case of **Robson & Sharpe vs. Drummond (1831),** the defendant had contracted Sharpe to maintain and repaint a coach for five years. Sharpe retired and informed the defendant that the work will be carried on by Robson. The defendant refused to accept performance by Robson and Robson sued. It was held that the defendant was not liable as Sharpe would not assign his liabilities without the consent of the debtor.

2.10 SUMMARY

You have learnt the following from this lecture:

- That a legally binding agreement will come into effect if all the essential elements of a valid contract are present. These essentials include offer and acceptance, consideration, contractual capacity, form, intention to create legal relations and legality;
- That a contract contains terms that must clearly set out the rights and obligations of the parties. These terms may be expressly stated or may be implied. They may also be warranties or conditions;
- That there are factors which affect the validity of a contract effectively causing such a contract to either be void or voidable. The factors include illegality, mistake, misrepresentation, non-disclosure, duress and undue influence ;
- That a contract may be discharged under various circumstances which are: performance, breach, agreement, frustration and operation of the law;
- That where there is breach, a number of remedies are available to the aggrieved party. These remedies are damages, cancellation, quantum meruit, specific performance, injunction among others; and
- That the law allows rights and obligations in a contract to be assigned under statute, equity or operation of the law.

2.11 ACTIVITY

1. Explains the various types of contracts.
2. Describe the various vitiating factors.
3. Outline the differences between an offer and an invitation to treat.
4. Explain ways in which a contract may be discharged.
5. List contracts which are contrary to public policy.
6. Explain the conditions necessary for effective statutory assignment.
7. Explain the exceptions to the doctrine of privity of contract.

2.12 READING LIST

i. The Law of Kenya by Tudor Jackson

ii. General Principles and Commercial Law of Kenya by Ashiq Hussain

iii. Past papers

LECTURE THREE

3.0 THE INSURANCE CONTRACT

LECTURE OUTLINE

3.1 INTRODUCTION

In the lecture two, you learnt about the general principles that govern all types of contracts. Welcome to lecture three. This lecture specifically discusses insurance contracts. From this lecture, you will be engaged in understanding how insurance contracts are formed, the relevant terms that apply to insurance contracts and have the ability to generally interpret provisions in insurance contracts.

3.2 LEARNING OUTCOMES

By the end of this lecture, you should be able to:

a) Explain the nature of an insurance contract;
b) Explain the requirements of a valid insurance ccontract;
c) Explain the terms in insurance contracts;
d) Describe the rules of interpretation for an insurance contract;
e) Explain the process of discharging an insurance contract;
f) Discuss assignment as applied to an insurance contract; and
g) Explain remedies for breach of an insurance contract.

Competence

The trainee should have the ability to apply the general principles of contract to insurance practice

Content
Let us now start by explaining the nature of insurance contracts.

3.3 NATURE OF INSURANCE CONTRACTS

From the last lecture, you are now familiar with what a contract is. Generally, an insurance contract is a legally binding agreement to insure. In general insurance, a contract is defined as an agreement between the insured and the insurer whereby in return for a premium, the insurer undertakes to indemnify the insured for a financial loss. In life insurance, it is an agreement to pay a sum of money on death of life assured or at the end of the period specified in the contract that is, maturity. As explained in lecture two, contracts are based on promises and so are insurance contracts. The binding nature of an insurance contract provides a solid foundation for the business of insurance and endears people to buy policies with confidence. Let me now understand how insurance contracts are classified.

3.3.1 Classification of Insurance Contracts

There are five (5) classifications into which insurance contracts fall namely:

- By nature of event by which a claim becomes payable;
- By nature of interest insured;
- By nature of the insurance contract;
- By nature of the programme of insurance; and
- Whether the business is direct or through reinsurance.

The Nature of the Event by which a Claim Becomes Payable

This classification is based on the event insured against and the contract assumes its identity from the event for example, marine insurance, fire insurance, life assurance among others. It places emphasis on the homogeneity of the group. In life insurance for example, the event is death or maturity while in marine insurance, the event insured are perils of the sea.

The Nature of the Interest Attached/Insured

This places insurance contracts into 3 categories which are:

- Personal Insurances which include life, accident, among others;
- Property Insurance for example, marine, fire, agriculture insurances; and
- Liability Insurance, these are policies taken out in compliance with statutory/legal obligations for example WIBA policies, Third Party motor insurance and other classes of liability insurance.

The Nature of the Contract of Insurance

There are two contracts of insurance, namely indemnity and benefit (non-indemnity).

Indemnity contracts: This is a contract of insurance whereby the insured pays a premium on the understanding that in the event of loss, he is entitled to compensation for the actual loss sustained. **In the case of Dalby v India & London Life Assurance,** the court observed that policies of insurance under fire and marine risks are properly speaking indemnity contracts that meaning that, the insurer undertakes to make good within limited the amount the loss sustained by the insured and nothing else.

Benefit/Non-indemnity contracts: The insured here secures the payment of a fixed sum of money previously determined as the sum assured. There is an assurance that the amount is payable in the event of occurrence of the contingency insured against.

By the Nature of the Programme of Insurance

Insurance programmes are either private/commercial or social. Private/commercial insurance is generally optional and voluntary. It is effected on account that the insured stands to lose should the risk attach. Social insurance is imposed upon the insured by statutes to protect the society from a hazard which no single individual can cushion against for example National Hospital Insurance Fund (NHIF). Social Insurance is said to be a device of pooling of risks by their transfer to an organization legally obliged to provide pecuniary or service benefits to or on behalf of the insured on the occurrence of loss.

Whether the Insurance is Direct or a Reinsurance.

Direct insurance refers to where an individual or an organization transfers their risks to an insurance company to secure protection in the event of a financial loss. The agreement entered into is known as an insurance contract. Reinsurance is defined as a system whereby an insurer who has accepted a risk can himself insure the liability he has assumed in part or in whole with another insurer. The agreement entered into is a reinsurance contract. It is a 20th century practice which evolved to protect insured against the insolvency of insurers. Reinsurance may be voluntary or compulsory.

3.4 REQUIREMENTS FOR A VALID INSURANCE CONTRACT

You learnt in lecture two that there are six essential elements/ingredients of a valid contract. Similarly, a valid insurance contract must contain the same requirements.

Do you recall which ones they were?

They included offer and acceptance, intention to create legal relations, consideration, contractual capacity, form and legality. The Contract of insurance must as a general rule satisfy the basic requirements of a contract at common law. An offer by one party must be unequivocally accepted by

another and consideration must be furnished. The parties to the contract must have intended their dealings to give rise to a legally binding agreement and the parties must have capacity to enter into contracts. The discussion below, of these essentials will enable you apply them in the practice of insurance.

3.4.1 Offer and Acceptance

The rules of offer and acceptance which we examined earlier in lecture two apply to insurance policies in the same way as they do to other contracts. An insurance contract will, therefore, come into existence once the offer made by one party and is unconditionally accepted by the other.

(a) Offer

An offer in insurance can be a filled proposal form, a premium quotation by an insurer or a renewal notice. There is no definite rule as to which party (the proposer or insurer) makes the offer and which party accepts. Invitation to treat that is explained in the last lecture also applies in insurance.

 What amounts to an invitation to treat in insurance?

- A prospectus;
- Blank proposal form;
- Advertisements both in print and electronic media;
- Renewal notice; and
- Representations made in the course of selling.

In insurance contracts, the most common way in which an offer is made is by the proposer completing a proposal form and submitting the same to the insurer. The proposal form is standard and hence the terms of the contract may not, as general rule, subject to bargain or negotiation. The offer must be as complete as possible in materiality and must be communicated to the insurer. The proposer must have insurable interest in the subject matter of insurance for the offer to be valid.

 **What is a Proposal Form?**

This is a document furnished by the insurer for completion by the proposer and varies in form and content with the nature of the contract. It solicits specific information in relation to the materiality of the subject matter and other information. It generally seeks information relating to:

(i) Particulars of proposer;

(ii) Risk(s) to be covered – This includes events insured and duration of cover;

(iii) Circumstances affecting the risk – These are matters peculiar to the subject matter for example perennial illnesses; and

(iv) History of the subject matter whether for example, previous insurance, refusal to insure if any, cancellations if any. This information enables the insurer make a fair decision on whether or not to take the risk and how much premium to charge.

Additionally, the proposer declares that the information provided is true and forms the basis of the contract between him and the insurer. This is referred to as the basis of the contract clause. Submission of the proposal form by the proposer constitutes the formal offer to contract and if accepted, an agreement comes into existence.

However, in property insurance, the insurer may require time to assess the risk while the proposer desires immediate cover. This conflict is resolved by a cover note. This is a technical term used with reference to temporal insurance cover extended to the proposer by the insurer during the interim period between submission of the proposal form and its formal acceptance or rejection. The cover note affords the insurer the requisite time to assess and ascertain the risk being undertaken.

The cover note operates as a contract between the Insurer and the proposer on the terms and conditions therein embodied or necessarily imputed from the type and nature of the policy subject matter. The insured is entitled to enforce the contract in the event of attachment of the risk. The legal effect of a cover note lapses when the insurer issues the policy. The effect of the policy is backdated to the date of issue of the note.

In life assurance, the insurer may require time to conduct medical examination on the proposed life assured or to undertake financial investigations depending on the information given in the proposal form.

(b) Acceptance

Note that acceptance of the proposal form is the sole prerogative of the insurer. Insurers are not bound to accept any application for insurance. However, refusal must be communicated though there is no obligation to give reasons. The insurer cannot, while accepting the proposal form, vary the terms of the contract without the proposer's concurrence. The insurer may signify his acceptance of the proposal form in any of the following ways:

Formal Communication

The insurer may formally write to the insured intimating to him his acceptance of the proposal form.

Issue of the Policy

As a general rule, the issue of the policy by the insurer is conclusive intimation of acceptance of the proposal form. The policy comes into force from the date of issue notwithstanding any defects in the proposal form.

Conduct of the Insurer

In certain circumstances, the absence of premium or policy does not necessarily mean that there is no contract of insurance. Evidence may suggest that the insurer had accepted the proposal form and hence there is a binding contract between the parties.

Acceptance of Premium

Acceptance and retention of premium by insurer raises a presumption that the insurer has accepted the proposal form. However, such receipt or retention does not create an obligation on the part of the insurer to issue a policy. However, the presumption is rebuttable meaning, the position can changes on the basis of the evidence available.

Acceptance of the Proposal Form

When the insurer accepts the proposal form which is the evidence of offer, this generally marks the end of the proposer's duty of disclosure. This is because the proposal form is the basis of the contract and an agreement is entered once the offer is accepted.

When does Insurance Cover Commence?

Commencement of cover determines the time from which the subject matter is covered against the insured risks. In indemnity contracts, insurance is for one year whereas in non-indemnity contracts, the duration is determined by the parties. The date and time of commencement of cover is critical since it limits the insurer's obligations. As a general rule, cover commences at the time and date stipulated by the policy cover note. If the document is silent, or in cases of ambiguity, cover commences at the beginning of the next full day. A full day is a period of 24 consecutive hours from midnight.

3.4.2 Contractual Intention and Insurance

No legally binding contract will be formed unless the parties intended to be legally bound and that, in the case of business agreements, this intention is usually presumed to exist unless there is strong evidence to the contrary. Insurance contracts, as commercial transactions, are almost invariably intended by the parties to be legally binding.

3.4.3 Consideration

As explained in lecture two, a promise is not legally binding unless it is supported by consideration, that is, unless something of value is given in exchange for it. The rules of consideration apply to insurance in the ordinary way. The consideration furnished by the insured in an insurance contract is, of course, the premium payable and the insurer promises to pay claims; in other words, the cover which is provided. While a valid contract of insurance will come into force once an offer has been accepted, the risk may not attach immediately. Equally, a valid insurance contract may exist before the insured has actually paid the premium, provided they have agreed to pay.

Section 156 of the Insurance Act makes provisions with regard to validity of an insurance contract and consideration. The Act provides that no insurer shall assume a risk in Kenya in respect of insurance business unless and until;

- The premium payable is received;
- Premium is guaranteed to be paid by a bank licensed under the Banking Act;
- An advance deposit is made with the insurer to the credit of the insured sufficient to cover the payment of the entire amount of the premium together with the premium; and
- The premium collected by an agent or a cheque received by him shall be deposited with or dispatched to the insurer immediately upon receipt.

Return of Premiums in Insurance

Once the risk starts to run, the insured is not entitled to any return of premium if the contract subsequently ends prematurely. However, if the insurers have never been on risk at all, the insured is entitled to recover their premium. In the latter case, there has been a 'total failure of consideration; which means that the insured has never had anything of value in return for their own payment.

The risk may fail to run, resulting in a total failure of consideration, for a number of reasons some of these are:

- The proposal may be withdrawn after the premium has been paid;
- The policy may be void for mistake or because there was no *consensus ad idem* (meeting of the minds)*;*
- The policy may be void because there is no insurable interest; and
- The policy may be avoided *ab initio* (from the beginning) for misrepresentation or non-disclosure.

The insurer must allow a full return of premium in all these cases, unless there has been fraud by the insured. Rules governing refund of premiums can be modified by the terms of the contract. In particular, insurers will often allow a partial return of premium when a policy is cancelled mid-term, even though the risk has obviously started to run in this case. A cancellation clause is a provision attaching to and forming part of the policy.

3.4.4 Form

This requires that a contract be in the form that is prescribed under the law. However, under Kenyan law, there is no general requirement for an insurance contract to be recorded in a written document. Insurance cover may be given orally (often by telephone) and, although a written policy is eventually issued in almost every case, a claim may be made before the policy is prepared.

There are a few exceptional cases of insurance contracts where some formality is required. These are briefly explained.

Marine Insurance
This is the only type of insurance contract which must be in writing is a marine insurance policy.
The Marine Insurance Act requires the policy to specify the name of the insured or their agent, be signed by or on behalf of the insurer and specify the subject matter of the insurance with reasonable certainty.

Motor Insurance
The law that regulates motor insurance that is, Chapter 405 provides that a policy of insurance is of no effect unless and until a certificate of insurance is delivered to the policyholder. This indicates that motor policies need to be supported by some written evidence.

Life Insurance
Life insurance contracts are also subject to some formal rules which require that the policy shall contain the name of the person interested in it which suggests the need for a formal policy. This is provided for in the Insurance Act.

3.4.5 Contractual Capacity
You recall from the last lecture that certain categories of persons have limited capacity to enter into contracts. What is their position if they purchase an insurance policy?

Contracts with a Minor
An insurance policy is generally not classified as a necessary with regard to a minor. However, we have seen from the last lecture that what is a necessary depends on the minor's station in life. A minor may therefore purchase an insurance policy. What are some of the effects of such a contract?

An insurer who grants cover to a minor is fully liable to meet all valid claims under the policy. It follows therefore, that an insurer cannot enforce an insurance contract against a minor by suing them for the premiums which are owing unless the contract is for necessaries or is beneficial as defined earlier. In practice, the fact that most insurance policies are either unenforceable against the minor or voidable by them does not create major difficulties. A minor will not be able to recover premiums which they have paid unless there has been a 'total failure of consideration', that is, the other party has given nothing of value in return. This means that once the risk has started to run and the minor

has had the benefit of some cover, they cannot reclaim their money simply by repudiating the contract. Equally, if a minor refuses to pay the premium their insurers are under no liability to pay a claim.

Mental Patients and Drunken Persons

The rules affecting drunken persons are similar to those governing mental patients. The drunken person can avoid the contract only if at the time of making it, they did not understand what they were doing, and the other party knew of this. In the case of **Imperial Life Insurance Co. of Canada v. Audett (1912),** an insurance agent obtained a proposal for life insurance from a man whom he knew to be drunk and the court held that the contract did not bind the proposer.

3.4.6 Contractual Capacity of Insurers

Insurers are, of course, corporations. Policyholders are likely to suffer if an insurer becomes insolvent and, to reduce the risk of this happening, insurers in the Kenya have been subject to government supervision through the Insurance Regulatory Authority (IRA). An insurer may lack contractual capacity if:

- It is not licenced by the regulator;
- It is not authorised to underwrite a given class of insurance; and
- It is not incorporated as per the requirements of the company law.

3.5 TERMS IN INSURANCE CONTRACTS

As explained in the last lecture, terms are detailed provisions in contracts that outline the rights and obligations of the parties. The express terms are provided for in the policy document. The policy document is the evidence of the insurance contract and contains the warranties, conditions, exclusions and other provisions. From these provisions, circumstances under which the insurer's liability may or may not attach are provided. In insurance contracts, one can either be in breach of contract or breach of good faith (to be discussed in the next lecture).

Breach of contract arises from failing to comply with a term of the contract itself, so that the breach occurs after the contract has been made and as a result of one party not keeping the agreement that has now come into force. The terms are usually contained in a written document, but in some cases they may be oral or implied by law. Terms are traditionally classified into conditions and warranties. This classification is based on the importance of the terms in question and the consequences if they are not observed.

Warranties

A warranty is, essentially, a promise or an undertaking made by the insured relating to facts or to something which they agree to do. It is a major/fundamental term in an insurance contract and brings about the most drastic effects if they are broken. In lecture two, under general law of contract, we said that a warranty is a minor term and entitles the aggrieved party to sue for damages. A warranty in insurance may relate to past or present facts or it may be a continuing warranty, in which the

insured promises that a state of affairs will continue to exist or they will continue to do something. Alternatively, the function of the warranty may be to ensure that certain high risk practices or activities are not introduced without the insurer's knowledge

Examples of Undertakings

- Rubbish to be cleared up each night; or;
- An intruder alarm system to be kept in good working order and regularly tested; or
- That the insured should take safe keys home with him when they leave business premises at night; and
- That no inflammable oils may be stored.

Generally, the requirement for warranties is that they must be exactly complied with. If it is broken, cover terminates even if the breach did not cause or have any connection with a loss and even if the breach has been remedied by the time a loss occurs. In Kenya, the Claims Management Guidelines issued by the IRA provides that an insurer cannot avoid payment of a claim for breach of a warranty or a condition where the circumstances of the loss are unconnected with the breach.

Warranties may be expressly stated in the policy for example watchman warranty in theft insurance requires watchmen to be employed to guard the business with as a pre-loss control measure, Safe and Books clause and the Escort Warranty in money insurance among others. Warranties may also be implied for example there is implied warranty of seaworthiness which the Marine Insurance Act Cap. 390 of the laws of Kenya automatically carry into every policy of marine insurance. There is also an implied warranty that the venture being undertaken is legal. Note, however, that a warranty cannot be implied in a non-marine insurance policy.

Activity

From what you covered in Principles and Practice of Insurance with regard to warranties, examine some of the warranties that you learned.

Conditions

A condition is an obligation imposed on the insured and carries consequences for non-compliance. Conditions in insurance contracts can be express of implied. Some of the express conditions include notification, cancellation, arbitration and premium payment. Implied conditions on the other hand include existence of the subject matter, insurance interest and utmost good faith. Conditions may be classified into:

Condition Precedent to the Contract: These are obligations that the insured must comply with before insurers go on cover. If a condition precedent to the contract is not fulfilled, the contract is

void ab initio (from the beginning). If the condition imposes a continuing obligation, the effect is similar to a breach of warranty, above, but cover may terminate only if there is a causal connection between the breach and the loss.

Condition Precedent to Liability: These are obligations that the insured must comply with before a claim is paid. The insurers may avoid the particular claim. The policy as a whole is not avoided and remains in force. The Claims Management Guidelines issued by IRA provides that an insurer cannot reject a claim on grounds of late reporting without establishing and considering the reasons for the late notification.

3.6 RULES OF INTERPRETATION AN INSURANCE CONTRACT

Note that even with careful policy drafting, disputes about the meaning of the words used in insurance contracts occur from time to time. They nearly always concern claims, and whether the words of the policy cover the loss in question or exclude it. The principles of interpretation used by the courts fall into two categories:

- Common law rules (rules developed by the courts); and
- Statutory rules (rules laid down in legislation).

3.6.1 Common Law Rules

A number of common law rules have been developed through case law and are used to interpret words and provisions in insurance contracts. They are explained below.

(i) Literal/Ordinary meaning

This rule requires that the words/phrases used in a contract be given their plain and grammatical meaning. In the case of **Leo Rapp v Mclore (1955),** the court said inter alia that in construing words in an insurance policy, it must give them their ordinary, natural meaning and that no words are removed or added to the policy. In ***Thompson v. Equity Fire Insurance Co. (1910)*** a fire policy covering a shop excluded liability for loss or damage occurring 'while gasoline is stored or kept in the building insured'. The policyholder did, in fact, have a small quantity of gasoline which he used for cooking but the court held that the exclusion did not apply because the words 'stored or kept', in their ordinary meaning, implied storage in large quantities, for the purpose of trade.

(ii) Intention of the Parties

It is a fundamental rule of construction that the intention of the parties prevails. Such intention is discernible from the policy itself and other documents if any, relied upon by the parties. This rule discourages courts from speculating, but reference to the surrounding circumstances may be made for example, a previous construction. The presumption that words are intended to bear their common meaning may not apply if the word in question has a clearly established technical meaning. In this case, the technical meaning may be taken to be the one intended. Insurance has its own vocabulary and some words such as 'average' have acquired such a technical meaning. A court may not allow an insurer to rely upon the technical meaning of a word unless they have made it very clear that a

technical meaning is intended, particularly if the insured is not likely to be familiar with the technical term in question.

(iii) Wholistic Rule

A policy must be interpreted as a whole. A court of law must give an insurance policy legal effect in its entity. As a general rule, the policy must be interpreted to give all clauses a positive meaning so as to give effect to the intention of the parties.

(iv) Noscitur a sociis Rule

This general principle of interpreting a word in the light of other words used with it is sometimes described as the noscitur a sociis, meaning that a word may be known by the company which it keeps. The meaning of a word always depends on its context. If the meaning is doubtful, a court will first consider the immediate context of a word and then, if necessary, the wider context of the paragraph or section, or even the policy as a whole.

(v) Ejusdem Generis

This is a more specific principle of construction based on context. It provides that general words which follow specific words are taken as referring to things of the same kind (ejusdem generis) as the specific words. In **Thames and Mersey Insurance Company Ltd v. Hamilton, Fraser Co. (1887),** the breakdown of a donkey engine was held not to be insured under an old marine policy covering 'perils of the seas and all other perils losses and misfortunes'. This was so because the general words 'all other perils losses and misfortunes' were held to refer only to risks of the same kind as perils of the seas.

(vi) Expressio Unius

This rule means that specifying one thing implies the exclusion of other things that are not specified. So, where specific words are used which are not followed by any general word, the provision in question applies only to the things specified. If in a comprehensive motor policy specifies the perils covered as accident, fire, theft and malicious damage, a loss caused by any other peril not specifically mentioned falls outside the scope of cover and insurers will not be liable.

(vii) Contra Preferentum

At times, words used in insurance contracts may be ambiguous, that is, they may carry two or more possible meanings. A dispute may occur because the insured insists on one meaning and the insurers insist on another. In this case, the courts apply the contra proferentum rule. The ambiguity is then construed against the party the drafted the document that contains the ambiguity, so that the other party is given the benefit of the doubt. Most insurance policies are drawn up by the insurers and any ambiguity will generally be construed in favour of the insured.

However, in some cases a broker acting for the insured will put forward clauses that he wants to incorporate in the policy, and any ambiguity in these will be interpreted in favour of the insurer.

Again, ambiguous terms in reinsurance contracts are most likely to be construed against the insurance company because reinsurance contracts are usually drawn up by the reinsured rather than the reinsurer.

The contra proferentem rule is illustrated by ***Houghton v. Trafalgar Insurance Co. Ltd. (1954).*** In this case an exception in a motor policy stated that cover would not apply when the vehicle was 'conveying any load in excess of that for which it was constructed'. The insurers argued that because the insured had carried six passengers in the insured vehicle (Which was designed for only five) the exception operated and the loss was not covered. However, the court accepted the alternative interpretation put forward by the insured, that the clause operated only where a weight load was exceeded, which had not happened in this case.

(viii) Inconsistencies

Insurance policies, like other written documents, sometimes contain inconsistencies or contradictions, so that one part of the document appears to conflict with another. The courts have developed a number of rules to address the inconsistencies.

First, where printed words conflict with words that are hand-written or typed, the latter take precedence since it is assumed that the parties intended to adapt a standard form to meet the needs of their particular case. On the same principle, an endorsement (I.e. a document or note recording a change in the insurance contact) is likely to overrule anything in the printed policy that appears to conflict with it.

Second, in the case of a contradiction between a proposal which is made the 'basis of the contract' and the terms of the policy document which is issued later, the policy document is likely to take precedence, being the final and formal expression of the agreement.

Finally, an express term of the contract will overrule any implied term. For example, a marine insurance policy may expressly override or modify the implied warranty of seaworthiness which section 39 of the Marine Insurance Act Cap. 390 carries into every contract of marine insurance.

(ix) Legal Meaning and Precedents

Insurance policies often use words that have a distinct legal meaning, and it is then presumed that the legal meaning is intended. Words like 'theft' and 'riot', both used in property insurance, provide good examples. In the case of ***London & Lancashire Fire Insurance Co. v. Bolands (1924),*** the insured held a theft policy that excluded losses caused by riot. Four armed men staged a hold-up in the insured's baker's shop and made off with all the money they could find, but the insurers denied liability on the grounds that this constituted a riot. The House of Lords upheld this interpretation of the policy, since the law at the time required the involvement of no more than three people in the case of riot and the other elements necessary for the commission of the crime were present. The fact that an ordinary person would not describe the event as a riot did not affect the decision

Once one court has considered the meaning of a word in a previous case, its decision is likely to influence future cases where the word is used in a similar context within the same sort of contract. So, although words such as 'fire' and 'storm' have no legal or technical meaning, they have acquired a particular meaning when used in insurance policies, as a result of a series of court decisions.

3.6.2 Statutory rules (rules laid down in legislation)

Acts of Parliament often contain an 'interpretation' section in which important words and phrases are given a precise definition. For example, section 2 of the Insurance Act is the interpretation section and provides definitions of various terms used in the Act. In the event that there is a dispute in a contract of insurance with regard to the terms, the court will fall back to the definition given it the Act.

A preamble is a clause at the beginning of a constitution or statute explaining the reasons for its enactment and the objectives it seeks to attain. Generally a preamble is a declaration by the legislature of the reasons for the passage of the statute, and it aids in the interpretation of any ambiguities within the statute to which it is prefixed.

3.7 TERMINATION OF INSURANCE CONTRACTS

This entails the circumstances under which the obligations of the parties to the contract came to an end. An Insurance contract may come to an end or terminate in any of the ways described below.

3.7.1 By Performance

Performance of a contract refers to where each party to the contract has done what was required of them under the terms of the agreement. In insurance, the Insured has paid the agreed premiums and observing terms and duties under the policy and the Insurer has assumed certain specified risks for an agreed period of time (like annually for non-life policies) even if no claims arise and paying any valid claims which may arise.

In property insurance, total indemnity by the insurer discharges the contract. In total loss claims, the contract will be discharged by the insurer’s payment of full sum insured or actual amount of loss. If the subject matter perishes completely, the contract is discharged even if the loss was not covered under the policy. The insured will pay a further full year’s premium if he replaces the property and wishes to insure again.

Reinstatement in indemnity contracts on account of partial loss does not terminate the contract. The subject matter exists hence the contract is not discharged. The insurer may have to pay for several such losses, even when such losses exceed the total sum insured (like under marine insurance). However in other contracts, the contract is discharged once sum insured is exhausted (for example under fire insurance) unless reinstated by payment of an extra premium.
In benefit contracts, payment of the sum assured on death or maturity terminates the contract.

3.7.2 By Mutual Consent/Agreement

The parties may at any time during the currency of the policy agree to discharge the contract. The cancellation clause in the policy provides for this at the instance of either party. However, the parties minds must be ad idem (consensus). The unused premiums in indemnity contracts are recoverable and the refundable portion is computed on pro-rata basis. In life assurance, the insured is entitled to the surrender value of the policy. However Section 89 of Insurance Act provides that if the insured surrenders a policy to the insurer, he is entitled to a partial re-imbursement of the total premiums paid provided he had been a bone fide insured for at least three Years.

3.7.3 Discharge by Breach

An insurance policy may be cancelled at the instance of the insurer for breach of a condition or warranty by the Insured. If an insured breaches a warranty or a condition precedent to the contract, the insurer has the right to treat the contract as discharged. Misrepresentation or non-disclosure (to be discussed in lecture four) by either party also cause an insurance contract to be rescinded effectively terminating it.

In the case of Jubilee Insurance V John Sematergo [1965] E.A 233, the Plaintiff Insurance Company filed an application for a declaration that it was entitled to avoid a motor policy on the ground of non-disclosure of material facts and misrepresentation. The insured had inter alia failed to disclose the fact that the subject matter had been involved in an accident a day before it was insured and that it had a major mechanical defect. The court held that the company was entitled to avoid the contract.

The right to void may occasionally lie with the insured. However misrepresentation may also be done by the insurer as illustrated in the case of **Kettlewell Vs. Refugee Assurance Co. (1909).**

The insured wanted to let her life policy lapse but the agent persuaded her to continue with it by falsely presenting that she would be entitled to a paid-up policy after 4 more years. It was held that she was entitled to avoid the policy and recover premiums since the date of the agent's misrepresentation.

Note that breach may occur in the following circumstances:

- Failure to pay a valid claim;
- Undue / unreasonable delay in reinstating / repairing the subject matter amounts to a breach; and
- Provision of a defective building or a badly repaired car amounts to a breach.

3.7.4 By Operation of Law

An insurance contract terminates if circumstances make its sustenance impossible for example winding up of the insurer or transfer of the subject matter. In the case of **Kinyanjui v South India Ins. Co. [1968] EA 160,** the plaintiff had obtained judgment under the Fatal Accidents Act against

driver and alleged owner of a minibus. The insurer disclaimed liability on the ground that though the alleged owner had taken out a policy, the minibus was being operated by a company to which it had been transferred hence the alleged owner had no insurable interest in it. The court held that since the company owned and operated the bus under its own driver, it alone had insurable interest therein and the alleged owner and driver were not liable nor the insurer since the policy lapsed when the bus was transferred to the company.

3.7.5 Frustration

This may occur if the subject matter of insurance is destroyed, this leads to termination of the contract. For example a motor vehicle is declared a total loss following a road accident; the effect is to discharge the contract for frustration. There is no refund of insurance premiums if the risk was already running at the time of loss.

3.7.6 Lapse of Time for Indemnity Contracts

On the expiry date of the policy, if there was no claim, the contract will discharge. Where a claim was lodged during the period of insurance and remains unsettled on expiry, the contract will not necessarily be discharged. The insurer will remain liable for losses sustained during the period of insurance even if they come to light afterwards for example, under employer's liability cover, where illness may be diagnosed much later.

3.8 ASSIGNMENT IN INSURANCE

In lecture two, you learnt assignment is the transfer of one's rights under a contract to another. You also understood the ways in which contracts may be assigned. In this lecture, you will be engaged on the application of assignment in insurance which may take the following forms:

3.8.1Assignment of the Subject Matter

Assignment of the subject matter does not transfer any rights under the policy. If the insured disposes off the subject matter of insurance, the effect is to bring the contract to an end. This is because the insured ceases to have insurable interest in the subject matter. The new owner will be required to enter into a completely new contract by making a fresh offer which is subject to acceptance and other requirements for validity of a contract.

3.8.2Assignment of the Benefit

The right to recover money under an insurance contract is a chose in action (a valuable but intangible piece of property) and can be assigned to another person. The entire contract is not assigned but only the benefit for example, proceeds from a valid claim and there is no change in the subject matter. However, notice must be given to the insurer and where notice is not given, the assignee cannot enforce his rights against the insurer. Where notice is given, consent of the insurer is not necessary.

Assignment of the benefit can take place before or after the loss and the assignee need not have insurable interest on the subject matter.

3.8.3 Assignment of the Contract

As mentioned in the lecture two, insurance contracts are generally not assignable. This is because there are factors that limit the assignment of the entire contract. Contracts of insurance are personal in character that is, cover is granted subject to some extent based on the insured's personal characteristics for example, nature of the person and their personal characteristics in relation to risk. However, there are certain contracts of insurance which by their nature are freely assignable. These contracts are explained below.

Marine Cargo Insurance

Marine cargo policies can be assigned. This is because the ownership of the cargo may change several times during the period of insurance and insurance cover can be easily transferred at the same time. The goods will remain in the same ship and the risk does not change. A cargo policy is therefore not personal contracts and assignment can take place. However, Marine Hull policies are not freely assignable because the ownership of the vessel will obviously affect the risk as it has the effect of transferring the subject matter.

Life Policies

Life policies provide a means of investment and a source of protection and acquire a surrender value after premiums have been paid for atleast three years. The insured therefore has a useful and valuable piece of property which may be transferred to another or be used as security. These policies are freely assignable provided the identity of the life assured does not change. Life insurance policies are therefore not personal contracts. Assignment can be absolute (complete and irrevocable) or conditional (refer to Principles and Practice of Insurance unit).

3.8.4 Types of Assignment

You have learnt the types of assignment in the last lecture. Let us now understand their relevance in the practice of insurance. The main types are explained below.

Statutory Assignment

The assignment of life policies must be done in accordance with the provisions of the Insurance Act. The Act provides that an assignment of a policy of life assurance shall:

- Be by memorandum of transfer and shall be endorsed upon the policy or upon an annexure to the policy that is referred to in, or in an endorsement on, the policy; and be
- Signed by the transferor in the presence of a witness; and
- Will not be recognized by or be binding on the insurer until it is registered in accordance with the provisions of the Act by the insurer who is liable under the policy.

Equitable Assignment

A life policy can be assigned through equitable assignment provided the intention to assign is clear.

Assignment of Life Policies by Operation of the Law

On death or bankruptcy of the life assured, their rights under the policy automatically pass on to the personal representative or trustee in bankruptcy. This was referred to as involuntary assignment in lecture two.

3.9 REMEDIES FOR BREACH AN INSURANCE CONTRACT

You have now understood the circumstances under which breach of an insurance contract may occur. Note that breach in insurance can be committed by either the insurer or the insured. There are various remedies available to both parties some of which have already been discussed in the last lecture. The common remedies in insurance contracts are discussed below.

3.8.1 Rescission/Avoidance

From lecture two, it was explained that this is cancellation of the contract and has the effect of effectively discharging the contract. However, for the remedy to be given, the breach must be so fundamental as to undermine the contract as a whole. A contract can be cancelled due to breach of good faith, warranty or a condition precedent to the contract. However, insurers may opt for other remedies instead of terminating the contract due to other considerations. This remedy is available to both parties to the contract.

3.9.2 Damages

As explained in lecture two, damages refer to the financial compensation awarded by courts with intent to place the aggrieved party to a position they would have occupied had the contract been performed. This remedy is given as of right and is dependent on whether the claim is for a liquidated or unliquidated sum. Damages may be given in lieu of rescission or in addition to damages. They are awarded in case of breach of condition subsequent to the contract or precedent to liability or where there is innocent misrepresentation. This is the most common remedy in liability claims. This remedy is not available to the insured in case of breach by the insurer. This will be explained in lecture four.

3.9.3 Retention of Premium

Where a policyholder fraudulently misrepresents material facts, insurers are entitled to retain the premiums. You may recall that money paid under an illegal contract cannot be recovered in court provided the parties are 'in pari delicto' (equal in wrongdoing). This can also arise in insurance contracts. In the case of **Worthington v. Curtis (1875),** an insurer paid under a life policy effected by father on the life of his son, knowing that the policyholder had no interest and the insurance was, therefore, illegal. The court held that the parties were *in pari delicto* and the father was entitled to keep the money.

3.9.4 Injunction

This is an equitable remedy whereby the court issues an order barring the other party from acting in some way. An injunction is not automatically available but is issued at the discretion of the court. Where the claimant is seeking an injunction, it may be necessary to apply for an injunction at the outset of proceedings to protect their position until the trial of the claim. Such injunctions are generally only available if they are prohibitory. An insurer who becomes aware of an action against the insured at the point of judgment will apply to the court for a prohibitory injunction to restrain the judgment debtor/plaintiff from taking any further action until their application is heard and determined.

3.9.5 Affirmation

The insurance may waive their right to cancel the policy by ignoring the breach and allowing the contract to continue. The insurer must exercise this option within a reasonable time of discovery of the breach. However, insurers cannot, for instance, refuse to pay a particular claim but at the same time affirm the contract and allow it to stand. This is a remedy regardless of the nature of breach. In some instances, insurers pay claims on ex-gratia (out of grace) even where contractually liability does not attach.

3.10 SUMMARY

From this lecture, we have found out that:

- A legally binding insurance contract cannot exist unless it complies with all the essential requirements which include offer and acceptance, consideration, form, intention to create legal relations and contractual capacity;
- There are various categories into which insurance contracts may be classified for example according to the nature of the contract, event under which a claim is paid, by the interest insured and whether the contract is direct or a reinsurance arrangement;
- Insurance contracts contain terms which the insured must comply with and there are consequences for non-compliance. These terms are warranties and conditions;
- Rules have been developed to assist in the interpretation of insurance contracts in the event of a dispute. Some of these rules are: Intention of the parties, expression unius, contra preferentum, literal rule among others;
- Insurance contracts may be discharged under various circumstance which include performance, agreement, frustration, operation of the law and breach;
- Breach of an insurance contract can be by either party and; there are remedies available in case of breach of a contract which are; avoidance, damages, retention of premium, affirmation and injunction.

3.11 ACTIVITY

1. Explain the rules of interpretation of insurance contracts.
2. Outline the circumstances under which an insurance contract may be discharged by breach.
3. Explain the remedies available to the insurer for breach of a contract by the insured.
4. Describe the classification of insurance contracts.
5. Explain situations under which acceptance is deemed to have occurred in insurance contracts.
6. Explain the types of information found in a proposal form.
7. Highlight the difference between a warranty and a condition as used in insurance contracts

3.12 READING LIST

i. Insurance Law (P05) CII

ii. General Principles of Law Simplified by N.A. Saleemi

iii. Past Papers

LECTURE FOUR

4.0 THE PRINCIPLES OF INSURANCE

LECTURE OUTLINE

4.1 Introduction
4.2 Learning outcomes
4.3 Implications of the legal aspect principles of insurance in insurance contract

- Insurable interest
- Utmost good faith
- Proximate cause
- Indemnity in insurance
- Subrogation
- Contribution

4.4 Summary
4.5 Activities
4.6 Reading list

4.1 INTRODUCTION

In lecture three, you examined the contract of insurance and learnt that for the contract to be valid, certain essentials must be present. You are also now able to interpret a contract from formation stage until the same is discharged.

Welcome to lecture four. In this lecture, you will learn about the principles of insurance and analyse their implications during underwriting and claims process. An agreement to insure must satisfy all the requirements as to offer and acceptance, consideration, contractual capacity and form which were discussed in the lecture three. However, even if these requirements are fulfilled, the contract may still fail if it does not comply with the legal principles of insurance. You may have covered these sub-topics in detail in Principles and Practice of Insurance Unit. These legal principles are Insurable Interest, Utmost Good Faith, Proximate Cause, Indemnity, Subrogation and Contribution. It is these principles that distinguish insurance contracts from other contracts.

4.2 LEARNING OUTCOMES

By the end of this lecture, you should be able to:

a. Explain the implications of the legal aspect of the principles of insurance in insurance contracts

Competence

The trainee should have the ability to apply the legal aspects of principles of insurance in the interpretation of an insurance contract

Content

Let us now start by explaining the implications of the legal aspect principles of insurance in insurance contract.

4.3 IMPLICATIONS OF THE LEGAL ASPECT PRINCIPLES OF INSURANCE IN INSURANCE CONTRACT

We will now discuss these principles starting with Insurable interest.

4.3.1 INSURABLE INTEREST

There is no single definition of insurable interest. For purposes of this study, insurable interest is the legal right to insure arising out of a financial relationship recognised at law, between the insured and the subject matter of insurance. This in simple terms means that the policyholder must be in a position where they will suffer loss if the event which they have insured against occurs. There are four key elements of insurable interest from the definition which include:

- Subject matter of insurance;
- The policyholder must have an economic or financial interest in the subject matter of insurance;

- The interest must be a legal interest; and
- Interest must be current and not expectancy.

These are explained below.

The Subject Matter

The term subject matter can refer to two things. It refers to the property, life or the liability which is the subject matter of insurance. It also refers to the financial interest that the insured has in the subject matter of insurance which in this context is the subject matter of the contract. It is important to understand that when a person arranges insurance on, say, their house, they are insuring not the property as such but their interest in that property. Although the property is the subject matter of insurance, it is this monetary value of the property which is the subject matter of the contract. The owner of property has an interest because destruction of, or damage to, the property will obviously cause the owner loss. In other cases, the subject matter of the insurance will be something other than material property; it may be human life or something intangible, such as a debt.

Economic/Financial Interest

The doctrine of insurable interest requires there to be a relationship between the insured and the subject matter of insurance whereby the insured will suffer a financial loss if the insured event insured against occurs. In the case **Castellain vs. preston**, the court held that a man is interested in a thing to whom advantage may arise or prejudice happen from the circumstances which may attend it. The court further stated that to be interested in the preservation of a thing is to be so circumstanced with respect to it as to have benefit from its existence or prejudice from its destruction. However, the interest must be one that is reasonably capable of valuation in money.

Legal Interest

In Kenya, the interest must also be a legal or equitable interest, that is, one that the law recognises and will support. The leading case is ***Macaura v. Northern Assurance Co. Ltd.*** **(1925),** Macaura had insured a quantity of timber on his estate under a fire policy in his own name. He had already sold the timber to a company of which he was the only shareholder. When the timber was destroyed in a fire incident, the insurers refused to meet the claim on the grounds that Macaura had no insurable interest in the assets of the company. The court supported the insurers, holding that the insured had an interest in his shares, but none in the timber, which was owned by the company, a separate legal entity. The fact that the insured would clearly suffer an economic loss as result of the fire, because the value of his shares would go down, was regarded as insufficient to give him an insurable interest.

It is worth noting that in a number of countries where the legal system is based on English law the *Macaura* principle has been rejected, abandoned, or never adopted. They include the USA, Australia and Canada. Generally, in these countries an economic or financial interest in the subject matter is required but a legal or equitable interest is not. In Kenya, we recognise legal and not economic interest.

Interest Must be Current and not Expectancy

The law requires that a person has a current interest in the subject matter of insurance. A mere hope or expectation of acquiring an interest in the future is not enough. Suppose the case of the heir at law of a man who has an estate worth Kes. 50 million and who is ninety years of age, upon his death bed intestate, and incapable from of making a will. There is no man who will deny that such an heir at law has a moral certainty of succeeding to the estate, yet the law will not allow that he has any interest, or anything more than a mere expectation.

Why does the law require insurable interest?

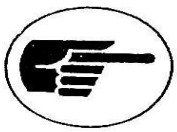
There are two main reasons why the law requires insurable interest:

(i) To Reduce Moral Hazards

Moral hazard relates to the character and behaviour of the insured in relation to the subject matter of insurance. The granting of insurance may actually increase the likelihood of a loss occurring, because it changes the incentives and behaviour of the insured in the absence of insurable interest. The insured may become less careful than they would be if they had no insurance or even cause a loss deliberately in order to collect the insurance money for example, tempting the policyholder to commit arson or other destructive acts in order to get the insurance money. The same is true in the case of life insurance, because an unlimited right to insure the lives of other people might provide a motive to murder so as to collect insurance claims money.

(ii) To Discourage Wagering

Society has often tried to suppress, or at least control wagering (or gambling). In the past insurance policies were often used as a cloak (to conceal) for gambling and it was this irresponsible use of insurance as a means of betting on the lives and property of others that led Parliament to discourage the practice by imposing a need for insurable interest. In fact, the presence of insurable interest is the key difference between an insurance policy and a wager.



You have already covered the application of insurable interest in various classes of insurance in Principles and Practice of Insurance unit. How does it arise in liability insurance where majority of the claims arising end in Litigation.

Liability insurance

Everybody faces the risk of being sued for damages if they cause harm to another person through their negligence or other unlawful act. They also face the risk of having to pay legal costs in defending themselves. Liability can arise in connection with a business enterprise or through private activities,

such as the ownership of a home or the driving of a car. Furthermore, liability of this sort is often unlimited, at least in theory. It follows that everybody has an interest that is insurable. It is sometimes stated that the subject matter of liability insurance is the potential liability itself. However, it is more correct to say that the subject matter of a liability policy is the insured's wealth or their assets, which will be reduced if they have to pay damages.

What Happens Where Two or more People Have Limited/Overlapping Interests in Property?

In some cases, a person will have only a limited interest in the property concerned. The interest of a part-owner will be limited to the value of their share in the property and the interest of a mortgagee such as a bank or building society will be limited to the amount of the loan that has been granted. A person who purchases a car from seller and has not made full payment for it has limited interest in the car to the extent of the amount paid.

It is important to understand that a person with a limited interest may, nevertheless, insure the property for its full value. To avoid confusion, and possible double insurance, it is sensible for the parties to agree about who should arrange the insurance. For this reason, a mortgage deed or lease agreement should normally state which of the parties shall have the duty to insure. This does not mean, however, that they can keep all the insurance money in such a case; on the contrary, the maximum amount that he will be able to retain is the amount of his own interest. Any surplus will generally be held on trust for the other person or persons with an interest in the property.

A mortgagee will have the right to insure mortgaged property for its full value but will be able to keep no more than the amount of the outstanding debt if the property is destroyed and the insurers pay for the loss in full. The balance must be paid over to the mortgagor (the purchaser of the house or property).

Case example

Waters v. Monarch Fire and Life Insurance Co. **(1856),** the claimants, who dealt in flour and corn, effected a fire policy on goods in their warehouse covering their own property and also goods belonging to others which they held in trust or on commission. A fire destroyed all the goods and the court held that the claimants could recover for the whole loss and not just the value of their own goods. That part of the claim payment which corresponded to the goods belonging to others had then, of course, to be paid by the insured to the owners of the goods in question, failure to do so would be a breach of trust

Outline how insurance interest arises in life and property insurance.

4.3.2 UTMOST GOOD FAITH

The duty of utmost good faith (uberrima fides) is central to the buying and selling of insurance. Accordingly, insurance policies are described as contracts uberrimae fidei (utmost good faith). This, in simple terms, means that the insurer and the person who is applying for insurance have a duty to deal honestly and openly with each other in the negotiations that lead up to the formation of the contract. This duty may also continue whilst the contract is in force. If one party is in breach of this duty the other party will usually have the right to avoid the contract entirely. The doctrine of utmost good faith imposes two duties on the parties to the contract.

- Duty not to misrepresent any matter relating to the insurance that is a duty to tell the truth; and
- Duty to disclose all material facts relating to the contract that is, a duty not to conceal anything that is relevant.

Breach of the duty of utmost good faith can therefore occur through misrepresentation or non-disclosure. These are explained below.

Misrepresentation

A misrepresentation has been defined in lecture two as a false statement of fact that induces the other party to enter into the contract. To affect the validity of the agreement the false statement must:

- Be one of fact rather than a statement of law, or of opinion
- Be made by a party to the contract;
- Be material (that is, something which would influence a reasonable person in deciding whether to enter into the agreement);
- Induce the contract (that is, be something that the other party relied upon in deciding to enter into the agreement); and
- Cause some loss or disadvantage to the person who relied upon it.

Duty of Disclosure

We have seen from the last chapter that contracts for the sale of goods are subject to the doctrine of 'caveat emptor' (let the buyer beware). Although the buyer of goods is given considerable protection by statutes such as ***Sale of Goods Act*** which applies to commercial contracts generally, but not to insurance, the basic responsibility of each party is still to make sure that they make a good bargain. This is largely because the buyer is able to examine the goods, assess their quality, and judge for

themselves whether the price is fair. Therefore, so long as neither party positively misleads the other, and any questions which are asked are answered truthfully, the contract cannot be avoided simply because one party finds that they have made a poor bargain. In particular, neither party is required to disclose information that is not asked for. This means, for example, that if you are selling a car you are under no positive duty to disclose anything about it to the buyer.

A contract for the sale of goods will involve tangible property, such as the car in our example above. However, the parties to an insurance contract are dealing with a product that is intangible. A positive duty exists in insurance contracts to fully disclose all the material facts relating to the subject matter. Non-disclosure will amount to breach of utmost good faith. Details of what must or need not be disclosed have been discussed in Principles and Practice of Insurance unit.

Non-disclosure and Misrepresentation

The dividing line between misrepresentation (making statements that are false), and non-disclosure (failing to disclose the whole truth) is a very fine one. A proposer for life insurance may say that they are in good health when they know that they are suffering from a serious illness. This might amount to both misrepresentation (an untrue statement about the proposer's state of health) and non-disclosure (a failure to tell the insurers about a serious illness).

Therefore, if the insurers in this case wished to avoid the insurance policy, they would probably raise both defences. In practice, misrepresentation and non-disclosure tend to be regarded as aspects of a more general duty to act in good faith.

Continuing Duty of Disclosure

The duty of utmost good faith is continuing duty, in the sense of a duty to disclose new material facts affecting the risk during the currency of the contract is required. However, as we shall see, a general duty of good faith continues throughout the contract and becomes important if there is a loss that results in a claim. We begin, however, with the two cases where there is an ongoing duty to disclose information relating to the risk.

(i) Changes in the Contract

The first case is where there is an agreed change in the contract during the period of insurance. In these circumstances the insured has a duty to notify material facts which relate to the change.

For example where the insured changes the engine of the car, or wishes to add new drivers to their motor policy, they clearly have a duty to disclose to their insurers all material facts relating to the vehicle or drivers concerned when making the change. Similarly, if a policyholder wished to increase the sum insured under their fire policy they would have to disclose details of any new property that they had acquired or any other relevant circumstances connected with the change.

(ii) Good Faith in the Claims Process

Although the common law duty to disclose facts material to the acceptance or pricing of the risk is confined to, at inception and renewal, the courts have confirmed that a general duty of good faith exists throughout the currency of the policy. This is most significant if there is a breach of good faith, and particularly fraud, during the claims process.

However, the right to repudiate a claim and the contract itself will arise only in the case of actual fraud in the claims process; that is, a deliberate attempt to deceive the insurers and gain an advantage. The falsehood in question must be substantial, willful and material in the sense that it had a decisive effect on the insurer's willingness to pay. The burden of proving fraud rests on the insurer and the standard of proof required is likely to be rather higher than the usual standard of the civil law. Claiming for a loss that one knows has not occurred, or for property that has not been lost, is clearly fraud. However, if the court believes that the insured has attempted to gain a dishonest advantage they may well say it is fraud, even if the amounts involved are not very large.
In Kenya, the Claims Management Guidelines issued by IRA provides that an insurer will not avoid a claim on grounds of:

- Non-disclosure of material facts which a policyholder will not reasonably be expected to have known; and
- Misrepresentation unless it is fraudulent or negligent misrepresentation of material facts.

Effects of Breach of utmost good faith
A breach of good faith may occur on the part of the insured or on the part of the insurer. What are the effects when this happens?

Breach by the Insured
Where the insured is in breach of utmost good faith, the insurer is entitled to various remedies and these are:

- The insurers have the right to avoid the contract 'ab initio' (from the beginning). The effect is that the contract is cancelled retrospectively, so that the insurers are not liable for any claims arising between the making of the contract and the time when it is avoided;
- If concealment or fraudulent misrepresentation is involved, the insurer may also keep any premium paid;
- If the insurer wishes, they may waive (give up) their right to avoid the contract and allow the policy to stand. The insurer must exercise their option within a reasonable time of discovery of the breach. If they do not, it will be assumed that they have decided to waive their rights; and
- In the case of misrepresentation, insurers may have a right to claim damages as an alternative (or, in the case of fraud, in addition) to avoiding the policy. If the insurers are in breach of their duty of good faith, the insured will be entitled to avoid the contract but cannot claim damages.

4.3.3 PROXIMATE CAUSE

We have seen that careful drafting of insurance policies is necessary to minimise disputes about the meaning of the words used. Unfortunately, even where there is no dispute about the meaning of the words used, a dispute may still arise as to the true cause of the loss. This is a separate issue. You are already familiar with the doctrine of proximate cause and that insurers will only pay if the loss is proximately caused by a peril insured against.

What is proximate cause?

There is no standard legal definition of proximate cause. It has been described, in various cases, as the active, direct, real, immediate, dominant, operative or efficient cause of the loss. To speak of a main or direct cause, suggests that there are also 'minor' or 'indirect' causes, in other words, causes which play only a small part in bringing about the loss. These are generally described as remote causes a remote cause being more or less the opposite of a proximate cause. The law will normally disregard remote causes and consider only the proximate cause of the loss.

A policy may cover fire but exclude fire caused by earthquake. What happens if a fire breaks out during an earthquake? There may be a dispute, not about the meaning of the words 'earthquake' or 'fire', but about whether or not the fire resulted from the earthquake. Like many insurance principles, the doctrine is codified in the Marine Insurance Act Cap. 390 of the laws of Kenya. Section 55(1) provides inter alia that unless the policy otherwise provides, the insurer is liable for any loss proximately caused by a peril insured against, it is not liable for any loss which is not proximately caused by a peril insured against.

The doctrine is easy to state but sometimes hard to apply in practice. Of course, when an accident or loss occurs, many things may have helped to bring it about. A road accident may be the combined result of careless driving, bad weather, a poor road surface, inadequate warning signs, a vehicle with poor safety features and many other chance factors. That which we regard as the 'proximate cause' may well depend on who we are and the purpose of our enquiry. For example, a policeman may take a different view from that of a motor vehicle engineer or road safety campaigner.
In insurance, however, we are concerned only with the proximate cause for the purpose of the agreement expressed in the insurance policy. In other words, our task is to establish whether or not the parties intended the loss to be covered. When a loss occurs, the insured will always be required, by a policy condition, to give notice of the loss and the burden of proof for the loss lies on the insured. To discharge the burden of proof, the insured must be able to establish two things:

- That the loss was caused by the operation of an insured peril; and
- The amount of his loss.

These things must be established by the insured on the balance of probabilities. In fact, finding the proximate cause of a loss is not difficult when the circumstances of a loss are simple and little time passes between the event which brings about the loss and the damage that results. There can be little dispute about the proximate cause of the loss when thieves break into a shop and steal electrical goods or when a car is stolen from a parking.

Difficult in ascertaining the proximate cause will arise in two circumstances which are:

- Chain of events; and
- Concurrent causes.

They are explained below.

(i) Chain of Events

This is said to arise when the loss results from a series of events which are spread over time and other perils, uninsured or excluded, are involved besides those which are insured. In other words, there is a chain (or train) of events. In the case of **Leyland Shipping v. Norwich Union Fire Insurance Society Ltd (1918),** the ship in question, the Ikara was insured under a policy that covered perils of the seas, but excluded war risks. She was hit by an enemy torpedo and, despite being badly holed and in danger of sinking, reached the port of Le Havre, where repair work was started. When a storm blew up, the harbour master ordered the ship to an outer berth to save the harbour from being blocked if she sank, which she did after she left port. Many earlier cases had been decided on the basis that where there was a 'chain of events' the last event to occur was the proximate cause but the Leyland Shipping case clearly put an end to this theory in English Law. Was the proximate cause of the loss the torpedo (a war risk which was excluded) or the storm, which was the last event to happen, and was insured as a peril of the sea.

The court held that the torpedo was the proximate cause of the loss because the damage it caused had been effective throughout and the 'chain of events' had not been broken. In theory, then, where there is a 'chain of events', the insurers are liable where the loss flows in an unbroken chain directly from an insured peril. Equally, there is no liability if the loss flows directly from an excluded peril. However, the chain will be unbroken only where each event is the natural and probable result of what happened before. If the chain is broken by some new intervening cause the position will be different.

Case example

In ***Marsden V. City and County Insurance (1865),*** a fire caused a mob to gather, and a glass was broken when a riot developed and the mob took to plundering. The policy in question covered breakage of glass but excluded breakage by fire. In this case, the riotous conduct of the mob was not an inevitable or probable result of the fire and so the chain of events was broken. The riot and not the fire was held to be the proximate cause, so the exception did not apply and the loss covered.

Efforts to Avoid or Reduce Loss

Insurance policies usually require the insured to take reasonable precautions to avoid loss or damage and also to take reasonable steps to mitigate (minimise) any loss which actually occurs. The latter duty may even apply automatically, as a matter of law. In any event, provided the steps taken are reasonable efforts to prevent or limit the operation of the insured peril, the insurers are liable for any damage to the subject matter that results, this action being regarded as part of the insured peril itself. To take some obvious examples, fire insurers are liable to pay for damage caused by water which is used to extinguish a fire. They are also liable to pay for damage to premises such as the breaking down of doors caused by fire services to gain access to the building that is on fire.

In the marine case of ***Canada Rice Mills v.Union Marine and General Insurance Co. (1941),*** the master of a ship was carrying rice in stormy seas ordered the ventilations to the holds to be closed to stop sea water getting in, and the lack of ventilation to the holds caused damage to the rice. It was held that this loss was covered because the proximate cause was the heavy weather, a peril of the sea that was insured by the policy.

Prevention costs

Although damage to the insured subject matter is covered if it is the result of reasonable efforts to avoid or reduce the impact of an insured peril, the English courts have refused to allow recovery for mere prevention costs. By this we mean, not damage to the subject matter itself, but expense incurred to prevent damage being caused to the subject matter by an insured peril.

(ii) Concurrent causes

Occasionally, two or more perils operate concurrently (at the same time) to bring about a loss. For example, a building might be damaged by a fire that was raging and a storm that was battering it at the same time. Where the perils are independent meaning, either one would have caused some loss without the other, the insurers are simply liable for that part of the toss attributable to whichever peril is insured. So, if the policy covered fire but excluded storm the insurers would be liable for the fire damage but not for the storm damage. In some cases, of course, it may be difficult to say how much damage would have been caused by the insured peril alone.

In other cases the perils may not only be independent but also interdependent, in the sense that neither peril would have caused damage on its own. It is impossible to attribute part of the damage to one peril and part to the other. The two causes might be equally powerful in their effect, so that each is a proximate cause. If this happens the result will depend on whether there is a combination of an insured peril and an excepted peril, or a combination of an insured peril and an uninsured peril.

Insured Peril Combined With Expected Peril

If one peril is an insured peril and the other is an excluded peril, the exception prevails and the insurers have no liability at all. In the case of **Wayne Tank and Pump Co. Ltd. v. Employers' liability Insurance Corporation Ltd. (1974),** the insured company had built a storage tank at a plasticine

factory. A fire started in the tank and destroyed the factory, so that they had to pay damages to the owners, Harbutt's Plasticine Ltd. The fire for which they were legally liable arose from a combination of two causes. First, from the defective state of the equipment installed (a source of liability which was excluded by the public liability policy) and, second, from the negligent act of an employee who switched on equipment so that it was left on all night (a source which was insured). These causes were independent and also interdependent.
The court held that the proximate cause of the loss was the defective state of the equipment but it was noted, obiter, that had both causes been equally powerful the insurers were held not liable.

Insured Peril Combines with Uninsured Peril
If one of the perils is an insured peril and the other is an uninsured peril (not specifically excluded) the position is different. In this case the insurers are liable for the whole of the loss.
In the case of ***J. J. Lloyd (Instruments) Ltd. v. Northern Star Insurance Co. Ltd. (1987)*** (The Miss Jay Jay), damage to a yacht was caused by two concurrent proximate causes. First, heavy weather (a peril of the sea which was insured) and, second, defective design (which was an uninsured peril). Neither cause would have brought about the loss on its own nor, since the former was insured and the latter was not excluded, the insurers were liable in full.

Modification of the doctrine of proximate cause
The principle of proximate cause can be excluded or modified by the particular words used in the policy. Insurers may wish to exclude some risks such as war risks absolutely and be in a position to refuse payment even where the peril operates as a remote cause. To achieve this, insurers sometimes exclude losses caused 'directly or indirectly' by the peril in question. If the clause is upheld, the effect will be to exclude any loss in which the peril operates, even though it does so only as a remote cause.

In the case of ***Coxe v. Employers' liability Insurance Corporation Ltd,*** the insured was killed in the darkness by a train whilst inspecting sentries guarding a railway, the lights having been extinguished under wartime regulations. War was excluded as an indirect as well as a direct cause and so the insurers were not liable, even though war was only a remote cause of the accident. The effect, therefore, was to widen the exclusion and reduce the scope of the cover for insurers.

4.3.4 INDEMNITY
Indemnity means protection or security against damage or loss. To indemnify is therefore to protect someone by promising to pay for the cost of possible future damage, loss, or injury. Accordingly, contracts of indemnity are intended to provide financial compensation for a loss which the insured has suffered thereby putting them in the same position they enjoyed immediately before the loss. The principle of indemnity requires that the insured be fully compensated for their loss. They should not be over-compensated or undercompensated.

However, not all insurance policies are contracts of indemnity. Indemnity insurances are those where the insurers agree to pay only when the insured suffers a loss of a particular type, and only for the

amount of the loss. Most types of general insurances are indemnity contracts, that is, property, pecuniary and liability insurances, including motor, marine and aviation. Benefit contracts on the other hand are policies in which insurers agree to pay a specified sum when a particular defined event occurs. The insured does not have to prove that they have suffered a loss, only that the event in question has happened. Life and Personal accident insurance policies provide the best example of this category. In this case, an agreed sum is payable in the event of death or after a certain number of years on maturity of the policy.

Measure of indemnity

A claim under a policy of indemnity has been described (in the case of ***Jabbour v. Custodian of Israeli Absentee Property (1954))*** as a claim for unliquidated damages**.** This means that the exact amount of the compensation is not known in advance but is to be fixed afterwards on the basis of the loss actually suffered.

Let us discuss measure of indemnity in a few classes of insurance

Property Insurance

The general rule is that the measure of indemnity for the loss of any property is determined not by its cost, but by its value at the date of loss and at the place of loss. Under property insurance the insured cannot claim for loss of prospective profits or other consequential losses unless these are specifically insured. Property policies cover only the actual financial value of the subject matter and the insured cannot claim any amount for sentimental value.

In a claim for buildings for example, the normal basis of indemnity will be the cost of repair or reconstruction at the time of the loss with, in many cases, a deduction for betterment. The appropriate basis depends on a number of factors, including the intentions of the insured with regard to rebuilding, and whether rebuilding is a reasonable course of action.

In the case of ***Reynolds and Anderson v. Phoenix Assurance Co. Ltd,*** the claimants had bought, in 1969, an old maltings (buildings used for processes employed in the brewing of beer) and insured them for £18,000, which was a little more than the anginal purchase price. Subsequently, the sum insured was increased to £628,000 to cover the probable cost of rebuilding in the event of the building being totally destroyed. A fire then occurred which destroyed a substantial part of the building and a dispute arose as to the appropriate basis of indemnity. The judge outlined three alternative bases:

- Market value;
- The cost of erecting a modern replacement building'(around £50,000); and
- The cost of reinstatement, i.e. rebuilding the damaged part in its original form which would amount to more than £250,000.

The market value of the building would have been difficult to assess, but would probably have been far less than the cost of rebuilding. The cost of a modern replacement would also have been much

lower than the rebuilding cost. Nevertheless, the court held that the appropriate basis of indemnity was the third alternative the cost of rebuilding in the original form. This was because the insured had a genuine and reasonable intention of rebuilding.

Pecuniary insurances

Pecuniary insurances cover various types of financial loss. Pecuniary insurances include business interruption insurances which cover loss of profit as a result of physical damage (such as by fire) to the insured's property, and credit insurances which cover bad debts arising from the insolvency or default of the insured's trading partners. In the case of business interruption insurance, the loss is, therefore, paid in accordance with a standard formula which is set out in the policy wording. In the case of credit insurance, indemnity will be easy to assess, being the amount of the bad debt, less any recoveries

Liability insurance

Liability insurances protect the policyholders against legal liability to third parties for injuries or damage to property to third parties in arising out of their activities. The measure of indemnity will be the amount of any court award or negotiated 'out of court' settlement plus costs and expenses arising in connection with the claim (such as lawyers fees, court fees, and payment for medical reports or the services of expert witnesses) plus any other expenses which have been incurred with the agreement of the insurers.

Marine insurance

Most marine policies are valued. In the case of an unvalued marine policy, the basis for the measure of indemnity (unless another basis has been agreed) is the 'insurable value', which is the value of the subject matter at the commencement of the risk. This is the amount recoverable in the event of a total loss. The amount recoverable for a partial loss depends on what is insured. For a ship, the measure will usually be the reasonable cost of repairs. However, if the vessel is not fully repaired, the measure of indemnity is the depreciation in its value. In the case of goods which are delivered in a damaged state, the insured is entitled to a proportion of the insured value

4.3.5 SUBROGATION

In the context of insurance, subrogation refers to the right of an insurer who has indemnified the insured in respect of a particular loss (paid a claim) to recover all or part of the claim payment by taking over any alternative right to indemnity which the insured possesses. It follows that subrogation will arise only where the insured has suffered a loss and has another means of recovering for it. This is common where one can claim on their insurance policy and a legal right or claim against some other person for the same loss. If the insured chooses the first option (a claim on their policy), then the alternative right, the claim against another, passes to the insurers. The effect is to prevent the insured from recovering twice for the same loss and so preserve the principle of indemnity.

Why does the law allow subrogation?

The main purpose of subrogation is simply to prevent what is known as the unjust enrichment of the insured in other words to prevent him from unfairly profiting from their loss and so to preserve the principle of indemnity. It is sometimes suggested that subrogation prevents the guilty party from being let off the hook, ensures that they do not escape their financial responsibilities simply because the other party has been careful enough to arrange insurance.

The case of Napier v. Hunter set the following principles with regard to subrogation.

- There is a duty on the part of the insured to start proceedings against a third party in order to reduce his loss ;
- A is an undertaking by the insured to account to the insurer for moneys received from the third party;
- A promise by the insured to permit the insurer to exercise their right of action against the third party should the insured fail to do so themselves; and
- A promise by the insured to act in good faith when proceeding against the third party.

Operation of Subrogation

The principle of subrogation can operate in two ways.

Firstly, the insured may succeed in recovering for the same loss twice by collecting a claim payment from his insurers and also recovered compensation for the same loss from another source. In this case the insurers can call upon the insured to pay back to them the 'profit' which has resulted from the double recovery. Moreover, the courts have held that insurers have an enforceable equitable lien or charge over such money. This means that the insurer may be able to secure an injunction requiring the money to be paid over.

Secondly, where the insured has not received compensation from another source, insurers who have indemnified the insured in respect of the loss may themselves bring an action against the third party who is legally responsible for it. This is the most common practice in Kenya. We will look at each of these situations in turn.

Where the insured has recovered for the same loss twice

In the case of ***Castellain v. Preston (1883),*** the seller of a house recovered £330 from his insurer when the property was damaged by fire between the signing of the contract and the completion of the sale. The buyer afterwards completed the purchase and, despite the fire, paid the full price of £3,100, which he was bound to do by the terms of the contract. Held that the seller had to pay to his insurer

£330 from the money that he had received from the buyer, otherwise the seller would have made a profit from his loss.

The rule that the insured cannot recover in respect of the same loss twice is subject to some qualifications:

(i) The Insured must be Indemnified

First, the insured is only accountable to the insurers if he has been indemnified for his loss.
In the case of ***Scottish Union and National Insurance v. Davies (1970)*** insurers had paid £409 to the motor vehicle repairers who had carried out repairs on the insured's car. However, even though three attempts had been made to repair the car, the work was not satisfactory, so the insured sued the person who caused the damage and recovered £350, which he used to get the work done properly. The motor insurers attempted to claim this £350 by way of subrogation but failed because the repairs they had paid for were useless and no satisfaction note had been signed by the insured. The judge held that the insurers were not entitled to recover.

(ii) Gifts

In some cases the insured may receive a gift (voluntary payment), after having suffered a toss, usually from somebody other than the wrongdoer. The insurers are not allowed to deduct the amount of the gift from the insurance claim. In general terms, it appears that where the giver intends the money to be for the sole benefit of the insured, it cannot be claimed by way of subrogation.

Exercising Subrogation by Insurers

Where the insurers have indemnified the insured and the insured has not enforced his alternative rights to compensation, the insurers may step into the shoes of the insured and pursue any right of action available to the insured to reduce the loss insured against. The action will normally lie against a third party whose negligence has caused the loss. However, subrogation can arise in other ways. Requirements for effective subrogation are outlined below.

Action Must Be in the Name of the Insured

The action must be brought in the name of the insured and legally it is regarded as the insured's own action although, the insurers will, effectively, be the main beneficiary.

One Action Only for the Whole Loss

When an action is taken by insurers in the name of the insured, it must be for the whole loss and not just for the portion which has been borne by the insurers. This is because, as a general rule, the Law only allows a person to sue once for a wrongful act that has been committed against them. The amount of claim need to include other losses incurred by the insured for example excess and loss of use costs.

Sharing the Recovery

The operation of the principle of subrogation, and the way in which any recovery from a third party is shared between the insured and the insurers, depends on three circumstances which are explained below.

(i) Recovery Equal to the Loss

Where the amount of the recovery from the third party is be exactly the same as the loss suffered by the insured, which is rare, the position is straightforward and no problem about sharing the money recovered will arise because, in effect, the whole of the loss will be borne by the third party.

(ii) Recovery Greater Than the Loss

If there is any surplus after the insurers have recovered their money the insured is entitled to keep it. Again, insurers may, in theory, be able to recover more than they have paid if, instead of relying on the doctrine of subrogation, they stipulate in the insurance contract that the insured shall assign to them any right of recovery against a third party, or persuade the insured to assign the right after a loss has occurred.

(iii) Recovery Less than the Loss

In some cases the recovery from the third party will be less than the loss that has been suffered by the insured. This may happen, for example, if the third party is insolvent or simply unable to pay. If the insurers have paid for the whole of the loss they will obviously be entitled to keep the whole of the sum that has been recovered. However, if the insurers have not paid the whole of the loss, because, for example, the policy is subject to an excess, a difficult question arises. The claim may also be subject to contributory negligence. Insurers need to refund a proportion of the excess paid by the insured.

Ex gratia Payments

So far we have dealt with situations where there is a valid claim under a policy. What happens if an insurer makes a payment when it is not strictly bound to do so by the policy terms? In fact, subrogation arises only from payments made under the terms of the policy. If the insurers make a payment outside the terms of the policy, making it clear that no legal obligation to pay is accepted, and that payment is made merely as a favour (known as an 'ex gratia' payment), they are not entitled to subrogate against a third party. The insured is entitled to retain any amounts secured in this way.

Modification or Denial of Subrogation Rights

Sometimes insurers agree not to enforce their subrogation right, and on other occasions they are prevented by law from exercising rights of subrogation that would otherwise exist. The situations where subrogation rights are denied are explained below.

(i) Market Agreements

Subrogation rights are often affected by general agreements between insurance companies. Sometimes insurers agree amongst themselves to waive (give up entirely) their rights of subrogation against third parties. If a third party is covered by their own liability insurance, the consequence is that one insurer will end up claiming from another. This can result in extra administrative costs and, possibly, wasteful and expensive litigation between the two insurers if they cannot agree which of their policyholders is to blame for the damage. The most well-known examples of waiver of subrogation rights are found in the field of motor insurance, where a network of 'knock-for-knock' agreements. When an accident occurs involving vehicles covered by different insurers, each insurer pays for the damage to its own policyholder's vehicle provided the policy covers the damage and gives up any subrogation rights that may exist against the other motorist.

(ii) Contractual Waiver of Subrogation

Quite often, insurers agree with a particular insured that they will not exercise subrogation rights against certain other parties or persons who are associated with the insured. They can do this by including in the policy a 'subrogation waiver clause'. The clause may, for example, expressly state that subrogation rights will not be exercised against affiliated or subsidiary companies of the policyholder, the intention being to prevent a subsidiary from having to pay back sums which had been paid to the parent company under an insurance claim.

(iii) Coinsurance Cases

The word coinsurance is used in this context to refer to where two or more persons are insured under the same policy. Coinsurance also describes the sharing of a risk between a group of direct insurers, or the sharing of a risk between the insurer and the insured where the insured agrees to bear, say, 5% of any loss that occurs. A question then arises as to whether an insurance company, having indemnified one co-insured for a loss covered by the policy, can exercise subrogation rights against another co-insured who was legally responsible for the loss. In some cases there may be an express waiver of subrogation clause to the effect that no subrogation rights will be exercised against a co-insured. However, even if there is no such clause, subrogation will usually be denied.

(iv) Public Policy

Public policy refers to situations or acts that may be undesirable or illegal. Insurers generally have agreed to give up their subrogation rights against negligent workers who injure their fellow employees in the course of employment. Everyone knows that risks such as these are covered by WIBA or Employers' Liability insurance. An employer is vicariously liable for injuries caused by an employee in the cause of duty.

4.3.5 CONTRIBUTION

You may be familiar with the principle of contribution from your study of the subject of Principles and Practice of Insurance.

This principle arises where one has more than one contract of indemnity over the same subject matter. In the past, deliberate double insurance was not unknown, a second insurance being arranged in case the first insurer should be insolvent and unable to pay. This would be rare nowadays, when the motive for deliberate double insurance is more likely to be an attempted fraud. More frequently, there may be some overlap in cover between two different types of policy which the insured has arranged. If a camera is stolen from a car, the loss might be covered under the owner's motor policy which may cover personal effects in the vehicle and a household contents or personal all risks policy. If the owner was on holiday at the time then there might be additional cover under separate travel insurance.

Remind yourself of the conditions necessary for contribution to arise.

Operation of contribution at common law

You are aware that an insured whose loss is covered by two or more policies cannot recover more than an indemnity. However, at common law, they can claim against the insurers in any order and for such proportion of the loss as they think fit. In particular, they may choose to claim from one insurer only and recover in full from that insurer. Having satisfied the loss, the insurer who pays may then, and only then, claim a contribution from the other insurer(s). Insurers have always regarded this as an unsatisfactory state of affairs, because the insurer that is called upon to pay has the full burden of handling the claim and paying the loss, plus the further inconvenience of claiming from another insurer. It may be some time before the paying insurer is able to make a recovery and the process of doing so may involve extra cost and, perhaps, even lead to a dispute with the other office.

For this reason, in almost every case, insurers include contribution condition in their policies. A contribution condition is a clause that sets out how the loss is to be met if the insured has another policy which covers it. The effect of the condition will be to change or override the common law rules described above.

Contribution Conditions

There are many different types of contribution conditions and only the more common varieties are described here. The 'rateable proportion' condition is the most common of all and therefore the most important. Some of this conditions are explained below.

- **Escape clauses;** an escape clause is a condition that effectively forbids the insured from taking out another policy without the consent of the insurers. It does this by providing that the insurance will be avoided if the insured takes out any further insurance on the same risk without notifying the insurers and obtaining their consent. The original purpose of these clauses was to prevent the insured from secretly arranging double or multiple insurances and so guard against possible fraud. The clause may also state that the insurance will be invalid if

the insured already has cover on the same risk with another insurer. What happens if a person takes out two policies and both prohibit other insurances?

- A clause may simply state that there will be no liability for any loss which is insured by another policy stating that there shall be no liability under the policy in respect of any loss for which the insured is entitled to indemnity under any other policy. These clauses are valid in law and their effect is to push the whole of any such loss onto the other insurer. However, the possibility that both contracts will have a similar clause, stating that there will be no liability if another policy covers the loss, so that the insured appears to have no cover at all. In fact, in such a case, the courts have held that the two policies will cancel each other and in this way, the policyholder will be compensated by both insurers to the extent of loss suffered.
- Other clauses may provide that insurers will exclude liability for the amount of the loss covered by the other policy but agree to contribute to the balance of any loss that is not insured by the first policy. In other words, they will pay once the cover provided by the other policy has been exhausted.

- In some cases a policy will provide that where a loss is covered by another more specific insurance, the policy will respond only when the cover provided by the more specific insurance has been exhausted. In other words, the policy operates like an excess of loss policy (above), but only where the 'primary' cover is more specific. The term more specific mayor may not be defined in the policy. However, a policy is likely to be regarded as more specific if it describes or identifies the subject matter more precisely. For Example, a policyholder may have a household contents policy covering household goods and personal effects in general and a separate 'all risks' policy covering specified items only, such as jewellery, cameras and other valuable possessions. The loss of, say, a camera could be covered under both policies, but if the household insurance carried a more specific insurance clause, the 'all risks' insurers would be primarily liable and the household insurers would contribute only if cover under the all risks policy was insufficient.

Again, if a loss is covered by two policies, but the range of property covered by one is narrower than the other, the former may be regarded as more specific.

Rateable Proportion Clauses

This clause states that the insurers will be liable for a 'rateable proportion' only of any loss that is also insured by another policy. A clause of this type is now included in virtually all indemnity insurances, and it is sometimes found in conjunction with other contribution conditions. The effect is to prevent the insured from recovering in full under a policy that includes the condition. Almost invariably, both policies will carry a clause of this type, so the insured will be obliged to separately claim an appropriate proportion from each insurer.

Basis of Contribution

As we have seen, contribution may arise at common law or much more frequently, under a standard rateable proportion clause. In either case, the question arises as to exactly how the loss should be shared by the insurers. Unfortunately, there is little legal authority on this issue as the law does not say exactly how this rateable proportion is to be calculated. Moreover, there is very little case law on the subject. For this reason the assessment of the insurers' liability in cases of double insurance is often based on market practice rather than established principles of law. In fact, there are two main methods of calculating the ratio of contribution; the maximum liability method and the independent liability method.

Maximum Liability Method

Under the maximum liability method the loss is shared by the insurers in proportion to the maximum amount of cover that is available under each policy which, in the case of property insurance, is usually equivalent to the sum insured.

Example

If property is insured for Kes.100, 000 with insurer A, and for Kes.200, 000 with insurer B, A will pay 1/3 of any loss and B will pay 2/3.
Loss occurs of Kes. 60, 000

A pays 100,000/300,000 x 60,000 = Kes.20, 000

B pays 200,000/ 300,000 x 60,000 = 40,000

This method will not operate fairly, or simply not work at all in certain situations for example:

- If the terms and conditions of the policies are not the same the maximum liability method will not operate fairly (for example, one policy may be subject to an average clause or policy excess).
- If the range of the two policies is different it will be difficult to compare properly the sums insured.
- If one policy provides unlimited cover (as in the case of some liability insurances), the method will not Work at all.

Independent Liability Method

Under the independent liability method, the liability of each insurer for the particular loss which has occurred is assessed as though its policy were the only one in force. The figure that results in each case represents the independent liability of the insurer for the loss. The loss is then shared in proportion to the independent liabilities of the two insurers.

Example

Policy A sum insured Kes.100, 000

Policy B sum insured Kes. 200, 000

Loss Kes.60, 000

Neither policy is subject to average

Step 1 Calculate independent liability of policy A (the amount payable if A was the only policy in force)'

This is also Kes. 60,000

Step 2 Calculate independent liability of policy B

This is also Kes.60, 000

Step 3 the loss is shared in proportion to the two independent liabilities (that is the proportion of the loss which the independent liability of each policy bears to the total of the independent liabilities),

A pays 60,000/ 120,000 x 60,000 = Kes.30, 000

B pays 60,000/120,000 x 60,000 = Kes.30, 000

4.4 SUMMARY

From this lecture, you have learned the following:

- That there are six fundamental principles of insurance namely; Insurable Interest, Utmost Good Faith, Proximate Cause, Indemnity, Subrogation and Contribution;
- That a legally binding insurance contract requires that insurable interest be present;
- That the insured must exercise good faith throughout the policy period and also during the claims process;
- That the proximate cause of a loss must be established before claim payment is made;
- That an insurer takes up their client's rights and remedies and pursue the third party in their client's name under the principle of subrogation;
- That the amount of indemnity is determined differently depending on the class of insurance business; and
- That the insured cannot receive more than indemnity even where they have engaged in double insurance.

4.5 ACTIVITIES

1. Explain the essentials of insurable interest.
2. Distinguish between insurance contracts and sale of goods contracts.
3. Explain the factors that determine how money recovered under subrogation is shared.

Assignment for submission

1. Explain the modifications under the principle of subrogation

4.4 Further readings

4.6 READING LIST

i. P05 (Insurance Law) Study Text 2015

ii. Past Papers

LECTURE FIVE

5.0 THE LAW OF TORTS

LECTURE OUTLINE

5.1 Introduction
5.2 Learning outcomes
5.3 Nature of law of torts
5.4 Types of torts
5.5 General defenses
5.6 Doctrines of joint tortfeasors and vicarious liability
5.7 Limitation and survival of actions
5.8 Remedies in tort
5.9 Framework governing the award of damages
5.10Summary
5.11 Activities
5.12 Reading list

5.1 INTRODUCTION

In the last chapter, you learnt that there are six fundamental principles that lay a firm foundation upon which insurance contracts are grounded. You recall that some of these principles have been embodied

in statutes and others have support through judicial precedents. You now understand the effect of each of the principles in insurance operations.

Welcome now to this lecture where you will be engaged in understanding the law of tort and its relevance in the practice of insurance. In this chapter, you will be introduced to various types of torts, learn about the defences and remedies available in case a tort has been committed.

5.2 LEARNING OUTCOMES

By the end of this lecture, you should be able to:

a) Explain the nature of the law of torts;
b) Classify types of torts;
c) Explain the general defences;
d) Describe the doctrines of joint tortfeasors and vicarious liability;
e) Explain limitation and survival of actions;
f) Explain the remedies in tort; and
g) Describe the framework governing the award of damages.

Competence
The trainee should have the ability to apply the general principles of the law of torts in insurance practice

Content
Let us now start by explaining the nature of law of torts.

5.3 NATURE OF LAW OF TORTS

5.3.1 What is a Tort?

The word tort is derived from the Latin term ‘tortum’ which means twisted or crooked. It includes conduct which is not straight or lawful. It is equivalent to the English term ‘wrong’. Salmond has defined tort as ‘A civil wrong for which the remedy is a common law action for unliquidated damages’. The word damages is not the plural of the word damage but rather the monetary compensation awarded to a person (aggrieved party) whose private rights have been violated. There are other remedies other than damages which may be available such as specific performance or injunction. These will be discussed later in this chapter. Tortious liability arises from breach of a duty primarily fixed by law that is, common law or statute. This duty is towards persons generally. The right of action in tort arises from breach of a duty which a person owes to other persons. When driving a car, the law requires one to drive carefully so as not to cause injury to others or

damage their property. If one breaks such a duty and cause harm to others, they can sue and claim damages. A person who commits a tort is known as a tortfeasor.

A tort is a civil wrong as opposed to a criminal wrong. However, not every civil wrong is a tort. Other civil wrongs may be breach of contract or breach of trust. A civil injury for which an action for damages will not arise is not a tort. To constitute a tort:

- There must be some wrongful act or omission by the defendant;
- There must be legal damage to the plaintiff; and
- The wrongful act or omission must give rise to a legal remedy.

The general purpose of the law of torts is to protect people's rights by allowing them to sue if their interests are invaded, threatened or harmed. The nature of tort can be explained either by distinguishing it from other wrongs or by mentioning some of the elements which are found in tort and not in other wrongs.

From lecture one, you were able to distinguish private law and public law. In this lecture, you need to understand the difference between a tort, a crime and breach of contract. They are outlined here below.

5.3.2 Tort and Contract Distinguished

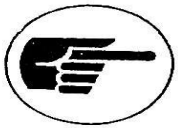
The main differences between a tort and a contract are:

- In tort, duties are fixed by law where as in contract, they are fixed by the parties to the contract;
- In tort, the duty is towards persons generally while in contract it is towards specific person/persons;
- Only parties to the contract can sue each other hence the doctrine of privity of contract. This doctrine is not applicable in tort as the person who brings an action is the one whose rights have been violated against the tortfeasor;
- In tort, the remedy is unliquidated damages while in contract, it is for both liquidated and unliquidated damages; and
- In tort, the emphasis is more on torts of commission where as in contract it is more on torts of omission.

5.3.3 Tort and Criminal Law Distinguished

- In tort, the ends of justice are met by an award of damages (compensation) to the injured party while in criminal law, the wrongdoer is punished which may take the form of a term of imprisonment or a fine, among others;
- The standard of proof required in criminal law is beyond reasonable doubt whereas in tort, the case need to be proved on balance of probabilities;

- The burden of proving a criminal case lies with the prosecution where as in civil law, it is the plaintiff. The party who alleges must, as a general rule, prove the case;
- A tort is an infringement of civil rights belonging to an individual whereas a crime is a violation of public rights affecting the whole community. Thus a tort is a private wrong whereas a crime is a public wrong;
- In tort, proceedings are brought by the aggrieved party (claimant) against the tortfeasor (wrongdoer) whereas in crime, they are brought in the name of the state against the accused person;
- Where a tort has been committed, the aggrieved party may agree to a compromise. In criminal law, the law does not permit an out of court settlement except in certain exceptional circumstances;
- One form of punishment under criminal law is imprisonment. In civil law, this only happens in cases of a judgment debtor may being arrested and detained in execution of a decree and is only released when the decree is satisfied. It can also arise where one fails to comply with a court order and is held to be in contempt of court; and
- Malice and motive may not be relevant in tort but are considered in criminal law.



Note that sometimes the same facts may amount to a tort and a crime e.g. where a vehicle is carelessly driven and causes an accident, the driver may be charged with the offence of careless driving and sued for compensation under the tort of negligence. The civil and criminal remedies in such a scenario are not alternative but concurrent.

5.3.4 Classification of Torts

Torts can be classified by looking at the type of behaviour which the wrongdoer must exhibit and, in particular, the degree of fault (if any) which is necessary.

- Intentional torts refer to deliberate acts that result in loss/damage to other people for example trespass, deceit, fraudulent misrepresentation;
- Torts requiring negligence or fault arises where the defendant's conduct is at least unreasonable for example, the tort of negligence and private nuisance; and
- Torts of strict liability which is committed neither intentionally nor negligently. This may arise under duties imposed by statute.

5.3.5 Relevance of Malice and Motive in Tort

The law of torts does not usually concern itself with why the defendant behaved in the way they did, in other words, the motive for their actions. This is why malice is not a necessary ingredient to the maintenance of an action in tort. However, where a person has a legal right to do an act, one may not succeed by proving it was motivated by ill-will or malice when it was exercised. Because malice or motive is not usually relevant, a person who acts with the very best of intentions in particular circumstances will still be held liable if the action is unlawful. On the other hand, even

if a person carries out an act with malicious intent, they will not be liable if what they have done is not unlawful. In most insurance policies for example motor and fire, damage to property that is maliciously caused by persons other than the insured is covered. This, in essence, means that one may maliciously commit the crime of arson against the insured property and insurers will still provide compensation as long as it is not through the insured's willful misconduct.

Malice may be relevant or considered in tort in the following instances:

- Malicious prosecution;
- Malicious falsehood; and
- In the tort of nuisance, some actions which are reasonable may become unreasonable if they are actuated by malice.

5.3.6 The maxims of Damnum Sine Injuria and Injuria Sine Damnum

As noted above, legal damage arises where there is infringement of the plaintiff's private right or unauthorised interference with his property. In order to succeed in an action for tort, the plaintiff must prove that legal damage has been caused to him meaning that there has to be violation of one's legal rights. A civil injury for which an action for damages will not arise is not a tort for example public nuisance.

Damnum sine injuria is a latin phrase which means causation of damage without violation of a legal right. It arises where there is actual and substantial damage or loss suffered by a person without violation of their legal rights. It is normally used to determine whether a party has a valid claim in tort or not. This may occur in ordinary trade competition for example, where one starts a rival business causing the competitor to lose customers. In the Gloucester Grammar School Master case, a new school was started by a former employee. The plaintiff was the headmaster and the new school caused a great reduction in the number of students causing him financial damage as the result of the competition. The court held that this was a case of Damnum Sine injuria and no legal injury had been caused to the plaintiff. The other school's owner will not be liable for to pay any damages for the same.

Injuria sine damnum on the other hand arises when there is infringement or violation of one's legal rights without actual damage being suffered. In most cases, an action in tort will succeed only where the claimant has suffered some form of injury, damage or loss. However, in some cases a tort may be actionable per se (actionable in itself). This means that the claimant does not have to prove that they have suffered loss or damage, only that the tort has been committed. The maxim is based in the equitable principle that where there is a right, there is a remedy. Examples include trespass and libel. In the case of *Ashby-vs.-White,* the plaintiff was a registered voter. He cast his vote during elections but the returning officer refused to register his vote. The candidate whom his vote was cast in favour won. It was held that a legal right had been violated and the defendant was therefore liable.

Having understood the nature of tort, we will now discuss the various types of tort.

List down some of the torts that you know.

5.4 TYPES OF TORTS

There are various torts that may be committed giving rise to civil actions. Some of these torts are discussed below.

5.4.1 Negligence

What is negligence?

Negligence was defined in the case of **Blyth vs. Birmingham Waterworks co. (1856)** as 'the omission to do something which a reasonable man guided by those considerations which ordinarily regulate the conduct of human affairs would do, or doing something which a prudent and reasonable man would not do'. Negligence is essentially negative in character. It is either a commission of a careless act or perhaps more accurately, it is the omission of an appropriate degree of care for the rights of others. Negligence is, essentially, a failure to take care in circumstances where the law demands that care should be taken, giving rise to a claim for damages by the person who suffers harm as a result.

This is the most common form of tort and the source of most tort cases in Kenyan courts. Virtually all cases arising from road accidents and work related injuries are based in the tort of negligence. However, it was only in the nineteenth century that negligence began to be regarded as a distinct wrong following the judgment in the case of **Donoghue v. Stevenson** (1932). Prior to this, it was considered as an ingredient in the tort of trespass or nuisance. For one to sustain or succeed in an action in negligence, the requirements below must be satisfied.

(i) That the Defendant Owed the Plaintiff a Duty of Care

A duty of care must exist before there can be negligence. Whether the duty of care exists is a question of law and courts over the years have developed a number of tests. A general principle governing the duty of care was established in the famous case of **Donoghue v. Stevenson (1932).**The plaintiff visited a restaurant with a friend who bought her ginger ale beer which was contained in an opaque bottle. A decomposed snail came out of the bottle and the plaintiff suffered mild sickness. She would not sue under contract as there was no contractual relationship between her and the vendor. Her only

recourse was to sue the manufacture on the grounds that they owed a duty of care to ultimate consumers.
The duty of care is a duty to take reasonable care to avoid acts or omissions reasonably foreseeable likely to cause injury to your neighbour.


The question then is who is your neighbour?

A neighbour in law is someone who is likely to be closely and directly affected by your act/omission. The neighhbour principle is also based on reasonable foreseeability. This is the ability to see or to know in advance, hence the reasonable anticipation that harm or injury is the likely result from one's acts or omissions. There should be sufficient proximity (closeness) between the plaintiff and the defendant. In the **case: Bourhill vs. Young (1943),** the plaintiff who was pregnant at the time suffered nervous shock and miscarried following an accident involving a cyclist and a car. She was neither a passenger in the car nor being carried by the cyclist. She sued administrators of the cyclist but the case failed. The House of Lords held that an action would not succeed unless the claimant was within the area of potential danger, such that the defendant should reasonably foresee that injury might occur.

(ii) The Plaintiff must Prove that the Duty of Care was Breached
This occurs where the defendant fails to take reasonable precautions. It is failing to do what a reasonable man would have done or doing what a reasonable man would not do. All of us make decisions on conduct, which may adversely affect others. The standard by which the defendant is judged is objective. The amount of care varies according to circumstances. For example, premises used by children, a higher duty of care is expected than those used by adults or nature of activity being undertaken determines the level of risk exposure. The standard of care generally required is that of a reasonable man. In the case of Blyth vs. Birmingham, it was stated that 'a reasonable man' is the foundation upon which the concept of standard of care in negligence has been built. Who then is a reasonable man? A reasonable man is the average person, the ordinary person and the man on the street.

A person engaged in an activity is expected to observe certain standards, for example, anybody who drives a car is expected to meet a basic standard of competence which does not vary according to whether the driver is a learner or a professional racing driver. However, a defendant who holds himself out as having some particular skill or ability will be expected to exercise that skill in a competent manner. A professional person such as a doctor will be judged by the standards prevailing in the medical profession and not according to the medical knowledge of the 'man in the street'. In ***Wisher* v. *Essex Health Authority* (1986),** a junior hospital doctor was held liable for negligent medical treatment which injured a premature baby, and his inexperience as a doctor was held to be no defence. Also in the case of Clark vs. Adams (1950), a physiotherapist failed to give the plaintiff adequate warning about the effects of the medication he prescribed leading to amputation of the plaintiff's leg. It was held that the defendant was negligent and therefore liable.

Over the years, certain guidelines have evolved which considerably assist the courts in setting standards of care. Breach of the duty will be determined by courts depending on the circumstances for example:

- The magnitude of the risk/exposure;
- Whether it would have been reduced or eliminated through certain measures being put in place;
- The relevance of cost; and
- The current scientific or technical knowledge.

The greater the risk presented by the defendant's activities, the greater will be the care expected of them.

(iii) The Plaintiff must Prove that he Suffered Injury to his Person or Damage to his Property

The injury or damage must be a consequence of the negligent act in order to provide a cause of action. Any degree of damage is actionable. Damage includes death, personal injury, property - damage and financial loss, among others. The breach of duty must be the proximate cause of injury or damage that is, the defendant's negligence must be the direct cause of the damage. Where the plaintiff does not suffer damage to his person or property but suffers financial loss, the loss is not recoverable. Where financial loss accompanies physical damage provided it is not too remote, the defendant is liable for example, a claim for loss of use arising from a road accident or loss of income resulting from fire damage to a building.

The test of remoteness is foreseeability. In the case of **Wagon mound No.1,** the defendant's employees negligently spilled oil into the Sydney Harbour. The oil spread into the plaintiff's wharf where welding operations were going on (a ship was being repaired). The sparks caused the oil to ignite causing the wharf to be burned. The owner of the wharf sued. It was held that the loss was too remote and therefore not recoverable

The Onus (burden) of Proof and Res ipsa oquitur

It is the duty of the person alleging negligence to prove the same. This is called the burden of proof. It is based on the principle that 'he who asserts must prove'. The onus of proof is on the plaintiff throughout the proceedings to show that on a balance of probabilities the defendant was negligent. The plaintiff must establish sufficient evidence to show that their injury or damage has been caused by the defendant's negligence. However, there are times when the plaintiff's burden of proof is relieved by the doctrine of res ipsa loquitur that is, the thing speaks for itself (the facts are plain and clear). The doctrine means that the incident ought not to have occurred had it not been for the negligence of the defendant. In such a case, the burden of proof shifts to the defendant who is supposed to rebut the presumption of negligence. This can, however, be rebutted by the defendant by adducing evidence to show that the accident could still have occurred without any negligence on their part.

The conditions which must be present for the doctrine to be successfully invoked include:

- The accident must be such that in the ordinary course of things, the event would not have occurred without negligence. There must be reasonable evidence of negligence for example, that the road was clear and the visibility was good;
- The object that caused the injury or damage was under the direct control of the defendant, their servant or agents; and
- That the accident would not have happened had the defendant exercised duty of care.

In the case of **Msuri Muhhidin vs. Nazzor bin Seif (1960),** the plaintiff sustained injuries when a bus he was travelling in overturned due to the offside tyre burst. Evidence adduced showed that the bus was not being driven at excessive speed and that the driver had certified that the tyres were in good condition. The defendant was discharged the burden under res ipsa loquitur and could not be held liable under the doctrine. In the case of **Embu Public Road Services vs. Riimi (1968),** the plaintiff's husband sustained fatal injuries when the bus he was travelling in overturned due to breakage of the main springs. The bus was traveling on a straight stretch of the road. Under normal circumstances, a reasonable competent driver could have controlled the bus. The defendant was found liable in negligence under the doctrine of res ipsa loquitur.

Negligent Misstatement

Originally, liability for negligent advice would only arise where there was a contract between the parties. The general rule of law was that a person was responsible for his negligent act but not for his negligent misstatement leading to financial loss suffered by the person who relied and acted on the statement. This position however changed in the case **Hedley Byrne vs. Heller & Partners ltd** where it was ruled that there can be liability for negligent misstatement which causes financial or physical loss. The facts were that the claimants had contacted the defendants who were bankers to a firm with which they were about to do business, for a reference. The defendants gave a good reference concerning the firm's credit-worthiness, although the document was headed by the words 'Without Responsibility' - a disclaimer of liability. The claimants acted on this misleading report (the firm was in trouble) and gave substantial credit, so that they lost heavily when the firm went into liquidation. They sued the defendants and the House of Lords held that the bankers would have been liable in negligence if they had not expressly disclaimed liability.

Hedley Byrne rule has expanded in recent years and it is clear that the rule now applies not just to negligent 'advice' or 'statements' but to negligent professional work generally, including the drawing up of plans, the carrying out of surveys and similar activities. This has led to a number of professionals taking out professional indemnity insurance policy to guard against claims based on professional negligence. Liability also lies where misrepresentation is made in a contract leading to a loss. From the case, liability arises where:

- There exists a special relationship where it is reasonable for the claimant to rely on advice given;

- The giver of advice could reasonably foresee that the advice is likely to be acted upon; and
- Advice is acted upon causing loss to the claimant.

The onus of proof lies with the defendant. The doctrine of res ipsa loquitur also applies until the defendant disapproves it.

Breach of Statutory Duty

Parliament has in other cases, by legislation, created new duties which are quite distinct from those of the common law, and an action for breach of statutory duty is an appropriate cause of civil actions brought under statutes of this sort. Majority of claims arising out of this statutes are based on the tort of negligence.

Occupier's liability

An occupier is a person who has sufficient degree of control over premises to put him under a duty of care towards those who lawfully come upon the premises. People are occasionally injured when visiting unsafe or badly maintained premises. Occupiers are therefore held liable in negligence for defective premises. Even where the building itself is safe, the visitor may come into contact with unexpected hazards such as dangerous machinery, vicious animals or toxic materials.

The occupier's liability in Kenya is governed by the Occupier's Liability Act Cap. 24. The Act provides that the occupier owes a duty of care to visitors that is, those who have been expressly or impliedly allowed to enter the premises. The duty is to ensure that the visitors are reasonably safe in using the premises for the purpose for which they were invited. The Act provides that the occupier may restrict or exclude liability by giving adequate warning. The occupier is generally not liable for incidents arising out of defective work of an independent contractor.

Liability for Defective Products

Manufacturers, wholesalers, retailers and other persons in the supply chain may find themselves liable for defects in products. Product liability is also an important area of law because defective products are another common source of injury and damage. Examples of these products include defective electrical equipment which is a frequent cause of fire or bodily injury; those made for direct human consumption, such as foodstuffs or pharmaceuticals can result in serious illness if they are unsafe. A person who suffers as a consequence of the defect may sue under the tort of negligence but can also base their case on breach of contract. Article 46 (1) (d) of the Constitution provides that consumers are entitled to compensation for loss or injury arising from defects in goods or services. Manufacturers may protect themselves against claims by consumers by purchasing product liability insurance cover.

Employers' Liability

This part of the law of torts is concerned with the liability of the employer for injuries suffered by employees in the course of their employment. The liability may arise under common law (tort of negligence) or under statute. As noted above, an example of vicarious liability in tort arises from the relationship of 'master and servant', which effectively means employer and employee. The rule is that an employer is vicariously liable for the torts committed by an employee in the course of their employment. This means that where an employee injures a fellow employee in the course of their job, or injures somebody who is not a fellow employee (such as a visitor to the premises), the victim can claim compensation from the employer, who is vicariously liable. The law that regulates injury to employees sustained in the course of duty is the Work Injury Benefits Act (WIBA). An overview of the Act will be given in lecture 8.

5.4.2 Nuisance

What is nuisance?

Nuisance is defined as a wrong done to a man by unlawfully disturbing or inconveniencing him in the enjoyment of his property or in some case, in the exercise of a common right. It is also defined as an unlawful interference with a person's use or enjoyment of land or some right over or in connection with it.

There are two forms of nuisance which are; public and private nuisance. They are briefly explained below.

a. Public Nuisance

This is an act or omission which materially affects or interferes with the enjoyment of a right which all members of the community are entitled to. It includes selling food not fit for human consumption, keeping a disorderly house, throwing fireworks in the street, running a brothel and the like. Public nuisance is a criminal offence. However note that a civil action for damages based on a commission of a public nuisance is only available if the claimant can show that they have suffered damage over and above the inconvenience suffered by the general public.

In the case of **Soltau vs. De Held (1851),** the plaintiff's house was next to the Roman Catholic Chapel. The defendant was a priest at the chapel. The chapel bell rang at all hours of the day and night. It was held that the ringing of the bell was a public nuisance. The plaintiff was entitled to an injunction since he suffered over and above the community as a whole.

b. Private Nuisance

This is where one uses their land in an unreasonable manner causing interference with another person's use and enjoyment of their land. Nuisance affects a particular individual or individuals and not the community as a whole. Examples include encroachment for example, by roots of trees, dilapidated buildings falling onto adjacent property, smells, noise, gas and smoke. The interferences are of two types. These are:

- Wrongful disturbance of rights attaching to land; and
- Wrongfully allowing escape of noxious things which interfere with the health, comfort and convenience of a person.

When can an Action Succeed in Nuisance?

An action in nuisance can succeed in the circumstances explained below.

The Action is Repeated or Continuous

The term nuisance connotes something continuing or repeated. For an action to succeed, the action amounting to a nuisance must have been continuous. In the case of **Bolton vs. Stone,**
the plaintiff was hit and injured by a cricket ball while standing on a highway. The court held that the action would not succeed since it was proved that the ball had only hit into the highway six times in thirty years and on no occasion had injury been reported. However, an isolated state of affairs which threatens damage may be sufficient to amount to a nuisance for example, one single escape of sewage.

Actual Damage Must be Caused

For an action to succeed, the plaintiff must suffer actual damage. Actual damage means physical damage to the property or interference with beneficial use of premises.

The Interference Caused Must be Unreasonable

A balance has to be maintained to ensure that the persons make reasonable use of their land while preventing unreasonable use of land which will adversely affect others. What is unreasonable depends on the seriousness of the interference and the cost of remedying the problem. One has a right to a reasonable amount of noise during legitimate use of his property. Noise that is intended to annoy will render one liable. In the case of **Christie vs. Davey (1893),**
The plaintiff and the defendant were neighbours. The plaintiff taught music in his house and the defendant was not happy with the noise. The defendant deliberately created noise by banging doors and hitting the ceiling. It was held that noise that was made by the defendant was not legitimate and he was therefore liable to pay damages.

Where the Nuisance took Place

The location where the action amounting to a nuisance took place will also determine whether one can succeed or not. The noise and smell of animals in a rural area is unlikely to amount to a nuisance

but can amount to nuisance in a sub-urban neighbourhood. Likewise fumes from a factory in an industrial area may not be a nuisance but can be a nuisance in the city centre.

Sensitivity of the Property and Person

No action will succeed if the property is abnormally sensitive to harmful influences. In the **case of Robison vs. Kilvert (1889**), the plaintiff's brown paper was damaged by heat which escaped from neighbouring premises. Action failed because the heat that escaped was not excessive and the damaged property was exceptionally delicate.

Points to Note

- It is no defence that the plaintiff came to the source of the nuisance or that the act causing the nuisance is for the public benefit. In the case of **Sturges vs. Bridgman (1879),** the plaintiff who was a doctor put up a consulting room next to the defendant's premises where he used a pestle and a mortar for 20 years. The noise and vibration from the defendant's premises interfered with the plaintiff's practice and he sued. It was held that the defendant was liable and his defence that the plaintiff came to the nuisance was not tenable.
- A person can cause a nuisance on the highway if his vehicle breaks down and is not removed within a reasonable time.
- An activity that is generally reasonable may become unreasonable if it is done maliciously. Malice becomes a factor in determining liability. In the case of **Hollywood Silver Fox Farm vs. Emmett,** the defendant instructed his son to fire using his gun near the plaintiff's farm with intent to cause female fox of the plaintiff to miscarry. The son did as instructed and the fox miscarried. The defendant was held liable as the action though lawful was committed out of malice.
- A person may still be liable for nuisance after his occupation has ceased.
- A person can create a nuisance in person or through his servants and becomes vicariously liable.

Defences in Nuisance

The defences available in nuisance are briefly outlined below.

Prescriptive Right

This is available where one has been carrying on the act for a period of over 20 years. This defence is not available in public nuisance.

Statutory Right

This is used where the act alleged to amount to a nuisance is allowed by statute or has been allowed by the national or county government in executing their legal mandates. For example airports and railway stations cannot be sued under nuisance.

Consent
Where one expressly or impliedly allows the defendant to make unreasonable use of property, they cannot complain unless he withdraws the consent.

Triviality
This is where the defendant argues that the act was an insignificant act or one act that is temporary like an afternoon party.

Reasonableness
The defendant here will argue that the act that amounted to nuisance was lawful use of property.

Remedies in Nuisance
Remedies refer to the means to achieve justice in any matter in which legal rights are involved or judicial relief. It refers to the manner in which a right is enforced or satisfied by a court when some harm or injury. The remedies in nuisance are:

- Unliquidated damages;
- Injunction; and
- Abatement that is where the plaintiff removes the nuisance without court action but must give a notice to the defendant.

 Highlight situations where the tort of nuisance may be relevant in the practice of insurance.

5.4.3 Defamation

Defamation is injury to a person's reputation. It is a false statement made about a person without lawful justification which tends to lower someone's reputation in the estimation of right thinking members of society. A statement is defamatory if it exposes the person to ridicule, contempt or hatred leading to one being shunned or avoided in their office, profession or trade. The victim's reputation must also be capable of being injured. A man's reputation is considered as property that is more valuable than any other property. If a person injures the reputation of another, he does so at his own risk. Note that a group or class of people may be defamed but the group must be sufficiently small for an individual's reputation to suffer.

There are two forms of defamation namely libel and slander. They are elaborated below.

(i) Libel
Libel is publishing an untrue and defamatory statement about a person to a third party. It is defamation in permanent form and it can be both a criminal offence and a tort. It is actionable per se that is, without proof of damage. It may be in the form of pictures, drawings, cartoons, radio and television broadcasting. In the case **Monson vs. Tussauds ltd,** the plaintiff had been charged with

murder and found not guilty. The defendant manufactured a wax effigy of the plaintiff and placed it next to effigies of murderers (notorious convicts) near the chamber of horrors. It was held that the effigy constituted libel because it was in permanent form.

(ii) Slander

This is a publication of a false statement that injures one's reputation in the eyes of right thinking members of society. It is a statement in transitory form in the form that is of words or gestures. The defamation is in temporary form. It is merely a civil wrong (tort) and is not actionable per se. The loss incurred as a result of the defamation must be proved.

Note that an action for slander can, however, succeed without proof of damages in the following cases:

- Where the defendant alleges that the plaintiff is guilty of a crime punishable by imprisonment;
- Where the defendant alleges that the plaintiff is suffering from a contagious disease;
- Where the defendant alleges that the plaintiff is unable to carry out his profession; and
- If the plaintiff is a woman, the allegation that she is guilty of sexual immorality

For an action in defamation to sustained, the following requirements have to be made:

There Must be a Defamatory Statement

A defamatory statement is one which exposes the plaintiff to hatred, contempt, ridicule and injures him in his profession or trade. It is a statement that injures one's reputation and not dignity. Innuendo statement is one made innocently but with a hidden meaning may also be defamatory. In the case of **Cassidy vs. Daily Mirror Newspaper,** the defendant published a photograph of Cassidy and miss X with words that they were about to be engaged. Mrs. Cassidy sued for defamation on grounds that the words imputed by innuendo that she was not the lawful wife of Cassidy and secondly that she was living in sin. The court held that she was entitled to damages.

The Defamatory Statement Must be Referring to the Plaintiff

The person alleging defamation must prove that those who heard or read the statement believe it applies to them. It can refer to the plaintiff directly or by innuendo. In the case **Newstead vs. London Express Newspapers,** the defendants published a story about one Harold Newstead who had been convicted of bigamy. Another man, by the same name and aged lived in the same area mentioned by the defendant. Many area residents believed the statement referred to him. He succeeded in recovering damages.

There must be a Publication of the Defamatory Statement

Publication consists of making known, the defamatory matter to someone else other than the person of whom it is written. A defamatory statement is not actionable unless it is published. A defamatory statement sent is a sealed envelope to the person it is written does not amount to a publication. Where the letter is to be open by another party, it amounts to a publication

Damage Need not be Proved except in Cases of Slander

In the case of defamation that is by word of mouth or gestures, the law requires the plaintiff to prove damage except in the circumstances mentioned above.

Defences in defamation

There are times when an alleged act may have some justification that may result in acquittal to the accused in criminal law or the acknowledgment of diminished responsibility in criminal and civil law. Such justifications are called defenses.

The defences available in defamation are outlined below.

Truth

This is where the alleged statements that amount to defamation are actually true. When this is established, it is a complete defence as a person cannot be defamed by truth.

Justification

This defence is raised where the allegation is substantially true even though some details may be false. For example, if the defendant alleges that the plaintiff is a thief who has served a prison term of ten months whereas the term served is nine months.

Fair Comment

These are statements which are a matter of comment or opinion rather than statements of fact. The defendants must prove that their remarks were honest, relevant and were made without malice or improper motive. They are fair comments on a matter of public interest affairs of the state, acts of public officials, local authorities in the performance of their duties.

Innocent Intent/Apology

These are statements published unintentionally and not through lack of care. The defamation Act requires the defendant to make an offer of amends by publishing a suitable apology:

- Stating that it was not intentional;
- Was without malice;
- That they did not intend publication to refer to the plaintiff;

- The defendant should take steps to notify persons to whom copies of the defamatory matter had been distributed; and
- The offer of amends should be made promptly.

Privilege

This defence will be available where statements which may amount to defamation are made on privileged occasions and they are therefore not actionable. The defence is based on the ground that the need to protect free speech takes priority over the need to protect people's reputations. Privilege can be absolute or qualified. Absolute privilege carries with it complete immunity whereas qualified privilege is actionable if the statement is made with a malicious motive

Examples of statements that enjoy absolute privilege are:

- Those made in judicial proceedings;
- Those made in parliament;
- Statements made between officers of state in the course of duty;
- Fair and accurate reports in newspapers regarding judicial proceedings; and
- Papers published by order of parliament.

Examples of statements made that enjoy qualified privilege are:

- Communications made between an advocate and a client;
- Reports of judicial proceedings in newspapers on foreign countries;
- Reports of public meetings/local authorities in newspapers;
- Fair and accurate reports regarding proceedings in parliament; and
- Statements made in pursuance of a legal, moral or social duty for example, an employer to employee.

Remedies in Defamation

The remedies available in defamation are explained below.

Damages

The amount of damages to be awarded is determined by:

- The nature of the defamation that is whether libel or slander;
- Extent of the circulation of the defamatory material and the status of the parties;
- Where the defendant has taken appropriate steps to apologise;
- Whether the defendant was provoked;
- Remoteness of damage; and
- Where one had a bad reputation already.

Injunction

An injunction is a court order that refrains one from doing a particular thing. The purpose of this in defamation is to restrain further publication or circulation of the defamatory material.

5.4.4 Strict Liability

This is a tort that is committed neither negligently nor intentionally. It is also referred to as the rule in Rylands vs. Fletcher. At common law, strict liability existed for straying animals. It is an offshoot of the tort of nuisance as it also involves a single escape. The tort is derived from the case of **Rylands vs. Fletcher** where the defendant contracted an independent contractor to construct a water reservoir (dam) on his land. In the process of construction, the contractor discovered disused mine shafts which connected to the plaintiff's land. After construction was completed, the water burst and flooded the plaintiff's mining area causing damage.

The court arising out of this case established a principle that an occupier of land who brings and keeps upon it anything likely to do damage, if it escapes, is bound at his peril to prevent its escape and is liable for all the direct consequences of its escape if he has been guilty of no negligence. This principle is the reference point for the future cases.

For strict liability to operate, two conditions must exist which the plaintiff must prove. They are:

- There must be an escape of the thing causing the damage; and
- There must be a non-natural use of land.

Defences to the Tort of Strict Liability

The defences in this tort are:

- Consent of the plaintiff ;
- Default of the plaintiff that is, where wilful or intentional act of the plaintiff was the cause of damage;
- Act of a stranger or third party;
- Act of God; and
- Statutory authority.

Activity

Find out situations in insurance where the tort of strict liability may be used.

5.4.5 Trespass

Trespass is an unlawful act committed with force and violence on the person, property or relative right of another. It is a civil wrong for which the remedy is a common law action for unliquidated damages. The violence may only be implied, for example, peaceful but wrongful entry to another's land or parking a car in another person's land.

Essentials of Trespass

For an action to be sustained in the tort of trespass, the following need to be proved:

- The plaintiff needs to prove that the defendant's act that amounted to trespass was intentional. Trespass must be deliberate (intentional) and not accidental;
- The act of the defendant must be direct (hitting a person) and not consequential (dumping rubbish on a highway and another person's car collides with the rubbish); and
- The claimant needs to prove that their legal rights were violated even if they did not suffer damage that is actionable per se especially in trespass to land.

Forms of Trespass

There are three forms of trespass and they are explained below.

(i) Trespass to the Person

There are three classifications of trespass to the person which are:

Assault

This is conduct or threat to do violence on the plaintiff leading the plaintiff to fear or be apprehensive. For example pointing a gun, waving a stick, use of a threatening gesture or holding a fist.

Battery

This is the actual application of force however slight for example hitting a person with a stick, shooting, touching in a rude manner, pouring water or spitting on another.

Certain defences are available to assault and battery and these are:

- Volenti non fit injuria: this is used where a person willingly engages in an activity that is risky and suffers injury. Such a person cannot sustain a case as this defence means that to him who is willing, there cannot be injury. However, where the defendant touches the other deliberately and mischievously, the defence will not stand;
- Private defence: The law gives a person the right to defend oneself, family and property. The person should however use reasonable force should be applied;
- A person can also defend themselves by arguing that they used reasonable force for example, to prevent forcible entry;
- Police officers can also use the defence of legal authority in case they violet one's rights in the course of duty; and
- Legitimate disciplinary action can also be used by parents in the case of their children.

False Imprisonment

This is where one imposes total bodily restraint on the plaintiff by unlawfully preventing them from going where they were going. It can happen in a prison, private house, a public street, a mental

institution or a vehicle. No physical contact between the plaintiff and the defendant is necessary. To succeed in a case based on false imprisonment, one has to prove that:

- There was total restraint on their personal freedom; and
- The detention was unlawful.

It should be noted that where one is unlawfully imprisoned without his knowledge and no damage or injury is suffered, an action can still stand even where the plaintiff had entered voluntarily.

(ii) Trespass to Goods

This is direct and intentional interference with goods in the possession of another. This can be done by taking goods in the possession of another or direct and immediate injury or damage to the goods for example, cutting down trees belonging to another person, beating another person's dog, scratching another person's car. Trespass to goods can take the form of conversion which refers to where a person deliberately deals with another person's goods in a way that is inconsistent with the rights of the person. Conversion occurs when:

- One wrongfully sells goods belonging to another;
- Stealing goods of another that is, taking the property wrongfully;
- Wrongfully parting with goods of another by giving them to a third party;
- Receiving goods which belong to another;
- Refusing to deliver goods to the owner;
- Wrongfully destroying property of another rendering it useless; and
- Wrongfully detaining goods of another.

Remedies to Trespass to Goods

The remedies available in trespass to goods include:

- Recaption that is, repossess the goods using reasonable force;
- Order for specific restitution. This will occur where damages are not adequate and the goods are not available in the market; and
- Action for damages which is an award for full value of the goods and damage for inconvenience suffered.

(iii) Trespass to land

Trespass to land is direct and intentional interference with land in possession of another. It is unjustifiable interference with possession or entry into another's land. It is actionable per se meaning that that one does not have to prove actual damage, force or unlawful intention for an action to succeed. Examples of trespass to land include:

- Entering another's land;
- Unlawfully placing or throwing material objects into the land of another;
- Remaining on the land after the right of entry has ceased;
- Using the right of entry for purposes other than that for which entry was allowed;
- Doing acts which interfere with plaintiff's conclusive right of possession; and
- Where one enters and abuses their right of entry and this will be treated as trespass ab initio.

Note that trespass to land is a civil wrong but can amount to a criminal offence in the following circumstances:

- Entering and remaining on another's land, put up a structure, cultivates or grazes stock without the occupier's consent;
- Tampering with a fence;
- Enter with intent to commit an offence, intimidate, annoy or insult; and
- Enter to steal stock or agricultural products.

The following points should be noted:

- Every continuance of trespass is a fresh trespass;
- A person's possession of land in law dates back to when he first became entitled to it. If another continues to occupy it against his will, this will amount to trespass;
- Trespass by cattle is treated as if the owner committed the trespass himself;
- The term land includes anything beneath and above the surface; and
- The person who is entitled to sue is one with immediate possession.

Defences to Trespass

The following defences are generally available in the tort of trespass:

- Prescriptive right;
- Statutory authority;
- Act of necessity for example where one enters another's land to put out a fire; and
- That the act was involuntary without any negligence for example where you enter another person land by mistake.

Remedies to trespass to land

The remedies available to the plaintiff in the tort of trespass to land are:

- Damages;
- Forcibly ejecting the trespasser using reasonable force; and
- Distress damage feasant. This involves seizing and retaining the trespassing animals until the owner pays compensation.

5.4.6 The Tort of Passing Off

The tort of passing off arises where damage is done to another person's business interests through an act intended to deceive the general public to believe that the goods are of another reputable business organization. This is done through use of similar name, trade name, identification mark or description of the goods. It is intended to protects the goodwill of a trader from a misrepresentation. In the case of **Hines vs. Winnick (1947),** the plaintiff who was an artist established a business name using the

name Dr. Crook. The defendant used the same name and the plaintiff sued. The defendant was restrained through an injunction.

Remedies for the Tort of Passing off

The remedies available under this tort include:

- Damages;
- Injunction; and
- Order for return of profits.

5.5 GENERAL DEFENCES IN TORT

We have already defined a defence as a justification that the defendant uses to minimise or avoid liability. General defences are those that may be used in more than one tort. We have seen from the torts already discussed that there are unique defences available to certain torts. You have noted that when one commits a tort, there is a likelihood that they may be sued and if this happens, the defendant will need to file a defence in response to the allegations made in the case. The defences are explained below.

5.5.1 Volenti Non Fit Injuria

What is volenti non fit injuria?

Volenti non fit injuria means that no legal wrong is done to a person who consents or 'to him who is willing, there can be no injury'. The defence applies where the claimant agrees to a deliberate act by the defendant which would be a tort if no consent had been given. This defence arises where one has voluntarily consented/assumed the risk. For example, the defence can be used by surgeons, footballers, those engaged in the game of boxing and those who operate hair salons among others. One must prove that the plaintiff knew the danger involved, appreciated the danger and assumed it.

Situations where volenti non fit cannot be pleaded:

- Where one is under a moral and legal duty to protect life and property;
- Claims by passengers who are injured in car accidents but knew that the driver was drunk and, therefore, likely to drive in a negligent way; and
- Injuries arising out of and in the course of employment.

5.5.2 Private/Self Defence

Note that the law allows people to use reasonable force to defend themselves, their property and to defend other persons, such as members of their family or employees. Reasonable force can also be used to prevent crime. The force used under these circumstances should not be out of proportion. Self

defence is a good (legal) defence to intentional torts against the person, such as battery or false imprisonment.

5.5.3 Act of God

An Act of God has been described as 'circumstances which no human foresight can provide against and of which human prudence is not bound to recognize the possibility'. Damage or loss has to be caused by earthquakes, storms, floods etc-natural causes directly and exclusively without human intervention.

5.5.4 Necessity

Necessity is essentially a plea that the act which is alleged to be a tort was carried out in order to avoid a greater evil. For example, if a person enters into another's land to assist in putting out a fire. It is a possible defence to intentional torts such as trespass. In the case of Dewey-vs.-White, the defendant pulled down the plaintiff's house to prevent fire from spreading to other property and the court held that he was motivated by necessity. This principle was again reiterated in the case of Leigh-vs.-Gladstone where prison staff was sued for forcefully feeding a prisoner who was on hunger strike. It was held that their act was justified to avoid greater evil of death by starvation.

5.5.5 Inevitable Accident

This is where the injury or damage sustained arises out of an accident that cannot be prevented by the exercise of ordinary care, caution or skill. It is an accident which occurs not arising out of anyone's fault. In the case of Stanley vs. Powell, the defendant in an attempt to shoot at a bird accidentally shot the plaintiff. It was held that no liability attached to the defendant since this was an accident and could not be avoided.

5.5.6 Statutory Authority

This is where government or local government employees/agents have been authorised under an Act of parliament or a by-law to perform a particular act. Statutory authority is a plea that the action which is alleged to be a tort is permitted by statute law. It is a common defence because, in the interest of society as a whole, Parliament often allows firms and individuals to engage in activities which have some harmful effect on others. We have seen, for example, that statute law permits civil aircraft to fly over private land (which would otherwise be a trespass).

5.5.7 Mistake

The defence is used where a person is arrested or injured under mistaken identity. It can be used in cases of malicious prosecution and false imprisonment. It can only be a mistake of fact and not a mistake of law where there is reasonable suspicion.

5.5.8 Contributory Negligence

This defence is pleaded where the plaintiff is partly to blame for the injuries or damage they have suffered at the hands of another. Section 4 (1) of the Law Reform Act. Cap. 26 provides that where a person suffers damage as a result partly of his own fault and partly of the fault of any other person or persons, a claim in respect of that damage shall not be defeated by reason of the fault of the person

suffering the damage, but the damages recoverable in respect thereof shall be reduced to such extent as the court thinks just and equitable having regard to the claimant's share in the responsibility for the damage.

For the defence to succeed, contributory negligence has to successfully pleaded in the defence. One of the shortcomings of the common law system was that contributory negligence was a complete defence hence the defendant would escape liability completely if they would establish that the claimant was in any way to blame for the injury suffered.

Contributory negligence can be fixed by the courts or by the parties. The court should find and record total damages before subjecting them to contribution. In the case of Sayers vs. Harlow Urban District Council, the plaintiff was trapped in a public lavaratory operated by the council due to a defective lock. She tried to climb over the door but fell and injured her leg. She recovered damages which were subjected to 25% contributory negligence.

5.5.9 Accord and Satisfaction

Some claims are settled out of court even before proceedings commence. The settlement forms a binding contract between the parties. This is known as accord and satisfaction and releases the defendant from any further liability and if proceedings are commenced, it can be used as a defence.

Activity

Explain other general defences that have not been discussed hereinabove.

5.6 DOCTRINES OF JOINT TORTFEASORS AND VICARIOUS LIABILITY

5.6.1 The Doctrine of Joint Tortfeasors

This doctrine is provided for in Section 3 of the Law Reform Act. Cap. 26 of the laws of Kenya. It applies where two or more persons are responsible in one way or another for causing damage that requires compensation. Joint tortfeasors are jointly and severally liable that is, any one of them separately or all of them together may be sued for the full amount of the loss. Note that contributory negligence focuses on whether the defendant can attribute some responsibility to the claimant. However, it may sometimes be open to the defendant to reduce his liability by claiming that someone else should share responsibility for the losses suffered by the claimant.

The Act provides that a judgment recovered against any tortfeasor liable in respect of that damage shall not be a bar to an action against any other person who would, if sued, have been liable as a joint tortfeasor in respect of the same damage. The distribution of the financial loss among

joint tortfeasors is known as contribution. The amount of the contribution will be such as the court finds to be 'just and equitable' having regard to the extent of that person's responsibility for the damage in question and may amount to a complete indemnity. Where judgment has been entered against one tortfeasor, he has a right of action against the other joint tortfeasors.

The method of seeking for contribution is through third party notice and taking out third party proceedings pleaded in a defence to enjoin the other tortfeasors as parties to the action. The amount recoverable must not exceed the amount awarded in the original suit.

Circumstances under which this doctrine applies include:

- Road accidents involving more than one vehicle resulting in injury/damage to third parties;
- Claims based on negligence against contractors, engineers and architectures arising out of poor workmanship; and
- Defects in products that may cause damage or injury to third parties and liability may lie on the manufacturer, wholesaler or retailer.

5.6.2 Vicarious Liability

Vicarious liability refers to a situation where someone is held responsible for the wrongful actions or omissions of another person. It is a doctrine that imposes responsibility upon one person for the failure of another, with whom the person has a special relationship to exercise such care as a reasonably prudent person would use under similar circumstances. It is guided by the principle that he who does an act on behalf of another does it himself. It is also referred to as imputed negligence. Some of the special relationships where vicarious liability can arise include master/servant, principal/agent, parent/child, partnership and principal/independent contractor in certain circumstances. These are explained here-under.

(i) Partnership

A partnership is a relationship which exists between persons carrying on business in harmony with a view of profit. All partners have unlimited liability for the debts of the firm to the extent of their wealth. Individual partners are agents of the firm and any contract entered into by one will bind all the others. The partners become vicariously liable for a tort committed by one of them in the course of carrying out activities on behalf of the partnership.

(ii) Parents and Children

A child can sue and be sued in tort but can only conduct litigation through the next friend and defence through the guardian or next of kin. A parent or guardian will become vicariously liable for the torts committed by their children under the following circumstances:

- Where a minor acts as the agent of the parent;
- If the minor act with the parent's knowledge and consent; and

- Where a father fails to teach and supervise children on how to handle dangerous things that are likely to cause injury or damage.

(iii) Principal/Agent

A principal is vicariously liable for the acts of his agent which he has authorized either expressly, impliedly or he has ratified. In insurance, whether an intermediary is an agent of the insured or the insurer will depend on the circumstances.

(iv) Master/Servant

A master is generally is vicariously liable for the acts of his agents even where the servant acts outside his authority and/or instructions. The concept of vicarious liability is founded on the common sense position that employees are people of meager means persons to recover from employers. However, the employer is only liable for torts committed while the employee is in the course of his duties.

(v) Principal and Independent Contractor

Generally a principal is not liable for the negligent acts of an independent contractor except in the following situations:

- Where the contractor is employed to do illegal acts;
- Where the principal retains a measure of control over the contractor by providing him with men and machinery;
- Where the principal is under statutory duty to perform work in a particular manner;
- Where the principal is negligent in employing an incompetent contractor; and
- Where the contractor is employed to do lawful acts which involves strict liability.

5.7 LIMITATION AND SURVIVAL OF ACTIONS

Limitation of actions relates to the law limiting the time period within which a person whose rights are violated can bring an action in a court of law. Survival of actions on the other hand is a doctrine that provides for actions to be brought in favour of or against the estate of a deceased person. Both situations are regulated by Acts of Parliament.

5.7.2 Limitation of Actions

The law allows a person who is a victim of a civil wrong only a limited period of time within which to begin their action against the wrong doer. To allow unlimited time would be unfair to the defendant since the possibility of legal action would hang over them indefinitely. A very long delay would also make a fair hearing difficult since evidence tends to become less clear and less easily available

(witnesses are either unavailable or unreliable) with the passage of time. The Limitations of Actions Act Cap.22 governs this area and provides the following:

- Limitation is three years from the date of the cause of action accruing;
- Where the damage is not discovered immediately, limitation period will start from the date of discovery of damage accruing;
- Where the plaintiff is under a disability, time will start running from the time the disability ceases for example, where one is a minor, time will start running when they attain the age of majority;
- Where the tort is a continuing one, a new cause of action arises from each repetition; and
- Where the cause of action is based on fraud or concealment, time will start running from when the fraud is discovered.

A claim filed outside the time limit is said to be statute-barred or out of time. Summons must also be served within twelve months from the date of issue otherwise they expire or cease to be in force unless renewed.

5.7.1 Survival of Actions

Note that under common law, a personal right of action dies with the person. However, this common law position has been modified by statute. Section 2 (1) of the Law Reform Act provides that all causes of action subsisting against or vested in him shall survive against, or, as the case may be, for the benefit of, his estate.

In Kenya, the Law Reform Act provides:

- Rights of action survive in favour of and against the estate of the deceased save for cases of defamation, adultery, seduction and inducing another person's spouse to leave him;
- Proceedings must be instituted within six months from the time the estate has assumed representation;
- Exemplary damages cannot be awarded in favour of the estate of the deceased; and
- In the case of a breach of promise to marry, damages against the estate shall be limited to such damage, if any, of that person as flows from the breach of promise to marry.

Those who are allowed to sue under the Act are the wife, husband, children, grandchildren, parents, grandparents, aunts, uncles but subject to proving a wrongful act, that the plaintiff suffered pecuniary damage and the proceedings must be brought within three years.

5.9 REMEDIES IN TORT

There are various remedies available under in tort. From the discussions in this chapter, you have noted that each type of tort may have its unique remedies. However, the main remedies available in tort and applies regardless of the type of tort are damages and injuction. The remedies available in tort are explained here-under.

5.9.1 Damages

From the definition of tort, it is stated that the remedy in tort is an action for unliquidated damages. There are, in fact, other remedies in tort but damages is the main remedy under common law. We need only note here that damages mean financial compensation. 'Unliquidated' means that the amount of damages is not fixed in advance but will be decided by the court, according to the seriousness of the injury, loss or damage caused.

The object of an award of damages is to compensate the claimant by paying for the loss which the defendant has caused by their wrongful act. When assessing damages, the court will attempt to arrive at a sum of money which will, as far as possible, put the claimant in the financial position they would have enjoyed if the wrong had not been committed.

Types of Damages

There are various types of damages namely: general, special, exemplary or punitive, nominal, contemptuous and aggravated damages and each is explained below.

General Damages

General damages do not require such strict pleading and proof because they relate to losses which the law automatically presumes to result from the breach. They are unliquidated and are therefore ascertained by courts depending on the circumstances of the loss. General damages are not capable of precise mathematical computation.

Special Damages

Special damages are those of which the claimant is required to give notice when they make their claim against the defendant and which they must prove strictly at trial. They are liquidated claims and do not arise directly from the breach.

Exemplary Damages

The object of an award of damages is not to punish the wrongdoers but to compensate the claimant, punishment being a function of the criminal law. Exemplary damages are awards which exceed the loss which has actually been suffered. They are intended to punish the defendant for their conduct. They may be awarded in defamation and trespass but is not available in negligence.

Nominal Damages

Where a person has committed a tort which is actionable per se such as libel or trespass and no real loss has been caused to the claimant, the court may award a nominal damages (a token) sum to mark the fact that the defendant was in the wrong.

Contemptuous Damages

This is the award of a tiny sum to mark the court's low opinion of the claim of the claimant or record their disapproval of the claimant's conduct. Contemptuous damages may be awarded for any tort, whether actionable per se or not.

Aggravated Damages

In certain torts (for example, assault or trespass) the court may award additional damages to reflect the fact that the motives and conduct of the defendant have aggravated the injury suffered, by injuring the claimant's sense of dignity or pride.

5.9.2 Injuction

An injunction is a court order that commands a person to do a particular thing or prevents a person from engaging in a particular act. It is usual for contracts to provide for negative undertakings for example, contract not to set up a rival business. There are two types of injunctions that is a mandatory injunction and a prohibitory injunction. A mandatory injunction compels the defendant to do a particular thing such as knock down a wall which is blocking a right of way. A prohibitory injunction on the other hand is an order that refrains the defendant from doing a particular thing such as publish a libelous book. An injunction will not be awarded when damages would be sufficient compensation but it is granted where damages are not appropriate. An injunction may therefore be awarded instead of, or in addition to, damages.

5.10 FRAMEWORK GOVERNING THE AWARD OF DAMAGES

We have already discussed the factors that guide courts in the award of damages in lecture.

 Do you remember those factors?

The considerations in the award of damages will include:

Nature of injury/damage suffered

The claimant will be required to prove their claim by producing documentary evidence in support before damages can be awarded. Injury cases for instance, a medical report, p3 form, treatment records and a police abstract report will be required.

Judicial Precedents

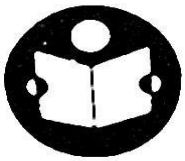
This was discussed in chapter one. The amount of damages awarded will be greatly influenced by past decided cases but issues of inflation will also be considered. Judge made law plays a crucial role in determining the amount of damages to be allowed in a given case.

Statutes

Some Acts of parliament may impact on the computation of damages for example Law Reform Act, Work Injury Benefits Act and other legislations that address issues of contributory negligence are also statutory provisions and will affect the amount of damages.

A detailed discuss of this will be in Liability Insurance Unit module three.

5.11 SUMMARY



We have found from this lecture that:

- Tort arises from violation of duties imposed on every legal person by the law;
- There are various types of torts that either have origins in the common law of statutes and these torts include negligence, trespass, nuisance, defamation and strict liability;
- Every civil action must be proved on a balance of probability while criminal cases require to be proved beyond reasonable doubt;
- The doctrine of vicarious liability arises where a person shoulders liability for a tort committed by another and such situations occur where a special relationship exist. Such relationships include principal and agent, master and servant, partnership, parent and child, principal and independent contractor among others;
- Civil actions must be filed within statutory period otherwise they may fail;
- Actions survive against or in favour of a deceased person;
- Various defences are available depending on the nature of the tort committed. Some of these defences are contributory negligence, self defence, necessity, statutory authority, inevitable accident and accord and satisfaction among others; and
- The most common remedy in tort is damages though other remedies are also available for example injunctions.

5.12 ACTIVITIES

1. Explain the differences between a tort and a contract.
2. Briefly describe the various types of torts.
3. Explain the essentials of defamation.

Assignment for submission

1. Explain various relationships that may give rise to vicarious liability.
2. Explain five conditions that the plaintiff must prove in order to succeed in a case based on the tort of negligence.

5.7 READING LIST

i. Law of Torts by Muriithi Wanjau

ii. General Principles and Commercial Law of Kenya by Ashiq Hussain

iii. The Law of Kenya by Tudor Jackson

v. Past Papers

LECTURE SIX

6.0 LAW OF AGENCY

COURSE OUTLINE

6.1 Introduction
6.2 Learning outcomes
6.3 Nature of agency
6.4 Creation of agency
6.5 Classes of agents
6.6 Nature of the agent's duties, rights and authority
6.7 Relationship between the principal, agent and third parties
6.8 Termination of agency relationship and effects of termination
6.9 Agency roles of insurance intermediaries
6.10 Statutory provisions relating to insurance intermediaries
6.11 Summary
6.12 Activities
6.13 Reading list

6.1 INTRODUCTION

You have learnt from the last lecture that the law imposes duties on every person. It requires everyone not to violate other people's rights as they undertake their activities. You now understand that where

a violation occurs, the aggrieved party may seek legal redress and be awarded damages. You also have gained understanding of the various torts and can now apply them in the practice of insurance.

Welcome now to lecture six. Insurance policies are often arranged through an insurance broker or agent of some type. This makes the knowledge of the law of agency important for insurance students. In this chapter, you will be introduced the general principles of the law of agency and the application of these principles in the practice of insurance. Here, you will first examine how the relationship of the principal and agent is created; we will then look at the rights and duties of agents and the nature of the authority or power which they have. You will then consider how the exercise of this authority affects the principal and third parties. Finally you will examine the way in which an agency relationship may come to an end and the law that regulates insurance agents and brokers.

6.2 LEARNING OUTCOMES

By the end of this lecture, you should be able to:

a) Explain the nature of agency;
b) Describe the creation of agency;
c) Explain the classes of agents;
d) Discuss the nature of the agent's duties, rights and authority;
e) Describe the relationship between the principal, agent and third parties;
f) Explain termination of agency and the effects of termination;
g) Explain the agency roles of insurance intermediaries; and
h) Explain the statutory provision relating to insurance intermediaries.

Competence
The trainee should have the ability to apply law of agency in the practice of insurance

Content
Let us now start by explaining the nature of agency.

6.3 NATURE OF AGENCY

Who is an agent?

An agent is a person who has authority or power expressly or impliedly to act for or represent another (known as the principal) in dealing with third parties. The law assumes that one who does an act through another does it himself. The relationship between the agent and the principal is known as agency. The Insurance Act defines an agent as a person who is not being a salaried employee of an insurer, but who in consideration of a commission, solicits or procures insurance business on behalf of an insurer or broker.

Note that once the agent brings the principal and the third party into contractual relations, he has no further interest in the agreement, and therefore drops out. It is important to understand that when an agent is employed to buy or sell, or arrange some other contract between the principal and third person, the agent is not usually a party to the contract arranged. For this reason, it is not necessary for the agent to have full contractual capacity, provided the principal and third party have such capacity.

The principal can sue or be sued under the contract. The agent is therefore said to be a connecting link, a mechanism, an intermediary and a middleman. Examples of agents include estate agents, travel agents, employment agencies, insurance intermediaries and advocates among others.

It is important to note that where an agency relationship exists, the scope of the agent's authority must be clearly defined.

Take note that Insurance brokers do not only arrange insurance contracts. They also undertake other tasks which include the giving of general advice on risk management, develop products and assist in negotiating claims. In some cases a person or may be described as an agent but may not be an agent in the strict legal sense of the word. An example is a motor agent in the motor trade is not usually an agent of the manufacturers whose cars they sell. In most cases they will buy vehicles from the manufacturer or distributor and then sell them on their own account as principals.

On the other hand, people who are agents in law may be described by another word, for example, insurance intermediaries may go under the name of insurance brokers, insurance consultants or use some other title. Again, all employees who deal with third parties such as customers of the firm for which they work do so as agents of their employers, although it is not usual to describe them as agents. You will learn in lecture seven that corporate bodies have no physical existence and, therefore, can only operate through agents, such as their employees.

6.4 CREATION OF AGENCY RELATIONSHIP

An agency relationship can come about in four ways as explained below.

6.4.1 By Agreement/Consent

In almost every case, the agency relationship is created through an agreement between the principal and agent. This agreement will often be a contract in itself described as a contract of agency. However, in some instances, the agreement will not amount to a legal contract, particularly when the agent receives no commission, fee or other payment for his work. Creation of agency relationship through agreement can be in writing, verbal or evidenced in writing. Where one is appointed to execute a deed by the principal, the appointment must be by deed. This is known as power of attorney.

Think


What is contained in the agency contract?

An agency contract will have to clearly stipulate the duties and the rights of the parties, the extent of nature and of authority of the agent, the form of remuneration of the agent and the duration of the contract.

6.4.2 By Implication or Conduct

This is where courts infer an agency relationship based on the conduct or relation of the parties especially where payment is made. Examples where agency will be implied include:

Agency by Estoppel: This is where one is made to believe they are agents especially where the undertake acts on behalf of another and payment for their services is made. The principal will be estopped from denying that an agency relationship exists. In the case of **Scarf-vs-Jardine (1882),** a retired partner of the defendant firm negotiated a contract with the plaintiff who did not know that the partner had retired. The court held that the firm was liable.You will understand in this lecture that the firm needed to have notified third parties that the partner has retired for them to be exonerated from liability.

An agency by Implication may be Implied by Cohabitation: This will be inferred or assumed for a husband and wife where the wife pledges the husband's credit for purchase of necessaries. The husband can however rebut this presumption by proving that he had sufficiently provided for necessaries and that he had forbidden the wife to pledge his credit.

6.4.3 Agency of Necessity

This arises where one is entrusted with goods/property belonging to another and by reason of genuine emergency acts with the intention of protecting the principal's property from deteriorating. The action must, however, be done in good faith and in circumstances where it is impossible to obtain the owner's instructions in time. The agent should not act for his own benefit. Examples are consignments on high seas, cargos carried by railway companies which can be sold by the carrier when further transport becomes impossible and the cargo is in danger of going bad.

6.4.4 Agency by Ratification

This is where the agent acts without prior authority or exceeds the authority given. The principal may choose to decline responsibility for the act or ratify the same. Ratification means the principal accepts the act as having been done properly on his behalf. Agency by ratification is created retrospectively that is, after the agent has undertaken the act. Valid ratification is subject to the following conditions:

- The agent must purport to act on behalf of the principal and not on his own behalf;
- The principal must be in existence at the material time with full contractual rights;
- The principal must at the time of ratification have full knowledge of all the material facts regarding the agent's act;
- Ratification must be of the whole contract and not part of it;
- Ratification must be within a reasonable time;

- The principal must be the person the agent had in mind at the time of the act; and
- A void or illegal contract cannot be ratified.

Note that under the doctrine of ratification a person may ratify an insurance contract which has been arranged on their behalf, even if the person was unaware that the insurance agent had arranged the cover and this may happen in marine insurance where a contract may be ratified even after a loss has occurred.

6.5 CLASSES OF AGENTS

There are various classes of agents as explained below.

Universal Agents
These agents have full powers to act for the principal. Examples of such agents a branch manager in an overseas branch of a company and an agent appointed by way of deed/seal.

General Agent
A general agent is appointed to do anything within the authority/specified capacities given. A shop manager or employees of companies are appointed and their limits of authority are in most cases specified.

Special Agent
These are agents appointed to do specified act or acts for example insurance agents are appointed to procure business and collect premiums on behalf of the principal but do not have authority to admit claims. Motor assessors are authorised to assess the extent of damage following an accident but cannot authorize the garage to carry out repairs on vehicles that they assess.

Del Credere Agent
These agents guarantee to pay the principal where the third party fails to pay and as a result, their commissions are higher.

Merchantile/Factor Agent
These agents have actual possession of the property and can sell the property in their name; obtain insurable interest and possess lien on the principal's goods.

Brokers
These agents buy and sell goods on behalf of the principal at a commission. An example is stockbrokers and they bind the principal to the extent of their authority.

Auctioneers
They sell property by public auction, they are agents for the seller. They however must act professionally as they undertake their duties and required to take professional indemnity insurance in case of negligent acts in the course of their duties.

Bankers

They undertake certain duties on behalf of their clients for instance effecting standing orders on request thereby acting as agents.

Commercial Agents

These are self employed intermediaries who have continuing authority to negotiate the sale of or purchase of goods on behalf of another person (principal). The agent must be paid commission on 'repeat orders' where the agent was responsible for the subsequent order. The agent must also receive commission after termination of the agency contract where the transaction is mainly attributable to the agent's efforts during the period of the contract. The agent must be paid commission even when the contract does not follow from the agent's lead in instances where the principal is to blame for the contract not being fulfilled.

6.6 NATURE OF THE AGENT'S DUTIES, RIGHTS AND AUTHORITY

Having understood the different classes of agents, we will now discuss the duties, the rights and authority of an agent.

6.6.1 Duties of an Agent

There are five main duties of agents which are discussed below.

(i) Obedience

The agent is required to must carry out the principal's work in accordance with the instructions given. The instructions, however, must be lawful and reasonable. The agent may be held liable for damages for failure to adhere to the instructions as disobedience will lead to breach. Where an insurance intermediary has no instructions on a particular point, he may follow market usage where such practice is clear.

(ii) Care and skill

An agent must exercise reasonable care, diligence and skill while carrying out the principal's work least he becomes liable for professional negligence. An insurance intermediary must exercise a level of care and skill that is appropriate for the class of agent he represents. A higher level of skill will usually be expected of an insurance broker than an agent. This is because the broker holds himself out to be an insurance expert.

The duty to exercise reasonable care and skill includes a duty to act in a timely manner and the intermediary will be liable for loss caused by his failure to act with appropriate speed, for example, in the placing of cover or the notification of claims. Where the insured suffers loss as a result of the broker's negligence in the exercise of their professional duty, the general measure of damages is that which will place the insured in the position that he would have been in were it not for the negligence.

Where there is negligent failure to renew and the insured suffers a loss that would have been covered by the policy, the broker will be liable in damages for the amount which would have been payable under the policy. Similarly, if a broker fails to disclose material facts on behalf of his insured, and the insurers discover this when investigating a claim, and they avoid the policy, the broker will be liable to the insured for the amount that would have been payable had the policy not been avoided.

(iii) Good Faith

The relationship between the agent and the principal is a fiduciary one based on good faith. Where the agent fails to exercise good faith, he will be held liable. In the case of **Keppel vs. Wheeler**, the defendant was an estate agent and was engaged to sell a house on behalf of the principal. He obtained two offers of £6150 and £6750 and sold the house at the lower offer and did not disclose the higher offer to the principal. It was held that the principal should recover £600 from the agent. The agent owes the principle a duty:

- Not conceal any relevant information from the principal;
- Maintain confidentiality;
- Not accept bribes;
- Not act for both parties;
- Not engage in acts that may amount to conflict of interest by letting personal interest to conflict with duties;
- Not accept secret commissions; and
- Generally act in the principal's best interest and not his own at all times.

(iv) Personal Performance

The agent should do the work personally and not delegate except in the following circumstances:

- where delegation has been expressly permitted by the principal;
- Where custom or trade allows delegation;
- Where there is an unforeseen emergency;
- Where it is necessary to finish the work properly and professionally; and
- Administrative purposes.

(v) Account for Money Received

An agent should keep proper accounts and produce them to the principal when required; account for all monies received and also keep separate accounts that is, for himself and the principal. This only applies where the agent collects money on behalf of the principal.

(vi) Keep the Principal Updated

An agent must keep the principal informed on all matters and developments with regard to the transaction they are engaged in on behalf of the principal.

Remedies for Breach of Duty by an Agent

When an agent is in breach of duty, the principal can:

- Sue the agent for damages for breach of contract;
- In certain circumstances, sue the agent in tort. This may occur when the agent has refused to return the principal's property;
- Sue the agent to recover any secret money/bribe received by the agent;
- Sue for an account if the agent fails to keep proper accounts of the agency transaction; and
- Dismiss the agent without compensation.

6.6.2 Rights of an Agent

Note that the duties of the agent are the rights of the principal while the rights of the agent are the duties of the principal. The rights of an agent are:

(i) Indemnity

An agent has a right to indemnity against all expenses and liabilities properly and lawfully incurred in the execution of his duties. For example, if a broker pays premiums on behalf of his clients which is a common practice in insurance, he has the right to be repaid. An agent may, however, loose this right if:

- His act is not authorized or ratified by the principal;
- He acts in breach of his duties;
- The act upon which they are claiming indemnity is illegal; and
- Where they incur liability out of their own fault or mistake.

(ii) Lien

This is where an agent retains the principal's goods as security for a debt (commission or any moneys owed) for example stockbrokers, bankers, advocates. There are two types of lien that is particular and general. An agent exercises particular lien when they retain the particular goods for which the payment is due. General lien is exercised when the agent retains as security any property. The agent can retain the goods but cannot sell them unless they obtain a court order. The right of lien ends when the principal pays or makes a promise to pay. In marine insurance, for example, an insurance broker can exercise a lien over the policy and can retain it as security for payment of the premium by the insured.

(iii) Remuneration

This is normally in the form of commission or any reward agreed on. The amount to be paid may be expressly stated in the contract, may be based on the trade usage or a court may award what is reasonable. Work must be done or event happens prior to payment being made. The level of commission for various lines of business will normally be set out in the agency agreement.

6.6.3 Authority of Agents

You recall that earlier in this lecture, you learnt that the principal must be clear on the limit of authority given to the agent. Note that there is a relationship between the manner of creating an agency relationship and the type of authority an agent has. Authority of an agent may include:

- Express authority;

- Implied authority;
- Usual authority; and
- Apparent or ostensible authority.

These are explained below.

Express authority

This is also known as real or actual authority. This can either be in writing, orally or under seal. Express authority arises from the instructions which have been given to the agent, stating what is required and what is allowed. These instructions form part of the agency agreement and may be oral or in writing. If the instructions are ambiguous the agent should seek clarification from the principal. However, if the principal cannot be contacted no liability will fall on the agent provided that the agent acted in good faith.

Implied authority

This is authority to do anything necessary or incidental to carrying out of the express authority. An investigator appointed by an insurer usually receives express instructions. However, he may incur other expenses in the cause of executing their duties like mileage and telephone cost.

Usual authority

This is where an agent may have implied authority to perform those acts which are usually performed by persons in the agent's position or usual in a particular trade or profession. This is known as usual authority (or customary authority

Activity

Outline circumstances where implied authority may arise.

Apparent or ostensible authority

An employee placed in a position of responsibility may be assumed by third parties to have authority that matches with the position. Third parties will not know the exact limits. This authority is not real authority but one that appears in the eyes of third parties. The law recognises this by what is termed as apparent authority. However, the principal must make some presentation by words or conduct to the third party and the third party relies on the presentation. The principal therefore gives the agent appearance of authority. Through representations, the principal may also hold out one as being his agent.

Apparent authority can arise in the following cases:

- Where the principal has restricted the authority of a validly appointed agent;
- Where an agent has never been appointed: a person may 'hold out' another person as being their agent when the latter has no authority at all, with the result that the third party is deceived. This is sometimes known as an agency 'by estoppel'; and
- Unknown to the third party, the agent's authority has been terminated. When an agency is terminated, the actual authority of the agent will also end. However, third parties who deal with the agent may be unaware that their authority has ceased and continue to deal with them. For this reason a principal who terminates an agency should inform third parties who have dealt with the agent in the past.

Case example where the principal holds out an agent with restricted authority

Watteau vs. Fenwick

Facts: the principal appointed a manager for his public house and took out the license in the name of the manager and put his name over the door. The manager bought cigars on credit but had been forbidden to do this. The court held that the principal was liable arguing that although this had been prohibited, the plaintiff would not know.

6.7 RELATIONSHIP BETWEEN THE PRINCIPAL, AGENT AND THIRD PARTIES

Note that an agent may act on behalf of a principal whose existence is known (disclosed) or one who is not disclosed. The question then arises; what is the position of third parties in both circumstances.

6.7.1 Disclosed Principal

Who is a disclosed principal?

A disclosed principal is one whose existence is known to the third party at the time the contract is made. The principal's name may be known or not known. Whether the principal is named or not makes little difference, because in either case, the third party will be aware that the person they are dealing with is an agent. The general rule is that the agent simply 'drops out' once the contract is made. The principal and third party can enforce the contract against each other but the agent can neither sue nor be sued on it.

At the beginning of this lecture, you have learnt that the agent's main responsibility is to bring the principal and the third party into contractual relations. He then moves out of the picture and cannot sue or be sued since he is not party to the contract. However, there are exceptions to this rule where an agent may be sued and therefore incurring personal liability. This may arise under the following circumstances:

- If the agent expressly assumes personal liability;
- By trade or custom;
- Where the agent signs a negotiable instrument in his name;
- If he executes a deed in his name;
- If he acts for a concealed principal;
- If he acts without or in excess of his authority; and
- Where they are acting in dual capacity.

6.7.2 The Undisclosed Principal

This is where the identity or existence of the principal is not known. The agent acts without disclosing the principal but discloses that he is acting in the capacity as an agent and not as principal. The undisclosed principal will, however, be liable for the acts of the agent. Where the agent acts in a manner that third parties are not aware that they are dealing with an agent, the undisclosed principal and the third party will have rights against the agent.

Can the undisclosed principal and the third party enforce the contract against each other?

The undisclosed principal can, as a general rule, enforce the contract against the third party except under the following situations where:

- They did not exist or lacked capacity;
- They cannot ratify the contract;
- They cannot sue where there is a provision that the person making it is the sole principal; and
- The principal cannot sue if the third party can prove that they had a good reason for dealing with the agent personally.

What are the rights of third party?

- The third party can sue the agent or principal. If he elects to sue one of them and obtains a judgment, he extinguishes right to sue the other; and
- Can sue the agent for breach of warranty of authority. This is where he has no authority or exceeds their authority and their acts cannot bind the principal.

6.8 TERMINATION OF AGENCY RELATIONSHIP AND EFFECTS OF TERMINATION

An agency relationship may come to an end either by operation of the law or by act of the parties. The following are ways in which the relationship may be terminated.

- By mutual agreement;

- By performance that is, after completion of the tasks;
- Renunciation that is where the agent renounces the contract after giving notice to do so. Where no notice is given, the agent may be sued by the principal for breach;
- Revocation/withdrawal: the principal may revoke or withdraw instructions and this may lead to breach of the contract if no notice is given. The agent may lose the right to sue if he incurs personal liability. The principal may also not revoke where he has given authority coupled with interest (where he borrows money from an agent and gives the agent property to sell on his behalf); and secondly where he has given the power of attorney, he cannot revoke without the agent's consent;
- End of a fixed period for agencies formed for a specified period;
- Where there is subsequent illegality that is, where the objects of the agency becomes illegal;
- On bankruptcy of the principal;
- On death or insanity of either party; and
- By frustration-this can be through destruction of the subject matter, illness of either party, futility among others.

6.8.1 Effects of Termination

Note that not all consequences of the agency relationship cease at termination. The following will survive.

- The agent will still have the right to commission/indemnity earned prior to termination;
- If the agent had been dismissed for breach or was in breach of his duties during the agency relationship, the right of action by the principal will remain; and
- If a third party has not been notified of the termination, the ostensible authority of the agent will remain and the principal will be liable for the actions of the agent.

6.9 AGENCY ROLES OF INSURANCE INTERMEDIARIES

Generally an insurance agent operates as an agent of the insurance company. Insurance brokers, on the other hand, are regarded as professionals and the law requires that they maintain a professional indemnity cover with a minimum limit of Kes. 10 million. The maxim 'qui facit per alium facit per se' means that what is done by an agent is deemed to have been done by the principal. Any knowledge which the agent possesses is imputed to the principal meaning, what is known to the agent is deemed to be known by the principal (imputed knowledge).

6.9.1 Who is the Principal of an Insurance Agent?

An intermediary may at different times act on behalf of both the insured and the insurer. They may be negligent by exceeding their authority when granting cover, fail to record information given accurately, omit to record information that was supplied or fail to supply extra information that he knows or ought to know. An insurance agent is generally deemed to be an agent of the insurer while a broker is deemed to be an agent of the insured.

As an Agent of the Insured/Proposer

An insurance agent may be regarded as an agent of the proposer in the following:

- When they give general advice regarding the cover required by the insured and recommends the type of policy;
- Where he fills a proposal form on behalf of the proposer, alters information on the form or supplies extra information and the proposer knew or ought to have known;
- If the agent completes the proposal form and the form and incorporates a wording to the effect that the person filling is not the proposer, the person will be deemed to be an agent of the proposer;
- When the agent and the insured collude to defraud the insurer;
- When the agent advises the insured on how to formulate a claim; and
- If he acts on behalf of the insurer and he has no authority, he will be deemed to be acting for the proposer.

As an agent of the insurer

- Where he has express authority to receive and handle proposal forms;
- Where he acts without express authority, the third party assumes he has apparent authority and the principal ratifies the act as was in the case Murfitt vs. Royal (1922), where insurers had ratified the agent's ultra vires actions on two previous occasions and the insured assumed the agent had authority. It was held that the insurers were liable;
- Where the agent has express or implied authority to collect premiums on behalf of the insurer.

Case: Wing vs. Harvey (1854)

Facts: The agent collected premiums from a client for a risk which he knew the client was in breach of a policy condition. The agent's action amounted to principal waiving their rights to reject the claim and the court estopped them from denying liability

- Where the agent has been authorized by the insurer to ask the insured questions and fill the proposal forms; and
- Where the agent acts as a risk surveyor and gives a description of the property to be insured on the insurer's behalf.

Generally, the roles of an insurance intermediary may include:

- They are the primary source of information on products;
- They act as mediators in case of claims disputes;
- They help in cost saving by ensuring repeat sales and customer retention; and
- The insurers get the benefits of face to face selling through use of agents.

6.10 STATUTORY PROVISIONS RELATING TO INSURANCE INTERMEDIARIES

The Insurance Act has various provisions relating to insurance intermediaries. We outline some of them hereunder.

6.10.1 Registration requirements for insurance brokers and medical insurance providers

Before being registered as a broker or medical insurance provider, an applicant should meet the following requirements as provided for in the Insurance Act:

- Submit an application in the prescribed format;
- Pay the appropriate registration fee;
- Be a company incorporated under the Companies Act;
- Obtain a minimum security of KES.5,000,000 through the purchase of a two year bond from the Central Bank of Kenya (CBK);
- Have a at least 60 per cent of its shares held by citizens of EAC member states;
- Have a minimum paid up capital of KES1,000,000;
- Have a fit and proper Principal officer; and
- Have a Professional Indemnity policy with a minimum limit of KES.10,000,000.

6.10.2 Registration requirements for insurance agents

To be registered as an insurance agent, one must fulfill the following requirements:

- Complete an application form which is in a prescribed format;
- Pay the applicable registration fee;
- Submit copies of identification documents;
- Be a citizen of a EAC Member state;
- Pass or be exempted from Certificate of Proficiency(COP) examination or Executive Certificate of Proficiency (ECOP);
- Submit a certificate of registration of business name for agents using a business name which, name must reflect the kind of business done; and
- Submit annual audited accounts in case of corporate agents.

The Act provides that an agent may be denied registration if:

- They are persons of unsound mind;
- They have been adjudged bankrupt; and
- Where one has been convicted of an offence related to fraud, dishonesty within the preceding five years.

6.10.3 Circumstances that May Lead to Cancellation of an Agent's Registration

- Failure to comply with or engaging in acts that are in contravention of the Insurance Act;
- Conducting business contrary to sound business practice;
- If the agent is declared bankrupt;
- Where the Cabinet Secretary in the ministry of Finance determines that it is not in public interest for the agent to continue operating;
- If an agent engages in unethical behavior or other malpractices and either has been found guilty or warned in writing by the commissioner; and
- Where the knowledge and experience of the agent is unable to satisfy the Commissioner that the business will be conducted in a satisfactory and efficient manner.

6.11 SUMMARY


In this lecture, you have found that:

- The role of an agent is to facilitate the contract between the principal and the third party;
- Agency relationship is created through various ways namely: Agreement, necessity, ratification and implication;
- An agency relationship creates rights which include remuneration, lien and indemnity. It also imposes obligations on both the agent and the principal. The duties of an agent include obedience, care and skill, good faith, accounting for money received, personal performance and keeping the principal updated on developments;
- An agent can act on behalf of a disclosed principal but the law also allows and agent to act for undisclosed principal;
- The relationship between an agent and principal is terminated under various circumstances among them, performance, agreement, frustration, bankruptcy, death, renunciation and revocation; and
- Insurance intermediaries are regulated through the Insurance Act and the Act provides for requirements for their registration among them submission of application forms and payment of application fee.

6.12 ACTIVITY


1. Explain ways in which an agency relationship may be created.
2. List the conditions for valid ratification.
3. Explain duties of agents.
4. Outline circumstances under which an agent may be terminated.
5. Outline the limitations of an undisclosed principal in enforcing a contract.
6. Describe the rights of an agent.
7. Outline classes of agents.

6.13 READING LIST

i. General Principles and Commercial Law of Kenya by Ashiq Hussain

ii. The Insurance Act Cap. 487 of the laws of Kenya

iii. General Principles of Law Simplied by N.A. Saleemi

iv. Past Papers

LECTURE SEVEN

7.0 COMPANY LAW

LECTURE OUTLINE

7.1 Introduction
7.2 Learning outcomes
7.3 Classes of legal persons
7.4 Types of business organizations
7.5 Procedure for formation of companies
7.6 Internal management and structure of companies
7.7 Procedure for winding up companies
7.8 Summary
7.9 Activities
7.10 Reading list.

7.1 INTRODUCTION

In lecture six, you learned that there are various types of agents. You have also on how agency relationship is created, the duties and rights of agents and circumstances under which agency agreements come to an end. You now have the ability to relate agency principles to the practice of insurance.

I now welcome you to this lecture on company law. The lecture introduces you to different types of business organisations and the advantages and disadvantages of each. You will, from this lecture

understand the requirements of formation, management and the circumstances under which companies are wound up.

7.2 LEARNING OUTCOMES

By the end of this lecture, you will be able to:

a) Explain the classes of legal persons;
b) Describe the different types of business organisations;
c) Explain the procedure for formation of companies;
d) Describe the internal management and structure of companies;
e) Explain the appointment, powers, duties and liabilities of the executive officers of incorporated and unincorporated companies; and
f) Explain the procedures for and winding up companies.

Competence

The trainee should have the ability to identify the implications of company law in insurance practice

Content

Let us now start by explaining the classes of legal persons.

7.3 CLASSES OF LEGAL PERSONS

In legal theory, the term company implies an association of a number of people for a common object/purpose. Company law, on the other hand, is the field of law concerning companies and other business organisations which include corporations, partnerships and other associations which usually carry on some form of economic, social or charitable activity. The statutory provisions which govern formation, conduct, management and winding up of companies are contained in the respective companies Acts. In Kenya, the provisions are contained in the Company's Act No. 17 of 2015 which repeals the Company's Act Cap. 486 of the laws of Kenya.

7.3.1 Legal Personality

Who is a legal person?

A legal person is one who the law recognises as having certain rights and duties which the courts can enforce. Generally all persons are subject to legal rules, which protect, give rights and impose duties on them. However, the law does not affect everybody in exactly the same way for example, some organisations, minors, persons of unsound mind, bankrupts and other special categories have their

own particular rights and duties. Detailed discussion of this has been done in lectures two and five. The law divides persons into two categories as explained hereunder.

Natural Persons

All human beings are referred to as natural legal persons. Generally the legal personality starts at birth and ends at death. They possess rights which the law recognises and are also subject to duties imposed on them by the law. Article 26 (2) of the Kenyan Constitution provides that life begins at conception. There are instances where one can sue for injuries sustained before birth and legal actions commenced before death can be continued after death. The law also allows actions to be commenced on behalf of a deceased person after death. Some classes of persons have a special status and the law grants them limited legal capacity for example minors, persons of unsound mind, bankrupts and aliens. This was explained in detail in chapters two and five.

Juristic Legal Persons

Juristic persons, or corporations, are non-human legal entities and are sometimes known as artificial legal persons. They are formed by people who wish to combine their resources for a common purpose. Corporations vary in size and complexity from vast multi-national firms to small clubs and societies. Corporations are subject to the law in much the same way as natural legal persons except where their very nature demands a different kind of treatment. A corporation may, for example, be found guilty of some crimes, even though it can only act through human agents. However, there are some criminal wrongs which would be difficult or impossible for a corporation to commit such as assault, rape or bigamy. Only limited criminal sanctions are available for companies which break the law for example, they can be fined, but not imprisoned. There are two types of corporation which are:

- Corporations sole; and
- Corporations aggregate.

Corporation Sole

A corporation sole is a legal person representing an official position which will be occupied by a series of different people. It is a legal entity consisting of a single "sole" incorporated office, occupied by a single "sole" natural person. Examples include:

- The president in his public capacity;
- The queen in her public capacity;
- The bishops and parish priests; and
- The Public Trustee.

They are legal entities which are quite distinct from the people who actually hold the positions at any given time. When a bishop for example dies, he ceases to exist as a natural legal person but the office of bishop remains. The corporation cannot die, and regardless of when the new bishop assumes office, there is no break in its powers and its property remains vested in it.

Corporation Aggregate

A corporation aggregate is a legal person consisting of a number of people. Its legal existence is quite separate from the members. Examples are universities in Kenya whose membership is always changing because of new admissions, resignations and deaths but the corporation does not change except to the extent that its charter and bye-laws may be altered from time to time and it has the same legal rights and liabilities as a natural person. Corporations aggregate are created by:

- Charter(chartered corporations);
- Private Act of Parliament (statutory corporations); and
- Registration under the Companies Acts (registered corporations).

Activity

Find out some of the crimes and torts that corporations may commit in the course of undertaking their activities as legal persons.

7.4 TYPES OF BUSINESS ORGANIZATIONS

Having understood the concept of legal personality, we will now discuss the types of business organisations. Before looking at company law, it is necessary to briefly discuss the main types of other forms of business organisations or entities that exist. These are:

- Sole proprietorships;
- Partnerships; and
- Registered companies.

A discussion of each is given below.

7.4.1 Sole Proprietorships

These are also known as sole traders. They are natural persons engaged in business on their own without association with others. They are thus deemed to be unincorporated business (or trading) organisations. Generally there is no regime for the regulation as to setting up and conduct of business as a sole trader and anyone is, therefore, free to engage in any type of business activity. The only requirement is that where the business name is not that of the owner, the same must be registered with the Registrar of Companies within 28 days of commencement of business by virtue of the provisions of the Registration of Business Names Act (Cap 499). Such registration does not, however, change the status of the business; it remains an unincorporated trading organisation.

The main feature of the sole trader is that the owner and the business are the same i.e. the business is not a separate entity from the owner. The sole trader is therefore liable for the debts of the business to the full extent of their fortune. Sole proprietorships are the most common business structure.

Advantages of Sole Proprietorship

A sole proprietorship has various advantages and disadvantages. They are explained below

Formation

One advantage of starting a sole proprietorship is the simplicity of formation. Very little paper work is required one chooses to file your business name. A small fee is required for completing the paperwork. One is given a certificate with the name of the business. The owner can then use the certificate to open bank accounts and apply for business credit cards. Unlike other business structures, individuals owning sole proprietorships are not required to file annual reports or legal documents required by some other business structures.

Ownership and management

The sole owner of the business possesses all authority to make decisions on behalf of the business. Owners are not required to attend formal meetings required of owners and members of other business structures. The owner can decide to sell or transfer the company to another individual and make important business decisions at his discretion.

Taxation

Sole proprietors are not required to file separate tax returns for their business. Income made from the business is counted as personal income and owners pay taxes according to their individual tax rates. The tax rules regarding sole proprietorships allow owners to avoid the double taxation of corporations. The tax master allows sole proprietors to take deductions on business expenses, which lowers owners' taxable income amount.

Changing Business Structures

If the business grows to a place that the business structure of a sole proprietorship no longer works to your advantage, the owner can easily change to a more complex model. The only requirement for going from a sole proprietorship to another business structure is filling out the paperwork for your new business structure.

Distribution of Profits

Sole proprietors are the sole owners of their businesses and do not split profits with other people. One hundred percent profit retention allows sole proprietors to use the money at their discretion. One can choose to reinvest the money back into the business to expand the company, start another business or use it for personal reasons.

Personal Contact with Customers

A sole proprietor knows their customers, their tastes and preferences and will therefore work more at retaining them.

Disadvantages of Sole Proprietorship

There are various disadvantages that are associated with sole proprietor businesses which are outlined below.

Finance

This is usually limited to any money the proprietor can provide or borrow from bank, building society, family and friends. This limits the scale of the business.

Unlimited Liability

This means that if business gets into debts, the owner will sell personal assets to pay off the liabilities of the business. The owner may stand to lose everything the business has been put as a security for a loan.

Expansion

Expanding a sole proprietorship may be limited due to lack of finances. Lack of finance may prevent the business from reaching a viable size. This may also be caused by limited ideas and also where the owner fails to plough back profits into the business.

Continuity

The firm heavily depends on the sole-proprietor. So, there may be problems on taking holidays or if the owner is ill. There is no perpetual succession as the business is likely to cease with the death of the owner.

Limited Expertise

A sole proprietor may have expertise in one area for example, technical knowledge but may be lacking in people management or marketing skills. A sole trader may for instance be good at repairing the body work of damaged cars but completely lacking in financial and public relations skills. Limited ideas on the part of the owner become a challenge in the growth of the business.

Find out other advantages and disadvantages of sole proprietorship.

7.4.2 Partnerships

A partnership is a relationship existing between two or more people carrying on business in common with a view to profit. In Kenya, there is limited regulation for this class of business under the Partnerships Act (Cap 29). A partnership can have up to 20 members.

The partnership is not a separate legal entity and therefore the partners own all property of the firm jointly. A partnership is therefore merely an association of persons carrying on business together. In general, partnerships are not limited liability organisations and consequently the partners are liable for the debts of the business to the full extent of their fortunes. It is possible to have some of the partners having limited liability in which case such firm is known as a limited liability partnership.

The only caveat here is that even then at least one partner must have unlimited liability. Such is known as a general partner with the other(s) being limited partners. In Kenya, the Limited Liability Act, 2012 now allows persons (individuals and body corporates) to register limited liability partnerships that are body corporate with a legal personality of their own. The Act requires such businesses to employ managers and make declarations of solvency or insolvency to the registrar of companies.

In partnerships, each member of the firm is the agent of the other partners and is therefore liable for any wrongs committed by any of the other partners, provided they are committed in the course of business. Partnerships are formed by simple agreements unlike companies which require the registration of various documents. A partnership is not affected by the rules of *ultra vires* and therefore can engage in any business activity.

The key features of partnership business are:

- The scope of activities may be changed by mutual agreement;
- All partners normally play an active role in management;
- Details of accounts and affairs may be kept private;
- Partnership must be in business 'with a view to profit';
- All partners must agree to the appointment of a new partner;
- All partners other than limited partners have unlimited liabilities for the debts of the firm; This means that partners in a business could lose their wealth if the business folds up;
- Any partner can bind the partners in a contract with third parties;
- All partners are jointly liable for meeting the obligation of contracts on behalf of the partnership. The partners usually are jointly and severally liable which means someone would take legal actions against the partners jointly or against each partner individually;
- A partnership lacks corporate existence. Just like a sole proprietor, is not a separate legal entity from its owners. It is the partners who are individually liable for liabilities of a partnership save for a limited partnership; and
- All partners share profit in an agreed manner.

Find out the advantages and disadvantages of a partnership.

7.4.3 Unincorporated Associations

Unincorporated associations are groups of people which have not been incorporated by any of the methods described above. They range in size from small social clubs and voluntary organisations with a few participants, to trade unions with memberships of a million or more. Unlike corporations, unincorporated associations are not generally treated as separate legal entities although there are 'quasi-corporations' which share some characteristics with corporations. They are simply groups of individuals, each of whom is a natural legal person with their own legal rights and responsibilities.

What happens when unincorporated association is in breach of a contract or one of the members commits a tort while carrying out the activities of the association?

Contract

A member who makes a contract on behalf of an unincorporated association, such as a social club, is usually personally liable on the contract. This means that a member who orders goods or supplies for the use of a club is personally liable to pay for them. The other members of the club will be liable only if they authorise or ratify the making of the contract, which may well happen if the rules of the club provide for it.

Tort

Members of unincorporated associations are generally liable for their own torts, even when they are committed in the course of the association's activities. Therefore, if one member of a club negligently injures another, the former is personally liable and no other member will bear any responsibility. However, if a person is injured as a result of the dangerous condition of the club's premises which it occupies, the committee which runs the club may in some cases be liable, depending again on the rules of the association.

If a person is injured as a result of the negligence of an employee of the club, the person or persons who appointed them (perhaps the secretary, or the committee or the club's trustees) may be vicariously liable. Vicarious liability arises where a person is held liable for a legal wrong committed by another. The main example of vicarious liability is that of an employer, for wrongs committed by their employees in the course of their employment.

Ownership of Property

Since an unincorporated association such as a club has no distinct legal existence, it cannot own property and, if no special steps are taken, any such property belongs to the members jointly and not to the association. For this reason, it is commonly arranged for club property to be held by trustees for the benefit of the association, in order to keep it separate from the members' own property. In this case, the trustees are the legal owners of club property and they may engage in legal action in connection with it, if necessary.

However, the members may, subject to the rules of the association, call for the dissolution of the trust, in which case the property will be divided amongst them in accordance with the rules of the association. In fact, if a club is dissolved for any reason, and whether or not its property is held in trust, the club property will be divided amongst the members in this way.

Rights of members

The rights of members generally depend upon the rules of the club. Every member is deemed to be in a contractual relationship, governed by the rules, with every other member. Therefore, a member who is denied rights given to them by the rules such as the right to vote or who is wrongfully expelled, may be able to sue for damages for breach of contract or for an injunction to prevent the association from acting in breach of the rules. The action may be brought against all the members personally or, if this is impractical, the aggrieved member may apply for a representative order against a certain member or members only, such as the secretary or officers of the club.

If damages are awarded, they will be payable by the representatives in question, who will in turn be entitled to be indemnified from the funds of the club. A representative action may also be brought against an unincorporated association by non-members in some cases.

7.4.4 State corporations

State corporations are organizations formed by the government for trading purposes under statutes of parliament. They may be formed under statutes enacted specifically to create and provide for them, for example, the Kenya Railways Corporation, Kenya Meat Commission and Kenya Ports Authority among others.

State corporations are regulated by the Acts by which they are established. In addition, some are subject to the provisions of the State Corporations Act. Like companies, they have a legal personality, can own property, can sue and be sued, have perpetual succession and limited liability. These concepts are explained below within the discussion on limited liability companies, which are by far the most important form of business organic actions.

7.4.5 Registered Companies

A company is an artificial person recognized by law with an entity separate from its members for the purpose of preserving in perpetual succession the rights, which would fail if vested in a natural person. In Kenya, the incorporation (by registration), regulation and bringing to an end the lifespan of a company by the registrar striking it off is governed by the Companies Acts No. 17 of 2015. Winding up (liquidation) of companies is governed by the Insolvency Act 18 of 2015.

The main features of limited companies are outlined below.

Separate Legal Status from that of the Members

A company has its own identity separate from its owners as a whole and individually. In the case of ***Salomon v. Salomon (1897),*** S sold his business to a company, which he formed. There were seven members; he with 20,000 shares and seven members of his family with a share apiece. No other shares were issued. S also lent a sum of 10,000 pounds to the business secured by a debenture. The company was later wound up with assets of only 6,000 pounds and liabilities of the said 10,000 due to on the debenture and a further 7,000 owed to unsecured creditors. The latter contended that as the company

was in reality the same person as S, he could not owe money to himself and they should thus be paid first. The House of Lords however held that the company was quite distinct from S and that the 6,000 pounds should be applied in part payment of unsecured debt.

The case of ***Macaura -v- Northern Assurance Company (1925)*** discussed earlier in the course is also a good illustration of the separate identity of the company. It may be useful to refer to the details thereof in the lecture on insurable interest.

Activities Defined in Articles of Association

A corporation is always established for a particular purpose or purposes and, in general terms, it must not engage in activities which are *ultra vires*, that is, 'beyond the powers' of the corporation or outside the purpose for which it was established. Section 28 (1) provides that unless the articles specifically restricts the objects of a company, they are deemed to be unrestricted. The corporation can alter the articles to change its objects by special resolution during an annual general meeting and a notice of the amendment must be lodged with the registrar.

Liability of Members is Limited to the Value of Shares or Guarantee

The liability of the members in a company is limited to the value of their shares. The effect of this limit of liability is that in the event the company is wound up, the liability of each shareholder is limited to the amount due to the company on the shares allotted to him; If these are fully paid up, no further payment is due from him, even if the assets of the company are insufficient to meet its liabilities. For those limited by guarantee, the liability of each member is limited to the undertaking given by the member on formation.

Managed by the Board of Directors

The requirement under the company laws provides for management through the board of directors. The duties of the directors are clearly spelt out in the law. They manage the day to day affairs of the company but this responsibility is delegated to the managing director or the chief executive officer.

Perpetual Succession

As stated before, the company is a separate legal entity from its shareholders, directors and staff. One consequence of this is that it has perpetual succession. This simply means that even if all the owners (shareholders) die, the company continues to exist. This explains how some companies have been in existence for centuries.

Corporations are subject to the General Law

A corporation has, in general, the same legal rights and duties as a private individual of full age and capacity. Obviously, a corporation can act only through human agents, such as its directors and employees. However, acts done as part of the corporation's business will be attributed to the corporation itself and a corporation may, therefore, make contracts, be liable in tort and commit

crimes. However, there are some crimes which a corporation as a non-human entity cannot commit and some restrictions on the way in which it may be punished.

Details of Accounts must be made Public
In the cause of their operations, companies enter into transactions with members of the public. The law requires companies to publish details of their accounts in the daily newspapers before the specified date once a year. This is intended to protect the public.

Company may or may not Trade for Profit
A registered company unlike a partnership may or may not trade for profits. Shareholders in a company are paid dividends.

Shares of Public Limited Companies may be Freely Acquired
Public companies trade in the stock exchange market and their shares are freely transferable.

Capacity to Own Immovable and Moveable Property
A company can own immovable property such as land and buildings as well as movable property such as motor vehicles in their name.

A corporation can Sue and be Sued in its own Name
Once a company is formed, it becomes a legal person. It can therefore bring actions in a court of law and suits can be filed against the company in its name.

Find out the advantages and disadvantages of registered companies.

7.5 PROCEDURE FOR FORMATION OF COMPANIES

The process of forming companies is referred to as promotion of companies. Promotion is the process by which a company is incorporated or brought into existence by registration under the company's Act and established as a going concern by issue of a prospectus. A single person can form a private and a public company. Formerly it was necessary to have at least two members for a private company and seven for a public company. A private company is still restricted to 50 members. People wishing to form a company are known as promoters. A promoter has been defined in the case **Tycross vs. Grant** as one who undertakes to form a company with reference to a given project and to set it going, and who sets the necessary steps to accomplish the purpose. Section 11 (1) of the company's Act provides that a company can be formed by one or more persons. A promoter is a person who assumes the primary responsibility to form a company. The promoter must decide on the following:

- The type of company to be registered;
- A suitable name for the company;
- The objects of the company and each member's liability;
- The registered office;
- Drawing up rules for Articles of Association;
- Memorandum of Association;
- Directors, auditors and bankers for the company; and
- Printing and issuing a prospectus.

A promoter stands in a fiduciary position and is accountable to the company for all moneys secretly received or any profit directly or indirectly made during promotion. A promoter may undertake preliminary contracts to obtain property for the company before incorporation. However, the promoter will remain personally liable for breach of contract or civil wrong done during the promotion period. In the **case: Kelner vs. Baxter,** the plaintiff agreed to sell a hotel to the defendant who was at the material time acting as an agent for a company that was yet to be formed. It was held that the defendant was personally liable as the company was not in existence at the time of contracting and would not therefore ratify the contract on incorporation. Contracts entered into between the date of incorporation and commencement of business is provisional and would bind the company only after it is entitled to commence business.

7.5.1 Types of Companies

The Companies Act provides for various types of companies which include:

- Limited companies;
- Companies limited by shares;
- Companies limited by guarantee;
- Unlimited companies;
- Private companies; and
- Public companies.

These are briefly explained below.

Limited Companies

Limited companies are those that are either limited by shares or limited by guarantee. A company is said to be limited by guarantee if:

- It does not have a share capital;
- The liability of its members is limited by the companies articles to the amount that members undertake to contribute to the assets of the company in the event of its liquidation; and
- Its certificate of incorporation states that it is a company limited by guarantee.

In companies limited by guarantee, each member undertakes to be liable to pay the company's debt up to a stated amount in the event of its being wound up. These companies are normally non-trading organisations. An example is the Kenya Medical Association.
In companies limited by shares, on the other hand;

- The liability of members is limited by the company's articles to any amount unpaid on the shares that the members are holding; and
- Have a share capital which is raised by the members paying to the company an amount of money equivalent to the value of the shares allotted to them.

Companies limited by shares are the vast majority in Kenya. The rest of this lecture will therefore restrict itself to companies limited by shares.

Companies can also be private limited, public limited or unlimited. A discussion of this follows here below.

Private Companies
A private company is defined in section 9 of the Act as one which by its articles;

- Restrict the right to transfer its shares;
- Limits the number of its members to fifty (excluding present and past employees);
- Prohibits any invitation to the public to subscribe for shares in it;
- Is not limited by guarantee; and
- Its certificate of incorporation states it is a private company.

Public Companies
A public company, on the other hand, is any company that:

- Allows its members the right to transfer their shares in the company;
- Do not prohibit invitations to the public to subscribe for shares or debentures of the company ; and
- Its certificate of incorporation states that it is a public company.

A public company must have a share capital. A private company, on the other hand, may or may not have a share capital.

Unlimited Companies
A company is said to be unlimited if there is no limit on the liability of its members meaning that in case of the company incurring debts, the personal assets of the members will be sold to satisfy such liabilities. The company's certificate of incorporation indicates that it is an unlimited company. Such companies are however rare in Kenya.

It should be noted that a company may alter its status from being:

- A private limited company to a public limited company;
- Private limited company to unlimited company;
- A public limited company to a private unlimited company; and
- A public limited company to a private limited company.

This can be achieved through a special resolution during a general meeting or a meeting of the members and lodged with the registrar. The company will need to change their name to reflect its new status.

7.5.1 Registration Requirements

Note that prior to registration, the following must be filed with the registrar of companies:

- Application for registration of the company;
- Memorandum of Association of the company; and
- A copy of the proposed Articles of Association.

Contents of the Application for Registration of a Company

The application for registration of a company can be submitted to the registrar either by subscribers to the Memorandum of Association or by an agent. The application for registration contains the following information:

- The proposed name of the company: the name should not be one that is prohibited by the law or similar to that of an existing company, among other requirements. Where the promoter has submitted a name to the registrar, it requires to be approved and is reserved for a period of 30 days. A company wishing to change their name can do so through a special resolution and in accordance with the provisions of the articles. A notice of change is then filed with the registrar. The name of a private company must end with the word limited (ltd) and a public company with the word Public Limited Company (plc). The name of the company is to be displayed in the specified places;
- The liability of members, that is, whether it is limited and if so, whether it is limited by shares or guarantee;
- Type of company, that is, if it is a private or a public company;
- A statement of capital, that is, whether the company has a share capital or a statement of guarantee if the company is limited by guarantee; and
- Statement of the proposed officers (director(s) and secretary(ries)

The Articles of Association

The Articles of Association of a company, under the new company laws, the constitution of the company. Under the repealed Act, the Memorandum of Association occupied this position. Provisions of the Memorandum of Association for existing companies will be treated as provisions of the Articles. Section 20 (2) of the company's Act provides that different model Articles may be prescribed for the various types of companies. The Articles of Association may also be amended by a special resolution but such amendments are to be registered with the registrar. For Articles to be registered, they are required to be:

- Contained in a single document;
- Printed;
- Divided into paragraphs; and
- Dated and signed by each subscriber to the Articles.

The Memorandum of Association

This is one of the documents that must be filed with the registrar to for those wishing to register companies. It must be authenticated by the subscribers. It provides for the following:

- That the subscribers to the articles wish to form a company; and
- They have agreed to become members.

When the registrar is satisfied with the documents, a certificate of incorporation is issued which gives the company a corporate legal entity independent of its members. The certificate is conclusive evidence that everything is in order with regard to registration and that the company has come into being with rights and liabilities of a natural legal person. Once a company is incorporated, it can undertake all the things an incorporated company can do. Information in the certificate of incorporation includes:

- The name of the company and its unique identification number;
- Date of incorporation;
- Whether the company's liability is limited or unlimited; and
- Whether the company is private or public.

7.6 INTERNAL MANAGEMENT AND STRUCTURE OF COMPANIES

The management structure of companies consists of two organs:

- The board of directors; and
- Meetings of shareholders.

This structure is particularly defined in large public companies, with the object behind it being to ensure that the management of the company does not disregard the interests of the shareholders.

7.6.1 BOARD OF DIRECTORS

A company is an artificial legal person and runs its affairs through natural legal persons known as directors. The directors' main responsibility is to manage the company whereas the shareholders' main control lies in the power to appoint directors. The directors consist of a relatively small number of persons who have been appointed directors of the company. A private company must have at least one director while a public company must have at least two directors. The new Act requires at least one director on the board of the company to be a natural person, although corporate directors are still permitted.

At the time of registration of a company, and at any time a new director is appointed, such person must consent to the appointment in writing. Directors are granted extensive powers under the Articles of Association, including the control of day-to-day operations, which they often delegate in turn, to one of them, the managing director/chief executive.

The first directors are usually named in the Articles of Association but such appointment is not valid until the director named has delivered to the registrar a written consent to act and a written undertaking to take his qualification shares. The directors must consent to their appointment. A person agent below 18 cannot be appointed as a director of a company.

The division of powers between the board and the meeting of shareholders is determined by the articles and where these give the board powers, the meetings of shareholders cannot interfere with the board's exercise of the same save to the extent of removing directors from office. The meeting can, however, also exercise such powers in the event of a deadlock or lack of quorum in the board.

7.6.2 APPOINTMENT, DUTIES, POWERS AND LIABILITIES OF THE EXECUTIVE OFFICERS OF INCORPORATED COMPANIES

Appointment of Directors

The number, appointment, term and removal from office of the directors will ordinarily be provided for in the Articles. The initial directors will normally be the shareholders or some of the subscribers to the Articles and the Memorandum. Subsequent appointment of directors is done by members of the company in a general meeting by an ordinary resolution. The Articles may alternatively provide that the first directors to be appointed by the subscribers.

Duties and Powers of Directors

The relationship between a company and its directors is that of a principal and agent. As agents, directors stand in a fiduciary relationship to their principal. When conducting their duties, the rules of agency apply to them. They are trustees to the company's money and

property. They also owe a duty of care at common law not to act negligently in managing the company affairs. They are required to carry their duties subject to the restrictions imposed by the Articles of Association.

Duties of Directors

There are six codified duties which are explained below.

Directors are Required to Act within Their Powers/Intra Vires

This means that they have to abide by the terms of the company's articles of association and decisions made by the shareholders. The directors are not personally liable when they enter into contracts without exceeding their powers as liability will attach to the company. In Ferguson vs. Wilson, it was held that directors are agents and liability will attach to the principal where they act intra vires.

Promote the Success of the Company

They must continue to act in a way that benefits the shareholders as a whole and other additional list of non-exhaustive factors to which the directors must have regard to. These factors are:

- The long term consequences of decisions;
- The interests of employees;
- The need to foster the company's business relationships with suppliers, customers and others;
- The impact on the community and the environment;
- The desire to maintain a reputation for high standards of business conduct; and
- The need to act fairly as between members.

Exercise Independent Judgment

They must not fetter their discretion to act, other than pursuant to an agreement entered into by the company or in a way authorised by the company's articles.

Exercise reasonable care, skill and diligence

The test is objective as they must be exercise to the standard expected of someone with the general knowledge, skill and experience reasonably expected of a person carrying out the functions of the director. There is a tendency in modern times to employ professionals as directors and the standard of care may be high. The directors may also take out directors and officers' liability insurance to protect themselves against their negligent acts;

Duty to Avoid Conflicts of Interest.

Directors should avoid situations where they may have a direct or indirect interest that may conflict with their duties to the company. They should act bonafide that is, honestly and in good faith;

Duty not to Accept Benefits from Third Parties
In the course of their duties, directors are not allowed to accept benefits from third parties. They are paid for their services to the company.

Duty to Declare Any Interest in a Proposed Transaction with the Company
Directors require to carve out matters that are likely to give rise to a conflict of interest, or of which the directors are already aware. There will be an additional statutory obligation to declare interests in relation to existing transactions.

Powers of Directors
Directors have powers to:

- Enter into contracts on behalf of the company;
- Engage and dismiss employees;
- Keep a register of members;
- Call an annual general meeting within the statutory time; and
- Fill casual vacancies in the board. The number, appointment, term and removal of directors are ordinarily provided for in the articles. Initial directors will normally be subscribers and the articles may provide so.

Remuneration of Directors
Directors have no right merely by virtue of their office to remuneration. If a director is to receive remuneration, his contract of service or the Articles of Association must expressly provide for it. The Act provides that the remuneration should be determined from time to time by the company through a general meeting. If the directors have a contract of service, the company should keep a copy which is open to inspection by members and the accounts of the company must disclose the emoluments of the directors and the chairperson.

Removal of Directors
A director can be removed from office by:

Ordinary Resolution at a General Meeting
This can be before expiry of his term in office regardless of anything in the articles or his contract of service to the contrary. The removal does not prejudice his rights to compensation for loss of office or for damages for wrongful dismissal.

By Disqualification
A director can be disqualified due to the following:

✓ Becoming a person of unsound mind;

- ✓ Being absent for more than six months from the meetings without permission of the other directors;
- ✓ Being declared bankrupt unless with leave of the court to act;
- ✓ By virtue of the age limit; and
- ✓ By sickness.

By Retirement

The Articles of Association provides that a certain number of directors retire during an AGM but they may be re-elected. In Re Moseley & Sons (1939), it was held that where articles provides that the number nearest but not exceeding one third shall retire and the number of directors is reduced to two, neither shall retire. This is known as retirement by rotation, that is, a third at a time.

By age

The upper age of a director of a public company to is seventy one and the lower limit is eighteen (18).

By Resignation

The articles usually provide that a director vacates office when he notifies his resignation to the company. The articles may require that the notice be in writing but it is not mandatory for the resignation to be in writing. Notice is effective as soon as it is communicated and there can be no withdrawal except with the consent of persons entitled to appoint directors. Reasonable notice should be given where the article provides that resignation be in writing. A verbal resignation accepted by the company in a general meeting is effective and cannot be revoked.

Liability of Directors and Executive Officers

Directors and executive officers may incur liability to the third parties, the company and to subscribers. Circumstances under which they incur liability are explained below.

a. Third Parties

A director may incur liability to third parties in the following situations:

Under Contract: as agents, directors will not normally be personally liable, they may be liable for breach of warranty of authority, where they do not disclose that they are acting or the company or if they do not use the word "limited" in the company's name;

Under Tort: a director is liable for torts committed or authorised by them even if this was done as an agent of the company. The company will be vicariously liable for the director's actions.

Fraudulent Trading

If a director is found guilty of knowingly carrying on business fraudulently, he may be ordered by the court to pay all or part of the company's debts. The New Act codifies the common law offence of fraudulent trading and makes persons who carry on a business of a company with the intent to defraud creditors of the company or creditors of any other person, or for any fraudulent purpose liable on conviction to imprisonment and/or a fine.

This is what is known as 'lifting the veil' and would apply also to any guilty shareholder who is not a director. The veil here is the apparent shield created by incorporation — whereby the company acquires an identity of its own with its owners not being liable for its liabilities. Lifting the veil relates to circumstances in which the law disregards the corporate entity and pays regard to the economic realities of justice and convenience

b. Subscribers for Shares

This will arise after a company has had a share offering that is, inviting others to buy shares in the company. The directors will issue a prospectus. A prospectus is defined as any notice, circular, advertisement or other invitation offering to the public subscription or purchase of shares/debentures of a company. The prospectus has details such as:

- The ownership business;
- The number of shares issued or agreed to be issued;
- Details of any property acquired by the company and the amount paid or agreed to be paid;
- Details of the voting rights of each class of shares; and
- Names, addresses and description of directors.

An offer for sale must be signed by two directors of a company. The intending purchaser is entitled to true disclosure and accurate and fair picture of the company. Where there are misrepresentations, the subscribers may rescind the contract. Directors may be held liable for misrepresentations or omissions made in the listing particulars and may be held liable to pay damages.

c. To the Company

This may arise in various ways some of which are explained below.

Negligence: directors are expected to exercise a reasonable degree of skill and diligence and to act honestly when performing their duties. They can be found liable to the company if in breach of this duty. The standard of care expected is not one of a specialist. For instance, a director of a life company need not act like an actuary or a doctor.

Breach of trust: this occurs where the director(s) has wrongfully applied the company's funds and includes for instance, paying dividend out of capital or applying funds to *ultra vires* purposes.

The Chairman

The Articles will provide for the appointment of a chairman by the board. His main duty is to chair the meetings of the board as well as the general meetings of the company. During the annual general meetings, the Chairman has a duty to keep order and see that business is conducted properly with the views of all shareholders being properly heard.

Executive Officers in Company Management

Other that the board of directors, there are officers in full time employment involved in management of companies. Some of these officers are:

The Managing Director

The board will also usually be authorised to appoint a managing director who reports to the board. The board normally delegates the whole of the management of the day-to-day affairs/operations of the company to the managing director. The MD receives such remuneration as the directors may determine. The board can revoke such appointment. The MD can be removed by a general meeting irrespective of the fact that his duration (term) is not over. Where services have been terminated in breach of the terms of appointment, the directors can claim for damages

The Secretary

Section 243 of the Company Laws 2015 provides that a private company is required to have a secretary only if it has a paid up capital of five million shillings or more. If a private company does not have a secretary, anything authorised or required to be given or sent to, or served on, the company by being given or sent to, or served on its secretary. Section 244 provides that every public company is required to have at least one secretary. Section 246 of the Act provides that a secretary be a person who appears to have the requisite knowledge and experience to discharge the functions of a secretary of the company; and is the holder of a practicing certificate issued under the Certified Public Secretaries of Kenya.

The appointment must be recorded in the register for directors and secretaries. Termination must also be recorded. The appointment should be notified to the registrar of companies. The secretary can be removed from office by the directors whether he/she has been appointed in a resolution or under agreement.

A secretary is an officer of the company as well as a servant. Conduct of his duties is governed by the terms of his appointment and also specific instructions. He cannot without express authority bind the company. In Barnett vs. South London Tramways, it was held that a secretary is a mere servant, his position is that he is to do what he is told.

Company secretaries may incur personal liability where:

- He fraudulently issues share certificates where he has forged the signature of directors;
- Contracts entered into on behalf of the company and sufficient care is not taken that is, failure to disclose that he is an agent of the company.

7.6.2 MEETINGS OF SHAREHOLDERS

A person wishing to become members/shareholder of company can achieve this by:

- Subscribing their names to the memorandum and articles of association; and
- Having their names entered in the register of members.

Members of a company have a right to:

- Be sent a proposed written resolution;
- Require directors to call for a meeting;
- Receive notices of general meetings;
- Appoint a proxy to act at a meeting; and
- Be sent a copy of the company's annual financial statements among other rights.

Members now have the *locus standi* to go to court and challenge a conduct that they think is oppressive or unfair. The individual members participation is confined to voting in general meetings. By exercising their rights to attend and vote at general meetings, shareholders may exert some control over the running of their company. The Act contains provisions for the calling, holding and conduct of general meetings. The members exercise the following rights:

- Can alter the articles to reduce the director's powers;
- May remove a director before his term expires by simple majority at a general meeting; and
- Can take proceedings against a director in the name of the company for negligence, breach of duty or breach of trust.

The meetings where members/shareholders can participate in are explained below.

(i) Statutory or First General Meeting

Every company limited by shares and every company limited by guarantee with a share capital holds a general meeting at least one month but no longer than three months from the date on which it is entitled to commence business. The object of the meeting is to afford the shareholders an opportunity of obtaining material information as to the circumstances of the company's promotion and its immediate prospects. The section provides further for a statutory report to be sent to the members at least fourteen days

prior to the meeting. The report must be certified by atleast two directors and lodged with the registrar of companies. Some of the contents of the report include:

- Total number of shares allotted as fully or partly paid;
- Total amount of cash received in respect of all shares allotted;
- The names, addresses and descriptions of directors, auditors, managers and the company secretary; and
- Particulars of any contracts to be modified together with particulars of modification or proposed modification.

Only one such meeting is held during the company's life

(ii) Annual General Meeting (AGM)

Annual General Meetings (AGMs) for private companies have been abolished although they can elect to provide for them in their articles if they so wish. Private companies can convene meetings at short notice where consent is given by holders of 90% by nominal value of shares carrying the right to vote. This is not so for public companies. A public company is required to hold its AGM within six months of the end of its financial year. The notice of a general meeting for a public company may be given in hard copy or electronic form, or by means of the company website.

Ordinary business of an AGM

Where a company calls for a meeting, the secretary will also state the issues to be discussed (agenda). The agenda may include:

- Declaration of dividends that is, profits of a company distributed among members in proportion to their shares;
- Consideration of accounts;
- Election of directors in place of those retiring; and
- Appointment and fixing of the remuneration of auditors.

Proceedings are commenced by the chairman who usually makes a speech on the company affairs and any other circumstance of interest to the company. He also answers questions from members.

(iii) Extraordinary General Meeting (EGM)

A part from AGM and statutory meeting, any other meeting held is termed as extra ordinary general meeting. Section 132 of the Act provides that directors of a company must regardless of anything contained in the Articles to the contrary convene an EGM if one is requested for by members holding not less than one tenth shares of a company. The directors may convene the meeting whenever they deem fit. All business transacted in an EGM shall be deemed special.

The directors are required to hold the meeting within 21 days from the time it is requested for otherwise those who requested may convene the meeting as nearly as possible in the manner required under the Articles. The company will reimburse those who requested for the meeting reasonable expenses incurred in convening the meeting.

Quorum of General Meeting

This is the number of members of sufficient to transact business at a general meeting. The quorum is fixed by the articles. Those who intend to vote by proxy are not taken into account when determining whether there is quorum or not unless the articles provides for them. If there is no quorum and the meeting proceeds, the business transacted is void.

Voting by Proxies

A proxy is a document by which one shareholder appoints another to vote in his place and is valid for only one meeting. Section 299 provides for appointment of proxies where a shareholder is unable to attend in person. The proxy may be any person; whether a member of the company or not; whether a natural or corporate person.

Resolutions

A company, in a general meeting, conducts the meeting by the passing of resolutions. Due notice of intention to pass the resolutions should be given to the members. The resolutions are written resolutions or meeting of members for private companies. Written resolutions may be ordinary or special. The Act recognises two types of resolutions and these are:

Ordinary resolution: this is a resolution passed by a simple majority of the members present and voting (either in person or by proxy) at a general meeting of the company. It can be by show of hands or by polling. An ordinary resolution is effective on appointment of auditors and directors, authorising issue of shares at a discount, declaration of dividends, approval of accounts, voluntary winding up of a company among others.

Special resolution: this is defined in section 257(2) of the Act as a resolution passed by majority of not less that seventy five percent and stated as a special resolution at a general meeting of which notice specifying the intention to pass the resolution has been duly given.

A special resolution passed relate to the following:

- Alteration of the objects;
- Alteration of the articles;
- Change of status of the company;

- Appointment of inspectors to investigate the affairs of a company; and
- To resolve that a company should be wound up.

Resolutions passed must be registered with the registrar. The company is required to keep minutes containing a fair summary of all proceedings of general meetings and any member is free to inspect them without being charged.

7.7 PROCEDURE FOR WINDING UP (LIQUIDATION) OF COMPANIES

A company is regarded as an artificial legal person separate from its members and enjoys perpetual life until it comes to an end through a process known as winding up. Winding up is the process by which a company's legal existence is brought to an end and its property administered for the benefit of its creditors and members. It is carried through by a person known as a *liquidator*. The work of the liquidator is to realise the assets of the company which is then applied in payment of the company's debts and their liabilities in their proper order and divides the surplus amongst the shareholders according to their rights. The liquidator is so known because they in effect facilitate the winding up of the company. The company's property does not vest in the liquidator, the liquidator only assumes all the functions of the directors. Winding up (liquidation) of companies is now regulated by the Insolvency Act No. 18 of 2015.

However, under section 894 of the Company's Act, the registrar has power to strike off a company that is not carrying on business. For this to be effective, the registrar is required to follow the following steps:

- Send a letter by post to the company where there are reasonable grounds to believe that a company is not in operation;
- If there is no response from the company, a reminder will be done;
- When the registrar is satisfied that the company is not carrying on business, they will send a notice to the company of intention to strike it off;
- The company is then deregistered; and
- The striking off is published in the Kenya Gazzette.

Section 381 of the Insolvency Act provides three ways in which a company may be wound up which are:

- Compulsory winding up by the court;
- voluntary winding up, which in turn may be;
    - ✓ members' voluntary winding up; or
    - ✓ Creditors' voluntary winding up.
- Winding up subject to supervision of the High Court.

7.7.1 Compulsory Liquidation by the Court

The process is commenced when a petition for a winding up order against the company is presented to the High Court by a petitioner. Section 425 of the Insolvency Act provides that the petitioner may be the Attorney General, director, creditor, contributory, provisional liquidator or a liquidator in case of a company under voluntary liquidation. Section 122 of the Insurance Act provides that where a petition for winding up of an insurer is presented by a person other than the Commissioner of Insurance, a copy of the petition should be served on the Commissioner who should be given an opportunity to be heard.

Section 424 sets out the grounds on which such a petition can be based. The petition must specify the ground(s) on which it is based. These are:

- If the company has by special resolution resolved that it should be wound up by the court;
- The company has not commenced business within a year of its incorporation or has, suspended its business for a year;
- In case of a public company, it has not been issued with a trading certificate and twelve months have elapsed;
- The company is unable to pay its debts within the meaning of Section 384 of the Insolvency Act;
- For private companies, the number of members of the company has reduced to less than two;
- The court is of the opinion that it is just and equitable to liquidate the company; and
- When the period of moratorium ends.

Grounds for Winding up an Insurance Company

An insurance company may be wound up on the following grounds.

- That the company is unable to pay its debts;
- A company underwriting long term business and has continued as a closed fund for a period of more than five (5) years;
- If an insurer has failed to comply with the requirements under the Insurance Act and a notice has been given by the Commissioner but the company continues with the contravention for six months after receiving the notice;
- Inability by an insurer to fulfil reasonable expectations of the policyholders or potential policyholders;
- If it is just and equitable in the interests of the policyholders that the insurer be wound up;
- If the insurer has failed to pay tax that is due and outstanding; and
- Where a company carries on insurance business and has not been registered as provided for under the insurance Act.

The most common and contentious grounds on which winding up by the court are commenced is inability to pay debts and when it is just and equitable to wind up a company. An outline of the two is given below.

Inability to Pay Debts

Under section 384 of the Act, a company is deemed to be unable to pay its debts if:

- Creditor(s) or assignees to whom the company owes more than one hundred thousand shillings (KES 100,000) serves on the company at its registered office a written demand for payment and the company fails to pay within three weeks (21 days) to either pay the debt or offer satisfactory security for it. An insurance company is deemed to be unable to pay its debts if it does not comply with the requirements for solvency margin set out in section 41 of the Insurance Act which provides for the extent to which the assets of a company should exceed the liabilities;
- Execution or other process issued on a judgment decree or order of any court in favour of a creditor of the company is returned unsatisfied in whole or in part; or
- It is proved to the satisfaction of the court that taking account of the contingent and prospective liabilities of the company; it is unable to pay its debts.

Winding Up on Basis of Just and Equitable

Winding up in this case will only be ordered if the court is of the opinion that the company should be so liquidated. This gives the court a very wide discretion that cannot be challenged. This ground is often used by a member who is dissatisfied with or is at loggerheads with the directors or controlling shareholders over the management of the company. Cases where winding up has been ordered included:

- Where the substratum (in essence, the reason for its being) of the company has disappeared (or is lost). *In Re German Date Coffee Company (1882),* the object clause of the company specified that the sole object of the company was to 'manufacture coffee under a German patent'. The German government refused to grant the patent. The company, however, manufactured coffee under a Swedish patent for sale in Germany. A contributory presented a petition for compulsory winding up which was opposed by the other contributories. It was held that the company that had been formed only to work a particular patent and as it could not do so, it should be wound up.
- Where there is a complete deadlock in the management of the affairs of the company. In the case of *Re Yenidje Tobacco Company (1946),* two sole traders converted their businesses into a company in which they were the only directors and shareholders. They quarreled bitterly and one sued the other for fraud. In the meantime, they refused to speak to each other and conducted board meetings by passing notes through the hands of the secretary. The defendant in the fraud action petitioned for the compulsory winding up of the company, which was opposed by the other member. The court held that as the business was in real terms a partnership, it was just and equitable to order liquidation since any prospect of cooperation that sustains a partnership had been destroyed by their animosity towards each other.

Procedure for Compulsory Winding Up

(i) Presentation of the petition for winding up to the court;
(ii) Service of the petition on the company;
(iii) Publishing in the official *gazette* and two daily newspapers to alert the public so that interested parties who may wish to be heard on it may lodge their notices of intention to appear and either oppose or support the petition and hearing in open court once all formalities are complied with;
(iv) Appointment of the Official Receiver to be the provisional liquidator upon commencement of winding up proceedings but before the winding up order is made. This is normally done to secure the assets of the company where there is danger of their being wasted. The Official Receiver (OR) is the receiver attached to the High Court for bankruptcy purposes;
(v) On hearing the petition, section 427 of The Insolvency Act allows the court to either:

- Issue an order to dismiss it with or without costs;
- Make an interim liquidation order;
- Adjourn the hearing conditionally or unconditionally; and
- Make an order it may deem fit including an order for compulsory winding up order or winding up under the court's supervision.

(vi) Once a liquidation order is made, section 432 of the Insolvency Act provides the following consequences:

- Liquidation is deemed to have started when the petition was presented;
- All powers of the directors cease;
- Any disposition of the company's assets is void unless ordered otherwise by the court;
- Any legal proceedings against the company are halted and can only be proceeded with after leave of the court is obtained;
- All staff of the company are automatically dismissed;
- Any attachment of the assets to the company is null and void;
- The winding up order operates in favour of creditors and contributories; and
- The date of commencement of the winding up is the date of presentation of the petition.

(vii) After the official receiver has realised the property of the company and has distributed the final dividends to the creditors and a final return to the contributories, the liquidator can then apply to the court who will arrange on the account to be prepared. The court will then after considering the report and any objections of the creditors or contributories grant release of the liquidator;
(viii) An order of the court releasing the liquidator and deregistering the company from the registrar of companies is issued.

7.7.2 Voluntary Winding up (Liquidation)

A company is created by members voluntarily and can also be put to an end voluntarily. Section 393 of the Act sets down the circumstances under which this may be done. These are:

- If any period set by the articles expires or event occurs as is provided by the articles as being the time when the company shall be wound up and the company has by special resolution resolved that it be wound up; and

- The company resolves by special resolution that it be wound up voluntarily. The Act requires a notice of such resolution to be published in the Gazette and at least two daily newspapers.

The winding up commences at the time of the passing of the resolution of winding up. Section119 of the Insurance Act Cap. 487 provide that notwithstanding anything to the contrary in the Company's Act, no insurer carrying on long term business shall be wound up through voluntary winding up.

There are two types of voluntary winding up that is, members' voluntary winding up and creditors' voluntary winding up. These are explained below.

Members' Voluntary Winding up

This is provided for under section 399 of the Insolvency Act. At a general meeting where a resolution for voluntary liquidation is passed, the members will appoint one or two liquidators. Upon this appointment, the powers of the directors will cease. A voluntary winding up is only a members' voluntary winding up if the directors have made and delivered to the Registrar a declaration of solvency. This is statutory declaration that the directors have made a full inquiry into the affairs of the company and formed the opinion that it will be able to pay its debts in full within a stated period; which must not exceed twelve months.

It is a requirement that all directors, or if they are more than two, majority, must sign the declaration. The declaration shall have no effect unless it is made within the thirty days immediately preceding the date of the resolution for winding up and delivered to the Registrar for registration before that date. It is an offence to make a declaration without having reasonable grounds thereof.

As the creditors are assured they will be paid by the declaration, they play no part in the winding up. The liquidator liquidates the company reporting to the members annually until the winding up is concluded when they send their final report to the Registrar who dissolves the company by removing its name from the register. Prior to sending the final report to the company, the liquidator is required to publish the liquidation in the Kenya Gazette and two newspaper dailies. If the liquidation continues after the end of twelve months, the liquidator is required to call for a general meeting and failure to do so constitute an offence.

If the liquidator is of the opinion that the company will not be able to pay their debts within the period stipulated in the declaration of solvency, a meeting of the creditors will be called within a period of 30 days from the time the opinion is formed. The notice for the meeting is required to be published in the Kenya Gazette, two newspaper dailies and the company's website.

Creditors' Voluntary Liquidation

This is a voluntary winding up where no declaration of solvency is made. Section 406 of the Insolvency Act requires that a company that is in the course of liquidation to convene a meeting. The creditors' meeting is convened through publishing a notice in the Kenya Gazette and two daily

newspapers. The directors are also required to send notices to the creditors individually. For the creditors 'meeting to be convened, the meeting of the members must take place first and pass the resolution to liquidate the company. The directors lay down the details of the finances of the company during the meeting and the creditors will appoint their choice of liquidator, which prevails if they are different from the one appointed by the members. The creditors will also nominate a liquidation committee. On appointment of the liquidator, all powers of the directors cease.

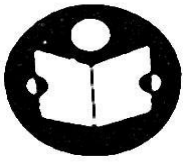
When the liquidation process is completed, the liquidator will publish the liquidation in the Kenya Gazette and two daily newspapers. The liquidator will then send their final report to the Registrar who dissolves the company by removing its name from the register.

7.7.3 Winding Up Subject to Court's Supervision

Where a company has passed a resolution for voluntary winding up, the court may order that the same shall proceed but subject to such supervision of the court and with such liberty for creditors and other interested parties to apply to the court and generally on such terms and conditions as the court thinks just. A petition for winding up subject to the court's supervision may be presented by any person or persons entitled to petition under compulsory winding up. The powers of the court in respect of a winding up by the court apply to winding up subject to its supervision.

The liquidator winds up the company in the same manner as if liquidation were an ordinary voluntary liquidation. The court is empowered to appoint an additional liquidator when a supervision order is made who has the same powers and duties as the one appointed under voluntary winding up. Winding up commences at the date of the resolution authorising liquidation. When the affairs have been wound up, the court makes an order that the company be dissolved from the date of the order.

7.8 SUMMARY

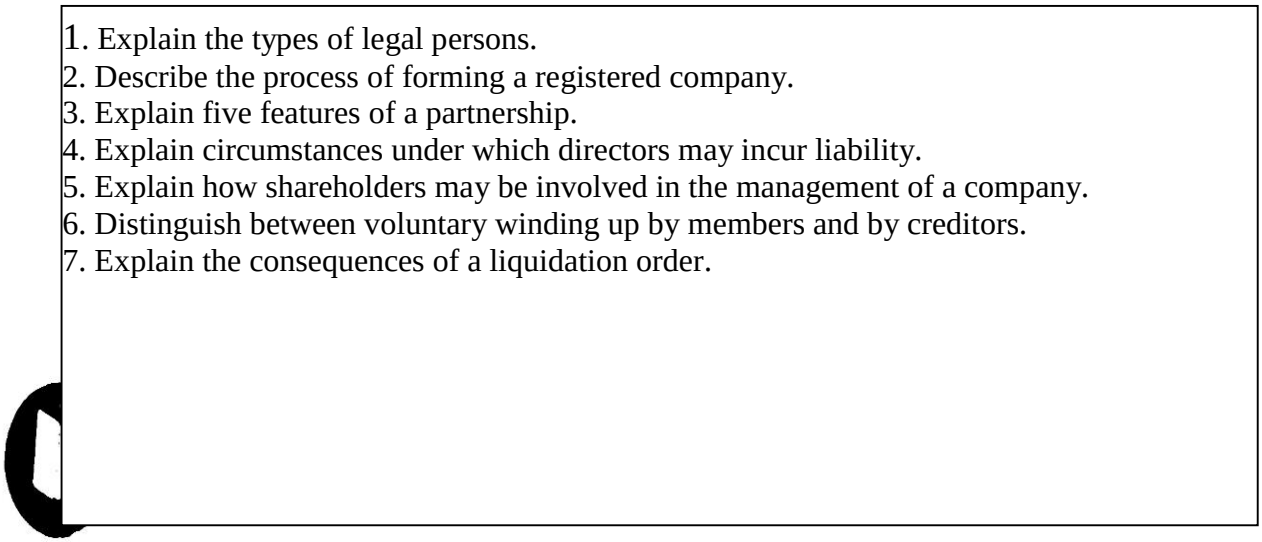


In this lecture, you have learned that:

- A legal person can be a natural (human being) or an artificial person (corporation);
- There are various types of business organisations which include sole proprietorship, partnership and registered companies.
- Each of the business organisation has advantages and disadvantages;
- The Articles and Memorandum of Association are mandatory requirements for a company to be registered;
- Management of companies is in the hands of the board of directors and meetings of shareholders;

- The duties of the board of directors are codified and include duty to avoid conflict of interest, duty to act within their powers, act for the best interest and success of the company, among others;
- The shareholders manage companies by attending and voting in the meetings;
- Meetings of shareholders pass resolutions which are classified either as ordinary or special; and
- A company can be liquidated voluntarily by members and creditors or by the court.

7.9 ACTIVITIES



7.10 FURTHER READINGS

i. The Company's Act no. 17 of 2015
ii. Insovency Act no. 18 of 2015
iii. Company Law in Kenya by Ashiq Hussain
iv. Past Papers
✓ (Include the APA format)

LECTURE EIGHT

8.0 OTHER LEGISLATIONS AFFECTING INSURANCE OPERATIONS

LECTURE OUTLINE

8.1 Introduction

8.2 Learning outcomes

8.3 Effects of other legislations in insurance practice

- The Insurance (Motor Third Party Risks) Act Cap. 405
- The Work Injury Benefits Act, 2007
- The Fatal Accidents Act Cap. 32
- The Law Reform Miscellaneous Provisions Act
- The Evidence Act
- The Anti-Money Laundering Act
- The Law of Succession Act Cap. 160

8.4 Summary

8.5 Activities

8.6 Reading list

8.1 INTRODUCTION

In the last lecture, you have learnt that there are different types of business organisations and each has different characteristics. You have learnt the requirements of forming a company, how companies are managed and the circumstances under which they are wound up.

Welcome to lecture eight. This lecture will give you a highlight of various acts of parliament that affects insurance and its operations. By the end of the lecture, you will learn some of the provisions of the acts and apply them in the practice of insurance. May I assure you that after this, you will be able to understand the effects of other legislations which affect the insurance industry. Welcome and enjoy.

8.2 LEARNING OUTCOMES

By the end of this lecture, you should be able to:

a. Explain the effects of other legislations in insurance practice.

Competence

The trainee should have the ability to apply provisions of other legislations in the practice of insurance.

Content
Let us now start by explaining the Effects of other legislations in insurance practice.

8.3 EFFECTS OF OTHER LEGISLATIONS IN INSURANCE PRACTICE

There are various Acts of parliament that affect insurance operations. Some of them are discussed below.

8.3.1 The Insurance (Motor Vehicle Third Party Risks)Act Chapter 405

You have learned from Introduction to Insurance that motor vehicles first appeared on Kenyan roads during the First World War. Those who sustained injuries arising out of the use of motor vehicles would receive compensation from the owners and the users. However, there were challenges especially where the owner or the user did not have sufficient funds to compensate the injured victim. It became necessary that parliament enacts laws to regulate the use of motor vehicles. The purpose of the law was to protect innocent accident victims against failure to recover damages from the responsible motorists.

What are some of the provisions of this Act?

- It makes it compulsory for the users or owners of vehicles on the Kenyan public roads to have in force a policy of insurance or such security covering third party risks. Failing to comply with the provision is an offence. Such security consists of an undertaking by the giver to make good such liability as is required by a policy of insurance and the same must be approved by the Cabinet Secretary in the ministry of finance;
- It provides that the third party policy issued insures such person/persons or classes of persons as may be specified therein against legal liability which may be incurred by them in respect of death or bodily injury to any person caused by or arising out of the use of the motor vehicle on the road. Third party property damage claims are not provided for under the Act;
- It also provides that policies issued should specify 'person, persons or classes of persons' as the insured or any other person authorised to drive the motor vehicle with insured's permission. This implies that persons injured where the driver is not authorised are not protected under the Act. Insurers require the owners of motor vehicles to disclose details of those who will be driving the insured motor vehicle in the proposal form;
- Under the Act, the insured's employees are not protected as they are expected to be suitably protected as provided for under the Work Injury Benefits Act (WIBA) or employer's liability. Liabilities arising under contract are also excluded.

- The Act does not regulate government owned vehicles, motor tractors or other motor vehicles solely used for agricultural purposes;
- A certificate of insurance is issued to the policyholder as evidence that they have in force an insurance policy that complies with the requirements of the Act;
- The certificate is expected to be displayed in a conspicuous and reasonably vertical position behind the windscreen glass or rear side window so that the form of the certificate shall be clearly visible at all times by daylight to a person standing in front of the motor vehicle or to the left or near side thereof;
- Different certificates are issued for different types of vehicles. They contain such details as the certificate no., policy no., registration no., name of insurer issuing certificate, commencing and expiry dates among others;
- Section 8 and 16 provides that these conditions may operate for the purpose of the contract between the policyholder and the insurer but shall not affect the rights of the third party. Section 8 renders any condition that allows an insurer to repudiate liability because of an omission or commission by the owner/user to be of no effect;
- Section 16 prevents an insurer from declining liability arising under the policy due to the following:

✓ Age, physical condition or mental condition of the driver;
✓ Condition of the vehicle & no. of persons carried;
✓ Time or area where the vehicle is used; and
✓ The weight or physical characteristics of the goods being carried.

- The section thus makes it compulsory for insurers to pay claims arising and covered under this Act. If the insurer pays a claim under such circumstances, it retains the right to recover their outlay from the policyholder;
- Section 10 of the Act requires insurers to pay judgments obtained against their insured arising under this Act notwithstanding they may be entitled to avoid or cancel or may have avoided or cancelled the policy. However, there are exceptions to this provision and they include:
    - ✓ If the claimant has not been subjected to medical examination;
    - ✓ Where the claimants willfully gives false information;
    - ✓ Where the insurer makes an application to verify information. However, such verification must be done within one month;
    - ✓ Where no statutory notice or summons were served;
    - ✓ If the policy had been cancelled by mutual consent prior to the happening of the event (accident);
    - ✓ Where the policy had been cancelled and the certificate (or a statutory declaration in lieu) surrendered to the insurer before the accident;
    - ✓ Where the insurer had cancelled the policy but the insured failed or refused to surrender the certificate. The insurer must, however, notify the registrar of motor vehicles and the deputy inspector general of police;

- ✓ Where prior to or 3 months after commencement of proceedings, the insurer has obtained a declaration that they are entitled to avoid the policy for non-disclosure of a material fact; and
- ✓ Where the insurer has obtained stay of proceedings pending appeal.

The injured victim still enjoys protection where the insured is adjudicated bankrupt as they will be treated among the ordinary creditors. However, there are shortcomings under the Act and they include:

- A victim of hit and run motor vehicle cannot obtain compensation under this Act;
- A victim who has not identified, proved fault and obtained judgment will not be compensated if the policyholder is wound up (in case of a company);
- The requirements of proving fault can be involving and creates an impression that the only means through which such disputes can be resolved is through the court;
- Accidents caused by unauthorised drivers causing (including thieves) are not provided for under the Act;
- Third party property damage claims are not covered.

 Find out other shortcomings of the Act.

8.3.2 The Law of Evidence

Rules of evidence are embodied in the Evidence Act Cap 80 of the laws of Kenya apply to both civil and criminal proceedings.

 **What is Evidence?**

Evidence refers to facts, signs or objects that one believes to be true. Evidence is information used in a court of law to prove/support a case or an argument. Note that the law of evidence determines the following:

- How facts may be proved in a court of law; and
- What facts should be proved.

Facts to be proved include the following:

- **Facts in issue**: this are facts the plaintiff or prosecution must prove in order to support and succeed in their claim or facts which the defendant or accused must tender in his defense for it to succeed;
- **Facts which are relevant to the issue**: this refers to those caused by other facts or conduct of a party to the proceedings. In the case of **Makin vs. AG for New South Wales,** a couple was charged with the murder of a baby they had acquired by paying a small fee. Evidence adduced was that other bodies of babies acquired under similar circumstances had been found in the grounds of houses occupied by the accused. The evidence was admissible as it was relevant to the issue;
- **Facts forming part of the same transaction**: this is when acts of the accused are so interwoven as to form part of the same transaction. In the case of **Republic vs. Premji Kurji,** the accused had been charged with the offence of murder using a dagger. There was evidence that the accused had been found standing over the deceased's body with a knife with blood. The prosecution adduced evidence that a few minutes earlier, the deceased had been assaulting the deceased's brother with a dagger and had said, 'I have finished with you, I am going to deal with your brother; and
- **Facts having a bearing on the legal perceptions**: for example, the behavior of a witness during examination may determine their credibility.

The law of evidence is concerned with:

- Establishing who has the duty or burden to prove a case;
- Who tenders evidence;
- The level of proof required;
- Competence and compellability of witnesses;
- Manner of presenting evidence; and
- Treatment of different types of evidence and witnesses.

Items of Judicial Evidence

This refers to the form evidence takes when being produced in court. These items are:

Testimony

This is the oral account or statement of facts or opinion that a witness gives in court. The statements are made to prove the truth of what is being ascertained or in support of an argument.

Admissible Hearsay Statements

Hearsay evidence is what is said or written by a person other than the person testifying or the person who perceived it. Hearsay evidence is generally inadmissible. However, where a statement is offered in evidence not to prove the truth of the facts contained in the statement but only to prove that the statement was is admissible, for example, where one is dying and says something, the person perceiving it may tender it and it is accepted.

Documents
These are written accounts of a transaction in a matter. They are of diverse types and include a book, a sale agreement, an endorsement and a policy document among others.

Things
These are material objects which are admitted to court for inspection and inference. They are also known as 'real' evidence for example a blood stained knife in a murder case.

Facts
These are circumstantial evidence which must be considered together with other evidence for example, a person seen running out of a house with a knife and a person is found dead in that house.

Facts that Need not be Proved

- Those that have been admitted;
- Those that are presumed/inferred. Presumptions are evidence which courts are entitled to produce notwithstanding the fact that there is contrary evidence about them. They are of three types:
    i) Presumption of fact-these are inferences that may be drawn upon establishment of a basic fact;
    ii) Rebuttable presumption of law –for example, a minor aged between 8-12 years is presumed not criminally liable unless there is evidence to the contrary, a person who disappears without trace for seven years is presumed dead, a child born within 280 days from the date of marriage is presumed to be a legitimate child unless the father produces evidence to the contrary and one is presumed innocent until proved guilty; and
    iii) An irrebuttable presumption of law for example, a minor aged eight years and below is presumed not criminally liable and one who is 12 years and below is not capable of canal knowledge. No evidence can change these presumptions.
- Those which the judiciary takes note of for example, names of counties, towns, road rules and ordinary cause of nature. In the case of **Brooke Bond Kenya vs. Chai Ltd**, the plaintiff brought action against the defendant for infringement of trade marks for using Green Label and make up of the tea packets. The case failed and the plaintiff appealed. On appeal, it was held that the test was 'passing off' (damage to business interests of another through acts which deceive the general public). The appeal succeeded because judicial notice was taken of those who are illiterate; and
- Facts which the opposite party is estopped from asserting or denying.

Classification of Evidence
Evidence is classified into:

(i) Direct and Circumstantial Evidence

Direct evidence is testimony concerning the perception of the facts in issue by a witness whereas circumstantial is evidential facts that are said to be evidence of the other that is those in issue or relevant facts. For example, a driver charged with dangerous driving and has previous convictions over the same offence.

(ii) Primary and Secondary Evidence

Primary evidence is evidence that does not by its very nature suggests the existence of better evidence. Examples are original documents like identity cards, passports, log book, lease agreement and policy documents. Where a document is executed in several parts; each part is primary evidence. Secondary evidence on the other hand suggests existence of better evidence. Examples are certified copies, photocopies and oral account of contents of a document.

(iii) Insufficient, Prima Facie and Conclusive Evidence

Insufficient evidence: This is evidence that is so weak that no reasonable man would properly decide an issue in favour of the person adducing it. The effect of this is that courts normally dismiss the case. Where courts decide a case on the face of insufficient evidence, the other party can file an appeal.

Prima facie: This is evidence that seems to be true on the face of it but can be proved false. It is evidence that necessitates a finding that the fact is proved if the evidence is not controverted. Courts can only put an accused in a criminal case on his defense if he has established a prima facie case. A police abstract report issued by the police following a road accident blaming one party is prima facie evidence.

Conclusive evidence: This relates to where the court must find that a particular fact has been proved without giving the other party an opportunity to call any evidence to prove the contrary, for example, irrebutable presumptions.

Burden of Proof

This is the legal obligation incumbent upon a party who desires a court to enter a judgment upon certain facts in his/her favour. The burden of proof is concerned with who has the responsibility to prove a case. It is different from the burden of adducing evidence. The latter is concerned with the duty to bring evidence before the court to discharge such a duty. Section 108 of the evidence Act provides that the burden of proof lies on a person who will fail if no evidence at all were given. The burden of adducing evidence ordinarily falls on the person whom the burden of proof lies. In civil cases, the burden of proof is normally upon the plaintiff whereas in criminal cases, it is upon the prosecution.

Standard of Proof

The standard of proof refers to the extent or degree to which one need to prove a case in order to succeed. In criminal cases, the burden of proof is beyond reasonable doubt. Beyond any reasonable doubt is explained to mean that the evidence is so strong against a man as to leave only a remote possibility in his favor which can be dismissed with a sentence. In civil cases the burden of proof is on a balance of probabilities that is on the basis of evidence adduced. The burden of proof is not the

same in all civil cases. The person on whom the burden of proof lies must prove the facts in issue to the respective level so as to succeed in the case.

Rules on Admissibility of Evidence

It should be noted that not all evidence that is adduced in a court of law is admissible. For evidence to be admitted, they must comply with rules that govern admissibility. These rules are briefly explained below.

(i) Competence and Compellability of Witnesses

Competence refers to one's capability. It also refers to one being conversant with the matters under consideration ordinary a competent witness. All sane adults not subject to diplomatic or sovereign immunity are competent and compellable. There are however exceptions which are:

Judicial officers: They cannot be compelled to testify on any issue arising from their conduct of official court duties as they enjoy official privilege;

Advocates: They cannot be compelled to testify in a manner as to disclose communication with clients under legal professional duty;

Public officer: Cannot be compelled to give evidence in the conduct of their official duties;

Clients: On communication with advocates;

Spouses: Cannot be compelled to give evidence against each other in a court of law; and

The accused persons: Cannot be compelled to give incriminating evidence against themselves.

(ii) Oath and Affirmation

Oath refers to the swearing in of a witness before testifying. All witnesses are required to be sworn in prior to giving evidence. There are exceptions to this rule which include:

- Those who do not profess a religious belief; and
- Those whose religious beliefs prohibit swearing by their duty in which case, they are affirmed.

(iii) Estoppel

This is where a person is estopped by law from asserting or denying what he/she has said previously. A party who has by an act or declaration led another to believe certain facts to be true and the latter acted upon them, the former cannot retract them.

(iv) Hearsay

This is the testimony given in court by a person other than the one who perceived it. It is generally inadmissible except:

- Where statements relate to the cause of death of the maker known as dying declaration;
- Statements made in the course of the makers' business or professional activity;
- Where the evidence is against interest of the maker that is, would have incriminated him;
- Evidence as to relationship by blood or marriage that is in issue in the proceedings; and
- Evidence as to family affairs in issue in the court proceedings.

(v) Documentary Evidence

A document is any publication on any matter written or expressed on described on any substance by figures, letters and any written thing capable of being evidence. Section 64 of the Evidence Act

provides for content of documents be either by primary or secondary evidence. The general rule is that documents must be proved by primary evidence except in the following:

- Original is in the power of another party and notice has been served on him to produce them;
- Contents of the original had been admitted by the other party;
- Original is destroyed or lost; and
- Original is not easily movable.

If the document is signed, the signature must be proved to be that of the signer. Certified documents of official bodies are admissible in evidence without calling the makers. The maker of reports for example, expert reports are required to produce the report themselves.

(vi) Oral Evidence

Once a transaction is reduced in writing, the document becomes final evidence. Oral or extrinsic evidence should not substitute a written document. The intention is to avoid use of oral evidence so that the written document is not contradicted, varied, added or subtracted.

(vii) Evidence of Character

General reputation of character and disposition such as inherent quality, upbringing, education and material condition is not admissible except in civil cases:

- Where character is in issue or directly relevant to the issue for example, where one is pleading the defence of justification in defamation cases;
- When character affects the amount of damages. If one can show in a defamation case that the person has no reputation, minimal damages may be awarded; and
- Where character is brought in to prove that a witness is not credible for example a doctor with fake reports.

(viii) Confessions

This is an admission made by a person charged with a crime stating or suggesting an inference that he or she committed the crime. The confession must be unequivocal that is in substantially all terms. It is not admissible if obtained by inducement, promise or threat.

(ix) Opinion

This is inference that one would draw from what they perceive, see, smell and feel. It is generally not admissible. However, experts can be called in to give opinions.

Who is an expert?

An expert is defined as a person competent with skill and adequate knowledge gained either through study or special experience. Experts have special skills in certain fields and the opinion becomes relevant for example, handwriting experts. Rules are laid down on how and who gives evidence for example opinions will only be accepted from experts. In the case of **Odindo vs. Republic,** the

accused was charged driving under the influence of drink. His appeal was dismissed and the court held that the police inspector who gave evidence on drunken driving was not an expert.

(x) Collaboration

This is evidence to confirm other evidence. The general rule under common law is that evidence of a single witness could sustain any civil suit or criminal case. The evidence Act provides that no particular number of witnesses shall in the absence of any provision of law to the contrary be required to prove any fact.

8.3.3 The Law of Succession

The law of succession deals with inheritance of property of a person following their death. It is also referred to as the law of inheritance that is, transmission of property rights from the dead to the living. Succession is governed by the Law of Succession Act (Cap 160 of the laws of Kenya). Where one person transfers his property to another, the transferee becomes entitled to the rights of the transferor. Succession normally occurs either on the death of a person or on his bankruptcy. In this study we are concerned with succession upon death as this has a direct bearing in the payment of the proceeds of death claims in life assurance policies, death claims in personal accident policies, pension dues upon death before retirement and settlement of insurance claims generally.

Inheritance is common in all human societies and is a concept of universal application. It is one of the ways of acquiring property because when a person dies, the rights to enjoy property dies with them, thus the rights over that property have to be acquired by someone else. The philosophical decision behind succession is the right of the owner to control his property even after their death.

The law of succession deals with three important situations. These are:

- Who is to receive the property;
- How is the distribution to be effected; and
- Mechanism for dispute resolution between persons who claim to be rightful claimants.

The law of Succession Act provides that any person may dispose of all or any of his property by will, and may make any disposition by reference to any secular or religious law that he chooses. Succession to immovable property in Kenya of a deceased person shall be regulated by the law of Kenya irrespective of the domicile of the person at his death. Succession of movable property of a deceased person shall be regulated by the law of the country of the domicile of the person at the time of his death.

Testate and Intestate Succession

Where a person makes a valid Will stating how his property is to be distributed, he is said to died 'testate'. Where there is no Will or where a will has failed to take effect, he is said to died 'intestate'.

What is a Will?

A Will is the main document by which the person making it provides for distribution of property after his death. Unless there is a clear intention to the contrary, it takes effect from the time of the death and not from the time of making it. The maker of a Will, if it is a man is known as the 'testator' and if a woman, is known as the' testatrix'. A Will can be altered by adding to it any number of codicils. A codicil is a document that explains, alters, or adds to the disposition or appointment of a Will and is made and executed in the same manner as a Will A codicil becomes part of the Will. A Will being the legal declaration by a person of his wishes or intentions regarding the deposition of his property after his death, it is made and executed according to the provisions of the Act.

Capacity to make a Will

Every person aged 18 years and above, and of sound mind may make a Will. Any person making a Will is presumed to be of sound mind at the time of execution of the Will unless he was in such a state of mind, whether caused by mental or physical illness, drunkenness or from any other cause as not to know what he was doing. The burden of proving this lies with the person who alleges it. Old age, illness, blindness and illiteracy can affect a person's capacity to make a will. A Will may be set aside by the court if it is procured by fraud or force. Before probate (certificate proving validity of a Will), is granted, the court has to be satisfied that a testator had not only the intention to make a Will but was aware of the contents of the Will before execution.

Formalities of Making a Valid Will

A will may be made either orally or in writing. However, an oral will shall not be valid unless it is made in the presence of two or more competent witnesses and the maker dies within three months from the date of making the Will. With regard to written wills, as a safeguard against fraud, the Act prescribes that no will shall be valid unless:

- It is signed by the testator or by someone else in his presence and by his direction;
- The testator must sign or acknowledge the Will in the presence of two witnesses; and
- No witness may benefit under a will, and if the Will purports to give a legacy (that is a particular thing given by Will) to a witness, the gift to the witness will fail unless the Will is attested by at least two additional competent and independent witnesses.

Revocation of Will

Wills are said to be 'ambulatory' that is, they 'walk' about until the death of the testator. This means that they can be revoked by the testator before his death. There are three ways of revoking a will:

(i) Change of Will

Having made a Will, a person sometimes wishes to amend it. He does this in the form of another testamentary document known as a codicil. A codicil explains, alters, or adds to the disposition or appointment of a will and is made and executed in the same manner as a Will. Where a latter Will or codicil does not clearly revoke the previous one, the two documents are read together. When a testator dies leaving two wills which conflict and which cannot be reconciled, the latter of which does not revoke the earlier Will, the earlier will is by implication revoked by the later Will, to the extent of the inconsistency. To avoid such confusions a Will usually commences with the clause 'I hereby revoke all former wills'.

(ii) Destruction of the Will

If the testator or some other person in the presence of and at the direction of the testator burns or otherwise destroys the Will with the intention to revoke it, then the will is revoked.

(iii) Revocation by Subsequent Marriage

The Act provides that a subsequent marriage revokes a previous will unless it is expressed to be made in contemplation of this marriage.

Effect of Alteration in Will

Any alteration made in a written Will shall have no effect unless the alteration is signed and attested as a written.

Revival of Will

The Act provides that a Will which has been wholly revoked in any manner cannot be revived unless a new Will is been made. Similarly, where only a part of a Will has been revoked, that part cannot be revived except by the re-execution hereof by a subsequent Will or codicil showing an intention to revive it.

Provision for Dependants

Before the Succession Act was enacted, a testator was free to dispose of his property in the manner he thought fit. A testator could prevent his wife and children from receiving even a shilling from his estate. This freedom caused tremendous hardships in some cases.

Who is a Dependant?

Section 29 of the Act provides a list of dependants as follows:

- The wife or wives or former wife or wives and the children of the deceased whether or not maintained by the deceased immediately before his death

- The deceased's parents, step-parents, grandparents, grandchildren, children whom the deceased had taken into his family as his own, brothers and sisters as were being maintained by the deceased immediately, before his death where the deceased was a woman, her husband if he was being maintained by her immediately prior to the date of her death.

What Happens when a Dependant is not provided for Under the Will?

The succession Act provides that dependants of the testator may apply to the court for provision to be made for them out of the Will. If an application is made by or on behalf of a dependant, the court may, if it thinks fit, order that a reasonable provision is made for that dependant out of the deceased's net estate. When making provision for a dependant, the court has complete discretion to order a specific share of the estate to be given to the dependant, or to make such other provision for him by way of periodical payments or a lump sum, and to impose conditions as it thinks fit.

Note that in considering whether any order should be made, the court must take into account:

- The nature and the amount of the deceased's property;
- Any past, present or future capital or income from any source of the dependant;
- The existing and future means and needs of the dependant;
- Whether the deceased had made any advancement or other gift to the dependant during his life time;
- The conduct of the dependant in relation to the deceased;
- The situation and circumstances of the deceased's other dependants; and
- The general circumstances of the case and the testator's reasons for not making provision for the dependant.

Gifts in Contemplation of Death

Such a gift does not become operative during the lifetime of the donor, but would be effective upon death. Thus, in case the donor recovers from his illness, he is free to resume full ownership of the property. The Act provides that a gift made in contemplation of death shall be valid if:

- The person making the gift is at the time contemplating the possibility of death as a result of a present illness or present or imminent danger;
- A person gives movable property which he could otherwise dispose of by will;

- There is delivery to the beneficiary, or possession or the means of possession of the property or of the documents or other evidence thereto;
- A person makes a gift in such circumstances as to show that he intends it to revert to him should he recover from his illness; and
- The person making that gift dies from any cause; and the intended beneficiary survives the person who made the gift to him.

Intestacy

A person is deemed to die intestate in respect of all his free property of which he has not made a valid Will. When a person dies intestacy, his estate will devolve according to the rule governing succession on intestacy.

Rules Governing the Distribution of an Intestate's Estate

Where the intestate leaves a surviving spouse and a child or children:

- The surviving spouse becomes entitled to the personal effects of the deceased absolutely, and a life interest in the whole residue of the net estate. However, if the surviving spouse is a widow, that interest terminates upon her re-marriage to any person;
- A surviving spouse acquires a power of appointment of all or any part of the capital of the net intestate is estate by way of gift, which takes immediate effect among the surviving child or children;
- Where any child considers that the power of appointment as above has been unreasonably exercised or withheld, he may apply to the court for appointment of his share. If he is a minor, then his representative may apply to the court; and
- Where an application is made, the court may award the applicant a share of the capital of the net intestate estate, and in determining whether an order is to be made, the court takes into consideration the same factors considered when a dependant is left out in a will and makes an application to court as outlined above except that the point of focus switches from the dependant to the applicant and the surviving spouse.

Power of Spouse during Life Interest

A surviving spouse entitled to a life interest may sell any of the property subject to that interest if necessary for his own maintenance with the consent of all the co-trustees and all children of full age or with the consent of the court. However, in the case of immovable property the exercise of such power is always subject to the consent of the court.

The provisions of this Act do not apply to:

- Agricultural land and crops thereon; and
- The first ten thousand shillings out of the residue of the net intestate's estate, or twenty per cent whichever is the greater.

Where an intestate leaves no spouse but leaves a child or children, the net intestate's estate devolves upon a child or' children. If the intestate leaves no surviving spouse or children, the net intestate's estate devolves upon the kindred of the intestate with those close to him such as father, mother,

brother or sister taking priority. Failing survival by any of the persons mentioned in the Act, the net intestate's estate vests in the State and is paid into the Consolidated Fund.

Polygamous Intestate

Where an intestate has married more than once under any system of law permitting polygamy, his personal and household effects and the residue of the net intestate estate is, in the first instance, to be divided among the houses according to the number of children in each house, but also adding any wife surviving him as an additional unit to the number of children.

Property held in Trust

Where the intestate leaves no husband or wife, but leaves a child or children, the net intestate's estate is held on the statutory trusts in equal shares in case of more than one child, contingent upon their attaining the age of majority or marrying. As soon as any member of the class attains full age or marries, he or she attains an absolutely vested interest. Where an intestate has, during his life time or by will, paid, given or settled any property to or for the benefit of a child, grandchild or house; or property has been appointed or awarded to any child or grandchild, that property is to be taken into account, before calculating the beneficiary's share in the intestate's estate.

Personal Representative

Whether a person dies testate or intestate, all his real and personal properties vest in his personal representative. The term 'personal representative' denotes either an executor or an administrator. A personal representative appointed by a testator in his will is called an executor. If there is no will, a personal representative must be appointed by the court and is called an administrator. As a general rule, any person can be appointed an executor. However, no grant of representation can be made to:

- An infant;
- A person of unsound mind;
- A bankrupt; or
- More than four persons in respect of the same property. Any person who has been appointed by a will as an executor may, either by oral declaration before the court or by writing, renounces the office of the executor. No person can be compelled to act as an executor. In practice, prior consent of the person to be appointed is sort.

The whole estate of a deceased testator vests automatically in the executor appointed by the Will immediately upon the death. If he refuses or fails to act, or dies before obtaining the probate, the court will appoint a person to administer the estate.

What are the Powers of the Personal Representative?

- Bring actions which survive or arises out of the death of the deceased;

- To sell all or part of the assets vested them;
- To assent to the vesting of a specific legacy;
- Appropriate any of the asset vested in them in satisfaction of any legacy bequeathed by the deceases; and
- Invest funds to provide for legacies.

Personal representatives also have the following duties:

- To provide and pay out of the estate of the deceased the expenses of a reasonable funeral for him; and
- To get all the free properties of the deceased, including debts owing to him and monies payable; and
- To ascertain and pay all his debts; after confirmation of the grants, to distribute or retain on trust all assets remaining after payment of expenses and debts.

Succession in Insurance

We have already pointed out the importance of this topic in insurance, especially life and pension business. In life, the policyholder is required to name the beneficiary. In case there is no dispute or challenge, the assurer pays the policy money to the named beneficiary. The Insurance Act provides that if the beneficiary named is a minor, then the policy holder must nominate another person to receive the money on their behalf. In pension, the beneficiary of the schedule is supposed to nominate a person or persons to who their proceeds would become payable in the event of their death before retirement. The trustees of a pension scheme have a leeway to exercise discretion in the payment of such dues and this is normally provided for in the trustee deed and rules of the pension scheme.

8.3.4 Work Injury Benefits Act (WIBA)

The Work Injury Benefits Act 2007 repealed the Workmen Compensation Act Cap. 236 of the laws of Kenya. It was a product of a series of new labour laws that were aimed at improving the welfare of workers. The Act came into operation in December 2007. The purpose of the Act is to govern compensation for employees who sustain injury by accident or disease arising out of and in the course of their employment.

Section 4 of the Act defines an employer to include *inter alia* the Government, trustees and managers, legal personal representatives of a diseased employer as well as an authorised employee or an agent of thee employer. Section 5 of the Act defines an employee to mean any person employed under a contract of service whether expressed or implied. It includes an apprentice as well as an indentured learner. When the employee is dead, his dependants and or personal representatives shall be deemed employees. The period of employment contract is immaterial. Persons not considered employees under the Act include:

- A casual worker; - A person whose terms of employment provide for his payment at the end of each day;
- Member of the Armed Forces;
- Person employed outside Kenya for a priod of more than one year (section 11 of the Act); and

- A family member living with the employer not for purposes of employment.

Obligations of an Employer

Registration: Section 8 requires every employer carrying on business in Kenya to be registered with the Director who shall determine the employers details required for that purpose.

Records: Section 9 requires the employer to keep records relating to employees, failure to which, an offence is committed. The records of remuneration are deemed to be proper records under this Section.

Notification of accidents: Section 22 obliges the employer to report to the Director any accident of an employee within seven (7) days of his getting notice of it and upon request to furnish a copy of the same to the victim or his
dependants.

Expenses: Section 47 requires an employer, subject to the Act, to settle any expenses (examples of which are given) reasonably incurred by employee as a result of accident. The Council shall determine the medical aid to be provided under this Section.

Some of the distinct features of the Act include:

- It compulsory for employers to insure to compensate employees against for bodily injury or disease sustained by employees in the course of duty.
- The maximum compensation is ninety six (96) months with respect to death or permanent disability benefits.
- An employer is required to cover all medical expenses including first aid, conveyance of the employee to and from a medical facility, dental surgical treatment, nursing care, replacement of artificial limbs among others. The medical limit under the WCA was KES. 30,000/=

Circumstances under Which an Employee will not be Protected under WIBA

- Liability not provided for in the WIBA Act;
- Accidental death or injury occurring outside the normal working hours of the employer;
- Injury by accident or disease sustained outside the Geographical Area;
- Injury caused by deliberate and willful misconduct of the employee;
- Liability arising out of court proceedings;
- Liability arising out of pre-existing medical conditions unless the same had been declared;
- Injury by accident or disease sustained by an employee who is below the age of 16 years;
- Any business or occupation not described in the schedule; and
- Injury by accident or disease attributable to war.

8.3.5 The Fatal Accidents Act

This is an act of parliament that makes provisions for compensating families of persons killed in accidents. In lecture five, you learnt that a deceased person's rights and duties survive their death. In lecture nine, you will also learn that most disputes in insurance arise from liability policies. Some of

the claims relate to where persons suffered fatal injuries accidents. The Act makes the following provisions:

- Every action brought by virtue of the provisions of the Act shall be for the benefit of the wife, husband, parent and child of the person whose death was so caused, and shall be brought by and in the name of the executor or administrator of the person deceased;
- In such action, the court may award such damages as it may think proportionate to the injury resulting from the death to the persons respectively for whom and for whose benefit the action is brought;
- That the case must be proved on a balance of probabilities for damages to be awarded;
- That not more than one action shall lie for and in respect of the same subject matter of complaint;
- That every such action shall be commenced within three years after the death of the deceased person;
- In assessing damages, the courts will take into account any sum paid under an insurance contract and pension scheme;
- That in the event of insolvency of the estate, the proceedings shall be deemed to be a debt provable in the administration of the estate; and
- That funeral expenses be awarded in addition to damages.

8.3.6 The Law Reform Act Chapter 26

The Law Reform Act provides for the following:

- Survival of Actions;
- Joint Tortfeasors;
- Contributory negligence; and
- Prerogative writs of Mandamus, Prohibition and Certiorari among other provisions.

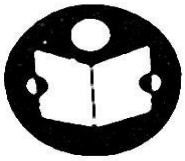
The first three have been explained in lecture five while the last one on prerogative writs has been discussed in lecture one.

8.3.7 Proceeds of Crime and Anti Money Laundering Act (POCAMLA) No. 9 of 2009

This Act and its implications in the practice of insurance will be discussed in lecture ten.

Find out the indicators of money laundering in insurance operations.

8.4 SUMMARY



You have found out from this lecture that:

- The law makes it compulsory for all vehicles on public roads to have insurance or some other security;
- Insurers are compelled to pay victims injured through road accidents where their policyholders have not complied with the terms of the contract;
- A person can die testate or intestate;
- A dependant can challenge a Will if they have not been provided for;
- WIBA protects employees who sustain injuries or contract diseases in the course of duty;
- The law of evidence requires civil cases to be proved on a balance of probabilities and civil cases beyond reasonable doubt; and
- The law provides for compensation to families of deceased persons who are injured in accidents.

8.5 ACTIVITIES

1. Explain the duties of an employer under WIBA.
2. List the main provisions of Cap. 405.
3. Describe the rules governing admissibility of evidence in a court of law.
4. Explain factors considered by courts in deciding whether to provide for a dependant who is not provided for under a Will.
5. Explain circumstances under which an insurer may not be compelled to honour a judgment arising under Cap. 405.

8.6 READING LIST

i. The Insurance (Motor Vehicle Third Party Risks) Act Chapter 405
ii. The Evidence Act Cap. 80 of the Laws of Kenya
iii. Work Injury Benefits Act, 2007
iv.The Law of Succession Act Cap. 160
v. Past Papers

LECTURE NINE

9.0 DISPUTE RESOLUTION MECHANISMS

LECTURE OUTLINE

9.1 INTRODUCTION

In the last lecture, you have examined the various Acts of parliament and understood their implications in the practice of insurance.

Welcome to lecture nine. In this lecture, you will understand that disputes arise in insurance operations. The lecture discusses the mechanisms available in to insurers in the event that a dispute arises. May I assure you that after this, you will be able to understand the various methods of resolving disputes and apply them in the practice of insurance. Welcome and enjoy.

9.2 LEARNING OUTCOMES

By the end of this lecture, you should be able to:

a) Explain the nature of disputes in insurance;
b) Explain litigation as a method of dispute resolution in insurance;
c) Describe arbitration as a dispute resolution mechanism; and
d) Discuss alternative dispute resolution methods.

Competence
The trainee should have the ability to apply provisions of other legislations in the practice of insurance.

Content
Let us now start by explaining the Nature of disputes in insurance.

9.3 NATURE OF DISPUTES IN INSURANCE

What is a Dispute?

A dispute is a disagreement between two or more persons, groups or countries. A dispute will arise where there are relations between the parties to the dispute which relations can be social, commercial or political. Disputes are inevitable where there are commercial dealings and transactions. Society

has, therefore, over time come up with ways and mechanisms of resolving disputes. Insurance companies may find themselves embroiled in disputes that may or may not be related to the policies they issue. Those that may not be related to the policies include:

- Taxation matters with the tax master;
- Claims under the Occupier's Liability Act;
- Claims by employees due to injury suffered or disease contracted in the course of duty. Disputes with employees may also be as a consequent of breach of employment laws; and
- Disputes relating to company law related matters among others.

Think

Discuss other disputes not related to the insurance contract that an insurer may be faced with.

Note that most disputes that an insurance firm and the insured/intermediary may be involved in mainly arise where claims are declined due to breach of good faith, breach of contract or where the amount offered for settlement is less than what the insured expected.

The dispute may also arise among insurers themselves on issues of sharing of claims under co-insurance or reinsurance arrangements. There may be disputes where insurance companies seek to defend their policyholders against third party claims in liability insurances.

There are three basic dispute resolution mechanisms available which are provided for under the law and also under agreements. These are explained below.

9.4 LITIGATION

Litigation is the use of the civil justice system (courts) by parties to a dispute to hear and adjudicate upon their differences of opinion. The person who commences litigation is known as the plaintiff and the person against whom a case is filed is known as the defendant. As highlighted in lecture one, cases handled by insurers are civil in nature.

9.4.1 The Litigation Process

Majority of disputes that are resolved through the courts involves lawyers who act on behalf of the parties. This is mainly attributable to the technical procedures involved and the fact that the civil justice system is a fault system that requires prove of negligence before judgment is given. A person who wishes to resolve a dispute through the courts must then understand the litigation process as explained below.

a) Choosing the Court

Choosing the court is the duty of the plaintiff. There are certain factors which will determine the court that will hear a given dispute. These include:

- The amount of damages being sought;

- The nature of the suit. Certain courts may not have jurisdiction to hear and determine some disputes for example, defamation cases can only be heard in the High Court and Magistrates Courts have original jurisdiction to hear disputes under customary among other matters; and
- The geographical location where the cause of action arose.

Find out which court hears divorce and election petitions.

b) Issuing the Claim

The claimant draws up a statement of their case. The rules of court prescribe both the form of the particulars as well as the content. It is only from the particulars that one can see the basis of the action as well as the relief sought. The particulars of claim, then, sets out the facts that give rise to the claim as well as what the plaintiff wants the court to decide. The statement of the case must contain the following:

- A heading;
- A statement of the facts on which the claim is based;
- Jurisdiction;
- A cause of action; and
- A prayer.

c) Service of Summons:

A summons is an official notice of a lawsuit. Once the summons has been issued by the registrar or clerk of the court, it may be served on the defendant. When a person is sued, they need to know about it so that they can come to court and defend themselves. The clerk or process server is required then to submit to the lawyer a return of service.

d) Default Judgment

Once the summons, with all annexures, has been served on the defendant, and the required time period for a response has lapsed without such a response, a party can apply for judgment. This is judgment on the basis that the defendant is in default. Default judgment under Kenya law is entered or given in the absence of the party against whom it is made. It frequently occurs when a defendant has failed to file his notice of intention to defend, but it can also be entered against the plaintiff. In terms of the rules, default judgment is granted in the following circumstances:

e) Notice of Intention to Defend

If the defendant decides to oppose the action as set out in the summons, he is required to deliver a notice setting out his intention within ten days of receipt of the summons (or twenty days in the case of the state). The document sets out the defendant's intention to defend the action, as well as the address at which he will receive all further documents in the proceedings.

f) Counterclaim

A counterclaim is a claim made to offset another claim in legal action. In a plea, a party simply answers the allegations raised by the plaintiff and it occurs, however, that the defendant has a counterclaim. The rules provide that a party may file a counterclaim against the plaintiff. For example, a plaintiff who alleges that his car was damaged by the negligence of the defendant may defend a counterclaim by the defendant who will also allege that the plaintiff was the one who caused the accident.

g) Application to Strike Out

The court has power to strike out all or part of the statement of the case either on request of one of the parties or on its own initiative. An application to strike out to be brought on the following grounds under Kenya law:

- The pleading contains statements that are scandalous, vexatious or irrelevant; and
- The applicant will be prejudiced in the conduct of his claim or defence if the offending statements are not struck out.

h) Stay to Attempt Settlement

Either party to the suit may ask for a stay of proceedings in order to attempt to settle the case outside court by way of Alternative Dispute Resolution (ADR). The initial stay will be for a specified period, but a further period can be ordered by the court.

i) Hearing

Under the Kenyan legal system, a court case is essentially a contest between two sides. In a civil case, it is the plaintiff and the defendant wheas in a criminal case, the prosecution and the defence. The court itself, consisting of a judge or judges or a magistrate, remains neutral. The role of the court is not to investigate but simply to listen to the evidence presented by the two sides and then give judgment for one side or the other. In civil proceedings, the claimant has the burden of proving his case on the balance of probabilities.

j) Judgment

After the parties have argued and supported their case, the court will enter judgment which in mostly an award of damages. The judgment debtor will be given a grace period within which to make good the judgment. Failure to honour the decree may result into orders to attach and sell property or the judgment debtor may be subjected to civil jail. A party that is not satisfied with the judgment of the court has a right to file an appeal by way of petition. Such appeal must be done within 14 days from the date of judgment.

Advantages of Litigation

- Judgments of the courts are enforceable and binding upon the losing party in the instance that they fail to pay the amount awarded. This is by way of taking out execution proceedings,

attachment of the judgment debtor's property and subsequent sale to recover the amount awarded;

- Litigation is involuntary: Litigation is used to force a party who is not willing to settle a matter following demands to do so;
- Legal costs: The winning party is awarded costs which are paid by the losing party. These are costs incurred in prosecuting or defending a case. Litigation is not therefore in vain;
- Access to the knowledge and experience of the courts and the judiciary: Through litigation, just, fair and high quality judgments or decisions are produced. Courts also give detailed reasons for their decisions. These decisions act as future precedents for cases with similar facts coming before the courts;
- Litigation provides a mechanism for curtailing disputes where there is no reasonable defence through a process known as summary judgment. It is only the issue of quantum that is addressed; and
- Courts have power to award interest on damages at rates fixed by the statute.

Disadvantages of Litigation

- Litigation is expensive: the costs for technical representation are high coupled with high court awards. In the insurance industry, some of the awards are above what they can sustain;
- Litigation is slow: this is due to the rigid procedural requirements and also the time taken to finalise a case regardless of the amount involved;
- Litigation is a public forum: disputes that are commercially sensitive may cause embarrassment to some of the parties involved;
- Litigation is inflexible in terms of the procedure followed: cases may be thrown out because of the technical procedures for example, lack of verifying affidavits or where the advocate does not have a practising licence;
- Knowledge of the presiding judge or magistrate may be limited in the area relating to the dispute; and
- Courts resolve disputes by reference to the law and commercial considerations may not be taken into account when arriving at their decisions.

9.5 ARBITRATION

This is the process of settling commercial disputes between two or more parties by one or more persons known as arbitrators. In Kenya, arbitration is governed by the Arbitration Act Cap. 49 of the laws of Kenya. Section 2 of the Act defines an arbitration agreement as a written agreement to refer present or future differences to arbitration whether an arbitrator is named or not. Many modern insurance contracts contain a clause in the policy requiring subsequent disputes between the parties on the amount payable to be referred to arbitration. An arbitrator who has a past or present relationship with either party cannot be allowed to arbitrate. This equally applies to one who has prior knowledge of the dispute. A dispute may be referred to arbitration in three ways. These are:

- **By order of the court:** a specified or the whole issue where technical or scientific opinion is required may be referred to an arbitrator.
- **Statutes:** certain statutes make provisions that parties can refer the subject matter of the dispute to arbitration.
- **Consent of the parties**: where the parties agree in writing, they are under an obligation to do so.

The decision of an arbitrator is known as an award. It is legally binding and enforceable upon the parties. One can however, file an appeal against the award in the High Court because of a mistake of law and not a mistake of fact. One can also challenge the award on the basis of serious irregularities which includes:

- Exceeding the arbitrator's powers;
- Failure to follow the agreed procedure;
- Obtaining an award by fraud;
- Failure to deal with all relevant issues; and
- Obtaining an award which is contrary to public policy.

Advantages of Arbitration

The advantages of litigation are:

- It takes place in private, hence avoiding unnecessary publicity and embarrassment;
- It is flexible as there are no rigid procedures followed since they are fixed by the parties. Parties also fix the time and place of conducting the proceedings;
- It is informal, faster and cheaper. An arbitrator who is not available may be prevented from arbitrating in a dispute;
- The award of the arbitrator is binding and enforceable against the losing party;
- The arbitrator may combine his special knowledge and skill with that of the law in arriving at an award; and
- Arbitration is voluntary and this is only at the time of entering the contract.

Disadvantages of Arbitration

The disadvantages of arbitration are:

- It can only be invoked where parties have agreed in writing to resolve any dispute arising through arbitration;
- It may be more expensive as opposed to litigation. Courts are partly financed by the public whereas arbitration is financed by the parties;
- There is potential for bias especially where one party may be at a more advantaged position than the other. Where the parties are not at equal bargaining and one party ends up influencing the appointment of the arbitrator in a way that is hard to detect;
- Where arbitration is purely on a question of the law, the arbitrator may be limited in knowledge of the law;

- There are no uniform and well settled rules of law that govern arbitration; and
- Arbitrators do not have powers to issue such orders as injunctions.

9.6 ALTERNATIVE DISPUTE RESOLUTION METHODS

This is any form of dispute resolution that is not litigation. It is based upon non-confrontation and meeting of the minds. It is a dispute resolution method that is gaining recognition. The main forms of Alternative Dispute Resolution (ADR) are:

Negotiation
This is dialogue between the parties to the dispute with intent to reach an agreement. Negotiation involves offers, counter offers and compromises. What is discussed during negotiation is done on a strictly without prejudice basis.

Mediation or Conciliation
This is where a neutral party is engaged by the parties as a mediator. His work is to propose or suggest constructive solutions and use persuasive language but he cannot make a determination.

Mini-trial or Structured Settlement
A neutral person sits as a chairman of a tribunal with representatives of each party. The representatives are people who are not connected with the dispute. They have authority to reach a compromise. They negotiate with each other with a view to settlement.

Expert Appraisal
Parties refer the dispute to an expert in that field to give an opinion. The opinion is not binding on the parties but may influence their approach to subsequent negotiations.

Advantages of ADR
The advantages of Alternative Dispute Resolution forms include:

- The proceedings take place in private as only parties the dispute or their representatives attend the forum;
- It is flexible since there are no rigid procedures, no court rules or statutes to comply with and there are no case law precedents to limit their decision;
- ADR is voluntary. The parties use ADR out of their own free will;
- It is faster. There is no time spent by lawyers in preparing and presenting their case the way it happens in litigation. Parties fix the time for hearing the disputes;
- It is less costly. This is due to enhanced speed and leads to savings in terms of advocates costs and interest;
- There is more control retained by the parties over the dispute resolution process;
- There is greater degree of trust and openness;

- The mediator might be a person with more commercial realities than a judge or a magistrate. He proposes suggestions which parties may not have envisaged;
- It helps in preserving business relationships and maintenance of the parties' reputation. This is because it is based on non-confrontation and meetings are conducted in private; and
- It makes substantial contribution to the more efficient use of judicial resources.

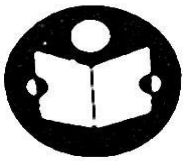
Disadvantages of ADR

The disadvantages of ADR are:

- Parties are not bound to resolve a dispute through ADR and the decisions they arrive at are not binding on the parties. They can withdraw from the negotiations at anytime during the proceedings;
- The decision of the mediator in not enforceable;
- Incomplete disclosure: The parties may not fully disclose all the facts and a wrong decision may therefore be arrived at;
- It is non-universal in application;
- Some remedies are not available in ADR;
- It does not apply precedents;
- It cannot be used where there is no real dispute; and
- It may be problematic to use ADR in cross border disputes where parties are from different territories/jurisdictions.

Find out other forms of ADR other than those explained above.

9.7 SUMMARY



From this lecture, you have learnt that:

- There are various disputes that arise in insurance operations. Majority of such disputes relate to the policies that insurers issue;
- There are three main methods used in the resolution of disputes which include litigation, arbitration and ADR;
- The litigation process commences with choosing the court and ends at the point of judgment or enforcement thereof;
- That each of the methods has advantages and disadvantages; and
- An insurer will use a method that is appropriate depending on the nature of the dispute.

9.8 ACTIVITIES

1. Explain the advantages of using litigation as a means of dispute resolution.
2. Describe the litigation process.
3. Describe five alternative dispute resolution methods.
4. Describe the litigation process
5. Explain the disadvantages of ADR.

9.9 FURTHER READINGS

1. **General Principles and Commercial Law in Kenya by Ashiq Hussain**
2. **General Principles of Law Simplified by N.A. Saleemi**
3. **Past Papers**

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LECTURE TEN

10.0 LEGAL CHALLENGES FACING THE INSURANCE OPERATIONS

LECTURE OUTLINE

10.1 INTRODUCTION

You have learned from lecture nine that disputes usually arise in insurance contracts. You have also examined the various dispute resolution methods available and the merits and demerits of each. You have also understood the processes of each method.

Welcome to lecture ten. In this lecture, you will learn about the various legal challenges that the insurance industry faces in their operations and some of the industry responses in addressing the challenges. May I assure you that at the end of this lecture, you will be able to understand the legal challenges facing insurance operations. Welcome and enjoy.

10.2 LEARNING OUTCOMES

By the end of this lecture, you should be able to:

a) Explain the legal challenges facing the insurance operations; and
b) Explain the industry response to the challenges.

Competence

The trainee should have the ability to identify the legal challenges facing the insurance operations and understand the responses by the industry.

Content

Let us now start by explaining the Legal challenges facing the insurance operations.

10.3 LEGAL CHALLENGES FACING THE INSURANCE OPERATIONS

The growth of the insurance industry in Kenya has generally been slow but steady. The insurance penetration is at three percent of the Gross Domestic Product (GDP). A number of factors can be attributed to this state of affairs. The factors may be cultural, social, economic, political and legal. In this lecture, we will only focus on challenges that are legal in nature. They are discussed below.

10.3.1 Insurance Fraud

What is insurance fraud?

It is any act committed with intent to deceive in order to obtain payment from an insurer. It is deceiving, concealing and misrepresenting information with intent to receive benefits from an insurer. The Insurance Regulations, 2015 defines Insurance Fraud to mean a deceptive act or omission intended to gain advantage for a party committing the fraud (the fraudster) or for other parties and may include:

- An exaggeration of an otherwise legitimate claim;
- Premeditated fabrication of a claim; or
- Fraudulent misrepresentation of material information with a possibility of a potential loss.

Insurance fraud is committed by persons within and outside the insurance companies. The exact extent of fraud cannot be determined as the act amounts to a crime and the standard of proof required is beyond reasonable doubt. In the absence of conclusive evidence, insurers opt to either pay such claims or repudiate them using other grounds.

Motivation to Commit Insurance Fraud

The factors that drive people to engage in criminal activities may not be different from those of insurance fraud. The fraud triangle has three aspects which are rationalisation, opportunity and incentive. The primary motivators of insurance fraud are:

- Financial gain;
- The high standard of proof;
- Chances of being discovered; and
- Lenient penalties.

Forms of Insurance Fraud

Insurance fraud may be committed in the following ways:

- Purchasing a policy with more than one company on the same subject matter and same interest;
- Deliberate damage to insured property. In motor insurance, this can be arranged by the owners, garages and assessors;

- Insuring non-existent properties and thereafter lodging fictitious claims;
- Insuring salvage vehicles;
- Inflating genuine claims;
- Repeat claims;
- Filing for injuries not related to the accident and claims by people not involved in the accident;
- Over-insurance;
- Faking death in life insurance;
- Taking out a life policy on the spouse with intent to kill and get the benefits;
- Concealing pre-existing conditions;
- Ineligible members receiving medical benefits by using the policyholder's name;
- Intentional/negligent non-disclosure of material facts by the insured for example on claims history; and
- Backdating of cover among others.

Effects of Insurance Fraud

The main effects of insurance fraud are:

- Increase in premiums;
- Increase in the cost of insurance operations;
- Delays in payment of claims;
- Loss of jobs;
- Insolvency and winding up of companies; and
- Loss of confidence by the insuring public.

10.3.2 High Court Awards

Some of the disputes that arise in insurance are resolved through litigation as discussed in lecture nine. It was explained that one of the disadvantages of using this mechanism is that it is expensive. A number of costs are associated with litigation for example legal fees and witness expenses among others. The awarding of damages is not standardized. All the costs arising from court cases are normally borne by the insurer. Again, in many instances, personal injury and death claims, the court awards are quiet high. Some of these awards cannot be sustained by the insurance industry in the long run.

10.3.3 Litigious Society

The word litigious is defined in the Oxford Dictionary to mean tending or too ready to take legal action to settle disputes. We live in a society that devotes a great focus to the possibility of 'suing' someone and the words 'I'll see you in court', are thrown around more frequently than they should be mainly after road accident claims. This was not the situation in the 1990s. There has been an ongoing suggestion so far that a litigious society is negative and problematic. Personal injury, death and third party property damage claims may be resolved through direct negotiation with insurers. Where parties opt for litigation, for insurers, this will lead to increased costs and other negative effects. Some of the reasons for increased litigation are:

- Increasing awareness by citizens of their rights. This has been possible due to advancement in technology, role of the media and the efforts by government to educate Kenyans of their rights;
- Ambulance chasing; which refers to lawyers who solicit for clients at disaster sites and encourages them to sue for damages; and
- Willingness by lawyers to offer pro bono (without charge) services as well as conditional fee agreements.

Effects of Increased Litigation

Some of the effects of increased litigation are:

- Increased cost of claims which may impact negatively on the insurers leading to liquidity problems;
- Negative perception about insurance by members of the public in instances where the claim is not paid for reasons beyond the control of insurers. For example where a case is statutory time barred because of negligence on the part of the lawyers;
- Delays in the judiciary that may be caused by the high no of cases in courts; and
- Outstretching of the judiciary resources.

10.3.4 Money Laundering

What is money laundering?

Money laundering involves concealing the source, identity, and destination of proceeds of crime. It is the process by which the criminals in possession of illegitimate money attempt to conceal the true origins and ownership of their wealth. It also relates to the transactions used to transform the proceeds from illicit activities into funds with an apparently legitimate source. The Proceeds of Crime and Anti Money Laundering Act (POCAMLA) No. 9 of 2009 defines money laundering as an offence in the following words; "Any person who knows or who ought to reasonably have known, enters into an agreement, engages in any arrangement or transaction, acquires, uses, transports, transmits or receives property that is part of the proceeds of crime or performs any other acts whose effect is to conceal source, location, disposition or movement commits an offence"

Stages in Money Laundering

There are three stages in money laundering which are:

Placement

This is inserting the proceeds into a legitimate financial system that is putting dirty money into the washing machine.

Layering

This is separating illicit proceeds from their source by creating complex layers of financial transactions designed to hamper audit trail, disguise origin of funds and provide anonymity to true owner. It is activating the washing machine.

Integration
This is placing laundered proceeds back into financial system in such a way as to appear to be legitimate business funds. Take out washed money and hang it to dry.

How Money Laundering may be Effected in Insurance
There are various ways in which money laundering may be effected in insurance. These are:

Life Policies
Illegal proceeds may be used to purchase life policies so that when it matures or is surrendered, funds become available to the policyholder or other beneficiary and such beneficiary may sometimes be changed possibly against payment before maturity or surrender in order that payments can be made by the insurer to a new beneficiary. These proceeds will look clean at the point of claim or surrender.

General Insurance
General insurance business may be vulnerable for money laundering through inflated and bogus claims for example by arson or other means causing fake claims to be made to recover part of the invested illegitimate claim.

Reinsurance
Proceeds of money laundering may be used by establishing fictitious (re)insurance companies and reinsurance intermediaries fronting arrangements and captives, or by misuse of normal reinsurance transactions which may include the deliberate placement via the insurer of the proceeds of crime with a reinsurance institution in order to disguise the source of funds.

Insurance Intermediaries
These are important channel of distribution and the link between the insurer and the customers may be used for money laundering by either failing to carry out due diligence or being established to facilitate illegal transactions.

Premium Financing
Premium financing by non regulated financial institutions can be used as an avenue for money laundering where the insured uses illegal funds to repay the premium loan with an intention of receiving clean funds upon occurrence of the risk and compensation by the insurer. The finances used for premium financing may also be from an illegal source and are being laundered by advancing loans to policyholders o r prospective policyholders.

Indicators of Money Laundering in Insurance
- A customer who usually purchases policies with low sums assured, suddenly requests one with a large sum assured;
- A customer who funds its policy using payments from a third party;
- Purchasing one or more single-premium investment-linked policies, then cashing them in as

short time later;

- Where the customer is more interested in learning about cancellation terms than about the benefits of the policy;
- Purchasing products that are inconsistent with the buyer's age, income, employment or history;
- A customer who wants to pay a large premium with foreign currency or by way of wire transfer.
- Paying a large top-up into an existing life insurance police;
- Purchasing a general insurance policy, then making a claim soon after;
- Purchasing an annuity with a lump sum rather than paying regular premiums over a period of time, particularly if the beneficiary is of an age which entitles him to receive the funds as soon after; and
- A client who accepts very unfavourable conditions unrelated to his or her health or age.

10.3.5 Regulatory Changes

Distrust of insurance by the public and potential policyholders has been a challenge for the insurance sector in Kenya. The insurance regulator has been prioritising building confidence and cleaning up after several insurers closed in recent years, due to poor governance and insufficient oversight. A number of regulatory changes to the sector, including a move towards risk-based capital, increased capital requirements, new guidelines for short-term business and Takaful rules have been introduced. The emphasis has been on tightening legislation and regulations to root out abuses. The new wave of regulatory changes is one of the risk currently facing the insurance industry**.**

The new rules relating to issues such as increased capital could swamp the industry with costs and compliance problems.

These new capital requirements may distract management from the more urgent task of running profitable businesses at a time when the industry is under stress. But there's a risk that by solely focusing on these recurring issues, insurers could miss other threats and opportunities coming up over the horizon. The industry faces transformational shifts in technology and customer expectations, which are reshaping how insurance is sold, how risk is priced and even what we mean by insurance. These developments could open the way for new entrants or other financial services players to move in and pick off the profitable business. Mergers and acquisitions being experienced are mainly as a result of these new changes. The insurance market is currently crowded and also characterised by high fragmentation, heavy competition and price undercutting. Consolidation of the market will be realised by the move towards risk-based compliance.

Find out other legal challenges other than those discussed above.

10.4 THE INDUSTRY RESPONSE TO THE CHALLENGES

The insurance industry players together with the Insurance Regulatory Authority (IRA) have taken various steps in addressing these challenges. Some of the actions taken include:

10.4.1 Establishment of the Insurance Fraud Investigation Unit

The mandate of this unit is to investigate and prosecute persons who engage in insurance fraud.

10.4.2 Regulatory Requirements for Insurers

The Insurance Regulations 2015 provides that every licensee (insurer) shall have in place a sound strategy approved by its board to manage fraud risks and financial crime arising out of its operations and which strategy shall be compatible with its risk profile and shall include:

- A clear mission statement to indicate the insurer‘s level of tolerance to financial crime and insurance fraud;
- The development of quantitative risk tolerance limits on financial crime and insurance fraud; and
- Provide direction to the overall financial crime and insurance fraud management plan.

10.4.3 Investigation of Claims

A high proportion of fraudulent cases are in liability claims. Insurers investigate cases using both internal and external investigators. Cases that also raise doubts or are suspicious are also investigated.

10.4.5 Mergers and Acquisitions

Mergers and Acquisitions essentially involves an equity transaction between companies; mergers involve the combination of two or more companies to form a single entity, while acquisitions involve the purchase of an equity stake in a company, be it minority or majority, by another. From a legal point of view, a merger is a legal consolidation of two entities into one entity, whereas an acquisition occurs when one entity takes ownership of another entity's stock, equity interests or assets. In this context, the cardinal equation follows that one plus one is greater than two, the rationale being the advantages of pulling together will lead to value creation for all stakeholders. As an aspect of strategic management, Mergers and Acquisitions can allow enterprises to grow, shrink, change the nature of their business or improve their competitive position.

The Kenyan insurance industry experienced a wave of mergers and acquisitions in 2014 as local insurance firms and financial services firms flexed their acquisition muscle in order to grow their revenues, consolidate their market share and expand regionally. Foreign insurance multinationals and international investors have been attracted to the Kenyan insurance market due to increased investor confidence arising from greater growth potential and stability in the sector.

Some of the mergers and acquisitions were as a result of the legal requirement that no one individual should own more than 25 percent of the share capital of an insurance company. In some cases, mergers and acquisitions resulted from foreign insurance multinationals establishing a foothold in Kenya with the aim of expanding to the rest of the East and Central African regions. Some of the mergers and acquisitions in Kenya are:

1. Saham Group of Morocco acquired a majority stake of 66.7 percent in Mercantile Insurance Company Ltd in April 2014.
2. Union Insurance of Mauritius acquired a controlling stake of 66.0 percent in Phoenix of East Africa Company Ltd in May 2014.
3. Prudential Plc, UK made a return to Kenya by wholly acquiring Shield Assurance Company Ltd in September 2014.
4. Metropolitan Insurance Group of South Africa acquired a majority stake in Cannon Assurance Ltd in November 2014.
5. Britam Investment Group acquired 99 percent of Real Insurance Company Ltd in December 2014.
6. Old Mutual Plc of South Africa acquired a majority stake of 60.7 percent in UAP Holdings Ltd in January 2015.

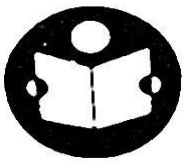
7. Pan Africa Insurance Holdings, a subsidiary of Sanlam Group of South Africa, acquired a 51 percent stake in Gateway Insurance Company Ltd in 2015.
8. Barclay Plc, Africa is set to acquire a controlling stake of 63.3 percent in First Assurance Company Ltd. The deal is yet to be completed.

Going forward, the Association of Kenya Insurers (AKI) predicts that more mergers and acquisitions are to be expected particularly in view of the proposed increase in minimum capital (Finance Bill, 2015).

Activity

Find out other legal challenges facing the insurance industry.

10.5 SUMMARY



From this lecture, you have learned that:

- That there are a number of legal challenges the affects operations of insurance some of which are; money laundering, insurance fraud and regulatory changes; and
- That the industry is taking steps to address the challenges. Among the responses by include the establishment of the Insurance Fraud Investigation Unit, Mergers and Acquistions, investigation of claims by insurers among others.

10.6 ACTIVITIES

1. Explain the challenges facing the insurance industry.
2. Describe the stages in money laundering.
3. List the indicators of insurance fraud.
4. Explain steps that the industry is taking to respond to the legal challenges.
5. Distinguish between a merger and an acquisition.

10.4
10.5

10.7 FURTHER READINGS

1. Insurance Regulations 2015
2. The Insurance Act Cap. 387 of the Law of Kenya
3. The Proceeds of Crime and Anti Money Laundering Act (POCAMLA) No. 9 of 2009
4. Past Papers

✓ (Include the APA format)