

LEGAL ASPECTS OF INSURANCE – CHAPTER THREE

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THE INSURANCE CONTRACT

Introduction

- 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/unconditionally **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.

Classification of Insurance Contracts

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

1. The nature of the event by which the sum assured becomes payable:

- ❖ **This classification is based on the event insured against and the contract assumes its identity from the event e.g. marine insurance, fire insurance, life assurance among others.**
- ❖ **It places emphasis on the homogeneity of the group.**

2. By the nature of the interest attached

This places insurance contracts into 3 categories;

- ❖ **Personal Insurance which include life, accident, fidelity etc.**
- ❖ **Property Insurance e.g. marine, fire, agriculture insurances**
- ❖ **Liability Insurance, these are policies taken out in compliance with statutory obligations e.g WIBA policies, Third Party motor insurance, NHIF.**

3. By the nature of the contract of Insurance

There are 2 contracts of insurance, namely indemnity and 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 indemnity for the actual loss sustained

📌 **Non-indemnity contracts:** The insured here secures the payment of a fixed sum of money previously determined as the value of the subject matter of Insurance. There is an assurance that the amount is payable in the event of attachment of the risk.

4. 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 e.g. 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

5. Whether the insurance is direct or re-insurance.

- ❖ Re-insurance takes place when an insurer who has already undertaken to indemnify the insured or pay the sum assured insures himself with a re-insurer.
- ❖ It is a 20th century practice which evolved to protect insured against the insolvency of insurers. Re-insurance may be voluntary or compulsory.
- ❖ An insurance company is free to re-insure itself to any extent.
- ❖ Re-insurance helps in the distribution and transfer of the economic process from company to another.
- ❖ Arguably, it also guarantees the meeting of losses in the event of the insolvency of an insurer.

Requirements for a valid insurance contract

1. Offer and acceptance

- ❖ An insurance contract will, therefore, come into existence once the offer made by one party is unconditionally accepted by the other.
- ❖ We need to distinguish between true offers and invitations to treat which are merely invitations to the other party to enter into negotiations.
- ❖ **An offer can be a filled proposal form, a premium quotation by an insurer and 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 in insurance

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

Offer

- ❖ In insurance contracts, the offer is made by the proposer by **completing the proposal form** and submitting the same to the insurer.
- ❖ The proposal form is standard and hence the terms of the contract are 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.

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:

Particulars of proposer

- ❑ **Risk(s) to be covered** – This includes events insured and duration of cover.
- **Circumstances affecting the risk** – This are matters peculiar to the subject matter eg perennial illnesses or weaknesses.
- **History of the subject matter whether** e.g. 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, a contractual relationship (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.

In the case of Julien Praet v H G Poland [1960] 111 P428

The judge stated that the typical motorist is an impatient person in the sense that having bought a car, he wishes to take and drive off it at once and he would not be willing to wait for the traditional steps to be taken.

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. If the document is comprehensive, he recovers on the basis of its terms and conditions. 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

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.

Acceptance by insurer in the following ways

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

2. 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.

3. 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.**

4. Acceptance of Premium

- ❖ **Acceptance & 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.**

5. Acceptance of the proposal form by the Insurer generally marks the end of the proposer's duty of disclosure.

Commencement of insurance cover

- ❖ Commencement of cover determines the time from which the subject matter is covered against the insured risks.
- ❖ In indemnity contracts, insurance was 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 delimits 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.

Case example : Cartright v Maccor

An insurance company issued a cover note to a motorist which showed the effective time and date of commencement at 11.45 am on December 2, 1959. The note further stated this cover note is valid for 15 days from the commencement date of risk. Under no circumstances in the time and date of commencement of risk to be prior to the actual time of issue of this cover note. In any event, the duration of this cover note shall not be more than 15 days from the date of commencement of Ins. Stated herein. The Motorist was involved in an accident at 5.45pm on December 17, 1959.

Issue: Was the Insurer liable?

Held: Insurer was held liable

The decision on the above case is justified on various grounds:

- 📌 On the Constructive of the cover act. That the Insurance cover did not commence until the midnight of Dec 2nd, 1959 and hence the policy was in force when the risk attached.**
- 📌 The Ins. Company in this case had not communicated its acceptance/rejection of the proposal form and arguably therefore the cover note was in force.**
- 📌 At common law, in the absence of express stipulation, the first day is usually ignored in the computation of Insurance.**

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. Consideration

- ❖ **As explained in lecture two, a promise is not legally binding unless it is supported by consideration, i.e. 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.**

The insurance 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**
- ❖ **the premium collected by an agent or a cheque received by him shall be deposited with or dispatched to the insurer immediately upon receipt**

CASE LAW

Insurance Company of East Africa vs. Marwa Distributors (2015)

- The insurance company rejected to pay a money claim made by the insured on the ground that the contract was not supported by consideration and the insured moved to court to seek legal redress.
- The magistrates' Court held that absence of premium does not invalidate a contract. However on appeal by the insurer, the High Court ruled that the contract was invalid for want of payment of premium.
- The court also established a principle to the effect that a company cannot cancel a policy that has not been consummated through payment of premium.

Return of premiums in insurance

- ❖ **Once the risk starts to run, the insured is not entitled to any return of premium if the contract is 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:

- 📄 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*;
- 📄 the policy may be void because there is no insurable interest
- 📄 the policy may be avoided *ab initio* 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.

Cancellation clause

- ❖ 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 attached to and forming part of the policy provides for this.

4 Form

- ❖ 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 well happen before the policy is prepared.
- ❖ There are a few exceptional cases of insurance contracts where some formality is required.
- ❖ 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.**
- ❖ **The law also requires some policies to be supported by some written evidence and an example is motor insurance, whereby Section 7 of Cap. 405 provide that a policy of insurance is of no effect unless and until a certificate of insurance is delivered to the policyholder.**
- ❖ **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.**

5 Contractual Capacity

You recall from the last chapter that certain categories of persons have limited capacity.

What is their position if they purchase an insurance policy?

Effects of a contract with a minor

- ❖ **An insurer who grants cover to a minor is fully liable to meet all valid claims under the policy.**
- ❖ **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 or patient 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.**

Case example

Imperial Life Insurance Co. of Canada v. Audett (1912), where 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._

Contractual capacity of insurers

❖ **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.**

An insurer may lack contractual capacity if they are

- **not licenced by the regulator,**
- **not authorised to underwrite a given class of insurance and**
- **if it is not incorporated as per the requirements of the company law.**

Terms in insurance contracts

- ❖ **As explained in the last lecture, terms are detailed provisions in contracts that details the rights and obligations of the parties.**
- ❖ **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 meaning breach of terms 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 to 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 and that 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 made by the insured relating to facts or to something which they agree to do.**
- ❖ **These are the most important terms in an insurance contract and bring about the most drastic effects if they are broken.**
- ❖ **In lecture two, under general law of contract, a warranty is a minor term.**
- ❖ **A warranty 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.**

Case example

In *Bank of Nova Scotia v. Hellenic Mutual War Risks Association (Bermuda) Ltd (The Good Luck)* (1992) the House of Lords held that a breach of warranty terminated cover automatically from the date of breach and, to all intents and purposes, terminated the insurance policy.




Silver Automobile Ltd v. Fidelity Shield Insurance

For breach of warranty to affect validity of a contract:

- It must be an express term in the policy;
- The insured must have signed a proposal form containing a question relating to the warranty;
- The provision on the warranty must be clear and unambiguous;
- It must be exactly complied with; and

Non-compliance absolves the insurer from liability.

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.

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 for example the warranty may provide:

- that no inflammable oils may be stored;

- ❖ **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**
- ❖ **Warranties may be expressly stated in the policy for example watchman warranty in theft insurance, Safe and books clause 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 carries 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**

Conditions

- ❖ **A condition is an obligation imposed on the insured and carries consequences for non-compliance.**
- ❖ **Conditions in insurance contracts can be express or 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:** If a condition precedent is never 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 subsequent to the contract**
- ❖ **Condition precedent to liability:** The insurers may avoid the particular claim. The policy as a whole is not avoided and remains in force.

Void insurance contracts

- 📋 **Where there is a fundamental mistake**
- 📋 **Lack of insurable interest**
- 📋 **Unlawful use of the subject matter of insurance**
- 📋 **Purpose of the contract is illegal**

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:**
 - **statutory rules (i.e. rules laid down in legislation); and**
 - **common law rules (i.e. rules developed by the courts).**

Common law rules

1. Ordinary meaning

This is, essentially, the same 'literal rule' that applies to the interpretation of statutes. 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

2. Importance of context

A. Noscitur a sociis rule:

- ❖ 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.
- ❖ There are a number of detailed rules concerning context.
- ❖ 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.

b. 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.**

c. 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**

Contra preferentem

- ❖ 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 proferentem 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.

Case example

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.

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 contract) 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 1906 carries into every contract of marine insurance.

Technical meaning

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.

Insurance policies also 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.

Case example

In the leading 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

Precedent

Once one court has considered the meaning of a word then 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 (though not absolutely precise) meaning when used in insurance policies, as a result of a series of court decisions.

DISCHARGE/TERMINATION OF INSURANCE CONTRACTS

An Insurance contract may come to an end or terminate in any of the following ways:

Discharge by performance

By the Insured: by payment of agreed premiums and observing terms and duties under the policy.

By the Insurer: By bearing certain 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 non-indemnity contracts, payment of the sum assured on death or maturity terminates the contract.**
- ❖ **Re-instatement 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 (e.g. under fire insurance) unless reinstated by payment of an extra premium**




2 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 refundable portion is computed on pro-rata basis. In life Insurance, the insured is entitled to the surrender value of the policy.**
- ❖ **However Section 89 of Insurance Act if provides that if the insured surrenders a policy to the insurer, he is entitled to a partial reimbursement of of the total premiums paid provided he had been a bone fide insured for at least 3 Years.**

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 three) also voids the contract.**

Note that breach may occur in the following circumstances:

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

4 Operation of Law

An Insurance Contract terminates if circumstances make its sustenance impossible e.g. winding up of the insurer or transfer of the subject matter.

5 Frustration

- ❖ **This applies in theory but practically is not of much importance e.g. if the subject matter of insurance is destroyed (there is an implied condition that subject matter exists), this leads to termination of the contract.**
- ❖ **There is no refund of insurance premiums if the risk was already running at the time of loss.**

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 e.g. under employer's liability cover, where illness may be diagnosed much later.

Assignment in insurance

1. Assignment 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 into 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.**

2. Assignment 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 e.g. proceeds from a valid claim and there is no change 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 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 i.e. cover is granted subject to some extent based on the insured's personal characteristics e.g. nature of the person.**
- ❖ **However, there are certain contracts of insurance which by their nature are freely assignable.**

1. 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 cash value once a number of premiums have been paid.
- ❖ The insured therefore has a useful and valuable piece of property which may be transferred to another or be used as security.
- ❖ They 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

Types of Assignment

1. Equitable assignment:

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

2. Statutory assignment: The Insurance Act Cap.487 of the laws of Kenya governs assignment of life policies.

Thus the assignment of these policies must be done in accordance with the provisions of the Insurance Act.

Requirements for assignment of a policy of life assurance

- ❏ 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.

3. Assignment of insurance policies by operation of the law: On death or bankruptcy of the life assured, his rights under the policy pass on to the personal representative or trustee in bankruptcy which in the lecture two was referred to as involuntary assignment.

Remedies for breach of an insurance contract

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.

2. Damages

- ❖ **Damages refer to the financial compensation awarded by court 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.**

3 Specific Performance

- ❖ **This is an equitable remedy where the court orders a party do something they are obliged to do under the contract i.e. contractual obligation.**
- ❖ **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 will only be granted when damages are an inadequate remedy.**
- ❖ **The prime example is that of contract for the sale of land.**

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.**

It will not be granted where:

- **damages would be an adequate remedy e.g. 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 e.g. if the cost of performing; is out of all proportion to the benefit to the plaintiff;**
- **where supervision would be required for performance of the contract;**
- **the contract was not supported by consideration (even if it had been under seal);**

It is not a common remedy in insurance cases.

4. Retention of premium

- ❖ You may now also recall that money paid under an illegal contract cannot be recovered in court provided the parties are '*in pari delicto*' (equal in wrongdoing).
- ❖ However, the insurance was held void for lack of insurable interest because the mother had no legal obligation to keep house for her son and he, in turn, had no legal obligation to bury her when she died.
- ❖ The result was that he could not recover his premiums. Insurers also have the right to retain premiums in case of fraudulent misrepresentation by the insured.

5. Injunctions

- ❖ This is another equitable remedy whereby the court issues an order barring the other party from acting in some way.
- ❖ It is usual for contracts with negative undertakings e.g. contract to set up a rival business.
- ❖ Injunctions may be *prohibitory* where they restrain the defendant from doing something or *mandatory* where they compel one to act in a stated way. An injunction is not automatically available but is issued at the discretion of the court.
- ❖ But it will not be awarded when damages would be sufficient compensation to the plaintiff.

6. Quantum merit

- ❖ **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 merit 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**

7. 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.**