

CHAPTER NINE

PRINCIPLES OF INSURANCE: PART ONE

9.0 Introduction

This chapter covers the various aspects of General Insurance such as Principles of utmost Good faith material fact Principle of Insurable Insures and Principle of Indemnity with its corollaries.

General Insurance comprises of insurance of property against fire, burglary etc, personal insurance such as Accident and Health Insurance, and liability insurance which covers legal liabilities. Suitable general Insurance covers are necessary for every family. It is important to protect one's property, which one might have acquired from one's hard earned income. Losses created to catastrophes such as the tsunami, earthquakes, cyclones etc. have left many homeless and penniless. Such losses can be devastating but insurance could help mitigate them. Property can be covered, so also the people against Personal Accident. A Health Insurance policy can provide financial relief to a person undergoing medical treatment whether due to a disease or an injury.

9.1 Nature of the Principle of Utmost Good Faith

Both the parties to a commercial contract are by law required to observe good faith. Let us say that you go to a shop to buy an electrical appliance. You simply will not enter, pay and pick up any sample piece but will check two, three or even more pieces. You may be even ask the shopkeeper to give a demonstration to ensure that it is in working condition and also ask several questions to satisfy yourself about what you are buying. Then when you go home you find it does not work or is not what you were looking for exactly so you decide to return the item but the shopkeeper may well refuse to take it back saying that before purchasing you had satisfied yourself; and he is possibly right. The common law principle "Caveat Emptor" or let the buyer beware is applicable to commercial contracts and the buyer must satisfy himself that the contract is good because he has no legal redress later on if he has made a bad bargain. The seller cannot misrepresent the item he has sold or deceive the buyer by giving wrong or misleading information but he is under no obligation to disclose all the information to the buyer and only selective information in reply to the buyers queries is required to be given. But in Insurance contracts the principles of "Uberrima fides" i.e. of Utmost Good Faith is observed and simple good faith is not enough. Why this difference in Insurance contracts?

Firstly, in Insurance contracts the seller is the insurer and he have no knowledge about the property to be insured. The proposer on the other hand knows or is supposed to know everything about the property. The condition is reverse of ordinary commercial contracts and the seller is entirely dependent upon the buyer to provide the information about the property and hence the need for Utmost Good Faith on the part of the proposer.

It may be said here that the insurer has the option of getting the subject matter of Insurance examined before covering the risk. This is true that he can conduct an examination in the case of a property being insured for fire risk or of getting a medical examination done in the case of a health policy. But even then, there will be facts which only the insured can know e.g., the history of Insurance of the property whether it has been refused earlier for Insurance by another company or whether it is also already insured with another company and the previous claim experience. Similarly, a medical examination may not reveal the previous history i.e. details of past illness, accidents etc. Therefore, Insurance contracts insist on the practice of Utmost Good Faith on the part of the Insured.

Secondly, Insurance is an intangible product. It cannot be seen or felt. It is simply a promise on the part of Insurer to make good the loss incurred by the Insured if and when it occurs.

Thus, the Insurer is also obliged to practice Utmost Good Faith in his dealings with the Insured. He cannot and should not make false promises during negotiations.

He should not withhold information from the Insured such as the discounts available for good features e.g., fire extinguishing Appliances discount in fire policies or that Earthquake risk is not covered under the standard fire policy but can be covered on payment of additional premium.

In the recent Earthquake disaster in Gujarat a number of Insured failed to get any relief from Insurance Companies as Earthquake risk was not covered.

Utmost Good Faith can be defined as "*A positive duty to voluntarily disclose, accurately and fully all facts material to the risk being proposed whether requested for or not*".

In Insurance contracts Utmost Good Faith means that "*each party to the proposed contract is legally obliged to disclose to the other all information which can influence the others decision to enter the contract*".

The following can be inferred from the above two definitions:

- (1) Each party is required to tell the other, the truth, the whole truth and nothing but the truth.
- (2) Unlike normal contract such an obligation is not limited to any questions asked and
- (3) Failure to reveal information even if not asked for gives the aggrieved party the right to regard the contract as void.

9.2 What is a Material Fact?

Material fact is every circumstance or information, which would influence the judgement of a prudent insurer in assessing the risk.

Or

Those circumstances which influence the insurer decision to accept or refuse the risk or which effect the fixing of the premium or the terms and conditions of the contract must be disclosed.

9.3 Facts, Which Must Be Disclosed

- i. Facts, which show that a risk represents a greater exposure than would be expected from its nature e.g., the fact that a part of the building is being used for storage of inflammable materials.
- ii. External factors that make the risk greater than normal e.g. the building is located next to a warehouse storing explosive material.
- iii. Facts, which would make the amount of loss greater than that normally expected e.g. there is no segregation of hazardous goods from non-hazardous goods in the storage facility.
- iv. History of Insurance (a) Details of previous losses and claims (b) if any other Insurance Company has earlier declined to insure the property and the special condition imposed by the other insurers; if any.
- v. The existence of other insurances
- vi. Full facts relating to the description of the subject matter of Insurance

Some examples of Material facts are;

- (a) In Fire Insurance: The construction of the building, the nature of its use i.e. whether it is of concrete or Kucha having thatched roofing and whether it is being used for residential purposes or as a go down, whether firefighting equipment is available or not.
- (b) In Motor Insurance: The type of vehicle, the purpose of its use, its age (Model), Cubic capacity and the fact that the driver has a consistently bad driving record.
- (c) In Marine Insurance: Type of packing, mode of carriage, name of carrier, nature of goods, the route.
- (d) In Personal Accident Insurance: Age, height, weight, occupation, previous medical history if it is likely to increase the chance of an accident, Bad habits such as drinking etc.
- (e) Burglary Insurance: Nature of stock, value of stock, type of security precautions taken.

9.4 Facts, Which Need Not Be Disclosed

- a. *Facts of Law:*** Everyone is deemed to know the law. Overloading of goods carrying vehicles is legally banned. The transporter cannot take excuse that he was not aware of this provision.
- b. *Facts which lessen the Risk:*** The existence of a good firefighting system in the building.
- c. *Facts of Common Knowledge:*** The insurer is expected to know the areas of strife and areas susceptible to riots and of the process followed in a particular trade or Industry.
- d. Facts which could be reasonably discovered:** For e.g. the previous history of claims which the Insurer is supposed to have in his record.
- e. *Facts which the insurers representative fails to notice:*** In burglary and fire Insurance it is often the practice of Insurance companies to depute surveyors to inspect the premises and in case the surveyor fails to notice hazardous features and provided the details are not withheld by the Insured or concealed by him them the Insured cannot be penalized.
- f. *Facts covered by policy condition:*** Warranties applied to Insurance policies i.e. there is a warranty that a watchman be deployed during night hours then this circumstance need not be disclosed.

9.5 Duration of Duty of Disclosure

The duty of disclosure remains in force throughout the entire negotiation stage and till the contract is finalized. Once the contract is finalized then the contract is subject to ordinary simple good faith. However, when an alteration is to be made in an existing contract then this duty of full disclosure recovers in respect of the proposed alteration.

The duty of disclosure also revives at the time of renewal of contract since legally renewal is regarded as a fresh contract.

For example: a landlord at the time of proposal has disclosed that the building is rented out and is being used as an office. If during the continuation of the policy the tenants vacate the building and the landlord subsequently rents it out to a person using it as a go down then he is required to disclose this fact to the Insurer as this is a change in material facts and effects the risks.

(Note: Please note that in long term Insurance Business the Insurer is obliged to accept the renewal premium if the Insured wishes to continue the contract and there is no duty of disclosure operating at the time of renewal. Normally Insurer arranges inspection on each renewal.)

9.6 Breaches of Utmost Good Faith

Breaches of Utmost Good Faith occur in either of 2 ways.

(1) *Misrepresentation*, which again may be either innocent or intentional. If intentional then they are fraudulent

(2) *Non-Disclosure*, which may be innocent or fraudulent. If fraudulent then it is called concealment.

9.6.1 Misrepresentation

This occurs when a person states a fact in the belief or expectation that it is right but it turns out to be wrong. While taking out a Marine Insurance Policy the owner states that the ship will leave on a specific date but in fact the ship leaves on a different date.

Intentional: Deliberate misrepresentation arises when the proposer intentionally distorts the known information to defraud the insurer. The selfish objective is somehow to enter the contract or to get a reduction in the premium e.g., If an applicant for motor Insurance stated that no one under 18 would drive the vehicle when in fact his 17 years old son drives frequently. Such a misrepresentation would be material as it would affect the decision of the insurer.

9.6.2 Non-Disclosure

Innocent: This arises when a person is not aware of the facts or when even though being aware of fact does not appreciate its significance e.g.

A proposer at the time of effecting the contract has undetected cancer therefore does not disclose it or

A proposer had suffered from Rheumatic fever in his childhood but he does not disclose this not knowing that people who have this are susceptible to heart diseases at a later age.

Deliberate: This is done with a deliberate intention to defraud the insurer entering into a contract, which he would not have done had he been aware of that fact.

A proposer for fire Insurance hides the fact knowingly by not disclosing that he has an outhouse next to his building, which is used as a store for highly inflammable material.

9.6.3 How to Deal with Breaches

How breaches are dealt with depends upon whether the breaches are

- (1) Innocent
- (2) Deliberate
- (3) Material to the risk
- (4) Immaterial to the risk

When Breach of Utmost Good Faith occurs, the aggrieved party gets the right to avoid the contract. The contract does not become automatically void and it must decide on the course to be taken. The options available are on case-to-case basis like: -

- 1) The contract becomes void from the very beginning if deliberate misrepresentation or non-disclosure is resorted to with the intention of misleading the insurer to enter into a contract.
- 2) To consider the contract void, the bereaved party, must notify the offending party that breach has been noticed and as per the conditions of the contract he is no longer governed with the terms of the contract agreed upon in covering the risk. In case the breach is discovered at the time of claim he will refuse to honour his promise and will not pay the claim. This again occurs when there has been a deliberate breach.
- 3) When the breach is innocent but it is material to the fact then the insurer may impose a penalty in the form of additional Premium.
- 4) Where the breach is found to be innocent and is not material the insurer can choose to ignore the breach or waive off the breach.