



Research Paper

Nature of Insurance Contracts

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ABSTRACT: In this article, the author delves into the nature of an insurance contract. He argues that an insurance contract is different from the general contract. This article relies on judicial precedents and scholarly works to emphasise this view.

KEYWORDS: adhesion, duty of disclosure, misrepresentation, agency

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I. INTRODUCTION

A contract is an agreement enforceable by law¹. It entails an unconditional undertaking by parties to the contract (the promisor and promisee) to fulfil their respective obligations. Such an unconditional contract is known as an **absolute** contract.

There exists another form of contract which is not absolute in nature. The performance this contract is hinged on the happening of a specified event. ²Such a contract is known as a **contingent** contract. Contracts of **indemnity** and **guarantee** fall under this category. A **contract of indemnity** is defined as- “A contract by which one party promises to save the other from loss caused to him by the conduct of the promisor himself, or by the conduct of any other person, is called a contract of indemnity. ”³ The English law definition of a contract of indemnity is – “it is a promise to save a person harmless from the consequences of an act”⁴. Thus it includes within its ambit losses caused not merely by human agency but also those caused by accident or fire or other natural calamities.

Every contract of insurance, other than life insurance, is a contract of indemnity[GajananMoreshwar v. Moreshwar Madan].⁵Therefore, an insurance contract is a legally binding agreement between an insurance company(indemnifier) and the insured (indemnity holder). The indemnifier promises to save the indemnity holder in case he suffers loss resulting from the causes enclosed in the insurance contract. The insurance company has different types of policies with varying prescriptions. An applicant is required to choose the most suitable policy to his needs. Normally, the applicant narrates to the agent of the insurance company the person or thing which he intends to cover. The agent then finds the relevant policy that fits the needs of the applicant.

There are different types of insurance contracts. They include;

1. Marine insurance
2. Aviation insurance
3. Automobile insurance
4. Aviation insurance
5. Fire insurance
6. Life insurance
7. Health insurance

Insurance contracts are not limited to the above category, there are also insurance contracts which are categorized according to the extent of the insurance cover. It can be specific or comprehensive et cetera.

¹ The Indian Contract Act, 1872

² Section 31 of the Indian Contract Act, 1872

³ Section 124 of the Indian Contract Act, 1872

⁵GajananMoreshwar v. MoreshwarMadan AIR 1942 BOM 302

II. UNIQUE CHARACTERISTICS OF INSURANCE CONTRACTS

An insurance, is a contract between an insurance company (insurer) and a client (the insured). The rule of strict construction is the hall mark of a contract of adhesion of which insurance is the classic example.⁶ It is drawn by the insurance company and the insured has little choice but agree to the terms.⁷

a. Absence of liberty of contract

An insurance company is entitled to have the terms of its contract enforced.⁸ Terms of an insurance policy are already made by underwriters- Prof. Woodruff in the second edition of his casebook on insurance in 1924, “What do they know of law of insurance?”⁹ Therefore, legislatures and courts have taken keen interest to ensure the interest of the insured public are protected.¹⁰ The approach of the above arms of government is to regulate the insurance companies by limiting the insurance premiums.¹²

In **GermanAllianceCo. V. Lewis**, the legislature of the state of Kansas passed Act which empowered the Superintendent of insurance to limit the maximum amount for fire insurance premiums. The aforesaid law was challenged in various courts until it reached the apex court. The Supreme court of United States of America upheld the decision of the state legislature.¹³

b. Duty of disclosure

The duty of disclosure is a key component of the English insurance law.¹⁴ The principle was first mentioned in the verdict of the Court of Appeal in **Joel v. Law Union Insurance Company**.¹⁶ Applying the principle of **uberrimafides**, the court bestowed a duty of disclosure on an insured. In other cases also, the courts upheld the insured’s duty of disclosure.¹⁷ According to the opinion of the law commission, the extent of the duty of the applicant should be limited to those facts which a reasonable man would think material to the insurance contract.¹⁹

It is not only the insured who owes the duty of disclosure, **LordMansfield** in (**Carter v. Boehm**)²⁰ emphasised that the insurer too has to discharge his duty of disclosure. In another case, **Justice Pain** established the insurer’s duty of disclosure in **Horry v. Tate & Lyle Refineries Ltd.**²¹ The insurer ought to have disclosed to the insured that the sum offered to the insured to settle his claim for injury was on the lowest side. Above all, it should have been disclosed to the insured that if he accepted the offer, he wouldn’t have an opportunity to raise the matter again.

While the principle of **uberrimafides** at the centre of a contract of insurance, the principle of **caveat emptor** is at the heart of other contracts. This means that in an insurance contract there is a duty of disclosure but in other contracts, for instance a buyer is cautioned to perform an extensive check before consenting to purchase goods because the seller owes him no duty of disclosure.

c. Misrepresentation

Misrepresentation in a contract of insurance is different from the general law of contracts.²² Rather than relying on materiality, insurers relied on “the basis of the contract to establish misrepresentation.”²³ This gave

⁶ Patterson, in *The Delivery of A Life-Insurance Policy*, 33 HARV. L. REV. 198, 222 (1919)

⁷ Ibid

⁸ *Drilling v. New York Life Ins. Co.*, 234 N. Y. 234, 241, 137 N. E. 314, 316 (1922).

⁹ Selection of cases on the law of insurance 2nd edition, 1924

¹⁰ *Whitfield v. Aetna Life Co. of Hartford*, 205 U.S. 895 (1907)

¹¹ *New York Life Insurance Co. v. Deer Lodge County*, 231 U.S. 495 (1913)

¹² *The Modern Law Review* volume 47 september 1984 No.5

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¹³ *German Alliance Co. V. Lewis* 233 U.S. 389 (1914)

¹⁴ *Treitel’s Law of Contract*, (6th edition, 1983) pp. 304-306

¹⁵ *Atiyah’s introduction to the law of contract*, (3rd edition, 1981) pp. 216-223

¹⁶ (1908) 2 K.B.863 (C.A)

¹⁷ *Bates v. Hewitt* (1867) L.R.2 Q.B 595

¹⁸ *London Assurance v. Mansel* (1879)11 Ch.D. 363

¹⁹ The report of the English law commission on Insurance Law: Non-Disclosure and Breach of Warranty, cmnd.8064(1980)

²⁰ (1766) 3 Burr. 1905

²¹ (1982) 2 Lloyd’s Rep. 416

²² *The Modern Law Review* volume 47 september 1984 No.5

insurers a leeway to void contracts without considering whether such misrepresentation is material to the insurance contracts. Although **Lord Greene M. R** denounced such practice in 1942,²⁴ it is still in vogue today. Judicial precedent outlines a divergent interpretation as to what constitutes misrepresentation in general contracts and insurance contracts. For instance, in **Dimmock v. Hallet**²⁵ a land which was abandoned due to its unproductivity was described as “very fertile and improvable” by the seller. The court held that the above statement was not a misrepresentation but a mere commendation. Therefore, in general contracts, mere statements do not amount to misrepresentation.

Contrary to general contracts, statements in contracts of insurance even if they concern health of a person or value of property are vital in establishing misrepresentation. If such statements are found to be incorrect, they entitle the insurer to avoid the policy as held in **Thompson v. Weems**²⁶ and **West v. National Union and Accident Insurance Co.**²⁷

d. Agency

In general contracts, the principal is held liable for the acts of the agent in the course of his employment. However, this is not always the case in insurance contracts as outlined in **Newsholme Road Transport General Insurance**.²⁸ An applicant gave a statement of replies to the questions in the contract application form. The agent noted down the replies in the application form although he knew the statements of the applicant weren't true. The applicant contended that although his statement was untrue, the agent of the insurance company too knew this fact but still wrote the statement therefore he acted on behalf of the principal (the insurance company). In his decision **Scrutton L.J** remarked that the act of the agent writing down the communication from the applicant wasn't on behalf of the insurance company but the applicant. Further, the applicant ought to have read the statement carefully before signing that the statement was nothing else but the truth.²⁹

In **Re Hooley Hill Rubber Co.**,³⁰ it was held that an insurance company cannot be held liable for statements made by agents which aren't part of existing facts of such insurance companies. The contention was that during negotiations of the insurance contract, the agent was asked whether the policy covered damage caused by an explosion following a fire to which the agent replied in affirmative. Thereafter applicant agreed to contract. After sometime, the factory of the insured was damaged by an explosion resulting from a fire. When he filed a claim to be indemnified for the damage caused, the insurance company contended that it doesn't cover damage caused by an explosion following a fire. **Bailhache J** in his decision remarked that the statement of the agent was not within the existing facts of the insurance company. Therefore, the insured wasn't entitled to his claim.³¹

e. Ability of minor to contract

In **Rousseau v. Norton**,³² a minor entered into a contract to insure his life without the consent of any of his parents. The minor borrowed the premium amount from an attorney who later sued him for failure to return the money lent. The court examined the insurance contract and remarked that considering his age, the contract was burdensome on the minor and he wasn't bound to pay the money lent. However, it did not void the insurance contract entered by the minor.

In **Halima Abdinoor Hassan & Ors v. Corporate Insurance Company Limited**,³³ the Kenyan court held that; “In law a minor may not have the capacity to enter into a contract but he can do so through legal guardians or trustees.”

In the above case, the father insured his aeroplane in the name of his minor daughter. When the daughter had attained age of maturity, the plane crashed thereby killing her father. The insurer refused to indemnify the daughter contending that the contract was void **abinitio**.

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²³ Hasson on “The Basis of Contract Clause in Insurance Law” (1971) 34 M.L.R.29

²⁴ In *Zurich Insurance Co. V. Morrison* (1942) 1 All E.R. 529,537 (C.A.)

²⁵ (1866) 2 Ch. App. 21.

²⁶ (1884) 9 App. Cas. 671

²⁷ (1954) 2 Lloyd's Rep. 461

²⁸ (1929) K.B.356.

²⁹ *Newsholme Road Transport General Insurance* (1929) K.B.356

³⁰ (1920) K.B. 257.

³¹ Court of Appeal upheld the decision in (1920) 1.K.B.264

³² ((1908)18 CTR 621),

³³ (2015) e KLR

The learned judge in his decision remarked that he couldn't understand why the insurer continued to receive payments for premium of the insurance if he knew that the insured was a minor. His Lordship referred to Halsbury's laws of England fourth edition volume 16 paragraph 1609 which details that:
"Thus the acceptance of premiums with the knowledge of circumstances entitling the insurer to avoid the policy stops him from averring that for that reason it is not a valid policy."³⁴

III. CONCLUSION

In conclusion, the scholarly articles, books, papers and judicial precedents clearly establish that an insurance possesses peculiar characteristics. Therefore, it can not be grouped in the same category with a general contract. The legislature, courts of law and legal scholars should take this into consideration when enacting law, interpreting statutes and when commenting on insurance contracts or relevant statutes.

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³⁴ Halsbury's laws of England fourth edition volume 16 paragraph 1609