

# **R.M.M. Law College, Saharsa**

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**L.L.B Part-2<sup>nd</sup>**

**Subject-Insurance Law**

**Paper-8<sup>th</sup>**

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## **Topic-Essential elements of an Insurance Contract**

Insurance may be defined as a contract between two parties whereby one party called insurer undertakes, in exchange for a fixed sum called premiums, to pay the other party called insured a fixed amount of money on the happening of a certain event.

The insurance, thus, is a contract whereby

1. Certain sum. called premium, is charged in consideration
2. Against the said consideration, a large sum is guaranteed to be paid by the insurer who received the premium
3. The payment will be made in a certain definite sum. I.e., I lose or the policy amount whichever may be, and
4. The payment is made only upon a contingency

Since Insurance is a contract, certain sections of the Contract Act are applicable.

All agreements are contracts if they are made by the free consent of the parties, competent to contract, for a lawful consideration and with a lawful object and which are not hereby declared to be void.

Elements of Insurance Contract can be classified into two sections;

1. The elements of general contract and
2. The elements of special contract relating to insurance: the special contract of insurance involves principles: insurable interest, utmost good faith, indemnity, subrogation, warranties. Proximate cause, assignment, and nomination, the return of premium.

## **Elements of Insurance Contract**

This Act says that all agreements are the contract if they are made by the free consent of the parties, competent to contract, for a lawful consideration and with a lawful object and which are not at this moment declared to be void”.

The insurance contract involves—(A) the elements of the general contract, and (B) the element of special contract relating to insurance.

The special contract of insurance involves principles:

1. Insurable Interest.
2. Utmost Good Faith.
3. Indemnity.
4. Subrogation.
5. Warranties.
6. Proximate Cause.
7. Assignment and Nomination.
8. Return of Premium.

So, in total, there are eight elements of the insurance contract which are discussed below:

## **General Contract**

The valid contract, according to Section 10 of the Indian Contract Act 1872, must have the following essentialities;

1. Agreement (offer and acceptance),
2. Legal consideration,
3. Competent to make a contract,
4. Free consent,
5. Legal object.

## **Offer and Acceptance**

The offer for entering into the contract may come from the insured.

The insurer may also propose to make the contract. Whether the offer is from the side of an insurer or the side of the insured, the main fact is acceptance. Any act that precedes it is the offer or a counter-offer. All that preceded the offerer counter-offer is an invitation to offer.

In insurance, the publication of the prospectus, the canvassing of the agents are invitations to offer.

When the prospect (the potential policy-holder) proposes to enter the contract, it is an offer and if there is any alteration in the offer that would be a counter-offer.

If this alteration or change (counter-offer) is accepted by the proposer, it would be acceptable.

In the absence of a counter-offer, the acceptance of the offer will be an acceptance by the insurer. At the moment, the notice of acceptance is given to another party; it would be a valid acceptance.

## **Legal Consideration**

The promise to pay a fixed sum at a given contingency is the insurer who must have some return or his promise. It need not be money only, but it must be valuable.

It may be summed, right, interest, profit or benefit Premium being the valuable consideration must be given for starting the insurance contract.

The amount of premium is not important to begin the contract. The fact is that without payment of premium, the insurance contract cannot start.

## **Competent to make the contract**

Every person is competent to contract;

1. Who is of an age of majority according to the law,
2. Who is of sound mind, and
3. Who is not disqualified from contracting by any law to which he is subject?

A minor is not competent to contract. A contract by a minor is void excepting contracts for necessities. A minor cannot sign a contract.

A person is said to be of sound mind to make a contract if, at the time when he makes it, he is capable of understanding it and of forming a rational judgment as to its effect upon his interests.

A person who is usually of unsound mind, but, occasionally of sound mind may .make a contract when he is of sound mind. Alien energy, an undischarged insolvent and criminals cannot agree. A contract made by an incompetent party/parties will be void.

## **Free Consent**

Parties entering into the contract should enter into it by their free consent.

The consent will be free when it is not caused by—

- (1) coercion,
- (2) undue influence,
- (3) fraud, or
- (4) misrepresentation, or
- (5) mistake.

When there is no free consent except fraud, the contract becomes voidable at the option of the party whose consent was so caused. In the case of fraud, the contract would be void.

The proposal for free consent must sign a declaration to this effect, the person explaining the subject matter of the proposal to the proposer must also accordingly make a written declaration or the proposal.

## **Legal Object**

To make a valid contract, the object of the agreement should be lawful. An object that is,

- (i) not forbidden by law or
- (ii) is not immoral, or
- (iii) opposed to public policy, or
- (iv) which does not defeat the provisions of any law, is lawful.

In the proposal from the object of insurance is asked which should be legal and the object should not be concealed. If the object of insurance, like the consideration, is found to be unlawful, the policy is void.

## **Insurable Interest**

For an insurance contract to be valid, the insured must possess an insurable interest in the subject matter of insurance.

The insurable interest is the pecuniary interest whereby the policy-holder is benefited by the existence of the subject-matter and is prejudiced death or damage of the subject- matter. The essentials of a valid insurable interest are the following:

1. There must be a subject-matter to be insured.
2. The policy-holder should have a monetary relationship with the subject-matter.
3. The relationship between the policy-holders and the subject-matter should be recognized by law. In other words, there should not be any illegal relationship between the policy-holder and the subject-matter to be insured.
4. The financial relationship between the policy-holder and subject-matter should be such that the policy-holder is economically benefited by the survival or existence of the subject-matter and or will suffer economic loss at the death or existence of the subject matter.

The subject-matter is life in the life insurance, property, and goods in property insurance, liability, and adventure in general insurance.

Insurable interest is essentially a pecuniary interest, i.e., the loss caused by fire happening of the insured risk must be capable of financial valuation.

### **Utmost Good Faith**

The doctrine of disclosing all material facts is embodied in the important principle 'utmost good faith' which applies to all forms of insurance.

Both parties to the insurance contract must agree (ad idem) at the time of the contract. There should not be any misrepresentation, non-disclosure or fraud concerning the material.

In case of insurance contract the legal maxim 'Caveat Emptor' (let the buyer beware) does not prevail, where it is the regard of the buyer to satisfy himself of the genuineness of the subject-matter and the seller is under no obligation to supply information about it.

But in the insurance contract, the seller, i.e., the insurer will also have to disclose all the material facts.

An insurance contract is a contract of *uherrimae fidei*, i.e., of absolute good faith both parties to the contract must disclose all the material facts and fully.

### **Material Facts**

A material fact is one which affects the judgment or decision of both parties in entering into the contract.

Facts which count materially are those which knowledge influences a party in deciding whether or not to offer or to accept such risk and if the risk, is acceptable, on what terms and conditions the risk should be accepted.

These facts have a direct bearing on the degree of risk about the subject of insurance.

In case of life insurance, the material facts or factors affecting the risk will be age, residence, occupation, health, income, etc., and in case of property insurance, it would make him use the design, owner, and situation of the property.

### **Full and True Disclosure**

The utmost Good Faith says that all the material facts should be disclosed in true and fill the form. It means that the facts should be disclosed in that form in which they exist.

There should be no concealment, misrepresentation, mistake or fraud about the material facts. There should be no false statement and no half-truth nor nay silence on the material facts.

### **The duty of Both the Parties**

The duty to disclose the material facts lies on both the parties the insured as well as the insurer, but in practice the assured has to be more particular, about the; observance of this principle because it is usually in full knowledge of facts relating to the subject-matter which, despite all effective inspections of the insurer, would not be disclosed.

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### **Principle of Indemnity**

As a rule, all insurance contracts except personal insurance are contracts of indemnity.

According to this principle, the insurer undertakes to put the insured, in the event of loss, in the same position that he occupied immediately before the happening of the event insured against, in a certain form of insurance, the principle of indemnity is modified to apply.

For example, in marine or fire insurance, sometimes, a certain profit margin which would have earned in the absence of the event, is also included in the loss. In a true sense of the indemnity, the insured is not entitled to make a profit from his loss.

### **Doctrine of Subrogation**

The doctrine of subrogation refers to the right of the insurer to stand in the place of the insured, after the settlement of a claim, in so far as the insured's right of recovery from an alternative source is involved.

If the insured is in a position to recover the loss in full or in part from a third party due to whose negligence the loss may have been precipitated, his right of recovery is subrogated to the insurer on the settlement of the claim.

The insurers, after that, recover the claim from the third party. The right of subrogation may be exercised by the insurer before payment of loss.

### **Warranties**

There are certain conditions and promises in the insurance contract which are called warranties.

According to Marine Insurance Act, "A warranty is that by which the assured undertakes that some particular thing shall or shall not be done, or that some

conditions shall be fulfilled, or whereby he affirms or negatives the existence of a particular state of facts.”

Warranties that are mentioned in the policy are called express warranties. Certain warranties are not mentioned in the policy.

### **Proximate Cause**

The rule; is that immediate and not the remote cause is to be regarded.

The real cause must be seen while payment of the loss. If the real cause of loss is insured, the insurer is liable to compensate for the loss; otherwise, the insurer may not be responsible for a loss.

Proximate cause means the actual efficient cause that sets in motion a train of events which brings about result, without the intervention of any force started and worked actively from a new and independent source.

### **Assignment or Transfer of Interest**

Marine and life policies can be freely assigned but assignments under fire and accident policies, are not valid without the prior consent of the insurers—except changes of interest by will or operation of law.

### **Return of Premium**

Ordinarily, the premium once paid cannot be refunded. However, in the following cases, the refund is allowed.

By Agreement in the Policy

The assured may pay a full premium while affecting the insurance but it may be agreed to return it wholly or partly in the happening of certain events. For example, special packing may reduce risk.