Unit II - Insurance Contract

According to the Indian Contract Act (Section 10) *"A Contract is an agreement made by the free consent of the parties competent to contract, for a lawful consideration and with a lawful object and which are not declared to be void".* As per this definition a valid contract needs the following features: 1) An agreement 2) Proposal and acceptance 3) Free consent of parties 4) Parties competent to contract 5) Lawful consideration 6) Lawful object and 7) Not declared as void.

As per the above definition insurance is a contract as it has the following features:

1) **Written Agreement**: Insurance is an agreement in written form. Such written agreement is called insurance policy. While making this agreement the insured makes an offer on printed *proposal form* and the insurance company gives its acceptance in the form of *notice of acceptance.*
2) **Competency of parties:** The parties to the contract must be competent. It means they should be above 18 years of age and must of sound mind. In insurance contract both insured must be above 18 years of age and of sound mind. And insurance company is an artificial person competent to make contract.
3) **Consideration:** In insurance contract the insurance company covers the risk of insured for which insured pays the consideration in the form of premium. Therefore the lawful consideration in the form of premium is present in case of insurance contract.
4) **Lawful object:** As per the contract act the object of the contract must be lawful. N insurance contract the objective is to cover the risk to the life and property of insured from the specific risk which is lawful.
5) **Free Consent:** There should be free consent of the parties to the contract. It means the agreement of the parties to the contract should not be induced by coercion, fraud, influence or misrepresentation. In insurance contract also there is free consent of both the parties to the contract.
6) **Agreement not declared void:** The contract should not have been declared as void by any law enforced in the country. The contracts which are contrary to laws are declared as void contracts. The insurance is legal business that helps in the economic development of the nation. Hence insurance agreement is not declared as void.

As explained above, insurance is a written agreement between the parties competent to contract who give their free consent and a consideration for the benefit received from the contract. Insurance has lawful object and hence it cannot be a void agreement. Thus insurance agreement has all the essential features of a valid contract.

Difference between Insurance and wagering contract:

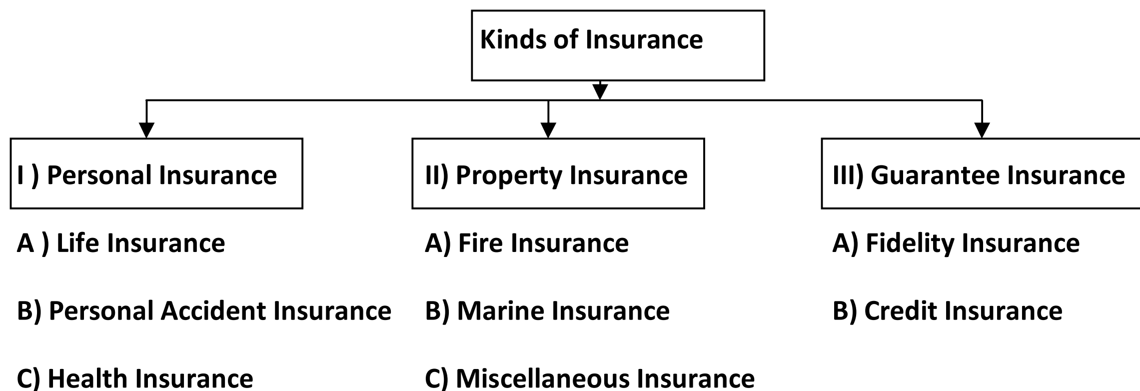
Insurance Contract	**Wagering Contract**

1. Meaning

Insurance	Wagering
Insurance is a contract according to which the insurance company promises to compensate loss to the life or property of insured from certain risks in return of the premium paid by the the insured. Thus it is a contract providing security to the insured.	Wagering is an agreement according to which one party promises to pay certain sum of the money or money's worth on happening of a certain event in consideration of the other party's promise to pay him if the event does not happen.
2. Insurable interest	
The insured has insurable interest in the subject matter of insurance.	Non of the parties has insurable interest in the event of wagering at the time of agreement.
3. Objective	
The main objective of insurance contract is to transfer the risk of the insure to the insurer.	The main objective of wagering is to make profit through wagering or gambling.
4. Enforcement by law	
Insurance contract is a valid contract hence it can be enforced at law.	Wagering is void contract hence it cannot be enforced at law.
5. **Scientific base**	
It is governed by Contract Act and Insurance Act Premium and claim amounts are calculated Scientifically by considering various factors.	It is not governed by any Act and it has no scientific base in determining the consideration and claim.
6. **Utmost good faith**	
Principle of utmost good faith is strictly observed.	Principle of utmost good faith is not used.
7. **Risk Involved**	
Risk of insured is involved in the contract.	No risk is present before making wagering .
8. Consideration	
Consideration in the form of premium is paid While making insurance contract.	Wagering agreements are made without payment of any consideration.

Types of Insurance or kinds of insurance:

Following are the different kinds of insurance;



1) Personal Insurance: Personal insurance is an insurance contract that covers the risks to the life and health of insured. Insured pays premium as a consideration to the assurance given by the insurance company. The types of personal insurance are as under:

i) Life Insurance: Life insurance is a contract according to which insurance covers the risk to the life of a person in consideration of premium paid by him. There are two types of life insurance contracts namely, (a) Whole Life Insurance and (b) Endowment Insurance. In Whole Life Insurance contract the insurance company agrees to pay the sum assured to the nominees or dependents of insured on his death in consideration of premiums paid by the insured at regular intervals. Whereas in Endowment Insurance contract the insurance company agrees to pay the sum assured either on death of insured or on completion of period of policy whichever is earlier.

ii) Personal Accident Insurance: Personal Accident Insurance is a contract under which the insurance company agrees to indemnify the loss due to the death or permanent disability of insured due to

accident in return of premium paid by him. Such insurance makes provision for payment of medical and hospital expenses in case of total or partial disability or death of insured in an accident. The insurance company prepares a table showing the compensation rates for partial or total disability or death due to accident according to which the claims are settled.

iii) Health Insurance: Under the health insurance or med claim policy the insurance company agrees to pay or reimburse the expenses on operations, medicines and hospitalization due to some specified diseases in return of the premium paid by the insured.

2) Property Insurance: Property insurance contracts refer to the policies that cover risk to the property of individuals or enterprises from specified perils. Property include buildings, furniture and fixtures, machinery, vehicles, goods, jewelry, and such other assets owned by the insured. The property insurance include following types:

i) Fire Insurance : Fire insurance is the contract under which insurance company covers the property of insured against the direct and incidental losses from the fire during the period of insurance in return of the premium paid by the insured.

ii) Marine Insurance: It is the contract that covers the losses to the property of insured from marine losses.

iii) Miscellaneous Insurance: It includes the various categories of insurance such as Motor Vehicles Insurance, Crop Insurance, Cattle Insurance, Theft and Burglary Insurance etc.

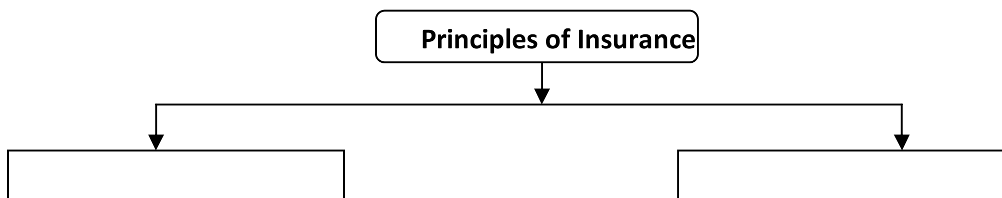
3) Guarantee Insurance: Guarantee insurance is a contract whereby the insurance company agrees to indemnify the insured for a fixed sum against losses arising through dishonesty, fraud or a breach of contract by a third party. This is a new type of insurance that has emerged in the modern times. Following types of policies are included under this category:

i) Fidelity Guarantee Insurance: It covers the losses suffered by the insured due to the dishonesty of his employees.

ii) Credit Insurance: It covers the suffered by the insured form the bad debts due to nonpayment of credit by the customers in return of the premium paid by the insured to the insurance company.

Principles of Insurance:

While making the insurance contract the insured and insurer are required to observe some guiding rules and conditions. These guidelines and conditions are called fundamental principles of insurance. These principles are common to all types of insurance contracts. However, only the principle of indemnity is not applicable to life insurance. These principles are as under:



A) Primary Principles	B) Secondary Principles
1) Utmost good faith	1) Contribution
2) Insurable Interest	2) Subrogation
3) Indemnity	3) *Causa Proxima*
4) Probability	4) Mitigation of Loss
5) Cooperation	

A) Primary Principles:

These are the main and important principles of insurance which were applied when the concept of insurance originated. These principles are as under:

1) **Principle of Utmost Good Faith:** Insurance contract is based on the mutual faith between insured and insurance company. Hence, according to the principle of utmost good faith both insured and insurance company should disclose all the material facts about the contract to each other while entering into contract. They should not give any wrong information or conceal any significant information related to the proposed contract that would influence the decision of the other party in entering the contract. If such important information is not disclosed the other party may waive its responsibility under the contract on the ground that there was breech of principle of utmost good faith while making contract. Thus principle of utmost good faith places the important duty on insured to provide all the vital information about himself and his property while filling up the proposal form for the insurance contract because he alone has the complete information.
2) **Principle of Insurable Interest:** According to this principle the insured must have insurable interest in the subject matter of insurance. It means the insured must be benefitted by the safety of the subject matter and he must suffer financial loss its destruction or damage. Every person has insurable interest in the assets and property owned by him. Hence he can take its insurance. He cannot take insurance on the assets belonging to the others. In life insurance and fire insurance the insurable interest must be present at the time of taking policy and at the time of occurrence of loss. Whereas in marine insurance the insured should have insurable interest at the time of actual loss only.

   In life insurance contract, the insurable interest is found between relations such as husband and wife, parents and their children, grandparents and grand children, brothers, and father in law and son in law etc.

   In general insurance the insurable interest is deemed to exist in the following relations:

   Owner and his property, Employers and employees, Creditors and **debtors**, Partner and firm, Agent and Property, Trustee and Property, Deposit receiver and depositor etc.

   Hence insurance can be taken in such relations.
3) **Principle of Indemnity:** Insurance is a contract of indemnity. According to this contract the insurance company agrees to indemnify the insured if there is any loss to his assets insured from specified perils. It means in the event of loss from the specific risk the insurance company promises to put the insured in the same position that he was occupying before happening of such event by reimbursing the entire loss. As per this principle, as the insurance is a contract

only to indemnify the loss, insured cannot claim any amount more than the loss suffered and thus try to make profit there from. This principle is applicable to all the types of insurance except the life insurance, personal accident and sickness insurance and medical insurance. Because the loss to life and health and life of a person cannot be reimbursed completely so as to bring the insured in the original position before the death or accident or disease.

Insurance company tries to indemnify the loss to the insured by payment of amount of loss in cash or by repairing the assets damaged or by replacing the assets lost in theft or destroyed completely.

4) **Principle of Probability:** The theory of probability in statistics is helpful in knowing the chances of losses and the amount of risk there from. This theory is used by the insurance companies to calculate the risk involved in an insurance contracts. The amount of premium is calculated on the basis of the risk in the insurance contract.

5) **Principle of Cooperation:** Principle of cooperation refers to voluntary coming together of people to solve common problems through joint efforts. In insurance scheme the people whose life and property is exposed to a common risk come together voluntarily and form a common fund by contributing premium in proportion to the risk involved. The actual loss, if any, of such members is compensated from such common fund. Thus the loss of few people contributing to such fund is shared by all. Thus the principle of cooperation, *" One for all and all for one"* is used in the insurance scheme.

B) Secondary Principles: These are the additional principles evolved out of primary principles. They are used in settlement of claims of insurance in such a manner that the insured should not take the undue advantage from the insurance contract in case of actual loss. These principles are as under:

1) Principle of contribution: The principle of contribution is applicable when insured takes out insurance policies from two or more insurance companies on the same property. In such situation, when the property is damaged or destroyed due to the risk specified in the insurance policy the loss is to be indemnified collectively by all such insurance companies. Each company should contribute to the loss in proportion to the policy amount of the insurance. This principle ensures the equitable distribution of loss between the different insurance companies. For example, if Mr. X takes insurance policy of Rs. 6 lakh from insurance company A and Rs. 4 lakh from insurance company B on his car valued at Rs.10 lakh and the car is damaged in a road accident resulting in loss of Rs. 5 lakh the insurance companies A and B will contribute the loss in the ratio of 6 : 4. Hence company A will pay Rs. 3 lakh and company B will pay Rs. 2 lakh. If company A pays Rs. 5 lakh it will have a right to recover Rs. 2 lakh from the company B. Thus this principle ensures equitable distribution of loss between different insurance in case of multiple insurance. It also ensures that the insured will not make profits through multiple insurance.

2) Principle of Subrogation: The principle of subrogation is also called *the principle of transfer of ownership rights*. This principle is applicable for marine, fire and theft insurance. According to this principle when an insurance company indemnifies the loss to the property of insured, the ownership rights in such property automatically pass on from insured to the insurance company without any legal process. The insurance company obtains the following legal ownership rights for unlimited period from the insured on indemnification of his loss.

i) Ownership rights on the remained parts of damaged property;

ii) Rights to sell out the remained parts of property;

than the value of insured property. This principle stops insured from claiming the loss from insurance company and recovering the loss once again from the party responsible for loss.

3) *Causa Proxima*: The term *causa proxima* is of Latin origin which means the *nearest or next cause*. According to insurance contract the insurance company agrees to indemnify the losses to the subject matter of insurance only from the risks specified in the contract. Hence while admitting the claim for loss to the property of insured if the real cause of the loss cannot be determined or if the actual cause of loss is not mentioned in the contract the insurance company can deny the claim. Under such situation as per the *causa proxima* principle the nearest clause of the loss is found out. If such cause is mentioned in the contract then the claim is admitted by the insurance company. For example, a marine policy is taken for the sugar against sea perils. During the transit the sugar is destroyed due to the water entering into the ship from the holes at the bottom of the ship that are drilled by the rats. In this case water is the nearest cause and rats is the remote cause. Therefore, as per the causa proxima principle the insurance company has to pay the claim because the loss by seawater is included in the peril of the sea even though the loss by rats is not specifically mentioned in the policy.

4) Mitigation of loss: Mitigation of loss means *to make the loss less severe and painful*. This principle of mitigation of loss places responsibility on insured to take necessary steps to minimize the loss to the subject matter of insurance when the mishap takes place. He has to take all efforts to reduce the damage that he would have taken if there was no insurance against that property. He should rush to the place of mishap, inform the fire brigade, try to save the goods from spreading fire and do all the efforts to minimize the loss due to fire. He should not show any negligence during the mishap because the property insured and the insurance company will bear the loss as per the insurance contract. As this principle the insurance company may reject the claim for compensation if it is found that the insured has not discharged his duty of mitigation of loss at the time of mishap.