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7 PRINCIPLES OF INSURANCE LAW

~ Rohan Dey

Introduction

In the field of Insurance Law, there are a lot of things which are important, one of them being Principles of Insurance Law. Being governed by these set of principles, it ensures the proper functioning of contracts of Insurance, and also helps protect both the interests of both policy holders and insurers. But before going in further, let us understand what insurance is.

Insurance-

Insurance, in its general sense, is a contract[1]. A contract between the insurer, for example an insurance company and the insured, for example us, an contract of Insurance helps protect us and our loved ones from financial loss which might occur because of an unexpected event, like a natural disaster, act of god, illness, or an accident. Depending on what type of Insurance contract it is, different things can be covered, like medical insurance covers medical costs, life insurance covers financial back up for the death of someone covered under the contract, and so on.

Insurance contract is also called as a Insurance policy, as it also outlines who or what will be covered under the contract of insurance, when and on the occurance of what event payment or financial compensation will be given by the insurance company, who will receive it, and how much they will receive, and everything else. As, Insurance is important to financially protect oneself, the people dependent, and one's assets from unexpected losses, emergencies and disasters, by mitigating risk, or, transferring potential financial burdens to the companies who

[1] MetLife, https://www.metlife.com/stories/benefits/what-is-insurance/, (last visited May 6., 2024)

provide Insurance in exchange of premiums, which are timely or regularly payments which are done on a timely basis, typically monthly, providing overall security, stability, and support at time when it is needed the most.

As in the case of LIFE INSURANCE CORPORATION OF INDIA AND Another Vs Sunita[2], Sunita's husband took up an insurance contract, but later faield to pay premium for a period of time and after he met an accident, he paid the premium. Here in this case, it was held that premium needs to be paid in time, and being an contract, there are 4 essential elements of an contract of insurance like-

1. The Definition of Risk- It refers to the possibility of loss occurring events or other adverse events which the insurance policy covers. The event is uncertain, which leads to a claim under the insurance policy. For example, in a car insurance policy, potential events like accidents or theft would be covered under the insurance policy.
2. Duration of Risk- It means the specific time period during which the coverage of insurance is active and in effect, and the insurer is liable for the losses covered. In simple terms, it means the time between the start date and end date of the policy of insurance. For example, if a car insurance policy is in effect from 1st January 2024 to 31st December 2024, the duration of risk is 1 year.
3. The Premium- It means the amount of money which is paid to the person who is insured by the insurer in exchange for coverage under the insurance policy. It can be paid monthly, quarterly, annually on a regular basis, and factors like the level of risk, type of insurance, amount of coverage determine the premium which has to be paid.
4. Amount of Insurance- Also known as coverage limit, it means the maximum amount which the insurer will pay out in case of occurrence of a loss which is covered under the insurance policy.

In short, insurance gives benefits like financial protection which means protection against losses and events which cannot be foreseen, resulting in high expenses, risk mitigation which means transfer and reduce financial burden, and other benefits like legal assistance, healthcare coverage.

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[2] LIFE INSURANCE CORPORATION OF INDIA AND Another Vs Sunita, LL 2021 SC 617

Principles of Insurance-

These Principles govern the field of Insurance law and form the foundation of legal framework for contracts of insurance and also provides guidilines for interpretation, enforcement and creation of policies of insurance.

There are 7 principles of insurance which are as follows-

1. Uberimmae Fides

The principle of uberimma fides means outmost good faith. It means that each party needs to, and is legally entitled to rely upon declarations and representations of others. There is a reasonable expectation that the other party is not trying to conceal, mislead or defraud any party, which is why they have the duty to reveal all the material information which is likely to influence a party's decision to either enter into or decline the contract. If any of these material facts have not been disclosed, then the other party will usually have the right to void the agreement.

Let us understand this with the case of Branch Manager, Bajaj Allianz Life Insurance Company Ltd and Others Vs Dalbir Kaur[3]. In this case, the proposer was suffering from an ailment affecting his liver, and one month before the issuance of his life insurance policy, he vomited blood. The fact that all this happened was concealed from the life insurance provider. As a result, the proposer was admitted in a hospital, and the provider conducted an investigation to determine the condition of the proposer, and it was discovered that the proposer was suffering from a severe medical ailment due to alcohol abuse and this fact, which was material to the insurance, was not provided by the proposer to the provider. The provider then rejected the life insurance claim of the proposer, and then this decision of the provider was challenged before the consumer forum, where the NRDC allowed the claim of life insurance and also included the costs. This decision was subsequently challenged before the Supreme Court. Various arguments were given, one being that there was no reasonable nexus between the cause of death and

[3] Branch Manager, Bajaj Allianz Life Insurance Company Ltd and Others Vs Dalbir Kaur , Civil Appeal No. 3397 of 2020

the disease, and the appellant highlighted the basic principle of insurance law, which is Uberimma Fides, and sic material which means outmost good faith. There should be good faith between the insured and insurance company, where the insured has to disclose everything which is materially needed for the insurance to the insurance company.

This was also relied upon in the case of Sulbha Prakash vs L.I.C [4], where it was held that there is a difference between disease and illness and as per Section 45 of Insurance Act[5], if a consumer does not provide all the material facts which are important for the contract of insurance, then insurance cannot be claimed.

2. Insurable Interest

The principle of Insurable interest means the particular thing on which a person wants the insurance to be on. It is a kind of pooling of risk which in the end protects the policy holders against financial losses. Insurable interest is the right which legally insures, arising out of financial relationship recognized under the law, between the person who is getting ins8ured the and subject matter of the insurance, which means that the policy holder must be ready to suffer a loss financially or suffer some other kind of disadvantage if the event which is insured actually occurs.

For an insurance contract to be valid, the existence of an insurable interest is crucial, making it a necessary prerequisite to a Insurance Contract. Without it, the contract will be held unenforceable and void, as it ensures that the person who is ensured has a legitimate interest in protecting the subject matter of the insurance. The timing as to when the insurable interest must exist also varies on the type of the insurance which is taken. For example, in life insurance, insurable interest must exist at the inception of the policy, whereas in a property and casualty insurance, the insurable interest must exist at the time of the occurrence of the loss. Along with the timing, the interest must be a pecuniary one, which means that it must be a economic interest, which would be financial in nature, as sentimental or emotional value alone is not sufficient. The interest must be direct and not

[4] Sulbha Prakash Motegaonkar V. L.I.C, Civil Appeal No. 8245 of 2015
[5] Insurance Act, 1938, Section 45, Acts of Parliament

indirect, where the insured must have a direct relationship with the subject matter that, if an event which is insured occurs, it would result in a financial loss.

Insurable interest prevents moral hazard, as it reduces the likelihood of individuals taking out insurance policies on subjects in which they actually do not have any interest which is legitimate, which results in preventing fraud and hazards which are of moral turpitude. It also maintains legal and ethical integrity of contracts of insurance by ensuring that the primary purpose of providing financial protection against genuine risks is served by that contract of insurance. In the end, it ends up insuring that financial protection is provided by insurance policies to those who have genuinely suffered a loss, maintaining the value and purpose of insurance as a tool for risk management.

In conclusion, the principle of insurable interest is very important and crucial in the industry of insurance as, it ensures that insurance contracts are made in good faith, provide financial protection which is genuine and would help uphold standards which are ethically and morally correct. By requiring a substantial and real interest in the subject matter of the insurance policy, this principle helps in maintaining the integrity and proper functioning of the system of insurance.

3. Proximate Cause

The principle of Proximate Cause is a concept which is fundamental in the law of insurance, which determines the primary cause of a loss in an claim of insurance. As held in the Wagon Mound[6] case, proximate cause in common means 'reasonable foresightedness' [7]which means the ability to plan and anticipate for future potential events or consequences in a manner which are prudent and sensible, by using information and resources which are available to make informed decisions in order to minimize the risks and maximize the benefits. In other words, it means that it is the capacity to think ahead and take steps in order to mitigate or prevent problems and challenges that can

6 Overseas Tankship (UK) Ltd v Morts Dock and Engineering Co Ltd, [1961] 1 All ER 404

7 Merriam-Webster, https://www.merriam-webster.com/dictionary/foresight (last visited 10th May, 2024)

potentially happen. It is where one should pay for the risk one expects, and not the aftermath which was a end result of a chain of events.

Proximate cause is the dominant, efficient or direct cause that sets a chain of events in motions, leading to the loss or damage at the end of the chain. It might not necessarily be the cause which is closest in time, but it would be the most significant one that leads to the ultimate outcome. The proximate cause, which is the event, must directly lead to the loss without any intervention which causes the chain of causation, or the chain of events to break. For example, if a fire happens, and it leads to the collapse of a building which results in injury or further damage, this fire will be considered as the proximate cause as the fire was the primary cause due to which the other series of events happened. Among multiple potential causes, the proximate cause would be identified as the predominant one that holds the most significance and important which would be leading to the loss. Like, if a storm causes flooding, which as a result causes electrical damage, this storm will be the proximate cause of the electric damage. This is why, determining the proximate cause is essential for deciding whether the loss which happened is covered under the policy of insurance as, only losses which resulted directly from perils which are covered are compensable, and by focusing on the direct cause of loss, the principle of proximate cause helps in preventing fraudulent claims where the actual cause of the loss would not be a covered peril, and it would also provide clarity in interpreting the policy coverage, making it easier for both the insurers and the persons who are getting insured to understand what is not covered and what is.

For example, in the Polemis and Furness Case[8], a ship was carrying large amounts of crude oil, and while in route, a leakage occurred and some of the crude oil got spilled in the sea water, and then went to a nearby harbor. In that same harbor, repairs were being taken place, and sparks of fire were being created in the process of repairing the harbor. The oil caught fire due to the spark, and it exploded, leading to the total loss of the ship. So the question came as to who was liable. Later, the decision was given where it was

[8] In Re Polemis & Furness, Withy & Co Ltd (1921), 3 KB 560

held that the defendant was not liable for the accident are the damage was not reasonably foreseeable.

4. Indemnity

The Principle of Indemnity is one of the cornerstones of insurance law, which is designed to ensure that the policy holders are restored to their financial position before a loss occurred, without profiting from the insurance claim, which means that is a person holding indemnity faces any loss, the loss will be compensated by the indemnifier, so that the person regains the financial position he was in before. Let us understand this with an example.

Let us say that we have a guitar, which is our prized possession, worth 15,000 rupees. One day, a fire breaks out and the guitar gets destroyed. Thankfully, the guitar was insured. So, we file a claim with our insurance company, and after assessing the damage, the company agrees to compensate us for the loss. Here is where the principle of indemnity comes into play. The insurance company would will pay us the market value of the guitar, which is 15,000 rupees. The goal of the insurance here is that to make us whole again, by putting us back in the financial position we were in before the fire, which is why they will not pay us more than 15,000 rupees because that would mean that we are profiting, which is not the main purpose of insurance.

The main things of this principle is restoration, where we are getting restored to our financial status, without giving us any windfall. If the loss is of 15,000 rupees, we will get 15,000 rupees only. Not more than that, nor less than that. Alone with that, the amount we should receive should be fair, and should reflect the actual value of the lost or damaged item, as it is about fairness and balance, ensuring that the insured person is neither out of the pocket nor ahead of the game. Along with that, by only covering the actual loss, the principle of indemnity discourages reckless behavior, as if people could profit from claims of insurance, then they would have been less careful with their property and possessions. For example, in a vehicle insurance, if one's car is totaled in an

accident, the insurance company will pay that person the car's market value at the time of the accident, not the price of a brand new car.

5. Subrogation

The Principle of subrogation is not defined anywhere per se, but it means standing at the foot of the person. Being a key concept in insurance that helps to keep things just and fair, it is all about making sure that the party who is ultimately responsible for causing the loss is also the person who ends up paying for it, even though the insurance company initially covers the loss, by transfer of some rights from the insured to the insurance company.

For example, let us say that we have a beautiful car, a new one, and one day, while driving, someone runs a red light and then crashes into our car. The damage is huge, and the repairs will cost us 10,000 rupees. Thankfully, we had car insurance so we filed a claim, and the insurance company ends up paying for the repairs. We are relieved because the car is fixed without us having to pay out of our pocket. But this is where subrogation comes into play. Our insurance company will not just absorb that 10,000 rupees loss. They will step into our shoes, and go after the person who actually caused the accident, or their insurance company, to get that money back. In other words, the insurance company seeks reimbursement from that party who is at fault. This way, the burden of the loss falls on the person who was actually responsible for causing the accident, and not on us or the insurance company which was insuring us.

The main things of this principle are the right to recovery, where once our insurance company pays for our loss, they aquire the right to recover that amount from the party who is at fault. It is like the company is saying "We covered this cost for our policy holder, and now you need to pay us back because you were the person responsible for causing the damage." Along with that, this principle prevents double recovery, as the principle of subrogation ensures that we don't get paid twice for the same loss. If our insurance company recovers the money for the party who is at fault, then we lose the right to go after the party at fault to get a second payout, as we have already been

compensated by the insurance company. And by recovering the costs from theparty who is responsible, insurance company can keep theoir losses down, which helps premiums become more affordable for everyone.

6. Contribution

The Principle of Subrogation is a concept in insurance that ensures fairness if someone has insured the same risk with multiple insurance policies, in order to prevent the insured from collecting more than the value of the total loss from multiple insurers.

For example, if we own a painting, which is very valuable and irreplaceable. Because we are very cautious, we decided to insure it with two different insurance companies, Company A and Company B, where each insurance policy covers the painting for it's full value of 50,000 rupees. Unfortunately, a fire breaks out and then the painting catches fire and then gets destroyed. We file for a claim with both the insurance companies, hoping to recover the loss. Here is where the principle of contribution comes into play, where we would get 50,000 rupees only from both the companies proportionately and not more than that. We will not receive 50,000 rupees each from both the companies, leading to a total of 1,00,000 rupees as the goal of insurance is to restore the insured to his financial position before the loss, and to prevent profit. The principle ensures that the cost of the claim is shared between the insurance companies proportionately based on the coverage they provide, so that the insured person is fairly compensated without profiting from the loss.

The main things in this principle is the concept of proportional sharing, which means that if one has multiple insurance policies, covering the same loss, each inrance company shall pay a proportionate share of the total loss. Like in the example of the painting, the insurance company would pay 25,000 rupees each, sharing the loss of 50,000 rupees equally. Thus, this principle prevents overcompensation, by ensuring that the insured person does not receive more than the actual value of his loss, maintaining fairness in the insurance system. This helps in keeping the insurance premium fair for everyone. Along with this, the most important thing which we have to keep in mind is that this principle

applies on insurance policies which are similar in nature, which are covering the same risk, and cannot apply when the insurance policies have different types of coverage.

7. Loss Minimization

The Principle of Loss Minimization is an important concept in the field of insurance, that focuses on the responsibility of the policyholder to take reasonable steps in order to prevent any further damage of loss when any accident or incident happens, by being proactive and responsible, trying to keep the damage as low as possible.

For example, let us say that we are out on a vacation, and everything is going well. But then we get a call from our neighbor saying that there is water leaking from our kitchen sink, and even though we have home insurance covering that water damage, we do not do anything to reduce the damage. Instead we choose to ignore the problem, knowing that we can get insurance claim, and let the water keep running. We will not get compensation in this case, as it is against the principle of loss minimization. However, in this case if we ask our neighbor to turn off the main water valve to stop the water leak and prevent further damage, this action of stopping the water flow to prevent more damage is what the principle of loss minimization is all about, where, as a policyholder, we should do everything we can to reduce the extent of damage when something goes wrong.

The key things in this principle is the active effort to reduce loss, were we are expected to take reasonable and practical steps to limit the damage when any insured event occurs, by being proactive in protecting our property. Our main goal is to prevent the situation from getting worse, by taking actions which are sensible and are within our ability to perform, without taking any extreme or unsafe measures. This helps in reducing overall costs, helps in the claim process and it is a legal requirement as most insurance policies include a clause that requires policyholders to minimize their losses, failing which would affect the payout of the insurance claim.

Conclusion-

In conclusion, all the principles of insurance like utmost good faith, insurable interest, indemnity, subrogation, contribution, proximate cause, and loss minimization helps in forming a framework that ensures transparency, fairnesss and efficiency which an industry of insurance. Each principle plays a crucial role in maintaining the balance between the insurer and the insured, providing a foundation for trust and reliability.

"The principle of utmost good faith underpins the mutual honesty required in insurance contracts, ensuring both parties provide all necessary information. Insurable interest mandates a legitimate stake in the insured subject, preventing speculative or unethical practices. Indemnity ensures that insurance serves its true purpose: to restore, not profit. Subrogation allows insurers to recover costs from third parties responsible for the loss, maintaining accountability. Contribution ensures a fair distribution of liability among multiple insurers, while proximate cause identifies the actual reason for the loss, aiding in precise claim settlements. Finally, loss minimization emphasizes the insured's responsibility to mitigate further damage, promoting proactive risk management"[9]

Together these principles create a comprehensive structure which legally protects the interests of all the stake holders who are involved in this policy. They help in making an environment which helps in managing the risks effectively, where claims are settled justly, helping in holding the overall integrity of the system of insurance. By adhering to these principles, the insurance industry can continue to provide essential financial protection and stability, adapting to new challenges while maintaining the trust of the public.

[9] Mootz, F.J., 1996. Principles of Insurance Coverage: A Guide for the Employment Lawyer. *W. New Eng. L. Rev.*, *18*, p.5.