

Protection of insurer in insurance contracts



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One of the most important things in any type contract is trust, without which, both parties would disregard the others interests. In insurance contracts, there is a fiduciary obligation[1]for both parties. The insurer needs to trust that their client is disclosing all relevant information to them regarding the object that they are insuring and in return the insured needs to trust that the insurer will pay out in the event of a legitimate claim. This essay will discuss how it is the insurer that requires utmost protection in the formation of an insurance contract.

It seems easy to place blame on insurers when there is an issue with a claim as they are assumed to have more knowledge regarding the insurance profession than a reasonable man/woman. This may be correct regarding more technical issues, however, when it comes to the object being insured, there is no doubt that the insured knows more information than the insurer, simply because it is their property. If the duty of disclosure was to be abolished and replaced by the duty to answer questions honestly and reasonably, the insurer is already at a disadvantage as they have little to no knowledge regarding the object looking to be insured. The duty to answer questions is a flawed system. Firstly, this process would take a lengthy amount of time. If it is the responsibility of the insurer to ask every relevant question regarding the object that is being insured, there is no limit to the amount of questions that they would be required to ask to guarantee that they have recorded all material facts that affect or could reasonably be expected to affect the price of the premium. Secondly, certain questions that the insurers ask may be open to interpretation. The insured may not fully understand what is being asked of them, and is more likely to provide

incorrect information. In the case of *MCPHEE v. ROYAL INSURANCE CO. LTD (1979)*, when the plaintiff was asked a question in the proposal form regarding the extreme length and breadth of the ship that he was insuring, he contacted the previous owner of the vessel instead of carrying out his own measurements and then passed on the information to the insurance company. Upon a loss occurring, an investigation revealed that the ships dimensions and the value of the ship were inaccurate in the proposal form. When insurers tried to void the policy, the plaintiff sued the insurance company stating that the questions relating to the dimensions of the ship were ambiguous and misleading, and that he had answered all questions on the proposal form to the best of his knowledge. Lord Stott believed the plaintiff did not approach the question with the attention that it required, and that he should have carried out his own measurements instead of relying on the information given by the previous owner. Therefore, the plaintiff could not state that the answers were to the best of his knowledge and belief. If the duty to disclose was removed, then it poses another question as to whether the insurer is financially liable for a claim in which a material fact was not discovered in the drawing up of a proposal form.

If the burden is on the insurer to collect all material facts through the process of questions during the writing up stage of a proposal form, then it poses the question as to whether the insurer should still be financially responsible for a claim if there is an omission of a material fact. If the insurer does not ask a specific question, therefore not including a material fact in the proposal form then they will charge a different premium than they would have if the material fact that increased the possibility of a loss occurring had

been included. The premium that is charged, and the risk profile of the client depends on the facts disclosed in the proposal form. Therefore, an incorrect, and cheaper premium would be charged. The insurer also looks at the probability of a loss occurring based on the proposal form, which affects the amount of money kept in reserves to pay out compensation for a claim the event of a loss occurring. If the insurance company miscalculates the amount of reserves needed based on an omission of a material fact, then if a claim arises they will not be able to pay out in full the compensation owed. If there are several miscalculations of the risks attached to clients, then the insurers may not have enough funds available to pay all their clients, potentially forcing them into bankruptcy. This would have a detrimental effect on the economy as it depends on insurance to grow. Firms depend on the insurance industry also, for example, if a company did not have a public liability[2]insurance policy and a member of the public seriously injured themselves on the company's property, then the business would be financially liable to pay any compensation due to the injured party. A large compensation fee could be the difference between a firm being able to remain in trade and being forced to shut down.

Another danger of abolishing the duty to disclose is the increased tendency to commit fraud. When consumers can pass on their legal responsibilities to insurance companies, there is a tendency to increase their moral hazard, meaning they may be less likely to try to prevent a loss from occurring. However, if the insured was liable for a claim if they failed to disclose something to the insurer then they would guarantee that the insurer is aware of the fact even if it affects their premium. The principle of Utmost Good

Faith is required so that both parties are protected from fraud and misrepresentation. Despite this there is still a culture to commit fraud where the insured purposefully lies to insurers. This was seen in the *Green's Wholesale Ltd v American Home (1985)* case. When insuring a sports car, the plaintiff realised that the defendant insurance company did not provide cover for sports cars. He then changed the classification of the car on the proposal form to 'two-door car'. Upon a loss occurring, the plaintiff attempted to claim off his insurance, however the insurer was entitled to avoid the contract due to the concealment of a material fact. If the duty to disclose was replaced with the duty to answer questions honestly and reasonably, even if consumers are aware of a detail that would alter the insurance cover available to them, they would not be obliged to tell the insurer unless asked which could lead to an increased fraud culture.

Even if insurers require protection in the formulation of an insurance contract, it could be argued that the insured has less knowledge about the insurance industry than the insurer and therefore needs more protection than the insurer. This may be true in the sense that insured do not know what is required of them in terms of disclosing information during the formulation of an insurance contract. However, the advance in technology in recent decades has allowed the common man/woman more access to information, and even scholarly writing from the comfort of their own home. This increased access to information means increased access to knowledge. This increased access to information can also be seen in the increased propensity to sue in Ireland and the U. K. Kritzer's paper which includes his 'Developmental Theory of Litigation' provides barriers that are being crossed

with more ease than before in recent years. One reason for this is that insured have more access to information regarding the insurance industry, which means that they now know what a legitimate claim is, how much they could receive in compensation and how to go about making a claim. The argument that an insured may not know what a material fact is can be countered with the fact that there is a section in the Marine Insurance Act stating that the assured must know everything that is deemed to be available in the ordinary course of business. This means that when looking for insurance, insureds need to know certain details that they are expected to disclose to the insurer when drawing up an insurance contract.

It is understandable that the insured is not as knowledgeable as an insurer and may need some protection, however, as the insurer bears the financial burden of claims then it is reasonable to conclude that they require more protection in the formation of an insurance contract. Furthermore, if the insurers were to be irreparably damaged due to the abolishment of the duty to disclose, then the economy would also suffer.

[1]An obligation to act in the best interests of one another.

[2]Protects the insured against injuries sustained by customers, the public or people that you visit.