

DEPARTMENT OF MERCANTILE LAW

**INSURANCE LAW
(LML405S)**

**[Tutorial Letter 501/3/2010
(Compiled by Prof JP van Niekerk)**

Contents

INTRODUCTION	
CHAPTER 1	Concept of Insurance; Origin and Historical Development of the Insurance Contract and Insurance Law; Classifications
CHAPTER 2	Sources of South African Insurance Law
CHAPTER 3	Nature and Characteristics of the Insurance Contract
CHAPTER 4	Requirements for a Valid Insurance Contract
CHAPTER 5	Parties to the Insurance Contract
CHAPTER 6	Insurable Interest
CHAPTER 7	Misrepresentation and the Insurance Contract
CHAPTER 8	Insurance Warranties
CHAPTER 9	Risk
CHAPTER 10	Premium
CHAPTER 11	Insurance Intermediaries
CHAPTER 12	Extent of the Insured's Claim: Principle of Indemnity
CHAPTER 13	Subrogation, Salvage and Contribution
CHAPTER 14	Enforcement and Cession of Insurance Claims; Termination of the Insurance Contract
CHAPTER 15	Interpretation of the Insurance Contract

INTRODUCTION

The LLB course in Insurance Law involves a fairly intensive and detailed study of the contractual aspects of insurance law. The prescribed textbook for this course is as follows:

Reinecke MFB, SWJ van der Merwe, JP van Niekerk & PH Havenga *General Principles of Insurance Law* (2002) Lexis Nexis Butterworths, Durban.

As the existing Study Guide for LML405S (Insurance Law) is based on a previous edition of this work, it can no longer be used for this course. Therefore, TUTORIAL LETTER 501 REPLACES THE STUDY GUIDE FOR LML405S and should be referred to in its place.

This tutorial letter, like the study guide it replaces, is no more than a "guide" to your study of insurance law in general, and to the prescribed textbook in this course in particular.

In each chapter in this tutorial letter, you will find some introductory and explanatory comments on some of the various topics treated in this course. You will also find an indication of the various paragraphs in the textbook ("Reinecke et al") which you should either READ for background purposes or STUDY in detail for examination purposes, and of the order in which you should read or study these paragraphs. READ means just that: you should carefully and attentively read through the relevant paragraph for background purposes, ensuring that you both comprehend what you are reading and identify the relevance to the topic concerned. STUDY means that you should not only comprehend the contents of the paragraph, but also memorise it for the purposes of the examination. Given the level of this course and the nature of the textbook, an instruction to study a particular paragraph in the textbook means that you have to study only the text in that paragraph, and that you need not (but obviously may, should you wish) descend into the footnotes attached to the paragraph. However, bear in mind that you will have to read and study your prescribed cases (as listed in Tutorial Letter 101) in conjunction with the textbook and may therefore have to

incorporate the judgments in those cases, or at least parts of them, as a “footnote” or appendix to the relevant paragraphs of the textbook.

Each chapter further contains a list of questions on the topics covered in that chapter. These questions are set merely to assist you in ascertaining whether or not you have picked up on what we consider to be some (note, not all) of the more important issues involved, and whether or not, therefore, you have covered the material in sufficient depth. They are not an indication of the type of question you may expect in the examination, and we shall not provide you with any “model answers” to them.

Lastly: we have included a number of diagrams at the end of each chapter to help you understand the structure (and contents) of this course. Note that these diagrams are not intended to be a complete summary of the study material. You have to study the diagrams, in conjunction with the prescribed study material.

CHAPTER 1 **CONCEPT OF INSURANCE; ORIGIN AND HISTORICAL DEVELOPMENT OF THE INSURANCE CONTRACT AND INSURANCE LAW; CLASSIFICATIONS**

1.1 Introduction: The Spreading of Risk

Underlying the whole idea of insurance as we know it today is the notion of the spreading of risk. Characteristic of human existence is the continuous threat to man himself, his assets or expectations. The calamities to which man is exposed create a need for security and protection. This need may be satisfied in a number of ways. One of them is to distribute the risk of the occurrence of undesirable events among a number of persons. This is known as the spreading of risk. The concept of insurance presents itself pre-eminently as an instrument for the spreading of risk among a number of people who are all exposed to the same or comparable dangers or risks.

Regarding the idea of the incidence, management and spreading of risk, READ Reinecke et al paragraphs 1-7. Also note the scope of the insurance contract, and of insurance law.

1.2 The Historical Development of Insurance and the Insurance Contract

The modern concept of insurance and the insurance contract is technically and legally the product of the development of two distinct, albeit intertwined, historical roots, namely, on the one hand, insurance on the basis of mutuality, and, on the other hand, insurance for a premium (also often referred to as insurance for profit, that is, the insurer spreads the risk against payment and for a profit).

Mutual insurance has its origins in Antiquity, in the practices of burial and other mutual-aid societies. It is founded upon the contributions by members of a particular group or community of equally exposed persons in the form of payments which are made either before or after the occurrence of an undesirable event affecting one of the members. This form of insurance is not for gain, and any surplus from contributions may be either repaid to members, or used to establish an emergency fund or to reduce future contributions.

By contrast, premium insurance in its modern form was not known in Roman law, although that system did recognise, as we still do today, other forms of contract in which the transference (as opposed to the spreading) of risk plays some (usually a subsidiary) role. An example here would be the passing of risk in the case of a contract of sale. The earliest traces of the modern concept of insurance for a premium, that is, involving the transfer of risk as the only (or at least the main) purpose of the contract, can be found in the mercantile practices of Mediterranean seafarers in the Middle Ages.

Today, it is generally accepted that the premium-insurance contract in its modern form evolved as a *sui generis* contract from analogous and antecedent commercial devices and contract forms, such as the contract of (maritime) loan, sale or exchange, in which spreading of the risk played an ancillary and often imperfect (or not yet perfected) role. The origin of the acceptance of risk against payment can be found in the Babylonian contract of loan and in the maritime loan contract of ancient Greece. On reflection, however, it appears that neither of these two types of contract can be regarded as a genuine form of insurance since their primary purpose was not the transfer of a specific risk or risks. Italian records dating from the second half of the fourteenth century are regarded as the first examples of independent contracts of insurance. These first contracts related to marine risks. For a long time, marine insurance was the most important form of insurance. Gradually, other forms of insurance, namely insurance against perils present in the carriage of

goods by land, fire insurance and life insurance also made their appearance.

On these historical aspects, READ Reinecke et al paragraphs 16-23.

1.3 Classification of Insurance Contracts

Insurance contracts may be classified in various ways. The distinctions emerging from these classifications, and especially the difference between indemnity and capital (or nonindemnity) insurance, are of importance for any study of insurance law, as some legal principles are said to apply to some types of insurance contract, but not to others. Note, too, that these classifications are not mutually exclusive, and that a particular type of insurance (contract) may belong to several different classes at the same time (eg, a particular marine-insurance contract may simultaneously be indemnity insurance, property insurance, short-term insurance and a valued insurance contract).

On the need for the different classifications and also on the way (or some of the ways) in which insurance and insurance contracts may be classified, STUDY Reinecke et al paragraphs 8-15. On the difference between indemnity and capital (nonindemnity) insurance in particular, STUDY Reinecke et al paragraphs 31-33, 34 and 39.

Summary

For the purposes of chapter 1, you should

STUDY Reinecke et al pars 8-15, 31-33, 34 and 39; and
READ Reinecke et al pars 1-7 and 16-23.

Questions

- (1) Distinguish between the following:
 - (a) indemnity insurance and capital (nonindemnity) insurance
 - (b) property insurance and liability insurance
 - (c) mutual insurance and premium (or profit) insurance
 - (d) fire insurance and marine insurance
 - (e) property insurance and personal-accident insurance
 - (f) life insurance and death insurance
 - (g) life insurance and personal-accident insurance
 - (h) long-term insurance and short-term insurance
 - (i) long-term insurance and indemnity insurance
 - (j) a valued insurance contract and an unvalued insurance contract
 - (k) private insurance and social insurance.

- (2) Why is it necessary to distinguish between indemnity insurance and capital (nonindemnity) insurance?

- (3) What is the distinction between indemnity insurance and capital (nonindemnity) insurance?

Diagrams for Chapter 1

Concept of Insurance= Spreading of Risk
(Read Reinecke et al pars 1-7)

Historical Development of Insurance and the Insurance Contract
(Read Reinecke et al pars 16-23)

Mutual Insurance

Insurance for a Premium

Classification of Insurance Contracts
(Study Reinecke et al pars 8-15, 31-33, 34 en 39)

Indemnity Insurance

Capital (Non-indemnity) Insurance

Property Insurance

Liability Insurance

Valued Insurance Contract

Unvalued Insurance Contract

Methods of Classification

- ▶ according to the nature of event insured against
(eg, fire, marine and personal-accident insurance)
- ▶ according to legislation for administrative purposes
(eg, short-term and long-term insurance)
- ▶ according to the method of insurance
(eg, profit and mutual insurance or private and social insurance)
- ▶ according to the type of interest insured
(eg, motor-vehicle and householders insurance)

CHAPTER 2 SOURCES OF SOUTH AFRICAN INSURANCE LAW

2.1 Common Law

The law of insurance may be divided into insurance contract law and insurance company law. As far as the former is concerned, it should be borne in mind that the insurance contract is merely a specific type of contract so that, like all other types of contract, it is governed by the general principles of the law of contract. One should therefore not hesitate to apply those general principles to insurance contracts in so far as they are applicable and compatible. Thus, as a starting point, the general principles of the (modern) South African law of, for instance, contract and delict, also apply in the insurance context.

It is now trite that in the seventeenth century, the law of Holland was taken over in the Cape as the common law of South Africa. As a starting point, therefore, our insurance law is governed by Roman-Dutch (insurance) law. Roman-Dutch law is a primary and binding source of our insurance law. This point was unequivocally confirmed in the landmark decision in *Mutual & Federal Insurance Co Ltd v Oudtshoorn Municipality* (1985 (1) SA 419 (A)). Note that the acceptance of the Roman-Dutch law as the common law for insurance matters does not prohibit reference to other legal systems, including English (insurance) law. Roman-Dutch (insurance) law is not our law, but merely our common law, and is not necessarily and inevitably applicable in every case, as it may no longer be suitable to modern conditions and requirements.

The Roman-Dutch law of insurance was highly developed and after contracts of sale and lease, insurance contracts were the most prevalent form of contract in use in the time of Van der Keessel at the end of the eighteenth century. Those Roman-Dutch jurists who did pay attention to the insurance contract devoted their writing almost exclusively to marine insurance. Therefore, there were no common-law writers after the end of the eighteenth century, when the other forms of insurance (such as fire and life insurance) first came into general use. However, this does not mean that the works of Roman-Dutch jurists are of no significance to the modern-day (nonmarine) insurance lawyer: indeed, the principles of the Roman-Dutch law of marine insurance can be applied, with adaptation, if necessary, to other forms of insurance in order to meet modern requirements. This adaptability is a characteristic of Roman-Dutch law, and such adaptation is quite possible in an uncodified system such as ours.

Other legal systems may also be relevant as comparative material in developing and refining our insurance law. In this regard, English law, in particular, has played, and will no doubt continue to play, an important role. At one stage in the past, binding authority was conferred on (certain aspects of) English insurance law in certain parts of South Africa. That has changed, though, and today English insurance law merely has persuasive authority in our courts, albeit strong persuasive authority.

On the common law as one of the sources of South African insurance law, STUDY Reinecke et al paragraphs 24-28 and 30.

2.2 Legislation

An increasing number of legislative enactments dealing with insurance matters also form an important source of our insurance law.

Of these, the two most important pieces of legislation are the Long-term Insurance Act 52 of 1998 ("LIA") and the Short-term Insurance Act 53 of 1998 ("SIA"). However, they deal mainly with

insurance regulation and insurance company law, matters such as the registration, control, financial stability and winding-up of insurance companies and the definitions of the various types of insurance business that may be transacted by registered insurance companies. Regulations and Policyholder Protection Rules have also been promulgated in terms of both the LIA and the SIA. Only a very few sections of the LIA and SIA touch on the focus of this course, namely insurance contract law. They will be referred to if necessary.

Various other Acts have an indirect bearing on insurance, for example the Export Credit and Foreign Investments Insurance Act 78 of 1957; the War Damage Insurance and Compensation Act 85 of 1976; the Financial Services Board Act 97 of 1990; the Conversion of SASRIA Act 134 of 1998; the Inspection of Financial Institutions Act 80 of 1998; and the Financial Institutions (Protection of Funds) Act 28 of 2001. As is apparent from their titles, they, too, concern matters with which we are not concerned in this course.

On the LIA, the SIA, and other legislative measures relevant to insurance, READ Reinecke et al paragraphs 531, 588, 605-606, and 607-622.

2.3 The Constitution

Obviously, our Constitution, of 1996, will turn out to be an important source of our law generally, and also of insurance law. In fact, the development of our insurance law, both in its common-law and statutory guises, will be influenced pertinently by the provisions contained in the Bill of Rights in particular. In short, the Constitution is an emerging and increasingly important source. In this regard, STUDY Reinecke et al paragraphs 29 and 165.

2.4 Custom and Trade Usage

Historically, custom and trade usage were important sources for the development of commercial law in general, and insurance law in particular. That is no longer the case, at least not formally so. These days, the law develops at such a rate that custom, which requires a particular practice not only to be well-known, but also to have been followed over a lengthy period of time before it may be considered as binding law, is no longer of much, if any, importance as a source of insurance law. That is not to say, though, that an insurance practice may, without amounting to a binding custom, not influence the statutory regulation of a particular aspect of insurance law.

Summary

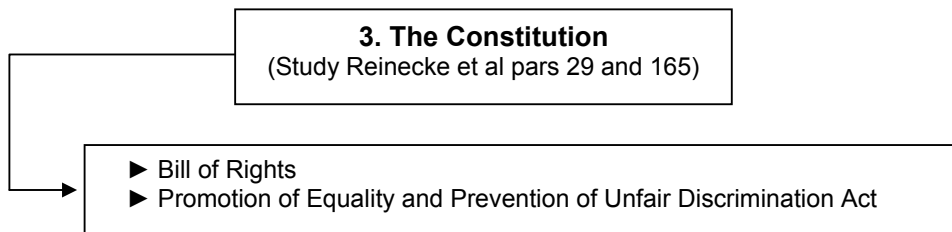
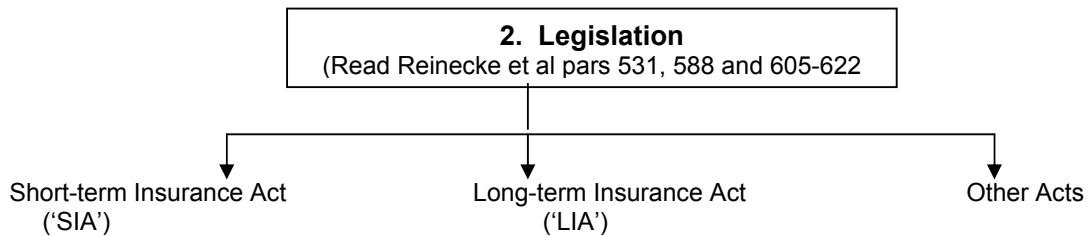
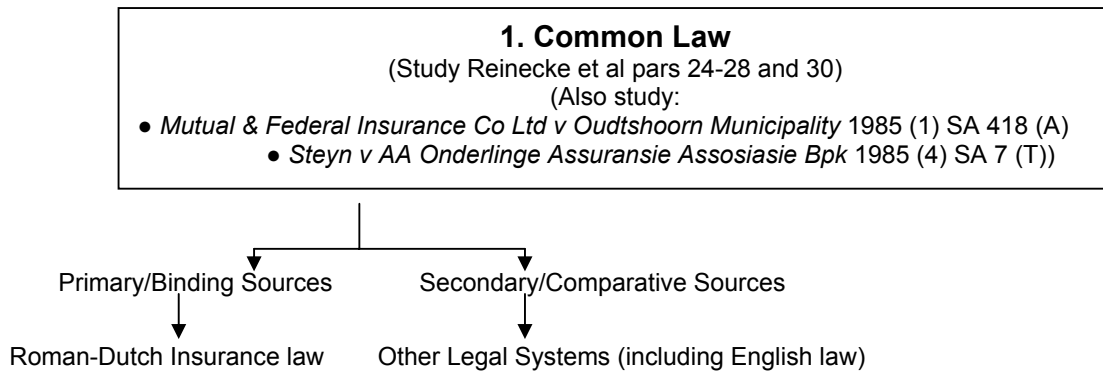
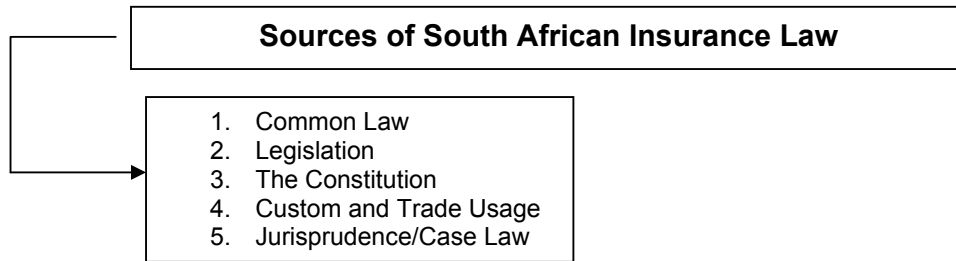
For the purposes of chapter 2, you should

STUDY Reinecke et al pars 24-30 and 165; and
READ Reinecke et al pars 531, 588 and 605-622.

Questions

- (1) Name the sources of South African insurance law.
- (2) Is the English law of insurance a source of the South African law of insurance? Is it a binding or persuasive source, a primary or secondary source, or is it merely comparative material?
- (3) What effect did the promulgation of the Pre-Union Statute Law Revision Act 43 of 1977 have on (the sources of) the South African law of insurance?
- (4) Will it be permissible for a South African court to resolve an insurance-law dispute by referring to the legal position in common-law systems such as the United States of America or Australia, or that in civil-law systems such as the Netherlands or Germany?
- (5) What is the effect of the decision in the *Oudtshoorn Municipality* case on the validity of those principles of English insurance law that have been applied in the South African law of insurance over the years?

Diagrams for Chapter 2



4. Custom and Trade Usage

5. Jurisprudence/Case Law
 (Important: Study the prescribed cases as set out in Tutorial Letter 101/3/2010 in conjunction with your study material as you proceed.)

CHAPTER 3 NATURE AND CHARACTERISTICS OF THE INSURANCE CONTRACT

3.1 Introduction

For various reasons, it may be necessary to determine whether or not in a particular case one has to do with insurance and an insurance contract. For this reason, it is necessary to define these concepts. The definition of an insurance contract should set out those characteristic features of the contract that distinguish it from other types of contract. These distinguishing features are referred to as the *essentialia* (essentials) of the contract and are (or should be) contained or reflected in the definition of that type of contract. *Essentialia* should be distinguished from *naturalia* (ie, terms which are, as natural consequences of a particular type of contract, always or naturally present in a contract of a particular type, but which may be excluded by agreement) and *accidentalialia* (ie, terms which may be included by agreement between the parties but which are not present unless they are so included).

Also, the *essentialia* of the insurance contract (the characteristics that have to be present before a contract can be classified as an insurance contract) should not be confused with the requirements for a valid (insurance) contract. These latter requirements apply to all contracts and are in fact the same for contracts generally, irrespective of the type of contract. They therefore apply also to insurance contracts (they are discussed in ch 4). If one or more of the *essentialia* of an insurance contract are not present, the contract cannot qualify as one of insurance, but it may (if the requirements for validity are present) still be a contract of another type, or even an unclassified (innominate or unnamed) contract. If one or more of the requirements of a valid (insurance) contract are not present, the (insurance) contract is void, and, in fact, there is no (insurance) contract at all.

On the need for a definition of the insurance contract, STUDY Reinecke et al paragraph 97. On the essentials and the requirements for the validity of an insurance contract, STUDY Reinecke et al paragraphs 96 and 147.

3.2 The Definition of an Insurance Contract

The main problem with the definition of the insurance contract is that an acceptable definition should be encompassing enough to include all the various types of insurance contract encountered in practice. In particular, it should include both indemnity and capital (nonindemnity) insurance. However, the definition should also be precise enough to distinguish (all the various forms of) the insurance contract from other types of contract it closely resembles. This close resemblance exists because the insurance contract and such other contracts have some, though obviously not all, of the *essentialia* of the insurance contract in common. Furthermore, the definition of the insurance contract (a legal concept) should take account of, and reflect that of, insurance (an economic concept).

It comes as no surprise that the search for an acceptable definition of the insurance contract is not yet over. The definitions accepted in our case law (and in particular in *Lake v Reinsurance Corp* 1967 (3) SA 124 (W)) and by the legislature are rather vague, and not in all respects satisfactory. They either do not include all the forms of insurance contract occurring in practice (eg, both indemnity insurance and capital insurance), or they are so vague that they do not distinguish the insurance contract from other analogous forms of contract.

On the definition of insurance, STUDY Reinecke et al paragraphs 5, 7 and 98-101.

From the possible definitions of the insurance contract, it is nevertheless possible to identify the terms which may qualify as the *essentialia* or characteristic features of the insurance contract. Whether they all in fact do, or should, qualify as such, is, of course, a different question. Some of these essential features will be considered in this chapter, while others will be dealt with in subsequent chapters. The possible *essentialia* of an insurance contract are as follows:

- (1) The insurance contract is a contract of good (or the utmost good) faith (see 7.1 below).
- (2) It must provide for the payment of a premium by the one party, the insured (see 10.1 below).
- (3) It must provide for the payment of a sum of money, or its equivalent, by the insurer, in exchange for the premium (see 3.3 and 12.1 below).
- (4) The insurer's performance must depend upon the outcome of an uncertain event (see 3.4 and 9.1 below).
- (5) The insured must have an interest in the outcome of that event (see 3.4 and ch 6 below).
- (6) The insurance contract is an independent and principal contract (see 3.5 below).

3.3 The Insurance Contract as a Reciprocal Contract

The transfer of risk from one party to another is a common feature of many contracts. Thus, the passing of risk from the seller to the buyer in a contract of sale is an important aspect of contracts of sale. However, such transfer of risk is not the main aim or feature of the contract of sale, but merely a subsidiary aspect: the main aim is to sell, to transfer possession, and (practically) to transfer ownership. The fact that there is a passing of risk does not turn the contract of sale into one of insurance. And neither does the absence of any passing of risk mean that the contract is not one of sale. The same goes for other contracts, such as contracts of lease, carriage or deposit, which involve a transfer of risk from one party to another.

In the case of an insurance contract, the main aim of the contract is to transfer risk. Such transfer is an essential feature, and in essence the only aim of the insurance contract. If there is no risk and no transfer of risk, there is no insurance contract.

The traditional view of an insurance contract is that it is a reciprocal contract in that the performance of the insured and that of the insurer are undertaken in exchange for each other. However, the view of the authors of the textbook is that that is not the case, and that neither the actual payment of a premium nor the undertaking on the part of the insured to pay a premium is a requirement for the validity of, or an essential for, an insurance contract. In this regard, STUDY Reinecke et al paragraphs 121-123.

The insured's performance, namely the payment of a premium, is considered in chapter 10. It may, at this stage, just be mentioned that an undertaking by an insurer to pay a sum of money for free (ie, without any premium having to be paid), though quite valid and enforceable, will seemingly not amount to an undertaking in terms of an insurance contract. However, it may be a contract for the donation of insurance benefits.

The extent of the insurer's performance is considered in chapter 12. At this stage, it is necessary only to say something in general about the nature of its performance. An insurer usually undertakes to pay a (determined or determinable) sum of money, though it is possible that it may quite validly undertake something other than the payment of money, for example, to provide a service or to reinstate or repair a damaged object. But the insurer must undertake to provide an enforceable performance: an undertaking to merely consider a claim for payment will not suffice. Such an undertaking, though quite valid, will result in the contract not being an insurance contract. In this regard, STUDY Reinecke et al paragraphs 115-117.

3.4 The Insurance Contract as an Aleatory Contract

The insurer's performance is dependent upon the outcome of a specific, but uncertain, event. The uncertainty of the event may relate to whether or not the event will occur ("will the house burn down during the period of insurance?"), or to when it may occur ("when will the insured die?"), or to the extent of its consequences ("will the wear and tear of the machine render it incapable of performance during the period of insurance?"). The event is usually a future event, but it may be a past event (as in the case of insurance "lost or not lost", in which the parties, eg, insure a ship which has already departed and of the whereabouts and fate of which they are not aware). On these matters, STUDY Reinecke et al paragraphs 125-127.

Insurance is, in the first instance, concerned with the spreading of risk, and the insurance contract involves the transfer of risk from the insured to the insurer. The nature and description of the risk, the materialisation of the risk, and related matters are considered in chapter 9.

The element of uncertainty inherent in the risk is a characteristic feature not only of insurance contracts, but also of other contracts. Thus, the transfer of risk is also encountered in various other contracts, such as that of sale or lease. But in those instances, the transfer of risk is not the main or substantial purpose of the contract. Also, in the case of insurance, the risk lies outside the control of the person to whom it is transferred, that is, the insurer. Further, insurance is not based merely upon a simple transfer of risk, but involves, economically speaking at least if not also legally speaking, the spreading of risk. In this regard, STUDY Reinecke et al paragraphs 128 and 130.

But there are other contracts, still, in which the transfer of risk is the essence of the contract. Such contracts are known as "aleatory contracts", and they are characterised by the fact that the obligation of the one (or even both) of the parties is conditional upon the occurrence or not of an uncertain event; additionally there is usually an inequality in the extent or value of the mutual undertakings.

Of these aleatory contracts, one of the most important contracts, and also the contract most easily confused with the insurance contract, is the wagering agreement. A wager (which is an agreement, and which should thus be contrasted with gambling, which is a game of chance) is a valid contract, but unlike an insurance contract, it is (in our law, and at present) an unenforceable contract. Hence the need to distinguish between the two. Again, STUDY Reinecke et al paragraph 97.

In this regard, the question arises what the position will be if there is a change in public policy so that wagers, if they are otherwise valid agreements (ie, if they meet the requirements of valid contracts generally, including that of lawfulness) are no longer regarded as unenforceable. This possibility was foreseen in, for example, *Nichol v Burger* (1990 (1) SA 231 (C)), and also earlier in *Rademeyer v Evenwel* (1971 (3) SA 339 (T)), in which the possibility was mentioned that certain wagers may be enforceable on the ground of being concerned with a moral issue (of being *super re honesta*). Further, public policy may have evolved to such an extent that wagers generally are no longer unenforceable (but may only, like contracts generally, be void if they are illegal). If so, will there then still be any need to distinguish between insurance contracts and wagering agreements?

In order to distinguish between insurance contracts and wagers, the doctrine of an insurable interest was developed. This insurable-interest doctrine also serves other purposes, and is considered in detail in chapter 6. In the meantime, STUDY Reinecke et al paragraphs 102-103, in which the question is raised whether insurable interest is, and should serve as, an essential of an insurance contract. Also STUDY Reinecke et al paragraphs 48, 111, 114 and 153-155 for the (possible) difference between insurance contracts and wagers. Furthermore, the references to wagers and the difference between them and insurance contracts in *Phillips v General Accident Insurance Co* (1983 (4) SA 652 (W)) and in *Steyn v AA Onderlinge Assuransie Assosiasie Bpk*

(1985 (4) SA 7 (T)), both of which will be encountered again in chapter 6, should be noted and critically considered at this stage.

3.5 The Insurance Contract and the Independent Transfer of Risk

A further feature of an insurance contract is that the risk that is transferred from the insured to the insurer is one over which the insurer has no control. For that reason, contracts in terms of which the manufacturer of goods undertakes to bear the risk, as against the buyers of those goods, of any loss of, or damage either to the goods themselves or otherwise resulting from their use, are not insurance contracts. STUDY Reinecke et al paragraphs 128 and 264.

3.6 The Insurance Contract as a Principal Contract

Like an insurance contract, a contract of suretyship involves an undertaking by one party (the surety) to pay a sum of money on the occurrence of an uncertain event. In particular, suretyship agreements closely resemble those indemnity-insurance contracts known as “credit insurance” (in terms of which an insurer undertakes to indemnify the insured in the event of the latter's debtor failing to pay his debt). In both cases, the one party (the insurer or surety) takes over the risk of another party (the insured or creditor) that a third party (the debtor) may not perform. On the need to distinguish between insurance contracts and contracts of suretyship and on how to do so, STUDY Reinecke et al paragraphs 118-120.

Summary

For the purposes of chapter 3, you should

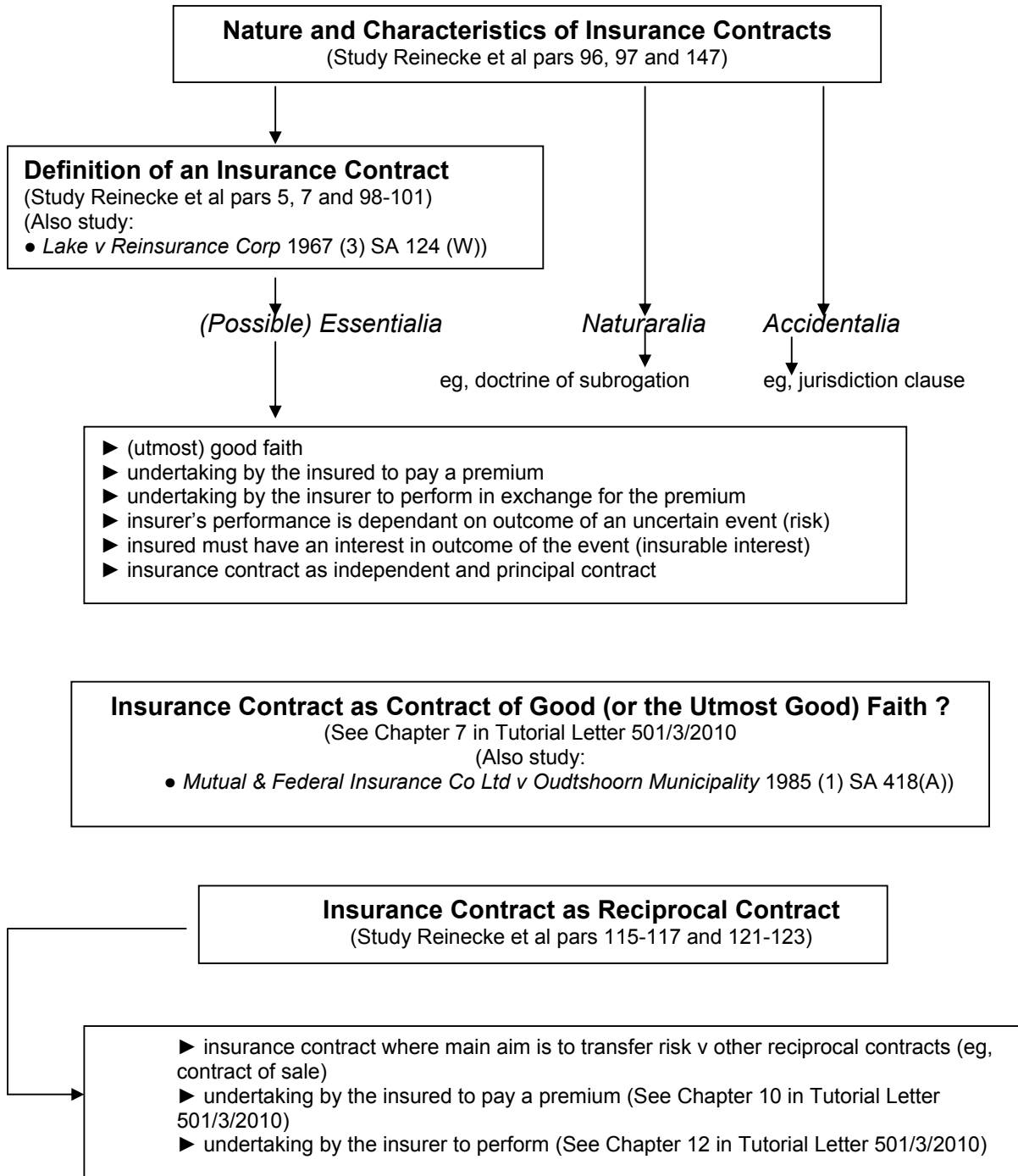
STUDY Reinecke et al pars 5, 7, 48, 96-103, 111, 114-123, 125-128, 130, 147, 153-155, and 264.

Questions

- (1) Distinguish between the characteristic features of, and the requirements for, the validity of an insurance contract.
- (2) List the possible *essentialia* of the insurance contract and explain which of them may be excluded from the list according to some views of the nature of the insurance contract.
- (3) In view of the (possible) *essentialia* of an insurance contract, distinguish between indemnity insurance and nonindemnity insurance.
- (4) Explain the similarities and differences between insurance contracts and
 - (a) wagering agreements
 - (b) contracts of suretyship
 - (b) contracts of sale, lease, or any other contract that involves the transfer of risk from one party to the other, and
 - (d) motor-vehicle warranties and other manufacturers' guarantees.

- (5) What is the (possible) role of the doctrine of an insurable interest, the principle of indemnity, and the intention of the parties respectively in distinguishing between insurance contracts and wagering agreements?

Diagrams for Chapter 3



Insurance Contract as Aleatory Contract

(Study Reinecke et al pars 48, 97, 102-103, 111, 114, 118-121, 125-128, 130 and 153-155)

(Also study:

- *Steyn v AA Onderlinge Assuransie Assosiasie Bpk* 1985 (4) SA 7 (T)
- *Phillips v General Accident Insurance Co* 1983 (4) SA 652 (W)

- ▶ transfer of risk (See Chapter 9 in Tutorial Letter 501/3/2010)
- ▶ doctrine of insurable interest (See Chapter 6 of Tutorial Letter 501/3/2010)
- ▶ insurance contract where insured must have an insurable interest in outcome of uncertain event v other aleatory contracts, eg, wagering agreements

Insurance Contracts and the Independent Transfer of Risk

(Study Reinecke et al pars 128 and 264)

- ▶ insurer has no control over transfer of risk
- ▶ insurance contracts v motor-vehicle warranties and other manufacturer's guarantees

Insurance Contracts as Independent and Principal Contract

(Study Reinecke et al pars 118 and 120)

- ▶ insurance contract as independent and principle contract v contract of suretyship

CHAPTER 4 REQUIREMENTS FOR A VALID INSURANCE CONTRACT

4.1 Introduction

An insurance contract is just another type of legally binding agreement or contract, and the requirements for the conclusion of valid contracts generally also apply in the case of insurance contracts. If any one of them has not been met, there is not only no insurance contract, but, in fact, also no contract at all, or, as it is often said, the “contract” is void. These requirements are agreement or *consensus*; the capacity to act; lawfulness or legality; the need for the performance to be possible and ascertainable; and compliance with any formalities.

4.2 *Consensus: Offer and Acceptance*

An insurance contract is a consensual contract and the parties, that is, the insured and the insurer, must be *ad idem* as to the obligations they wish to create. Like any other contract, the insurance contract is therefore formed by offer and acceptance. STUDY Reinecke et al pars 131-135 in this regard.

4.3 Capacity to Act

A further requirement for the existence of a valid and binding insurance contract is that the parties, and in particular in the insurance context the person concluding the contract (usually, but not necessarily, the insured), must have the capacity to act in general, and to contract in particular. In the absence of such capacity there is in fact no valid contract between the parties. STUDY Reinecke et al paragraph 148.

4.4 Legality

Like other contracts, the conclusion, performance and object of an insurance contract must not be prohibited. Students should pay particular attention to the effect of section 60 of the LIA and section 54 of the SIA on the requirement of the legality of insurance contracts. Note should also be taken of the general consequences of unlawful agreements, and in particular of how this affects an insurance contract which has been concluded unlawfully. Two points may be made. First, an illegal contract is void, and can therefore not be enforced. Secondly, that which has been performed in terms of the illegal and void contract may not be recovered as a consequence of the application of the *par delictum* rule. You should remember that in certain circumstances the *par delictum* rule may be relaxed and the recovery permitted of that which has been performed if public policy will be better served by permitting such recovery.

A simple example will illustrate these principles. An unlawful insurance contract is concluded to insure a brothel (the assumption being, though, that prostitution is unlawful: that may not, or no longer, be the case). Since the contract is illegal and therefore void, the insured may not claim the sum insured in the event of loss occurring, and neither may the insurer claim the premium. But should the insurer have paid the sum insured or the insured the premium, the *par delictum* rule may prevent the recovery of the sum insured by the insurer, or of the premium by the insured.

Finally, students should make a mental note that the question whether an insurance contract concluded without an insurable interest is unlawful may also be relevant in the present context. This issue is dealt with separately in 6.1 below.

On the question of legality, STUDY Reinecke et al paragraphs 149-152 and 159-165.

4.5 Performance Must Be Possible and Ascertainable

The requirement that performance must be possible has little application in the case of insurance contracts, since the performance of both parties, as a rule, consists in the payment of money: STUDY Reinecke et al paragraphs 166-167. In accordance with the general principles of the law of contract, the performance of the parties must also be ascertainable, and on this aspect STUDY Reinecke et al paragraphs 168-169.

4.6 Formalities

The law itself does not lay down any formalities for the conclusion of a valid insurance contract, such as writing, notarial execution or registration. An oral and informal insurance contract is therefore possible and completely valid and binding. In practice, though, insurance contracts are generally embodied in a written document known as a policy. In terms of the Stamp Duties Act 77 of 1968 and the Value-added Tax Act 89 of 1991, some insurance contracts may, for revenue purposes, be required to be in writing. Noncompliance with these provisions may entail penal sanctions, but will not necessarily make the contract unlawful and consequently void. STUDY Reinecke et al paragraphs 136-137 and 170-171.

4.7 The Policy

Although an insurance contract need not be in writing, it is common practice to reduce these contracts to writing. A document embodying a contract of insurance is called a policy. Despite common usage to the contrary, there is therefore a difference between an insurance contract and an insurance policy. An insurance contract is the intangible agreement; the policy is the reduction of that agreement to a tangible form. But the policy is (or may be) but one of the documents in which a particular insurance contract may be contained: its (other) terms may be found in other documents such as application forms (which are made the basis of, and are incorporated into, the subsequently concluded contract) and endorsements. And just like a single insurance contract may be contained in several documents (of which the policy is but one), a single policy may evidence more than one insurance contract.

The fact that the contract of insurance is reduced to a written policy has important consequences. For example, the parol-evidence rule then becomes applicable. Also, both the insured and the insurer are entitled to rectification of the policy if it does not correctly reflect the terms of the agreement between them. Special provision is made by way of legislation for the insured to obtain a copy of the policy from the insurer. For these matters, STUDY Reinecke et al paragraphs 210-212 and 238.

4.8 Interim Insurance: Cover Notes

In order to provide a prospective insured with insurance cover during the period after he has submitted his proposal and before the acceptance or rejection of his offer by the insurer, the latter may authorise its agents to provide the proposer with interim insurance cover. Students should know what the purpose and nature of an interim insurance contract is and how such a contract is formed, and should, for this purpose, STUDY Reinecke et al paragraphs 138-142.

Summary

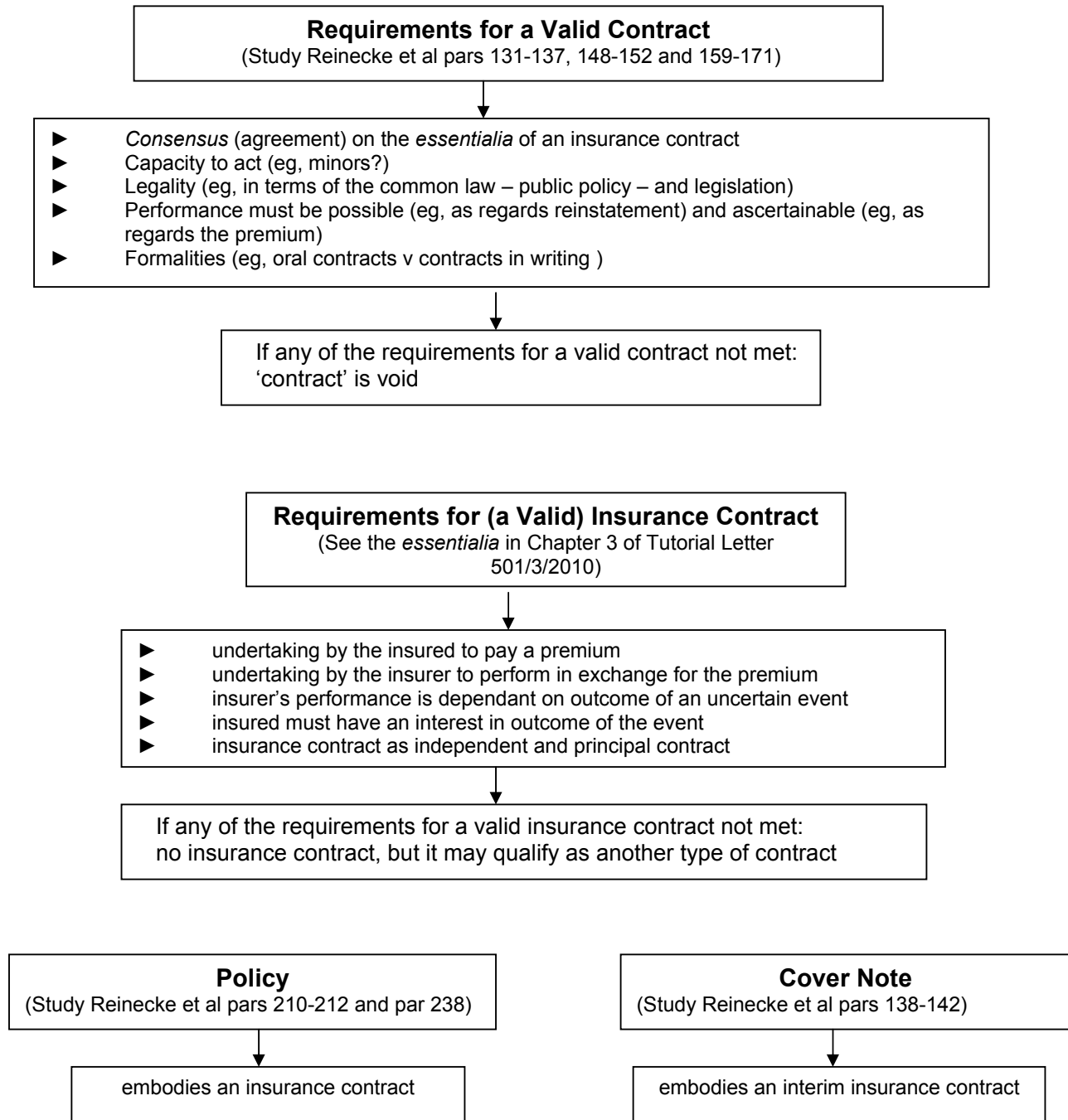
For the purposes of chapter 4, you should

STUDY Reinecke et al pars 131-142, 148-152, 159-171, 210-212, and 238.

Questions

- (1) An insured and an insurer agree to insure smuggled goods. Does their agreement amount to a valid insurance contract?
- (2) May a minor above the age of 18 years conclude any insurance contract on his own life or on that of another person? What about insuring his or her personal property? And a minor under 18 years?
- (3) May a married woman conclude a life-insurance contract on her own life? And on her husband's life?
- (4) Is an insurance contract concluded with an insurer who is not registered in terms of the Long-term Insurance Act or in terms of the Short-term Insurance Act illegal and therefore void?
- (5) An insurance contract is concluded by a South African concern with an insurer which has its principal place of business in a country which is at war with South Africa. Will the insured be able to claim the sum insured? Will the insurer be able to claim the premium?
- (6) An insurer paid the sum insured under an insurance contract which is illegal, and therefore void. The insurer is of the opinion that since the contract is void, the respective parties to the contract must return that which they received in terms of it, and it therefore claims a return of the sum insured from the insured. Will the insurer succeed in this claim? Can the insured claim that premiums which he or she paid in terms of this contract be returned?
- (7) What is the nature of an interim insurance contract and in what respects does it differ from a regular insurance contract?
- (8) What must a party prove for the rectification of an insurance policy to be permitted?

Diagrams for Chapter 4



CHAPTER 5 PARTIES TO THE INSURANCE CONTRACT

There are at least two parties to an insurance contract – namely, the insurer and the insured – although multiple insured or multiple insurers may also be involved. STUDY Reinecke et al paragraphs 132 and 258-259. Third parties, too, may be involved, and may, in some instances, obtain rights from the insurance contract between the insured and the insurer.

5.1 The Insurer

As far as the insurer is concerned, you need to know only that the Long-term Insurance Act and the Short-term Insurance Act require insurers to be registered, and that they lay down numerous requirements for the financial stability of insurance companies. A study of insurance-company law (ie, the statutory control of insurance business) falls outside the scope of this course. Regarding the consequences of contracting with an unregistered insurer, see again 4.4 above for the general requirement of legality for the conclusion of a valid insurance contract and for the effect of the provisions of section 60 of the LIA and section 54 of the SIA in this regard.

5.2 The Insured

As far as the insured is concerned, see again 4.3 above for the requirement of capacity to act on the part of the insured. Note, also, the difference between an insured and the “owner of a policy” or the “policyholder”. Furthermore, it is necessary to distinguish between the following:

- (1) the person taking out the insurance (ie, the person concluding the contract with the insurer)
- (2) the person whose interest is insured, and
- (3) in the case of life insurance, the person whose life is insured.

The following examples will illustrate some of the possibilities:

- (1) A may insure his or her own interest in his or her own house. A may insure his or her own interest in B’s house. A may insure B’s interest in his or her own (A’s) house, or in B’s house, or in C’s house.
- (2) A may insure his or her own interest in his or her own life. A may insure his or her own interest in B’s life. A may insure B’s interest in C’s life.

5.3 Third Parties

Apart from the insured and the insurer, a third party may also acquire rights under an insurance contract. STUDY, generally, Reinecke et al paragraph 406. Note that here we are concerned only with third parties to, or who acquire rights under, the insurance contract, and not with other (third) parties who may be involved in the insurance situation (eg, intermediaries [see ch 11] or a person appointed as *solutionis causa adiectus* to receive payment under an insurance contract [see 14.3 below regarding the discharge of an insurance contract through payment]).

A third party may acquire rights under the insurance contract in the following ways:

- (1) Through cession – this matter is dealt with in 14.2 below.
- (2) Through a stipulation in favour of a third party – STUDY Reinecke et al paragraphs 407-411 for the general principles involved.
In this regard, various possibilities may arise – STUDY Reinecke et al paragraph 418:
 - (a) The third party may be a beneficiary under a life-insurance contract and may as such be entitled to claim payment from the insured on the death of the life insured. STUDY Reinecke et al paragraph 421 and note that, again, several possibilities may arise in this regard. For instance, A may insure his or her own life and appoint B as beneficiary, or A may insure (his or her interest in) B's life and appoint C as beneficiary.
 - (b) The third party may himself, or herself, be an insured (and thus enjoy insurance cover) under the insurance contract. STUDY Reinecke et al paragraphs 431-434 and note the role of extension clauses in this regard.
 - (c) The third party's interest in the object of risk may be noted on the policy. STUDY Reinecke et al paragraph 420.
- (3) Through a statutory provision. One example of this, in our law, pertains to liability insurance. At common law, there is no contractual relationship between the liability insurer and a third party to whom the insured has incurred a liability covered by the insurance contract in question. The third party therefore cannot claim directly from the insured's liability insurer. But, if the insured becomes insolvent, section 156 of the Insolvency Act 24 of 1936 provides that the third party will be entitled to claim directly from the insurer the amount the insured could have claimed from it.

Summary

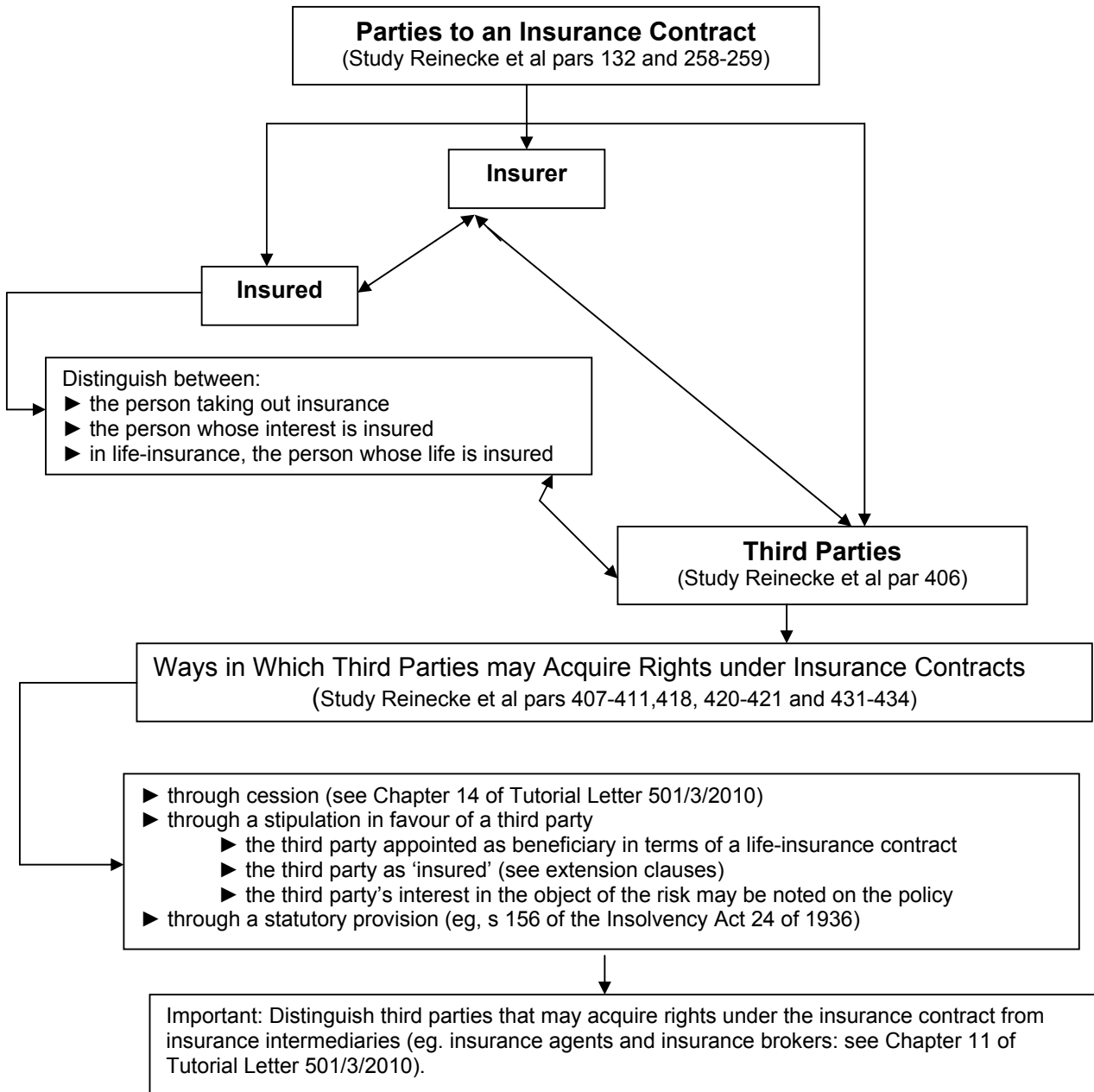
For the purposes of chapter 5, you should

STUDY Reinecke et al pars 132, 258-259, 406-411, 418, 420-421, and 431-434.

Questions

- (1) Distinguish between the following:
 - (a) the insured
 - (b) the beneficiary of an insurance contract
 - (c) the owner of an insurance contract
 - (d) the life assured
 - (e) the cessionary of rights under an insurance contract, and
 - (f) the person taking out (ie, concluding) the insurance.
- (2) Is it possible for the insured not to be a party to the insurance contract?
- (3) Distinguish between the case in which a third party acquires rights under a policy as the, or an, insured, and the case in which such third party is not the, or an, insured.
- (4) What is the relevance of the stipulation in favour of a third party in explaining the various aspects of the legal position of
 - (a) a beneficiary under a life- insurance contract, and
 - (b) an authorised driver under a comprehensive motor-vehicle insurance contract?

Diagrams for Chapter 5



CHAPTER 6 INSURABLE INTEREST

6.1 Introduction

As explained above, the existence of an independent interest in the happening of an uncertain event is generally regarded as of cardinal importance when distinguishing between an insurance contract and other aleatory contracts (eg, wagering agreements). In the case of insurance, it is the existence of such an interest (or at least the expectation that such an interest may be acquired) which moves the one party (the insured) to conclude the contract, whereas in the case of a wager, such an interest is created by, and is merely a consequence of, the contract itself (see again 3.4 above).

Such an interest is therefore (at least under English law; under South African law, the position, at present, is unsettled) regarded as a distinguishing feature or *essentiale* of the insurance contract. In the absence of such an insurable interest, the contract will not be one of insurance, but a wager, and therefore unenforceable, although generally not invalid. As to whether insurable interest is an *essentiale* of an insurance contract, READ Reinecke et al paragraphs 102-108.

But, it is also said that an insurable interest is a requirement for an insurance contract and that this requirement is based either on statutory requirement (and, more particularly, English statutes which may be applicable here), or on consideration of public policy which demands the existence of an insurable interest to prevent wagering and, in the case of life insurance, to prevent murder. However, it is not clear whether an insurable interest is required for the validity of an insurance contract, or merely for its enforceability. READ Reinecke et al paragraphs 156-158.

At this stage, it should be clear that, at least on a theoretical level, the role of insurable interest in our law, largely taken over in our law from and under the influence of English law, is uncertain. However, despite arguments that this interest theory is neither necessary nor even tenable, and despite doubts about whether the existence of an “insurable interest” is in fact an *essentiale*, and/or a requirement for the validity, of an insurance contract, the interest theory has generally been applied and followed in South African insurance law and practice.

It is therefore necessary to investigate the nature of the interest, the time when it is required to exist, and to analyse some practical examples of such interests in some detail. In this regard, a distinction is usually drawn between the position in the case of indemnity insurance and that in the case of capital (or nonindemnity) insurance. The distinction, as you will realise, is not merely one of convenience. In this regard, you should again refer to 3.1 above for the difference between indemnity- and capital- (nonindemnity-) insurance contracts.

First some terminology, though. In common parlance, it is said that A insures his or her house, or his or her life. In truth, according to the interest theory, A insures his or her own (insurable) interest in his or her house, or his or her life. His or her interest is the object of the insurance, and his or her house or life is the object of risk. Different persons may have an interest in the same object of risk. Thus, A may insure his or her own interest in his or her house or life and B, too, may insure his or her (B's) own interest in A's house or A's life. In this regard, STUDY Reinecke et al paragraphs 51-53 and 83.

6.2 Indemnity Insurance

6.2.1 Nature of the Interest Required

In the case of an indemnity-insurance contract, the principle of indemnity (involving, as it does, the concepts of “loss” or “damage”) and the concept of an “insurable interest” are closely linked. In addition to being (possibly) based upon public policy, the interest requirement may merely be a necessary incident of an indemnity-insurance contract flowing from the nature of the contract itself. The explanation is simple. The insurer undertakes to indemnify the insured against loss. In order to recover from his or her insurer, the insured has to show that he or she has suffered loss as a result of the occurrence of the event insured against. He or she will suffer loss as a result of the loss of or damage to the object at risk only if he or she has some interest in that object. Hence, no interest, no loss for the insured, and no indemnity. The nature of the interest required in the case of indemnity insurance is therefore a financial interest. STUDY Reinecke et al paragraphs 56-60.

6.2.2 Time When the Interest is Required

In the case of indemnity-insurance contracts, the relevant insurable interest is required to exist at the time of the loss. If it does not exist at the time, there will be no loss or damage against which the insurer will be bound to indemnify the insured. Thus, the requirement that the interest must exist at the time of loss is a logical consequence of the indemnity principle. An insurable interest need not be in existence at the time of the conclusion of the contract. It is possible that, in order to avoid what would amount to a wager, it could be required that there should exist, at the date of the contract, at least a genuine expectation that an insurable interest will be acquired. This proposition is, however, not at all clear in our law, in which, unlike in English law, there is no statutory provision governing the matter. STUDY Reinecke et al paragraph 64.

One consequence, in the case of indemnity insurance, of this requirement about the time when the interest must exist is that future and ascertainable interests, too, may be insured, and that a change or transfer of an interest during the currency of the insurance may have particular consequences for the insured. STUDY Reinecke et al paragraphs 67-71.

Note, also, that, in the case of indemnity insurance, given that an interest need exist only at the time of the loss, such an interest can hardly serve as an essential and distinguishing feature of the insurance contract. It will not be possible to classify the contract as one of insurance (because of the presence of the required interest) immediately upon its conclusion, but only at a later stage (viz, on the occurrence of loss), if at all (there may, in fact, be no loss at all during the currency of the contract).

6.2.3 Examples

The requirement of an insurable interest in indemnity insurance may be illustrated by examining a number of instances in which an insurable interest has been held to exist. For these, STUDY Reinecke et al paragraphs 72-82 in detail.

6.3 Capital (Nonindemnity) Insurance

6.3.1 Nature of the Interest Required

The true nature of capital (nonindemnity) insurance has not yet been determined authoritatively in South African law. However, under the influence of English law, an insurable interest may well be required. Again, though, there is uncertainty about whether it will qualify as an essential feature of, say, a life-insurance contract, or whether it will be merely a requirement for the validity of such a contract. READ Reinecke et al paragraphs 41-43.

Given that the nature of capital insurance is uncertain, it is not surprising that the nature of the interest required for such insurance, too, is shrouded in uncertainty. Two possibilities arise. On the one hand, it may be argued that capital insurance does not (or should not), in principle, differ from indemnity-insurance contracts, and that the nature of the insurable interest should be similar, whereas on the other hand, it may be argued that in so far as capital insurance does differ from indemnity insurance, the nature of the interest required should differ as well. English law (which South African courts will probably follow, rather than developing an indigenous solution), as it will appear, follows a middle path and distinguishes, when it comes to life insurance, between insurance on own life (or that of a spouse) and insurance on the life of a third party.

In the case of insurance on own life (and on the life of a spouse), an insurable interest is, by law, presumed to exist. Also, it is an unlimited interest. Thus, a person can insure his or her own life (and that of his or her spouse) for as much as he or she wishes and, obviously, can afford. Accordingly, the interest is a presumed unlimited interest and does not have any financial basis, which makes sense, given that here one is concerned with capital (or nonindemnity) insurance.

In the case of insurance on the life of a third person, though, English law disregards the nonindemnity nature of the insurance in question and requires a financial interest. Thus, a person can insure the life of a third person only if, and then only to the extent that, he or she has a financial interest in that person's life. Thus, the interest is a financial and (usually) a limited interest. STUDY Reinecke et al paragraphs 39 and 85-86.

6.3.2 Time When the Interest is Required

In the case of capital (nonindemnity insurance), in terms of English law, the interest is required only at the time when the contract is concluded. STUDY Reinecke et al paragraphs 84 and 87.

This has several consequences:

- (1) Insurable interest may serve as an essential feature of a capital- (nonindemnity-) insurance contract.
- (2) The fact that the interest falls away after the conclusion of the contract has no bearing on the validity of the contract. Thus, if A insures his wife's life and they are subsequently divorced, the insurance contract remains in force (ie, as long as A continues paying the premiums), and A can claim the sum insured from the insurer on his former wife's death. Likewise, if A has an interest in B's life in the amount of R200 (say B owes him or her R200) and insures B's life for that amount, and the interest subsequently falls away (because B repays the debt), A may continue with the insurance (it may, however, not be an economical proposition to do so) and claim the sum insured from the insurer when B dies. Clearly, in both these cases, there may be quite an incentive for the insured to wish for the occurrence of the uncertain event (the death of the life insured), but, given the time when the interest is required to exist, the law seemingly does nothing about it.

- (3) In the case of insurance on the life of a third person, there is an anomaly: although a financial interest is required and the amount insurable and recoverable to the value of that interest is limited, the fact that the interest subsequently falls away is then ignored and the insured is permitted to recover the sum insured despite the fact that he or she no longer suffers any “loss” on the occurrence of the uncertain event. This is permitted because here we are concerned with nonindemnity insurance, but the same reason does not apply when, in determining the legality or extent of the insurance upon its conclusion, it comes to the nature of the required interest.

6.3.3 Examples

The requirement of an insurable interest in capital (nonindemnity) insurance may be illustrated by examining a number of instances in which an insurable interest may be taken to exist. STUDY Reinecke et al paragraphs 39 and 88-95. Most of these examples concern life-insurance contracts.

Apart from the distinction between insurance on own life (presumed, unlimited interest) and insurance on a third person’s life (in which case a financial interest is required), it is convenient to distinguish, in the latter group, insurances on the lives of family members from that on the lives of other persons.

To effect an enforceable insurance on the life of a family member it is necessary for the person effecting the insurance to have a legal right to claim support and maintenance from such family member – only in such a case will the required insurable interest exist. The interest is based on the loss of the right to support. Obviously, the value of this right can only be estimated, and consideration will have to be given to factors such as the ages, health and expected duration of life of the person effecting the policy and the person whose life is insured. In South African law, there is a legal duty (as opposed to a mere moral duty) of support in, for example, the following cases: husband and wife, ascendants and descendants (eg, parent and child, grandparent and grandchild), and collaterals related in the second degree (eg, brothers and sisters). In all these cases, therefore, the person that has a right to claim support has an insurable interest in the life of the family member concerned. However, it should be noted that there are certain statutory limitations on the amount for which the life of children may be insured.

Outside the context of family members, the instances in which one person has an insurable interest in the life of another occur mainly in the context of business. Thus, a creditor has an insurable interest in the life of his or her debtor. The creditor (who, incidentally, also has an insurable interest sufficient to support an insurance against his or her debtor’s insolvency, or against the latter’s failure to repay the debt by a certain date, though not, as you may have noted, an interest in the debtor’s unsecured property) has an interest which is limited to the amount of the debt, with interest. Thus, if the amount due (with interest) is R1 000, the creditor may insure his or her debtor’s life for this amount, and on the death of the debtor he or she may recover only this amount.

Summary

For the purposes of chapter 6, you should

STUDY Reinecke et al pars 39, 51-53, 56-60, 64, and 67-95; and
 READ Reinecke et al pars 41-43, 102-108, and 156-158.

Questions

- (1) Is an insurable interest an *essentiale* of the insurance contract? Or a requirement for the validity of an insurance contract? Or a way to determine whether the insured has suffered a loss?
- (2) Distinguish between the object of insurance and the object of risk.
- (3) Can South African law do without the interest theory?
- (4) Must there be an insurable interest at the time when an indemnity-insurance contract is concluded? And when a capital-insurance contract is concluded? Is there a difference, in principle, between indemnity and nonindemnity insurance in South African law?
- (5) Discuss the insurable interest of a creditor in the life of his or her debtor.
- (6) Discuss the insurable interest of a creditor in the property of his or her debtor.
- (7) Discuss the insurable interest of a buyer in the article bought and of a seller in the article sold. Will it make any difference if the article in question is a stolen article?
- (8) Discuss the interest of spouses in each other's property.
- (9) Discuss the insurable interest of a shareholder in the property of the company in which he or she holds shares, and of the company in the property of its director.
- (10) When must an insurable interest exist in the case of a personal-accident insurance contract?
- (11) Can a person insure his or her own life for an unlimited amount? For instance, can a beggar insure his or her life for R10 million?
- (12) Does a wife have an insurable interest in her husband's life? What is the basis of such an interest? Is her interest limited in any way?
- (13) Can a parent insure the life of his or her child for an unlimited amount? When can a child insure the life of his or her parent?

Diagrams for Chapter 6

Insurable Interest

(Read Reinecke et al pars 102-108 and 156-158)

(Study Reinecke et al pars 51-53 and 83)

(Also Study:

- *Littlejohn v Norwich Union Fire Insurance Society* 1905 TH 374
- *Phillips v General Accident Insurance Co (SA) Ltd* 1983 (4) SA 652 (W)
- *Steyn v AA Onderlinge Assuransie Assosiasie Bpk* 1985 (4) SA (T)
- *Refrigerated Trucking (Pty) Ltd v Zive NO (Aegis Insurance Co Ltd, Third Party)* 1996 (2) SA 361 (T)
- *Manderson t/a Hillcrest Electrical v Standard General Insurance Co Ltd* 1996 (3) SA 434 (D)

- ▶ insurance contract (where insured must have an insurable interest in outcome of uncertain event; interest leads to contract) v other aleatory contracts eg, wagering agreements (where contract creates interest; see Chapter 3 in Tutorial Letter 501/3/2010).
- ▶ *essentiale* or requirement for insurance contract? (in case of last-mentioned, requirement in terms of statute or common-law?; requirement for validity or enforceability of insurance contract?)
- ▶ object of insurance v object of the risk (eg, A insures his interest in his boat. Object of insurance: his interest in his boat. Object of risk: the boat. Important: in liability insurance, the insured's interest is not embodied in a particular object of risk; the interest is the interest of not incurring liability towards third parties.)

Indemnity Insurance v Capital Insurance

(See Chapter 2 in Tutorial Letter 501/3/2010)

- ▶ indemnity insurance: insurer indemnifies the insured for patrimonial loss or damage as result of happening of event insured against
- ▶ capital insurance: insurer undertakes to pay a specified amount to the insured on happening of event insured against

Indemnity Insurance

(Study Reinecke et al pars 56-60, 64 and 67-71)

Examples	Nature of Interest Required	Time when Interest is Required
1) A insures his interest in his own house 2) creditor X insures his interest in the property of his debtor See more examples in Reinecke et al pars 72-82	1) limited financial interest (maximum to loss/damage) 2) limited financial interest (maximum to debt due plus interest)	1) insurable interest required to exist at the time of the loss 2) insurable interest required to exist at the time of the loss

Capital Insurance

(Read Reinecke et al pars 41-43)

(Study Reinecke et al pars 39 and 84-87)

(Important: position uncertain in SA law, see English law)

Examples	Nature of Interest Required	Time when Interest is Required
1) A insures his interest in his own life or his own interest in his wife's life 2) B insures his interest in the life of another family member (not his wife's life) 3) creditor X insures his interest in the life of his debtor See more examples in Reinecke et al pars 88-95	1) presumed unlimited interest: no financial basis 2) limited financial interest (depends on insured's legal right of support and of maintenance from family member) 3) limited financial interest (maximum to debt due plus interest)	1) insurable interest required to exist at the time when the contract is concluded 2) insurable interest required to exist at the time when the contract is concluded 3) insurable interest required to exist at the time when the contract is concluded

CHAPTER 7 MISREPRESENTATION AND THE INSURANCE CONTRACT

7.1 Good Faith

In South African law, all contracts are contracts of good faith (contracts *bonae fidei*). In English law, the insurance contract is a contract of the utmost good faith (a contract *uberrimae fidei*). In *Mutual & Federal Insurance Co Ltd v Oudtshoorn Municipality* (1985 (1) SA 419 (A)), it was held that there are no degrees of good faith (*bona fides*) such as good, better or best (utmost good) faith; only good or bad faith. Accordingly, the court explained, in our law, the insurance contract is, like all other contracts, one of good faith. Therefore, in our law, the requirement of good faith is not a distinguishing feature of the insurance contract. Any difference between insurance contracts and other contracts when it comes to the operation of the requirement of good faith is therefore not one of principle, but merely one of degree.

For the role of good faith regarding insurance contracts, STUDY Reinecke et al paragraphs 172-178 and 215. Note that the requirement plays a role at different stages, namely precontractually, during the currency of the contract, and at the claims stage. Note, too, that the insurer is also under a duty of good faith.

7.2 Positive and Negative Misrepresentation

One of the requirements for a valid (insurance) contract is that the parties must have reached *consensus* on the essential terms of their contract (see again 4.2 above). Failing such *consensus*, the contract is void. If there is *consensus*, but it has been obtained in an unlawful manner, the contract is voidable at the instance of the innocent party. One way in which *consensus* may be obtained in an unlawful manner, is through misrepresentation. Misrepresentation is a delict.

Misrepresentation plays an important role in the insurance context. If the insurer is induced to enter into an insurance contract (or to grant insurance cover at a specific rate of premium or on certain conditions) by a false representation of a material fact made to it by the insured, the insurance contract will be voidable at the instance of the insurer who may also, in appropriate instances, be able to claim damages. The reason for this is that the insured's false representation of a material fact inducing the contract amounts to a (precontractual) misrepresentation. The usual requirements for a delict (for that is what a misrepresentation is) must, however, be present before the insurer will be in a position to rely on its remedy to avoid the contract and/or to claim damages.

The insured's misrepresentation may take the form of a positive misrepresentation (a misrepresentation *per commissionem*), or a negative misrepresentation (a misrepresentation *per omissionem*). The former occurs when the insured makes a positive incorrect statement concerning a material fact to the insurer, for instance, when he or she provides an incorrect answer to a question put to him or her in a proposal form, or otherwise. The latter occurs when the insured fails to disclose a material fact to the insurer. Both are misrepresentations and, in principle, subject to the same (delictual) requirements. That is so not only on general principles, but also for practical reasons, as, in certain instances, it may be difficult to distinguish between them: an insured's (positive) incorrect statement on a material fact may (and often does) at the same time amount to his or her failure to disclose the truth regarding that fact.

For the nature and elements of misrepresentation generally, STUDY Reinecke et al paragraphs 179-184. For the general features of positive and negative misrepresentation in the insurance context, STUDY Reinecke et al paragraphs 186-192, and for the differences between the two forms of misrepresentation, STUDY Reinecke et al paragraphs 180, 187 and 192.

The most likely source of (positive) misrepresentations in the insurance context is in the form of incorrect statements on the proposal form completed by the insured. In practice, such statements will almost inevitably amount to warranties, in respect of which strict compliance is necessary and for which the materiality of the misstatement was irrelevant at common law. The scope of insurance warranties and their statutory curtailment is considered in chapter 8. However, at this stage, you should appreciate that the same incorrect statement by an insured may amount to both a (positive) misrepresentation and a breach of warranty, thus providing the insurer with alternative causes of action to avoid liability for a claim by the insured. But, obviously, careful distinction should be drawn between misrepresentation (a delict) and breach of warranty (breach of contract). In this regard, STUDY Reinecke et al paragraph 185.

7.3 The Insured's Duty to Disclose

As a rule, in our law, there is no general duty upon contracting parties to disclose to each other any facts or circumstances known to one of them which may influence the mind of the other party in deciding whether or not (or on what terms) to conclude the contract. However, there is an exception to this rule in cases in which there is a relationship of trust or confidence between the parties and an involuntary reliance by the one on a disclosure of relevant facts by the other.

In the insurance context, it is almost unquestioningly accepted that such a relationship exists between the proposer for insurance and the insurer. It is generally taken that the insurer relies on the prospective insured to provide it with information relevant to the risk prior to the conclusion of the contract which will enable it to assess that risk in order to decide whether it will, in fact, conclude the insurance contract and, if so, on what terms. The proposer is therefore under a duty to disclose certain facts to the insurer, and the failure to do so amounts to a (negative) misrepresentation. It is also commonly said that the insured's duty of disclosure is an instance of his or her duty of good faith.

For an exposition of the origin and nature of the insured's duty of disclosure, STUDY Reinecke et al paragraphs 193-196.

7.4 Materiality

As mentioned, a (positive or a negative) misrepresentation in the insurance context is a delict. One of the requirements for a delict is that the conduct of the wrongdoer must be unlawful (wrongful). In the insurance context, an incorrect representation will be wrongful (ie, it will be a *misrepresentation*) if it relates to a material fact.

Generally speaking, a material fact is one which bears some relation to the risk to be transferred to the insurer. A material fact is one which is relevant to the risk. However, the vexed question is, according to whose view should such relevance be determined? Several possibilities arise: the particular insured, the particular insurer, a reasonable insured, or a reasonable insurer. Or should the views of more than one party be combined? Obviously, a reasonable insurer may not attach the same weight to a certain fact as a particular insured.

Note that the difference among the various tests relates, in particular, to the burden of proof of materiality. For an insurer to prove that *it* considers a particular fact as material (a subjective test) involves a much lighter burden of proof than establishing that *a reasonable insurer* regards that fact as material (an objective test). Given that here we are concerned with materiality, which, in the insurance context, is equivalent to unlawfulness, it is clear that an objective test should apply: either that of the reasonable insured, or that of the reasonable insurer (the former will favour the insured,

and the latter will favour insurers – in theory, at least).

In *Mutual & Federal Insurance Co Ltd v Oudtshoorn Municipality* (1985 (1) SA 419 (A)), a case involving a failure by the insured to disclose a particular fact (thus, a case of a negative misrepresentation), the court, in trying to do justice between the parties to an insurance contract, formulated another, even more objective, test, namely that of the reasonable person. The test to establish whether a particular fact or information should be disclosed, that is, whether it is material, is whether the reasonable person (and not either the reasonable insurer or the reasonable insured) would consider that that fact or information should be conveyed to the insurer so that it could reach a decision about whether or not it would accept the risk, and on what conditions and at what rate of premium (see *President Versekeringsmaatskappy Bpk v Trust Bank van Afrika Bpk & 'n Ander* 1989 (1) SA 280 (A), in which this test was explained at 216E-F).

However, in *Qilingele v South African Mutual Life Assurance Society* (1993 (1) SA 69 (A)), the court decided that the reasonable-person test was applicable only in the case of a negative misrepresentation (a failure to disclose), and not when there was a positive misrepresentation. In the latter case, a different test applied, namely that of the particular insurer. The test for materiality, and the question to be asked in that case, is whether the particular insurer considered the fact or information as relevant to the risk in question, and whether it either would not have concluded the contract, or would have done so on different terms had there been no misrepresentation and had it known the true facts.

In *Clifford v Commercial Union Insurance Co of SA Ltd* (1998 (4) SA 150 (SCA)), the decision in *Qilingele* was severely criticised in a minority judgment. The main points of criticism were that different tests now applied to determine the materiality of a representation, depending on whether it is considered a negative or a positive representation; that an unacceptably pro-insurer subjective test applied to determine the materiality (unlawfulness) of a positive representation; that that test applied irrespective of whether the positive representation was warranted to be true or not (thus, the same particular insurer test applies when it has to be determined whether a fact warranted to be true is material); and that this subjective test confuses the test for materiality with that for inducement (causation).

On the issue of materiality, and the test for and proof of materiality, STUDY Reinecke et al paragraphs 197-202.

Note that the duty to disclose is not an unlimited one. Only material facts have to be disclosed. Also, it is a vexed question whether the proposer for insurance has a duty to disclose all material facts, or whether the duty to disclose is limited to material facts of which he or she has knowledge, or whether, as suggested in *Mutual & Federal Insurance Co Ltd v Oudtshoorn Municipality* at 436E, the duty relates to material facts which lie within the insured's actual knowledge and also to material facts of which he or she has constructive knowledge (ie, of material facts of which a reasonable person in his or her position would have knowledge). A number of other types of (material) fact also need not be disclosed in the absence of a specific enquiry by the insurer:

- (1) The proposer need not disclose facts or circumstances which diminish the risk (presumably because they are not material).
- (2) The proposer need not disclose circumstances of which the insurer has knowledge or of which it is deemed to have knowledge, presumably because the element of inducement will be absent in such a case.
- (3) The proposer need not disclose a fact regarding information which the insurer has waived (note, in this regard, the difference between waiver by an insurer of its right to the disclosure of certain material facts and waiver by an insurer of its right to avoid the contract on the ground of misrepresentation (the nondisclosure of those facts): regarding

the latter, see 14.3 below).

It should also be noted that since here we are concerned with precontractual misrepresentation, the proposer's duty to inform the insurer of all the material facts continues up to the time of the conclusion of the contract. If a proposer for insurance on his or her own life, for example, were to become aware of certain material facts concerning his or her health after having completed the proposal form but before conclusion of the contract (on this, see, once again, 4.2 above), he or she must disclose those facts to the insurer.

7.5 Inducement

Another, and separate, element of a delict, apart from unlawfulness, is causation. Thus, an insurer who denies liability on the grounds of misrepresentation, must establish not only that the incorrect representation (the conduct) concerned a material fact (was unlawful), but also that that incorrect representation induced it to conclude, and therefore resulted in and caused, the contract in question. The test for inducement is a subjective one, and the question is whether the particular insurer was induced by the insured's positive representation (his or her incorrect statement of facts) or his or her negative representation (his or her failure to disclose a fact). On inducement, STUDY Reinecke et al paragraph 203.

7.6 The Consequences of, and Remedies for, Misrepresentation

In the case of both a positive and a negative misrepresentation by the proposer for insurance, the usual remedies are available to the insurer. Although insurance contracts frequently provide that misrepresentation or nondisclosure (ie, positive or negative misrepresentation) will render the contract void and that the insured will forfeit his or her rights, this does not reflect the true legal position. Misrepresentation merely renders the contract voidable, and not void.

Regarding the remedies available (to both parties, since a misrepresentation may also be committed by the insurer or by someone on its behalf), STUDY Reinecke et al paragraphs 205-207. Note, also, that fault is not a requirement for the avoidance of an insurance contract on the grounds of misrepresentation: innocent misrepresentation, too, renders the contract voidable. On the requirement of fault (which must be established only if the innocent party wishes to claim damages), STUDY Reinecke et al paragraph 204. Remember, further, that a misrepresentation may be made not by the parties to the insurance contract themselves, but by one of their representatives (see ch 11), and that the insured's misrepresentation may result in the forfeiture of premiums (see ch 10).

Summary

For the purposes of chapter 7, you should

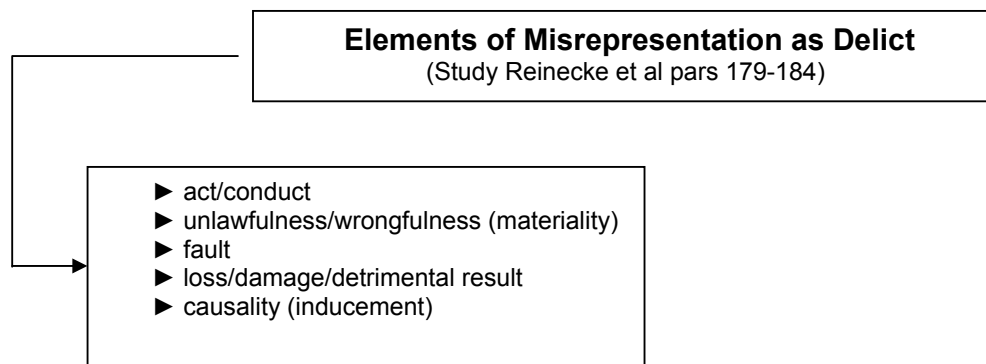
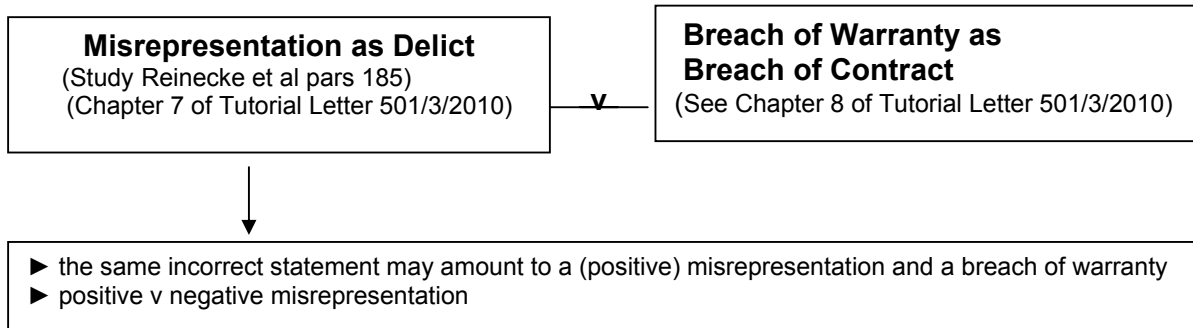
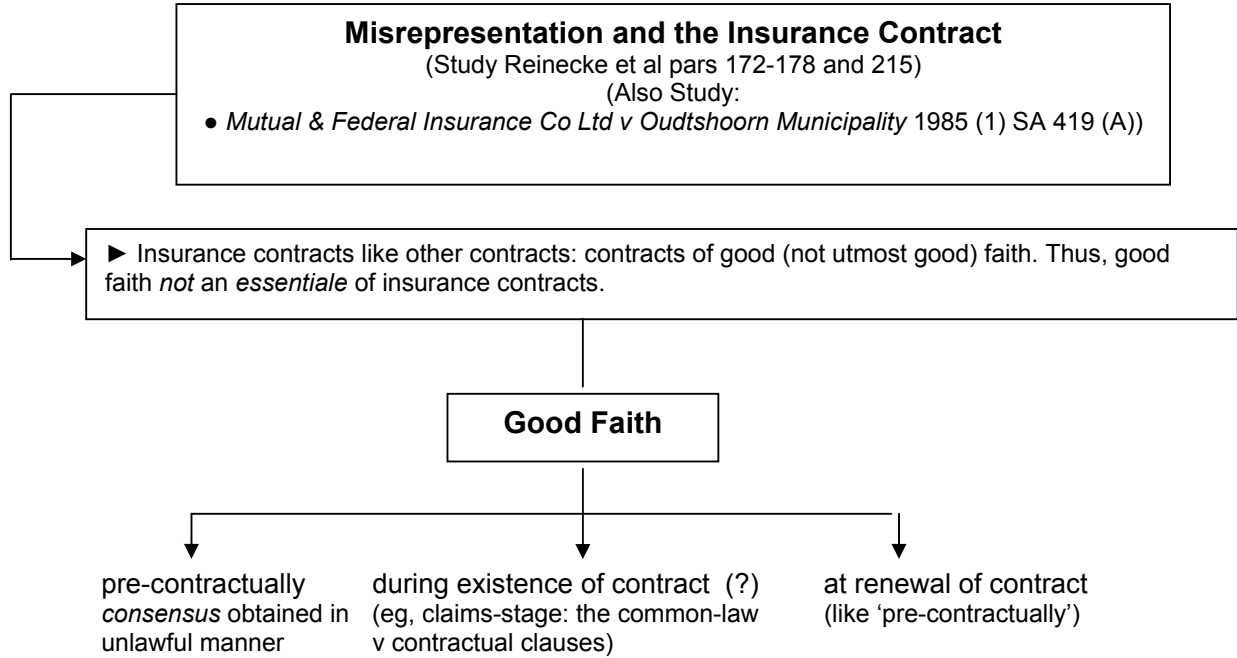
STUDY Reinecke et al pars 172-207 and 215.

Questions

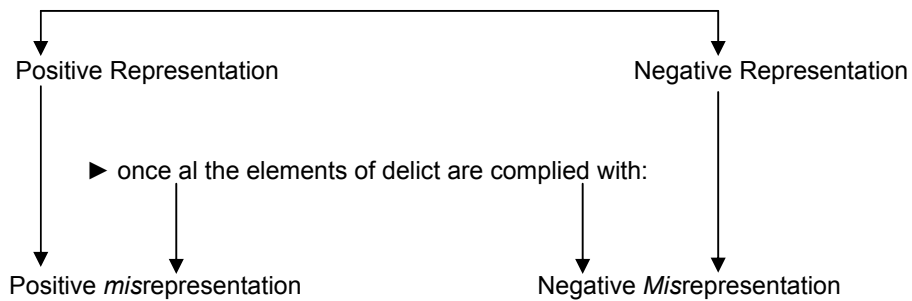
- (1) What is the legal nature of a misrepresentation?
- (2) Why is it necessary to distinguish between a misrepresentation and a nondisclosure? And between an incorrect representation and a misrepresentation?

- (3) What is the basis of the doctrine of nondisclosure?
- (4) What are the differences and similarities between a misrepresentation and a breach of warranty (see ch 8 for the nature of a warranty)?
- (5) Explain, and differentiate between, the different tests currently applicable in our law regarding the elements of the materiality of, and the inducement caused by, incorrectly represented facts.
- (6) X applied for life cover on his own life. He was unaware of the fact that he was suffering from a terminal disease. Consequently, he did not disclose this fact to the insurer. Also, in the proposal form for insurance the insurer did not ask X any question about his health. Would the insurer be able to avoid liability for a claim on the contract should it appear, after X's death, not only that X had been suffering from such a disease at the time he applied for the insurance cover, but also that that disease had in fact been the cause of his death?
- (7) Would it make any difference to your answer in (6) if
 - (a) X had been aware of the disease, but had not considered it necessary to disclose it to the insurer?
 - (b) the medical doctor to whom X had been sent by the insurer for an evaluation prior to the conclusion of the contract had discovered that he was suffering from the disease but had decided not to tell X about it?
 - (c) X had contracted the disease only after the conclusion of the contract in question?
 - (d) X had applied not for life insurance, but for motor-vehicle insurance?
- (8) Will previous losses suffered by the proposer for insurance always qualify as material facts which must be disclosed in a proposal for insurance?
- (9) What are the different remedies available to an insurer if the applicant for insurance failed to disclose certain material facts? And if the applicant misrepresented certain facts?
- (10) Why (if at all) is it necessary to distinguish between a fraudulent, a negligent, and an innocent misrepresentation?

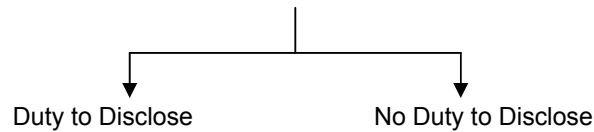
Diagrams for Chapter 7



1. Act/Conduct
(Study Reinecke et al pars 180 and 186-192)



**2. Unlawfulness/Wrongfulness
(Materiality)**
(Study Reinecke et al pars 181, 193-202)
(Also Study:
 • *Mutual & Federal Insurance Co Ltd v Oudtshoorn Municipality* 1985 (1) SA 419 (A)
 • *President Versekeringsmaatskappy Bpk v Trust Bank van Afrika Bpk & 'n Ander* 1989 (1) SA 280 (A)
 • *Qilingele v South African Mutual Life Assurance Society* 1993 (1) SA 69 (A)
 • *Clifford v Commercial Union Insurance Co of SA Ltd* 1998 (4) SA 150 (SCA))
 (Important: Study the amendments to Chapter 7 at the end of Chapter 8 in Tutorial Letter 510/3/2010)



Duty to Disclose

- ▶ material facts: facts relevant to the risk
- ▶ test for materiality: if a reasonable prudent person would consider the information relevant to the assessment of the risk by an insurer (objective test, see s 59(1) of the LIA and s 53(1) of the SIA)

No Duty to Disclose

- ▶ *immaterial* facts
- ▶ material facts:
 - ▶ of which insured has no actual or presumed knowledge
 - ▶ which diminish the risk
 - ▶ of which the insurer has knowledge (or is deemed to have knowledge)
 - ▶ which the insurer has waived that the insured had to disclose the information

3. Fault (Negligence or Intent)

(Study Reinecke et al pars 184 and 204)

- ▶ fault is not a requirement for avoidance of the insurance contract: possible to cancel an insurance contract due to innocent misrepresentation
- ▶ fault is a requirement if the innocent party wishes to claim damages

4. Loss/Damage/Detrimental Result

(Study Reinecke et al par 182)

- ▶ incorrect statement induced insurer to conclude a contract which it would not have concluded or which it would have concluded on different terms and/or
- ▶ the insurer suffered damage as a result of the incorrect statement

5. Causation (Inducement)

(Study Reinecke et al pars 182 and 203)

- ▶ incorrect representation must have induced the contract or its particular terms
- ▶ test for inducement: whether the particular insurer was induced by the incorrect statement or failure to disclose (subjective test: compare with the objective test for materiality)

Misrepresentation: Consequences and Remedies

(Study Reinecke et al pars 204-207)

(Important: misrepresentation may be committed by the insurer, the insured and/or by their representatives: see Chapter 11 of Tutorial Letter 501/3/2010)

- ▶ contract is voidable (not void): prejudiced party may avoid the contract from date of inception (compare with rescission in case of breach of warranty)
- ▶ damages, if applicable (and not for innocent misrepresentation)
- ▶ forfeiture of premiums? (see Chapter 10 of Tutorial Letter 501/3/2010)

CHAPTER 8 INSURANCE WARRANTIES

8.1 Introduction

Insurers employ the warranty technique both to add to their common-law rights in the event of an incorrect representation of facts by the insured (affirmative warranties), and in an attempt to exercise some measure of control over the risk during the currency of the contract (promissory warranties). The warranty technique was taken over from English insurance law, and has resulted in some terminological confusion. READ Reinecke et al paragraphs 356-357. Regarding the purpose of warranties, STUDY Reinecke et al paragraph 358.

The terms of a contract determine the content of the contract, and may be either essential or nonessential. An *essential* (or *vital*) *term* is one which, in the event of its breach, will entitle the innocent party to avoid liability on the contract, or to rescind from the contract and claim damages. A *nonessential term* will, in the event of its breach, entitle the innocent party merely to a claim for damages, and will not relieve him or her from his or her obligation to perform in terms of the contract. An insurance warranty is an essential term of an insurance contract and must be strictly complied with. Breach of this essential term by the insured entitles the insurer to rescind from the contract as from the time of its breach.

For an exposition of the nature of, obligations arising from, and defences available in the case of breach of an insurance warranty, STUDY Reinecke et al paragraphs 359-360 and 364.

8.2 Types of Warranty

Basically, there are two types of warranty. The first is a warranty that particular facts are true at the date the warranty is given (the affirmative warranty). The other is a warranty regarding the future: that a particular fact or state of affairs will be true or will continue to be true or complied with (the promissory or continuing warranty).

Affirmative warranties relate to an event or fact of the past or present, and thus to a determinable fact. They usually arise from answers to questions on the proposal form and signify that a particular fact or facts are true or that a particular state of affairs exists at the date the warranty is given. The insured is asked to warrant the truth of his or her answers, and those answers (and the questions to which they relate) are incorporated into, and made terms of, the insurance contract which is subsequently concluded. Thus, if an insured answers “no” to a question in a proposal form for insurance about whether he or she has had any accidents in the past three years, and his or her answer is warranted as true and the proposal form is incorporated into the insurance contract, that contract, in effect, contains a term which provides that the insured warrants (guarantees) that he or she has had no accidents in the three years preceding the conclusion of the contract. Should the insurer subsequently establish that his or her answer was incorrect, the insured breaches that term and commits a breach of contract. Remember that his or her incorrect answer at the same time amounts to an incorrect (precontractual) representation, so that the insurer has a choice whether to avoid liability on the grounds of breach of contract (breach of the warranty), or delict (misrepresentation). Again, STUDY Reinecke et al paragraph 185 for the difference between these two causes of action.

Promissory (or continuing) warranties relate to the future and signify that a particular fact or state of affairs will continue to be true or to exist, or that the insured will do or refrain from doing certain things. They appear as actual terms in the insurance contract. For instance, the insured warrants (and undertakes) to keep the insured vehicle in a roadworthy condition. Should that not be the case,

the insured breaches the insurance contract and the insurer may be able to avoid liability. Note, though, that there is authority to the effect that the insurer will be able to do so only if it can establish a causal link between the breach (the unroadworthy condition of the vehicle) and *the loss* for which the insured claims (note: *not the risk* insured by the contract). Thus, the unroadworthy condition (eg, the fact that the tyres of the insured vehicle were worn) will avail the insurer only if it caused, or contributed to, the loss or damage (eg, if the vehicle was damaged when it skidded on a wet road and collided with another vehicle), and not if there was no connection (eg, if the vehicle was damaged when another collided with it while it was stationary in a parking garage, or if it was stolen).

There are also other types of warranty. Affirmative warranties may be warranties of fact, of knowledge, or of opinion, depending on the interpretation of the particular contract. Warranties of fact and warranties of knowledge should, however, be distinguished from warranties of opinion, in which case the insured need only give his or her opinion fairly, reasonably and honestly, and there will be no question of breach of such warranty if subsequently his or her opinion proves to be wrong: there will, in fact, be a breach of a warranty of opinion only if the insured did, in fact, not hold the opinion indicated, that is, if he or she acted fraudulently.

Regarding the different types of insurance warranty, STUDY Reinecke et al paragraphs 361-362.

8.3 Breach of Warranty and Remedies

In order to ascertain whether an insurance warranty has been breached, one has to distinguish between relative warranties and absolute warranties. For the difference, STUDY Reinecke et al paragraph 363.

Breach of an insurance warranty is nothing more than a breach of contract. The usual remedies for breach of an essential (vital) term of contract apply. The insurer may resile from the contract and/or claim damages. The insurer resiles from the contract as from the date of the breach, which may (eg, in the case of an affirmative warranty) be from the time of the conclusion of the contract, but which may also be from a later date (eg, in the case of a promissory warranty). It incurs no liability for claims arising after the breach, but will not be able to avoid liability for prior losses. (Remember that a breach of warranty may, depending upon the circumstances, also amount to a misrepresentation by the insured, but that in this case the insurer avoids the contract from its inception, and therefore cannot incur any liability at all on it.) On the insurer's remedies for breach by the insured of an insurance warranty, STUDY Reinecke et al paragraph 365-366.

8.4 Statutory Modification

Although warranties (being terms of the insurance contract) are, as a rule, strictly interpreted and construed against the insurer in the case of ambiguity, they may still operate unduly harshly against the insured. One of the main points of criticism levelled against the use of insurance warranties is the fact that it enables the insurer to avoid liability and to resile from the insurance contract for any breach of an affirmative warranty (any objectively inaccurate statement of fact in the proposal form) or for any breach of a promissory warranty, even if the subject-matter of the warranty (ie, the fact guaranteed to be true or the obligation undertaken by the insured) has no bearing whatsoever on *the risk* taken over in terms of the insurance contract. This right to resile from the contract is at the insurer's disposal however trivial the inaccuracy, and even though the proposer made the statement honestly and carefully and did not know, or could not reasonably have known, of the inaccuracy. Likewise, even if the obligation undertaken has no bearing on the risk covered by the insurer, the breach will enable it to resile (remember, though, that a causal link between the breach and *the loss*

may be required). In short, the warranty, being an essential term (see par 8.1 above), does not have to be concerned with a material fact.

As a result of the unfairness of the decision in *Jordan v New Zealand Insurance Co Ltd* (1968 (2) SA 238 (EC)), in which the court applied the law as set out above, the legislature deemed it necessary to intervene in the relationship between insurers and insured. This was done in 1969, by the addition of subsection (3) to section 63 of the Insurance Act 27 of 1943. Section 63(3) required that the incorrectness of representations be such “as to be likely to have materially affected the assessment of the risk” before an insurer will be entitled to rely on it in order to avoid liability. Note that section 63(3) applied to such representations whether or not warranted to be true, that is, to positive misrepresentations and to breaches of (affirmative) warranty. In 1998, the provisions of section 63(3) were taken over without any “material” (no pun intended) alteration in section 59(1) of the LIA and section 53(1) of the SIA.

The interpretation of section 63(3) and the appropriateness of the remedies available to an insurer for the breach of an insurance warranty came under the spotlight in the decision in *Pillay v South African National Life Assurance Co Ltd* (1991 (1) SA 363 (D)). The court felt that an amendment to section 63(3) should be considered. In terms of its proposal, a proviso should be introduced in terms of which the insurer acquires the right, and is confined to the remedy, of merely deducting from the proved claim the additional premiums that it would have charged throughout the duration of the contract if it had known the true facts before the conclusion of the contract. An alternative idea advanced by the court was the possible implementation of the “proportionality principle”, in terms of which the insurer has to pay the proportion of the proved claim which the actual premium bears to the premium it would, with knowledge of the true position, have levied. In any event, the test for materiality in this regard (ie, for positive representations warranted to be true) in the *Pillay* case was assumed to be the same as that laid down for negative representations (failures to disclose) in the *Oudtshoorn Municipality* case, namely the reasonable-person test (see again 7.4 above).

In *Qilingele v South African Mutual Life Assurance Society* (1993 (1) SA 69 (A)) it was decided that the test for materiality formulated in the *Oudtshoorn Municipality* case applies only to cases in which the ground for repudiation is a failure of the common-law duty to disclose material facts, and not in which it has to be decided if, in terms of section 63(3), the incorrectness of a representation was such as to entitle the insurer to avoid liability on the policy. It was also decided that in answering the question whether or not a certain fact is material for the purposes of section 63(3), a court has to determine whether the falsehood of the representation in question is such that it probably would have affected the assessment of the risk undertaken by the particular insurer when it extended the insurance cover under which the insurance claim is brought. Materiality is not a relative concept: something is either material, or it is not. According to the court, in the context of subsection 63(3), “materiality” means that only risks undertaken on the strength of significant misrepresentations may be repudiated. The enquiry about the materiality of the misrepresentation is focused on a particular assessment, and is not conducted in the abstract. The evidence of the underwriter who attended to that assessment therefore not only is relevant, but also may prove crucial. (See again ch 7 for the nature of the tests for materiality and for causation in the context of misrepresentation.)

Note, too, that the test laid down in *Qilingele* was criticised in the minority judgment in *Clifford v Commercial Union Insurance Co of SA Ltd* (1998 (4) SA 150 (SCA)) (see 7.4 above).

In another decision, that in *South African Eagle Insurance Co Ltd v Norman Welthagen (Pty) Ltd* (1994 (2) SA 122 (A)), the court held that section 63(3) does not apply to promissory warranties, as they are not based on “representations” made by the insured to the insurer.

For a detailed exposition of the statutory curtailment of the insurer's rights in the case of breach of warranty, STUDY Reinecke et al paragraphs 367-372.

8.5 Incorrect Age

An incorrect statement or representation in a proposal form for life insurance and certain other types of insurance (eg, accident and health insurance) about the age of the life insured is clearly material to the assessment of the risk. Section 63(3) and its successors will consequently provide no (further) protection to the insured in such a case. However, the legislature had even before the introduction of section 63(3) restricted the insurer's common-law rights to rely on incorrect representations about age. Re-enacting analogous, but not identical, provisions in the old Insurance Act, section 59(2) of the LIA and section 53(2) of the SIA currently provide for the adjustment (either upwards or downwards) of the sum insured and other benefits (note: not for the adjustment of premiums) in the case of an incorrect statement of age in the proposal form for life and accident and health insurance. In this regard, STUDY Reinecke et al paragraph 371.

Summary

For the purposes of chapter 8, you should

STUDY Reinecke et al pars 185 and 358-372; and
READ Reinecke et al pars 356-357.

Amendment to Chapters 7 and 8

The study material contained in chapter 7 (Misrepresentation) and chapter 8 (Warranties) in Tutorial Letter 501, as well as the relevant sections in the prescribed textbook, must now be read in the light of a recent legislative amendment.

This amendment was brought about by the Insurance Amendment Act 17 of 2003 which in its (almost) identical ss 19 and 35 amended the successors of s 63(3) of the old Insurance Act 27 of 1943, namely s 59(1) of the LIA and s 53(1) of the SIA. (Note that ss 59(2) and 53(2) remain unaltered.) The background to and possible effect of this amendment may be considered very briefly.

It has often been said that our law relating to misrepresentation and breach of warranty in the insurance context is not only unclear but also unfair towards the insured. And not without some justification. Over the years legislative amendment (notably the infamous s 63(3)) and judicial decisions (specifically, but not only, those in *Mutual and Federal Insurance Co Ltd v Oudtshoorn Municipality* 1985 (1) SA 419 (A) and *Qilingele v SA Mutual Life Assurance Society* 1993 (1) SA 69 (A)) have, no doubt quite unintendedly, contributed to this confusion and iniquity.

Briefly, s 63(3) introduced, in a roundabout way, the requirement of materiality, which has always existed for misrepresentation, also for breach of warranty, that is, for an incorrect representation warranted to be true; the *Oudtshoorn Municipality* decision, which concerned a non-disclosure, formulated an objective (reasonable person) test for materiality rather than the reasonable insurer test and, on occasion, the reasonable insured test, which had been employed up to then; and the *Qilingele* decision held that this reasonable person test applied only to non-disclosures and formulated a subjective particular insurer test for positive misrepresentations, whether or not warranted to be true.

The amendments to s 59(1) of the LIA and s 53(1) of the SIA aim, in particular, at nullifying the *Qilingele* decision and at giving statutory imprimatur to the test 'created' in the *Oudtshoorn Municipality* decision. Unfortunately one has to report that, once again, this legislative intervention amounts to an instance of a laudable intent poorly executed.

The new s 59(1) [as also s 53(1)] provides as follows:

'Misrepresentation and failure to disclose material information

53(1)(a) Notwithstanding anything to the contrary contained in a long-term [short-term] policy, whether entered into before or after the commencement of the Act, but subject to subsection (2) -

(i) the policy shall not be invalidated;

(ii) the obligation of the long-term [short-term] insurer thereunder shall not be excluded or limited; and

(iii) the obligations of the policyholder shall not be increased,

on account of any representation made to the insurer which is not true, or failure to disclose information, whether or not the representation or disclosure has been warranted to be true and correct, unless that representation or non-disclosure is such as to be likely to have materially affected the assessment of the risk under the policy concerned at the time of its issue or at the time of any renewal or variation thereof.

(b) The representation or non-disclosure shall be regarded as material if a reasonable, prudent person would consider that the particular information constituting the representation or which was not disclosed, as the case may be, should have been correctly disclosed to the long-term insurer [short-term insurer] so that the insurer could form its own view as to the effect of such information on the assessment of the relevant risk.'

The amendment may be faulted for various reasons. First, the often criticised format of s 63(3) was simply retained in ss 59(1)(a) and 53(1)(a); secondly, the terminology employed displays a curious lack of insight into the underlying general legal principles involved in the case of misrepresentation; thirdly, although eliminating the disparity created by the *Qilingele* decision between the materiality tests for positive misrepresentations and negative misrepresentations (non-disclosures) by giving legislative approval to the reasonable person test formulated in the *Oudtshoorn Municipality* decision for both forms of misrepresentation, the often aired criticisms against the formulation of that materiality test were simply ignored; and fourthly, the opportunity of addressing pressing issues other than that of materiality has once again been passed up. Each of these points may be commented on very succinctly.

First, rather than starting afresh, the Legislature simply adapted the existing formulation contained in s 59(1) of the LIA and s 53(1) of the SIA which they, in turn, had taken over from the original s 63(3). The intention with s 63(3) was to eliminate the unfair advantages insurers had gained over insured by relying on breach of warranty (a incorrect representation warranted to be correct), where materiality of the fact warranted was not required, rather than by relying on misrepresentation, where materiality of the fact incorrectly represented was required at common law. This was, and is still, achieved by rather circuitously requiring materiality for incorrect representations 'whether or not warranted to be true'. In effect, therefore, the requirement of materiality for incorrect representations *not* warranted to be true was unnecessary and no more than a confirmation of the existing position; but it superimposed the statutory notion of materiality on that which had previously applied and opened the door for an alteration of the common-law position. It also obscured the plain aim of the measure, namely to require materiality for incorrect representations which *were* warranted to be correct. At the heart of the problem, in short, was the fact that the Legislature sought to deal with breach of warranty (breach of contract) only indirectly and by dealing (also) with misrepresentation (a delict).

The resulting confusion is now carried further. This is plainly illustrated by the terminology employed in the amended measures. On display is a lamentable confusion of the underlying general legal principles involved in the case of misrepresentation and breach of warranty.

Misrepresentation is a delict (whereas breach of warranty is a breach of contract). As is the case with any delict, it contains certain elements, one of which is wrongfulness or, in the insurance context, materiality. (As wrongfulness or materiality is not an element required at common law for reliance on breach of contract, there arose the need for statutory intervention to curtail insurers'

reliance on breach of insurance warranties). As materiality is required before an incorrect representation can qualify as the delict misrepresentation, there is, strictly and correctly speaking, no such thing as a *misrepresentation* of an immaterial fact.

Misrepresentation can take the form of a positive misrepresentation or a negative misrepresentation (non-disclosure). It therefore involves either the positive incorrect representation of, or failure to disclose, a material fact.

In an attempt to widen the scope of the sections, and so to eliminate the *Qilingele* differentiation, the phrase 'failure to disclose' or 'non-disclosure' has now been inserted in appropriate places in ss 59(1) and 53(1). This has curious results. Thus, the new heading of ss 59 and 53, namely 'Misrepresentation and failure to disclose material information' is not only tautologous but simply wrong: the term misrepresentation already includes the notion of a failure to disclose material information. Further, in their previous guise, the provisions in question concerned, and required materiality for, 'any representation made to the insurer which is not true, whether or not the representation has been warranted to be true'. That now reads 'any representation made to the insurer which is not true, *or failure to disclose information*, whether or not the representation *or disclosure* has been warranted to be true *and correct*'. Thus, the provisions now also concern, and require materiality for, 'any ... failure to disclose information, whether or not the ...disclosure has been warranted to be true and correct'. It is difficult to conceive of a situation involving a non-disclosure of a fact where the disclosure of that fact has been warranted to be true or correct.

Thirdly, the new ss 59(1)(b) and 53(1)(b) now lay down a statutory test for the materiality required in subs (1)(a) for both forms of misrepresentation and for breach of warranty (note only affirmative warranties and not promissory warranties as well; *Norman Welthagen (Pty) Ltd* above).

This, in essence (and despite the fact that there is mention of a person who is not only reasonable but also prudent), is the objective reasonable person test formulated in the *Oudtshoorn Municipality* decision and expanded on in later judgments. Defective as that test may be, given its overtones of the delictual element of fault, at least it now applies equally to all forms of misrepresentation and breach of warranty. Goodbye then, at last, to *Qilingele*.

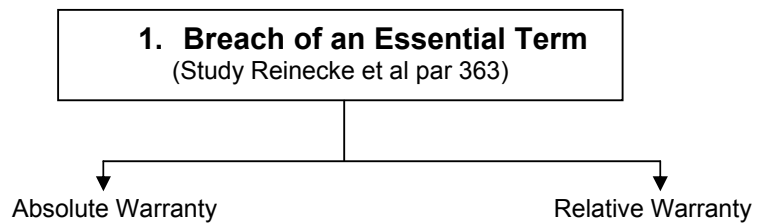
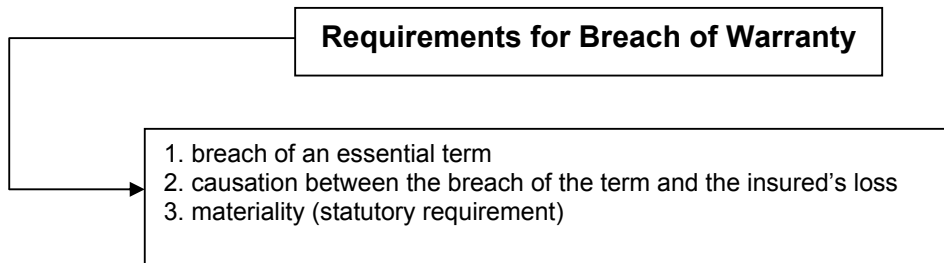
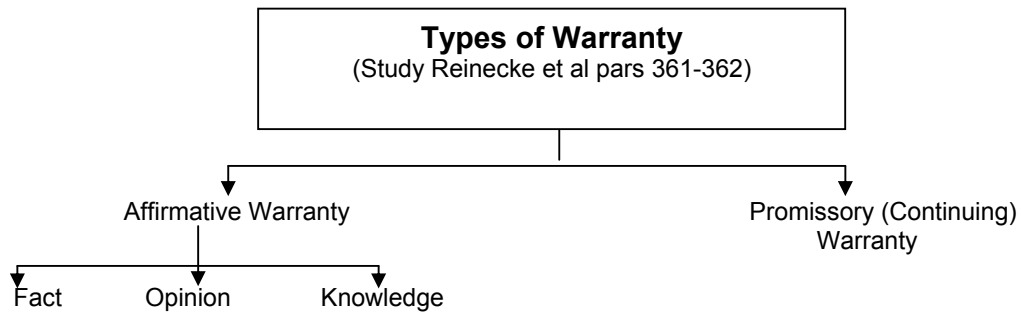
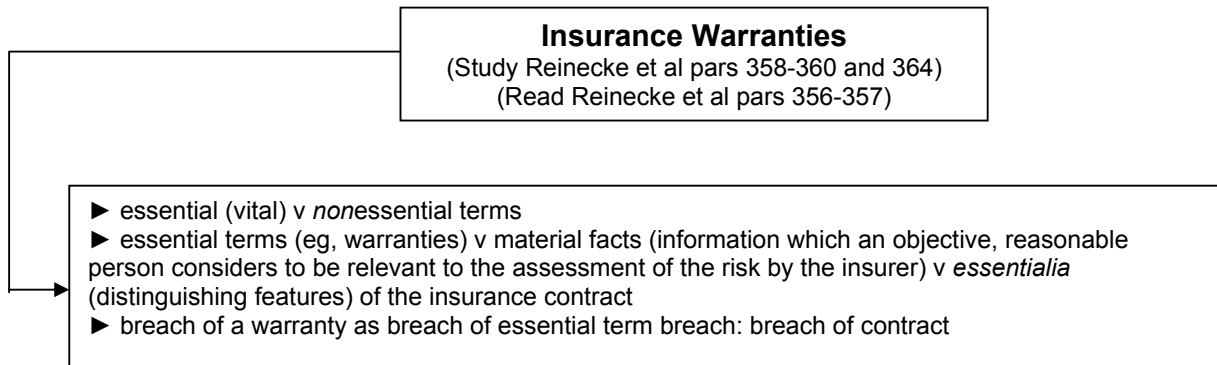
Finally and regrettably, yet another opportunity has now passed to reform our insurance law when it comes to misrepresentation and breach of warranty. Numerous other aspects in dire need of reform have again escaped attention, which is curious, given the avowed consumer protectionist aims of both the LIA and the SIA. Thus, matters which could have benefitted from legislative reform include the fact that both innocent and negligent misrepresentation still allow insurers to avoid liability, and that insurers are not in appropriate cases (eg, in case of non-causal fraud) restricted to lesser remedies (eg, to a claim for damages, or to avoidance only as to the future) than that of the total and retrospective avoidance of the insurance contract. And it is not as if the need for the reform of these and other matters have not been highlighted, both judicially (see, eg, *Pillay v SA National Life Assurance Co Ltd* 1991 (1) SA 363 (D)) and academically (see, eg, MFB Reinecke 'An Insurer's Remedies for Misrepresentation and Breach of Warranty' (2001) 13 *SA Mercantile LJ* 70-77 where the author proposed and in fact drafted detailed amendments to ss 59 and 53).

Questions

- (1) Why is it necessary to distinguish between misrepresentation and breach of warranty?
- (2) How is it possible for the same conduct by an insured to constitute both a misrepresentation and a breach of warranty? And for the same action to amount to both a positive and a negative misrepresentation?

- (3) Distinguish between affirmative and promissory warranties regarding
- (a) their aim
 - (b) the way in which they are created
 - (c) the way in which they may be breached, and
 - (d) the remedies available to an insurer following their breach.
- 4) Why is it necessary to distinguish (and what is the distinction?)
- (a) among warranties of fact, opinion and knowledge?
 - (b) between relative and absolute warranties?
- (5) You are approached for a legal opinion by an insurance company. The insurer has concluded an insurance contract with an applicant for insurance. The latter failed to disclose certain information to the insurer. She also provided incorrect information on certain other matters in the proposal form submitted for the insurance cover. The information provided in the proposal form was warranted to be true, and the proposal form was made the basis of the contract. Identify the different possible causes of action upon which the insurer may rely in order to avoid liability on the policy. Advise the insurer about the most favourable cause of action it can rely on.
- (6) Which test is currently applicable in order to establish whether a particular fact is material for the purposes of section 59(1) of the LIA and section 53(1) of the SIA? How does this test differ from both the test for materiality and the test for inducement in the context of (negative) misrepresentation? What criticism may be levelled against this test?
- (7) Do section 59(1) of the LIA and section 53(1) of the SIA find any application in the case of continuing warranties? Should they? In what other way is an insured protected in the case of breach of such a warranty?
- (8) Why did (the predecessors of) section 59(2) of the LIA and section 53(2) of the SIA not assist the insured in the *Jordan* case?
-

Diagrams for Chapter 8



2. Causation

- ▶ causal link between the breach of the term and the loss (*not the risk*)

3. Materiality (Statutory Requirement)

(Study Reinecke et al pars 367-372)

(Also study:

- *Kliptown Clothing Industries (Pty) Ltd v Marine & Trade Insurance Co of SA Ltd* 1961 (1) SA 103 (A)
 - *Jordan v New Zealand Insurance Co Ltd* 1968 (2) SA 238 (EC)
 - *Pillay v South African National Life Assurance Co Ltd* 1991 (1) SA 363 (D)
 - *Mutual & Federal Insurance Co Ltd v Oudtshoorn Municipality* 1985 (1) SA 419 (A)
 - *President Versekeringsmaatskappy Bpk v Trust Bank van Afrika Bpk & 'n Ander* 1989 (1) SA 280 (A)
 - *Qilingele v South African Mutual Life Assurance Society* 1993 (1) SA 69 (A)
 - *Clifford v Commercial Union Insurance Co of SA Ltd* 1998 (4) SA 150 (SCA)
 - *South African Eagle Insurance Co Ltd v Norman Welthagen (Pty) Ltd* 1994 (2) SA 122 (A))
- (Important: Study the amendments to Chapter 8 at the end of Chapter 8 in Tutorial Letter 501/3/2010)

- ▶ materiality a requirement for breach of warranty (also promissory warranties?)
- ▶ test for materiality: if a reasonable prudent person would consider the information relevant to the assessment of the risk by the insurer (same objective test as for materiality in case of misrepresentation: see s 59(1) of the LIA and s 53(1) of the SIA)

Breach of Warranty: Remedies

(Study Reinecke et al pars 363, 365, 366 and 371)

- ▶ the innocent party may cancel the contract and resile from the contract as from date of breach
- ▶ claim for damages, if applicable
- ▶ breach of warranty due to incorrect age in life-insurance and certain other types of insurance: merely adjustment of sum insured (*not* of the premiums); see s 59(2) of the LIA and s 53(2) of the SIA

Misrepresentation as Delict

(Study Reinecke et al pars 185)
(Chapter 7 of Tutorial Letter 501/3/2010)

v

Breach of Warranty as Breach of Contract

(Chapter 8 of Tutorial Letter 501/3/2010)

CHAPTER 9 RISK

9.1 Introduction and Terminology

An element of uncertainty or risk, and the transfer of that risk from one party (the insured) to another (the insurer), are essential characteristics of an insurance contract (see again 3.2 above regarding the definition of the insurance contract).

Risk is the possibility of harm, and the factors that may cause such harm are referred to as perils or hazards. Thus, there is a risk (uncertainty) that a peril (eg, fire) may cause harm (loss). On the general requirement of risk, and the requirement of its transfer as an independent obligation, STUDY Reinecke et al paragraphs 125 (and have another look at 3.4 above) and 261-262. In this regard, also take note of risk in its objective and its subjective senses, and of the effect of insurance "lost or not lost": STUDY Reinecke et al paragraphs 126 and 263.

9.2 Description of the Risk

An insurer's obligation in terms of an insurance contract is not only dependent upon the occurrence of an uncertain event, but also limited by a description of the risk taken over, that is, of the event insured against. Such description of the risk may refer to any one or more of the following matters: the object of risk (which should be distinguished from the object of insurance); the event insured against; the peril; the circumstances affecting the risk; and qualifications regarding time and place, and in this regard, the duration and renewal of insurance contracts. For these matters, STUDY Reinecke et al paragraphs 265 (general), 129 and 267 (object of risk), 266 (event insured against), 268 (peril), 269 (circumstances affecting the risk), 270 and 287-288 (qualifications regarding time and place and duration).

9.3 Causation and the Burden of Proof

A causal link is required between the peril insured against and the loss or occurrence insured against: the fire insured against must have caused the damage to the insured house. In this regard, the general principles of the doctrine of causation (eg, the distinction between factual and legal causation) as applied in other areas of the law (eg, the law of delict) are relevant, but their application in the insurance context is always subject to the intention of the parties to the insurance contract in question. On causation, STUDY Reinecke et al paragraphs 277-280.

As a rule, the insured must prove that the risk has materialised and that it has caused the event insured against. Thus, the insured must prove that there has been a fire and that that fire has caused the damage to the insured house. However, that is not always the case and of importance in considering the incidence of the burden of proof is the difference, in the description of the risk, between limitations upon and exceptions to the risk. On these matters, STUDY Reinecke et al paragraphs 272 and 289.

9.4 Fortuitousness, Changes in and the Materialisation of the Risk

A topic of general importance regarding the whole issue of the risk, and in fact one regarding which the general principles applicable in this area of the insurance law are practically illustrated and tested, is that of insurance against all risks. The risk taken over by the insured in the case of all-risks insurance is not qualified by reference to an event or peril insured against: the insured house is covered against all risks. However, there are some inherent (implied) limitations upon all-risks

cover (and, for that matter, upon any form of insurance cover, except that they are not illustrated as prominently when there is some or other express limitation of the risk with reference to the event or peril insured against). Cover against all risks clearly does not mean cover against all losses. Some form of uncertainty is still required, and there can be no valid insurance against loss or damage that has either occurred, or the occurrence of which is certain. On these matters, STUDY Reinecke et al paragraphs 127, 261, 275 and 551.

Although it is accepted that fortuitousness in the sense of uncertainty is required for a true contract of insurance it is often a difficult question whether or not such uncertainty is present when the event insured against materialises because of (ie, is caused by) the conduct of the insured himself or herself, or whether the insurer will be relieved of liability if the loss occurs through such conduct. The same applies if the insured's conduct (or, for that matter, external factors) cause either an increase or an alteration in the risk taken over by the insurer.

On these matters, STUDY Reinecke et al paragraphs 276 (alteration of risk) and 281-286 (conduct of the insured causing materialisation).

Summary

For the purposes of chapter 9, you should

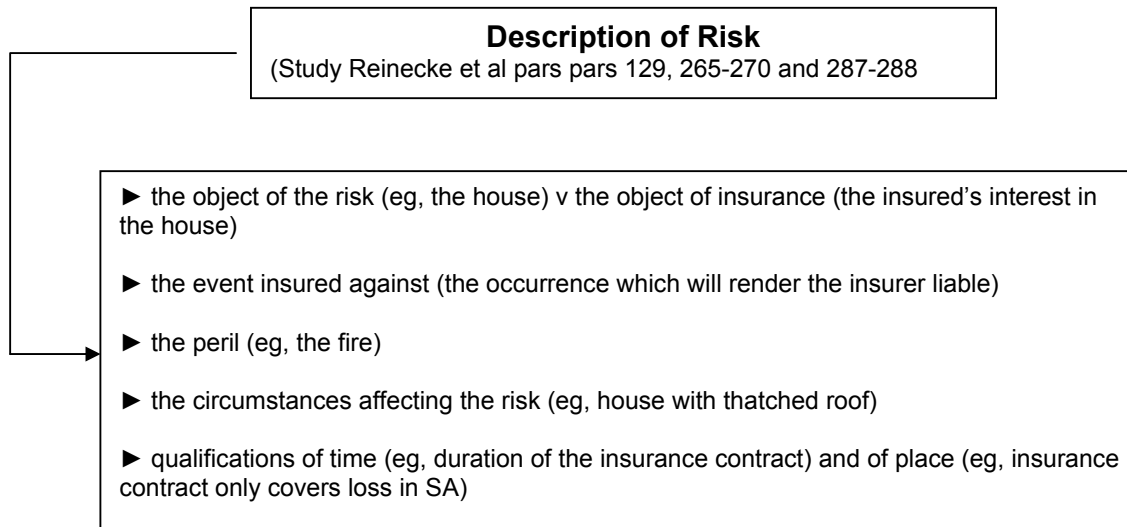
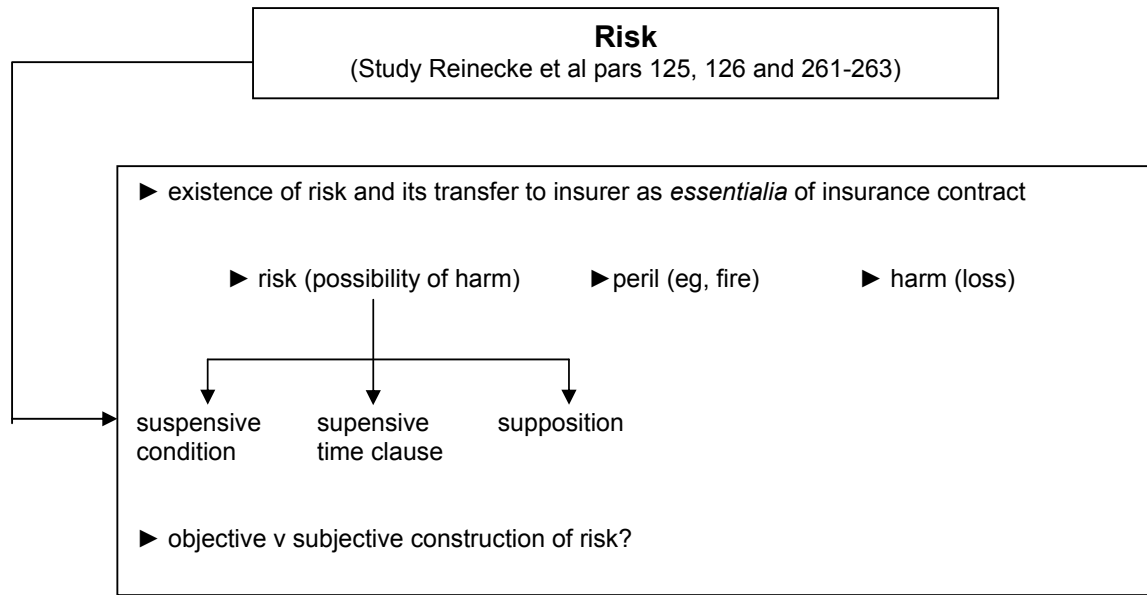
STUDY Reinecke et al pars 125-127, 129, 261-263, 265-270, 272, 275-289, and 551.

Questions

- (1) Describe, and distinguish (if relevant) among, the following concepts: risk, peril, fortuitousness, uncertainty, the object of risk and the object of insurance, the objective and the subjective possibility of harm, and objective and subjective risk circumstances.
- (2) Distinguish between the limitation of risk and the exception to risk and explain the relevance of this distinction for the insured's burden of proof.
- (3) Describe the operation of the doctrine of causation in insurance law, and the extent to which terms in the insurance contract itself may have an influence in this regard.
- (4) Describe the instances in which the insurer's liability on the contract will be excluded because of the conduct of the insured increasing, altering or causing the materialisation of the risk. Distinguish among the different types of conduct relevant in this regard, and explain the basis for the exclusion of liability in certain instances, and for its nonexclusion in other instances.
- (5) A insures his house against fire. Will the insurer be liable if the house is damaged by fire in the following circumstances (you may assume that the contract contains no relevant express term):
 - (a) the fire is caused by lightning
 - (b) the fire is caused negligently, by one of A's guests, during a barbeque
 - (c) the fire is started intentionally, by one of A's enemies
 - (d) the fire is started negligently, by A
 - (e) the fire is started recklessly, by A
 - (f) the fire is started intentionally, by A
 - (g) the fire is started by A's wife.

- (6) Would it make any difference to your answer to (5)(d) above if the insurance contract contained a clause stating that the insured had to take all reasonable precautions to protect the object of risk and to prevent loss or damage?
- (7) Inherent vice and wear and tear are not covered in an insurance against all risks. Why not? But an insurance contract may validly provide express cover against inherent vice and wear and tear. Why? Is there a difference between insurance against all risks and insurance (or should that be "insurance"?) against all loss? In what respect, if any, is the insured's burden of proof exceptional in the case of an insurance against all risks?

Diagrams for Chapter 9



Fortuitousness

(Study Reinecke et al pars 127, 261, 275, 276, 281-286 and 551)

- ▶ uncertainty is required for a true contract of insurance
- ▶ all-risk cover v cover against all losses
- ▶ cover for ordinary wear and tear and inherent vice?
- ▶ conduct of the insured causing materialisation or alteration of the risk:
 - ▶ no fault
 - ▶ negligent conduct
 - ▶ intentional (including reckless) conduct
 - ▶ suicide
 - ▶ duty to avert or minimise the risk

Causation

(Study Reinecke et al pars 277-280)

(Also Study:

- *Otto v Santam Versekering Bpk & 'n Ander* 1992 (3) SA 615 (O)
- *Napier v Collett & Another* 1995 (3) SA 140 (A)

- ▶ a causal link is required between the peril insured against and the loss or event insured against (eg, the fire insured against must have caused the damage to the insured's house)
- ▶ doctrine of causation (factual v legal causation)

Burden of Proof

(Study Reinecke et al pars 272 and 289)

- ▶ balance of probabilities
- ▶ the insured must prove:
 - ▶ that the risk materialised and that it has caused the event insured against (eg, that there has been a fire and that the fire has caused the damage to the insured house)
 - ▶ limitations upon the risk (eg, that cover is provided for damage caused by fire which is not the result of war; insured must prove the damage was caused by fire which was not the result of war)
- ▶ the insurer must prove:
 - ▶ exceptions to the risk (eg, all damage caused by fire is covered, followed by another term, excepting from the cover fire caused by war; insurer must prove the fire was caused by war)

CHAPTER 10 PREMIUM

10.1 General

The premium is the performance required of the insured in return for which the insurer undertakes its obligations under the insurance contract. The premium need not, although it usually will, take the form of a monetary payment. An insurance premium may, for example, consist of the mere liability of a member of a mutual-insurance society to contribute when another member suffers a loss. Regarding the reason for, and the nature and function of, the insurance premium, STUDY Reinecke et al paragraphs 123-124 and 323-324.

In the (unlikely) absence of any provision in the insurance contract about the need for the payment of a premium, actual payment of a premium is not required as an *essentiale* of an insurance contract. As long as there is an (express or tacit) undertaking to pay a premium, there is an insurance contract. Therefore, an undertaking by an insurer to provide “insurance” cover free of charge is not an undertaking in terms of an insurance contract. Likewise, in the (equally unlikely) absence of any provision in the insurance contract about the actual payment of a premium as a requirement for the validity of, or for the liability of the insurer in terms of, the contract, such payment is not necessary for the conclusion of a valid insurance contract or for the insurer to be liable in terms of it. At common law, payment in arrears is all that is required.

However, insurance contracts invariably contain express terms about the insurance premium. Such terms may have any one of a number of effects: they may make payment of the premium an essential requirement, or a condition for the conclusion of the insurance contract, or a condition for the insurer’s liability in terms of it, or a condition for the continued existence of the insurance contract, or even a formality. Different consequences flow from each of these terms. For these matters, you should STUDY Reinecke et al paragraphs 121-122 and 325-329.

10.2 Payment of the Premium

Regarding the general principles concerning the time of payment of the premium, the means by which this may be done, by and to whom payment must be, and the place of payment, READ Reinecke et al paragraphs 331-344. Note, too, that in terms of legislation, payment of an insurance premium to a representative of the insurer will be regarded as actual payment to the insurer: STUDY Reinecke et al paragraph 330 in this regard.

10.3 Repayment of the Premium

Regarding the different circumstances in which the insured will be entitled to a return of the premium, STUDY Reinecke et al paragraphs 347-355.

Summary

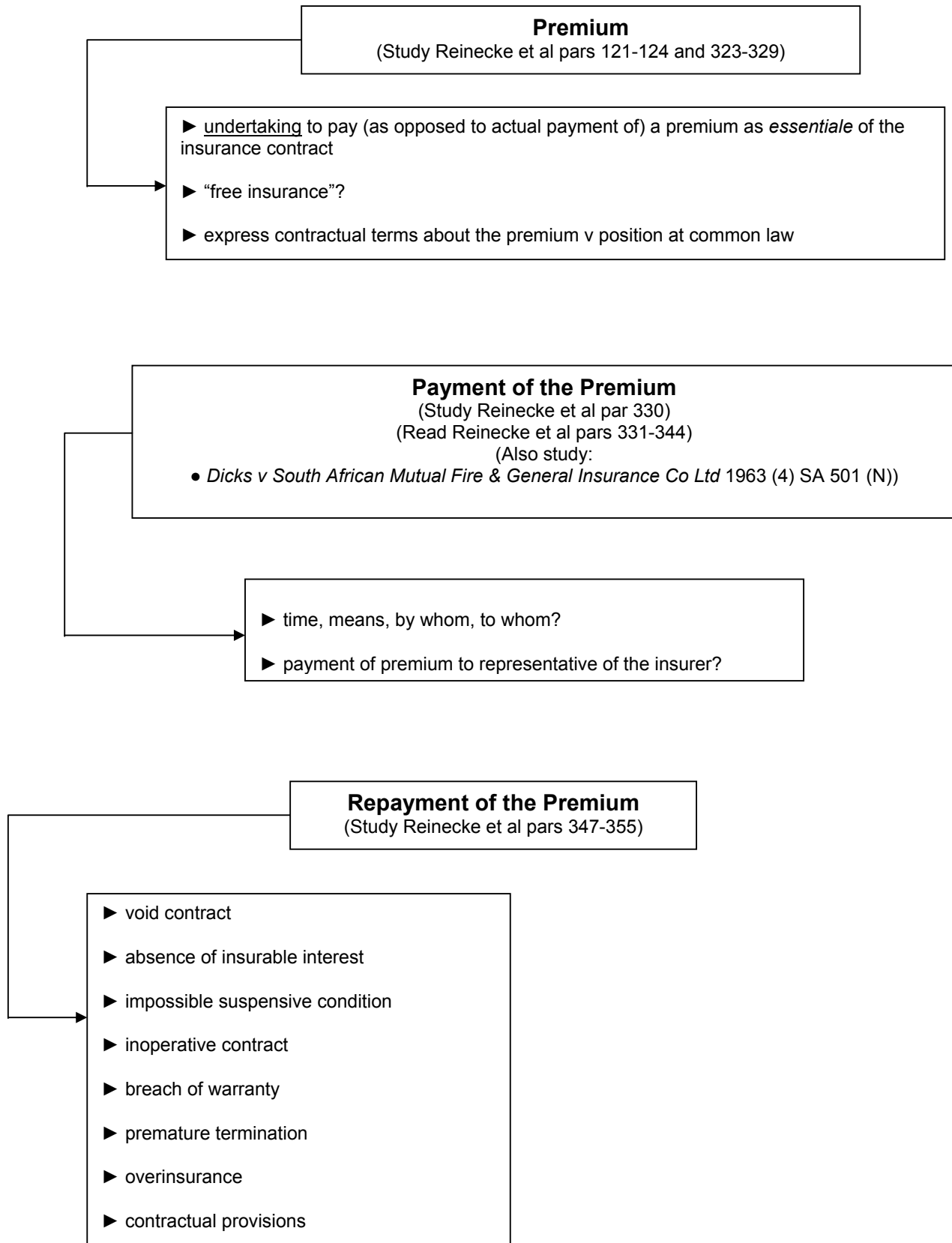
For the purposes of chapter 10, you should

STUDY Reinecke et al pars 121-124, 323-330, and 347-355; and
READ Reinecke et al pars 331-344.

Questions

- (1) Is an agreement about, or the actual payment of, an insurance premium an essential feature of a contract of insurance?
- (2) Is an express undertaking by the insured to pay a premium a requirement for the conclusion of a valid insurance contract?
- (3) Is an agreement on the amount of the premium a requirement for the conclusion of a valid insurance contract?
- (4) As part of its marketing and advertising strategy, Sporting Life Insurance Co provides each of the members of a South African national sporting team with free life-insurance cover in the amount of R100 000 for the duration of their overseas tour. One of the team members is involved in a motor-vehicle accident while on tour and dies. Is there any contract in this case? If so, what type of contract? And will the insurer be liable to pay out R100 000 on it?
- (5) Can there be a valid insurance contract if no time for payment of the premium has been agreed upon?
- (6) Will the insured be entitled to a return of the premium if he or she did not have the required insurable interest in the object of risk?
- (7) Will the insured be entitled to a return of the premium if the contract is void for illegality, but the insured was unaware of the illegality of the contract?
- (8) An insured pays the first and only premium due on her insurance contract to the canvassing agent of the insurer. When a claim arises on the contract the insurer denies liability on the basis that the premium has not been paid. It appears that the agent never paid the amount over to the insurer. Advise the insured on her legal position. Would it make any difference to your answer if she had paid the premium not to the canvassing agent, but to her broker?

Diagrams for Chapter 10



CHAPTER 11 INSURANCE INTERMEDIARIES

11.1 Introduction

Broadly speaking, insurance intermediaries may be classified as either representatives of the insurer, or representatives of the insured. This distinction is not always clear, since the same intermediary may, in a particular insurance transaction, as far as certain matters are concerned, act on behalf of the insurer, and as far as other matters are concerned, act on behalf of the insured. Also, not all representatives are “agents”, that is, not all representatives are persons who are empowered to conclude juristic acts on behalf of their principals. The term “insurance agent”, therefore, is, strictly speaking, not correct.

Obviously, the general principles of the law of agency and, more specifically, of the contract of mandate, also apply to insurance intermediaries. As a general introduction, STUDY Reinecke et al paragraphs 461-462. On the liability of a principal for a misrepresentation by an intermediary, READ Reinecke et al paragraphs 465-469.

For the broad types of insurance intermediary, STUDY Reinecke et al paragraphs 463-464.

11.2 Insurance Agents

There are two types of insurance agent: full-time employees of the insurer, or “independent” or “free” contractors acting on behalf of the insurer. In the former instance, a principal is liable for the negligent acts of its agent within the scope of his or her authority as employee, but not in the latter instance. On these matters, READ Reinecke et al paragraph 497.

On insurance agents in general, STUDY Reinecke et al paragraph 496; on their authority, STUDY Reinecke et al paragraphs 498-509 and 511; and on their rights, STUDY Reinecke et al paragraph 510.

11.3 Insurance Brokers

The insured, too, may employ a representative to act on his or her behalf in negotiating, obtaining and maintaining insurance cover. Such a representative may be an insurance broker, but there are, obviously, many other persons who may, likewise, act for the insured in this regard. On brokers in general, STUDY Reinecke et al paragraph 470.

The exact scope of an insurance broker’s authority is, again, a factual question in every case. Therefore, when an insurance broker concludes an insurance contract on behalf of an insured, the general principles of the law of agency apply. Generally speaking, an insurance broker is the representative (and usually the agent) of the insured, and a brokerage agreement (a type of contract of mandate) exists between them. A wide range of duties may flow from this contract, as may several rights. On the relationship between the insured and the broker, the brokerage contract, and the broker’s duties towards and rights against the insured, STUDY Reinecke et al paragraphs 471-489, 490 and 492.

The broker also has a contractual relationship with the insurer, and, in fact, receives his or her commission from it. On the relationship between the insurer and the broker, the commission contract, and the broker’s duties towards and rights against the insurer, STUDY Reinecke et al paragraphs 491 and 493-495.

Summary

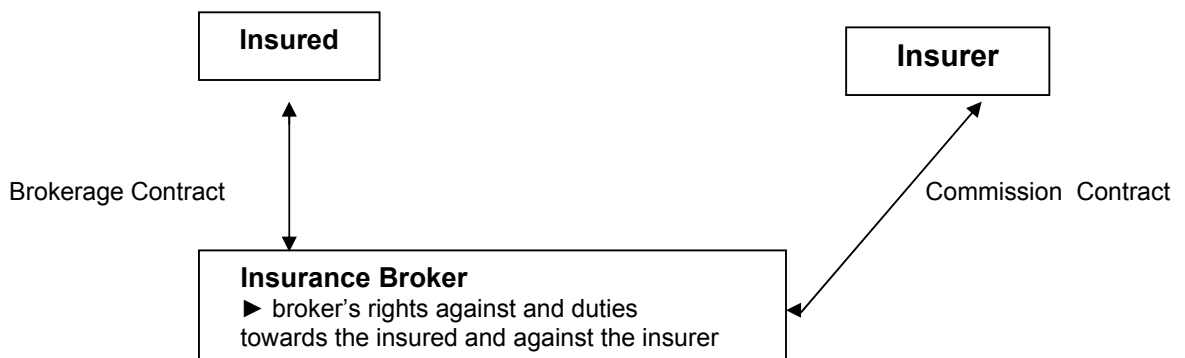
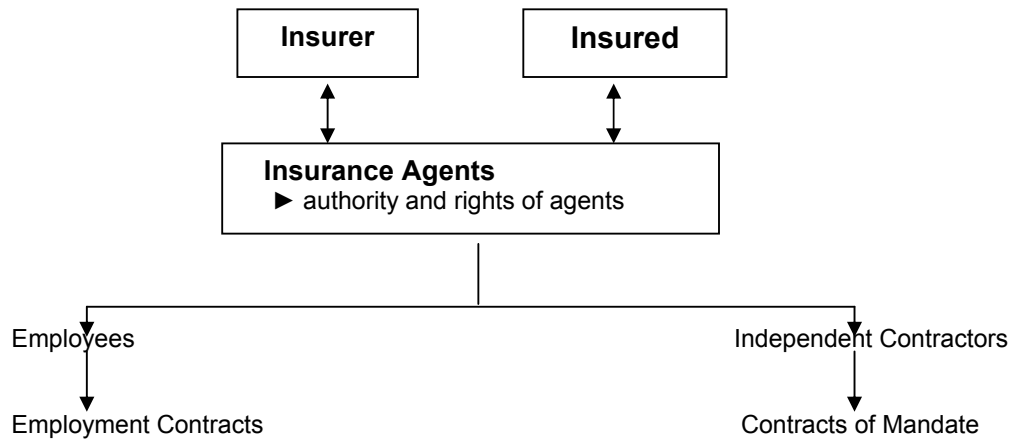
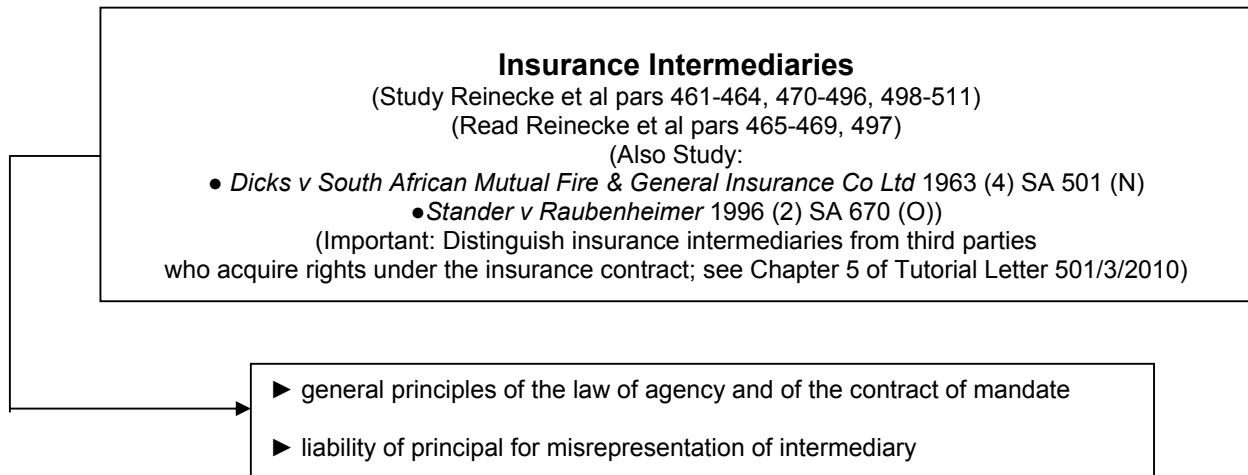
For the purposes of chapter 11, you should

STUDY Reinecke et al pars 461-464, 470-496, and 498-511; and
READ Reinecke et al pars 465-469 and 497.

Questions

- (1) Distinguish between insurance agents and insurance brokers.
- (2) Briefly discuss the legal position of an insurance agent.
- (3) Why is an insurance “agent” not an agent in the true sense of the word?
- (4) Discuss the legal position of an insurance broker.
- (5) Distinguish between a brokerage contract and a commission contract.
- (6) Distinguish between a commission contract, on the one hand, and a contract of mandate (or employment?) between an insurer and an insurance agent, on the other hand.
- (7) List the duties of an insurance broker towards the insured and towards the insurer.
- (8) Does an insurance agent have the authority to conclude an insurance contract on behalf of the insurer? And to conclude a contract of interim insurance?
- (9) Does an insurance broker have the authority to conclude an insurance contract on behalf of the insured? And to do so on behalf of the insurer? And does he or she have the authority to alter or terminate insurance contracts?
- (10) How must an insurance agent and an insurance broker deal with premiums? What authority do they (or may they) have in this regard?

Diagrams for Chapter 11



CHAPTER 12 EXTENT OF THE INSURED'S CLAIM: PRINCIPLE OF INDEMNITY

12.1 Introduction

Above (see 1.3), we considered the difference between indemnity insurance and capital (or nonindemnity) insurance. The difference lies in the nature of the insurer's performance. In the case of indemnity insurance, the insurer undertakes to indemnify the insured against loss or damage resulting from the occurrence of an uncertain event. The amount to be paid is not ascertained, but merely ascertainable, and is, in fact, ascertainable only after the occurrence of the uncertain event. In the case of capital insurance, the insurer undertakes to pay an ascertained sum of money to the insured on the occurrence of an uncertain event. The capital insurer's performance is not linked to any loss or damage that the insured may suffer.

In this chapter, we are concerned with the extent of the insurer's liability, and thus with the extent of the insured's claim on the insurance contract. The difference between indemnity-insurance contracts and capital-insurance contracts necessitates that we consider them separately.

12.2 Capital (Nonindemnity) Insurance

There are some cardinal differences between indemnity and nonindemnity insurance (see again 1.3 above for the differences), even though the true nature of nonindemnity insurance is still unsettled in South African law. These differences concern matters such as the nature of the interest insured (see again ch 6) and also, importantly, and not unrelated to the issue of interest, the (determination of the) extent of the insurer's liability and of the insured's claim.

In the case of nonindemnity insurance, the extent of the insurer's liability on the contract on the occurrence of the uncertain event is, as a rule, determined at the time of the conclusion of the contract. The insurer does not undertake to provide an (as yet undetermined, though, subsequently, determinable) amount by way of indemnity against damage, but undertakes to pay a specified amount on the occurrence of the event insured against. Thus, if A insures his or her life for R200 000, at the time of the conclusion of the contract it is already certain what the insurer will have to pay on the occurrence of the uncertain event (A's death). Likewise, if B takes out accident insurance covering himself or herself against the consequences of an accident, and the insurer, for instance, undertakes to pay out R30 000 for the loss of a limb, at the time of the conclusion of the contract it is already certain what the insurer will have to pay on the occurrence of the uncertain event (the loss of B's limb). In these instances, the sum insured by the insurer is also the amount it will have to pay out. The only uncertainties here are whether the uncertain events will take place (ie, whether or when A will die, or whether or not B will lose a limb).

For the nature of capital insurance and the extent of the capital insurer's performance, STUDY Reinecke et al paragraphs 42, 312 and 315.

12.3 Indemnity Insurance

In the case of indemnity insurance, the insurer is liable for an undetermined but determinable amount aimed at indemnifying the insured against loss or damage. The fact that a house is insured for R200 000 does not mean that the insurer will invariably be liable for that amount. The insurer will be liable to indemnify the insured only against loss, and the extent of that loss therefore has to be determined, something which is possible only after the occurrence of the uncertain event. The determination of the extent of the insured's loss depends on various factors, such as the nature of

the loss (ie, a total loss or a partial loss), the value of the object of risk, and whether the insured's interest in it is unlimited or limited. Also, the insurance contract itself may limit the extent of the insurer's liability.

The principle of indemnity involves that an insured may not make a profit from his or her insurance. He or she may not recover more than a mere indemnity against his or her loss or damage, and, as we shall see, will in fact often recover less than such an indemnity.

Regarding the nature of indemnity insurance and the indemnity principle in general, STUDY Reinecke et al paragraphs 34 and 293, and regarding the question when there is a "loss", STUDY Reinecke et al paragraph 295.

The cardinal question in the case of indemnity insurance is how to determine the extent (or measure) of the indemnity and, with reference to that, the extent of the insured's claim against the insurer. In this regard, a difference may conveniently be drawn between liability insurance and property insurance. Remember, though, that the same principle, namely that of indemnity, applies in both cases.

12.3.1 Liability Insurance

Although it is also a form of indemnity insurance, liability insurance differs from property insurance generally in a number of ways (see again 1.3 above for the difference between liability and property insurance). Thus, in the case of liability insurance, the risk is not described with reference to a particular object of risk. In the case of liability insurance, the determination of the extent of the insurer's liability is, because of the absence of a specified object of risk, relatively straightforward.

Take a simple example: A insures himself or herself against liability towards third persons in the amount of R500 000. Assume, also, that he or she incurs liability towards a third person in the amount of R300 000. In this case, A's loss is R300 000. That is the amount the insurer will have to pay on the insurance contract. The R500 000 is merely the sum insured, the maximum amount for which the insurer can be liable, and also, incidentally, the amount with reference to which the premium is calculated. Thus, should A have incurred liability towards a third party in the amount of R600 000, he or she will not be able to recover from the insurer more than R500 000.

12.3.2 Property Insurance

In the case of property insurance, the determination of the measure of indemnity is more involved. Generally, in order to determine the extent of the insurer's liability, it is necessary to determine the extent of the insured's loss, and to do that it is usually necessary to determine the extent of the loss of or damage to the object of insurance (the insured's interest in the object of risk) and the extent of the loss of or damage to the object of risk. That, in turn, involves determining the value of the object of risk.

Again, a simple example: A insures his or her house against fire for R500 000. The house is damaged by fire. In order to determine the measure of indemnity and the extent of the insurer's liability it is necessary to determine the extent of the damage and, also, the value of the house. Thus, if the house has been damaged to the extent of 50 percent (thus, a partial loss) and it was worth, say R400 000, the amount of the damage is R200 000. That is, the amount A will be able to recover (assuming that there are no terms in the contract limiting the application of the indemnity principle) if his or her interest in the house is an unlimited interest (eg, if he or she is the owner). Here, too, the sum insured of R500 000 is merely the maximum extent of the insurer's liability, and

not (necessarily) the amount recoverable. Because A's interest in the house was unlimited (he or she was the owner), the extent of the damage to and the value of the object of the insurance and the object of the risk were identical, and it was not necessary to compute the value of the former. If, however, the insured has merely a limited interest in the object of risk, such a further calculation may be necessary and will, more often than not, cause considerable difficulties. For the purposes of this course, we shall therefore assume that the insured's interest is unlimited, and the explanations which follow will proceed on that basis.

On the general principles involved in the quantification of loss or damage, and on the market value and the cost of repairs as measures of indemnity, STUDY Reinecke et al paragraphs 299-302.

12.3.3 Contractual Indemnity Terms

In addition to determining the measure of indemnity in every case, attention must invariably be paid to the terms of the particular contract in order to determine to what extent the insured's claim against the insurer may have been restricted.

As seen above, the sum insured is the maximum amount recoverable from the insurer. Other ways in which the insurer's liability may be limited is in the case of underinsurance by the application of the average clause (see below), and in the case of overinsurance by an application of the contribution clause (see below). STUDY, in this regard, Reinecke et al paragraph 297.

Although they may not exclude the application of the principle of indemnity without affecting the nature of their contract (STUDY Reinecke et al par 294), the parties may also expand or limit that principle, and thus the insurer's liability. There are several ways of doing this and we will consider them briefly.

One of them is to insure (usually new objects, or objects such as household goods which do not have any, or any readily ascertainable, market value) on the basis of new (or replacement) value. Naturally, such insurance is more expensive than insurance on the "ordinary" indemnity basis, in which case, if the new value of an object of risk is taken as the basis of the measure of indemnity, a deduction has to be made for the fact that the insured may not have lost a new object, but a second-hand one; a "deduction new for old" has to be made to account for the betterment the insured would otherwise receive if he loses a second-hand object but is compensated on the basis of the value of a new one. However, if the insurance is on the basis of new (replacement) value, there is no such deduction. In this regard, STUDY Reinecke et al paragraphs 36 and 304.

Another way in which the ordinary indemnity principle may be altered, is by the conclusion of a valued policy. In the case of an unvalued policy, it is necessary to determine the value of the object of risk in order to determine the measure of indemnity. But it is possible for the parties to avoid the practical difficulties inherent in proving the (market) value of the object of risk by agreeing at the time of the conclusion of the insurance contract on the value of the object of risk. In such a case, the policy is known as a valued policy. Valued policies occur, as a general rule, in the case of marine insurance and in the case of other objects of risk such as works of art. A valuation may be an overvaluation or an undervaluation (thus, a ship with a real (market) value of R300 000 may be valued in the insurance contract at R350 000 or at R250 000). For the effect of a valued policy, the difference between valued and unvalued policies, and the relationship between valued policies and the principle of indemnity, STUDY Reinecke et al paragraphs 35, 307 and 571.

A further way is to include an excess clause. In terms of this clause the insured is to bear a proportion or certain amount (eg, R2000) of every loss. Thus, only if the loss exceeds that proportion or amount will the insurer incur any liability.

Note also, in this regard, the possibility of an insurer not providing an indirect indemnity by means of monetary payment, but a direct indemnity by means of the reinstatement or repair of the damaged object of risk. For reinstatement clauses, STUDY Reinecke et al paragraphs 443-447.

12.3.4 Overinsurance and Underinsurance

While there is no legal prohibition on overinsurance, an insured will not be able to recover more than an indemnity because he or she is overinsured. Thus, although A may insure his or her house, which is worth R500 000, for R600 000 (he or she may be wasting premiums by doing so), in the case of a loss, A will not be able to recover more than the amount of his or her loss, which, even if it is a total loss, cannot exceed the value of the house.

Overinsurance should be distinguished from overvaluation (a ship with an actual value of R300 000 may be valued at R400 000 and insured for R450 000, in which case it is both overvalued and overinsured). Also, overinsurance should be distinguished from double insurance which may, but need not, involve overinsurance. On overinsurance, STUDY Reinecke et al paragraph 523.

An insured may also be underinsured (eg, a house worth R500 000 may be insured for R400 000). In that case, the insured will recover less than a full indemnity, either less than the amount of his or her loss, or less than the sum insured if the average principle applies. This principle applies automatically in the case of marine insurance, or is expressly made applicable in the case of nonmarine insurances. One example: say a house worth R400 000, is insured for R300 000 and is damaged to the extent of R100 000. Ordinarily, the insured would be entitled to the amount of his or her loss (subject to the maximum of the sum insured), thus, in our example, to R100 000. If the average principle applies, the insured is entitled to only a proportion of the loss, namely the same proportion as that in which he or she was underinsured. Thus, being insured for only three quarters of the value of the house (insurance of R300 000 on a house worth R400 000), he or she can recover only three quarters of the loss, that is, R75 000. On underinsurance and the average principle, STUDY Reinecke et al paragraphs 298, 524-525 and 574.

Summary

For the purposes of chapter 12, you should:

STUDY Reinecke et al pars 34-36, 42, 293-295, 297-302, 304, 307, 312, 315, 443-447, 523-525, 571, and 574.

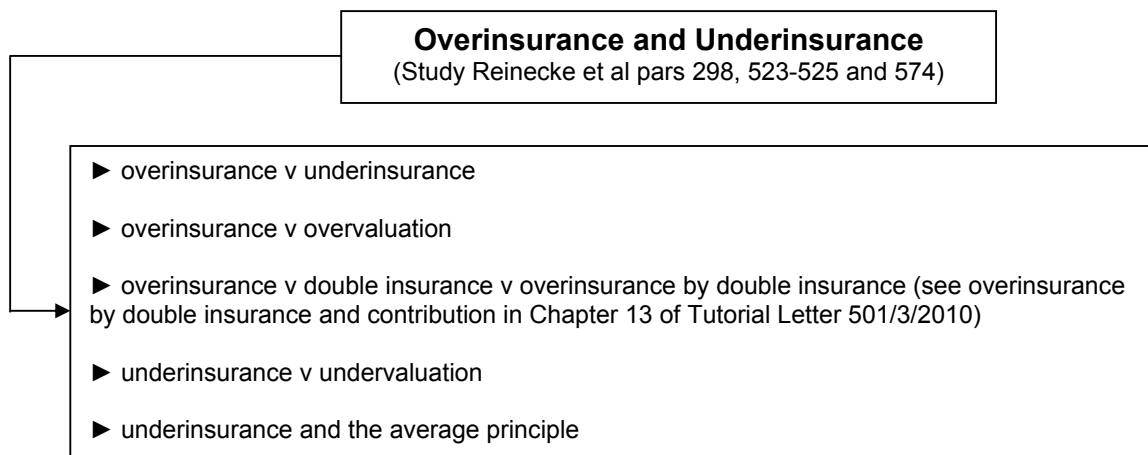
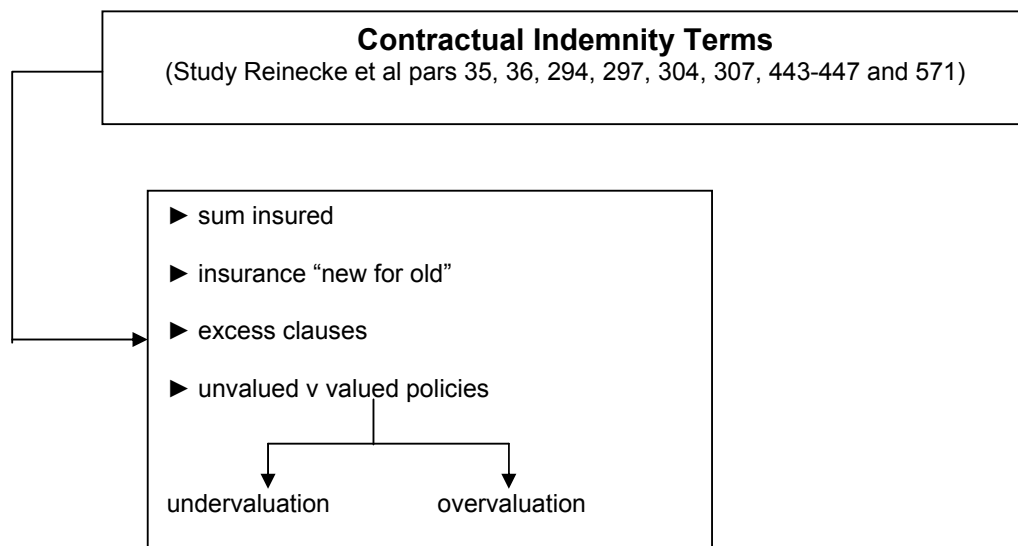
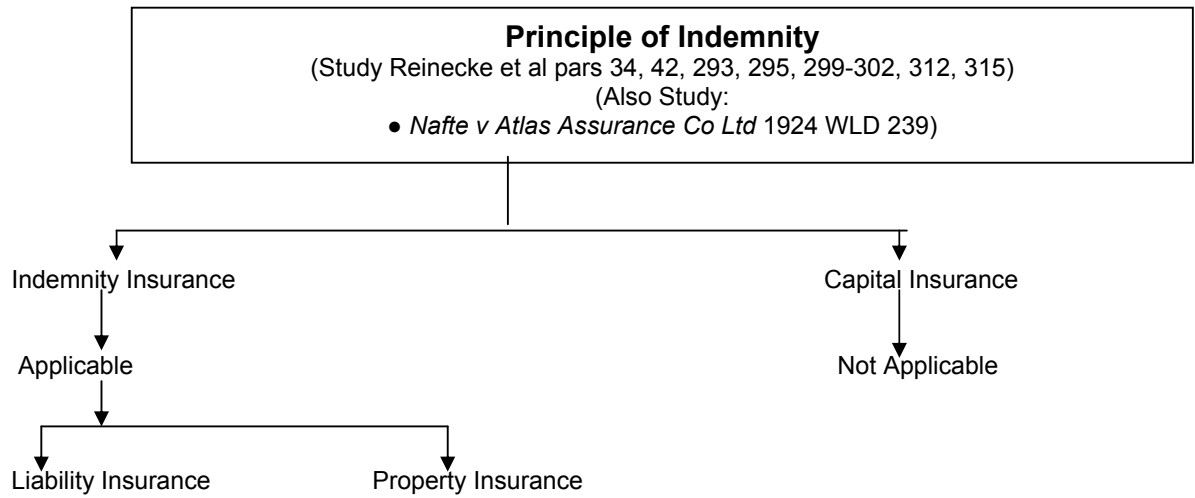
Questions

- (1) Distinguish between indemnity insurance and capital insurance with reference to the nature of the insurer's performance and the way in which it is determined.
- (2) Distinguish between capital insurance and indemnity insurance by means of a valued policy. Can the latter be regarded as a species of the former?
- (3) Explain valued policies and insurance for new value with regard to the principle of indemnity.
- (4) What are the similarities and differences between property insurance and liability insurance?
- (5) What is the relevance of market value, reinstatement value, sentimental value, and the

cost of repair in the calculation of the measure of indemnity?

- (6) Explain the various contractual limitations imposed, in practice, on the application of the principle of indemnity. May the principle be expanded so that the insured lawfully receives more than a strict indemnity?
- (7) What is the function of the sum insured?
- (8) Distinguish among overinsurance, overvaluation, underinsurance, undervaluation, double insurance, and overinsurance by double insurance.

Diagrams for Chapter 12



CHAPTER 13 SUBROGATION, SALVAGE AND CONTRIBUTION

13.1 Subrogation

In indemnity-insurance contracts, the insured is, subject to the terms of the contract, entitled to a full indemnity against his or her loss, and no more. His or her indemnity is also the maximum limit of the insurer's liability in terms of the contract.

Very often, the insured's loss occurs in circumstances in which a third party is liable to compensate him or her for it. In such event, the operation of two principles may result in the insured being overcompensated for his or her loss:

- (1) The insurer has primary liability as far as the insured is concerned, and cannot refuse payment merely because the insured is entitled to claim compensation for that loss from the third party. Ordinarily, the insurer is liable to indemnify the insured against loss, and not merely against loss for which compensation is not recoverable from a third party. Of course, if the insured has already received compensation from a third party, the insurer may, in appropriate circumstances, take such indemnification from an outside source (indemnification *aliunde*) into account in determining its liability in terms of the insurance contract.
- (2) The existence of insurance cover, the liability of an insurer and even the actual payment of an indemnity in terms of an insurance contract for the same loss for which the third party is liable cannot be raised by the third party when the insured seeks to recover compensation for that loss from him or her. The insurance is said to be a matter between the other (two) parties (*res inter alios acta*) as far as the third party is concerned.

In the light of the above, the doctrine of subrogation operates to prevent an infringement of the indemnity principle when the insured first recovers from his or her insurer and then recovers from a liable third party. The doctrine permits the insurer to recover the compensation from the third party and to have the benefit of that compensation, thus preventing the insured from receiving more than an indemnity.

On the issue of indemnification *aliunde*, STUDY Reinecke et al paragraphs 308-311, and on the nature, origin, basis and purpose of subrogation, STUDY Reinecke et al paragraphs 373-379.

Subrogation applies automatically to indemnity (insurance) contracts (it is said to be a *naturale* of such a contract), and applies to all rights the insured may have against a third party, whether by delict or contract, as long as those rights serve to compensate the insured against the very loss for which he or she has already been indemnified by the insurer. Subrogation should be distinguished from a transfer of rights (ie, a transfer of the insured's rights against the third party to the insurer), whether by means of agreement (thus, cession), or by means of the operation of law. On the scope of subrogation and the types of right against the third party that fall within the ambit of its operation, STUDY Reinecke et al paragraphs 380-384.

There are several requirements that have to be met at common law before an insurer is entitled to exercise its right of subrogation against the insured. The most important of these is that the insurer must already have indemnified the insured in full against the loss for which compensation may also be recovered from a third party. For the requirements, STUDY Reinecke et al paragraphs 385-388.

Also, it should be noted that the insurer's right of subrogation, which is a right it has against the insured, and not against the third party, involves two distinct aspects:

- (1) The first involves the insurer's right (as against the insured) to enforce the insured's claim against the third party in the insured's name. The insurer is in charge of that litigation (it is *dominus litis*). If found liable, the third party must ordinarily pay the insured, not the insurer: after all, the action was brought in the insured's name, and the third party need not even know that an insurer is involved as the real claimant.
- (2) The second aspect of the insurer's right of subrogation involves a right of recourse (against the insured) to claim the proceeds of the insured's action against the third party from the insured. The insured may have obtained those proceeds either because the insurer exercised the first aspect of its right of subrogation, or because the third party paid voluntarily, and without any action being instituted against him or her.

On the contents of the insurer's right of subrogation, STUDY Reinecke et al paragraphs 389-390.

However, there is also a further (third) aspect of the insurer's right of subrogation. This may arise even before the first two aspects can arise (ie, before the requirements for subrogation have been met), and obviously applies also after they have arisen. The insured is under a duty not to prejudice the insurer's right of subrogation. He or she may, for instance, not settle with the third party or release the third party from liability prior to (or, for that matter, after) claiming and receiving an indemnity from the insurer. In this regard, the insurer may be said to have a conditional right of subrogation. On the insured's duties and the insurer's concomitant rights in this regard, STUDY Reinecke et al paragraphs 391-395.

For the position of the third party in instances in which an insurer is subrogated to the rights of an insured against such a third party, STUDY Reinecke et al paragraphs 396-397.

Lastly, take note of subrogation clauses which largely confirm the insurers right of subrogation at common law, but which also, in some significant respects, add to those rights and thus improve the position of the insurer. As these clauses invariably appear in insurance contracts you should ensure that you fully understand the way in which they alter the common-law right of subrogation. For this, STUDY Reinecke et al paragraphs 398-399.

13.2 Salvage

Analogous to the insurer's right of subrogation is its right, also against the insured, to salvage, that is, to the object of risk or whatever may remain of it. You should pay particular attention to the circumstances in which this right may arise, and to the similarities and differences between the right of subrogation and the right to salvage. STUDY Reinecke et al paragraphs 403-405.

13.3 Contribution

We already considered the question of overinsurance in 12.3.4 above. Related to overinsurance, but to be carefully distinguished from it, is double insurance, which involves two or more insurers. Double insurance may, or may not, amount to overinsurance. On the nature and effect of, and the requirements for, double insurance, STUDY Reinecke et al paragraphs 516-517. And on the clauses which require notice, or which limit or even exclude an insurer's liability in the case of double insurance, STUDY Reinecke et al paragraphs 518-519.

If the amount insured through double insurance is more than the amount of the insured's loss (ie, if double insurance amounts to overinsurance), the insurers involved are, as between themselves (but, in the absence of a contribution or rateable proportion clause, not as against the insured), merely proportionately liable to indemnify the insured for that loss. An insurer that has paid more

than its proportion of the loss, as it may be obliged to do as against the insured, has the right to claim a rateable contribution from the other insurer (or insurers) involved. This right of contribution shows a certain similarity to, and may also interact with, the insurer's right of subrogation. On these matters, STUDY Reinecke et al paragraphs 520-522.

Summary

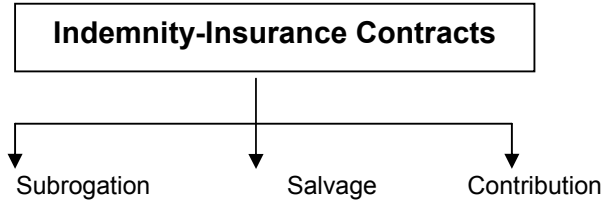
For the purposes of chapter 13, you should

STUDY Reinecke et al pars 308-311, 373-399, 403-405, and 516-522.

Questions

- (1) Distinguish between the insurer's right of recourse, its right to proceed against the third party, and its right not to have its potential or conditional right of subrogation interfered with.
- (2) The right of subrogation is the insurer's right against the insured, not against the third party. Explain.
- (3) Distinguish between subrogation and cession.
- (4) Can the insurer's right of subrogation validly be excluded from an indemnity- insurance contract through an express agreement to that effect? And can such a right validly be conferred upon a nonindemnity insurer through an express provision to that effect contained in the insurance contract?
- (5) What, for the purposes of the doctrine of subrogation, is a third party, and how are such a third party's rights affected by the operation of the doctrine? Also, what if the third party himself or herself is insured against the liability he or she has incurred towards the insured?
- (6) What are the requirements for the exercise of the right of subrogation, and what is the effect of an express provision for subrogation upon these requirements?
- (7) Distinguish between the insurer's right of subrogation and its right to salvage.
- (8) Distinguish among overinsurance, double insurance, and overinsurance through double insurance.
- (9) What are the requirements for the exercise of the right of contribution and what is the effect of the provisions of a contribution clause on these requirements?

Diagrams for Chapter 13



Subrogation

(Study Reinecke et al pars 308-311 and 373-384)

(Also Study:

- *Ackerman v Loubser* 1918 OPD 31)

- ▶ subrogation as *naturale* of indemnity-insurance contract
- ▶ insured is entitled to a full indemnity, but limited to the sum insured (indemnity principle)
- ▶ if third party is liable to compensate the insured:
 - ▶ existence of insurance or payment by insurer is not a defence for the third party when insured seeks compensation from him (insurance as *res inter alios acta*)
 - ▶ insurer may take earlier compensation by third party into account (indemnification *aliunde*)
- ▶ subrogation (no transfer of rights) v transfer of rights (eg, by cession or operation of law: see chapter 14 of Tutorial Letter 501/3/2010)

Requirements for Subrogation

(Study Reinecke et al pars 385-388)

- ▶ valid insurance contract
- ▶ insurer must have indemnified the insured
- ▶ insurer must have indemnified the insured in full
- ▶ insured must have a right which is susceptible to subrogation against the third party

Rights of Insurer against the Insured under Subrogation

(Study Reinecke et al pars 389-393)

- ▶ right of recourse against insured
- ▶ right to conduct proceedings against third party in the name of the insured
- ▶ right to preservation of claim (against the third party) by the insured

Duties of Insurer against the Insured under Subrogation

(Study Reinecke et al pars 394-395)

- ▶ preservation of the insured's claim
- ▶ indemnification in costs of proceedings

Common-law Right of Subrogation v Subrogation Clauses

(Study Reinecke et al pars 398-399)

Effect of Subrogation on Third Parties

(Study Reinecke et al pars 396-397)

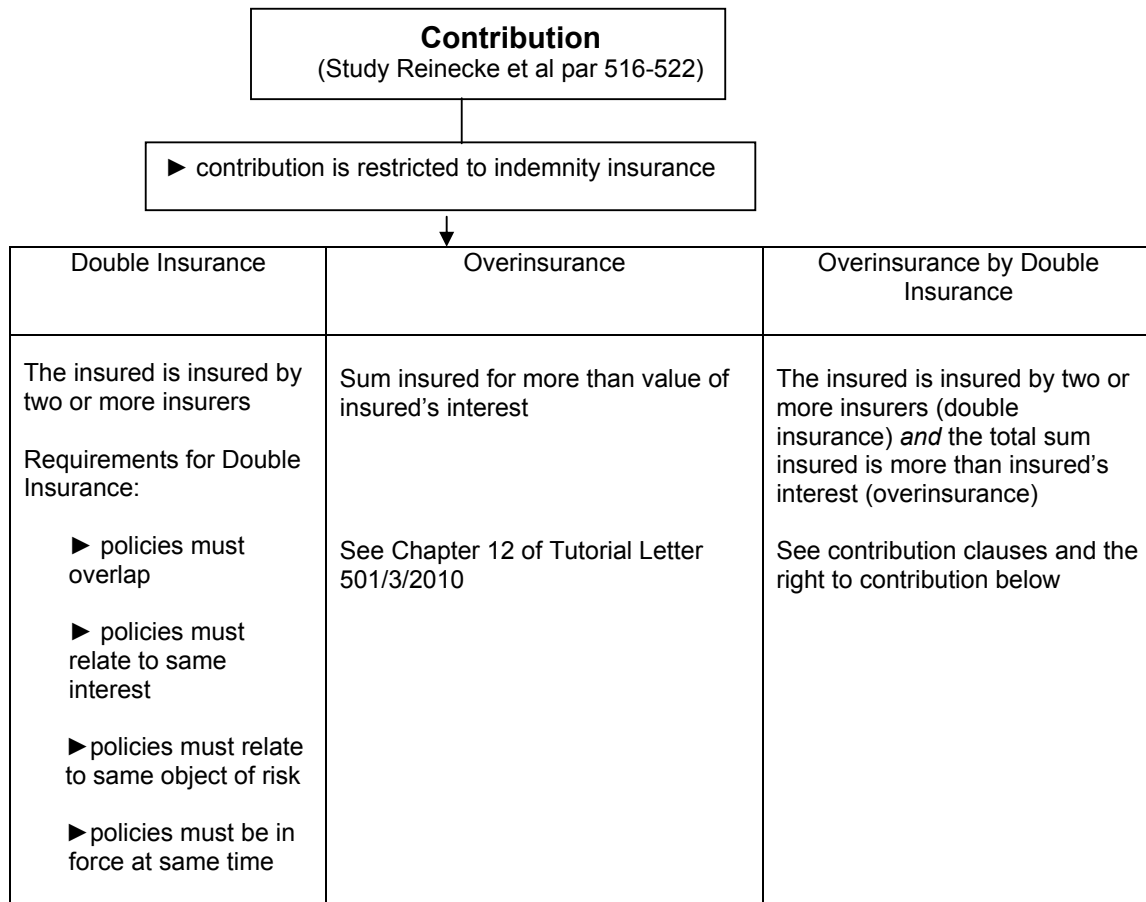
- ▶ defences
- ▶ settlement/release of claim by the insured

Salvage
(Study Reinecke et al pars 403-404)

- ▶ right to salvage as *naturale* of indemnity-insurance contract
- ▶ right to salvage v subrogation
- ▶ insurer's entitlement to remaining/recovered property

Requirements for Salvage
(Study Reinecke et al par 405)

- ▶ total loss
- ▶ valid insurance contract
- ▶ insurer must have indemnified the insured
- ▶ insurer must have indemnified the insured in full
- ▶ insured must have a real right to the insured property (or the remains thereof)



- ▶ An insured is free to decide how much of his loss he wishes to claim from each insurer in the absence of an *contribution clause*
- ▶ An insurer who has paid more than its proportion of the loss, has a *right to contribution*.
- ▶ Distinguish:
- ▶ *contribution clauses* (clauses between an insured and its insurer eg, requiring notice of double insurance, or limiting/excluding the insurer's liability in case of double insurance) v
 - ▶ the *right to contribution* (a common-law right that insurers have amongst themselves; eg, if an insurer has paid more than its proportion of the loss in case of double insurance, he may claim a rateable contribution from the other insurers)

Requirements: Right to Contribution

- ▶ the insurer claiming contribution must have discharged its liability to the insured
- ▶ the insurer claiming contribution must have paid more than its rateable proportion of the loss
- ▶ the payment by the insurer claiming contribution must have been in respect of an interest which is the object of double insurance existing at the time of the loss
- ▶ the double insurance in respect of the insured interest must have been for an amount in excess of the loss (double insurance by overinsurance)
- ▶ no contractual exclusion in one or both policies

CHAPTER 14 ENFORCEMENT AND CESSION OF INSURANCE CLAIMS; TERMINATION OF THE INSURANCE CONTRACT

14.1 The Enforcement of Claims on the Insurance Contract

Above, we already considered the extent of the insured's claim in terms of the insurance contract (see ch 12). Some procedural matters regarding the institution of that claim may now be considered.

Before an insured's claim on his or her contract becomes vested, certain requirements have to be met. For these requirements, STUDY Reinecke et al paragraphs 290-291 and 312-313.

The enforcement of claims on insurance contracts, and the insured's duties in this regard, are largely matters regulated by express terms in the insurance contract itself. The insured must, for instance, give notice of his or her loss and his or her claim to the insurer, and must do so within prescribed time limits. Provision may be made for disputed claims to be referred to arbitration. On these matters, READ Reinecke et al paragraphs 316-318 and 321.

Of more importance, for present purposes, is the clause concerning the institution of fraudulent claims by the insured. Such clauses seek to add to the insurer's common-law rights in this regard and should therefore be seen against the common-law background. Several questions arise in this regard. Firstly, it is uncertain whether or not the institution of a fraudulent insurance claim constitutes a breach by the insured of his or her duty of good faith (and more specifically, whether that duty applies at all during the currency of the contract), and, secondly, it has to be determined what the effect of such a claim is on the rights of the insured and how the position may be affected by express terms in the contract. On these matters, STUDY Reinecke et al paragraphs 176 and 320.

14.2 The Cession of Insurance Claims

A third party may acquire rights on an insurance contract in a number of ways (see again 5.3 above). One of them is by the insured transferring or ceding his or her rights against the insurer to such a third party. The third party, as cessionary, then acquires a right to claim from the insurer for a loss the insured himself or herself, as cedent, has suffered. The third party does not acquire a right against the insurer to claim for a loss he himself or she herself has suffered. Thus, if the insured has suffered no loss (because he or she has transferred the object of risk and has therefore lost his or her interest in it), the third party has no claim against the insurer (even if the object of risk has been transferred to him or her). On the question of cession, STUDY Reinecke et al paragraphs 435-437.

Closely related to, but nevertheless distinguishable from, the transfer or cession of rights in terms of an insurance contract is the transfer of the object of risk (which may occur together with a such a cession). The mere transfer of an insured object of risk does not amount to either a transfer of any rights from the insurance contract covering that object or to a transfer of the insurance contract itself. STUDY Reinecke et al paragraphs 70-71.

Also to be distinguished from cession (and from the transfer of the object of risk) is the transfer or "assignment" of the insurance contract itself. STUDY Reinecke et al paragraphs 439 and 450.

14.3 Termination of the Insurance Contract

An insurance contract is terminated in the same ways as any other contract (READ Reinecke et al paragraph 449):

- (1) It is terminated by the effluxion of the period of time (if any) for which it was concluded (see again 9.2 above).
- (2) It is terminated by performance, whether through payment of a sum of money by the insurer, or through reinstatement (as to the latter, see again 12.3.4 above). In the case of a monetary payment, the insurer must pay the right person, and in this regard, the possibility of payment to someone other than the insured should be borne in mind, and also matters such as the circumstances under which payment may be recovered, the effect of an *ex gratia* payment, and the inclusion of interest in the amount to be paid. On these matters, READ Reinecke et al paragraphs 440-442.
- (3) An insurance contract may be terminated by cancellation. Such cancellation may be a right *ex lege* by the operation of law (eg, by reason of the other party's misrepresentation or breach of contract (warranty)) or may arise *ex contractu* through an agreement (in the form, eg, of a cancellation clause), may accrue to the insurer or to the insured, and may be a right to cancel the contract from its inception (ie, *ab initio*), or only from a subsequent time. Also, the insurer's right to cancel the insurance contract as a whole should be distinguished from its right merely to avoid liability for a particular claim on the contract. On these matters, READ Reinecke et al paragraph 452. Note that the right to cancel the contract of insurance may be taken to have been waived in certain circumstances, or that the insurer may be estopped from relying on such right: READ Reinecke et al paragraphs 454-460.
- (4) An insurance contract may be terminated by settlement or compromise: READ Reinecke et al paragraph 453.
- (5) Apart from the contractual duty that may be imposed upon the insured to claim within particular time limits (again, READ Reinecke et al par 318), claims on an insurance contract may also be extinguished by prescription: READ Reinecke et al paragraph 451.

Summary

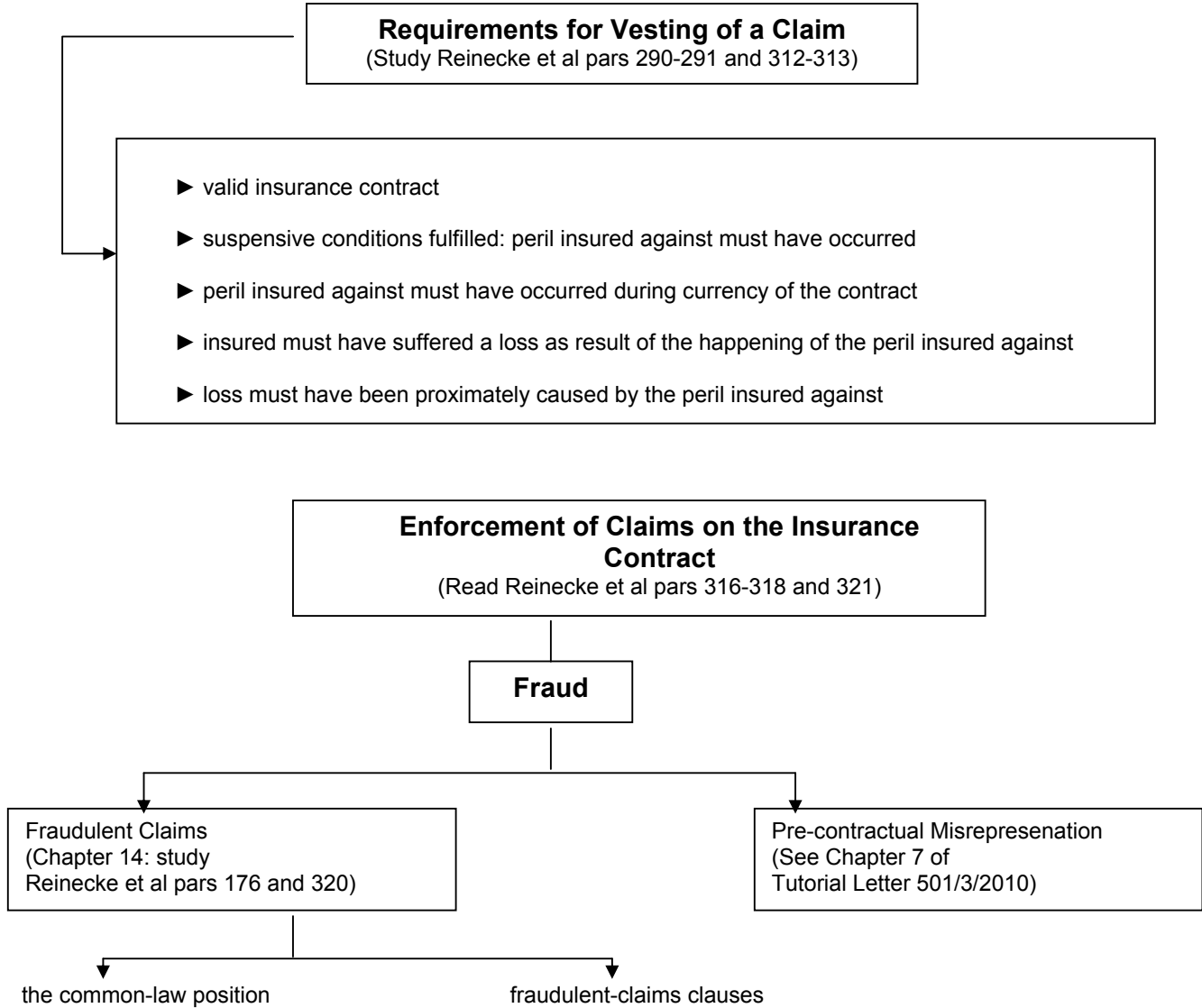
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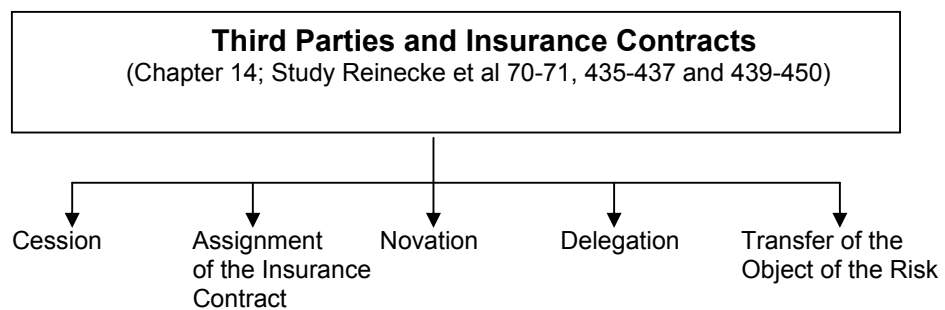
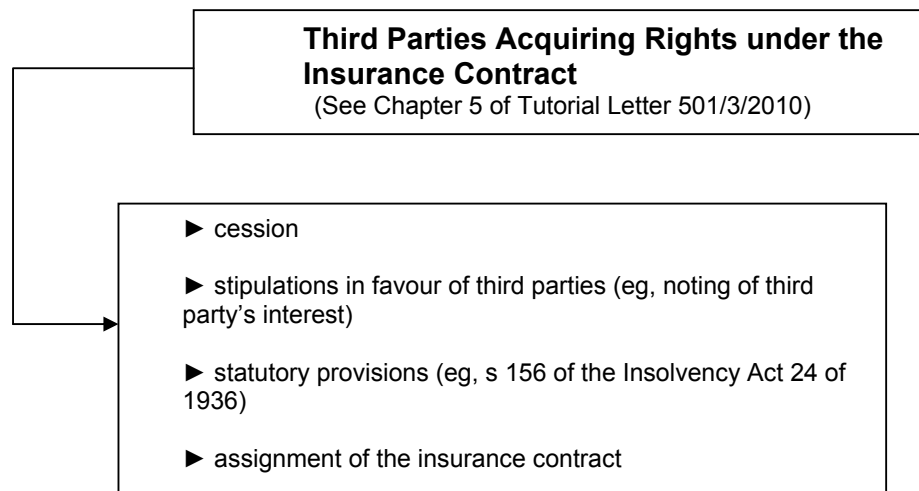
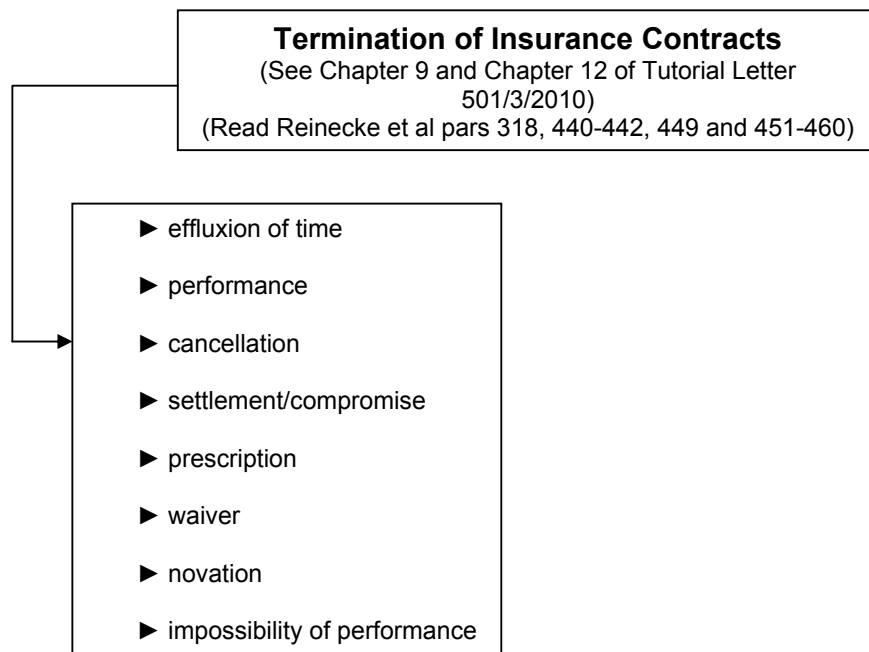
STUDY Reinecke et al pars 70-71, 176, 290-291, 312-313, 320, 435-437, 439, and 450; and READ Reinecke et al pars 316-318, 321, 440-442, 449, and 451-460.

Questions

- (1) Describe the consequences of the institution of a fraudulent claim by the insured – both at common law, and in terms of the usual express clause regarding fraudulent claims.
- (2) Distinguish between the transfer of rights under an insurance contract, the transfer of the insurance contract itself, and the transfer of the object of risk insured under the insurance contract.
- (3) A is the owner of a motor vehicle. It is insured with the X Insurance Company. A sells the vehicle to B and ownership passes. Two months later, the vehicle is involved in an accident. Can B claim an indemnity from the insurer? Would B have been able to claim had A ceded his rights under the contract against the insurer to her? And if A had physically delivered the insurance policy covering the vehicle to her? What is required for B to claim against the X Insurance Company?

Diagrams for Chapter 14





CHAPTER 15 INTERPRETATION OF THE INSURANCE CONTRACT

15.1 General

An insurance contract is not interpreted according to special rules. The principles which apply to the interpretation of contracts in general likewise apply to the interpretation of insurance contracts. Rules of interpretation are guidelines in establishing the intention of parties as expressed in the contract. For the sake of convenience, the rules in question may be distinguished in different categories. For present purposes, we shall consider a few of these rules which have particular application to insurance contracts. READ Reinecke et al paragraphs 216-219.

15.2 Ordinary and Technical Meaning

As a rule, words and terms used in insurance contracts are given their ordinary, everyday, popular and literal meaning. This rule, which is a primary rule, does not apply in those cases in which the ordinary grammatical meaning is clearly contrary to the actual intention of the parties. For examples of the application of this rule and the exceptions to it, READ Reinecke et al paragraphs 220-221.

15.3 *Eiusdem Generis* Rule

If a general word or concept is preceded or followed by one or more particular words or concepts, the general word or concept will be interpreted in such a way that it is qualified by the particular words or concepts, that is, in such a way that its meaning is confined to the range (or *genus*, hence "same *genus*" or *eiusdem generis*) indicated by the particular words. On this secondary rule, STUDY Reinecke et al paragraph 231.

15.4 *Contra Proferentem* Rule

Of particular importance in the insurance context is the rule that in the event of ambiguity the contract will be construed against the party who drafted it. This rule is referred to as the *contra proferentem* rule. The rule may, however, be applied only if all the other (primary and, if relevant, secondary) rules of interpretation have been applied and a real, as opposed to a simulated, ambiguity still exists. The *contra proferentem* rule is therefore a subordinate or tertiary rule of interpretation. STUDY Reinecke et al paragraphs 225 and 235.

Summary

For the purposes of chapter 15, you should

STUDY Reinecke et al pars 225, 231, and 235; and
READ Reinecke et al pars 216-221.

Questions

- (1) Which principles apply to the interpretation of insurance contracts?
- (2) How is the ordinary grammatical meaning of a word in an insurance contract determined?

- (3) Is the intention of the parties to an insurance contract relevant in determining the ordinary grammatical meaning of a word?
- (4) Which meaning of a word is ascribed to it in the case in which the word bears both an ordinary grammatical meaning and a technical meaning?
- (5) Why is the *contra proferentem* rule a tertiary rule of interpretation?
- (6) When will the *contra proferentem* rule apply against the insurer, and when against the insured?

Diagrams for Chapter 15