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Fraud and Misrepresentation in Insurance Contract

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In the modern days, contract plays a significant role while formulating policy, executing work, and undertaking various turnkey projects in day to day activity of the nation, individual and different sector both public and private. At the time of execution of a contract and even after execution of the contract fraud and misrepresentation may take place or parties to the contract may commit fraud and misrepresentation and conceal a material fact in order to induce the other party to have illegal gain out of the contract. Therefore, Fraud and misrepresentation in a contract lead to vitiation of contract. In a contract, a person who use to give an offer has to disclose all material particular to the offeree so that the offeree should not know the detail particular of the nature, scope, and objective of the contract prior to entering into the contract. Any non-disclosure of the fact whether it is relevant or relevant to the offeree amounts to material suppression of fact which leads to fraud and misrepresentation. Therefore, any contract to be valid and operative in the eye of law should disclose all material facts, particularly without suppressing any fact so that the offeree can accept it with an open eye and open mind. Thus a contract is concluded after a person gives an offer and such offer is conveyed to the offeree by disclosing all material facts and after knowing the same the offeree accepts the same by agreeing to its terms and conditions.

Keywords: *contract, insurance contract, fraud, misrepresentation.*

INTRODUCTION

Fraud and misrepresentation are widely seen in insurance contracts. In most insurance contracts the proposer who proposes to take an insurance policy very often uses to suppress/misrepresent material facts at the time of giving a proposal to the insurer. In the Indian context mostly fraud and misrepresentation take place in the insurance contract. Therefore, keeping in view of the nature of the insurance contract the insurance act 1938¹ has incorporated a specific provision namely section 45 of the insurance act,² which gives a rider to the insurance company to call the insurance policy in question on the ground of fraud and misrepresentation.

Apart from the insurance contract in the contract of general nature fraud and misrepresentation is being less seen. In the Indian contract act section 17³ deals with Fraud and section 18⁴ deals with misrepresentation. In the aforesaid context, fraud implies if a person or his agent in order to deceive the other party may give incorrect facts with active knowledge of the said fact or council fact which is within knowledge with an intention to persuade the other party to go for a contract amounts to fraud. Misrepresentation implies that a person is disclosing information in a contract that is not true and in order to deceive the other party by misleading in order to have illegal gain amounts to misrepresentation.

STATEMENT OF PROBLEM

At the time of execution of the insurance contract in most cases, the proposer never uses to disclose the correct fact in the proposal form at the time of insuring himself/herself this lead to misrepresentation, fraud, and otherwise mounts to misrepresentation of fact. This Fraud and misrepresentation can be avoided at the time of submitting the proposal by the insured if the insurance company or its agent explains the proposer the disclosure in the proposal form and the truthiness of such statement. Any incorrect statement made by a policyholder or any misleading information supplied by the proposer at the time of taking the policy amounts to fraud, or misrepresentation as a result of which the contract of insurance use becomes null and void.

¹ Insurance Act 1938

² Insurance Act 1938, s 45

³ Indian Contract Act 1872, s 17

⁴ Indian Contract Act 1872, s 18

Since the contract of insurance is based upon utmost good faith. The party to the contract as far as practicable should disclose the correct fact and make a correct statement as regards his health, age, and other particulars before inducing the insurance company to enter into a contractual obligation. Therefore, utmost care should be taken by the proposer to disclose correct facts so that the insurance company is at liberty to take the decision on whether to enter into the contract in order to accept the contract. In the Indian context, the insurance company uses to sell a policy by taking the proposal from the insurer, and on the basis of the disclosure made in the proposal form, the insurance company issued the policy. If later on it is found that the proposer insurer suppressed any material fact or disclosed statement which is incorrect and the said disclosure is within the knowledge of the insurance company then the policy becomes vitiated due to fraud, or misrepresentation.

Fraud and misrepresentation can be avoided in an insurance contract if the insurance company prior to the signing of the proposal form educates the proposer policyholder about the consequence of non-disclosure or the consequence of the suppression of fact and how it has a great bearing on the contract. If an incorrect statement is being made by a policyholder and the said statement is within his knowledge that amounts to fraudulent suppression of material fact.

LITERATURE REVIEW

From the review of the aforesaid research in the context of an insurance contract, it is evident that the contract of insurance is a contract that is different from a general contract like other contract it is based upon good faith at the time of execution of the contract the insurance company without verifying the credential of the policyholder uses to accept the contract basing on the mere statement of the policyholder. Initially, there was no specific period for the acceptance of the contract but due to IRDAI 2002 Regulation,⁵ has been framed by the regulator that for acceptance and conclusion of a contract there is a free look in the period of 15 days i.e. after insurance of the policy by the insurance company the insured policyholder may accept the terms and condition or disagree with the terms and condition. Therefore, if the

⁵ Insurance Regulatory and Development Authority (Insurance Brokers) Regulations 2002

policyholder did not agree to the terms and conditions of the policy he can return the policy indicating his disagreement within 15 days in such event the policy is cancelled and the insurance company uses to refund the premium by cancelling the policy.⁶ Thus, due to the framing of regulation by the IRDA the policyholder interest is being protected for which the insurance company could not able to exploit the policyholder.

RESEARCH QUESTION

1. How Fraud and misrepresentation crept into the contract?
2. What is the scope of fraud and misrepresentation in an insurance contract?
3. How Fraud and misrepresentation can be prevented in an insurance contract?

HOW FRAUD AND MISREPRESENTATION CREPT INTO INSURANCE CONTRACTS?

From the study of various case laws related to contracts, it is evident while entering into a contract in a few cases parties to the contract misrepresent facts and suppress material facts in order to have illegal gain out of it. Especially fraud and misrepresentation usually very often take place in an insurance contract. This usually happens when a life insurance policy is involved in a contract. In a life insurance contract, the contract is based upon utmost good faith in as much as a policyholder/proposer use to answer the question indicated in a proposal form as regard to age, health, income, and other material particular based upon such answer the insurance company accepts the proposal and issues the policy. At the time of accepting the proposal, the insurance company accepts the same in good faith believing the disclosure made in the proposal form to be true and correct.

Therefore, the insurance company's decision to issue a life insurance contract/policy very much depends upon the statement made in the proposal form which constitutes the basis of the contract. It is just like an inducement by the offeror to the offeree to enter into a contract. Thus any misstatement of fact or suppression of fact or incorrect disclosure of fact by the offeror to the offeree amounts to fraud misrepresentation which leads to a breach of good faith for which the contract is vitiated and the same become null and void as a result of which the party to the contract is not entitled to any benefit under the contract.

⁶ *Ibid*

In this context section 45 of the insurance act 1938,⁷ stipulates that a contract entered between the life insurance company and its policyholder can be called into question by the insurance company within 3 years from the date of commencement of risk on account of fraud and misrepresentation if it comes to the notice of insurance company that the policyholder while proposing his/her life have committed misrepresentation of fact by not disclosing correct fact though it is between the conscious knowledge of the proposer/policyholder. Otherwise, it is said a fraudulent suppression of fact in order to deceive the insurance company to have illegal gain. Thus, the contract of insurance can be called into question by the insurer within 3 years of the commencement of the policy.

HOW FRAUD AND MISREPRESENTATION CAN BE PREVENTED IN INSURANCE CONTRACTS?

Fraud and misrepresentation can be prevented in an insurance contract if a proposer is being explained the consequence of non-disclosure of correct fact which may lead to the cancellation of the contract. Further at the time of selling an insurance policy, the policyholder should be educated about the nature and implication of the contract since the same is based upon good faith. Therefore, the breach of good faith can only be prevented if the consequence of such breach is disclosed properly.⁸

LEADING CASE LAW

Leading case law regarding fraud and misrepresentation in an insurance contract dealing with sections 17⁹ and 18¹⁰ of the contract act was the case of *Mithoolal Nayak v LIC of India*,¹¹ *LIC of India v Asha Goel*¹², *P.J. Chacko v Chairman, LIC of India*.¹³ It has been clearly laid down by the honourable supreme court that the contract of insurance is based upon utmost good faith and the policyholder is obliged to disclose correct material facts at the time of giving a proposal for insurance. In case of any non-disclosure, suppression, and misrepresentation of

⁷ Insurance Act 1938, s 45

⁸ *Ibid*

⁹ Indian Contract Act 1872, s 17

¹⁰ Indian Contract Act 1872, s 18

¹¹ *Mithoolal Nayak v LIC of India* AIR 1962 SC 814

¹² *LIC of India v Asha Goel* 2001 SCC SC 160

¹³ *PJ Chacko v Chairman, LIC of India* AIR 2008 SC 424

fact by the life assured amounts to a breach of good faith and if it comes to the knowledge of the insurance company subsequently the contract of insurance is being vitiated on the ground of fraud and misrepresentation and the policyholder is not entitled to any benefit under the policy.¹⁴ In all the above cases¹⁵ the proposer policyholder has suppressed material facts pertaining to their ailment/disease which the proposer was undergoing treatment prior to taking of the policy¹⁶ but he has not disclosed the same in the proposal form this act of the policyholder amounts to ¹⁷the deliberate suppression of fact in order to gain illegal benefit.¹⁸

Suppression of fact in order to be a material suppression should best upon fraudulent intention to deceive the insurance company. However, the onus of proof lies with the insurance company to prove fraud and misrepresentation by leading evidence in support of the plea so as to establish the fraudulent intention of the party. The famous case in this regard is the *Mithoolal Nayak case*¹⁹ and the P.J. Chacko case²⁰ where the Hon'ble Supreme Court has interpreted section 17 and 19 of the contract act in the context of insurance act section 45.²¹ In the case of one Mahajan Deolal has taken a LIC policy and the said policy was assigned in favour of Mithoolal. Mahajan died after which Mithoolal as assignee of the policy claimed the policy amount from the LIC refuse to give the claim on the ground that Mahajan Deolal was suffering from an ailment like Animea, Oedema of the feet at the time of giving a proposal for insurance but he has not disclosed the said fact in the proposal form.

This fact of treatment came to the knowledge of the insurance company after the death of the policyholder for which the claim was rejected by the LIC. Challenging the rejection of the claim a case was filed before the civil court. The case of the Mithoolal Nayak before the court was that the LIC doctor examined the policyholder Mahajan Deolal at the time of taking the policy therefore he was not guilty of suppression of material fact nor he has made any misstatement of fact. Therefore, he is entitled to the LIC money. On the other hand, LIC

¹⁴ *Ibid*

¹⁵ *LIC of India* (n 12)

¹⁶ *Ibid*

¹⁷ *Mithoolal Nayak* (n 11)

¹⁸ *Ibid*

¹⁹ *Ibid*

²⁰ *PJ Chacko* (n 20)

²¹ *Ibid*

appeared before the district court and took the plea that the insurance contract is based on good faith and on the basis of the declaration made in the proposal form.

Therefore, even if the examination by the doctor cannot absolve the policyholder for not making correct facts in the proposal form in this respect the insurance company relied upon sections 17 and 19 of the contract act which explain fraud and misrepresentation and so also section 45 of the insurance act. Before the trial court, Mithoolal Nayak lost the case and thereafter he file an appeal before the high court of Mumbai at Nagpur there he also lost the case thereafter matter went to the honourable supreme court. In the Supreme Court, Mithoolal Nayak also lost the case. The ratio of law decided by the Hon'ble Supreme Court in the case of Mithoolal Nayak is as follows-

1. Fraud and misrepresentation vitiate the contract which leads to null and void and the beneficiary of the contract is not entitled to the benefit.
2. Fraud and misrepresentation in an insurance contract have great bearing on the contract because the insurance contract is based upon utmost good faith. Therefore, the proposer is under a solemn obligation to state the correct and true fact.
3. The insurance contract is based upon the declaration made in the proposal form therefore the statement must be made truly any suppression or misstatement amounts to fraudulent suppression.

In the case of P.J. Chacko, a similar view was expressed by the Hon'ble Supreme Court²² whereby the Court ruled a deliberate wrong answer which has a great bearing on the contract of insurance if discovered may lead to the policy being vitiated in law. The policy should not be obtained by giving fraudulent disclosure.²³ A deliberate wrong answer which has a great bearing on the contract of insurance if discovered may lead to the policy being vitiated in law.²⁴ Thus, in the contract of insurance, the life-assured proposer must disclose correct material facts at the time of taking the policy since the proposal form for insurance constitutes

²² Sir Dinshaw Fardunji Mulla, *The Indian Contract Act* (15th edn, LexisNexis 2019) 82

²³ *Ibid*

²⁴ *Ibid*

the basis of the contract.²⁵ To conclude the sum and substance of the aforesaid ratio of law enunciated by the Hon'ble Supreme Court discuss the fact of how fraud and misrepresentation play a crucial role in the context of the insurance contract.

CONCLUSION AND SUGGESTION

Thus in view of the aforesaid analysis and the case referred it is well concluded that fraud and misrepresentation often take place in the insurance contract. However, the same can be avoided if the parties to the contract take utmost caution by verifying the disclosure made in the proposal form at the time of proposing for insurance at the time inception of the policy if the said prevention is being taken fraud and misrepresentation can be prevented at the initial stage. Therefore, if both parties take preventive measures to check the contemplated fraud which may take place then the same can be prevented. Hence it is well-said that prevention is better than cure. In addition to the aforesaid fact while selling the policy by the insurance company, the agent should be appropriately trained while canvassing the pros and cons of the policy by highlighting its feature so that a policyholder proposer before entering into a contract knows about the terms, condition, and benefit in order to proceed with the matter. This can also prevent Fraud and Misrepresentation while preparation of the policy document since its inception.

²⁵ *Ibid*