**Chapter Four**

**Legal Principle of Insurance Contract**

The legal or fundamental principles are common to all types of insurance contracts with the exception of indemnity, which is not applicable to personal insurance contracts. These principles are discussed briefly as follows:

## Principle of indemnity

The principle of indemnity states that the insured, in the event or loss, receives financial compensation equal to the amount of the loss or the face value of the policy, whichever is lower. The whole purpose is to restore the insured to his/her former financial position. Thus, the principle eliminates the intention of gambling, which incorporates profit motive. It is the controlling principle in insurance contract that limits compensation. This principle is not applicable to personal insurances because the loss due to risk cannot be calculated and so a previous agreement regarding the amount payable on the happening of risk is made between the insurer and the insured.

Indemnity implies that:

* There must be an actual loss
* The loss should have occurred through the risk insured
* The loss must be capable of calculation in terms of money
* The payment made by another person (third party) should not exceed the actual loss suffered.

Indemnity can take different forms: cash payment, replacement of property or reinstatement of the property or repair.

* 1. **Principle of insurable Interest**

For an insurance contract to be valid, the insured must possess an insurable interest in the subject matter of insurance. Insurable interest refers to the existence of financial relationship to the subject matter insured. The subject matter of insurance may be a property, life or legal liability.

The insurable interest to be valid must be recognized as such under the law and must satisfy the following conditions:

1. There must be some subject matter of insurance such as physical object or potential liability;
2. There must be risk to which the subject matter is exposed
3. The insured must have some legally recognized relationship with the subject matter insured.
4. The insured should stand to benefit by the safety of the subject matter and should incur loss by its destruction or damage; and
5. The subject matter should be measurable in terms of money.

Generally in the case of life insurance insurable interest must exist at the inception of the policy. In the case of property insurance, with few exceptions, insurable interest must exist both at the time of effecting insurance and at the time of loss.

The doctrine of insurable interest in property insurance is to prevent insurance from becoming gambling contract and in life insurance it is required in order to prevent acts of murder. Insurable interest may take the following ways, i.e., ownership, lawful possession, contract or insurer.

* 1. **Principle of subrogation**

Subrogation is the right to an insurer who has paid a claim under a policy issued by him to receive the benefit of all rights and remedies of the insured will extinguish or diminish the ultimate loss sustained. It is the right of one person (the insurer) to stand in the place of another (the insured) to avail himself on the latter's rights and remedies.

Principle of subrogation is a supplement to the principle of indemnity. The reason behind this principle is to eliminate the profit motive of the insured. That means, the insured cannot claim both from the insurer and the wrong doer for single accident, which would enable him/her collect more than what was actually lost.

Subrogation implies that:

* The insurer makes payment to the insured for his actual loss
* The insurer after making good the loss, places himself in the position of the insured and has all the rights and remedies of the insured
* The insurer cannot recover anything more than he has paid to the insured

Like principle of indemnity, principle of subrogation is not applicable to life insurances.

* 1. **Principle of utmost good-faith**

Insurance contracts are based upon mutual trust and confidence between the insurer and the insured. This principle requires each party to tell the other "the truth, the whole truth and nothing but the truth". It means that both the insured and insurer must make full disclosure of material facts and information relating to the contract or facts that have a bearing on the assessment of the risk. Material facts are of the following types:

1. those which affect the nature or incidence of risk; and
2. those which affect the character of insured.

Non-disclosure, concealment, innocent misrepresentation, and fraud may lead to avoidance or cancellation of the insurance contract by one of the parties to the contract.

## Principle of contribution

Contribution is also corollary of /or supplement of the principle of indemnity. The doctrine of this principle preaches for an "equitable distribution" of any loss among insurers. In other words it applies that when there is more than one policy covering the same subject matter against the same peril for the same period and for the same insured. In this case, the insured can make claims under all policies with different insurers and recover pro rata from each. Contribution is the right of an insurer who has paid a loss under a policy to recover a proportionate amount from other insurers who are liable for the same loss.

The principle of contribution is enforceable only under the following conditions:

1. The policies must cover the same period
2. The policies must have been enforce at the time of loss
3. They must protect the same interest
4. The subject matter of insurance must be the same, and
5. The insured must be the same person.

Note: The principle of contribution is not applicable to life insurances.

## Principle of proximate cause

The maxim *'causa proxima non remota spectature'* means that proximate (nearest) causa and not the remote one is to be taken notice of at the time of determining the liability of the insurer. The insurer is not liable for remote cause even if it is one of the insured risk for the occurrence of which the insured is to be compensated the insurer is liable to make the payment of loss under the policy, otherwise not. The insured may recover the loss from the insurer only when:

* The loss has been caused by the insured peril; and
* The cause has been proximate to the loss.

Therefore, the insurer is not liable for the loss due to a proximate cause, which is not an insured peril.

##### Example

Ato Abebe insured his car worth of Br. 500,000 in two insurance companies: Ethiopian Insurance Corporation and Awash Insurance Company for Br 300,000 and 200,000 Birr respectively. While the policy is in force the car was damaged due to collusion done intentionally by Kebede. The loss is estimated to be Br. 200,000.

*Required:*

1. How much each insurance company is going to pay to Ato Abebe? Why?
2. How much Ato Abebe is going to claim? Why?
3. Abebe has an intention to claim compensation from the two insurance companies and Kebede at the same time. Advice him. What he/she should does?

###### Answers

* 1. The insured has the right to claim compensation from the insurer as far as the policy is in force an amount equal to the loss or face value of the policy. (Indemnity principle). Due to contribution principle, Abebe can the amount of loss (Br. 200,000) from the two companies. They contribute to the loss based on the proportion insured. The proportion is calculated as:
	2. Ato Abebe can collect a total of Br. 200,000 an amount of the loss; and 120,000 Br from EIC and 80,000 BR from Awash.
	3. Ato Abebe cannot collect claim from the insurance companies and the wrong doers because of the principle of indemnity and subrogation.