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Good Faith and Misrepresentation in Contracts of Insurance

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INTRODUCTION

One of the requirements of a valid contract is that the parties to the contract reach consensus on the terms of the contract. When information is materially misrepresented during the underwriting stage of a contact of insurance, it can (and likely will) have an adverse and negative impact on the legal nature of the contract and could, in certain instances, render the entire contract (or portions of it) voidable, at the discretion of the insurer.

This article examines of the topics of material misrepresentation and good faith in terms of a contract of insurance and looks at the consequences of non-disclosure.

GOOD FAITH IN INSURANCE POLICIES

In the case of Mutual & Federal Insurance Co Ltd v Oudtshoorn Municipality (1985) (1) SA 419 (A) ("Oudtshoorn Municipality Case"), the Court abandoned the concept of utmost good faith in insurance contacts. This, however, did not result in the abandonment of the doctrine of good faith altogether but rather dispensed with the application of differing degrees of good faith.

Accordingly, the Oudtshoorn Municipality Case serves to confirm, among other things, that when entering into a contract of insurance, both parties are required to act with good faith, which includes the disclosure of material facts and the omission of wilful misrepresentations.

TYPES OF MISREPRESENTATION

An insurance contract is subject to the requirements for contractual validity, namely consensus, legality, formalities, possibility, capacity and certainty. With specific reference to the requirement of consensus (once more), parties to a contract need to reach consensus on the essential terms of the contract, failing which, the contract will be voidable. If consensus is obtained in a wrongful manner, such as intentional misrepresentation, the contract will be voidable at the discretion of the innocent party.

Misrepresentations made in relation to contracts of insurance can take the form of positive misrepresentations or negative misrepresentations. A positive misrepresentation occurs when the (prospective) insured makes an incorrect statement that has to do with a material fact to the insurer, an example of this would be intentionally answering a question in a medical incorrectly. A negative misrepresentation occurs when the (prospective) insured fails to disclose a material fact to the insurer, an example being failure to disclose a medical condition known to the (prospective) insured at the time of completing the proposal form.

If the insurer is induced to contract by the insured's misrepresentation (that relates to a material fact), the insurance contract will be voidable at the discretion of the insurer and a claim for damages can potentially also be pursued.

WHAT FACTS ARE MATERIAL?

The courts have determined that whether a fact is material or not, insofar as it relates to disclosure, is an objective question. The court in the Oudtshoorn Municipality Case held that the test for the materiality of a fact, for the purpose of disclosure, was judged neither from the point of view of the reasonable insured nor that of the reasonable insurer but was rather judged from the point of view of the reasonable person. This view was upheld by the judgement in the case of *President Versekeringsmaatskappy Bpk v Trust Bank van Afrika Bpk & 'n Ander 1989 (1) SA 208 (A*). In both cases the question posed was whether a reasonable person would consider that the information or facts that were misrepresented were reasonably relative to the risk or the assessment of the premiums, if they were then the facts were material in nature.

DUTY TO DISCLOSE

Our law does not place a general duty on contracting parties to disclose facts known to one of them, which may have the effect of impacting the consensus of the other party, however there is an exception to this rule in cases of contracts of insurance as held by the court in

the Oudtshoorn Municipality case, where it was explained that a common law duty is imposed and places an obligation on both the insurer and the insured to disclose to each other prior to entering into the contract of insurance, every fact relative and material to risk or the assessment of the premium.

The duty to disclose extends to all facts which are material, subject to the following exclusions:

- facts provided in a proposal form that have the effect of diminishing the risk;
- material facts that fall into a class of information previously waived by the insurer;
- material facts of which the insurer already has knowledge; and
- material facts that are covered by either an express or implied warranty in the contract of insurance.

CONCLUSION

The above is only a summary of a complex area of the law. Should you have any disputes with your insurer, we suggest that you approach a lawyer with the requite expertise in insurance law, as it is easily misunderstood, which could result in you not obtaining the results you wish.

Kindly contact the authors of this article on 011 568 8500 for more information.

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