

## **INSURANCE LAW'S ESSENTIAL DISTORTION AND MISREPRESENTATION**

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### **ABSTRACT**

*The complex world of insurance regulations is a cornerstone of risk management in contemporary society, yet it is rife with uncertainties that can result in fundamental misrepresentations and distortions. Although the intention of these legal frameworks is to protect both insurers and policyholders, the intricacy of policy language and the possibility of dishonest behavior may compromise this protection. Important information about coverage, exclusions, and each party's responsibilities is frequently hidden by the spread of false information, whether via brokers or agents. By examining the mechanisms of distortion and deception in insurance legislation, this paper seeks to clarify their effects on consumer confidence, the efficacy of regulations, and the integrity of the market as a whole. Through analyzing these problems, the conversation will advance a better comprehension of main causes of litigation and disputes pertaining to insurance contracts. The paper discusses how convoluted policy language and deceptive practices by brokers and agents can obscure critical information regarding coverage and responsibilities, ultimately eroding consumer trust and the effectiveness of regulations. By focusing on these issues, the research aims to shed light on the root causes of litigation and disputes in insurance contracts, especially in India, where enforcement mechanisms are inadequate. The paper concludes with suggestions for potential reforms to address these challenges.*

**Keywords:** Insurance, Distortion, Misrepresentation, Risk Management

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## **INTRODUCTION**

The intricate realm of insurance laws serves as a foundational element for risk management in modern society, yet it is fraught with ambiguities that can lead to essential distortions and misrepresentation. The relationship between insurers and insured parties is greatly impacted by misrepresentation in insurance contracts, as it distorts risk assessments. It may result in serious repercussions like policy revocation or claim denial. The fundamental duty of good faith is compromised when one party gives misleading information. These legal frameworks are designed to provide protection for both insurers and policyholders; however, the complexity of policy language and the potential for deceptive practices can undermine this intended protection. The proliferation of misleading information, whether from agents or brokers, often obscures critical details regarding coverage, exclusions, and the obligations of each party. This paper aims to explore the mechanisms of distortion and misrepresentation within insurance laws, shedding light on their implications for consumer trust, regulatory effectiveness, and overall market integrity. By dissecting these issues, the discussion will contribute to a deeper understanding of how misleading practices not only affect individual policyholders but also impact the broader insurance landscape.

## **UNDERSTANDING DISTORTION IN INSURANCE PRACTICES**

The distortion in insurance practices often arises from the intricate interplay between regulatory frameworks, market behavior, and consumer perceptions. Insurers, motivated by the desire to maintain profitability, may engage in misrepresentation of policy terms or coverage limits, ultimately leading to significant customer dissatisfaction and financial repercussions for the insured. **ICICI Prudential Life Insurance Co. Ltd. vs. Lakhwinder Singh**<sup>1</sup>, in this instance, the insured gave false information on the proposal form about their occupation and income. The court affirmed the insurer's choice to reject the claim, highlighting how the contract is void when important facts are suppressed. (Furthermore, regulatory oversight is frequently challenged by the complexities inherent in insurance language, which can obscure critical details from consumers. This obscurity not only enables misrepresentation but also complicates the disclosure of essential information, creating a gap in public understanding of insurance products. In instances where misrepresentation becomes egregious, affected parties may seek remedial action; Considering the implications of such practices, it becomes vital to explore the

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<sup>1</sup> May 31, 2024. District Consumer Disputes Redressal Commission, Chandigarh.

legal standards governing insurance laws, which seek to mitigate the risks associated with these distortions and protect consumers in an often opaque market.

## **DISTORTION AND THEIR IMPACT ON POLICYHOLDERS**

Understanding the various types of distortion in insurance practices is crucial for evaluating their impact on policyholders. Distortions can manifest as misrepresentations of coverage, exaggerated claims of benefits, or misinformation about policy conditions. Such practices not only undermine the trust between insurers and consumers but also lead to significant financial repercussions for policyholders. For instance, when potential buyers are misled about the necessity or value of a product like life insurance<sup>2</sup>, it creates a barrier to informed decisions. Additionally, the emergence of interest groups opposing reform initiatives, such as those presented in the Restatement of the Law of Liability Insurance, highlights a trend where entity biases can further distort the legal landscape, disadvantaging the very individuals these policies aim the protection.<sup>3</sup> A material fact is a critical fact that is highly relevant for insurance purposes. If a policyholder withholds a material fact and the insurer issues a policy without knowledge of this fact, then it might constitute insurance fraud. Withholding certain material facts can also void policies entirely<sup>4</sup>. “There are a number of different material facts whose withholding could void an insurance policy. For example, if a person with terminal cancer applies for life insurance and does not disclose the cancer diagnosis, or lies about it, this could void the policy. This is because the material fact that the person had cancer is deemed so important to the insurance coverage that withholding it could violate policy terms and conditions<sup>5</sup>.” “A non-disclosure agreement (NDA) is a legal contract between two or more parties that signifies a confidential relationship exists between them. The confidential relationship exists because the parties share information among themselves that should not be made available to any other parties outside of those involved, such as competitors or the general

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<sup>2</sup> Hanson, Jon S., Kimball, Spencer L.. "The Regulation of Specialty Policies in Life Insurance". University of Michigan Law School Scholarship Repository, 1963, <https://core.ac.uk/download/346441289.pdf> visited on 1st November, 2024, last visited at 4.00am.

<sup>3</sup> Stempel, Jeffrey W. "Hard Battles Over Soft Law: The Troubling Implications of Insurance Industry Attacks on the American Law Institute Restatement of the Law of Liability Insurance". Scholarly Commons @ UNLV Boyd Law, 2021, <https://core.ac.uk/download/423485837.pdf> last visited on 1st November,2024 at 4.10am

<sup>4</sup> Sophia Harrison, What Is a Material Fact in Insurance?, Sapling, 11-May 2013, <https://www.sapling.com/8008841/material-fact-insurance>; last visited on 1<sup>st</sup> November;2024 at 4.18am.

<sup>5</sup> Ms. Nargis Yeasmeen, Consequences of Non-Disclosure in the Contract of Insurance, IOSR Journal of Business and Management (IOSR-JBM), Vol 17, 2015.

public or. An NDA may also be referred to as a confidentiality agreement.<sup>6</sup> "The policyholder must act in good faith by fully disclosing all information that affects the insurance company's level of risk, even if the insurance company agrees to share the risk of loss with the policyholder." By charging the policyholder a premium that fairly represents the amount of risk it is taking on or even by declining to issue a policy if the risk is too great, full transparency enables the insurer to safeguard itself.

## **MISREPRESENTATION IN INSURANCE CONTRACTS**

Misrepresentation in insurance contracts poses significant challenges, as it undermines the principle of good faith integral to the insurer-insured relationship. When parties to a contract provide false information, they distort the risk assessment, which can lead to severe financial repercussions for both sides. In life insurance, for example, an insured's failure to disclose critical health history can result in claims being denied, impacting beneficiaries relying on these policies for financial security<sup>7</sup>. This ethical dilemma intensifies with aggressive sales techniques, where insurers may inadvertently create pressures that lead to misrepresentation by consumers who feel rushed or inadequately informed about their policies. Furthermore, legal mechanisms designed to address consumer protection, such as cooling-off rules, are often insufficient in the context of these contracts, as they do not inherently consider the unique aspects of insurance transactions<sup>8</sup>. Hence, addressing these issues necessitates comprehensive reforms to enhance transparency and accountability in the industry. In the case of **Okonkwo v Midland & Mansfield Insurance Co. Ltd.**,<sup>9</sup> the court held that "Insurance contract is described as where a person is called insurer/insurance Company in return for an agreed consideration in money or money's worth called premium paid to them by another person called an insured/assured agrees or undertakes to pay money or indemnify the latter on the occurrence or happening of a certain specified hazardous event. In the context of insurance, making a false statement in an application for a policy or during an interview is considered misrepresentation. It could be so trivial that the insurance just needs to amend the policy, or it

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<sup>6</sup> WILL KENTON, Non-Disclosure Agreement – NDA, Investopedia, Jun 29, 2018, <https://www.investopedia.com/terms/n/nda.asp#ixzz5TGLOSkUB>

<sup>7</sup> Supra footnote-2

<sup>8</sup> Fabian Maramarosy, Sarah. "Caveat Vendor: A Call to Reform the Scope of Rights of Withdrawal for Off-Premises Contracts Under U.S. Consumer Protection Laws with Respect to the Auction of Art". FLASH: The Fordham Law Archive of Scholarship and History, 2020, <https://core.ac.uk/download/289198357.pdf>

<sup>9</sup> Okonkwo v Midland & Mansfield Insurance Co. Ltd (1980) FHCLR 149

could be so serious that it gives the insurer good reason to terminate the agreement.<sup>10</sup> **Oriental Insurance Company Ltd. vs. Mahendra Construction**<sup>11</sup> held that the insured failed to disclose previous insurance claims, which was deemed a suppression of material facts. The Supreme Court ruled in favour of the insurer, stating that non-disclosure of information influencing the insurer's decision constitutes a valid ground for repudiation. In an insurance policy, the insurance company has the authority to cancel the policy if the insured makes false representations.

## **IMPORTANCE OF PROPER REPRESENTATION AND GENUINE DISCLOSURE**

“In insurance applications, lying or omitting information could have serious consequences. False, inaccurate, or even incomplete responses in the application or failure to disclose important facts could undermine the contract's foundation and endanger its ongoing existence.<sup>12</sup>” Mutual obligations of good faith and trust establish the connection between the insured and the insurer. The relevant details are typically well understood by the applicant at the time of application, but it can be challenging for the insurer to ascertain them. When deciding whether to issue a policy and what particular exclusions to require, the insurer is vulnerable and needs the relevant information in order to calculate the premium.<sup>13</sup> The requirements that an insured disclose all facts, transaction with the surety not to misrepresent material facts in an insurance contract are universal requirements. **New India Assurance Co. Ltd. vs. Yallavva and Another**<sup>14</sup> court held, the burden of proof lies on the insurer to establish non-disclosure or misrepresentation. Without evidence of suppression or misrepresentation, the insurer cannot avoid the policy. The Disclosure in the insurance context is distinct from the approach in commercial contracts, and in others between persons dealing at arm's length. the requirement to affirmatively volunteer information in relation to insurance transactions reflects, first, the potentially mortal impact inadequate information poses to the insurance

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<sup>10</sup> ShareLawyerson, The Difference between Fraudulent and Innocent Misrepresentation in Insurance Claims, Share Lawyers, Mar 10, 2014, <https://www.sharelawyers.com/blog/2014/03/the-difference-between-fraudulent-and-innocent-misrepresentation-in-insurance-claims.html> ; last visited on 1st November, 2024 at 4.21 am

<sup>11</sup> SC 317, (2019) 137 ALL LR 232

<sup>12</sup> Ms. Nargis Yeasmeen, Consequences of Non-Disclosure in the Contract of Insurance, IOSR Journal of Business and Management (IOSR-JBM), 1-05-2011, <http://iosrjournals.org/iosr-jbm/papers/Vol17-issue6/Version-3/D017632936.pdf>, last visited on 1<sup>st</sup> November, 2024 at 4.45am.

<sup>13</sup> Misrepresentation and Non-Disclosure in Insurance Law. Identical Twins or Separate Issues?, John Birds and Norma J. Hird, The Modern Law Review, Vol. 59, No. 2 (Mar., 1996), Pg 4.

<sup>14</sup> 2020 KAR 986

industry's vitality, and second, the practical reality that certain critical information may be peculiarly within the insured's knowledge and difficult to elicit.<sup>15</sup> However, in cases, such as the **House of Lords in Banque Financiere de la cite S.A. v. Westgate Insurance Co Ltd**<sup>16</sup> have affirmed that the duty of utmost good faith and the duty of disclosure are mutual and fall upon both insurer and insured and again affirmed in the **Bank of Nova Scotia v. Hellenic Mutual War Risk Association**, the English Court of Appeal "did not think it necessary" to question the view that the duty of utmost good faith continues during the currency of the insurance contract, Secondly, that the insured and insurer act in the utmost good faith towards each other is not confined to the duty of disclosure and a duty not to misrepresent material facts. As the Australian Law Reform Commission" points out, "it should apply equally to other aspects of the insurance relationship", for example, to an insurer's breach of the duty of good faith in relation to the settlement of a claim.

## **LEGAL CONSEQUENCES OF MISREPRESENTATION FOR INSURERS AND INSURED**

The legal consequences of misrepresentation in insurance contracts pose significant implications for both insurers and insured parties, fundamentally shaping the dynamics of their relationship. Misrepresentation occurs when one party provides false or misleading information, which can result in the insured facing denial of claims or the insurer being compelled to honor contracts under dubious terms. This paradigm raises essential questions about the duty of good faith, particularly given the information asymmetry that often exists between insurers and insured individuals<sup>17</sup>. Instances of misrepresentation can lead to severe repercussions, including rescission of the policy, where insurers may void the contract altogether, thus leaving the insured without coverage at critical moments<sup>18</sup> Therefore, a thorough understanding of these legal consequences is vital in fostering ethical practices within the insurance industry and ensuring that both insurers and insured are protected from the adverse outcomes of misinformation. In the case of **Rakesh Patel vs LIC Of India &Anr.**, the court held that, "The term "material fact" is not defined and, therefore, it has been explained

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<sup>15</sup> M. A. Clarke, *The Law of Insurance Contracts* (3rd edition, 1997), Chaps 22-23.

<sup>16</sup> *Banque Financiere de la cite S.A. v. Westgate Insurance Co Ltd*, [1991] 2 A.C. 249.

<sup>17</sup> Julie-Anne Tarr, Janet Mack. "Auditor obligations in an evolving legal landscape". *Accounting Auditing & Accountability Journal*, 2013, <https://doi.org/10.1108/aaaj-03-2013-1262> p-1009-1026. Last visited on 2<sup>nd</sup> November, 2024 at 8.00pm.

<sup>18</sup> Gero Verheyen, Edith Quintrell. "Old Risks-New Solutions, or Is It the Other Way Around?". *The World Bank eBooks*, 2013, <https://doi.org/10.1596/978-0-8213-9877-7>

by the Courts in terms generally understandable which mean as any fact which would influence the judgment of a prudent insurer in fixing the premium or formative whether he would like to accept the risk. Any fact which goes to the root of the Contract of Insurance and has a bearing on the risk involved would be "material"<sup>19</sup>. False and improper answers or non-disclosure of material facts may lead to the contract becoming voidable on part of the insurer and put its continued existence in jeopardy. in the case of **Pan Atlantic Co Ltd and Another v Pine Top Insurance Co Ltd**, the court established that, "Every circumstance is material which would influence the judgment of a prudent insurer in fixing the premium, or determining whether he will take the risk or not". And also mentioned that - The insurer is vulnerable and requires the material facts in order to determine whether to issue a policy or not, what specific exclusions it may or may not require, and what premium it will or will not charge<sup>20</sup>, The affiliation amongst the insurer and the insured can be recognized by the mutual obligations of trust and good faith which are dominant. When the application is being made, the essential facts are definitely known by the applicant but it may be challenging for the insurer to ascertain the same. The insurer is at risk and requires knowing all the material facts in order to determine whether or not it can issue a policy and with the doubt what premium it shall charge<sup>21</sup>. In the case of **Satwant Kaur Sandhu vs. New India Assurance Co. Ltd.**, the court said that, "It needs little emphasis that when an information on a specific aspect is asked for in the proposal form, an assured is under a solemn obligation to make a true and full disclosure of the information on the subject which is within his knowledge. It is not for the proposer to determine whether the information sought for is material for the purpose of the policy or not"<sup>22</sup>. This case acknowledges that the proposer must decide what information must be sought, but it doesn't specify why or how one determines the level of risk. There are two distinctive duties on the applicant during the process. Typically, the applicant converses with the agent or broker in order to complete the application. Subject to the nature and type of insurance coverage sought, the application contains a series of questions regarding the history, business activities, health etc. of the applicant<sup>23</sup>. And the application contains a declaration executed by the applicant that the answers given are bonafide and true. "When an insurer takes the position that a policy is

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<sup>19</sup>Rakesh Patel vs Lic Of India & Anr, Revision Petition No. 408 of 2013, Decided On, 16 January 2015.

<sup>20</sup> Pan Atlantic Co Ltd and Another v Pine Top Insurance Co Ltd, [1995] 1 AC 501, [1994] 3 All ER 581, [1994] 2 Lloyd's Rep 427, [1994] 3 WLR 677

<sup>21</sup>Insurance Law. Under the Influence, Malcolm Clarke Malcolm Clarke, The Cambridge Law Journal, Vol. 53, No. 3 (Nov., 1994), pp. 438-440.

<sup>22</sup>Satwant Kaur Sandhu Vs. New India Assurance Co. Ltd. (2009) 8 SCC 316

<sup>23</sup> Non-Disclosure: Hair shirt or Halo?, David Allen, The Modern Law Review, Vol. 55, No. 1 (Jan., 1992), pp. 96-101

void by reason of misrepresentation or non-disclosure, the insurer is not required to establish the motives of the insured. The insured's motives are not relevant as long as the misrepresentations are of a fact known to the insured which could be regarded by a reasonable insurer as material to the risk"<sup>24</sup>. "As a general rule, just because questions relating to the risk are put to the applicant does not release him or her from the independent obligation to disclose all material facts. In situations where the application form is completed with the assistance of an agent or broker, the factual circumstances surrounding the completion of the application are relevant to a determination as to whether there was misrepresentation or non-disclosure"<sup>25</sup>. "Where the agent or broker misinterprets the question or provides misleading or incorrect advice to the insured, the insured may not be held responsible for inaccurate answers. Further, if there is any uncertainty in the scope and purview of the answers sought, the issue will be resolved in favor of the insured. And the duty of disclosure imposed on the insured does not stop at the application stage. It continues up to the moment when a binding insurance contract is concluded"<sup>26</sup> in the case of **LIC of India vs. Shobha Rani Shah and Anr**, where "the court accepted the claim of the appellants saying that, the agents act on behalf of proposer at the time of filling up the form. Therefore, insurance company is not responsible for the act done by the agent. Looking all this circumstances, the insurance company has rightly rejected the insurance claim"<sup>26</sup>. This judgment realized the fact that the insured will only answer the questions asked by the agent or the insurance company and apply the mind of its own, therefore there is a law needed in order to regulate these contracts and the roles of insurance company and the agents. In the case of **L.I.C vs. Shakunthalabai**, the court put additional burden on the L.I.C. agents while procuring new business. The Honourable Court did not approve of the repudiation because the insurer could not establish by clean and cogent evidence that the question was properly explained to her and she was not told that illness included such casual disturbance of health." Thus, it was held that the insurer must act "fairly and honorably to the insured explaining properly the implications of the declaration to be signed by the insured and the range and the amplitude of the questions required to be answered."<sup>27</sup> In **Black King Shipping Corporation v Massie**, 'Litsion Pride's case', the courts had introduced a novel concept in the law when he "extended the duty of disclosure to circumstances beyond the conclusion of the

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<sup>24</sup>Contracts: Misunderstanding: Misrepresentation of the Contents of a Written Offer, D. L. Q., Michigan Law Review, Vol. 34, No. 5 (Mar., 1936), pp. 705-716.

<sup>25</sup> Ibid.

<sup>26</sup>LIC of India vs. Shobha Rani Shah and Anr, (2011) CPJ 166 (NC

<sup>27</sup> Life Insurance Corporation of India vs ShakuntalaBai, AIR 1975 AP 68



contract. *Litsion Pride* has made it patently clear that the duty of utmost good faith is not only overriding, going beyond the obligations set out in the following sections, but that it is also continuing. *Hirst J* also referred to the duty not to make fraudulent claims as a facet of the duty to observe utmost good faith<sup>28</sup>. The insured is under a duty to disclose only facts of his knowledge. According to *Fletcher Moulton LJ* in ***Joel v Law Union and Crown Insurance***<sup>29</sup> “you cannot disclose what you do not know”. Formerly, “the test for materiality was whether a prudent insurer would consider it relevant in deciding whether or not to accept the risk or in fixing the premium. There was no need for the particular insurer in question to regard it as material. The insurer could avoid it if it was a fact that would have influenced a prudent insurer<sup>30</sup>. In the case of ***Container Transport International Inc v Oceanus Mutual Underwriting Association (Bermuda) Ltd***,” the Court of Appeal held that an insurer was entitled to avoid a contract under Section 18 of the Marine Insurance Act where there was undisclosed before the contract was concluded, any circumstance which a prudent insurer would have taken into account when reaching his decision whether or not to accept that risk or what premium to charge<sup>31</sup>. The court had rejected the decisive influence test as, “the test for materiality and instead stated the non-disclosed information should have been of such a nature that a prudent insurer would have wished to know the facts. The consideration here is the prudent insurer and not the particular insurer.”

In ***Carter v Boehm***, The court said: “Insurance is a contract based upon speculation. The special facts, upon which the contingent chance is to be computed, lie most commonly in the knowledge of the insured only; the underwriter trusts to his representation and proceeds upon the confidence that he does not keep back any circumstance in his knowledge, to mislead the underwriter into a belief that the circumstance does not exist, and to induce him to estimate the risk as if it did not exist.”<sup>32</sup>

## **CONCLUSION**

Amid the growing complexities of the insurance landscape, the imperative for reform in insurance laws becomes increasingly evident, particularly in addressing the pervasive issues of

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<sup>28</sup> *Black King Shipping Corporation v Massie*, ‘*Litsion Pride*’ [1985] 1 Lloyd’s Rep 437

<sup>29</sup> *Joel v Law Union and Crown Insurance* [1908] 2KB 863

<sup>30</sup> *John Lowry & Phillip Rawlings*, *Insurance Law Cases and Materials* 2004.

<sup>31</sup> *Container Transport International Inc v Oceanus Mutual Underwriting Association (Bermuda) Ltd* [1984] 1 Lloyd’s Rep 476.

<sup>32</sup> (1766) 3 Burr 1905

distortion and misrepresentation. These practices not only undermine consumer trust but also skew the competitive balance within the industry, resulting in detrimental outcomes for both policyholders and insurers. Distortion often occurs when insurers engage in misleading advertising or fail to provide transparent information about policy terms, while misrepresentation arises when either party provides inaccurate information during the application process. Such behaviors can lead to claims disputes, coverage gaps, and financial losses for consumers who rely on insurance for protection. In order to reduce the issue or relieve the complexities resulting from misrepresentation and non-disclosure, the researchers in this work have made a few recommendations.

- To enable the insurer to read and comprehend the terms and conditions of the policies, the first step should be the creation of the "standard notice." All potential material facts pertaining to the policies should be specifically mentioned in the notice. Although each company has different terms and conditions, the central authority should standardize this notification.
- Secondly, insurance providers can offer a hotline service that gives the insured a different means of understanding all legal requirements and the complexities of insurance contracts before they sign. The insured can utilize these helpline lines to discover the material data required by the insurer and to comprehend all the terms and conditions of the insurance contracts.
- A regulation that explicitly outlines the responsibilities and rights of insurers, agents, and insured is unquestionably necessary. The act will include all the clauses required to keep the contracts in effect, as well as the standard templates for Standard Notices, confidentiality agreements, acknowledgements, and dispute resolution clauses. The act will specify how the supervisory committee will be established, along with its responsibilities and authority.
- The act would impose duties not only on the insured but also on the insurers, allowing for the observance of any violations of the act's regulations. In order for the business and the insured to be afraid of legal action for the duty violation. The legislation will also specify the procedure that will be used when the court finds a violation.

Therefore, revising existing regulations to enhance transparency, enforce stricter penalties for deceptive practices, and promote informed decision-making is essential. Ultimately, reforming insurance laws is crucial to ensure fair dealings, restore public confidence, and maintain the integrity of the insurance market.