CASE NO.:
Appeal (civil) 1350 of 2001

PETITIONER:
NATIONAL INSURANCE COMPANY LTD.

Vs.

RESPONDENT:
SEEMA MALHOTRA AND ORS.

DATE OF JUDGMENT: 20/02/2001

BENCH:
K.T. Thomas & R.P. Sethi.

JUDGMENT:

L...I...T.....T.....T.....T.....T.....T.....T..JJ U D G M E N T

THOMAS, J.

Leave granted.

Under a contract of insurance the insured gave a cheque to the insurer towards the first premium amount, but the cheque was dishonoured by the drawee bank due to insufficiency of funds in the account of the drawer. Is the insurer liable in such a situation to honour the contract of insurance? There is no dispute that the insurer is liable as against third parties because it is covered by the statutory provisions contained in Chapter X of the Motor vehicles Act 1988. But the insurer vehemently disputed the liability when the claim is made by the insured himself or his legal heirs, without any third party being involved. To avoid confusion we may point out that the insurance company has no dispute that the claims, if any, made by the kith and kin of the insured for the injuries sustained by them in the accident including the claims made by the legal representatives of the deceased in such accident would also be treated as third party claims).

A division bench of the High Court of Jammu and Kashmir held, on the facts of the case, that the insurance company is still liable because it chose to cancel the policy with effect from the date of bouncing of the cheque, whereas the liability was incurred prior to it.

The question can be dealt with after summarizing the facts in this case which led to the impugned judgment of the High Court. The insured was one Yash Paul Malhotra. He and the appellant insurance company entered into an insurance contract on 21st December, 1993, by insuring a Maruti car for a sum of Rupees one lakh and fifty thousand. On the same day, the insured gave a cheque for Rs.4492/- towards the first instalment of the premium and the insurance company issued a cover note as contemplated in Section 149 of the Motor Vehicles Act. But unfortunately, the last day

in the year 1993 became the last day of the insured as well as his Maruti car because the insured died and the car was completely damaged in an accident which occurred on 31.12.1993.

On 10.1.1994 the bank on which the cheque was drawn by the insured sent an intimation to the insurance company that the cheque was dishonoured as there was no funds in the account of the insured. On 20.1.1994 the insurance company informed the business concern of the insured as under:

Notwithstanding anything contained to the contrary, it is hereby agreed and declared that your cheque has been dishonoured by the bank. So we are cancelling the above said policy with immediate effect. The company is not at risk.

The respondents who are the widow and children of the insured, who died in the accident, filed a claim for the loss of the vehicle. When the claim was repudiated, the respondents moved the State Consumer Protection Commission. As per a judgment pronounced by the Commission the said claim was rejected. The judicial member of the State Commission, who delivered the judgment, has stated thus:

In so far the facts of the present case are concerned, it is a settled law that the insurer even if it had issued a cover note is entitled to cancel the policy if it fails to cash the cheque for premium. The concept of contract in essence envisages a proposal, acceptance and passing of consideration. In the absence of any consideration there can be no contract and that is all what is recognised by section 64-VB of the Insurance Act. The insurer was justified in repudiating the contract and it has done it in time and soon after the cheque bounced. In this view of the matter there is no need for us to go to any other point that may arise in this case.

When the respondents (legal heirs of the insured) moved the High Court of Jammu and Kashmir, the division bench which heard the matter reversed the order passed by the State Consumer Commission and held the insurance company liable to honour the claim. The Division Bench directed the State Commission to assess the compensation in accordance with law and pay the same after deducting the amount of premium (as the cheque was dishonoured). The following reasoning was mainly adopted by the learned judge of the division bench for holding that the insurance company is liable on the fact situation:

While ordering the cancellation of policy in question, respondent insurance company instead of cancelling the same due to dishonour of cheque of the premium from the date it was issued i.e. 21.12.1993, chose to cancel it with immediate effect. This clearly indicates that till the issuance of this communication respondent insurance company itself treated the policy subsisting. Besides this, it had not chosen to treat the same cancelled from the date of issue. In the face of this position, this case need not detain us any further and for this reason the argument addressed on behalf of the insurance company based on section 64- VB of the Insurance Act also does not hold good. There was nothing which prevented the insurance company to

have informed the appellants that the policy stood cancelled from the date of its issuance, and as such it is not liable for the payment of any compensation.

The direction that insurance company can now deduct the premium amount from the compensation to be fixed is no solace to the insurer. The essence of the insurance business is the coverage of the risk by undertaking to indemnify the insured against loss or damage. They agree to pay the damages arising out of any accident by taking a chance that no accident might happen. Motivation of the insurance business is that the premium would turn to be the profit of the business in case no damage occurs. Such business of the insurance company can be carried on only with the premium paid by the insured persons on the insurance policy. The only profit, if at all the insurance company makes, of the insurance business is the premium paid when no accident or damage occurs. But to ask the insurance company to bear the entire loss of damages of somebody else without the company receiving a pie towards premium is contrary to the principles of equity, though the insurance companies are made liable to third parties on account of statutory compulsions due to the initial agreement, entered between the insured and the company concerned.

A three-Judge Bench in Oriental Insurance Co. Ltd. vs. Inderjit Kaur (1998 (1) SCC 371) left this point unconsidered. In that case also the premium was paid by cheque which was later dishonoured and the insured was intimated about it by the insurance company two months after the vehicle got involved in the accident. When a claim was made by the legal heirs of the driver who died in the accident the insurance company resisted the claim on the strength of Section 64-VB of the Insurance Act of 1938. Repelling the contention of the insurance company, the three-Judge Bench held thus:

We have, therefore, this position. Despite the bar created by Section 64- VB of the Insurance Act, the appellant, an authorised insurer, issued a policy of insurance to cover the bus without receiving the premium therefor. By reason of the provisions of Sections 147(5) and 149(1) of the Motor Vehicles Act, the appellant became liable to indemnify third parties in respect of the liability which that policy covered and to satisfy awards of compensation in respect thereof notwithstanding its entitlement (upon which we do not express any opinion) to avoid or cancel the policy for the reason that the cheque issued in payment of the premium thereon had not been honoured.

Thus, the three-Judge Bench refrained from expressing any opinion on the question of insurers entitlement to avoid or cancel the policy as against the insured when the cheque issued for payment of the premium was dishonoured.

Subsequently the same question was mooted before a two-Judge Bench of this Court in New India Assurance Co. Ltd. vs. Rula and ors. {2000 (3) SCC 195} but the question of insurers right to repudiate the claim as against the insurer in a similar situation did not arise therein and hence the Bench parried the question.

Thus the question has now to be considered as the same is the crux of the issue involved in this case. As pointed

out earlier the insurance is a contract whereby one undertakes to indemnify another against loss, damage or liability arising from an unknown or contingent event and is applicable only to some contingency or act to occur in future. We have to consider how far the legislature has controlled the insurance business. Section 2(9) of the Insurance Act defines insurer, inter alia, as any body corporate carrying on the business of insurance which is a body corporate incorporated under any law for the time being in force in India. Section 2(d) of the Act says that every insurer shall be subject to all the provisions of this Act in relation to any class of insurance business so long as his liabilities in India in respect of business of that class remain unsatisfied or not otherwise provided for.

It is in the aforesaid context that we have to consider the impact of Section 64-VB of the Insurance Act. As sub-sections (1) and (2) of the said section alone are material for the purpose we extract them herein:

(1) No insurer shall assume any risk in India in respect of any insurance business on which premium is not ordinarily payable outside India unless and until the premium payable is received by him or is guaranteed to be paid by such person in such manner and within such time as may be prescribed or unless and until deposit of such amount as may be prescribed, is made in advance in the prescribed manner.

(2) For the purposes of this section, in the case of risks for which premium can be ascertained in advance, the risk may be assumed not earlier than the date on which the premium has been paid in cash or by cheque to the insurer.

Sub-section (1) is not applicable to cases in which premium is ordinarily payable outside India. In other words, the insurer has no liability to the insured unless and until the premium payable is received by the insurer. As the premium can be paid in cash or by cheque, what is the position when the cheque issued to the insurer is dishonoured by the drawee bank?

Sections 51, 52 and 54 of the Indian Contract Act can profitably be referred to for the purpose of deciding the point. They are subsumed under the sub- title Performance of reciprocal promises in the said Act. Section 51 deals with a contract concerning reciprocal promises to be simultaneously performed and in such a contract the promisee is absolved from performing his promise unless the promisor is ready or willing to perform his part of the promise. Section 52 says that where the order in which reciprocal promises are to be performed has not been expressly provided in the contract such promise shall be performed in that order which the nature of the transaction warrants it. Illustration (b) given to Section 52 highlights the utility of the provision. That illustration is as follows: A and B contract that A shall make over his stock-in-trade to B at a fixed price, and B promise to give security for the payment of the money. As promise need not be performed until the security is given, for the nature of transaction requires that A should have security before he delivers up his stock.

Section 54 of the Contract Act is to be read in that background. It is extracted below:

When a contract consists of reciprocal promises, such that one of them cannot be performed, or that its performance cannot be claimed till the other has been performed, and the promisor of the promise last mentioned fails to perform it, such promisor cannot claim the performance of the reciprocal promise, and must make compensation to the other party to the contract for any loss which such other party may sustain by the non-performance of the contract.

In a contract of insurance when an insurer gives a cheque towards payment of premium or part of the premium, such a contract consists of reciprocal promise. The drawer of the cheque promises the insurer that the cheque, on presentation, would yield the amount in cash. It cannot be forgotten that a cheque is a Bill of Exchange drawn on a specified banker. A Bill of Exchange is an instrument in writing containing an unconditional order directing a certain person to pay a certain sum of money to a certain person. It involves a promise that such money would be paid.

Thus, when the insured fails to pay the premium promised, or when the cheque issued by him towards the premium is returned dishonoured by the bank concerned the insurer need not perform his part of the promise. The corollary is that the insured cannot claim performance from the insurer in such a situation.

Under Section 25 of the Contract Act an agreement made without consideration is void. Section 65 of the Contract Act says that when a contract becomes void any person who has received any advantage under such contract is bound to restore it to the person from whom he received it. So, even if the insurer has disbursed the amount covered by the policy to the insured before the cheque was returned dishonoured, insurer is entitled to get the money back.

However, if the insured makes up the premium even after the cheque was dishonoured but before the date of accident it would be a different case as payment of consideration can be treated as paid in the order in which the nature of transaction required it. As such an event did not happen in this case the insurance company is legally justified in refusing to pay the amount claimed by the respondents.

In the light of the above legal position we uphold the contention of the appellant insurance company. We, therefore, allow this appeal and set aside the impugned judgment of the Division Bench of the High Court. The order passed by the State Consumer Commission will stand restored.

J
(K.T. Thomas)

J
(R.P. Sethi)

New Delhi;
February 20, 2001.