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Financier’s Right to Insurance Claim: Supreme Court Reaffirms Privity of Contract in Vehicle Insurance

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The Supreme Court's decision in **K. Prakashchand v. Oriental Insurance Co. Ltd.** is an important ruling on the rights of financiers in motor insurance claims. The judgment clarifies that a financier or lender, merely by having a financial interest in a vehicle, cannot automatically claim insurance proceeds unless there is a clear contractual or legal basis for doing so.

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Introduction

The case deals with a common commercial situation where a vehicle is purchased through finance, the borrower defaults, the vehicle is allegedly surrendered to the financier, and thereafter the vehicle is lost or stolen. The core question before the Court was whether the financier could directly claim the insurance amount from the insurance company, even though the **insurance policy** was issued in the name of the borrower/insured person.

The Supreme Court answered this question in the negative and held that an insurance contract is generally a **personal contract** between the insurer and the insured. A third party cannot enforce such a contract unless it is clearly recognised under the policy or under law.

Factual Background

The appellant, K. Prakashchand, had financed the purchase of a vehicle for one Somashekhar, who was the insured person. The vehicle was covered under a **comprehensive motor insurance policy** issued by Oriental Insurance Co. Ltd. for the period from 8 February 2003 to 7 February 2004.

According to the appellant, the insured person failed to regularly pay the loan instalments due to financial difficulties. As a result, he allegedly surrendered the vehicle to the appellant on 13 December 2003.

The appellant claimed that while the vehicle was in his custody, it was **stolen**. A police complaint was lodged on 15 December 2003, and since the vehicle could not be traced, the police filed a closure report.

Thereafter, the appellant submitted a claim to Oriental Insurance. He also offered to execute a letter of subrogation or undertaking in respect of any future claim that may be made by the insured person. However, the insurance company **repudiated the claim** on the ground that the appellant was not the insured person and had no direct contractual relationship with the insurer.

Proceedings Before the Consumer Fora

District Forum and State Commission

The appellant approached the **District Consumer Disputes Redressal Forum** at Mysore, alleging deficiency in service on the part of the insurance company. The District Forum allowed the complaint and directed Oriental Insurance to pay ?5,27,850 to the appellant.

The District Forum held that the arrangement between the appellant and the insured person was in the nature of hypothecation and not a pure hire-purchase agreement. It further held that the appellant had an interest in the insurance money as a **pledgee under IMT-7** of the policy.

Oriental Insurance challenged this order before the Karnataka State Consumer Disputes Redressal Commission. The State Commission dismissed the appeal and upheld the order of the District Forum.

It observed that where the loss or damage to the vehicle could not be made good by repair or replacement, the pledgee or financier would be entitled to receive the insurance money otherwise payable to the insured person.

National Consumer Disputes Redressal Commission

However, the **National Consumer Disputes Redressal Commission** reversed these findings. It held that there was no privity of contract between the appellant and the insurance company.

The National Commission observed that although the policy contained an endorsement relating to hire-purchase, hypothecation or lease, the insurer was not a party to the agreement between the appellant and the insured person. Further, the appellant had not produced the agreement on record.

Arguments Before the Supreme Court

Appellant's Arguments

Before the Supreme Court, the appellant argued that the transaction was essentially a **loan arrangement secured by hypothecation** of the vehicle. It was submitted that the insurance policy contained an endorsement recognising the financier's interest, and therefore the insurer could not avoid liability merely by stating that the appellant was not the registered owner.

The appellant also relied on *Sundaram Finance Ltd. v. State of Kerala*, where the Supreme Court had examined the nature of hire-purchase transactions and recognised that in such transactions, the financier may retain an interest in the vehicle until repayment is completed.

Respondent's Arguments

On the other hand, Oriental Insurance argued that the appellant was neither the registered owner nor the insured person under the policy. The insurer contended that **insurance is a personal contract** between the insurer and the insured, and no third party can claim under it unless the policy or law specifically permits such a claim.

It was also argued that the alleged surrender of the vehicle did not make the appellant the owner of the vehicle. Further, the appellant could not execute a letter of subrogation or undertaking on behalf of the insured person.

Issues Before the Court

The main issues before the Supreme Court were:

1. Whether the appellant-financier could directly claim insurance proceeds from the insurer.
2. Whether the endorsement relating to hire-purchase/hypothecation/lease created a direct right in favour of the appellant.
3. Whether there was **privity of contract** between the appellant and Oriental Insurance.
4. Whether the appellant had proved the surrender and theft of the vehicle with sufficient evidence.

Findings of the Supreme Court

The Supreme Court upheld the order of the National Commission and **dismissed the appeal**.

No Privity of Contract

The Court held that there was no privity of contract between the appellant and Oriental Insurance. The financing agreement was entered into only between the appellant and the insured person. The insurance company was not a party to that agreement.

Further, no copy of the agreement was supplied to the insurance company. Therefore, the insurer had no clear notice of the exact nature of the arrangement between the financier and the insured person.

The Court also observed that the **nature of the agreement itself was not clearly established**. It was not clear whether the arrangement was a hire-purchase agreement, hypothecation, lease, or pledge. Because of this lack of clarity, the Court held that the appellant could not rely on the decision in *Sundaram Finance Ltd.*, as that judgment would apply only where the nature of the transaction is clearly established.

Failure of Evidence

The Supreme Court further found that the appellant had failed to produce proper evidence showing that the insured person had actually surrendered the vehicle. The appellant also failed to provide clear details of the alleged theft, including the exact place, date and time of the incident. These gaps weakened the appellant's case.

Most importantly, the Court reaffirmed that an **insurance contract is a personal contract** between the insurer and the insured. A third party cannot claim under such a contract merely because it has a financial interest in the insured asset. Even if the vehicle was surrendered to the appellant, that by itself would not make the appellant the owner of the vehicle or entitle him to claim insurance proceeds directly.

Significance of the Judgment

This judgment is significant for banks, NBFCs, vehicle financiers, insurers and borrowers. It clarifies that a financier's economic or security interest in a vehicle is not the same as a **direct right to claim insurance proceeds**.

Importance of Documentation and Notice

The ruling emphasises that financiers must ensure **proper documentation** at the time of financing. If the financier expects to receive insurance proceeds in case of theft, loss or damage, such entitlement must be clearly recorded in the policy documents.

A general endorsement or an unclear reference to hire-purchase, hypothecation or lease may not be sufficient. The judgment also highlights the importance of giving notice to the insurer. If the insurer is not made aware of the financing arrangement, or if the relevant agreement is not supplied to the insurer, the financier may not be able to enforce any claim against the insurer.

Emphasis on Evidence

Another important aspect of the ruling is its emphasis on **evidence**. The financier must prove not only its financial interest but also the facts giving rise to the claim. In this case, the absence of proof of surrender and lack of clear details regarding the theft became material factors against the appellant.

For insurers, the judgment reinforces the principle that they cannot be compelled to indemnify a person who is not a party to the insurance contract, unless the policy expressly recognises such entitlement. For borrowers and financiers, it serves as a reminder that insurance documentation should be aligned with the financing arrangement from the beginning.

Conclusion

The Supreme Court's ruling in **K. Prakashchand v. Oriental Insurance Co. Ltd.** reinforces the doctrine of privity of contract in insurance law. The Court made it clear that a financier cannot directly claim insurance proceeds merely because the financed vehicle was allegedly surrendered to him or because he had a financial interest in the vehicle.

The judgment draws a clear distinction between having a **security interest** in an asset and having an enforceable right under an insurance policy. Unless the financier's right is clearly recognised in the policy or supported by proper documentation and notice to the insurer, the insurer cannot be forced to settle the claim in favour of the financier.

In practical terms, the decision is a cautionary precedent for financiers. The following steps are essential to protect a financier's position:

- Proper drafting of financing documents
- Clear policy endorsements recognising the financier's interest
- Timely disclosure of the financing arrangement to the insurer
- Proper proof of loss at the time of making a claim

Without these, a financier's claim against an insurer may fail, even where the financier has suffered a genuine financial loss.

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