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Insurance Contract Law: Insurable Interest

**Extract from LLCCP 201 / SLCDP 152
(Post Contract Duties and other Issues)**

LLCCP 201 / SLCDP 152 (Extract))

March 2015

PART 11

INSURABLE INTEREST: THE CURRENT LAW

- 11.1 The law on insurable interest is complex. Here we start by describing the history of legislation in this area. A succession of moral concerns over gambling in the guise of insurance has led to a legislative tangle.
- 11.2 The following sections look at how the concept has been defined, first for indemnity insurance, and then for life insurance. Generally, the various Acts do not attempt to define insurable interest: this has been left to the courts. For indemnity insurance, the courts have tended towards a wide, open-ended definition. For life insurance, the rules have been interpreted more strictly.
- 11.3 In 2003, the Court of Appeal reviewed the whole area of insurable interest in *Feasey v Sun Life Assurance Co.*¹ The final section examines this case, which highlights that the categories of insurable interest are far from fixed. They are likely to be developed in the future to meet the needs of commercial convenience. A more detailed account of the law can be found in Issues Paper 4, together with the text of the relevant legislation.

THE HISTORY OF LEGISLATION

- 11.4 As we shall see, the statutes on insurable interest are dated, confused and varied. We start with the common law, and then describe the history of statutes from 1745.

The common law

- 11.5 In Scotland, the common law requires an insurable interest for the policyholder to have a valid policy. There must be a “subject in which the insured has an interest”.²
- 11.6 English law is less straightforward: it is not entirely clear whether a requirement of insurable interest exists at common law or whether the doctrine was imposed by statute.³ Although some early cases suggest that insurable interest was needed, by the mid-eighteenth century it was common to use marine and life insurance as a form of gambling. Marine policies were written on the basis that the policy itself was “conclusive proof of interest” (known as “PPI terms”), and the courts were reluctant to override these words.

The Marine Insurance Act 1745

- 11.7 The issue became a public concern, and Parliament intervened. The first legislation to create a requirement of insurable interest was the Marine Insurance Act 1745. Its preamble stated that:

¹ [2003] EWCA Civ 885, [2003] 2 All ER (Comm) 587.

² Bell’s Principles, s 457. See also *The Laws of Scotland (Stair Memorial Encyclopaedia)*, Vol 12, para 848 and *Scottish Amicable Heritable Securities Association Ltd v Northern Assurance Co* (1883) 11 R 287 at 303 per Lord Justice-Clerk Moncreiff.

³ We look at this in more detail below: see para 11.30 and following.

It hath been found by experience, that the making of insurances, interest or no interest, or without further proof of interest than the policy, hath been productive of many pernicious practices, whereby great numbers of ships, with their cargoes, have been fraudulently lost or destroyed.⁴

- 11.8 The Act rendered void any marine policy made without interest, or by way of gaming. It also voided marine policies written on PPI terms.

The Life Assurance Act 1774

- 11.9 For the next thirty years, it remained common for policies to be taken out on the lives of public figures – such as George II and Sir Robert Walpole.⁵ Policies were also issued on distant family members and acquaintances. Complaints were made when newspapers started to print the odds of survival of public figures. Many believed that reading the odds hastened the deaths of those who were named.⁶

- 11.10 This led to the Life Assurance Act 1774.⁷ The Act prevents insurance on lives being taken out without a valid interest and declares null and void any contracts of insurance taken without interest. Its preamble states:

Whereas it hath been found by experience that the making of insurances on lives or other events wherein the assured shall have no interest hath introduced a mischievous kind of gaming...

- 11.11 The Act comprises four sections:

- (1) Section 1 bans the making of insurances where there is no interest, and renders any policy issued in such circumstances null and void.
- (2) Section 2 requires the names of those interested to be noted in the policy document. If not, the policy is unlawful.
- (3) Section 3 limits the amount of any recovery to the value of the interest.
- (4) Section 4 provides that the 1774 Act does not apply to "ships, goods, or merchandises".

- 11.12 The 1774 Act is not confined to lives. It also applies to "other events". There was some doubt as to whether the Act extended to insurance on land. In *Siu Yin Kwan v Eastern Insurance Co Ltd*,⁸ however, the Privy Council held that the Act does not apply to indemnity insurance of any kind.

⁴ Preamble to the Marine Insurance Act 1745 the scope of which extended to all of Great Britain.

⁵ Geoffrey Clark, *Betting on Lives* (1999).

⁶ Welford, *Insurance Guide and Handbook* (4th ed 1901) at pp 27 and 28 quoted in *Colinvaux and Merkin's Insurance Contract Law* A-0385.

⁷ Applicable to England & Wales and Scotland.

⁸ [1994] 2 AC 199.

The Marine Insurance Act 1788

11.13 The Marine Insurance Act 1788 followed.⁹ It required the names of those interested in the insurance to be inserted into the policy, to make it easier to check that they had a valid insurable interest.

11.14 Despite its current title, the Act may not be confined to marine insurance. It states that it applies to:

Any Policy or Policies of Assurance upon any Ship or Ships, Vessel or Vessels, or upon any Goods, Merchandizes, Effects, or other Property whatsoever.

11.15 The Act was repealed by the Marine Insurance Act 1906, but only insofar as it affected marine insurance. The Act continues to apply to non-marine insurance on “goods, merchandizes, effects or other property”, although it does not appear to have any practical effects.

The Gaming Act 1845

11.16 The nineteenth century saw a further hardening of attitudes towards gambling. It was said to promote idleness amongst the lower classes and dishonour and suicide amongst the aristocracy. The courts had become reluctant to enforce wagering contracts as they wasted the courts’ time. In 1845 these sentiments led to the passing of a Gaming Act,¹⁰ which held that wagers were unenforceable. A gambling contract is defined as one in which none of the contracting parties has an interest in the subject matter of the contract other than the stake they may win or lose.¹¹ Section 18 of the 1845 Act provided:

All contracts or agreements, whether by parole or in writing, by way of gaming or wagering, shall be null and void; and no suit shall be brought or maintained in any court of law or equity for recovering any sum of money or valuable thing alleged to be won upon any wager.

11.17 As wagers are contracts in which neither party has an interest apart from the contract itself, this section had the effect of making all contracts of insurance unenforceable where no interest could be demonstrated. For general indemnity insurance, therefore, section 18 of the Gaming Act 1845 created an indirect requirement of insurable interest.

The Marine Insurance Act 1906

11.18 The Marine Insurance Act 1906 codified the law at that stage. It repealed the Marine Insurance Act 1745 and the Marine Insurance Act 1788 (in so far as it applied to marine policies on goods), and encapsulated the main case law.

11.19 Section 4 states that:

⁹ Applicable to England & Wales and Scotland.

¹⁰ The Gaming Act 1845 does not apply to Scotland. See *Russell v Grey* (1894) 1 SLT 529 and *Levy v Jackson* (1903) 5 F 1170.

¹¹ *Carlill v Carbolic Smoke Ball Co* [1893] 1 QB 256; see also the first instance decision where there is a fuller consideration of the issue; [1892] 2 QB 484.

- (1) Every contract of marine insurance by way of gaming or wagering is void.
- (2) A contract of marine insurance is deemed to be a gaming or wagering contract -
 - (a) Where the assured has not an insurable interest as defined by this Act, and the contract is entered into with no expectation of acquiring such an interest... .

11.20 Section 5 provides a partial definition of insurable interest. Section 5(1) states that “every person has an insurable interest who is interested in a marine adventure”. Section 5(2) then provides a list of some things that may amount to such an interest:

In particular a person is interested in a marine adventure where he stands in any legal or equitable relation to the adventure or to any insurable property at risk therein, in consequence of which he may benefit by the safety or due arrival of insurable property, or may be prejudiced by its loss, or by damage thereto, or by the detention thereof, or may incur liability in respect thereof.

11.21 This is the only attempt to define insurable interest in statute. There are four points to make about it.

- (1) It only applies to marine insurance. Unlike some other provisions of the 1906 Act, it does not extend to other forms of insurance.
- (2) The definition is non-exhaustive. It states that those who come within the definition have an interest. It does not state that those outside the list fail to have interest.
- (3) It is a broad definition. In *Feasey v Sun Life Assurance Company of Canada*, Lord Justice Waller commented that the words “legal or equitable relation to the adventure” are “intended to be a broad concept”.¹²
- (4) The words “legal or equitable relation” are not apt in relation to Scots law in which the concept of “equitable relation” is unknown. In *Cowan v Jeffrey Associates*, Lord Hamilton recognised this and used English case law to shape his interpretation of this requirement of insurable interest. Having given some examples of insurable interest in Scots law, he added that they were “illustrative of the requirement for a close legal relationship between the person insuring and the property insured”.¹³

11.22 Even in marine insurance, insurable interest is a fluid concept which is difficult to pin down precisely.

¹² [2003] EWCA Civ 885, [2003] 2 All ER 587, at [97].

¹³ 1998 SC 496 at 502.

- 11.23 Section 26 of the 1906 Act states that while “the subject matter insured must be designated with reasonable certainty”, the nature of the insurable interest “need not be specified”. This reflects a long tradition: insurance contracts do not necessarily set out the required relationship between the insured and the subject matter. The insurable interest required by the contract is often left to be inferred from a construction of the contract, from custom and practice and from case law. The effect is that the legal doctrine of insurable interest has a dual outcome; it distinguishes insurance from other risk transfer transactions; it is also used to specify who is entitled to make a claim under any specific form of insurance. We return to this issue in Part 12 when we discuss the purpose of a doctrine of insurable interest.

The Marine Insurance (Gambling Policies) Act 1909

- 11.24 Three years later Parliament considered it necessary to strengthen the sanctions against those who took out marine policies without insurable interest. The Marine Insurance (Gambling Policies) Act 1909¹⁴ made it a criminal offence, punishable by a fine or imprisonment for up to six months.
- 11.25 We have not found any evidence of prosecutions under the Act, which suggests that it has not been used for the purpose for which it was enacted. In any event, a criminal sanction for effecting insurance without interest seems disproportionate and out of place today.

The position in 2005

- 11.26 After 1909, the legislation remained unchanged for nearly one hundred years. By the beginning of the twenty-first century, the requirement for an insurable interest was largely statutory. For marine risks, it was set out in the Marine Insurance Act 1906. For life and other contingent insurance, the Life Assurance Act 1774 provided that insurance made without interest was null and void. For other insurance, the Gaming Act 1845 indirectly required the policyholder to show an insurable interest, as any contract for gaming or wagering was void and unenforceable.

The Gambling Act 2005

- 11.27 Further change was introduced by the Gambling Act 2005.¹⁵ The object of the Act was to regulate certain types of licensed gambling activities¹⁶ and to take account of the internet and new technology.¹⁷ As a result, gambling contracts that related to those activities could be enforced at law, for example allowing consumers to take bookmakers to court to be paid out their winnings.

¹⁴ Applicable in the UK.

¹⁵ Applicable to England & Wales and Scotland (with a restricted application to Northern Ireland).

¹⁶ The 2005 Act defines which gambling activities to which it applies; see, for example, ss 3, 6, 9 and 14.

¹⁷ Government Response to the First Report of the Joint Committee on the Draft Gambling Bill, session 2003-2004, Cm. 6253, June 2004, at p 2.

- 11.28 The Gambling Act 2005 repealed section 18 of the Gaming Act 1845.¹⁸ In its place, the Act states that “the fact that a contract relates to gambling shall not prevent its enforcement”.¹⁹ This provision came into force on 1 September 2007.²⁰
- 11.29 When the Act was passed there was no discussion in Parliament of its effect on insurance contracts. It raises a question which has remained dormant for 160 years: is there a common law requirement that indemnity insurance must have insurable interest? Or was this simply an indirect statutory requirement, which has now been removed?
- 11.30 In Issues Paper 4, we explained that there was a common law requirement in Scotland but the position in England was uncertain. Some early authorities suggest that the courts required interest, including a case from 1692, *Goddard v Garrett*.²¹ In 1743, a case involving fire insurance, *The Sadler’s Company v Badcock*,²² held that the insured party must hold an interest in the insured property both at the outset of the insurance and at the time of the fire. Both cases were subsequently cited by Lord Eldon in *Lucena v Craufurd*.²³ He considered whether the Marine Insurance Act 1745²⁴ was a “legislative declaration that an insurance might have been effected before that statute without interest”.²⁵ Lord Eldon doubted that it was such a declaration, holding instead that the Act precluded the use of particular forms of policy for marine insurance which allowed for the proof of interest to be dispensed with.²⁶
- 11.31 In Issues Paper 4, we speculated that in England, for non-marine indemnity insurance, the only requirement that the insured should have an interest in the insured subject matter may be the indemnity principle itself – namely that the insured must show a genuine loss and therefore an interest in the insured subject matter. We asked whether the 2005 Act had abolished the requirement for insurable interest by the backdoor.
- 11.32 Several consultees argued that the 2005 Act had not abolished the requirement for insurable interest. They pointed out that the 2005 Act was not intended to affect insurance, and did not include insurance within its statutory definitions. As the Lloyd’s Market Association put it:

¹⁸ Gambling Act 2005, s 334(1)(c).

¹⁹ Gambling Act 2005, s 335.

²⁰ SI 2006 No 3272 as amended by SI 2007 No 1157.

²¹ (1692) 2 Vern 269. For further discussion, see Mark Templeman QC, “Insurable Interest: a suitable case for treatment?”, in Dr B Soyer, *Reforming Marine & Commercial Insurance Law*, (2008) at p189.

²² (1743) 2 Atk 554. A case which pre-dates the Marine Insurance Act 1745.

²³ (1806) 2 Bos & PNR 269.

²⁴ Referred to in his opinion as 19 Geo.2.

²⁵ This had been suggested by Lord Kenyon in *Craufurd v Hunter* (1798) 8 TR 13 at p 23.

²⁶ (1806) 2 Bos & PNR 269.

The effect of [the Gambling Act 2005] on insurance contract law seems, to us, theoretical at best, and the Act has no effect, in practice, on commercial or personal insurance business. Statutory definitions of gambling, betting, gaming, games of chance, and participating in lottery are provided in the 2005 Act; none of which refer to contracts of insurance, or seem applicable or relevant to contracts of insurance, which is already regulated by statute, regulation and a wealth of common law.

11.33 Mark Templeman QC made a similar point, arguing that the mischief addressed by the Marine Insurance Act 1906 was not restricted to gambling. A contract void under section 4 is not void merely because it relates to gambling; it is also void for reasons of public policy.²⁷ He thought that the same applied to all insurance.

11.34 Nicholas Legh–Jones QC commented:

I wonder if it is right to say that the Gaming Act [1845] created an obligation for insurable interest in the form developed by the courts. A bona fide expectation of benefit in the preservation of the subject matter would appear to take the insurance outside the scope of section 18, but it would not suffice to establish a valid insurable interest permitting enforcement of the contract.

11.35 That said, the ABI and others thought that the Gambling Act 2005 had introduced unfortunate uncertainty into the law. This view is shared by some academics.²⁸ We agree. In Part 12 we make proposals to clarify that the requirement of insurable interest continues to apply to all insurance.

The timing of the interest

11.36 In life insurance, the Life Assurance Act 1774 does not provide when an interest must exist but case law has established that interest is required at the time of the contract.²⁹ By contrast, section 6 of the Marine Insurance Act states that

The assured must be interested in the subject-matter insured at the time of the loss though he need not be interested when the insurance is effected.

²⁷ Mark Templeman QC, “Insurable Interest: a suitable case for treatment?” see above fn 21, at p195.

²⁸ In *Colinvaux’s Law of Insurance* (8th ed, 2006), at para 4-09, it is stated that the effect of the 2005 Act on insurable interest was “a matter of some difficulty”; this was particularly so with marine policies. *Chitty on Contract* (30th ed 2008), thought it unlikely that the Act affected life or marine policies and it was “questionable” whether making an insurance contract without interest would necessarily come within the meaning of the 2005 Act.

²⁹ See *Dalby v India and London Life Assurance Company* (1854) 15 CB 365. See also *Turnbull & Co v Scottish Provident Institution* (1896) 34 SLR 146 (OH).

- 11.37 For non-marine indemnity insurance, in Scotland the common law requires an interest to be demonstrated at the time the policy is taken out.³⁰ In England and Wales, the law is less clear. Clarke argues that the position is probably the same as for marine insurance.³¹ In Part 12 we propose to clarify this issue.

The consequences of lack of insurable interest

- 11.38 The various statutes provide for different outcomes where the requirement of insurable interest is not satisfied.
- 11.39 The Marine Insurance Act 1906, section 4 provides that, without interest, a contract for marine insurance is void. The 1909 Act, however, goes further and states that the writing of marine insurance without insurable interest is a criminal offence.
- 11.40 For life and contingency insurance, the Life Assurance Act 1774, section 1 provides that policies made without interest are null and void. A later case has held that they will also be illegal.³² As a consequence policyholders cannot claim under their contracts and may not be able to recover the premiums they have paid. In *Feasey*, Lord Justice Ward remarked “why it [the contract] also has to be illegal baffles me”.³³ He suggested that Parliament should look at this point again.
- 11.41 We think that the effect of lack of insurable interest should be the same across the board. In Parts 12 and 13, we propose that the effect of lack of insurable interest should make a contract void. It should not, however, make the contract illegal. Nor should it be a criminal offence.

Conclusion

- 11.42 The statutes on insurable interest are overly complex. The Life Assurance Act 1774 imposes a statutory requirement of insurable interest for life and other contingency insurance. The Marine Insurance Act 1906 imposes a requirement for marine insurance. For other forms of insurance there is probably a common law requirement, but in England and Wales the issue is by no means certain. There are also confusing differences about when the requirement must be satisfied and the effect of a lack of insurable interest on the contract.
- 11.43 Two other statutes remain on the statute book, but now appear moribund: the Marine Insurance Act 1788 and the Marine Insurance (Gambling Policies) Act 1909.

³⁰ See 12 *Stair Memorial Encyclopaedia*, para 856.

³¹ M A Clarke *The Law of Insurance Contracts* (2011) at para 4-4.

³² See *Harse v Pearl Life Assurance Co Ltd* [1904] 1 KB 558.

³³ [2003] EWCA Civ 885, [2003] 2 All ER 587, at [192].

THE DEFINITION IN INDEMNITY INSURANCE

- 11.44 The definition of insurable interest has been largely left to the courts. At first, the courts defined insurable interest narrowly, to focus on property rights. The insured was required to show a legal or equitable interest in the property or a right to it under a contract.³⁴ For the last 200 years, however, the courts have expanded this definition, to meet the needs of a developing insurance market. As an academic commentator remarked:

The English courts seldom shrink from sacrificing doctrine to the practical needs of commerce...³⁵

- 11.45 Where the insurers have written a policy on clear terms, the courts have been extremely reluctant to find that the insurance is invalid for lack of interest. As the Master of the Rolls put it in 1884:

It is the duty of a Court always to lean in favour of an insurable interest, if possible, for it seems to me that after underwriters have received the premium, the objection that there was no insurable interest is often... a technical objection, and one which has no real merit, certainly not as between the assured and the insurer.³⁶

Lucena: the classic definition

- 11.46 The classic definition was set out by the House of Lords in 1806, in the case of *Lucena v Craufurd*.³⁷ Lord Eldon described an insurable interest as:

A right in the property, or a right derivable out of some contract about the property, which in either case may be lost upon some contingency affecting the possession or enjoyment of the party.³⁸

- 11.47 This is a narrow test. The insured must show a legal or equitable interest in the insured property or a right under a contract.³⁹

³⁴ From the opinion of Lord Eldon in *Lucena v Craufurd* (1806) 2 Bos & PNR 269.

³⁵ Chris Nicoll, University of Auckland, *Insurable interest: as intended?* [2008] JBL, 5, 432-447, at p 422.

³⁶ Brett MR in *Stock v Inglis* [1884] 1 QBD 564, at p 571 – quoted by Waller LJ in *Feasey v Sun Life Assurance Co* [2003] EWCA Civ 885, [2003] 2 All ER 587, at [7].

³⁷ (1806) 2 Bos & PNR 269.

³⁸ Above, at [321].

³⁹ In Scots law, the interest must generally be proprietary (including that of a right in security) or one giving either a right to enjoyment of the property in some way or a liability for its loss or destruction, usually under a contract: Gloag & Henderson, *The Law of Scotland*, 12th ed, para 21.04.

11.48 *Lucena v Craufurd* concerned ships that were to be brought into British ports but had been lost during the voyage. Commissioners had been appointed by the King to oversee the venture. The House of Lords sought the advice of the judges⁴⁰ on particular questions of law, one of which one was whether the Commissioners had a sufficient interest in the ships to insure them. One of the judges from whom advice was sought, Mr Justice Lawrence, formulated a broader test. As he put it:

To be interested in the preservation of a thing is to be so circumstanced with respect to it as to have benefit from its existence, prejudice from its destruction.⁴¹

11.49 This test looked not just at the legal relationship between the insured and the property but at likely events. Mr Justice Lawrence stressed that the expectation of benefit or loss must arise “according to the ordinary and probable course of things”. He understood the objection to insuring property in which the insured lacked an interest to be based not on an absence of interest, but on whether the interest the insured did have was such that it was liable to be prejudicially affected by a range of events other than the insured peril. In such a case it would be impossible to say with certainty that the loss was a sufficiently probable outcome on the occurrence of the peril.⁴² The insured would be unable to establish a claim to compensation because he could not show “his loss having clearly arisen from the perils insured against”. Mr Justice Lawrence spoke in terms of the insured having a “moral certainty” of advantage or benefit. In other words, one could not insure a speculative profit, which was unlikely to eventuate.

11.50 Lord Eldon, by contrast, rejected the idea of “moral certainty”, saying that he tried in vain to define a middle category “between a certainty and an expectation”.

11.51 Although Lord Eldon gave the leading opinion in the case, subsequent courts have often referred to Mr Justice Lawrence’s views with approval.⁴³ The courts have inched towards a “factual expectation” test, which now appears to represent the current law.⁴⁴

⁴⁰ That is, the judges of the lower court.

⁴¹ *Lucena v Craufurd* (1806) 2 Bos & PNR 269 at [302].

⁴² For an example of an interest that would not satisfy this test see paras 12.30 and 12.31.

⁴³ See Waller LJ in *Feasey* at [70].

⁴⁴ The test has been adopted and applied in a case of the Canadian Supreme Court, *Constitution Insurance Co of Canada v Kosmopoulos* (1987) 34 DLR 208.

Bailees

- 11.52 One of the earliest extensions was for bailees,⁴⁵ that is, for those who hold other people's goods in their possession, with a duty to take care of them. The courts permitted bailees to insure the goods against all perils, not simply against losses caused by the policyholder's negligence.⁴⁶
- 11.53 An example is a firm of carriers which insures goods in transit. The carrier is entitled to insure for more than their own liability to the owners. Instead, the carrier may insure goods in its possession for their full value against all risks, holding the proceeds in trust for the owner.⁴⁷
- 11.54 This extension was justified on technical grounds: that a bailee had a possessory interest sufficient to recover goods in trover.⁴⁸ The more important reason, however, was that it was commercially convenient. Someone who holds other people's goods is responsible for them in a general sense. It makes commercial sense for them to be able to insure them for their full value, and pass on the proceeds to the owner.⁴⁹

Shareholders

- 11.55 Is a shareholder in a company entitled to insure property owned by the company? This question arose in two cases: *Macaura v Northern Assurance Company Ltd*⁵⁰ and *Wilson v Jones*.⁵¹ The cases are superficially similar, but led to different outcomes.
- 11.56 In *Macaura*, a sole shareholder and main creditor of a company insured timber belonging to the company in his own name. When the timber was destroyed by fire, the insured's claim was rejected on the basis that he held no legal or equitable interest in the insured property. The House of Lords confirmed that a shareholder had no right to insure property owned by a company.⁵²

⁴⁵ In Scots law, there is no direct equivalent of bailment but, for example, in terms of a contract of deposit, a depository is obliged to provide a secure place of custody and to exercise due care to prevent loss of or damage to the property. See Gloag and Henderson, *The Law of Scotland*, (12th Ed, 2007), para 15.06.

⁴⁶ See *Waters v Monarch Fire and Life Assurance Co* (1856) 5 EL & BL 870 and *Dalglish v Buchanan & Co* (1854) 16 D 332.

⁴⁷ *A Tomlinson (Hauliers) Ltd v Hepburn* [1966] AC 451.

⁴⁸ *Waters v Monarch Fire and Life Assurance Co* (1856) 5 EL & BL 870. Trover was an action to recover damages from a person who holds another's goods and refuses to return them. A bailee has no legal entitlement to goods held in this way but is entitled to bring this action. It is superseded by the modern law of conversion.

⁴⁹ See Lloyd J's discussion of this point in *Petrofina (UK) Ltd v Magnaload Ltd* [1984] QB 127 at p 135.

⁵⁰ [1925] AC 619. See also *Arif v Excess Insurance Group* 1987 SLT 473 following *Macaura*.

⁵¹ (1865 - 66) LR 2 EX 139.

⁵² In the Scottish case, *Cowan v Jeffrey Associates* 1998 SC 496, on similar facts, Lord Hamilton (at 503) expressed unhappiness that he could not distinguish *Macaura* in favour of a test based upon factual expectancy.

- 11.57 *Wilson v Jones* also concerned a shareholder who took out insurance on property owned by the company – a telegraph cable. In this case, however, the court allowed his claim. The policy was in a standard form, but included an additional handwritten clause stating that cover extended to every risk and contingency “attending the conveyance and successful laying of the cable”. The court found that the policy was not on the cable but on the shareholder’s interest in the successful completion of the project to lay the cable. Mr Wilson had insured the right thing in the right capacity and was therefore entitled to claim.
- 11.58 These two cases highlight that insurable interest often depends on a careful reading of the contract. Usually, standard insurance on goods is limited to those who have a legal or equitable interest in the goods, or a right to them under a contract. If, however, the insurer was aware of the insured’s circumstances, and wrote the insurance on this basis, the courts will usually extend the notion of insurable interest to cover the circumstances.
- 11.59 The courts will look for ways to find an insurable interest, as is demonstrated by *The Moonacre*.⁵³ Mr Sharp took out insurance on a yacht owned by his company of which he was the sole shareholder. He was given full use of the yacht by two powers of attorney, granted to him by the company. The court found that the right to use the yacht was a valuable benefit, and the power of attorney founded a sufficient legal interest.

“Pervasive interest”

- 11.60 In complex construction sites, standard forms of contract usually require the site owners, contractors and sub-contractors to take out joint insurance on the whole site. In *Petrofina (UK) Ltd v Magnaload Ltd*⁵⁴ the court was asked to analyse the nature of such a contract. Was it a single insurance policy, in which all the parties jointly insured the whole site, or was it a series of smaller policies, in which each party insured its respective interest? The issue mattered in deciding subrogation rights. If the parties were co-insured under a single policy, then they were not entitled to sue each other for their respective losses.
- 11.61 In *Petrofina*, the main contractors took out insurance to cover the construction of an oil refinery extension, in the name of the contractors, sub-contractors and site owners. Sub-contractors supplying heavy lifting equipment dropped a gantry, damaging the work in progress. The insurers then sued the sub-contractors for negligence, in the name of the contractors. The question was whether the sub-contractors had an insurable interest that extended to the whole of the contract works, or whether their interest was limited to the equipment owned by them.

⁵³ [1992] 2 Lloyd’s Rep 501.

⁵⁴ [1984] QB 127.

11.62 After construing the contract, Mr Justice Lloyd held that the sub-contractors were covered in respect of the entire contract works. They had a “pervasive interest”⁵⁵ in the whole site, which included property owned by any other co-insured or for which they were responsible. The judge described the situation as analogous to that of a bailee, even though the sub-contractor is not in possession of the property. The main reason for the decision was that it is commercially convenient to allow all the parties to insure the whole site:

Otherwise each sub-contractor would be compelled to take out his own separate policy. This would mean, at the very least, extra paperwork; at worst it could lead to overlapping claims and cross-claims.⁵⁶

11.63 Subsequent cases have confirmed that contractors and sub-contractors may have a “pervasive interest” in the whole construction site.⁵⁷ Joint insurance of sites is clearly commercially convenient, and has become a common practice. In some cases it is even an industry requirement.⁵⁸

11.64 The courts have, however, sought to limit the concept. It is stressed that the outcome of the case must depend on the construction of the contract.⁵⁹ It has been held that sub-contractors have no “pervasive interest” in the site after the work is completed.⁶⁰ Nor do they have a “pervasive interest” in adjacent property.⁶¹

11.65 For a “pervasive interest” to arise, it is likely that the policyholder needs more than a potential liability for negligence. There may also need to be some element of a joint project, so that all the parties would benefit from the project’s successful completion. In *Deepak*, for example, the court held that the parties had an insurable interest in the construction work because:

they might lose the opportunity to do the work and be remunerated for it if the property were damaged or destroyed.⁶²

⁵⁵ See the decision of the Supreme Court of Canada in *Commonwealth Construction Co Ltd v Imperial Oil Ltd* (1977) 69 DLR (3d) 558 at 560.

⁵⁶ *Petrofina (UK) Ltd v Magnaload Ltd* [1984] Q.B. 127 at p136.

⁵⁷ *Stone Vickers Ltd v Appledore Ferguson Shipbuilders Ltd* [1991] 2 Lloyd’s Rep 288; *National Oilwell (UK) Ltd v Davy Offshore Ltd* [1993] 2 Lloyd’s Rep 582.

⁵⁸ The JCT standard form of contract requires the employer to take out insurance in the name of the employer and contractor for certain risks.

⁵⁹ See *Co-operative Retail Services Ltd v Taylor Young Partnership Ltd* [2002] UKHL 17, [2002] 1 All ER 918, as applied in *Tyco Fire and Integrated Solutions (UK) Ltd v Rolls-Royce Motor Cars Ltd* [2008] EWCA Civ 286, [2008] 2 All ER 584.

⁶⁰ *Deepak Fertilisers and Petrochemical Corporation v ICI Chemicals & Polymers Ltd* [1999] 1 Lloyd’s Rep 387.

⁶¹ *Tyco Fire and Integrated Solutions (UK) Ltd v Rolls-Royce Motor Cars Ltd* [2008] EWCA Civ 286, [2008] 2 All ER 584.

⁶² *Deepak Fertilisers and Petrochemical Corporation v ICI Chemicals & Polymers Ltd* [1999] 1 Lloyd’s Rep 387 at p 399.

11.66 In *Feasey*, however (discussed below), Lord Justice Waller cast doubt on whether there needs to be an additional link between insured and subject matter, other than potential liability.⁶³ The exact boundaries of the concept of “pervasive interest” are far from fixed.

Conclusion

11.67 Insurable interest is interpreted broadly. Where the insurer has deliberately written a policy in respect of the insured’s circumstances, courts will be reluctant to find that the requirement has not been met.

11.68 The issue is one of construction. The court must start by analysing the terms of the contract. Generally, for property insurance, the insured must have a right in the property, or a right derivable out of some contract concerning the property, but this is not a hard and fast rule. Other forms of interest may be sufficient in circumstances where there is a real probability that the insured will suffer a loss or incur a liability on the occurrence of the insured peril.

11.69 Furthermore, as we shall see, the categories of insurable interest are not closed. As insurance products develop to meet consumer demand, new forms of insurable interest may be recognised.

THE DEFINITION IN LIFE INSURANCE

11.70 In life insurance, the courts have interpreted the requirement of insurable interest more restrictively. Although the Life Assurance Act 1774 does not define an insurable interest, subsequent case law and statutes have established three categories. An interest may arise from:

- (1) natural affection;
- (2) a potential financial loss which is recognised by law and can be shown at the time of the contract;
- (3) other statutory provisions.

11.71 Finally, in *Feasey*, the court recognised that there may be forms of insurable interest for group policies which do not fall into any of these three categories.⁶⁴

⁶³ [2003] EWCA Civ 885, [2003] 2 All ER 587, at [95].

⁶⁴ Above at [97].

Natural affection

- 11.72 This enables a person to insure their own life,⁶⁵ or the life of their husband or wife.⁶⁶ Section 253 of the Civil Partnership Act 2004 added civil partners to this category.⁶⁷ The insurance may be for an unlimited amount. The class is extremely limited. In the absence of any pecuniary and legal interest, there is no right to insure the life of a cohabitant.

Parents and children

- 11.73 Similarly, in English law there is no general right for a parent to insure the life of a child. The leading English case is *Halford v Kymer*.⁶⁸ A father took out a policy of life insurance on the life of his son. When the insurance company refused to pay, the father argued that he had an insurable interest because if his son died his chances of receiving care and maintenance would be reduced. The judge stated that, as the parish was bound to maintain him, it was a matter of indifference to the father whether he were maintained by the parish or by his son.
- 11.74 Nor is there a right for an adult child to insure the life of a parent. In the case of *Harse v Pearl Life Assurance Co Ltd*⁶⁹ an adult child insured the life of his mother who cooked and kept house for him. The insurance was said to be for the purpose of funeral expenses. The court found that the policy was void for lack of interest. There was no obligation for a son to incur financial expense in burying his mother (the council would cover such expenses, if necessary) and there was no legal obligation for the mother to keep house for her son.
- 11.75 Although a child who is a minor could suffer a financial detriment on the death of a parent there is no general common law or statutory right in England and Wales for a child to insure the life of a parent. Parents are under an obligation to maintain their children,⁷⁰ and it may be therefore that a child has a sufficient pecuniary interest on which to found an insurable interest in some circumstances.⁷¹

⁶⁵ See *Wainwright v Bland* (1836) 150 ER 334.

⁶⁶ See *Reed v Royal Exchange Assurance* (1795) 170 ER 198 and *Griffiths v Fleming* [1909] 1 KB 805.

⁶⁷ In the paragraphs that follow we use the term “spouse” to refer to a husband, wife or civil partner.

⁶⁸ (1830) 10 B&C 724.

⁶⁹ [1904] 1 KB 558.

⁷⁰ There is no single statutory source for this obligation, because the statutory vehicle for its enforcement varies from context to context. Parents who do not live with their children are liable to make payments calculated under the Child Support Act 1991, while the duty can be seen in more general terms in the Matrimonial Causes Act 1973 and Schedule 1 to the Children Act 1989.

⁷¹ It has been suggested that in principle in England and Wales a child may have an insurable interest in a parent who has been made subject to an order for maintenance; see *MacGillivray on Insurance Law* (11th ed 2008), para 1-101.

11.76 In Scotland, as in England, there is no general right for a parent to insure the life of a child.⁷² Regarding the insurable interest of a child in a parent, however, it has been suggested that, in Scots law, a child is entitled to insure the life of a parent in some circumstances;⁷³ this follows from the obligation of parents to maintain their children (an obligation referred to as “aliment”).⁷⁴ The legal obligation to provide maintenance or aliment may form the basis for a child to have an insurable interest in the life of his or her parents to the value of the obligation. An insurable interest would exist only for as long as the obligation of aliment is owed: it ceases when the child reaches 18 years of age, or 25 years of age if the child is in education or training.⁷⁵

Statutory provisions relating to children

11.77 There is a small exception to the general rule that parents do not have insurable interests in their children’s lives. In reliance on section 99 of the Friendly Societies Act 1992 a parent is able to take out insurance with a friendly society on a child’s life without insurable interest. If that child is under the age of 10, however, the amount recoverable is limited to £800.⁷⁶ The section applies to England, Wales and Scotland.

11.78 Other Acts make it clear that people who stand in the place of parents have no right to insure the lives of the children they look after. For example, the Children Act 1989 and the Foster Children (Scotland) Act 1984 provide that a person who maintains a foster child for reward shall be deemed for the purposes of the Life Assurance Act 1774 to have no interest in the life of that child.

An interest arising out of a financial loss

11.79 It is also permissible to insure the life of another person on the ground that the insured would suffer a loss on the other’s death. Typical examples include:

- (1) A creditor in the life of a debtor, to the amount of the loan.
- (2) A joint debtor in the life of a joint debtor, to the amount of the debt. For example, cohabiting friends buying a house together who are declared to be jointly and severally liable for the mortgage will be able to insure each others’ lives to the amount of the whole of the mortgage debt.

⁷² There is at least one case where an insurance policy taken out by a father on the life of his son (with a provision for the son to take over payment of the premiums at age 21) was upheld despite the lack of insurable interest as the insurance company had chosen to honour it; see *Carmichael v Carmichael’s Executrix* 1919 SC 636. This case was reversed by the House of Lords – see 1920 SC (HL) 195 – although not on the issue of insurable interest.

⁷³ See *MacGillivray on Insurance Law*, (11th ed 2008), para 1-103.

⁷⁴ The Family Law (Scotland) Act 1985, s 1(1) provides that the obligation of aliment is owed by a parent to a child, or to a person accepted as a child of the family. Under s 1(2) the obligation is to provide “such support as is reasonable in the circumstances”.

⁷⁵ Family Law (Scotland) Act 1985, s 1(5) (a) and (b).

⁷⁶ This provision applies in England & Wales and Scotland.

- (3) An employer in the life of an employee, to the value of the period of notice. If the employee is a "key person" it may also be possible to insure the costs of recruiting and training a replacement, and any loss of profits in the meantime.
- 11.80 This category is also extremely limited. The insured must show an interest which is "pecuniary and recognised by law". A "pecuniary interest" is one that is capable of valuation. It must represent an underlying legal obligation, not a voluntary undertaking. Furthermore, section 3 of the Life Assurance Act 1774 limits the sum insured to the economic value of that interest at the time the contract is made and this can lead to practical difficulties. A creditor can insure the life of a debtor but where the loan is not of a fixed term it is not possible to calculate the amount of interest that may become payable over the life of the loan. As a result the sum insured cannot take account of interest that may accrue after the insurance is taken out as this amount is uncertain.
- 11.81 The case of *Hebden v West* illustrates how restrictive the effect of section 3 can be.⁷⁷ A clerk insured his employer's life with two insurance companies for £5,000 and £2,500 respectively. On the employer's death the first insurer paid out £5,000 but the second refused the claim for £2,500, for lack of insurable interest. The clerk had a 7 year fixed term contract of employment at an annual salary of £600. His employer had also lent him £4,700, promising him that he need not repay it while his employer was alive. The court, however, found that only the employment was an interest recognised at law. The promise not to demand the loan was a mere forbearance and not a legally binding promise. As the employee had already recovered to the full extent of his interest in the employment under the first policy (valued at £600 x 7 years), the second policy was void for lack of insurable interest.
- 11.82 Case law has established that employers may insure the lives of employees, but only for a limited amount. In *Simcock v Scottish Imperial Insurance Co*,⁷⁸ the extent of the loss was limited to the value of the employee's services during the time of their notice period. The notice period was the only legally recognised right the employer possessed. The expectation that the employee would stay longer was not sufficient to constitute an insurable interest. We understand that this rule is now widely ignored: key employee insurance is often written for more than the value of the notice period.
- 11.83 In the USA it is sufficient if a beneficiary has "a reasonable expectation of benefit or loss dependent on the duration of a human life".⁷⁹ In the UK this is not enough. As MacGillivray states:

A mere expectancy or hope of future pecuniary benefit from the prolongation of the life insured or of the fulfilment by him of moral obligations owed to the assured, is insufficient to sustain an insurable

⁷⁷ (1863) 3 B&S 579.

⁷⁸ (1902) 10 SLT 286.

⁷⁹ M A Clarke, *The Law of Insurance Contracts* (5th ed 2006), para 3-6B.

interest.⁸⁰

- 11.84 Note that with life insurance, the valuation must be made at the time of the contract, not at the time of death. This creates difficulties for those who are insuring themselves against future uncertainties.

Interest arising out of statutory provisions

- 11.85 In some cases, an insurable interest is created by statute, notably the Local Government Act 1972, the Local Government (Scotland) Act 1973, the Land Drainage Act 1991⁸¹ and the Police (Northern Ireland) Act 2003.
- 11.86 These Acts give local authorities or councils the right to insure the life of members of the authority or the council or the district policing partnership whilst engaged on the business of the authority or council.

THE FEASEY CASE

- 11.87 *Feasey v Sun Life Assurance Co* is a decision of the Court of Appeal, and the most important to consider the test of insurable interest in a modern context.⁸²
- 11.88 The facts are complicated. A protection and indemnity insurance (P&I) club, Steamship Mutual, insured its members against liability claims brought by employees and others who were injured on board their members' vessels. Steamship Mutual approached a Lloyd's syndicate to reinsure the risk, but the syndicate suggested another form of policy, which was more favourably treated under the Lloyd's risk codes. The result was that Steamship Mutual took out a first party personal accident policy, whereby the syndicate agreed to pay a fixed sum to Steamship Mutual for each death or disablement aboard their members' vessels. This in turn was reinsured by Sun Life Assurance Co. Later, when a dispute arose, it was alleged that Steamship Mutual did not have an insurable interest in the lives it had insured.
- 11.89 The case concerned both life insurance and marine insurance, and the judges took the opportunity to re-examine the case law of the last 200 years.
- 11.90 Lord Justice Waller gave the leading majority judgment. He found that Steamship Mutual did have a sufficient insurable interest. He analysed the authorities and placed them into four groups:
- (1) Group 1 is where the court has defined the subject matter as an item of property and the insurance is to recover the value. Here the test is the strict one formulated by Lord Eldon: there must be a legal or equitable interest in the property.
 - (2) Group 2 concerned life insurance. The cases indicated a narrow definition, requiring a legal or pecuniary interest.

⁸⁰ *MacGillivray on Insurance Law* (11th ed 2008), para 1-070.

⁸¹ This Act does not apply to Scotland.

⁸² [2003] EWCA Civ 885 [2003]; 2 All ER (Comm) 587.

- (3) Group 3 is where the subject matter appears to be a particular item of property, but where “properly construed the policy extends beyond that item and embraces such insurable interest as the insured has”.⁸³ This included *Wilson v Jones*,⁸⁴ where the insurance appeared to be on cable, but was in fact on the “adventure” of laying the cable. In these cases, the appropriate test is the “factual expectation test”, first set out by Mr Justice Lawrence, in *Lucena v Craufurd*,⁸⁵ in the ordinary probable course of things, will the insured be deprived of an advantage or suffer a loss?
- (4) Group 4 was even wider. In some cases the courts have recognised interests which are “not even strictly pecuniary” such as policies on the life of a spouse. Lord Justice Waller commented that even in property insurance cases, “something less than a legal or equitable or even a pecuniary interest has been thought to be sufficient”.⁸⁶ For this group, he mentioned *The Moonacre*,⁸⁷ and the cases on “pervasive interest”.

11.91 Lord Justice Waller concluded:

In an insurance of a specific identified life, it will be difficult to establish a legal or equitable relation without a pecuniary liability recognised by law arising on the death of that particular person.

There is however no authority which deals with a policy on many lives and over a substantial period [as was the case with Steamship Mutual] and where it can be seen that a pecuniary liability will arise by reference to those lives and the intention is to cover that legal liability.⁸⁸

11.92 In these cases, he thought that insurable interest should be interpreted broadly, as with the decisions on “pervasive interest”. Here Steamship Mutual had a pecuniary liability in respect of the lives covered, and the intention was to cover that liability. This was sufficient to found an insurable interest.

⁸³ *Feasey v Sun Life Assurance Co of Canada* [2003] EWCA Civ 885, at [87]; [2003] 2 All ER (Comm) 587.

⁸⁴ (1867) LR 2 Exch 139.

⁸⁵ (1806) 2 Bos & PNR 269.

⁸⁶ *Feasey v Sun Life assurance Co of Canada* [2003] EWCA Civ 885, at [90]; [2003] 2 All ER (Comm) 587.

⁸⁷ [1992] 2 Lloyd's Rep 501.

⁸⁸ *Feasey v Sun Life Assurance Co of Canada* [2003] EWCA Civ 885, at [97]; [2003] 2 All ER (Comm) 587.

11.93 Lord Justice Ward gave a dissenting judgment. He concluded, reluctantly, that Steamship Mutual did not have a sufficient insurable interest. He did not accept that the Court of Appeal could ignore two House of Lords decisions, in *Lucena*⁸⁹ and *Macaura*,⁹⁰ that there must be a legal or equitable relationship between the insured and the subject matter of the insurance. It was not possible to ignore this requirement simply because it would be commercially convenient to do so. This, he thought, was a matter for Parliament or the House of Lords (now the Supreme Court).

CONCLUSION

11.94 By its nature, insurable interest is a fluid concept, which is difficult to pin down. Even so, the law on insurable interest is more complicated than it needs to be. The legislation is confused, leaving some room for doubt over whether a requirement of insurable interest exists for all forms of insurance. Two statutes appear moribund.

11.95 For indemnity insurance, the courts have interpreted the requirement of insurable interest in a flexible, open-ended way. In life insurance, however, the categories are more restricted. The law does not generally allow cohabitants, parents or children to insure each other's lives, even if they rely on each other for economic support.

11.96 In life insurance, to found an interest based on financial loss, the case law requires "a pecuniary interest recognised by law": the policyholder must have a legal right to payment, not a reasonable expectation of loss in fact. The problem is compounded by the fact that the amount of the payment must reflect the legal right. For example, in strict law, if an employer insures a key employee, the amount should be no more than the loss during the notice period, together with the costs of replacement.

11.97 Recently, the Court of Appeal has recognised that insurable interest is an open-ended test. For insurance on many lives over a substantial period, a more fluid test may be applied. It is unclear, however, how far this extends.

11.98 In Part 13 we propose a measured extension of insurable interest in life insurance. This would bring the law into line with current practice, allow some small increase in the insurance that may be written, and provide greater clarity to the law.

⁸⁹ (1806) 2 Bos & PNR 269.

⁹⁰ [1925] AC 619.