Response by the City of London Law Society, Insurance Law Committee, to the English and Scottish Law Commissions' Issues Paper 4 on Insurance Contract Law - Insurable Interest

The City of London Law Society (CLLS) represents approximately 12,000 lawyers through individual and corporate membership, including some of the world's largest international firms. Lawyers represented by the CLLS advise a variety of clients, from multi-national companies and financial institutions to government departments, often in relation to complex, multi-jurisdictional, legal issues.

The CLLS responds to government consultations on issues of importance to its members through its 17 specialist committees. This response has been prepared by the CLLS Insurance Law Committee, the members of which are experts in their field. A list of the current members appears at Appendix B to this response.

INTRODUCTION

Our overall thesis is that insurable interest provides an important check and balance against the misuse of insurance for purposes other than the protection of the policyholder. It serves useful functions in relation to both the contractual and regulatory aspects of insurance law and the majority of the Committee support its retention. There are certainly cogent reasons for its rationalisation, but the consequences of its abolition - even in part, as proposed by the Issues Paper - require further consideration.

We have set out in Appendix A to this response a detailed discussion of the history and function of the requirement for insurable interest, but focus below on the specific questions posed by the Issues Paper. Where relevant, our specific responses will refer to the appropriate part of the more detailed discussion in Appendix A.

RESPONSES TO LIST OF PROPOSALS

Paragraph numbers below refer to the corresponding paragraphs of the Issues Paper.

SHOULD THERE BE A REQUIREMENT FOR INSURABLE INTEREST?

Non-Indemnity Insurance

8.2 Should there continue to be a requirement for insurable interest in life insurance contracts? (7.41).

Yes, on the ground of reducing moral hazard and subject to the rules being amended to deal in a sensible manner with pure investment contracts, and with the categories of those who are deemed to have (or are able to show) an insurable interest being expanded. These points are considered in more detail below. The interest should exist at the time the policy is taken out, or there should be a realistic prospect of the interest arising during the policy period. Some members of the Committee are of the view that the interest should also subsist at the date of the death of the life assured, but the majority favour continuation of the current rule that interest does not need to be shown after inception of the contract. This is partly based on the view that the current rule, while to an extent illogical, does not appear to have given rise to any abuse; and partly on the view that the ability to assign a policy to a person without interest has assumed an important economic function (i.e. to maximise policy values) which outweigh the potential moral hazard.

Investment contracts

Life insurance bonds often contain a minimal amount of insurance risk (e.g. an extra 1% over the surrender value is payable on death). Following the Court of Appeal's decision in *Fuji Finance Inc v Aetna Life Insurance Company Ltd*,[1] such contracts can arguably be issued with no additional amount payable on death. The reality is therefore that where the death risk is minimal or non-existent, the contract will contain no element of moral hazard. In practice there can be significant upfront charges in establishing such a contract and the commercial imperative of the person taking out the contract is for the investment to last as long as possible and not to be triggered by the untimely death of the one and only life assured. This tends in practice to result in such contracts being issued on joint lives, quite often in trust for the children or grandchildren of the person taking out the policy. There can also be tax advantages in particular types of trust. In such cases the owners of the policies, who often invest significant amounts of money, currently rely upon the good faith of the insurer not to seek to rely upon section 2 of the 1774 Act. Much of this could be dealt with by the widening of the extent of natural affection and removal of any limit on the resulting interest to the fullest extent suggested by the Law Commissions. This would however not necessarily deal with all situations in which such investment contracts are taken out, which include (in particular) contracts made by trustees of occupational pension schemes and unincorporated associations. It may be that the latter situation could be dealt with by specific rules dealing with group policies.

[1] [1997] Ch 173

Another type of investment contract which should be considered is the unit-linked life policy. These policies, commonly issued to pension scheme trustees, operate like unit trusts but allow the trustees to exercise an option to purchase an annuity from the insurance company (which would be funded by the surrender of "policy units") where the trustees have the obligation to provide a pension of a corresponding amount to a member the pension scheme at the time of retirement. The annuity terms are set by reference to the prevailing annuity rates at the time the annuity is purchased and there is therefore little or no economic risk being taken on under this type of policy by the insurer. It can be argued that, because the insurer is subject to an uncertainty as to when the policy units will be surrendered, in whole or in part by the holder of the policy, there is a sufficient element of uncertainty for the policy to fall within the test of insurance as set out in the *Fuji* case. From a regulatory perspective, the contract is a contract to pay annuities on a human life falling within Class 3 (as set out in the Financial Services and Markets Act 2000 (Regulated Authorities) Order 2001, Schedule 1, Part II). The market for these types of policy runs to billions of pounds and it is therefore important that any changes which are made to the law of insurable interest do not adversely affect the status of these products.

In the case of both of these types of investment contract, it is important that any reform of the law on insurable interest does not adversely affect their status as contracts of insurance. More positively, it would be helpful to clarify that these types of contract *do* constitute contracts of insurance, although care would have to be taken not to introduce categories or definitions which are overly rigid as the insurance market is constantly evolving.

8.3 Should there continue to be a requirement for insurable interest in other forms of non-life, non-indemnity insurance (i.e. valued policies on e.g. land or buildings?) (7.43).

Again, yes, on the grounds discussed in more detail in paragraphs 35 to 38 of Appendix A, which may be summarised as the increased probability of persons taking out policies on property in which their interest is tenuous, thus aligning the resulting contract more with a wager, increasing the moral hazard to the insurer and potentially leading to such property becoming effectively uninsurable by those with a real interest in the property. If there are any particular scenarios where this would be likely to work injustice, they should be dealt with by way of specific exception.

There is an incidental question which has occurred to us in considering this issue, namely how the Contracts (Rights of Third Parties) Act 1999 may affect a defence based upon lack of insurable interest either of the insured or of a named third party. Do the defences available to the insurer in an action on the policy by the third party include lack of insurable

interest by (a) the insured or by (b) the third party? MacGillivray[2] suggests that (b) is available. However, the wording of the Act seems to us to point more towards (a).

Indemnity Insurance

8.4 We see the force of the tentative proposal that there should be no requirement of insurable interest for indemnity policies and that the legality and enforceability of such policies should be governed by the indemnity principle (7.50), but ultimately we do not concur with it. While we accept that the indemnity principle will go far to reduce moral hazard, we are not convinced that it is adequate to protect against speculative contracts. Further, the removal of the requirement could lead to an undesirable increase in the number of cases where the measurement of any indemnity would come into dispute.

8.5 Should there be a legal requirement on insurers to check that policyholders have an expectation or a chance of loss at the outset of a contract of indemnity insurance, or should such matters be left to regulation (7.54)?

We presume this question arises because the Law Commissions have elsewhere, as part of the insurance contract law review project, proposed doing away with the duty of disclosure in consumer cases. The requirement for disclosure might involve the insured having to explain the nature of his relationship with the subject matter of the insurance. If the insured's duty of disclosure is replaced by an obligation to answer honestly any relevant questions, we might expect insurers to ask such questions. Our view, however, is that to make it a legal requirement to ask such questions (in addition to requirements which exist already under the "treating customers fairly" principle forming part of the structure of regulation of insurers by the FSA) would represent a needless complication (if not duplication) of the relevant rules. Such matters can probably be left to be governed by the regulatory structure already in place.

IF A REQUIREMENT OF INSURABLE INTEREST IN LIFE INSURANCE CONTRACTS IS RETAINED, SHOULD IT BE AMENDED?

Insurable interest based on natural affection

8.6 We agree with the tentative proposal (7.61) that the categories of insurable interest supported by "natural affection" should be increased, but the concept of "natural affection" - from which the law might do well to distance itself because it is difficult to define and use of the phrase is not always appropriate on the facts - should be replaced by a list of specified

[2] *MacGillivray on Insurance Law* (10th ed 2003) 20-66

relationships and that where there is no such relationship a test of actual or potential economic loss should be available. As to the alternative, if the death of the life assured would cause the policyholder measurable pecuniary or economic loss which could be made good by monetary recompense, replacement goods or the provision of replacement services, then there would be insurable interest. The precise degree of kinship between the policyholder and the life assured should not matter.

8.7 Subject to the general comments in the preceding paragraph, we agree with the list of groups set out in 7.62 who should be deemed to have an insurable interest arising out of "natural affection".

8.8 As regards other relationships (7.64):

(1) No particular need seems to have been demonstrated for parents being able to insure the lives of their children under 18, but there can be no objection to permitting this where expectation of support can be shown, and the increase in moral hazard in other cases is probably marginal.

(2) Fiancés should be treated in the same way as cohabitees, particularly in an age where it is quite likely that the couple have been cohabiting for some time prior to their formal engagement and may have had children or invested in property together.

(3) Siblings; and

(4) Grandparents and grandchildren - in relation to these categories, some members of the Committee are of the view that insurable interest should be created by economic considerations (including expectation of support as well as actual support) rather than natural affection, while others would allow the expansion of interest to siblings, grandparents and grandchildren without any limit other than the amount of cover which the underwriter is willing to provide. Provision may also have to be made for family trusts and pure investment contracts - see above at 8.2.

8.9 As regards the tentative proposal (7.66) that where there is a relationship of natural affection between the policyholder and the life insured (including the expanded categories proposed by the Law Commission), the policyholder should be permitted to insure that life for an unlimited amount, we would allow policyholders to insure for any limit that the insurer is willing to provide.

Insurable interest based on economic loss

8.10 The majority of us agree with the tentative proposal (7.69) that the category of insurable interest supported by a legal pecuniary loss should be amended by relaxing the test to be applied, so that the requirement becomes that the policyholder has a reasonable expectation of pecuniary or economic loss on the death of the life assured, and that a pecuniary interest recognised by law should no longer be necessary, subject to the further exception for investment contracts referred to at 8.2 above. One member of the Committee has however pointed out that unless "expectation" is confined to legally enforceable interests (e.g. a debt or obligation of support owed by the assured), it might be possible to insure a life for far more than the value of the interest. Also, this proposal could permit professional look-alikes to insure the lives of the celebrities whom they resemble without the knowledge or consent of the celebrities concerned, which might be considered objectionable by the subjects of the policies should they become aware of such a practice.

8.11 We take the view that, provided insurable interest has been established by showing the requisite expectation of pecuniary or economic loss, the extent or value of the interest should be the same as for life insurance where the insurable interest is established by virtue of natural affection – i.e. policyholders should be allowed to insure for any limit that the insurer is willing to provide. Amongst other things, this would remedy the problem with key man insurance as there would be no need for the company to attempt to value its loss on the death of the employee concerned. We recognise the risk of permitting insurance for an amount significantly in excess of the policyholder's real loss, but we presume that a higher premium would be payable and that underwriters would be reluctant to provide exorbitant limits; we consider these factors to be sufficient mitigation. We consider that the basic rule should be included in any amending legislation, although any subsidiary rules which may be necessary, such as how the interest is to be valued, may be left to regulation. One issue which does not appear to have been considered in the Issues Paper is what is to happen if the expectation of loss ceases or does not crystallise prior to the death of the life insured. As commented in paragraph 8.2, we favour the continuation of the current rule that interest does not need to be shown after inception of the contract. Consistent with this, our view is that cessation of expectation of loss should not affect the validity of the policy.

Consent

8.12 If the categories of insurable interest in lives are expanded as suggested elsewhere in the Issues Paper, and having regard to the problem referred to in the next paragraph, we do not think that there are likely to be many situations in practice where the consent of the life insured is likely to provide the only basis for an insurable interest. While we agree (for the reasons stated in the Issues Paper) with the authors' reluctance (7.76) to propose that consent should become the sole requirement or an additional requirement for insurable interest in the UK, we do not agree with the tentative proposal (7.79) that consent of a life insured should provide an alternative ground for establishing insurable interest where the policyholder and the life to be insured do not fit within the categories of natural affection or a reasonable expectation of loss. Apart from the evidential problems referred to at 7.74 - 75, it may be necessary to guard against forgery or blackmail. We note the possible connection between this question and the issue of assignment of policies, dealt with at 8.20 below; anticipating our response to that issue, we do not consider that consent should be either a necessary or sufficient basis for assignment.

8.13 If the law is amended so that consent becomes a self-standing basis for insurable interest in another's life, it seems difficult to limit the value of the policy by reference to any criterion other than the amount to which the life assured consents, unless an arbitrary upper limit is to be set by legislation or regulation. Although this may seem far fetched, one can imagine a situation in which A persuades B to consent to A's insuring B's life for a substantial sum with a view to A's having B murdered - a possibility which seems to have at least crossed the minds of the authors of the Issues Paper (7.75). As a variation on this theme, we understand that persuading people with Mafia "contracts" out on them to buy life insurance and assign the proceeds is an old and frequently used device - a consideration which might be thought to support the retention of insurable interest. On the other hand, where an expectation of loss exists, we consider it to be strongly arguable that the consent of the life assured should not be required at all.

Insurable interest in group policies

8.14 We do not consider that special rules are necessarily required for group policies (7.84) – see the observations made in 8.16 below. However, if there is any real doubt concerning the effect or efficacy of group life schemes, we would support rules designed to support them.

8.15 If special rules are considered desirable for group policies, we agree with the suggestion (7.85) that employers taking out group policies should be exempt from showing a reasonable expectation of loss on an employee's death, for the reasons stated in the Issues Paper. We would however point out that group life policies should be distinguished

from employers' insuring their employees for their (the employers') own benefit. There is no reason why the latter category of insurance should not be subject to the same rules as other life insurance (which would, if the tentative proposals in the issues paper are implemented, include the possibility of insuring against the employer's reasonable expectation of pecuniary or economic loss). On the other hand, the employer might wish to offer death in service benefits by providing for cover to be offered direct to the employees, which could be transferred with any change of employment. In such cases, there appears to be no compelling reason why the employer should be the insured.

8.16 Should group life schemes to be treated as being insurance on lives rather than third party liability insurance (7.86)?

We agree that group life schemes should continue to be treated as insurance on lives rather than third party liability insurance, as this is the basis on which the industry currently writes such policies.

It is not at all clear why *Feasey* (and in particular the fourth of Waller LJ's suggested categories rather than the second) should affect the analysis of insurable interest under a group life contract. The contract in *Feasey* was not a contract of life assurance and none of the life examples given in the fourth category are based on a pecuniary interest.

It seems to us that the amendment to section 2 of the 1774 Act for group policies is based on the premise that insurable interest subsists once the employee is actually covered by the scheme (i.e. the change was to make clear that if the person was eligible for inclusion in the group, the fact that he could not be named in the policy at inception did not make the contract illegal). The basis for insurable interest outside the current cases of natural affection or statute is a pecuniary loss flowing from the death of the person(s) on whose life or lives the policy is written. So, for example, if an employer lends his employee a sum of money, he could insure the employee's life in relation to the amount outstanding at that time.

Similarly, if the employer makes an enforceable agreement to pay the same amount to his employee should he die in employment, then the employer would himself suffer a pecuniary loss if the life assured did die. A life policy issued to the employer would cover the risk and consequences of death of the employee (as opposed to the employer's liability to pay) on the basis that the employer has a pecuniary interest in the death of the employee because he would suffer a loss. It is submitted that this situation (i.e. where there is an additional legal obligation to make payment) is different from the interest of an employer where there is no such obligation to make a payment. In such cases the loss is

limited to the employer's loss during the notice period. Accordingly *Hebdon v West*[3] and *Simcock v Scottish Imperial Insurance Co*[4] could be distinguished on the basis that in neither case was there an independent obligation to pay money to the employee if he died.

In our experience, group contracts are issued to employers on the basis that they have an insurable interest in the employees' lives for the reason indicated above. They are not however issued to employers where *joint* policies are involved, often involving trustees (unless they cover inheritance or other tax loss to the remaining beneficiaries under a trust). Arguably, only a bare trust for a sole beneficiary satisfies the insurable interest test on an agency basis. Trusts do therefore cause real practical issues and consideration should be given to whether certain types of trust (e.g. a family trust) should be permitted as an extended category of natural affection, or whether there should be a specific exemption for investment contracts (e.g. occupational pension fund trustees investing trust assets in managed pension fund contracts or unincorporated associations investing their assets).

Remedy

8.17 We agree with the tentative proposal (7.88) that a contract of non-indemnity life assurance without insurable interest should be void and not illegal.

8.18 We see no relevant difference in this context between indemnity and non-indemnity (including life) insurance. Accordingly, our answer to the question posed at 7.90 is the same as that set out at 8.5 above in relation to indemnity insurance - that is that insurers should not be required to ask whether a valid insurable interest exists at the outset of a life policy. The question whether insurers who fail to enquire should be prevented from relying on lack of insurable interest as a defence to any claim accordingly falls away, although we believe the reality is that insurers will seek to ascertain the nature of the relationship between the insured and the subject matter of the insurance. If the requirement of insurable interest is to be retained for non-indemnity insurance (and we believe that there are good reasons why it should be retained), insurers should not be prevented from raising lack of insurable interest as a defence to a claim under a policy: this would be to subvert the insurable interest requirement via the back door.

Composite policies

[3] (1863) 3 B&S 579

[4] (1902) 10 SLT 286

8.19 We agree only in part with the tentative proposal (7.93) that composite policies should be regarded as severable, so that if a policy combines indemnity insurance with non-indemnity benefits and there is insufficient insurable interest to support the validity of the non-indemnity part of the policy, only that part of the policy should be invalid. The reason for our qualified agreement is that this question assumes that insurable interest will no longer be required for indemnity insurance - a proposition which we do not support.

Assignment or lapse of interest

8.20 We do not see a need to reform the law in this respect: see 8.2 above. A requirement for the consent of the life assured to the continuation or assignment of the policy could cause problems of the kind alluded to in 7.94 and should therefore be avoided.

FURTHER POINTS OF REFORM - NON-INDEMNITY AND INDEMNITY INSURANCE

Criminal penalties for marine insurance

8.21 It is difficult to understand, nearly 100 years later, why the Marine Insurance (Gambling Policies) Act 1909 was ever thought to be necessary. It has certainly not been effective, as "tonners" (i.e. insurance or reinsurance contracts which were essentially wagers on the total value of marine casualties over a certain period) continued to be written at Lloyd's until outlawed by a resolution of the Committee in 1981. Even thereafter, the practice may have continued because it seems to have been necessary in 1993 for Lloyd's underwriters to be reminded of the prohibition by a Solvency Department bulletin. In any event, the spirit behind the 1909 Act seems inconsistent with the Gambling Act 2005. We therefore agree with the tentative proposal (7.97) that the criminal penalty imposed by the 1909 Act should be abolished and that a marine insurance contract entered into without insurable interest should not be illegal. We should perhaps point out, however, that if such a contract was made on a non-indemnity basis and the recommendation for the continuation of the requirement for insurable interest in such policies was not maintained (see 7.43 and 8.3), such contracts might (subject to the Lloyd's resolution mentioned above) become legally enforceable by reason of the Gambling Act 2005.

The names of interested parties

8.22 We agree with the tentative proposal (7.101) that insurers should not be permitted to avoid policies only by reason that the names of the persons interested are not specified in the policy document, for the reasons given in the Issues Paper.

ADDITIONAL QUESTIONS

Non-indemnity insurance

8.24 It should be recognised that Example 1 in paragraph 3.61 simply cannot be rationalised according to current rules on insurable interest. The range of possible solutions, in our view, is (a) to expand the categories of those with an insurable interest in the lives of others (as suggested above), or (b) to recognise that what is being insured here is the employers' contractual liability to pay death in service benefits - notwithstanding that this is not how employers and their insurers currently regard schemes of this sort, or (c) to formulate special rules for group insurance.

Although Example 2 (3.62) is directed principally (if not exclusively) to insurers rather than lawyers, we would make the comment that if the categories of insurable interest in the life of a third party are expanded as suggested above, company A might well have an insurable interest in the life of Mr Whizz in the circumstances described.

As for Example 3 (3.63), unless the categories of insurable interest by reason of natural affection are expanded to include children under 18, the only legal analysis by which payment of the full policy amount on the death of a child might be enforced is that suggested in 3.63(3) - i.e. that the adult taking out the policy is regarded as contracting as an agent on behalf of his or her child. If that analysis were to be accepted, then insurers could either fix a lower policy payment for the death of a child than that set for an adult, or (presumably for an increased premium) permit the deceased child's personal representatives to claim, on behalf of the estate, the full policy value. In relation to children taking out policies, it is worth bearing in mind that many life contracts contain some element of investment and that therefore there are scenarios in which the policy value will be less than the premiums paid. For this reason, many life companies (other than friendly societies) are loath to issue policies to children on the basis that they then risk the contract being avoided by the child, either during their minority or on attaining majority, especially if investment market returns have fallen in the interim.

Indemnity insurance

8.26 Assuming that (a) Example 1 (5.47) presents a realistic scenario, (b) a requirement for insurable interest is to be maintained and (c) the scenario is considered to be of practical importance, it should be dealt with by a specific amendment to the meaning of insurable interest. It should however be considered whether this would amount to "insurance" for

the purposes of the EU Non-Life Insurance Directives so as to enable the insurer to write the business: would it fall within Class 13 as "liability"? If the requirement of insurable interest is abandoned, we doubt whether the risk in this example would fall within the indemnity principle as currently understood, though we see no difficulty as a matter of contract about the policy covering the payment.

As for Example 2, (5.48) if a requirement for insurable interest is maintained, we agree that the analysis in (1) may be applicable, although again this may be an appropriate case for making an exception to the requirement (see 8.3 above). If the requirement is abandoned, again we see no difficulty about the policy providing for payment of the total loss (if necessary with a provision for the payment to be made to the son), but subject to a similar doubt as expressed in relation to Example 1 above about the meaning of the Non-Life Directives.

Other possible issues for consideration by the Commissions

Before closing, we suggest that, if any new legislation is to maintain a requirement of insurable interest for either life or general insurance, there would be merit in expressly prescribing its territorial application, and in that case we suggest that it should be confined to contracts governed by English or Scottish law. We have not found any authority on the application of the 1774 Act and the authorities on the 1845 Act appear ambivalent.[5]

You may also wish to consider the possibility of a challenge to the requirement of insurable interest based on Community law. Specifically we should draw your attention to the European Commission's interpretative communication 2000/C 43/03 concerning the freedom to provide services and the general good in the insurance sector, II.2 (e) (proportionality). Our consideration of the ECJ case-law[6] does not, however, suggest that any challenge to the current rules (or the pre-Gambling Act rules) would currently have much prospect of success.

[5] Compare Dicey, Morris and Collins: *The Conflict of Laws* (14th ed) 33-448 and Halsbury's Laws (4th ed) Vol 4(1) para 38.

[6] See notably Cases 15/78 (time-bargains) and 124/97 (slot machines).

SUMMARY OF OUR CONCLUSIONS AND RECOMMENDATIONS

1 The reason for the requirement of insurable interest remains sound. The fact that we have not seen much in the way of gambling with so-called insurance policies recently[7] does not alter the abiding, underlying soundness of the need to separate the two, nor does the complexity which judgments over the centuries has introduced.

2 We nevertheless accept the case for improvement. Although arguments about insurable interest are (thankfully) rare, when they arise they are often perceived to be part of the professional conspiracy to entrap the insured which the public associates with the insurance industry. Looked at objectively, this may be unwarranted, but perceptions do not always change in the face of the facts. In any event, it lies ill in the mouth of an insurer to sell a product and later tell the insured that he was not entitled to buy it. The general tenor of the Commissions' proposed reforms of insurance contract law is to dismantle the kind of machinery that occasionally allows insurers to take what is perceived as unfair advantage (non-disclosure, warranties etc) and it seems to some members of the Committee consistent that this particular loophole should also be blocked whenever it is superfluous or takes the benefit of the doubt away from the insured. The majority of us are, however, persuaded more by the force of the moral hazard argument, particularly in relation to life assurance. Overall, we favour a régime (overriding the Gambling Act 2005 insofar as necessary) on the following lines:

(a) There must be either an interest in the subject matter of the insurance when the policy is effected, or the realistic prospect of one arising at some point during the policy period.

(b) For indemnity insurance and for non-life, non-indemnity insurance there should be an interest in the subject matter of the insurance at the time of loss. This should apply to assignees as well, and some members of the Committee are of the view that life and general insurance should be treated alike in this respect, although the majority favour maintaining the position that insurable interest need only be shown at inception for life insurance.

[7] Although the sanctions of the criminal law should remain the principal method by which society protects itself against murder with a view to profiting from a policy on the life of the victim taken out by the murderer, insurable interest may have a role to play here as well. In March 2008, a case was reported from California in which two elderly women took out a total of more than 35 policies, worth altogether $2.3 million, on the lives of two homeless men, whom they are alleged to have then murdered. Might some investigation of the alleged interest of the beneficiaries of the policies have had a preventative effect?

(c) In the absence of insurable interest at either relevant time, the contract should be void, but the premium should be returned; and in the absence of such interest at both times the contract should be unenforceable.

(d) In the case of general insurance, insurable interest is to be measured in the same way as the indemnity principle, i.e. if the loss of or damage to the subject matter insured would cause measurable pecuniary or economic loss to support a claim to indemnity (whether in the form of monetary recompense, replacement goods or the provision of replacement services) by the policyholder, there is insurable interest.

(e) In the case of liability insurance, insurable interest is to be measured similarly: if the policyholder is exposed to the liability insured against, or there is a realistic prospect that he will be so exposed at some time during the policy period, and when the policyholder incurs the liability he suffers measurable pecuniary or economic loss that would support a claim to indemnity (whether in the form of monetary recompense, or - much less likely we concede, but nevertheless possibly - replacement goods or the provision of replacement services), then there is insurable interest.

(f) In the case of life insurance, insurable interest will exist in the circumstances discussed in paragraphs 8.6 to 8.11 of the main body of the paper (i.e. the expanded categories of natural affection or where there is a reasonable expectation of pecuniary or economic loss).

3 It should be accepted that, realistically, there is nothing the law can do to prevent the *Macaura* type of case (nor purchasing cover against the wrong type of loss). It would be wise to recognise the limitations of the law and to keep away from the temptation to provide "cotton-wool wrapping" to consumers in this area. On quantum, if there is insurable interest but the loss is too remote or too speculative to value, it should be recognised that this is likely in most cases to be the result of a bad purchasing decision; the law should not involve itself in the absence of some other factor such as mis-selling or negligent advice.

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Appendix A

HISTORY AND DEFINITION OF INSURABLE INTEREST - AND POTENTIAL CONSEQUENCES OF THE RELAXATION OF THE REQUIREMENT TO SHOW IT

1 We believe that it is appropriate to append to our response a detailed commentary on the Law Commissions' views on the history and definition of insurable interest, since we offer what is at some points a sharply contrasting view. We also point out the risk of possibly unforeseen consequences if the requirement of insurable interest were to be abolished or relaxed to too great an extent.

A. Introduction

2 The subjects of history and definition are interlinked: if (as we believe we can show, but contrary to the Commissions' views) insurable interest was a known concept before the Marine Insurance Act 1745, it would most likely be because at common law it was a requirement for an insured to make a recovery under an insurance policy.

B. History, Non-Life

3 What Roche J says in *Williams v Baltic Insurance*[8] is:

> "There is nothing in the common law of England which prohibits insurance, even if no interest exists. It may be necessary to show interest but there is no prohibition in law."

In the Issues Paper, the Commissions refer only to the first sentence from the extract quoted above. There is a difference between not enforcing a contract and prohibiting it[9], but we must ask in any event whether the first sentence is correct. Roche J makes a general reference to McGillivray for support, but the current edition of McGillivray repeats the first sentence of Roche J's judgment and cites no other authority, so the argument is somewhat circular. If the only authority relied on for a proposition that the common law did not prohibit insurance without interest is a remark by a first instance judge some 150 years after the statutes dealing with insurable interest were passed, one might regard that

[8] [1924] 2 KB at 288 (quoted at 2.2 of the Issues Paper)

[9] A contract binding in honour only, or any agreement not intended to create legal relations, is not prohibited but it cannot be enforced. A contract for no consideration is unenforceable, not prohibited. We shall come back to consideration below.

proposition as unproven. The second sentence of the extract from *Williams*' case cited above is consistent with the proposition that the common law did require interest to be proved to enforce an insurance contract.

4 *The Sadlers Company v Badcock* was decided in 1743.[10] It was a decision of the Lord Chancellor, Lord Hardwicke, and he states that he is following the earlier House of Lords decision of *Lynch v Dalzell*.[11] The Lord Chancellor says: "I am of opinion it is necessary the party insured should have an interest in property at the time of the insuring and at the time the fire happens".[12] He acknowledges that some vessels are expressly insured "interest or no interest" but adds that where that is not the case interest must be proved. He then says: "The Common Law leant strongly against these policies for some time but being found beneficial, they winked at it." Contrary to the Commissions' assertion (5.29) that the case "has not been cited since", it was cited in *Lucena v Craufurd* (as was *Goddart v Garrett*).[13] The *Sadlers* case being heard in 1743 and the 1745 Act appearing two years later, perhaps the proposition that insurable interest was necessary for insurance contracts was thereafter regarded as sufficiently well accepted as not to require additional support.

4 *Goddart v Garrett* (1692)[14] is a case deciding before the winking began. There it was stated: "If a man has no interest and insures the insurance is void and though it be expressed in the policy 'interested or not interested'".[15]

5 Furthermore, the Commissions' suggestion that the 1745 Act was the beginning of a requirement for insurable interest is at odds with the statute itself. The Act assumes an existing requirement of insurable interest. Section 1 prohibits insurance on any English ships or any cargo laden on board:

i) "interest or no interest or

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[10] 2 Atk 554, English Reports 26.733

[11] 4 Bro PC 431 (1729) English Reports 2.292

[12] The Marine Insurance Act 1906, section 6(1) does not require an interest when the policy is effected, but section 4(2)(a) provides that if insurance is obtained when the insured has "no expectation of acquiring an interest" the policy is deemed gaming and wagering. So, if one is intending to buy something, one can put the policy in place before one makes the purchase.

[13] 2 Vern 269

[14] 2 Vern 269, English Reports 23.774

[15] It may be thought that the judiciary have a tendency to wink at failures to comply with the law relating to insurance. In *Craufurd v Hunter* (1798) 8 TR 13, English Reports 101.1239, Lord Kenyon described the insurer's case of no insurable interest as "unconscientious" (adding that the insurer "has the right to insist upon it"). In the 1980's judges expressed disapproval of reinsurers' declining to indemnify insurers that had issued void policies (because unauthorised). A leading case on life insurance, *Dalby v India Life* 15 CBNS 365 (1854), English Reports 139.465 (on "counter insurance", which is reinsurance by another name), was heard at a time when reinsurance was "not lawful".

ii) without further proof of interest other than the policy or

iii) by way of gaming or wagering or

iv) without benefit of salvage …."

6 If there were no existing requirement for insurable interest, one would expect to find a prohibition of insurance "where there is no insurable interest", as there is in the present codifying statute, the Marine Insurance Act of 1906 (and in the Life Assurance Act, 1774). In effect, the 1745 Act is saying that the parties cannot evade the common law requirement for insurable interest by expressly stating that the policy is made “interest or no interest” or PPI, or by entering into the contract as a wager rather than as insurance. (Foreign ships were exempt from the requirement "on account of the difficulty of bringing witnesses from abroad to prove the interest" - *Thellusson v Fletcher*[16] - not on account of English law wishing to see insurance with no insurable interest flourish.)

7 It is evident from *Lucena v Craufurd* that the English law requirement of insurable interest for an insurance contract was not a creature of the 1745 Act. The House of Lords asked a group of lower courts judges their opinions on eight questions. Only one question related to the 1745 Act and that was whether after the Act the assured had to plead his interest in the subject matter any differently from before the Act. The judges (page 308) advised that the statute made no difference to the pleading requirements, and the object of the Act was "to prevent gaming by prohibiting the insertion of certain clauses in the policy which dispensed with proof of interest". One of Lord Eldon's references to the statute could suggest the statute broke new ground. He says (page 320) "Since the [statute] it is clear that the insured must have an interest…" But he goes on to say "Lord Kenyon in *Craufurd v Hunter* considered [the statute] as a statutory declaration that insurance might have been effected before that Statute without interest. It is with great deference that I entertain doubts on the subject." That indicates quite clearly that Lord Eldon's first remark is addressed to the fact that it is no longer permissible for the insurer expressly not to require an interest. He cites the earlier cases of *The Sadlers Company* and *Pringle v Hartley*.[17]

8 The plaintiff makes the point in the other report of *Lucena v Craufurd*[18] "that a mere wager is legal there can be no doubt but insurance is a different thing from a wager" and that "all

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[16] (1789) 1 Doug 315

[17] 3 Atk 195, English reports 26.914

[18] 3 Bos & Pul 75, English Reports 127.42

precedents printed and manuscript previous to the [statute] with one single exception[19] either aver an interest or contain a dispensation of the proof of interest." This is consistent with the way the statute is framed. Before 1745 contracts of insurance did require that the insured have an insurable interest, but the courts began to wink where marine contracts expressly stated that proof of the interest was not required. The 1745 Act brought an end to that. One could wager if one wished; it was lawful to do so. But one could not wager under the guise of an insurance contract.[20] If one entered into an insurance contract one had to have an insurable interest.

C History: Life

9 The Life Assurance Act 1774 continued this two-pronged approach of prohibiting both wagering by way of insurance, and effecting insurance without interest. It barred (section 1) insurance where the beneficiary "shall have no interest" and also barred insurance "by way of gaming or wagering". (Note, the statute says "interest", not "insurable interest". The statute was to be read purposively: "Every assurance made contrary to the true intent and meaning hereof shall be null and void.")

10 The Marine Insurance Act 1906 (the MIA) was passed after gaming and wagering had been declared by statute to be illegal (by the Games and Wagers Act 1845).[21] The MIA has the two-pronged approach but, in light of the fact that wagering was by then unlawful, puts it differently:

i) Section 4(1) Every contract of marine insurance by way of gaming or wagering is void.

ii) Section 4(2) A contract of marine insurance is deemed to be a gaming and wagering contract:

(a) where the assured has not an insurable interest……

(b) where the policy is made 'interest or no interest' or 'without further proof of interest than the policy itself' or 'without benefit of salvage'.

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[19] (which the plaintiff believed to be inaccurate)

[20] The issues paper understands this: "The original 'mischief' that insurable interest was intended to prevent was not gambling itself, but gambling in the guise of insurance." (7.35). That does not seem to inform the rest of what the Commissions say, particularly about the effect of the Gambling Act 2005 - see below. In any event, the requirement for interest goes beyond blocking an abuse.

[21] This was the name of the statute when it came into force. It became the Gaming Act some 50 years later with the Short Titles Act 1892.

11 This dichotomy between policies which are wagers and policies where there is no interest, though they were not entered into as wagers, becomes relevant in considering whether the Gambling Act 2005 has done away with the requirement for insurable interest.[22]

12 Whilst insurable interest was required at common law for non-life insurance, it is reasonably clear that this was not the case for life insurance. Indeed the 1774 Act was passed to end the practice of insuring the lives of persons whom the parties taking out the policies wished to die. That is why the statute bans insurance on lives where there is no interest, while the 1745 Act banned practices designed to avoid the requirement for interest.

13 Insurance on anything other than a marine adventure was in its infancy even in the middle of the 18th century. There was some "life" insurance for funeral expenses - and small "mutuals" - but the first life company did not appear in England until the very end of the 17th century and what is now regarded as life insurance began only in about 1760.[23] Prior to 1774 there was a rash of gambling on lives, particularly of public figures, by use of life insurance policies. There seems no reason why the courts could not have ruled that an insurable interest in the life was required before such policies could be enforced, insisting on the removal of wagering from life insurance, but they did not. As *Dalby v India and London Life Assurance Company*[24] demonstrates, the judges winked at the absence of interest, and at the absence of loss, and at the prohibition of reinsurance.

14 The 1774 Act was introduced to stop abuses that had developed and it did so by bringing life alongside property insurance and requiring "interest". Indeed, it did more: the statute provided that no greater sum should be recovered from an insurer than the amount or value of the interest. It intended life to be indemnity based, as was non-life. The difference between life and non-life insurance was that for life the interest and the correctness of the amount had to be assessed at the time the policy was taken out (it could therefore be a fixed sum). If what the courts have subsequently accepted as "interest" in life has not kept up with social developments, one might cure the ill by expanding the concept of interest and still preserve the barrier against abuse. If it is considered

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[22] See below.

[23] Geoffrey Clark: *Betting on Lives: The Culture of Life Insurance in England 1695 - 1775*

[24] (1854) 15 CB 365, English Reports 139.465; see also footnote 15 above. A vicar insured the life of a duke with an insurance company. There is no evidence in the case that he had an interest in the life of the duke. A director of the insurance company, Dalby, effected "counter insurance" with New India. (It seems that at that time directors were as liable for the debts of the company as the company.) The vicar exchanged his life policy on the duke for an annuity. Eventually the duke died and Dalby claimed on New India. Successfully. New India asserted that Dalby had suffered no loss because the vicar's policy had already terminated. The court held that Dalby's policy was on the life of the duke and he could recover. It was of course reinsurance and Dalby's company was not getting a windfall; it was paying the vicar an annuity. There is no evidence that Dalby recovered more than the annuity being paid.

inappropriate that an insured who could be financially exposed on the dropping of a life should continue the insurance after his financial exposure has ended, some requirement may be imposed that interest must exist also at the time the life drops in such cases. If it is considered inappropriate for a person with no family ties and no financial exposure to profit from the death of another by claiming on an insurance policy, changing the law so that insurable interest was not required at any time would simply exacerbate the problem.

D Definition: Property

15 In *David Cowan v Jeffrey Associates and Others*[25] Lord Hamilton said:

> "In the Court of Appeal in England excerpts from Lawrence J's opinion [in *Lucena v Craufurd*] have been described as "the classic definition of insurable interest" (*Mark Rowlands* at 228, *Glengate* at 621, 626). It is to be noted, however, that in neither case did the learned judges refer to the observations in *Lucena v Craufurd* in the House of Lords, where, as noted in MacGillivray on Insurance Law at para. 1-116, the House of Lords did not agree with some at least of Lawrence J's views."

16 Lawrence J was one of the judges giving an opinion to the House of Lords before the House itself ruled. Possibly because of the political delicacy of the position (the rights of the King being potentially involved), the Lords consulted widely. The decisions of Lord Eldon, Lord Ellenborough and the Lord Chancellor are the true decisions of the House of Lords. Lawrence J thought insurable interest was required for an insurance contract:

> "That a man must somehow be interested in the preservation of the subject-matter exposed to perils follows from the nature of this contract when not sued as a mode of wager but as applicable to the purposes for which it was originally introduced; but to confine it to the protection of the interest which arises out of property is adding a restriction to the contract which does not arise out of its nature."

17 He then went on to cite two Roman authorities, one in the original Latin,[26] and it is this definition which the Issues Paper uses at 2.1. However, at 5.12 the Law Commissions quote Lord Eldon's definition of insurable interest as "the classic": that is correct. Lawrence J's opinion was that "where a man is so circumstanced with respect to matters exposed to certain risks or dangers as to have a moral certainty of advantage or benefit but

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[25] 1998 SC 496

[26] A further indication perhaps that insurable interest as a concept in England goes back beyond 1745.

for those risks or dangers he may be said to be interested in the safety of the thing."[27] Lord Eldon directly disagreed. He was unable "to point out what is an interest unless it be a right in the property, or a right derivable out of some contact about the property which in either case may be lost upon some contingency affecting the possession or enjoyment of the party." The Lord Chancellor, Lord Erskine, added that if insurance were permitted on the argued basis, "it would introduce infinite confusion in the administration of justice and enable persons to insure property who have no manner of right."

18 Many of the cases cited by the Commissions where insurable interest arises as an issue are cases where the insured has not insured his property in the subject-matter of the insurance but someone else's property. In *Macaura v Northern Assurance Company Limited*[28] the insured did not insure his (ownership) interest in the company but property owned exclusively by the company. The insured made a mistake. The view put forward by the Law Commissions is that *Macaura* was an unhelpful decision and a wider test would have enabled Macaura to recover (5.14 - 5.19). However, had Macaura recovered and had there been many creditors of the company, what would have happened to the proceeds of the claim? The interest that a potential insured may have (and the extent of that interest) may be relevant to the insurer's assessment of the risk. If the law is changed so that a potential insured is not concerned to think about what his interest is and take the trouble to insure that interest and no other, what other evils may be born and how will they be addressed?

19 In *Anderson v Morice*[29] the buyer insured the goods from the time they became his property at his risk and not before. They were at the seller's risk before the goods were fully loaded on a vessel, but the seller had failed to take insurance for that period and activity. The goods were lost before being fully loaded. The buyer agreed to take a bill of lading for what had been loaded before the loss (not a full load) and claimed on his insurance. This was improper: his insurer had not been asked to take the risk prior to the cargo being fully loaded and had received no premium for that risk. If the insurer had been required to pay, he would have had no subrogated claim on the ship because the ship owed his insured no duty at the time of loss. If the insured is not required to identify the nature of his interest in the risk, how will the insurer price the risk? If the response is

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[27] Every passenger on an aeroplane comes within that description; every house-owner on its flight-path. They are interested in the safety of the airplane. Insurable interest required more than "being interested". Lord Eldon said "if moral certainty be a ground of insurable interest there are hundreds, perhaps thousands, who would be entitled to insure."

[28] [1925] AC 619

[29] LR 10 CP 609 (1876) H.L

that the insurer can ask what the nature of the interest is (and if we expect him to do so), why change the law?

20 In *Macaura* and in *Anderson*, would the decisions have been different if the test of insurable interest had been whether there was a reasonable expectation of the insured being benefited by the preservation of the subject matter or disadvantaged by its loss? If, in the *Macaura* case, the company had also insured, would both insurances have had to pay? How would each insurer have learnt of the cover provided by the other? If the company's claim remained unsatisfied when Macaura claimed on his personal contract, would his insurers have been able to decline to pay? If Macaura's company had been insolvent and all the proceeds of the company's claim on insurance (if it had any) would go to the company's creditors, would Macaura have been able to recover on his insurance also? What Macaura would have lost in those circumstances would have been future income on his shareholding. Would it be right for an insurance on property to take effect as credit or loss of profits insurance that the insurer had not underwritten? In *Anderson*, the seller remained under a duty to ship the whole load. Suppose that the buyer had not obtained bills of lading (which the seller had no legal right to require the buyer to take) but had simply claimed on his insurer, had he anything to be indemnified for if the goods were not his? Was he disadvantaged? Suppose that the seller and the buyer had insured the goods during loading, could both recover? How would the one insurer learn of the other?

E Definition: Life

21 What is insurable in life assurance has two elements: a commercial relationship that exposes one to financial loss on the dropping of the life of the other; and "natural affection". Natural affection is narrowly defined in case law and supplemented by statute. The Commissions have identified that the primary issue is whether to drop any requirement for insurable interest or to update the definition of natural affection. They recognise that inextricably entwined in this discussion is the time at which an insurable interest should be required to exist and what controls, if any, there should be over the amounts paid. The Commissions are clearly concerned about whether there are any bright line restrictions that can exist between requiring insurable interest and having no such requirement.

F Insurable Interest and Wagering

22 The Issues Paper asserts (2.12) that section 18 of the Games and Wagers Act 1845 had the effect of making all contracts of insurance unenforceable where no interest could be demonstrated. Section 18 of the 1845 Act therefore created, say the authors, a

requirement that the policyholder must be able to demonstrate an insurable interest in the subject matter of the insurance - otherwise the contract is a wager and unenforceable.

23 The Games and Wagers Act of 1845 in fact says nothing about insurance or insurable interest: it is an act about tennis, bows and arrows, bagatelle, bowling, billiards, cloyshcayls, coyting, half bowl, and other long forgotten games. Section 18 declared contracts of gaming and wagering null and void. It also provided that no suit could be brought for any money alleged to have been won on a wager or for money which is deposited in the hands of any person to abide by an event - which makes it clear what wagers it refers to. Contracts of insurance on property for wagering had been illegal at common law, devices to avoid the common law had been blocked by statute for 100 years, and contracts of insurance on life for wagering had been prohibited (and made null and void) since 1774. Wagering other than by the device of insurance contracts was not generally prohibited until this 1845 Statute. The Law Commissions say (1.15): "Following the Gambling Act 2005, it may be that most indemnity contracts no longer require insurable interest to be enforceable."

24 The Gambling Act 2005, section 335 provides:

> Enforceability of gambling contracts
>
> (1) The fact that a contract relates to gambling shall not prevent its enforcement.
>
> (2) Subsection (1) is without prejudice to any rule of law preventing the enforcement of a contract on the grounds of unlawfulness (other than a rule relating specifically to gambling).

25 The Issues Paper is ambivalent about what effect this has on insurance contracts.[30] The authors waver between asserting that the 2005 Act may have changed the law on

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[30] Cf 1.17 "Now that the [Gambling] Act is in force) it appears that under English law most contracts of indemnity insurance without insurable interest are valid ..."; 1.41 “In England, case law and the Gambling Act 2005 appear to have abolished the requirement of insurable interest in indemnity insurance."; 1.42 "Our tentative view is that it would be difficult to justify reintroducing a statutory requirement for insurable interest for indemnity contracts."; 2.18 "As a result [of section 335 of the Gambling Act] the need for any formal distinction between indemnity insurance and wagering agreements for the purposes of enforceability had disappeared. As we shall see later, it appears that for the purposes of enforceability at least insurable interest is no longer necessary in non-marine indemnity insurance in England and Wales…. There is some debate over whether the Gambling Act 2005 has abolished the need for insurable interest in marine insurance."; 3.66 "However, until the Gambling Act 2005 if such insurance contracts [on ship and goods] were to be enforceable, they would have had to have shown insurable interest..."; 5.11 "When the Gambling Act 2005 came into force (on 1 September 2007) the law on insurable interest in indemnity insurance changed. Insurable interest is no longer required to enforce most forms of indemnity contracts."; 5.23 "Since 1 September 2007 section 335 of the Gambling Act 2005 governs wagering …. The result is that a policyholder no longer needs to show an insurable interest…"; 5.30 "If these assumptions [that the 1774 Act does not apply to buildings and indemnity insurance] then the position for buildings and land post the Gambling Act 2005 is as for goods, described above. That is, the Gaming Act 1845 no longer applies to

insurable interest and asserting that it has changed the law. We submit that a number of points are overlooked:

i) The requirement for insurable interest in insurance contracts for non life insurance arises at common law, not under statute.

ii) The statutes that reinforced the requirement for insurable interest in non life insurance or imposed insurable interest for life insurance did so for two reasons: to ensure that only people with an interest effected insurance and to stop people wagering under the guise of insurance.

iii) If the Games and Wagers Act 1845 had never been passed, still insurable interest would be required for insurance contracts.

iv) The 1845 Act does not mention insurance.

v) The 2005 Act section 335 does not mention insurance.

vi) Section 335 expressly restricts its scope to gambling.

vii) It is almost inconceivable that it was the intent of the legislature to abolish 250 years of law without mention of this aspect in the 2005 Act or discussion during the Bill's progress. (Hansard has nothing on this section).

viii) There is no reason to suppose that Parliament would wish people to wager under the guise of insurance (or to insure a subject matter in which they have no interest) or that if they did, they would do so without discussion or mention of it.

26 We respectfully submit, therefore, that there is a strong argument that insurable interest is indeed still a requirement of English law and that any debate should be about whether it should continue to be a requirement and if so how it is to be defined.

27 As to the common law, paragraph 1.41 of the Issues Paper suggests that case law as well as the 2005 Act has done away with insurable interest. *Feasey*[31] seems to be the most

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hold contracts without interest unenforceable."; 5.40 "For insurance of goods, statute no longer demands that the insured must have an insurable interest in the subject matter in order for the insurance contract to be enforceable."; 6.2 "The Gambling Act appears to have affected contracts of insurance by accident…. Under English law it appears likely that there is no longer any need for a policyholder to demonstrate an insurable interest in non-marine indemnity insurance."; 7.48 "We therefore conclude that the statutory requirement for insurable interest in indemnity insurance should not be reinstated."

[31] [2003] EWHC Civ 885

recent and strongest attack. It was a Court of Appeal decision. *Lucena v Craufurd* is a decision of the House of Lords; so is *Macaura*. They are both higher authority than *Feasey*. Two members of the Court of Appeal in *Feasey* found insurable interest of a kind. The decision, as the Law Commissions recognise (3.47), has been "received with caution" by commentators.

G Insurable Interest: Liability

28 When a person insures against his liability, he necessarily has an interest in the subject matter. We have seen no pressure for a person to be able to insure against the liability of a third party for whom he bears no responsibility. If the requirement of insurable interest were abolished, it would become possible to insure another's liability. To the retort that it would be pointless to do so, there are a number of responses. Why abolish the requirement if no one would effect liability insurance without it? To abolish the requirement would make it possible for people to insure the wrong thing. A car park owner outside a stadium may say to himself: "If there is an accident in the stadium and the stadium is liable it may have to close and I will lose my income; I had better insure against the stadium becoming liable to third parties." No, he ought to insure against loss of profits. As with *Macaura* above, insuring the stadium owner's liability is insuring the wrong thing - and making it possible to do so does not help avoid that.

H Insurable Interest and Indemnity

29 To set the scene, Lord Eldon stated the law on insurable interest for non-life insurance - that interest means a right in property, or derived from contract, in the subject-matter. Lawrence J opined it sufficient for insurable interest that one could benefit from the preservation of, or suffer disadvantage from the destruction of, the subject-matter. One may clearly benefit from the preservation of, and suffer disadvantage from the destruction of, countless things in which one has no interest.[32] The whole population of England benefits from royal palaces, Tower Bridge or Anne Hathaway's cottage, because they bring tourists and revenue. Some sectors of the population - such as tour companies, or tour guides, or souvenir and snack shopkeepers near these visitors' attractions - have a more particular interest. If someone destroyed one of these attractions and any member of the population, or a souvenir shopkeeper, was to sue the destroyer for damages, the law would not grant a remedy, in both cases because no duty would be owed and in the second case

[32] See footnote 27 and the comment of Lord Eldon.

for the additional reason that any loss would be pure economic loss.[33] If, in the second case, the destroyer did owe a duty, the court would assess damages by reference to loss of income. If the shopkeeper had foreseen that he might lose income if the local attraction were destroyed and had insured the attraction, he would have taken out the wrong insurance. He should take out contingency cover. If the insured asks for cover for a building, he will go to a property insurer who will consider the risk of the property being damaged or destroyed and rate the risk accordingly. If the building is destroyed and the insurer receives a claim on the basis of loss of future profits, he will be faced with a claim for a risk he has not valued. A child may learn that his parents consider insurance to be a waste of money and have not therefore insured their house. The child may think this foolish and, hoping one day to inherit, he may insure the house. Suppose that it is destroyed. Suppose the law has no requirement for insurable interest. Does the child qualify for payment under the indemnity principle? Possibly, but how is the child's indemnity to be calculated? At zero? At 100%? If 100%, is he to keep the money? Suppose that he has siblings?

30 Lawrence J foresaw this problem:

> "….if the interest intended to be protected by the assurance is liable to be affected by other matters than the perils insured against of which matters some might happen in the interval between the time of the loss and the probable time when the risk would have ceased had no loss happened it may be impossible to refer to those perils the prejudice or damage against which the insured meant to protect himself with such degree of certainty as to enable the assured to establish his claim to a compensation on the ground of his loss having clearly arisen from the perils insured against."

31 Lawrence J looked at the terms of the commission granted to the commissioners and concluded they had no interest. In the case of the child, the parents might move house, divorce, fall out with the child, mortgage the house to the hilt, go bankrupt, out-live the child. How is the court to "indemnify" the child? It is trying to value a speculation. If there is no requirement for insurable interest, in all cases of this nature, the insurer cannot apply for summary dismissal. The court must go through an intensive exercise in probability analysis. It must value the prospects of a person winning the beauty contest without

[33] See *Tesco Stores v Constable* [2007] EWHC 2088. Chiltern Railway suffered a pure economic loss when a Tesco construction collapsed onto a railway line. But Tesco had given Chiltern a contractual indemnity and so Chiltern was paid. Tesco sought recovery from its liability insurers and failed. Liability meant tortious liability.

seeing the other contestants[34] and possibly concluding that prospects are low and the "indemnity" very little. Why bother?

32 And what if the court considers that the loss is so speculative that no indemnity can be awarded? Is there then premium paid for no consideration and can the insured recover his premium? The insured will assert that he paid premium in exchange for the insurer being exposed to loss but the court has determined that insurer was never exposed to loss because the insured's connection with the subject-matter is too remote. But if there must be some realistic link between the insured and the subject-matter of the insurance, which causes him to suffer a loss recognised by the law, is that not simply insurable interest in another guise? And if that link must be a right recognised by the law, enforceable at law, have we not come full circle? The Law Commissions are aware that even ignoring insurable interest, "interest" is an element of indemnity insurance: "The indemnity principle … states that … the insured needs to have an interest in the insured property." (5.6) If that were the case and the requirement for insurable interest were abolished, then might the insurer still apply to dismiss a claim on the basis of "no interest"? If interest recognised by law is a necessary element of indemnity insurance, then there is no question of abolishing insurable interest. The question is only how to define it.

33 At this point it becomes relevant to pick up again on "contracts" which are not enforceable for lack of consideration. Consideration is provided where the promisor gives a benefit or suffers a detriment.[35] The intention, as explained by Chitty[36] is to "put some legal limits on the enforceability of agreements". We look later at regulation of insurance and why there may be regulatory requirements which make insurable interest appropriate, but at this point we suggest that one reason for retaining insurable interest is to put some legal limit on what "insurance" contracts the courts will enforce. If there is no such limit, the courts may find themselves asked to assess the value of something, a connection with the insured subject-matter, which has not previously been recognised in law.

I Non-Indemnity Insurance

34 The Law Commissions' position on non-life non-indemnity insurance - 3.64. 3.66 and 7.42 - is that it is "possible in theory", probably does not require an insurable interest, and can provide elements of certainty. In what context these elements of certainty may exist is not

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[34] *Chaplin v Hicks* [1911] 2 KB 786

[35] *Chitty on Contracts* (29th ed, 2004) Vol 1 3-004

[36] *Ibid* 3-001

set out. Non-indemnity insurance exists in valued policies (MIA 1906, section 27). Valued policies are materially different from indemnity policies - *Toomey v Banco Vitalicio*.[37] A claim by an insured against an insurer where the insurer has declined to pay a claim is a claim for damages for failing to pay the claim. In the general law of contract, agreed damages for breach of contract are penalty clauses and unenforceable if they are not a genuine pre-estimates of damages. The agreed value of an insured subject matter is - absent fraud - conclusive as to its value. This is a specific provision of the MIA and required because the value of a ship can fluctuate viciously depending on the rate of freight, but once the owner has bought her on borrowed money with the vessel as security, he and his lender need to know that if she is lost, the insurance will repay the amount borrowed. We have no reason to think that the judges would not enforce any valued policies. The inference from the Issues Paper is that the Law Commissions also think judges would enforce them.

35 If the law is changed so that a person can pay a single premium to an insurer to return a fixed amount if a building is destroyed, or a ship lost, or an event occurs or does not occur, where the "insured" has no interest other than in the loss, destruction or event occurring or not, we have wagering through the medium of insurance policies. The "insured" has no interest in the preservation of the subject matter, only in its destruction. It is not clear from the Issues Paper whether the Law Commissions would still expect an insured under a valued policy to need to have sufficient interest in the subject matter to satisfy the definition of insurance in the *Prudential* case[38], i.e. that the payment of benefits under the contract must be triggered by an event which is prima facie adverse to the interest of the insured. If not, and unless specific provision is made in the legislation to establish otherwise, the contract is not really one of insurance at all, which would potentially have significant ramifications from a regulatory perspective. (Would the “insured” receive priority on insolvency of the insurance company? Would the “insurer” include these contracts with contracts of insurance as we know it today when he claims on reinsurers? Does the fund for the protection of policyholders pay if the “insurer” cannot?) It also raises the question whether, in such a case, the "insurer" would need to be authorised under the Gambling Act 2005 to offer the policy.

36 A specific concern might arise in the context of property insurance if the requirement for insurable interest were removed. Suppose that a newspaper article appears reporting that "there has been a recent rash of non indemnity policies on the O2 Arena". Does the

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[37] [2004] EWCA Civ 622

[38] *Prudential Insurance v Inland Revenue Commissioners* [1904] 2 KB 658

property insurance premium of the owner go up because the insurer has become alarmed that there is a plot to torch the Arena? In the present day, horse racing, cricket and football have all been affected by scandals of "fixing" results. How soon before insurance of this nature becomes as prevalent as the insurance on lives in the first half of the 18th century? There is no comfort in saying it will not happen or even it cannot happen. We say everything that can go wrong will go wrong because we, and more so insurers, are well aware that everything that apparently cannot go wrong, can (and will) go wrong. Admittedly, other forms of contract may be taken out, whether in the form of a wagering contract or a derivative transaction, which may have a similar effect to one of insurance, but that is not a good argument for extending the problem to insurance and diluting its social benefit.

37 Suppose that a requirement for insurable interest is retained but is defined in the Lawrence J manner rather than the Lord Eldon manner. Why would it be a good thing to make it easier for people with tenuous interests in things to be able to insure to any amount they pleased without demonstrating any loss? And again, if the insured failed to establish even the relaxed test, can he say in any event he wants his premium back for no consideration? How many insurances may there be on a property (say the local football stadium) in which all the thousands of local people "have an interest", before the insurers become concerned that it may be torched? And how do the insurers keep track of how many insurances on the stadium have been taken out? Relaxing the test of insurable interest - in the same way as removing it altogether - invites non-indemnity, valued, policies to be taken out.

38 Suppose that a requirement for insurable interest is retained in the manner stated by Lord Eldon, it is still pertinent to ask why, in situations other than marine insurance, it is appropriate for the law on damages for breach of contract other than insurance to be so different from the law of damages for breach of an insurance contract. If one is going to permit fixed amount claims on insurers which bear no relation to any loss, that would seem to be the most inappropriate time to relax the requirements for insurable interest.

J Regulation and Tax

39 The Law Commissions have rightly drawn attention to a statement by the FSA that it "doubts whether there is any regulatory interest in the use to which an insurance (or any other instrument) is put." (7.4) This could be interpreted as meaning that the FSA does not really care whether insurance policies are obtained as a wager or gamble or for protection against loss or damage, but it seems that what the FSA meant was that the reason for buying insurance is not relevant to the question of whether what is bought is in fact an insurance contract.

40 In reality, regulation in the UK (and the EU) has been developed for the protection of the policyholder at a time when the policyholder had a great deal to lose if his policy did not respond. Thus insurance companies must be authorised for each particular kind of insurance they wish to provide - and demonstrate an ability to provide it before they obtain authorisation; insurance companies are restricted to the business of insurance and such other activities as arise from that; insurance companies are closely regulated and monitored; their solvency and capital requirements are strict; policyholders can seek recompense from the regulator, through the FOS, if their claims are not paid. The FSA may have no interest in the use for which insurance - as it currently is known - is put, but if "insurance" is permitted where there is no interest, would the FSA be equally disinterested? The safeguards have been put in place for an insured with a clear legal interest. Would they be appropriate for lesser or no interests? How, if at all, may the regulator protect policyholders with a lot to lose, if those with not a lot to lose but a lot to gain have the same type of policy with the same insurer?

K Insurers

The Law Commissions acknowledge (7.36) that insurers are reluctant to part with a requirement for insurable interest. They fear what we have set out above, that the industry may slip to the lowest common denominator and policies look more like wagers than insurance. The Commissions also note that though insurable interest has been abolished as a requirement in Australia, it remains for underwriting purposes (7.33). If insurers are not in favour of doing away with the duty of utmost good faith or of providing remedies for breach of warranty other than immediate termination of the insurance, one might accuse them of self-interest, but dispensing with, or relaxing the requirement for insurable interest, facilitating more non-indemnity valued policies on property or life, would provide many more opportunities for insurers. It would be difficult to assert that insurers like the requirement for insurable interest because it enables them to defeat claims. The cases where the defence has been successful are cases where the insured has made a mistake (*Macaura, Deepack*), or is being a little “sharp” (*Anderson v Morice*), or where the insured is protected (*Marc Rowland v Berni Inns*), and are not frequent. The ramifications of dispensing with insurable interest potentially go way beyond a future where an insured goes straight to proving his loss. And if he were to go straight to proving his loss, one may ask a question reminiscent of *Lucena v Craufurd* - whether in reality the insured would prove his loss any differently after the removal of the requirement for insurable interest than before, or whether he would not first describe his interest in the subject-matter, so that the judge could go on to see how the loss of or damage to it might be indemnified.

Appendix B

Name	Firm
Ian Mathers (Chairman)	Allen & Overy
Martin Bakes	Herbert Smith
James Bateson	Norton Rose
Maxine Cupitt	Cameron McKenna
Charles Gordon	DLA Piper
Catherine Hawkins	Berrymans Lace Mawer
Glen James	Slaughter & May
Stephen Lewis	Clyde & Co
Geoff Lord	Kennedys
Martin Mankabady	Lawrence Graham
Kenneth McKenzie	Davies Arnold Cooper
Michael Mendelowitz	Norton Rose
Terry O'Neill	Clifford Chance
Richard Spiller	Edwards Angell Palmer & Dodge
Anna Tipping	Linklaters
Christian Wells	Lovells
Paul Wordley	Holman Fenwick & Willan

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