INSURABLE INTEREST IN MARINE INSURANCE LAW

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ABSTRACT

If an individual wants to insure a property, he/she must have an insurable interest in the property; i.e. loss or damage to the property should affect the person financially. Marine insurance is based on the insurable interest in the property. Although it is important to note that it is not essential for the insured to have an insurable interest at the time of effecting the insurance. Instead, he/she should have such an interest in due course of time. Otherwise, he will not become entitled to indemnification. It is of utmost importance for insurable interest to be present at the time of loss. It could be a defence for insurer not to indemnify the assured if there is an absence of insurable interest. Besides this, the presence of insurable interest distinguishes marine insurance from wager.

In reality, the doctrine of insurable interest, even with its deficiencies, maintains a workable framework and has proven flexible enough to adjust to contemporary commercial demands. A possible solution to get away with the inconsistencies is to reform the law accordingly rather than abolishing it completely due to the benefits associated with maintaining the insurable interest requirement. The paper discusses that despite the fact that marine insurable interest is puzzled with a lot of inconsistencies and ambiguities; the issue is not that severe to completely abolish the well established 200 years doctrine.

KEYWORDS: Insurable Interest, Marine Insurance, Wager, Indemnify, Insurer, Gambling Policies and Policy Proof of Interest (PPI).

1. INTRODUCTION

The fundamental theory of insurable interest seems very simple and logical: a person cannot take out an insurance policy on someone or something unless and until he has a connection to the insured person or thing. This required connection is identified by insurance law as the insurable interest.[1] It is essential to the validity of a contract of marine insurance that the assured has an insurable interest in the subject matter of the marine insurance.

[1] Jacob Loshinal, Insurance Law's Hapless Busybody: A Case Against the Insurable Interest Requirement, 117 YALE L.J. 474, 484 (2007)

The requirement of insurable interest originates in and continues to reflect the fundamental nature of the contract of marine insurance as a contract of indemnity. The insurance would perform its function to afford an indemnity against the loss or damages only if the assured has an insurable interest in the subject matter.[2] Therefore, it could be a defence for insurer not to indemnify the assured if there is an absence of insurable interest.[3]

Besides this, the presence of insurable interest distinguishes marine insurance from wager. The Marine Insurance Act 1906 provided that "every contract of marine insurance by way of gaming or wagering is void".[4] In addition, the Marine Insurance (Gambling Policies) Act 1909 made it an offence to make a contract of marine insurance without an interest. Such contracts are deemed to be a contract by way of gambling on loss by maritime perils, and the person affecting it shall be guilty of an offence.[5]

In the light of the Gambling Act 2005 and its repeal of Section 18 of the Gaming Act 1845, indemnity insurance which includes most forms of property and liability insurance will not be rendered unenforceable due to the lack of an insurable interest. In principle, a gambling contract is not enforceable in insurance cases in spite of the accidental effect of the Gambling Act 2005.[6] Nevertheless, the enactment has triggered concern and a review of whether insurable interest is now redundant in marine and other insurances.

2. CONCEPT OF MARINE INSURABLE INTEREST

2.1. British Law

The Marine Insurance Act of 1906 sought to codify the British law as it stood in 1906, and it now serves as the governing law of British marine insurance. In order to have an insurable interest under MIA 1906, a person must have a "legal or equitable relationship to the subject matter of the insurance and he must also have an economic interest in the subject matter.[7]

The ruling in *Feasy v. Sun Life Assurance Co*[8] of Canada shows that in case of non existence of a gamble or wager at the inception of the contract an economic interest is enough justification for insurable interest and there is no longer the need to abide to the strict legal requirements of the past, in light of modem commercial needs.

In the case of *Linelevel Ltd v. Powszechny Zaklad Ubezpieczen SA, (The Nore Challenger)*[9], the court followed the approach that economic relationships which are conducive to commercial convenience, such as the duty of repair and the loss of hire caused by the need of accomplishment of that duty, are enough to constitute evidence of the existence of an insurable interest, even in cases where an explicit direct legal or analogous relation does not exist.

[2] Lucena v Craufurd, [1806] 2 Bos. & Pul. (NR) 269
[3] Macaura v. Northern Assurance [1925] A.C. 619
[4] Section 4(1), Marine Insurance Act, 1906 (UK)
[5] Section 1(1), Marine Insurance (Gambling Policies) Act, 1909
[6] Chris Nicoll, Insurable interest. as intended?, Journal of Business Law (2008)
[7] Lucena v. Craufurd, (1806) 2 Bos & PNR 269; Macaura v. Northern Assurance Co. Ltd., [1925] AC 619
[8] Feasey v. Sun Life Assurance Co of Canada [200212 A1lE.R. (Comm) 292
[9] Linelevel Ltd v Powszechny Zaklad Ubezpieczen SA, (The Nore Challenger) [2005] EWHC 421(Comm).

2.2. British Gambling Act, 2005

The British Gambling Act 2005 introduced a new provision permitting the enforcement of wagering or gambling contracts except in circumstances in which other laws expressly prohibits such contracts, notwithstanding a rule specifically relate gambling.[10] This provision has raised questions as to whether the Gambling Act 2005 overrides Marine Insurance Act of 1906 given that, technically, gambling policies in the marine context are illegal if they fall outside the scope of the Gambling Act 2005. In addition, the Gambling Act 2005 raises questions regarding whether the common and commercially favoured "policy proof of interest" ("PPI"), a device which was once illegal because it traditionally fell within the definition of a gambling policy, is now legally enforceable.[11]

It is submitted that the Section 335(1) of the 2005 Act does not make enforceable contracts that are otherwise void under Section 4 of the 1906 Act for three reasons. Firstly, the Marine Insurance (Gambling Policies) Act, 1909, makes any such policy as might fall within the definition of gambling in the 2005 Act not merely void, but illegal.[12]

Secondly, while Section 4 of the 1906 Act is couched in terms suggestive of a rule relating to gambling, it is clear from the preamble to the 1745 Act that the rule was originally related not merely to gambling, but also to other perceived iniquities. Accordingly, a contract which is void under section 4 of the 1906 Act is not void merely because it relates to gambling, but also for other reasons of public policy.[13] Thirdly, it is highly unlikely that the courts would interpret the 2005 Act as having overruled s.4 of the 1906 Act by implication, when that was not the expressed intention of the 2005 Act.

2.3. Approaches to define insurable interest

Currently, three competing approaches are used to test whether or not an insurable interest exists in the English law: (1) the legalist approach; (2) the pecuniary interest approach; and (3) the pragmatic commercial approach.

2.3.1. Legalistic Approach

The legalistic approach in defining insurable interest is carved out in Section 5(2) of the Marine Insurance Act, 1906. It provides that an insurable interest in the marine insurance context is "any legal or equitable relation to the adventure or to any insurable property at risk therein, in consequence of which [the insured] may benefit by the safety, or due arrival of insurable property, or may be prejudiced by its loss."[14] Thus, under the legalist approach, simply having an economic interest in the subject matter of the insurance is insufficient to form the basis of a "connection" to that subject matter.[15]

[10] Section 335, Marine Insurance Act, 1906 (UK); Mark Templeman, Insurable Interest: A Suitable Case for Treatment?, in REFORMING MARINE AND COMMERCIAL INSURANCE LAW 187, 195 (2008).
[11] Joseph Bockrath, Insurable Interest in Maritime Law, 8 J. MAR. L. & COM. 258 (1976)
[12] Section 1(1), Marine Insurance (Gambling Policies) Act, 1909; Jonathan Gilman, Arnold's Law of Marine Insurance and Average, 329 (2008)
[13] Cheshire v. Vaughan, [1920] 3 KB 240
[14] Lucena v. Craufurd, (1806) 2 Bos & PNR 269
[15] Macaura v. Northern Assurance Co. Ltd., [1925] AC 619

2.3.2. Pecuniary Approach

This "pecuniary" approach bases an insurable interest solely on pecuniary or economic interests of the insured and not on any legal or equitable relation to the subject matter.[16] The risk of loss is capable to be valued in monetary terms. The approach runs in parallel with the fundamental economic nature of insurance contracts which is to indemnify an assured for pecuniary losses.[17] Compared with the legalistic approach, the pecuniary interest approach defines insurable interest in a less technical and legalistic way and therefore gives a desirable flexibility. It broadens the potential range of legitimate insurance without necessarily undermining considerations of public policy.

2.3.3. Pragmatic Commercial Approach

Although the "Pragmatic Commercial Approach" has yet to be formally established as a distinct approach to defining the insurable interest, the commercial interests of the market have played a unique role in supplementing findings for insurable interests under the pecuniary approach. The emphasis is on looking at the contract of insurance that the parties have entered into in a commercial manner. If the insurance is commercially comprehensible, sensible and justified, there is no reason to justify the law interfering and frustrating the reasonable commercial expectations of the parties, particularly if the agreement is otherwise untainted by fraud or profound considerations of public policy.[18]

The argument behind this possible third approach provides that if the "insurance is commercially comprehensible, sensible and justified; there is little or no reason to justify the law interfering and frustrating the reasonable commercial expectations of the parties.[19] The economic interests in light of commercial needs were enough to establish an insurable interest for a P&I Club seeking to recover reinsurance that did not meet the strict legalist definition of insurable interest.[20]

3. MARINE INSURABLE INTEREST IN INDIA

Every person who is interested in a marine adventure is deemed to have an insurable interest in it.[21] An owner of a ship is interested in its safety. A buyer of a ship becomes interested only when the property has passed to him. As long as the property is with the seller, the buyer does not have any insurable interest in the ship.[22]

A contract of marine insurance made without insurable interest has been expressly declared to be void by way of wagering.[23] Where a Policy Proof of Interest policy was taken by a firm of exporters on their prospective profits, the policy was held to be void in spite of the fact that they did in fact have real interest. The court reasoned: it seems that Parliament has said, "If you put this clause in your policy without more we deem it to be a gaming and wagering policy, because it is a gaming and wagering clause."[24]

[16] Constitution Company of Canada v. Kosmopoulos, (1987) 34 D.L.R. (4th) 208 (Can.)
[17] Rhidian Thomas, Marine Insurance: The Law in Transition, (2006)
[18] Juntan Huang, Approaches to Marine Insurable Interest available at https://lup.lub.lu.se/student-papers/search/publication/3912789 (last visited on March 28, 2015)
[19] Rhidian Thomas, Marine Insurance: The Law in Transition, 37 (2006)
[20] Feasey v. Sun Life Assurance Co. of Canada, [2003] 12 All E.R. (Comm.)
[21] Section 7, Marine Insurance Act, 1963
[22] Piper v. Royal Exchange Assurance, (1932) 44 LIL Rep 103
[23] Section 6, Marine Insurance Act, 1963
[24] Thomas Chesire & Co v. Vaughan Bros & Co., (1920) 123 LT 487

3.1. When interest exists?

The insurable interest should exist at the time of the loss. It is not necessary that it should exist at the time when the policy is affected.[25] When the parties are not aware about the existence or loss of the goods, they are permitted to insure them under a clause "lost or not lost".

The policy is valid and the assured can recover even if he acquires an interest in the goods after they have been lost.[26] But such a policy would be void if the assured, but not the insurer, was aware that the goods have been already lost. Where a person taking out a policy is already aware of the loss and he had no interest at the time of the loss, he cannot acquire interest for the purpose of insurance, by any act done after he became aware of the loss.[27]

3.2. Specific instances of insurable interests

3.2.1. Contingent Interest

A contingent interest is insurable, as also is a defeasible interest.[28] For example, liability for salvage expenses is insurable[29] and also the liability for carriage of passengers.[30] Liability for loss caused by jettison, in case it becomes necessary, is insurable. An instance of a defeasible interest is to be found in a case in which certain goods were shipped to a buyer who insured them, but subsequently rejected them while still on board and the seller resold them to another buyer. The goods were lost. The original buyer was allowed to sue on the policy. The court said that if the plaintiff had an insurable interest at the time that the policy was effected, whatever change may have taken place in the property in the boats since, can have no effect in relieving the underwriters from their liability, as the plaintiff may sue on the policy for the benefit of the party to whom such benefit has passed.

3.2.2. Partial Interest

A partial interest of any nature is insurable.[31] A person having interest in a ship[32], in its cargo[33] or in its freight[34], has a right to insure his interest. In a case it was held that the subject matter of insurance was the one-third loss of freight in consequence of sea-damage, the plaintiffs were entitled to recover from each underwriter such proportion of the amount of the loss as the amount of his subscription bore to the total sum for which the underwriter subscribed the policy.

3.2.3. Reinsurance

The insurer under a contract of marine insurance has an insurable interest in his risk, and may reinsure in respect of it.[35] The original assured will have no right in respect of such reinsurance, unless the policy so

[25] Section 8, Marine Insurance Act, 1963
[26] Sutherland v. Pratt, (1843) 11 M&W 296
[27] Avatar Singh, Law of Insurance 254 (2010)
[28] Section 9, Marine Insurance Act, 1963
[29] Briggs v. Merchant Traders' Ship & Insurance Association, (1849) 13 QB 167
[30] Gibson v. Bradford, (1855) 4 E&B 586
[31] Section 9, Marine Insurance Act, 1963
[32] Stephens v. Australian Insurance Co., (1872) LR 8 CP 18
[33] Robertson v. Hamilton, 104 ER 708
[34] Peise v. Aguilar, 128 ER 201
[35] Section 11, Marine Insurance Act, 1963

provides. This is so for the obvious reason that reinsurance is taken out by an insurer for his own protection. As a group, the international Group of P&I clubs reinsures the risks of its member clubs. Reinsurance contracts, whether reinsuring risks under primary contracts of marine or other risks, are types of insuring contracts but they have peculiar characteristics.[36]

3.2.4. Bottomry and respondentia

The lender of money on bottomry or respondentia has an insurable interest in respect of the loan.[37] He can affect a policy on the ship to the extent of his interest. Although a person may not insure against his debtor's increased difficulty of discharging a debt as a result of loss, he can insure to the extent that a security for the debt is prejudiced. The Act of 1906 also specifically provides that a mortgagee has an insurable interest in respect of any sum due or to become due under the mortgage[38] and that the lender of money on bottomry and respondentia has an insurable interest of his loan[39], the loan not being repayable if the security fails to arrive safely.

3.2.5. Advance Freight

The ship owner has an interest in the freight which he will earn on the successful completion of the voyage.[40] He can insure the risk of his being not able to earn the freight by any accident. This interest arises out of ownership of the ship.[41]Where the freight has been paid in advance, the consignor who has paid the freight in advance gets an insurable interest to the extent of the advance freight but, provided that such freight is not refundable to him in the event of loss. His freight must be at risk and there is no risk if in the event of any loss of goods, the ship owner will be bound to return the freight money. Thus where an advance freight was paid as a kind of loan to the carrier, it was held that the consignor had no insurable interest in such payment.[42]

3.2.6. Interest in Profits

It would be a strange thing if freight could not be the subject of protection by an instrument which had its origin from commerce and was introduced for the very' purpose of giving security to mercantile transactions. It is a solid substantial interest ascertained by contract and arising from labour and capital employed for the purpose of commerce.

The insurance of profits ascertained by positive contract may be equally just and reasonable and is hardly to be distinguished in principle from the case of freight. A mere speculation on profit is not insurable. Thus the profit which a ship owner is likely to earn on the successful completion of a voyage is insurable.

[36] F D Rose, Marine Insurance Law and Practice, 7 (2012)
[37] Section 12, Marine Insurance Act, 1963
[38] Continental Illinuos National Bank & Trust Co of Chicago v. Bathurst, [1985] 1 Llyod's Rep 625
[39] Section 10, Marine Insurance Act, 1906
[40] Section 14, Marine Insurance Act, 1963
[41] Camden v. Anderson, (1794) 5 Term Rep 709
[42] Mansfield v. Maitland, 106 ER 1049

4. CRITICISMS TO THE DOCTRINE OF MARINE INSURABLE INTEREST

Because of the recent developments in law and from historic ambiguities over the precise definition and scope of insurable interest there have been several criticisms over this doctrine. The most common criticisms have been explained below.

4.1. The law is outdated and opaque

One major criticism of the present marine insurable interest doctrine is outdated and needs express revision. For example, critics argue that the Gambling Act 2005, via its interaction with Marine Insurance Act, 1909 has worsened the opaque nature of Act of 1909 by assigning criminal liability to gambling policies.[43] The concern is that in its current state the law would lead to an absurd result, such that the Gambling Act 2005 renders a marine insurance contract enforceable (such as a PPI), even though it lacks insurable interest; yet, under the Act of 1909, such a contract would be a wager and thus deemed a crime.[44]

Additionally, critics argue that the barriers to gambling posed by the insurable interest doctrine no longer provide effective deterrence in the case of sophisticated parties, which now use many tools to circumvent any restrictions that the insurable interest doctrine was intended to establish.[45]

Finally, PPIs, which are now enforceable in Britain under sections 335(1) and (2) of the Gambling Act 2005,6 offer a mechanized tool for sophisticated parties to enter into contracts where there is a commercial practice to insure the risk but it is questionable whether the insurable interest really exists.[46]

4.2. Ambiguities lead to unpredictability and exploitation

The inconsistencies and ambiguities created by legalistic and pecuniary approaches to defining insurable interest have disturbed clarity with regard to the clarity and stability of the legal doctrine of insurable interest. For example, the court in *Macaura* held that a sole shareholder who clearly had a pecuniary interest in the company's timber nonetheless lacked an insurable interest in the timber.[47] On the other hand, in *Wilson's case*, Wilson was a shareholder in a company formed to lay a transatlantic cable and had no personal, proprietary or contractual rights in the cable or the vessel laying the cable. Nonetheless, the court found that Wilson had an insurable interest because he had an interest in the profits derived from the successful completion of the contract.[48]

The inconsistent results in these two cases exemplify the polarization of the approaches adopted by courts in regards to the insurable interest doctrine, and do not represent isolated or unusual decisions.

[43] The English Law Commission and the Scottish Law Commission, Insurance Contract Law: Summary of Responses to Second Consultation Paper, Post Contract Duties and Other Issues, Chapter 3: Insurable Interest, 2013, at § 4.2, available at http://lawcomniission.justice.gov.uk/docs/post-contractduties responses-insurable-interest.pdf (last visited March 27, 2015)
[44] Mark Templeman, Insurable Interest: A Suitable Case for Treatment?, in REFORMING MARINE AND COMMERCIAL INSURANCE LAW 201 (2008)
[45] Sharo Michael Atmeh, Regulation Not Prohibition: The Comparative Case Against the Insurable Interest Doctrine, 32.1 Nw. J. INT'L L. & Bus. 93 (2012)
[46] Joseph Bockrath, Insurable Interest in Maritime Law, 8 J. MAR. L. & COM. 258 (1976)
[47] Macaura v. Northern Assurance, [1925] A.C. 619
[48] Wilson v. Jones, [1867] L.R. 2 Ex. 139

However, due to the law's ambiguity in determining whether an insurable interest exists, in many instances, it is unclear whether or not the insured has an insurable interest, especially in marine insurance.[49]Perhaps the most disagreeable consequence resulting from the ambiguities in testing for insurable interest is the incentive that ambiguities give to insurance companies for exploitation of those seeking insurance by the insurance companies.

4.3. Inefficiencies in the Doctrine

The final major criticism originates from a disconnect between the insurable interest doctrine and the actual prevention of moral hazard. Because the insurable interest doctrine is an imperfect gauge of moral hazard, "it creates a gap between contracts with a legitimately intolerable level of moral hazard and those with a tolerable level but that are nevertheless swept into the insurable interest doctrine's net."[50]

An example of a situation in which the insurable interest doctrine could restrict otherwise-valid commercial practices are when an uninformed, but well-intentioned party takes out an insurance policy that is commercially beneficial and without a motive of moral hazard - such as a father taking a policy out on a boat he purchased for his adult son as a gift to that son. There is no moral hazard in this situation and the arrangement is commercially beneficial to both parties, yet the insurable interest doctrine would invalidate the contract because the father, as a non-owner, has no insurable interest in the son's vessel.

The insurable interest doctrine, when applied too rigidly, may create inefficiencies in the market by prohibiting beneficial commercial practices that do not pose a high risk of moral hazard yet are impermissible under the insurable interest doctrine as it currently exists.

5. CONCLUSION

It is undoubtedly admitted that the doctrine of marine insurable interest is puzzled with a lot of inconsistencies and ambiguities that make it vulnerable to existing as well as potential concerns. But, the issues are not that severe to completely abolish the well established 200 years doctrine.

In reality, the doctrine of insurable interest, even with its deficiencies, maintains a workable framework and has proven flexible enough to adjust to contemporary commercial demands. A possible solution to get away with the inconsistencies is to reform the law accordingly rather than abolishing it completely due to the benefits associated with maintaining the insurable interest requirement.

Moreover, abolishing the insurable interest doctrine would transfer the regulatory function of the law in marine insurance away from notions of insurable interest to the right of recovery under the policy. Although subtle, this change in legal focus would inherently change the underlying legal principle of marine insurance, wherein an individual who had no right to insure something theoretically could collect as long as circumstances eventually show a sufficient nexus or causal link between the insured event and the loss.

[49] Jacob Loshinal, Insurance Law's Hapless Busybody: A Case Against the Insurable Interest Requirement, 117 YALE L.J. 474 (2007)
[50] Id

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