

**The Study of Marine Insurable Interest: A Comparison of Laws in China  
and the United Kingdom**

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## Abstract

The insurable interest doctrine is one of the fundamental principles in insurance law. It has been long established that it can affect whether the contract is void and whether an assured can make a claim. It has played a role in distinguishing insurance contracts from other risk-transferring contracts, preventing wager policies and moral hazards, etc. However, since the nineteenth century, there has been a debate about what can be sufficient to constitute an insurable interest. Also, along with other issues with insurable interest, it has been argued that the requirement is nowadays unnecessary and may have had a negative effect on the assured's position. Thus, the proposals to remove the requirement and to widen the concept of insurable interest, etc. have arisen globally amongst academics, the courts and legal practitioners.

The UK has thus responded to the call for reform by the Law Commissions conducting a review project on insurable interest. They have in detail discussed the problems with insurable interest and then set out arguments for both retaining and repealing it. They then published the proposals for the purpose of clarifying and ascertaining the law on insurable interest. To benefit the discussion on reform in this area of law in the UK, the reform of the law on insurable interest in other countries, such as in Australia, New Zealand and China has also been studied.

Without a deep understanding of the background and theory of insurable interest, it can be difficult to conclude whether it should be retained and which test for it should be adopted. In order to make it clear, the history and pure theory of insurable interest is discussed in Chapters 1 and 2. Chapter 3 then

sets out the problems with the requirement of insurable interest derived from both law and practice. The remaining three chapters, i.e. Chapters 4, 5 and 6 have, from a comparative perspective, introduced the law on insurable interest in indemnity insurance, including marine insurance and relevant reforms. Indeed, other jurisdictions have adopted different approaches to the requirement of insurable interest at the time of contract and its definitions seem to be distinct from those in the UK.

Finally, in conclusion, the core issue will be answered for the purpose of unifying the law on insurable interest in indemnity insurance and promoting the prosperity of the insurance industry: that is, whether the insurable interest is still required nowadays, and, if it is, when it must attach; additionally, whether an economic interest is sufficient to be an insurable interest or whether the legal relation to the subject matter of insurance is still needed.

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## Introduction

The requirement for insurable interest is a fundamental principle in insurance contracts. Assureds failing to comply with the requirement will find their insurance regarded as void. To meet the requirement, the assured must have a real insurable interest or an expectation of acquiring such an interest in the subject matter of the insurance contract at the time of taking out the contract. Besides, in order to make a claim, there must be an actual insurable interest at the time of the loss. This has been clearly provided for in marine insurance contracts under the Marine Insurance Act 1906 (the 1906 MIA).

There is a close connection between wagers and insurance. The elements constituting their definitions are similar and it is believed that insurance is derived from wagers. In the past, insurance was made on purely speculative events, like wagers. It is said that the origin of insurable interest arises from the statutory prohibition on wagers. Thus, before the study of insurable interest, it is necessary to first examine the history of wagers in Chapter 1.

As the fundamental principle in marine insurance, rules on insurable interest in marine insurance, i.e. ss 4-15 of the 1906 MIA, will be discussed in Chapter 2. In particular, the requirement and the classic concept of insurable interest will be looked at, which is the basis for understanding other provisions on insurable interest and for the argument as to whether the requirement should be repealed and whether the classic test is too strict in restricting the marine insurance market.

After a detailed discussion of the law on insurable interest, then the problems with the doctrine are studied in Chapter 3, and the necessity for its reform. As to the problems with the earlier law, the law on insurable interest in non-life insurance was uncertain. Some statutes on insurable interest were also archaic, such as the Life Assurance Act 1774 (1774 LAA), the Marine Insurance Act 1788 (the 1788 MIA) and the Marine Insurance (Gambling Policies) Act 1909 (the 1909 MIA). There is confusion whether the Gambling Act 2005 (the 2005 GA) has an effect on insurance contracts. The UK law was complex because both statute and common law governed insurable interest; the rules under statute were different from each other depending on the categories of insurance; different kinds of insurance applied different rules of insurable interest. It thus needs clarification of the rules of law on insurable interest. In the practice of marine insurance, there also exist many problems, in particular, the buyer on Free On Board (FOB) or like terms cannot cover his pre-shipment loss due to the requirement of insurable interest.

Because of the above problems, there have been calls for reforming the insurable interest requirement in UK and Chapter 4 will study the reasoning. The Law Commission of England and Wales and the Scottish Law Commission have therefore been conducting a joint review of insurance contract law<sup>1</sup> since January 2006 when they published a scoping study to consult on which areas of insurance contract law were in need of reform.<sup>2</sup> As a result of the scoping project, the law on insurance contracts should better balance the interests of the

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<sup>1</sup> The Law Commission and The Scottish Law Commission (Law Commissions), *Issues paper 4: Insurable Interest* (henceforth, 2008 IP 4,) para 1.1;

<sup>2</sup> Law Commissions, *Insurance Contract Law: A Joint Scoping Paper* (Law Com No 353, 2006)

assured and the insurer, reflect the needs of modern insurance practice and allow both assured and insurer to clearly know their rights and obligations.<sup>3</sup> The law of insurable interest has more recently been selected by the Law Commissions in their second paper<sup>4</sup> as one area within the scope of the project.<sup>5</sup> By looking at this reforming project, it is expected that certain problems with insurable interest will be addressed: such as whether the requirement of insurable interest should be repealed, the tests for it and the timing of any repeals, etc.

The Marine Insurance Laws of Australia and New Zealand, including of course the rule on insurable interest, are identical with the UK 1906 MIA. Neither country is satisfied with the requirement of insurable interest and its strict definition. Both countries proposed reforming the law on insurable interest long before the counterpart reform in UK. It is thus meaningful to draw on the experience of the two countries for the reform in the UK and to clarify the relevant issues concerning insurable interest.

Turning to the situation in China, in order to promote the development of the insurance market and better balance the benefits of the parties to contracts of insurance, the Insurance Law, including insurable interest, has been amended several times, as well as the Interpretation and Guidance by the Supreme People's Court. However, the requirement, definition and some of the issues concerning insurable interest are not so clear, and this needs to be explored below. By analysing the methods of reforming insurable interest in the above

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<sup>3</sup> Law Commissions, *Insurance contract law: post contract duties and other issues* (2011 CP) para 1.1

<sup>4</sup> Law Commissions, *Analysis of Responses and Decisions on Scope* (Law Com No 353, 2006)

<sup>5</sup> 2011 CP, para 1.3

countries, the law on insurable interest and the insurance business can be improved.

## Chapter 1 History of Wager Contracts

### 1.1 The history of wager contracts

There is a close connection between the doctrine of insurable interest and the attitudes of the law to wager contracts.<sup>6</sup> The court held that a contract relating to which the assured had an insurable interest was not one of wager. When a judge encountered a case to determine whether or not the plaintiffs were gamblers, the learned judge did not describe the difference between contracts of wager and insurance by means of defining what gambling contracts are; he held that they were not gamblers on the basis that they had an insurable interest in the ships and cargos.<sup>7</sup> The definition of the insurance contract is in turn defined as one having no wager elements. Valid insurance can in consequence be defined as any insurance that does not promote the spreading of wagers.<sup>8</sup> Also, for the purpose of the function of the insurable interest requirement, there is a debate that statutes providing for the requirement of insurable interest aim to forbid the problems caused by moral hazard and gambling.<sup>9</sup> In light of the close connection, it is therefore appropriate to discuss wager policies at inception.

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<sup>6</sup> Jonathan Gilman, Professor Robert M Merkin, Claire Blanchard and Mark Templeman, *Arnould's Law of Marine Insurance* (18th Revised edn, Sweet & Maxwell 2013) 11-03

<sup>7</sup> *Robertson v Hamilton* (1811) 14 East 522 [533]

<sup>8</sup> Malcolm A Clarke, Julian M Burling and Robert L Purves, *The law of insurance contracts* (5th edn, Informa 2006) 132

<sup>9</sup> *2008 IP 4*, para 1.9

### **1.1.1 Difference between gaming, gambling, betting and wagering**

#### **1.1.1.1 Need for first distinguishing gaming, gambling, betting and wagering**

The requirement of insurable interest is a useful tool to distinguish valid insurance policies from unenforceable wager contracts. By studying the history of wager policies, it will be plain as to how wager contracts without an insurable interest operate. Then, turning to its opposite, it will be clear that there is a real necessity for the requirement of insurable interest and that it would thus be helpful to study this doctrine. However, the formulation of “gaming or wagering by insurance” is often referred to when talking about a wager policy in the guise of an insurance contract being void for lack of an insurable interest. It is unfortunately not so easy to tell in detail the difference between “gaming, gambling, betting and wagering”, because they have closely allied meanings. In particular, in terms of the resemblance of gambling to wagering, confusion may occur if there is no distinction made between these two words.

#### **1.1.1.2 A gaming contract under English law**

Generally, the word “games” refers to most pastimes and many sports, irrespective of their lawful or unlawful character. Gaming also means the staking of money or money’s worth on the result of a game of pure chance, or mixed skill and chance; and gambling has the same meaning, with a suggestion that the stakes are excessive or the practice otherwise reprehensible.<sup>10</sup> In the 2005 GA, gambling means:

- gaming
- betting; and

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<sup>10</sup> *Encyclopædia Britannica* (11th edn, 1911) vol 11, 450

- participating in a lottery.<sup>11</sup>

Thus, in order to make it clear what a gambling contract consists of, it is necessary first to investigate what a gaming contract is. In the Gaming Act 1968, gaming means the playing of any game of chance for winning in money or money's worth, whether any person playing the game is at risk of losing money or money's worth or not.<sup>12</sup> In line with this meaning, a gaming contract is one relying on the occurrence of a future event but does not require the parties to the contract to have an insurable interest. In addition to the above definition, the 2005 GA further defines gaming as playing a game relying on a chance excluding a sport for a prize of:

- winning in money or money's worth; and
- both a prize provided by a person organising gaming and winnings of money staked.<sup>13</sup>

Obviously, the former definition is wider than the latter. Under common law, it was held that the playing of any game for money or money's worth was gaming,<sup>14</sup> which included horse-racing,<sup>15</sup> other kinds of racing and some kinds of contest.<sup>16</sup> By comparing these two concepts, it is obvious that common law definitions are wider than statutory definitions, because the latter is limited only to "any game of chance" other than "any game". But both statutory and common law definitions show that the parties to a gaming contract do not have to possess an insurable interest in the subject matter and the purpose of gaming is

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<sup>11</sup> 2005 GA, s 3

<sup>12</sup> Gaming Act 1968, s 52(1)

<sup>13</sup> 2005 GA, s 6(1),(5)

<sup>14</sup> *Dyson v Mason* [1889] LR 22 QB 351 (QB) 356; *Patten v Rhymer* (1860) 121 ER 345 [5]; *Ellesmere v Wallace* [1929] 2 Ch 1 (Ch) 55; *Ankers v Bartlett* [1936] 1 KB 147 (KB) 152

<sup>15</sup> *Applegarth v Colley* (1842) 152 ER 663, 666

<sup>16</sup> Professor Hugh Beale, *Chitty on Contracts* (vol II, 32th edn, Sweet & Maxwell 2016) 41-004

to win a prize rather than to transfer a risk for which insurance has been designed. Apart from gaming being one part of gambling under the 2005 GA, the difference between gaming and gambling was set out as follows: to put it simply, the former meant joy, pleasure, sports or gaming; while the latter meant to play extravagantly for money.<sup>17</sup>

#### *1.1.1.3 Difference between gaming and wagering*

A gaming contract differs from a wagering contract. The definition of a wager contract is that one party to the wager has promised to pay the other party depending on the result of an uncertain event. To become a contract of gaming, participants have to take part in a game for the prize. More importantly, more than two parties can be allowed to participate in a gaming contract,<sup>18</sup> whereas there can only be two parties to a wager contract. Albeit a wager can be made upon the outcome of a game and the parties to this wager seemingly take part in the game, such a game is not necessarily to be regarded as a wager. In other words, even though a wager is placed on the outcome of a game, it can still not be regarded as a wager if more than two parties have taken part in this game or if no party will have to win or lose.<sup>19</sup> In order to constitute a wager, four elements have to be satisfied, which will be discussed below in the concept of a contract of wager.

#### *1.1.1.4 Betting and lottery*

As to the concept of betting, it is a wider definition under the 2005 GA than that of a wager because one party to a bet may now bet on a certain event which

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<sup>17</sup> John Ashton, *The History of Gambling in England* (London: Duckworth 1898) 15

<sup>18</sup> Professor Hugh Beale, *Chitty on Contracts* (vol II, 32th edn, Sweet & Maxwell 2016) 41-004

<sup>19</sup> Professor Hugh Beale, *Chitty on Contracts* (vol II, 32th edn, Sweet & Maxwell 2016) 41-004

can be controlled by the other party.<sup>20</sup> It in detail means making or accepting a bet on:

- the outcome of an event
- the likelihood of anything occurring or not occurring; or
- whether anything is or is not true.<sup>21</sup>

In spite of the above definition, it has been argued that it is “self-referential and unhelpful”. Thus, it has been submitted that the person making the bet must normally pay a stake in order to participate in the bet; and that a person accepting a bet undertakes that he will make a payment to the person making the bet if that person’s forecast or assertion on the event listed above happens.<sup>22</sup> It is obvious that betting on the outcome of a future event includes wagering policies, although a bet is commonly restricted to a wager on events relating to sports or games. Because betting is one kind of gambling, gambling of course includes wagering policies.<sup>23</sup>

In general, lottery means speculation to obtain prizes by lot or chance. Under the 2005 Act, an arrangement will be a lottery if it satisfies one of the descriptions of a lottery in ss 14(2) and (3) of the Act. Section 14(2) sets out what a simple lottery is: it is an arrangement in the course of which one or more prizes allocated by a process wholly relying on chance will be allocated to one or more members who have paid so as to take part in the arrangement. Section 14(3) provides for the definition of a complex lottery: a series of processes, not

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<sup>20</sup> Professor Hugh Beale, *Chitty on Contracts* (vol II, 32th edn, Sweet & Maxwell 2016) 41-004

<sup>21</sup> 2005 GA, s 9(1)

<sup>22</sup> Professor Hugh Beale, *Chitty on Contracts* (vol II, 32th edn, Sweet & Maxwell 2016) 41-005

<sup>23</sup> Jonathan Gilman, Professor Robert M Merkin, Claire Blanchard and Mark Templeman, *Arnould’s Law of Marine Insurance* (18th Revised edn, Sweet & Maxwell 2013) 11-10; see 1.1.1.5 below

just one process, which will allocate the prize, and the first of the process of the allocation wholly relies on chance.

#### *1.1.1.5 The same meaning in the specific context*

Although, in the 2005 GA, the definition of gambling, gaming or betting does not refer to the term of wager, there are some similarities between the definition of a bet under the 2005 GA, which is a type of gambling, and that of a wager at common law.<sup>24</sup> One element of a bet is the likelihood of anything occurring or not occurring and betting is thought of as a special type of wagering.<sup>25</sup> With the mutual intention in both betting and wagering, one party promises to pay the other party on the occurrence of some event or situation.<sup>26</sup> Additionally, neither party should have an interest in the subject matter other than the stake itself. The scope of the concept of betting (and hence gambling<sup>27</sup>) under the Act is otherwise different from that of a wager at common law. The former does not include insurance contracts,<sup>28</sup> an activity regulated under s 22 of the Financial Services and Market Act 2000.<sup>29</sup>

Therefore, in the ambit of sham insurance, gaming, gambling, betting and wagering could be understood as a promise to win or lose for money upon the happening of a future uncertain event<sup>30</sup> in which no party has an interest in the subject matter other than the stake. When gambling is referred to, it should be restrictively interpreted as wagering. In other words, gambling contracts refer

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<sup>24</sup> Professor Hugh Beale, *Chitty on Contracts* (vol II, 32th edn, Sweet & Maxwell 2016) 41-004

<sup>25</sup> John Ashton, *The History of Gambling in England* (London: Duckworth 1898) 150

<sup>26</sup> For the event or situation as to a bet, see 2005 GA, s 9(1)

<sup>27</sup> 2005 GA, s 3

<sup>28</sup> Financial Services and Market Act 2000, schedule 2, 2(2)

<sup>29</sup> Professor Hugh Beale, *Chitty on Contracts* (vol II, 32th edn, Sweet & Maxwell 2016) 41-003, 41-003

<sup>30</sup> Ernest W Huffcut, *Principles of the Law of Contract* (8th edn, New York and Albany: Banks & Bros 1897) 228

only to those contracts aiming to win money on the occurrence of a future uncertain event in which the assured has no insurable interest<sup>31</sup> in the insured subject. Tindal CJ expressed the similar idea that gambling only referred to gambling in the guise of insurance wherein the parties had no insurable interest in the subject matter.<sup>32</sup> Also, gaming could be understood as wager from the preamble of the Life Assurance 1774 LAA,<sup>33</sup> which is still in force,<sup>34</sup> where the meaning of wager, i.e. in the guise of insurance contracts without insurable interest, was regarded as not only a kind of gaming but also mischievous.<sup>35</sup> Similarly, a class of<sup>36</sup> gaming or wagering contracts were deemed ones where the assured has neither an insurable interest nor any expectation of obtaining such an interest in the future uncertain event apart from the stake to win or lose.<sup>37</sup>

In short, in the context of discussing an insurance contract being void for lack of an insurable interest, the terms of gaming, gambling, betting and wager could be regarded as synonymous. Therefore, a contract where the parties have no interest in the insured subject matter is a bet or wager;<sup>38</sup> and the premise clarifies the confusion about the detailed distinctions of these terms.

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<sup>31</sup> *Feasey v Sun Life Assurance Co* [2002] Lloyd's Rep IR 807 [163]

<sup>32</sup> *Paterson v Powell* [1832] 9 Bing 320 [320], [ 327]

<sup>33</sup> 14 Geo. 3, c. 48, also known as the Gambling Act 1774

<sup>34</sup> Robert Surridge, Noleen Dignan, Sara Forrest, Alison Broadberry and Duncan Backus, *Houseman and Davies: Law of Life Assurance* (11th edn, Butterworths 1994) 17

<sup>35</sup> The preamble of the 1774 LAA

<sup>36</sup> The other class is terms with PPI wording.

<sup>37</sup> 1906 MIA, s 4(2)(a)

<sup>38</sup> Jonathan Gilman, Professor Robert M Merkin, Claire Blanchard and Mark Templeman, *Arnould's Law of Marine Insurance* (18th Revised edn, Sweet & Maxwell 2013) 11-02

## 1.1.2 Life insurance's abuse in the period leading up to the 1774 LAA

### 1.1.2.1 Brief history of life insurance

Life insurance originated in the Mediterranean around the fifteenth century, and was used to insure passengers' or slaves' lives during overseas marine voyages.<sup>39</sup> About one hundred and fifty years later, Italian merchants had introduced life insurance into England. Although there is a long history of life insurance in England, prior to the eighteenth century, most British people were not familiar with the idea of insurance.<sup>40</sup>

Although life insurance did not originate from England, wager policies on life insurance entirely originated and developed in England<sup>41</sup>. The English were often passionate about the practice of wager policies in the guise of life insurance. As regards the location for wagering, although it was not uncommon to see people wagering at dinner parties and in gentlemen's clubs, the British mainly wagered at insurance offices.<sup>42</sup>

In the eighteenth century, gambling by means of life insurance was extremely prevalent in England.<sup>43</sup> The subject matters for gambling in the guise of life insurance were surprisingly wide by the early years of the eighteenth century,

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<sup>39</sup> Geoffrey Wilson Clark, *Betting on Lives: The Culture of Life Insurance in England, 1695-1775* (Manchester University Press 1999) 13

<sup>40</sup> Geoffrey Wilson Clark, *Betting on Lives: The Culture of Life Insurance in England, 1695-1775* (Manchester University Press 1999) 4

<sup>41</sup> Geoffrey Wilson Clark, *Betting on Lives: The Culture of Life Insurance in England, 1695-1775* (Manchester University Press 1999) 49

<sup>42</sup> Geoffrey Wilson Clark, *Betting on Lives: The Culture of Life Insurance in England, 1695-1775* (Manchester University Press 1999) 49

<sup>43</sup> Geoffrey Wilson Clark, *Betting on Lives: The Culture of Life Insurance in England, 1695-1775* (Manchester University Press 1999) 7

such as “a marriage, a birth, or the fall of a besieged city” or even “highway robbery, lying in conversation, cuckoldry, or death by drinking gin” for a time.<sup>44</sup>

### *1.1.2.2 The abuse of life insurance wager*

By the eighteenth century, wager policies by life insurance flourished and represented a large proportion of the insurance market.<sup>45</sup> As a matter of fact, there was a booming market of wagering policies throughout the first three quarters of the eighteenth century until the passage of the 1774 LAA.<sup>46</sup> It was common to see a British person daily taking out wager policies in the guise of insurance upon personalities’ life in which the policyholder had no insurable interest and on the chances of public events.<sup>47</sup> The public were enthusiastic about wagers upon peoples’ longevity, and it was immoral to hope for the death of the persons wagered upon for the claim.<sup>48</sup>

However, despite the undeniable popularity of wager by life insurance, those unscrupulous wagers upon third parties’ lives brought about many mischiefs. Wager had even been made upon whether George II could stay alive from the Dettingen battle.<sup>49</sup> Besides, it would not be surprising to open a wager on the current parliament election or dissolution within one year.<sup>50</sup> The preamble of the 1774 LAA indicates such problems as follows:

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<sup>44</sup> Geoffrey Wilson Clark, *Betting on Lives: The Culture of Life Insurance in England, 1695-1775* (Manchester University Press 1999) 1

<sup>45</sup> Geoffrey Wilson Clark, *Betting on Lives: The Culture of Life Insurance in England, 1695-1775* (Manchester University Press 1999) 44

<sup>46</sup> Lucy Stuart Sutherland, *A London Merchant, 1695-1774* (Oxford University Press 1933) 49

<sup>47</sup> Samuel Marshall, *A Treatise on the Law of Insurance* (vol 1, Manning and Loring 1805) 672

<sup>48</sup> Welford, *Insurance Guide and Handbook* (4th edn, 1901) 27-28

<sup>49</sup> John Francis, *Annals, Anecdotes and Legends: A Chronicle of Life Assurance* (Spottiswoodes and Shaw 1853) Chap IX

<sup>50</sup> John Francis, *Annals, Anecdotes and Legends: A Chronicle of Life Assurance* (Spottiswoodes and Shaw 1853) 147

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

Although the preamble did not state what exact kind of pernicious gaming had been introduced by wager policies by life insurance, generally speaking, as far as the eighteenth century is concerned, prior to the first half, objections were mainly focused on the problems of fraud and crime.<sup>51</sup> During the second half, many had realised the inherent defect of wager policies: that it was deemed as moral degeneracy.<sup>52</sup> Professor Merkin QC described “a mischievous kind of gaming” which had brought miserable outcomes as follows:

“The duration of lives of persons believed to be on their death bed was a common hazard, and the dissolution of persons, who saw themselves insured in the Public papers at 90%, was, not unlikely, hastened by such announcement.”<sup>53</sup>

The problems arising from fraud and crime were not uncommon in the eighteenth century. As to fraud, speculators would choose to insure those who were physically not in good condition. As a result, it was unfair to the policyholder who was not involved in fraud since they could recover less when the events insured against occurred. The underwriter would also encounter many more losses because they had to deal with more claims due to the fraud

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<sup>51</sup> Geoffrey Wilson Clark, *Betting on Lives: The Culture of Life Insurance in England, 1695-1775* (Manchester University Press 1999) 52

<sup>52</sup> Geoffrey Wilson Clark, *Betting on Lives: The Culture of Life Insurance in England, 1695-1775* (Manchester University Press 1999) 52

<sup>53</sup> R Merkin, ‘Gambling by Insurance - A study of The Life Assurance Act 1774’ (1980) 9 Anglo-Am 331, 332

of those deliberately insuring persons who were ill.<sup>54</sup> This could be illustrated by the judgement of Langley J. in the case of *Feasey*.<sup>55</sup> He stated that gambling was undermining the security of insurance companies and may have contributed to the passage of the 1774 LAA, because the aim of the Act to protect life insurers was clear.<sup>56</sup> As for the evil of promoting crime, in order to successfully claim for recovery or get stakes, a policyholder having no interest in the insured lives could perpetrate a crime to hasten the claim.<sup>57</sup> For example, in 1794, in the village of Berkley, Mary persuaded her husband, William Reed, to insure his life and she was later accused of being involved in Reed's death when she tried to recover the insurance money.<sup>58</sup>

People began to believe that wager by life insurance had inherent vice and in consequence such wager policies were violently deplored after the mid-eighteenth century.<sup>59</sup> Rapid growth in the numbers of wager policies of insurance on third parties' lives were denounced as "proof of the degeneracy of the time".<sup>60</sup> Taking part in contracts of wager was additionally harmful for the increasing of production of the whole society since the purpose of wager contracts was to win money without having to work, which inevitably resulted in

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<sup>54</sup> William Whiston, *An Account of the Past and Present State of the Amicable Society for a Perpetual Assurance office* (London, 1732) 5

<sup>55</sup> *Feasey v Sun Life Assurance Co* [2002] Lloyd's Rep IR 807 [162]

<sup>56</sup> Robert Surridge, Noleen Dignan, Sara Forrest, Alison Broadberry and Duncan Backus, *Houseman and Davies: Law of Life Assurance* (11th edn, Butterworths 1994) 26

<sup>57</sup> John Richardson, *Some Remarks and Considerations on the Original and Supplemental Charters, which Incorporate the Amicable Society for a Perpetual Assurance office* (London, 1732) 8-9

<sup>58</sup> Katherine D Watson, *Poisoned Lives: English Poisoners and Their Victims* (1st edn, Hambledon Continuum 2006) 107-108

<sup>59</sup> Geoffrey Wilson Clark, *Betting on Lives: The Culture of Life Insurance in England, 1695-1775* (Manchester University Press 1999) 51-52

<sup>60</sup> John Francis, *Annals, Anecdotes and Legends: A Chronicle of Life Assurance* (*Spottiswoodes and Shaw 1853*) 147

idleness.<sup>61</sup> Wager was also said to have dishonoured the insurance industry because of the nature of wager.<sup>62</sup> In 1770, two young men wagered whose father would live the longer.<sup>63</sup> This notorious case inflamed the British public's outrage. The mischiefs caused by wager, whether it be fraud, crime or wager itself, they all contributed to the legislature passing the 1774 LAA.<sup>64</sup>

### *1.1.2.3 Reasons for the abuse of life insurance wager*

Three factors brought about the rapid growth in the numbers of wager policies by life insurance as follows:

- the development of the insurance industry
- no prohibition by English law
- the insurer not inquiring the existence of insurable interest

First, owing to the progress of material conditions in England,<sup>65</sup> the insurance industry had made such great improvement that lots of undesirable risks had been brought under control.<sup>66</sup> Paradoxically, due to the elimination of controllable risks, the British were rather keen on risk-taking, just as wager contracts had revealed.<sup>67</sup> Therefore, the passion for speculation, like the

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<sup>61</sup> Edwin W Patterson, 'Insurable Interest in Life' (1918) 18 CLR 381, 386

<sup>62</sup> John Weskett, *A Complete Digest of the Theory, Laws, and Practice of Insurance: Compiled from the Best Authorities in Different Languages* (Frys, Couchman, & Collier: and sold by Richardson & Urquhart; J Sewell; Whieldon & Waller; and W Flexney, 1781) lv-lvi

<sup>63</sup> *Earl of March v Pigot* (1771) 5 Burrow 2802, 98 ER 471

<sup>64</sup> Samuel Marshall, *A Treatise on the Law of Insurance* (vol 1, Manning and Loring 1805) 672

<sup>65</sup> Geoffrey Wilson Clark, *Betting on Lives: The Culture of Life Insurance in England, 1695-1775* (Manchester University Press 1999) 2

<sup>66</sup> Geoffrey Wilson Clark, *Betting on Lives: The Culture of Life Insurance in England, 1695-1775* (Manchester University Press 1999) 40

<sup>67</sup> Geoffrey Wilson Clark, *Betting on Lives: The Culture of Life Insurance in England, 1695-1775* (Manchester University Press 1999) 4

popularity of wager policies, had been stimulated by the practice of insurance in the eighteenth century.<sup>68</sup>

Secondly, English law contributed much to the popularity of wager in the guise of life insurance, since underwriting life policies on third parties under which the policyholder had no insurable interest, remained unrestricted by law, neither at common law nor by statutes, until the passage of the 1774 LAA.<sup>69</sup>

Thirdly, underwriters made it easy for an assured, who had an insurable interest or not, to make wager policies on third parties' lives, because they seldom inquired about the grounds for taking out such policies.<sup>70</sup> Just as Nicolas Magens commented: ".....in London people take the liberty to make insurances on any one's life without exception; and the insurers seldom enquire much if there are good or bad reasons for such an insurance".<sup>71</sup>

#### *1.1.2.4 The effect of the 1774 LAA*

The effect on wager policies by life insurance of the 1774 LAA could be illustrated by the analysis arising out of the two betting books, which involved a variety of wagers, separately kept at the well-known gentlemen's clubs of St James's – White's and Brook's. Although there were statutes regulating wager

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<sup>68</sup> Geoffrey Wilson Clark, *Betting on Lives: The Culture of Life Insurance in England, 1695-1775* (Manchester University Press 1999) 4

<sup>69</sup> Geoffrey Wilson Clark, *Betting on Lives: The Culture of Life Insurance in England, 1695-1775* (Manchester University Press 1999) 49

<sup>70</sup> James Allan Park, *A System of the Law of Marine Insurances, with Three Chapters on Bottomry; on Insurance on Lives; and on Insurance against Fire* (4th edn, A Strahan 1800) 490

<sup>71</sup> Nicolas Magens, *An Essay on Insurances* (J Haberkorn, and sold by W Baker 1755) vol 1, 32-3

or gambling, general wager policies, other than those relating to marine insurance and life insurance, remained valid until the enactment of the 1845 Gambling Act (1845 GA); and, before the 1774 LAA, no law then existed to prohibit wager in the guise of insurance on life. First, taking the figures in the betting book at White's from October 1743 to April 1752, of the first 150 wagers, such policies on births and deaths of human lives collectively represented 52 per cent.<sup>72</sup> In comparison, by analysing the figures in Brook's betting book spanning the mid-1770s, 29 per cent of 117 wagers concerned deaths or lives.<sup>73</sup> Therefore, comparing vertically, wager policies upon death or life decrease from 52 per cent to 29 per cent; comparing horizontally, wagers upon death or life decline from over half of all the wagers to only 29 per cent of all wager policies. It was clear that wager policies by life insurance had been effectively prohibited because of the passage of the 1774 LAA which ruled that life insurance policies without insurable interest, namely wager policies, shall be null and void<sup>74</sup>.

### 1.1.3 Marine insurance's abuse in the period leading up to the Marine Insurance Act 1745 (1745 MIA)<sup>75</sup>

It was common to see a marine policy inserting "interest or no interest" in the eighteenth century. In the case of *Sadlers' Co v Badcock*<sup>76</sup>, Lord Hardwicke briefly introduced the history of wager policies of marine insurance written on "interest or no interest". His Lordship said that insurance on ships was as old as the laws of Oléron in the twelfth century

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<sup>72</sup> Figures calculated and examples taken from William Biggs Boulton, *The History of White's*, vol 2: *The betting Book of White's* (London 1892) 1-26

<sup>73</sup> Geoffrey Wilson Clark, *Betting on Lives: The Culture of Life Insurance in England, 1695-1775* (Manchester University Press 1999) 50

<sup>74</sup> 1774 LAA, s 1

<sup>75</sup> I.e. 19 Geo. 2. c. 37, the scope of which extended to all of Great Britain

<sup>76</sup> *Sadlers' Co v Badcock* (1743) 2 Atk 554 [556]

and Rhodes about the tenth century BC but wager policies without interest however first began in the Spanish trade. Whereas marine policies were intended to avert any damages or loss the assured might sustain, wager policies of marine insurance termed with “interest or no interest” were used in order to dispense with proof of insurable interest and to benefit from such sham policies. In the case of *Dalby*,<sup>77</sup> the judge set out that policies of insurance against fire and against marine risks were then both good indemnity contracts which were made with the intention of indemnifying the losses the assured had suffered in the subject matter insured. Policies on maritime risks were afterwards used improperly, and people made mere wagers on the happening of those perils.

The reasons for the popularity of wager policies on marine risks may be as follows: firstly, the assured tried, by averting proof of insurable interest, to successfully carry on contraband trade and benefit by destroying ships which were then called fraudulent policies;<sup>78</sup> secondly, prior to the 1745 MIA and the 1774 LAA, under common law, wager contracts of all kinds were valid; thirdly, before the 1745 MIA, though the common law leaned strongly against these policies for some time, due to them being beneficial to merchants, the court rendered them valid.<sup>79</sup> In conclusion, due to the tacit acceptance by the court and the lack of relevant statutes to ban wager policies prior to the 1745 MIA, problems attributable to the abuse of such wagers increased.

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<sup>77</sup> *Dalby v India and London Life Assurance Co* (1854) 15 CBP 365 [387]

<sup>78</sup> *Sadlers' Co v Badcock* (1743) 2 Atk 554 [556]

<sup>79</sup> *Sadlers' Co v Badcock* (1743) 2 Atk 554 [556]

Insurance companies then effected policies exceeding the bounds of their respective fortunes. The general British public were also fanatical about and addicted to wagers, leading to degeneracy among those of a lower class and suicide and disgrace among the nobility.<sup>80</sup> This had occasioned moral objections to the abuse of wager policies.<sup>81</sup> Patterson expressed strong social objections in detail:

“More specifically, unearned gains lead to idleness, and the wagerer becomes a social parasite. On the moral side, idleness leads to vice; and the impoverishment of the loser entails misery, and, in its consequence, crime.”<sup>82</sup>

## 1.2 The early statutory measures against gambling

It has been stated that the progress of the development of the statutes as to contracts of gambling can be divided into two stages.<sup>83</sup> The first stage is prior to the passage of the 2005 GA<sup>84</sup>. Under the Gaming Acts of 1710 and 1835, restriction had been imposed on credit for gaming. The 1845 GA makes contracts of gaming and wagering void and the Gaming Act 1892 invalidated certain transactions in relation to such contracts.<sup>85</sup> The second stage is after the 2005 GA, in which the legislation relating to gambling before the Act was repealed;<sup>86</sup> this was done by stipulating that a contract related to gambling can

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<sup>80</sup> William Blackstone, *Commentaries on the Law of England* (1st edn, Clarendon Press 1765-1769) vol 4, 171

<sup>81</sup> Professor Robert M Merkin, *Colinvaux's Law of Insurance* (11th edn, Sweet & Maxwell 2016) 4-001

<sup>82</sup> Edwin W Patterson, 'Insurable Interest in Life' (1918) 18 CLR 381, 386

<sup>83</sup> Professor Hugh Beale, *Chitty on Contracts* (vol II, 32th edn, Sweet & Maxwell 2016) 41-001

<sup>84</sup> Discussed, below

<sup>85</sup> Professor Hugh Beale, *Chitty on Contracts* (vol II, 32th edn, Sweet & Maxwell 2016) 41-001

<sup>86</sup> 2005 GA, s 334(1), s 356

be enforced,<sup>87</sup> in spite of two exceptions that an unlawful gambling contract is by virtue of s 335(2) possibly unenforceable and the Gambling Commission may under s 336 have power to void certain bets. The insurable interest requirement may be imposed in three distinct ways: statutes as to insurance, statutes as to wager and the indemnity principle in contracts of marine insurance which has the nature of indemnity.<sup>88</sup> Such statutes will be hereinafter examined.

### 1.2.1 Legislation against gaming and gambling contracts of types other than insurance

Prior to the eighteenth century, the beginning point when statutes interfered in the playing of games was probably in 1389; their purposes as with later statutes were to govern games or gaming in archery and other manly sports.<sup>89</sup> Such legislation otherwise did not relate to a wager contract under which parties, who had no interest in the subject other than the stake, would stake money on the occurrence of an uncertain event.

Gambling was for the first time prohibited by an Act in 1541<sup>90</sup> with the purpose of maintaining archery by suppressing certain games and preventing gambling which had caused social problems of impoverishment, crime and neglect of divine service.<sup>91</sup> In 1621, an anti-gambling act was passed to prohibit lotteries.

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<sup>87</sup> 2005 GA, s 335(1)

<sup>88</sup> The Australian Law Reform Commission, *Insurance Contracts (ALRC Report No 20 1982)* (hereinafter, *ALRC 20*) para 107

<sup>89</sup> A statute in the reign of Richard II. in 1388 which renders some kinds of games unlawful and were stopped; II Hen. IV. c. 4 in 1409 stipulated more drastic rules on games; 17 Edw. IV. c. 3 in 1477 on penalties to unlawful games which parties played on their premises; 33 Hen. VIII. c. 9 in 1541 which is an act for the maintenance of artillery, and debarring unlawful games

<sup>90</sup> 33 Hen. VIII. c. 9 in 1541

<sup>91</sup> Malcolm A Clarke, Julian M Burling and Robert L Purves, *The law of insurance contracts* (5th edn, Informa 2006) 133

Although for a long time wager contracts were at common law valid, legislation had tried to interfere in wager other than wager policies on insurance. Statutes were not aimed to govern wager until the passage of 16 Car. 2, c. 7<sup>92</sup> with the purpose of preventing fraudulent and excessive gaming. Accordingly, the party who won, by gaming or betting on the sides or hands of the players, was not entitled to recover a debt arising from such gambling, and wagers in excess of £100, and securities for the debt, were also void.<sup>93</sup> Gaming such as cock-fighting, horse-races, dog-matches...or games whatsoever were banned by 16 Car. 2, c. 7. As a result, wagers upon such subjects would be held illegal. The Act of 9 Anne, c.19,<sup>94</sup> the modern statute against gambling and wager, was afterwards passed, with the similar object of better preventing “fraudulent and excessive gambling and betting at games or sports”. The first section of the Act rendered void securities for such wagers for any amount and diminished the sum for which a loser could sue to £10. Therefore, gaming, gambling or wagering in general, not falling within these Acts, would not be held void.<sup>95</sup> In other words, it was lawful to wager upon subjects which had not been prohibited by the two Acts.

However, Parliament did not intervene in wager policies of insurance other than the foregoing wager contracts of other types until the eighteenth century. The 1745 MIA for the first time prohibited marine insurance by way of gaming or wagering; and the 1774 LAA also directly made wager policies on life insurance void.

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<sup>92</sup> Gaming Act 1664

<sup>93</sup> Reuven Brenner and Gabrielle A Brenner, *Gambling and Speculation: a Theory, a History and a Future of some Human Decisions* (Cambridge University Press 1990) 59

<sup>94</sup> Gaming Act 1710

<sup>95</sup> *Danvers v Thistlewaite* (1669) SC 1 Sid 394

After the eighteenth century, the legislature had already intervened in gambling and few of them governed wager contracts of policies on insurance and of other types. In 1708, for the purpose of the war against France, an Act of 7 Anne c. 16 was temporarily passed to avoid wagers and securities relating to the war.<sup>96</sup> Numerous statutes regulating gambling had been passed between 1710 and 1892. Two Acts were passed aiming to restrict credit for gaming,<sup>97</sup> which was also reflected in a later Act.<sup>98</sup> All contracts by way of gaming or wagering<sup>99</sup> (which will be discussed below in detail) and promises to repay sums paid under such contracts<sup>100</sup> were later made void. Besides, “excessive and deceitful Gaming” had been directed against such gaming by the Act of 12 Geo. II. c. 28<sup>101</sup> and 18 Geo. II. c. 34,<sup>102</sup> and the latter one was passed because of the ineffectual prevention of such gaming. The 2005 GA then made gambling valid contracts by repealing s 18 of the 1845 GA. The foregoing Acts related to gambling otherwise did not affect wager policies of insurance except the 1845 GA which indirectly made all contracts by way of gaming or wagering void.

After the eighteenth century, even though there were a number of Acts governing gambling and wagering, the foregoing Acts of 1745, 1774 and 1845 related to wager policies of insurance. In addition, s 4(1) of the 1906 MIA further provided every contract of marine insurance by way of gaming or wagering as

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<sup>96</sup> *Encyclopædia Britannica* (11th edn, 1911) vol 11, 450

<sup>97</sup> Gaming Acts 1710 and 1835

<sup>98</sup> Gaming Act 1968, s 16

<sup>99</sup> Gaming Acts 1845, s 18; This may be cited as 8 & 9 Vict. c. 109.

<sup>100</sup> Gaming Acts 1892, s 1

<sup>101</sup> Gaming Act 1738

<sup>102</sup> Gaming Act 1744

void. The 2016 Draft<sup>103</sup>, the ambit of which does not include marine insurance, then also made wager policies on non-life insurance contracts void.

## 1.2.2 Acts against gambling in the form of insurance

### 1.2.2.1 The Marine Insurance Acts

#### 1.2.2.1.1 The 1745 MIA<sup>104</sup>

##### 1.2.2.1.1.1 Scope of the Act

The 1745 MIA was an Act with the purpose of imposing a prohibition on wagers by marine insurance in the scope of British ships and merchandise. Wager policies in the guise of marine insurance, however, could legally be made at liberty at common law upon foreign vessels, merchandise carried therein, British privateers, and merchandise carried from Spanish and Portuguese possessions in Europe or America, which was beyond the scope of the Act.<sup>105</sup>

##### 1.2.2.1.1.2 Effects of wager policies by marine insurance under the 1745 MIA

It may not be very clear as to the effect of breaching s 1 of the 1745 MIA which renders wager policies on marine insurance null and void. A policy insuring cash advances on a ship subject to terms which can render policies itself proof of interest (PPI clauses) was held to be void under the Act.<sup>106</sup> Also, the court held that the Act would avoid a policy inserted into PPI clauses (PPI policy) dispensing with proof of insurable interest.<sup>107</sup> On the other hand, pursuant to Bankes LJ's dictum, the 1745 MIA made PPI policies illegal because making such policies was against public policy.<sup>108</sup> Scrutton LJ expressed the same

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<sup>103</sup> Law Commissions, *Draft Insurable Interest Bill for Consultation (2016) (2016 Draft)*

<sup>104</sup> 19 Geo. 2, c. 37; Short Titles Act 1896 (59 & 60 Vict. c. 14)

<sup>105</sup> *Thellusson v Fletcher* (1780) 1 Doug 315; *Lucena v Craufurd* (1806) B & PNR 269 [322] (foreign ships and cargoes); *Da Costa v Firth* (1766) 4 Burr 1966 (Portuguese bullion)

<sup>106</sup> *Berridge v Man on Insurance Co* (1887) 18 QBD 346 (AC) 348

<sup>107</sup> *Murphy v Bell* (1828) 4 Bing 567

<sup>108</sup> *Cheshire v Vaughan* [1920] 3 KB 240 (AC) 251

opinion in the same case.<sup>109</sup> Arnould similarly set out that a wager policy on British ships and their cargoes shall be illegal under the Act.<sup>110</sup> Anyway, the court would not enforce such policies any more.

#### *1.2.2.1.1.3 Objects of the Act*

By the beginning of the eighteenth century, wager contracts in the guise of marine insurance could be enforced by the courts at common law, even though the assured had no insurable interest in the subject matter.<sup>111</sup> To suppress such practices, the Act for the first time stipulated the requirement of insurable interest in English statute<sup>112</sup> and directly prohibited wager policies by way of marine insurance.<sup>113</sup> Its preamble however shows that guarding against wagering policies is not the sole object, but the Act is perhaps mainly designed to prohibit evils such as the assured carrying on illegal traffic and making insurance the means of gaining (or fraudulent destruction).<sup>114</sup> For this purpose, Best CJ stated in *Murphy*<sup>115</sup> case that:

“The preamble of the Act shows that gaming was the least of the evils that the legislature proposed to remedy. Adventures on which gambling policies might be made but which were not likely to be undertaken for the other purposes which it was the object of the statute to prevent, are exempted from its operation. The preamble states that policies of insurance with clauses of interest or no interest, or such as in case of loss made the policies sufficient proof of interest, were used to protect persons who were

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<sup>109</sup> *Cheshire v Vaughan* [1920] 3 KB 240 (AC) 252

<sup>110</sup> Jonathan Gilman, Professor Robert M Merkin, Claire Blanchard and Mark Templeman, *Arnould's Law of Marine Insurance* (18th Revised edn, Sweet & Maxwell 2013) 11-02; *Cheshire v Vaughan* [1920] 3 KB 240 (AC) 251, 256

<sup>111</sup> *Sharp v Sphere Drake Insurance Co (The Moonacre)* (1992) 2 Lloyd's Rep 501, 509

<sup>112</sup> Professor Robert M Merkin, *Colinvaux's Law of Insurance* (11th edn, Sweet & Maxwell 2016) 4-001

<sup>113</sup> Nicholas Legh-Jones, Professor John Birds and David Owen, *MacGillivray on Insurance Law* (11th edn, Sweet & Maxwell 2008) 1-001

<sup>114</sup> *Feasey v Sun Life Assurance Co* [2002] Lloyd's Rep IR 807 [162]

<sup>115</sup> *Murphy v Bell* (1828) 4 Bing 567 [569]-[570]

carrying on illegal traffic, and were made the means of profiting by the wilful destruction and capture of ships. ... This shows that gambling was not the only thing guarded against.”

As to illegal traffic, without proof of interest, wager policies made it easier for the assured to carry on contraband trade.<sup>116</sup> In order to benefit from wager policies, the policyholder was tempted to wilfully destroy the ships and their cargoes, as well as to make overvalued insurance.<sup>117</sup> The latter can also be referred to as a moral hazard attributable to the abuse of wager policies by marine insurance. The preamble in consequence expressed that wager policies without interest and inserted PPI terms or like ones had caused many pernicious practices, i.e. the assured would have fraudulently lost or destroyed ships, and their cargoes. Making wager policies a way of benefiting by the foregoing measures had thus brought about inconvenience to the insurer,<sup>118</sup> for example, having undermined the security of the insurer, which was treated as one of the reasons why Parliament had passed statutes suppressing wager policies.<sup>119</sup>

Nevertheless, some scholars thought that even if there is a statutory insurable interest, it is not sufficient to prevent the assured from profiting by destroying the insured subject. Taking the example of the valued policy, because the value of the insured subject matter is agreed at the date of the policy other than at the time immediately prior to the loss, even though the assured has an interest in the matter insured, the assured might be tempted to destroy it or just make a

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<sup>116</sup> *Sadlers' Co v Badcock* (1743) 2 Atk 554 [556]

<sup>117</sup> *Lucena v Craufurd* (1806) B & PNR 269 [296]

<sup>118</sup> *Sadlers' Co v Badcock* (1743) 2 Atk 554 [556]

<sup>119</sup> *Feasey v Sun Life Assurance Co* [2002] Lloyd's Rep IR 807 [162]

wager policy on the chance of its loss where its agreed value excessively exceeds the actual value. Similarly, evils of fraudulent destruction might be caused by the marine insurance on the ship the value of which, according to s 16 of the 1906 MIA, is ascertained at the time of the contract.<sup>120</sup>

#### *1.2.2.1.1.4 PPI clauses not confined to certain specified words*

The 1745 MIA, which was afterwards fully repealed by the 1906 MIA, provided that no policies of insurance shall be made without interest or contain PPI terms, such as interest or no interest, without further proof of interest other than the policy, or by way of gaming or wagering, or without benefit of salvage to the assurer; such policies shall be null and void. Terms of “interest or no interest”, compared to other PPI terms, were not so commonly used because such words might imply that the assured could not satisfy the requirement of insurable interest.<sup>121</sup> The policies which contained words like “interest or no interest” or “without further proof of interest than the policy” or similar words, which attempted to dispense with proof of insurable interest, are called PPI policies.<sup>122</sup>

However, the recited PPI clauses under the Act did not necessarily mean that only the appearance of those certain specified words would render a policy null and void, whereas words to the same effect, that dispensed with the necessity of proof of interest, were sufficient to avoid such a policy. Therefore, in *Murphy v Bell*,<sup>123</sup> in order to give the exact explanation of clauses without interest or PPI terms by the Act, Best CJ set out that “The meaning of this clause is, that no

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<sup>120</sup> Professor Robert M Merkin, *Colinvaux’s Law of Insurance* (11th edn, Sweet & Maxwell 2016) 4-002

<sup>121</sup> Robert H Brown, *Dictionary of Marine Insurance Terms and Clauses* (5th edn, Witherby & Co Ltd 1989)

<sup>122</sup> Jonathan Gilman, Professor Robert M Merkin, Claire Blanchard and Mark Templeman, *Arnould’s Law of Marine Insurance* (18th Revised edn, Sweet & Maxwell 2013) 2-20

<sup>123</sup> *Murphy v Bell* (1828) 4 Bing 567 [570]-[571]

insurance shall be effected by a policy so worded as to entitle the assured to recover against the underwriters a certain stipulated sum of money, whether he had any interest in the ship or cargo or not, or that binds the underwriter not to require any other proof of the assured's interest but the admission of such interest in the policy." In short, whatever words may be used, if that be the effect of the policy, no action could be maintained on it. In this case, the court held that the policy containing "that the goods insured were and should be valued at five tierces coffee, valued at £ 27. per tierce, say £ 135; that policy to be deemed sufficient proof of interest" had the same effect as the policy containing PPI clauses and thus the policy was void under the Act. Best CJ justified his explanation giving two reasons. First, the evils caused by wagering policies enumerated in the preamble of the Act, such as fraudulent insurance and clandestine trade, were dreadful. It was thus necessary to impose a much more strict explanation of PPI terms. Secondly, without such an explanation, the court would have rendered inoperative s 1 of the Act. Therefore, the courts tended to broadly interpret the meaning of PPI clauses. Similarly, the Court of Appeal held that a policy containing the term "full interest admitted" was void under the 1745 MIA because this term not only meant that the interest shall, if it existed, be valued at a certain sum, but that no proof of interest needed to be provided, which in fact dispensed with the proof of interest.<sup>124</sup>

*1.2.2.1.1.5 The term relating to valuation of interest is not equivalent to that of dispensing with proof of interest.*

On the other hand, where a term merely meant the valuation of interest, the policy including such a term would not be void for the purpose of PPI terms, unless the fixed value hugely exceeded the actual value of the subject matter

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<sup>124</sup> *Berridge v Man on Insurance Co* (1887) 18 QBD 346 (CA) 348

exposed to marine perils.<sup>125</sup> In *Grant v Parkinson*<sup>126</sup>, the policy was made on profits expected to arise on the cargo of the ship in the event of her safe arrival and included the term “in case of loss the insurers agree to pay the same without any other voucher (valuation) than the policy”. The court held that this policy with no insertion of PPI terms was not void under s 1 of the 1745 MIA and the assured who had a real interest was thus entitled to recover. Lord Mansfield stated that the policy in question was a valued policy which was not void if the assured could prove some actual interest and was not meant to conceal the interest but to get rid of the proof the quantum. Therefore, when deciding whether a term was a PPI term, the nature of the term needed to be carefully considered: if it was a valuation of interest in order to preclude dispute concerning the value of the subject insured at the time of recovering, which was the normal business practice and was not a breach of the indemnity principle, the policy would not be void for the purpose of PPI terms; by contrast, if it allowed the assured no necessity of proving its interest, the policy would be a void one within the ambit of the 1745 MIA.

*1.2.2.1.1.6 PPI terms will vitiate the policy even though the assured has a real interest.*

Best CJ held that if a policy included words like PPI terms recited in the Act or like terms, the case was within it and void, although it may be manifest that it was not a wagering policy.<sup>127</sup> Where the assured having advanced money on the security of a ship made the policy on such advances with “full interest admitted” which had the same effect as PPI terms, the court held the policy was void for the purpose of PPI terms even though the policy was in effect not a wagering policy and the assured had a real interest in the ship to the extent of

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<sup>125</sup> *Lewis v Rucker* (1761) 2 Burr 1167; applied in *Grant v Parkinson* (1781) 3 Douglas 16

<sup>126</sup> *Grant v Parkinson* (1781) 3 Douglas 16

<sup>127</sup> *Murphy v Bell* (1828) 4 Bing 567 [570]

such advances.<sup>128</sup> However, the case may be distinguished today. In the *Feasey* case, Waller LJ held that, due to the broad definition by modern courts, the courts nowadays would be reluctant to hold that a policy did not cover an insurable interest, even though the terms of the policy were plainly ones without interest or including PPI terms.<sup>129</sup>

*1.2.2.1.1.7 The validity of the valued policy for the purpose of PPI terms.*

It was thought in the past that the valued policy was void under the 1745 MIA, especially where fraudulent insurance caused by loss of ships may be attained by means of policies under which a much higher value was put on subjects insured than they were worth.<sup>130</sup> It is not the case. Prior to the 1745 MIA, a valued policy was common and then, at the trial, the assured was not required to prove either value or interest, whether or not PPI terms had been included. After the enactment of the Act, it had been held that a valued policy was not void, but the assured needed to prove some interest. Where a policy contained “in case of loss the insurers agree to pay the same without any other voucher than the policy”, the term was the valuation of interest and the policy was a valid one.<sup>131</sup> Best CJ thus set out the test of identifying whether a policy was within the Act that “If a policy then dispenses with all proof of interest, it is within the Act, and void. If the Plaintiff must prove his interest, and the policy only saves him the trouble of shewing its amount, it is a valued policy and good.”<sup>132</sup> Even though there is excessive overvaluation, i.e. the agreed value by the assured

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<sup>128</sup> *Berridge v Man on Insurance Co* (1887) 18 QBD 346

<sup>129</sup> *Feasey v Sun Life Assurance Co* [2003] Lloyd’s Rep IR 637 [92]; Rhidian Thomas, *The Modern Law Of Marine Insurance: Volume 4* (1st edn, Informa Law from Routledge 2015) 13

<sup>130</sup> *Murphy v Bell* (1828) 4 Bing 567 [571]

<sup>131</sup> *Grant v Parkinson* (1781) 3 Douglas 16 [17]-[18]

<sup>132</sup> *Murphy v Bell* (1828) 4 Bing 567 [572]

and the insurer inserted into the policy is enormously higher than the true value of the subject insured, the policy was still not void as long as it had no PPI terms because the assured has a real insurable interest.<sup>133</sup>

#### *1.2.2.1.1.8 Useful honour policies*

Honour policies were actually useful where the nature of interest was beyond the ambit of the statutory insurable interest or the insurable interest in the subject matter insured was too fluctuating to measure it.<sup>134</sup> Because of the commercial convenience - that the assured, having a real interest, did not need to prove the amount of insurable interest, - and because of the evil of making insurance a way of profiting by deliberate destruction of the subject insured, in which the assured had no interest and by over-valuation on the chance of a loss, - the practice of honour policies prevailed.<sup>135</sup> Thus, it could not be said that PPI policies, or, as more precisely called, honour policies, were designed to be an instrument of wager at their inception because such policies severed their clear commercial purposes at first and then, unfortunately, lots of them were made wager policies.<sup>136</sup> Therefore, PPI terms inserted into a policy could not be regarded as self-proof of the nature of a wager policy, even though the form of the policy would taint its validity.<sup>137</sup> Honour policies were those which included at least one term similar to the effect of those stipulated in s 4(2)(b) of the 1906 MIA. Losses suffered which were insured by such policies could not be compensated for by an action under the 1745 MIA, but nonetheless

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<sup>133</sup> *Glafki Shipping Co SA v Pinios Shipping Co No 1, The Maira (No 2)* [1984] 1 Lloyd's Rep 660

<sup>134</sup> Jonathan Gilman, Professor Robert M Merkin, Claire Blanchard and Mark Templeman, *Arnould's Law of Marine Insurance*, (18th Revised edn, Sweet & Maxwell 2013) 1-09

<sup>135</sup> *Cheshire v Vaughan* [1920] 3 KB 240 (AC) 252

<sup>136</sup> 1906 MIA, s 4(2)(b)

<sup>137</sup> See the last sentence of this para.

compensation could be recovered under the honour of the underwriter.<sup>138</sup> From the perspective of pure commerce, it is significant to distinguish honour policies from mere wager policies. This is because the interest of the former, which were some kind of non-legal or equitable risks and genuine in commercial practice, was distinct from the latter where the assured took no risks other than the losing of his stake.

In addition, honour policies had been used where the assured had difficulty measuring the amount of its interest, despite having a real insurable interest: with the introduction of honour policies, it would be convenient for the assured who indeed had an insurable interest to insure certain types of subjects, since in certain cases the interest that the assured had was not easy to define or to determine its extent.<sup>139</sup> Trying to avoid the difficult of proving the exact amount of insurable interest may be the chief reason for honour policies prevailing. The insurer would honour such policies as well only if the assured had a bona fide insurable interest. In the event of insurance on “Increased Value” of cargo, although the assured had an interest in cargo, it was difficult to define the increase exceeding the insurable value. Similarly, in the case of “Anticipated Freight”, where the shipowner was effecting a contract of insurance on his vessel and it was easy to prove its good conditions as a freight earner, nevertheless, because it was difficult to figure out the exact freight which his

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<sup>138</sup> Jonathan Gilman, Professor Robert M Merkin, Claire Blanchard and Mark Templeman, *Arnould's Law of Marine Insurance*, (18th Revised edn, Sweet & Maxwell 2013) 2-19

<sup>139</sup> Robert H Brown, *Dictionary of Marine Insurance Terms and Clauses* (5th edn, Witherby & Co Ltd 1989) [16]

vessel could earn, he would face difficulty when required to demonstrate the amount of interest he had in freight.<sup>140</sup>

#### *1.2.2.1.1.9 Conflicts between law and practice as to such policies*

There existed for a long time an unfortunate conflict between the statutes and the practice of businessmen.<sup>141</sup> As discussed above, for the commercial convenience of dispensing proof of the amount of interest, honour policies were commonly taken out. Despite the insertion of such terms into a policy, the insurer still had a right to claim in court that the assured had no insurable interest.<sup>142</sup> In such a situation, the assured adopting the commercial practice would be put at a substantial disadvantage since honour policies were pronounced to be either illegal<sup>143</sup> or void<sup>144</sup> by statute. Furthermore, it should be noticed that the anti-wager Acts did not separately distinguish PPI policies and honour policies from those with actual interests. As long as PPI terms appeared on the face of the policy, such kinds of policies would be deemed as contracts by way of gaming and wagering, and void.<sup>145</sup>

#### *1.2.2.1.2 Names to be checked under the Marine Insurance Act 1788 (the 1788 MIA)<sup>146</sup>*

The application of the 1788 MIA was not only confined to marine insurance on ships and their goods, it also applied to indemnity insurances on non-marine subjects, such as merchandise, effects, or other property whatsoever.<sup>147</sup> The 1788 MIA was also repealed by the 1906 MIA so far as marine insurance was

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<sup>140</sup> Robert H Brown, *Dictionary of Marine Insurance Terms and Clauses* (5th edn, Witherby & Co Ltd 1989) [16]

<sup>141</sup> *Cheshire v Vaughan* [1920] 3 KB 240 (AC) 251

<sup>142</sup> *Anctil v Manufacturers' life Ins Co* [1899] AC 604; *Royal Exchange Ass V Sjöforsakrings* [1902] 2 KB 384

<sup>143</sup> 1909 MIA

<sup>144</sup> 1745 MIA and 1845 GA

<sup>145</sup> 1906 MIA, s 4

<sup>146</sup> 28 Geo. 2, c. 56; Short Titles Act 1896 (59 & 60 Vict. c. 14). Applicable to England & Wales and Scotland

<sup>147</sup> 1788 MIA

concerned.<sup>148</sup> As a result, the 1788 MIA still applies to policies of insurance on non-marine subjects. According to the *2016 Draft*, the Act should be wholly repealed because it has for a long time been of no effect in insurance contracts.

The Act provided that it would be void if the parties having an interest in the insurance did not at the beginning insert their names into the policy. The insertion was regarded as convenience for the insurer checking whether the assured had a valid insurable interest.<sup>149</sup> However, when to test what was sufficient to prevent a policy to be a wager policy, the requirement of an “interest”, rather than “a valid insurable interest”, was enough. Also, the fact that the assured had an expectation of acquiring one was not a valid or real insurable interest, but nevertheless was sufficient to protect a policy from falling within the anti-wager Acts.<sup>150</sup>

#### 1.2.2.1.3 The Marine Insurance (Gambling Policies) 1909 MIA (the 1909 MIA)<sup>151</sup>

The Act prohibited wagers upon loss by marine perils:<sup>152</sup> it rendered wager policies made in the guise of marine insurance illegal and those making them guilty of criminal offence. The Act provided for punishment of those who took out or helped on purpose to effect a marine insurance policy where the assured could not establish an insurable interest. The punishment was by a fine or imprisonment for up to six months, although no prosecutions were taken under the Act.

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<sup>148</sup> *2011 CP*, para 11.13

<sup>149</sup> *2011 CP*, para 11.13

<sup>150</sup> *2011 CP*, para 11. 34, per Nicholas Legh–Jones QC

<sup>151</sup> Applicable in the UK, more commonly called the Gambling Policies Act

<sup>152</sup> *Glafki Shipping Co SA v Pinios Shipping Co No 1, The Maira (No 2)* [1984] 1 Lloyd’s Rep 660, 667

It has been argued that the Act should be abolished, mainly depending on the following two reasons: firstly, the criminal offence created by the Act was thought unnecessary,<sup>153</sup> because the insurance contract, a commercial issue, should be governed by related financial laws<sup>154</sup> rather than criminal penalties; secondly, the Act had no application in practice and no action had ever been taken under the Act.<sup>155</sup> Thus, the *2016 Draft* has proposed the repeal of the 1909 MIA.

### *1.2.2.2 Whether the 1774 LAA applies to indemnity insurance*

#### 1.2.2.2.1 Grounds for the passing of the 1774 LAA

Wagers by life insurance, which had continually caused the life insurance industry a lot of trouble, was believed to have led to the passing of the Act:

“Contracts of this nature became so much a mode of gambling (for people took the liberty of insuring any one’s life, without hesitation, whether connected with him, or not, and the insurers seldom asked any question about the reasons, for which such insurances were made), that it at last became a subject of Parliament discussion.”<sup>156</sup>

Those wager contracts of insurance were thus regarded as a mischievous kind of gaming in the Act. According to s 1 of the Act, the assured under the insurance contracts within the ambit of this Act must have an insurable interest at the outset of the contract; otherwise the contract was rendered null and void.

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<sup>153</sup> 2011 CP, para 10.2

<sup>154</sup> Law Commissions, *Issues paper 10: Insurable Interest Issues (2015 IP 10)*, para 2.29

<sup>155</sup> 2011 CP, para 11.25

<sup>156</sup> James Allan Park, *A System of the Law of Marine Insurances, with Three Chapters on Bottomry; on Insurance on Lives; and on Insurance against Fire* (4th edn, A Strahan 1800) 430

#### 1.2.2.2.2 Scope of the Act

Although the 1745 MIA had prohibited wager policies in the form of marine insurance, wagers by other types of insurance had still been left to common law without Parliament's intervention until the passing of the 1774 LAA,<sup>157</sup> which intended to prevent wager policies of insurance contracts other than marine ones from evading gambling laws.<sup>158</sup> The 1774 LAA prohibited wager policies of life insurance other than pure wager contracts of other kinds<sup>159</sup> by providing that no insurance on lives or "any other events" should be made, worded by "no interest" or by means of "gaming or wagering"; otherwise, such policies were null and void.<sup>160</sup>

It was argued that it may probably not be right to see the title of the Act and then to think that the Act only applied to life insurance. The unclear ambit of the Act may possibly have arisen from the terms "on any other event or events whatsoever" in s 1. Because of this provision, although s 4 clearly provided that the Act did not apply to the bona fide making of insurance on the subject of ships, goods or merchandise,<sup>161</sup> it was argued that it may also apply to other indemnity insurance, like land, buildings and liability insurance.<sup>162</sup> However, the Act in effect only applied to policies of insurance on life. Although in an old case the court held that the assured must have an insurable interest in the subject of

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<sup>157</sup> Nicholas Legh-Jones, Professor John Birds and David Owen, *MacGillivray on Insurance Law* (11th edn, Sweet & Maxwell 2008) 1-028

<sup>158</sup> Jonathan Gilman, Professor Robert M Merkin, Claire Blanchard and Mark Templeman, *Arnould's Law of Marine Insurance*, (18th Revised edn, Sweet & Maxwell 2013) 1-028

<sup>159</sup> *Good v Elliott* [1790] 3 T P 693; *Paterson v Powell* [1832] 9 Bing 320; *Roebuck v Hammerton* [1778] 2 Cowp 737; *Morgan v Pebrer* [1837] 3 Bing NC 457; *Re London County Commercial Reins Office* [1992] 2 Ch 67 (Ch) 78

<sup>160</sup> 1774 LAA, s 1

<sup>161</sup> 1774 LAA, s 4

<sup>162</sup> Malcolm A Clarke, Julian M Burling and Robert L Purves, *The law of insurance contracts* (5th edn, Informa, 2006) 4-4; John Birds, *Modern Insurance Law* (7th ed, Sweet & Maxwell 2007) 53-56

land and buildings at the time of making the contract, this decision has never been cited.<sup>163</sup> Under the current common law, the position therefore seems to be clear that it limits its application merely to life insurance and thus does not apply to any indemnity insurance.<sup>164</sup> One reason for such a position is that the 1774 LAA was enacted to prevent a mischievous kind of gaming while it was clear that indemnity insurance was not included in that.<sup>165</sup> In conclusion, the 1774 LAA did not govern the policies on ships, goods or merchandise, nor land and buildings policies and liability policies. To make the law on insurable interest clearer and more certain, the *2016 Draft* has suggested repealing this Act.

### **1.2.2.3 Conclusion**

Different Acts apply to different kinds of wager policies of insurance: for wagers by marine insurance, the Acts of 1906 and 1909 apply; the 1774 LAA governs wager policies of life insurance on the payment of a sum of money on the occurrence of an insured event; for wager policies in other types of non-marine indemnity insurance, as discussed below, the 1845 GA applied. Because of its repeal by the 2005 GA, the non-life related insurance, including non-marine indemnity insurance, will be governed by the forthcoming Insurable Interest Act. To be valid under these Acts for the purpose of insurable interest, the assured must have an insurable interest or an expectation of obtaining one in the insured subject matter at the time of contract.

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<sup>163</sup> *Sadler's Co v Badcock* (1743) 2 Atk 554

<sup>164</sup> *Mark Rowlands Ltd v Berni Inns Ltd* [1986] 1 QB 211 (AC) 227; *Siu Yin Kwan v Eastern Insurance Co Ltd* [1994] 2 AC 199 (Hong Kong)

<sup>165</sup> *Siu Yin Kwan v Eastern Insurance Co Ltd* [1994] 2 AC 199 (Hong Kong) 211

### 1.2.3 Two crucial gambling statutes

#### 1.2.3.1 Indirect requirement of insurable interest under the 1845 GA<sup>166</sup>

Before the passing of the 1845 GA, only wagering policies on marine risks and life insurance were prohibited for being mischievous kinds of gaming; on the other hand, wager contracts in general remained lawful and wager policies of non-marine insurance were enforceable at that time and so remained until 1845.<sup>167</sup>

The problem then needed to be dealt with relating to the enforceability of wager policies of non-marine indemnity insurance. Although wagers by insurance against marine and life risks had been clearly subject to relevant statutes, the validity of wager policies in the form of insurance on non-marine chattels was left unclear at common law, which had been ended by the 1845 GA.<sup>168</sup> Although the 1788 MIA also applied to non-marine insurance on goods, there was no requirement of the assured having an insurable interest. Likewise, even though there was a debate as to whether the 1774 LAA applied to indemnity insurance, it had been clearly held that only life insurance fell within the ambit of its operation.

After the enactment of the Act, both wager policies of all classes of insurance and wager contracts of other kinds had been rendered unenforceable by the

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<sup>166</sup> Also known as 8 & 9 Vict., c. 109

<sup>167</sup> *Sharp v Sphere Drake Insurance Co (The Moonacre)* (1992) 2 Lloyd's Rep 501, 510

<sup>168</sup> Professor Robert M Merkin, *Colinvaux's Law of Insurance* (11th edn, Sweet & Maxwell 2016) 4-008

1845 GA,<sup>169</sup> which provided that “All contracts or agreements, whether by parole or in writing, by way of gaming or wagering, shall be null and void”.<sup>170</sup> Following this provision, it was clear that gaming or wagering contracts were void, whereas the prohibition imposed on wager policies was rather indirect: under a wager contract, the parties to the contract had no insurable interest in the subject matter staked, apart from the sum to win or lose; by rendering a contract without interest void, the parties had to have an insurable interest in a contract to avoid being unenforceable. Consequently, the validity of wagers in the guise of all types of insurance on all subject matters for the first time was made definitely void according to s 18 of the Act. That is to say, it indirectly required that general indemnity contracts of insurance must fulfil the need for an insurable interest in order to be valid.<sup>171</sup>

#### *1.2.3.2 Uncertainty in insurance contracts under the 2005 GA<sup>172</sup>*

Doubts have arisen about whether or not the requirement of insurable interest was accidentally affected by the 2005 GA, which repealed section 18 of the 1845 GA<sup>173</sup> and allowed gambling contracts to be enforceable. Section 335(1) of the 2005 GA provides that a contract should not be unenforceable due to the fact that it relates to gambling.<sup>174</sup> Section 335(2) then stipulates that the enforceability of gambling by s 335(1) should be 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). Therefore, as long as a rule is concerning gambling, s 335 applies to such contracts, no matter whether

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<sup>169</sup> Contracts and Commercial Law Reform Committee, *Aspects of Insurance Law (2)*, para 4.4

<sup>170</sup> 1845 GA, s 18

<sup>171</sup> 2011 CP, para 11.17

<sup>172</sup> Applicable to England & Wales and Scotland (with a restricted application to Northern Ireland); The Act came into force on September 1, 2007; also see 3.1.2, below, which has in details discussed this topic.

<sup>173</sup> 2005 GA, s 334(1)(c)

<sup>174</sup> 2005 GA, s 335

being void or unlawful leads to their being unenforceable. After the 2005 GA came into force, a wager policy which falls within the definition of gambling by this Act is no longer void under the Gambling Acts. Clearly, s 4 of the 1906 MIA relates to the enforceability of gambling contracts: s 4(1) sets out that wagering policies on marine perils are not enforceable while s 4(2) then points out two types of such policies: without insurable interest or the expectation of obtaining one and those containing PPI terms or similar. Therefore, it has been argued that s 335 has repealed s 4 and wager policies consequently are now enforceable. If so, because wager policies do not require independent insurable interest, s 335 thus has accidentally abolished the requirement of insurable interest.

On the other hand, it has also been argued that s 335 has not affected the operation of s 4. First, s 335 does not expressly repeal s 4 and intentionally influence the Insurance Acts.<sup>175</sup> Secondly, Parliament has not considered the influence of s 335 on s 4, which means the purpose of legislation was not intended to affect this area of insurance law.

The Act has thus introduced “unfortunate uncertainty into the law” because Parliament had no discussion concerning its effect on contracts of insurance at the time the law was passed.<sup>176</sup> Before the enactment of the Act, under the 1845 GA and the 1906 MIA, in the context of marine insurance, the requirement of insurable interest has to be shown at the time of loss by the policyholder to

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<sup>175</sup> 2005 GA, s 356, Schedule 17

<sup>176</sup> 2011 CP, chapter 11

preclude insurance contracts from being treated as wagering agreements leading to their unenforceability. Under the 2005 GA, gambling contracts are now enforceable; consequently, as to its enforceability, it is not necessary to differentiate between indemnity insurance and wagering contracts. In light of the effect of the Act, it may be reasonable to conclude that, at least to make an insurance contract enforceable, insurable interest in non-marine indemnity insurance is no longer an essential requirement in England and Wales.<sup>177</sup> However, in Scotland, it still remains a common law requirement.

### **1.3 The validity of wagering contracts at common law**

As far as indemnity insurance was concerned, prior to the passage of the 1845 GA, as to the validity at common law, the positions of wager policies of marine insurance, non-marine insurance and wager contracts of other kinds were different. It can be looked at in four stages: the period before the 1745 MIA, the period between the 1745 MIA and before the 1845 GA, then after the 1845 GA and before the 2005 GA, and then after the 2005 GA. At common law, before the passage of the 1745 MIA, wager contracts of all kinds were deemed as goods contracts with some restrictions<sup>178</sup> and could be enforced by the courts, unless they became a public nuisance or broke public policy such as immorality, caused a breach of the peace or exposed a third party to ridicule.<sup>179</sup> After the 1745 MIA, although wager policies on marine risks and life had been prohibited by the relating Acts, wager policies of non-marine insurance and pure wagers were still valid at common law until the passage of the 1845 GA: after the 1745 MIA, wager policies of insurance against maritime risks were illegal; the 1774 LAA rendered void wager policies on life insurance; wager policies of insurance

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<sup>177</sup> 2008 IP 4, para 1.15

<sup>178</sup> Discussed, *infra*

<sup>179</sup> *Dalby v India and London Life Assurance Co* (1854) 15 CBP 365 [387]-[388]

on other subjects and general wager contracts remained valid under common law until the 1845 GA came into force. In other words, the provisions of the Acts of 1745 and 1774 appeared to be confined only to the scope of wager policies of insurance, and not extending to pure wager contracts.<sup>180</sup> As a result, between the period after the 1745 MIA and before the 1845 GA, a wager policy in the guise of marine insurance and life insurance was void whereas a mere wager on such subjects was valid. After the 1845 GA and before the 2005 GA, all wager contracts were rendered void at common law. After the enactment of the 2005 GA, the wager contracts not in the guise of insurance are enforceable by the courts.

### 1.3.1 Wager contracts in general enforceable at common law before the 1745 MIA

Before falling within the scope of Parliament's consideration, namely, prior to the passage of the Act 1745,<sup>181</sup> wagering was deemed to be a valid contract<sup>182</sup> and therefore not illegal at common law in England, though in Scotland<sup>183</sup> it was held that contracts relating to wagers were void by the law of Scotland.<sup>184</sup> Exceptions to the validity of wager contracts were those contrary to public policy.<sup>185</sup> Prior to the period when the 1774 LAA was passed, a wager contract by insurance other than against marine risks was regarded as legal and even as a kind of insurance.<sup>186</sup> Waller LJ thus stated that "gaming and wagering outside the insurance context was lawful and enforced by the courts".<sup>187</sup> Generally speaking, it was safe to say that, due to no relating Acts, wager contracts were

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<sup>180</sup> *Roebuck v Hammerton* [1778] 2 Cowp 737

<sup>181</sup> ALRC 20, para 108

<sup>182</sup> *Micklefield v Hippin* (1760) 1 Anst 33; *Good v Elliott* [1790] 3 T P 693; *Hussey v Crickitt* (1811) 3 Camp 168; *Khodari v Tamimi* [2010] EWCA Civ 1109 [18]

<sup>183</sup> Robert Surridge, Noleen Dignan, Sara Forrest, Alison Broadberry and Duncan Backus, *Houseman and Davies: Law of Life Assurance* (11 th edn, Butterworths 1994) 17

<sup>184</sup> *Bruce v Ross* (1787) Mor Dic 9523

<sup>185</sup> ALRC 20, para 108

<sup>186</sup> Daniel Defoe, *Essay Upon Projects* (Cassell & Company 1887) the chapter of "Of Wagering"

<sup>187</sup> *Feasey v Sun Life Assurance Co* [2003] Lloyd's Rep IR 637 [49]

legal under common law before the 1745 MIA, and even after the passage of the 1745 MIA before the 1845 GA, wager policies on non-marine indemnity insurance were still not void.<sup>188</sup> Lord Mansfield was of the same opinion:

“Indifferent wagers upon indifferent matters, without interest to either of the parties, are certainly allowed by the law of this country, in so far as they have not been restrained by particular Acts of Parliament: and the restraints imposed in particular cases, support the general rule. For where Parliament interposes and says, ‘Unless you have an interest in such a case, any wager or insurance upon it shall be void and of no effect;’ it implies, that in cases not specially prohibited by Act of Parliament, parties may wager or insure at pleasure. ... wagers ... have too long and too often been held good and valid contracts.”<sup>189</sup>

In *Andrews v Herne*<sup>190</sup> where the parties made a wagering contract as to whether Charles Stuart then being in exile could be restored to the throne within twelve months, the courts then held that such a wagering contract was good enough to satisfy the concept of a wager and valid for three grounds: firstly, the consideration for the wager was good; secondly, the wager was made on a future uncertain event that is, at the time of betting, whether Charles Stuart could be the king of England; lastly, the parties mutually intended to take out such a wager.

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<sup>188</sup> *Hussey v Crickitt* (1811) 3 Campbell 168 (Heath J)

<sup>189</sup> *Da Costa v Jones* (1778) 2 Cowper 729

<sup>190</sup> *Andrews v Herne* (1660) 1 Levinz 33

Therefore, the courts would not hesitate to adjudicate upon wagers, even though sometimes adjudicating such wagers was thought to have wasted the time of the courts<sup>191</sup> and the courts actually were not in favour of wagers<sup>192</sup>. Even the result of a case before the courts could be made subjects of wager contracts, but nonetheless such wagers were also regarded to be valid contracts and not void. In *Jones v Randall*,<sup>193</sup> a dispute arose as to the plaintiff recovering money won by him upon a wager: “whether a decree of the Court of Chancery would be reversed or not on appeal to the House of Lords”. The courts held that wagering contracts were neither banned by statute nor illegal at common law. Mr. Wallace and Mr. Mansfield upheld the plaintiff for the following three reasons: firstly, the wagering contract was an equal transaction, because each of the parties had equal knowledge or equal ignorance and both of them made the wager depend upon an uncertain event; secondly, such a contract was not the sort of contract which was prohibited by statute stating that the plaintiff could not recover his money; thirdly, at common law, there was no case to render such contracts illegal.

According to the above judgement, wagering contracts were deemed fair transactions and legal at common law. It was clearly and manifestly right that there was no positive law to ban such contracts prior to the 1745 MIA, which for the first time formally recognised that insurance contracts effected without insurable interest were a pernicious practice.

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<sup>191</sup> Nicholas Legh-Jones, Professor John Birds and David Owen, *MacGillivray on Insurance Law* (11th edn, Sweet & Maxwell 2008) 1-021

<sup>192</sup> *Jackson v Colegrave* (1699) Carthew 338

<sup>193</sup> *Jones v Randall* (1774) 1 Cowp 37

### 1.3.2 Cases not within the general validity of wagers

However, in some cases, running counter to principles of sound policy and morality, wager contracts might nevertheless be held to be void.<sup>194</sup> According to the decision in *Jones v Randall*,<sup>195</sup> the instances that wagers would be illegal were as follows: firstly, they were prohibited by the positive law. Wager contracts were however not void until the passage of the 1745 MIA, although during the period of the war in 1708, the Wagers Act 1708 was enacted to prevent wagers upon that war. However, the 1708 Act was just a temporary one and soon expired when the war ended. Wager policies of insurance on non-marine insurance were not clearly prohibited by statute until the passage of the 1845 GA. Secondly, the illegality of wagers was adjudged by judicial precedent. Wagers in general were valid before the 1845 Act under common law, with certain exceptions. Thirdly, they were contrary to principles of sound policy and morality. Those wagers could bring evils which, for example, could influence the exercise of some office, using physical violence. Lord Mansfield pointed out such principles, any of which might render void wagering contracts which were otherwise not prohibited by any statutes and not illegal at common laws.<sup>196</sup> The test for the morality should be inferred from the nature of a wagering contract. Both of the parties had equal positions and made sure such contracts to be fair transactions, namely, no fraud, no imposition imputed to either of the parties, equal knowledge or equal ignorance. Besides, the bet must depend on the future uncertain event, viz. neither of the parties would be sure to win or lose. He mentioned nothing about the test for the latter; the case of *Atherfold v Beard* was however about sound policy, which will be discussed in detail infra.

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<sup>194</sup> *Jones v Randall* (1774) 1 Cowp 37

<sup>195</sup> *Jones v Randall* (1774) 1 Cowp 37 [39]

<sup>196</sup> *Jones v Randall* (1774) 1 Cowp 37

Besides, although wager contracts were not held void, the courts disliking this position at common law, then tended to hold the invalidity of wager contracts for many other reasons, like fool wagers:<sup>197</sup> “wagering has long been frowned upon in England.”<sup>198</sup> Ashhurst J<sup>199</sup> expressed this dissatisfactory attitude to wager contracts:

“In my opinion the Courts have gone far enough in encouraging impertinent wagers. Perhaps it would have been better for the public, if the Courts had originally determined that no action to enforce the payment of wagers should be permitted.”

Accordingly, it was not right to think that the court could not go further, other than in the event of it being contrary to public policy and could only “discourage action on wagers by refusing to grant facilities in procedure available to other litigants”.<sup>200</sup>

Furthermore, the validity of wagers could be vitiated by the subject matter of wagers or by the legality of such subjects, in spite of the general validity of wagers at common law. It has been submitted that wagers upon the following subjects were held illegal in addition to them leading to public mischiefs:

“these included wagers on unlawful games; wagers that one of the parties would commit a legal wrong or do an immoral act; wagers which affected the interests and feelings of a third person so as to

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<sup>197</sup> Professor Hugh Beale, *Chitty on Contracts* (vol II, 32th edn, Sweet & Maxwell 2016) 41-010

<sup>198</sup> Professor Robert M Merkin, *Colinvaux’s Law of Insurance* (11th edn, Sweet & Maxwell 2016) 4-001

<sup>199</sup> *Atherfold v Beard* (1788) 2 TR 610

<sup>200</sup> Nicholas Legh-Jones, Professor John Birds and David Owen, *MacGillivray on Insurance Law* (11th edn, Sweet & Maxwell 2008) 1-021

make a breach of the peace likely; and wagers which were 'against sound policy'.<sup>201</sup>

### *1.3.2.1 Wagers contrary to public policy invalid*

There was a definite decision at common law that a wager could not bring any mischiefs or inconvenience to public policy; otherwise such wagers would not be enforced by the courts.<sup>202</sup> The case of *Atherfold v Beard*<sup>203</sup> can be used to illustrate the occasion in which a wager ran counter to sound policy. In this case, a wager concerning the future amount of any branch of the public revenues was made between two persons, who had no concerns in the subject. The courts held that such a wager respecting public matters was illegal, because it had introduced improper discussions and was contrary to the public policy of the kingdom. In Buller J's opinion, which had gone further, a wager without interest was illegal, as he had put in this case:

"I do not find that it has ever been established as a position of law, that a wager between two persons, not interested in the subject-matter, is legal."

He also made a distinction in terms of the validity of wagering contracts effected on public matters and private events. He stated that a wager was a good one if it was taken out on private matters;<sup>204</sup> by contrast, he went further by referring to Lord Mansfield's judgement in the case of *Murray v Kell* to decide that a wager on public matters was void.

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<sup>201</sup> Professor Hugh Beale, *Chitty on Contracts* (vol II, 32th edn, Sweet & Maxwell 2016) 41-010

<sup>202</sup> *Gilbert v Sykes* (1812) 16 East 150 (Ellenborough CJ)

<sup>203</sup> *Atherfold v Beard* (1788) 2 TR 610

<sup>204</sup> *Good v Elliott* [1790] 3 T P 693; *Murray v Kell* M 25 G 3

Lord Ellenborough CJ said that most cases as to wagers had not been so fully discussed regarding the illegality of wagers as they might have been.<sup>205</sup> The court held that a wager, between the proprietors of two carriages for the conveyance of passengers for hire, stating that a given person should go past one of these carriages, and no other, was illegal, because such a wager would expose other parties rather than the parties who made the wager to some inconvenience.<sup>206</sup> Further concerns had been set out that a wager like this might possibly produce inconvenience to the public, since such a wager might also be laid on a matter involving thirty or forty passengers, not merely to the specific person, which would certainly be productive of great inconvenience to the public.<sup>207</sup>

#### *1.3.2.2 Wager contracts on moral grounds rendered void*

Wager contracts resulting in corruption, physical violence and other results could not be enforced by the courts on the ground that the principle of morality would be violated.<sup>208</sup> The case of *Allen v Rescous*<sup>209</sup> established that wagering contracts were illegal and void if such contracts led to physical violence. In *Allen v Hearne*,<sup>210</sup> a wager between two voters, which was laid upon the event of the election, was held to be illegal, because it could lead to bribery. The decision was thus decided on the ground that such a wager could affect the two voters when they were involved in the elections of candidates. Such ideas were also enunciated in *Jones v Randall*, a wager having been used to disguise the intention of one party to purchase the bishopric was made void.

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<sup>205</sup> *Eltham v Kingsman* (1818) 1 B & A 683

<sup>206</sup> *Eltham v Kingsman* (1818) 1 B & A 683 (Ellenborough CJ)

<sup>207</sup> *Eltham v Kingsman* (1818) 1 B & A 683 (Abbott J)

<sup>208</sup> R Merkin, 'Gambling by Insurance - A study of The Life Assurance Act 1774' (1980) 9 Anglo-Am 331, 335

<sup>209</sup> *Allen v Rescous* (1675) 2 Levinz 174

<sup>210</sup> *Allen v Hearn* (1785) 1 TR 56

### *1.3.2.3 Foolish wager contracts unenforceable*

Categories of foolish wager contracts were blamed to have improperly occupied the time of the courts leading to loss of time for more important cases.<sup>211</sup> Bayley J. observed that the wager was not illegal but foolish, for it not only produced inconvenience to a third party but also wasted time in a Court of Justice, which should be used for trying meaningful actions which would affect people's rights. Because of the above two problems caused by foolish wagers, the courts held that judges ought not to try actions caused by such wagers.<sup>212</sup>

Trying a foolish wager would tend to vilify and degrade a court of justice.<sup>213</sup> Since a wager had the nature of idleness made upon the matter as to how many ways of nicking seven on the dice can be achieved, Lord Loughborough also refused to try such an action upon such a wager. He thought that the wager in question was highly improper to be made the foundation of an action. Besides, Gould J pointed out in the case, a public discussion of this wager of an idle nature would greatly prejudice the morals of the nation. Additionally, Heath J thought that the subject matter of this wager was illegal, because "all games at dice except backgammon are prohibited by law". Sometimes the court would thus render an idle wager void simply for its foolish nature.<sup>214</sup> Gibbs CJ refused to maintain an action on the wager upon whether an unmarried woman had had a child because he would not want to waste the court's time. Going further he said that a court should not try a case respecting a wager between persons who

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<sup>211</sup> *Eltham v Kingsman* (1818) 1 B & A 683 [687] (Ellenborough CJ); *Atherfold v Beard* (1788) 2 TR 610

<sup>212</sup> *Eltham v Kingsman* (1818) 1 B & A 683 [687]-[688]

<sup>213</sup> *Brown v Leeson* (1792) 2 Blackstone (H) 43 (Heath J)

<sup>214</sup> Professor Hugh Beale, *Chitty on Contracts* (vol II, 32th edn, Sweet & Maxwell 2016) 41-010

had no interest in the subject matter.<sup>215</sup>

Acting in the same way, in order to avoid the wasting of courts' time by hearing cases brought to the courts for idle curiosity, Lord Ellenborough refused to try an action on a wager in which the parties had no interest in the judgement by the court but only intended to satisfy their curiosity relating to the court's decision. In this case, in order to make certain "whether a person may be lawfully held to bail on a special original for a debt under £40", in which the parties had no legal interest in the outcome of this abstract issue of law, they laid money on it. His Lordship thought the decision on the point of law, which was the subject matter of the wager, was not for the purposes of justice and such an action would bring inconvenience to the courts and be regarded as indecent behaviour.<sup>216</sup>

#### *1.3.2.4 A wager affecting third parties' peace void*

The common law affecting third parties had undergone a change of attitude from one of tolerance to one much stricter. At the beginning, despite its notorious reputation, a wager on the life of two young men's fathers being run against one another was upheld as valid.<sup>217</sup> The court held that a wager upon third parties was enforceable unless it might bring them physical violence.<sup>218</sup>

Then, the court would not try an action upon a wager which had materially affected the interest or feelings of a third person as to violating public peace. In

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<sup>215</sup> *Ditchburn v Goldsmith* (1815) 4 Campbell 152

<sup>216</sup> *Henkin v Gerss* (1810) 2 Campbell 406

<sup>217</sup> *March v Pigot* (1771) 5 Burr 2802

<sup>218</sup> Professor Robert M Merkin, *Colinvaux's Law of Insurance* (11th edn, Sweet & Maxwell 2016) 4-004, fn 16

*Da Costa v Jones*,<sup>219</sup> a wager was laid between two unconnected persons upon the sex of a third party. The court did not maintain the action on the grounds that it would bring an injury to a third person and to the peace of society. Lord Mansfield in this case gave three species of wagers regarding third persons for which the judges would reject the actions: “an incitement to a breach of the peace”, like a wager on physical violence as to a third person,<sup>220</sup> “an incitement to immorality” and “contra bonos mores”.

At last, wagers made upon other parties in whatever manner affecting them were rendered unenforceable.<sup>221</sup> A wager upon whether an unmarried woman had had a child was held void because a third party, the woman, had been affected regardless of whether or not her feelings or reputation had been injured.<sup>222</sup> Similarly, a wager bringing any inconvenience was void and illegal.<sup>223</sup>

A wager in relation to a third person could be maintained by the court only if the occasion that the third person who happened to be the subject matter of the wager would not be injured or affected by the wager.<sup>224</sup> Accordingly, the case of *Micklefield v Hepgin*<sup>225</sup> held that a wager was good as to “whether a certain agreement purporting to be subscribed by A really was subscribed by him”. Eyre, the Chief Baron, insisted that that wager was valid because the wager did not affect the character or feeling of the third party.

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<sup>219</sup> *Da Costa v Jones* (1778) 2 Cowper 729

<sup>220</sup> *Allen v Rescouis* (1675) 2 Levinz 174

<sup>221</sup> R Merkin, ‘Gambling by Insurance - A study of The Life Assurance Act 1774’ (1980) 9 Anglo-Am 331, 336

<sup>222</sup> *Ditchburn v Goldsmith* (1815) 4 Campbell 152

<sup>223</sup> *Eltham v Kingsman* (1818) 1 B & Ald.683

<sup>224</sup> *Earl of March v Pigot* (1771) 5 Burrow 2802

<sup>225</sup> *Micklefield v Hepgin* (1792) 1 Anstruther 133

### *1.3.2.5 Wagers upon unlawful subjects invalid*

At common law, such wager contracts upon “cock-fighting, card games (other than those of mere skill) and (probably) all games of chance”<sup>226</sup> were held void in the courts. No action could lie on a wager in relation to cock-fighting, and the court would not try such an action. Lord Ellenborough thought that there were two reasons for this doctrine. In the first place, cruelty to the cock in the game of cock-fighting should be considered questionable. Allowing such barbarous diversion could also degrade the Courts of Justice and was inconsistent with that dignity which was essential to the public welfare that a Court of Justice should always preserve.<sup>227</sup>

So with a wager upon a dog-fight, the judge would order it to be struck out of the cause paper and he would not try such a case.<sup>228</sup> Abbott CJ was of the opinion that trying an action concerning a dog-fight or man-fight was wasting the Court’s time and that such wagers were illegal. What should however be pointed out here is that a wager could not be simply decided legal or not merely because neither parties of the wager had an interest in the subject matter of the wager.<sup>229</sup> In comparison, an action was rendered maintainable on a wager of “a rump and dozen” (a good dinner and wine), whether the defendant be older than the plaintiff, since no uncertainty and illegality existed as to the subject matter.<sup>230</sup>

Also, the court would try an action upon a wager on a legal horse-race, however, two prerequisites must be satisfied: firstly, the sums betted by the parties must

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<sup>226</sup> Professor Hugh Beale, *Chitty on Contracts* (vol II, 32th edn, Sweet & Maxwell 2016) 41-010

<sup>227</sup> *Squires v Whisken* (1811) 3 Campbell 140

<sup>228</sup> *Egerton v Furzeman* (1825) 1 Carrington & Payne 613

<sup>229</sup> *Good v Elliott* [1790] 3 T P 693 settled this doctrine.

<sup>230</sup> *Hussey v Crickitt* (1811) 3 Campbell 168

be under £10, otherwise, it would run counter to 9 Ann. c. 14, which had prohibited various species of gaming under heavy penalties; secondly, the race itself must be, or upwards of, £50, or, it would be contrary to 13 Geo. II. c. 19, which had prohibited many species of horse-racing and nevertheless had also allowed horse races to be run for plates or sums of money amounting to £50.

Even though where the race run for was above £50, “a wager on the race might also be illegal unless it was a *bona fide* contest between two or more horses running on the turf.”<sup>231</sup> Lord Eldon Ch J said so in *Whaley v Pajot*,<sup>232</sup> which related to an action on a wager “that a single horse shall run on the high road from A to B and arrive sooner than one of two horses placed at any distance the owner shall please” with the sum run for being above £50, that the court should not try such an action, for the grounds that in terms of the exceptions to the prohibition of kinds of horse-racing being deemed to be illegal, 13 & 18 Geo. 2 related to bona fide horse-racing only, while the wager was obviously not concerning bona fide racing.<sup>233</sup> In *Ximenes v Jaques*,<sup>234</sup> a wager that the plaintiff could perform a journey of 240 miles in a post chaise and pair of horses in a given time was illegal, even though the sum run for was over £50, for it was not a case of bona fides. An action upon a wager on a horse-race, which was prohibited by the law due to lacking both of the qualifications, was not be maintained and might even have been illegal.<sup>235</sup>

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<sup>231</sup> *M'Allester v Haden* (1810) 2 Campbell 438

<sup>232</sup> *Whaley v Pajot* (1799) 2 B & P 51

<sup>233</sup> This was also the judgment of that Court in *Ximenes v Jacques* (1795) 6 TR 499

<sup>234</sup> *Ximenes v Jaques*, (1795) 6 TR 499

<sup>235</sup> *M'Allester v Haden* (1810) 2 Campbell 438

### 1.3.3 Wager policies by insurance

Although it had been suggested that wager policies were strongly disapproved of at common law in the earlier cases,<sup>236</sup> the position of whether or not wager policies in the guise of different types of insurance were valid was in effect uncertain at common law before the passage of the 1745 MIA.<sup>237</sup> Before the 1774 LAA was passed, at common law, the courts always tended to enforce wager policies in the form of life insurance in England.<sup>238</sup> Wager policies of insurance other than on marine risks, before the 1845 GA, could also be enforced.<sup>239</sup> By contrast, in equity, wager policies by insurance seemed to be void: for example, in a case of fire insurance, the assured was required to have an interest or property in the subject matter insured, at the time not only of effecting the insurance contract, but also at the time of the loss occurring.<sup>240</sup>

#### 1.3.3.1 Invalid in earlier decisions

At common law, an old judgement<sup>241</sup> held that a wager policy was void, namely, the assured could not recover against the insurer unless he had an interest in the subject matter, but such policies could otherwise be put before the courts. Despite the frequent use of PPI clauses, the courts would be more favourable to a bona fide assured than a wagerer. In equity, it was held as certain law that an insurance policy, in which the assured had no insurable interest, of course including a PPI policy, was void<sup>242</sup> and it had this effect from the very beginning.<sup>243</sup> The ground for this decision was that insurance was made for

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<sup>236</sup> *Sadlers' Co v Badcock* (1743) 2 Atk 554 [556]

<sup>237</sup> *Lucena v Craufurd* (1806) B & PNR 269 [296]

<sup>238</sup> James Allan Park, *A System of the Law of Marine Insurances, with Three Chapters on Bottomry; on Insurance on Lives; and on Insurance against Fire* (4th edn, A Strahan 1800) 430

<sup>239</sup> Nicholas Legh-Jones, Professor John Birds and David Owen, *MacGillivray on Insurance Law* (11th edn, Sweet & Maxwell 2008) 1-028

<sup>240</sup> *Sadlers' Co v Badcock* (1743) 2 Atk 554 [556]

<sup>241</sup> *Assievedo v Cambridge* (1711) 10 Modern 77

<sup>242</sup> *Godds v Garrett* (1692) 2 Vern 269

<sup>243</sup> *Martin v Sitwell* (1691) 1 Shower KB 156

encouraging the advancement of trade, rather than for persons, who had no interest making wagers, to gain a benefit. This decision seemed to represent the opinions of courts of equity.<sup>244</sup> In addition, an insurance policy upon goods made by the assured, who was not required to prove the interest, was held void.<sup>245</sup> The Court of Chancery would also tend to decree an insurance policy without interest to be cancelled.<sup>246</sup>

### 1.3.3.2 Valid period

Unfortunately, later courts were favourable to the validity of wager policies by insurance. There has been abundant evidence to prove the enforceability of wager policies by insurance at common law insofar as what was well established by the authorities, and this was stated by Chambre J:<sup>247</sup>

“particularly by the law of England as it stood at the time of passing the act 19 Geo. 2, a wager policy, in which the parties by express terms, such as the words “interest or no interest,” or “without proof of interest,” disclaimed the intention of making a contract of indemnity, was then (contrary to older determinations) deemed a valid contract of insurance”

In particular, prior to the eighteenth century, in relation to some cases at common law, such as *Jones v Randall*<sup>248</sup> and *Micklefield v Hepgin*,<sup>249</sup> the courts would totally enforce gambling contracts under the pretence of insuring,<sup>250</sup> as long as they were not falling within certain restrictions. It was also held in

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<sup>244</sup> Jonathan Gilman, Professor Robert M Merkin, Claire Blanchard and Mark Templeman, *Arnould's Law of Marine Insurance* (18th Revised edn, Sweet & Maxwell 2013) [11-04 footnote 14]

<sup>245</sup> *Le Pypre v Farr* (1716) 2 Vernon's Cases in Chancery 716

<sup>246</sup> *Whittingham v Thornburgh* (1690) 2 Vernon's Cases in Chancery 206

<sup>247</sup> *Lucena v Craufurd* (1802) 3 B & P 75 [101]

<sup>248</sup> *Jones v Randall* (1774) 1 Cowp 37

<sup>249</sup> *Micklefield v Hepgin* (1793) 1 Anst 133

<sup>250</sup> Yang Liangyi, *Marine Cargo Insurance* (3rd edn, Law Press China 2013) 107

*Depaba v Ludlow* that a policy with the term “interest or no interest” was a good one, and the significance of such terms was that the assured did not have to prove his interest, because the insurer could not controvert that.<sup>251</sup> In fact, prior to passing the 1745 MIA, the validity of wager contracts and of those in the guise of insurance under English law was the same: they were enforceable contracts unless they did contravene public interest.<sup>252</sup> In the case of *Dean v Dicker*,<sup>253</sup> an insurance policy having “interest or no interest” clauses written on the face of it was held as a wager and the plaintiff was entitled to recover since he had entered into a wager policy with the insurer on the basis of a total loss in the course of the voyage and this is what had happened. It could be inferred from this case that the courts would deal with wager policies and pure wagers and such policies were enforceable. The common law afterwards required the assured to show a loss to invalidate insurance by way of wagering; however, PPI terms were inappropriately used to evade the requirement of indemnity.<sup>254</sup>

Because of merchants being able to benefit from such policies, PPI policies were widely used in the practice of insurance:<sup>255</sup> in the time of Charles II, such policies were common in marine insurance practice; and they were also deemed to be valid and legal in the reign of Queen Anne.<sup>256</sup> Wager policies then had not been prohibited by common law, the insurance companies would therefore not bother to inquire about the existence of insurable interest and issue such policies taking the advantage of the legal position to get much more

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<sup>251</sup> *Depaba v Ludlow* (1720) 1 Comyns 360

<sup>252</sup> ALRC 20, para 108

<sup>253</sup> *Dean v Dicker* (1746) 2 Str 1250

<sup>254</sup> ALRC 20, para 108

<sup>255</sup> *Sadlers' Co v Badcock* (1743) 2 Atk 554 [556]

<sup>256</sup> Jonathan Gilman, Professor Robert M Merkin, Claire Blanchard and Mark Templeman, *Arnould's Law of Marine Insurance* (18th Revised edn, Sweet & Maxwell 2013) 11-02

profit. In return, because wager policies could bring the practice of insurance more benefits and, to a large extent convenience, the courts tended to enforce such policies.<sup>257</sup> Because of the above reasons, contrary to common sense, such contracts therefore became legal at last.<sup>258</sup>

#### *1.3.3.3 Intentions of parties to contracts affecting validity.*

However, the purpose of the parties to a wager policy by insurance would influence the validity of such a policy. If the parties really intended to lay a wager of winning or losing the stake, then such a policy would not be held void by showing this purpose of making a wager and they would not be regarded as being an indemnity contract and not ruled by the principle of indemnity. This is because PPI policies on marine risks were in general valid at common law before the 1745 MIA.<sup>259</sup> Despite the effect of the Act, a pure wager on marine risks, rather than one in the guise of marine insurance, was valid because wagers were valid until the 1845 GA. The assured thus needed not to prove its interest in the subject matter and the insurer would not be allowed to controvert that.<sup>260</sup> By contrast, where it was intended to be an indemnity contract or there was no obvious evidence to show it was a wager, it would be regarded as an unenforceable policy due to the lack of insurable interest in the subject matter, just as was the position of a normal insurance contract. Because, if the policy of marine insurance in question was declared to be an indemnity insurance, and subject to the indemnity principle, the assured could not recover without showing its interest in the subject matter insured to prove its loss.

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<sup>257</sup> Robert Surridge, Noleen Dignan, Sara Forrest, Alison Broadberry and Duncan Backus, *Houseman and Davies: Law of Life Assurance* (11 th edn, Butterworths 1994) 17

<sup>258</sup> *Cousins v Nantes* (1811) 3 Taunt 513

<sup>259</sup> *Dean v Dicker* (1746) 2 Str 1250

<sup>260</sup> *Depaba v Ludlow* (1720) 1 Comyns 360

Because of the above analysis, where the insurer rejected a claim by the assured under an insurance policy not written with PPI terms but having had no insurable interest, neither could the assured be entitled to recover by bringing an action alleging it to be a wager policy. The nature of marine insurance policy mattered: if it was held as an indemnity contract and the purpose of the parties was deemed to be claiming for a real loss, as a result, the policy could not be enforced without the proof of an interest. A judge<sup>261</sup> set out that: “a policy containing no such clause, disclaiming or dispensing with the proof of interest, was to be considered as a contract of indemnity only, upon which the assured could never recover without proof of an interest.” If there was nothing to show that a policy was a wager policy, such a policy would be treated as one dependent on the requirement for insurable interest. Without showing the possession of insurable interest in the subject matter, the action would not be maintained and such a policy would be held illegal and void.<sup>262</sup> On the other hand, by showing the existence of PPI terms in the policy, a PPI policy into which PPI terms had been inserted was held as a wager due to the form of the policy.

Therefore, for the convenience of a claim, PPI clauses had commonly been inserted into wager policies to prove that the purpose of them was to wager rather than to get indemnified for a real loss. Without inserting such clauses into a policy, the assured could not recover his loss unless an insurable interest was proved.<sup>263</sup> Although PPI clauses had been improperly used as an instrument of

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<sup>261</sup> *Lucena v Craufurd* (1802) 3 B & P 75 [101]

<sup>262</sup> *Cousins v Nantes* (1811) 3 Taunt 513

<sup>263</sup> *Sadlers' Co v Badcock* (1743) 2 Atk 554 [556]

wager for profiting, it was not right to have the view that only wager policy tended to use PPI terms.<sup>264</sup> Such terms were originally used in circumstances in which the assured had a real insurable interest but which was difficult to prove. Lawrence J stated the same opinion that, on some occasions other than the possession of property, there may be some difficulty in showing that the advantages which the assured had insured would have arisen without the happening of sea risks.<sup>265</sup> Unfortunately, such terms were however widely abused as an instrument to wager.<sup>266</sup>

#### **1.3.3.4 Conclusion**

In light of the validity of wager policies at common law, they were then void at earlier common law and in contemporaneous equity law. Before the 1745 MIA, and later common law, for reasons of facilitating business, men validated wager policies of insurance. In spite of the validity, without declaring a wager policy to be a wager rather than an indemnity contract, it would be deemed as a normal insurance contract and the assured would be required to prove his possession of insurable interest in order to recover. Thus, both the 1745 MIA and subsequent common law required an assured to have an insurable interest at the time of loss for recovery. As to exceptions to the application of the 1745 MIA, such as foreign ships, in light of the validity of wagers under the common law, it would validate policies on subjects falling within the ambit of exceptions, which must include terms dispensing with insurable interest and PPI or like terms.

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<sup>264</sup> For example, honour policies

<sup>265</sup> *Lucena v Craufurd* (1806) B & PNR 269 [301]

<sup>266</sup> Nicholas Legh-Jones, Professor John Birds and David Owen, *MacGillivray on Insurance Law* (11th edn, Sweet & Maxwell 2008) 1-022

## 1.4 The relationship between contracts of wager and insurance

The payments under both contracts of wager and insurance depend on the future uncertain event. It is the requirement of insurable interest that distinguishes them: for an insurance contract, the assured must have an insurable interest in the subject matter of the insurance or such an expectation at the time of the contract to avoid it being void, and it must have an interest in the subject at the time of loss to prove that it has suffered a loss should the matter be destroyed; in comparison, the parties to a wager contract have no interest in the contract other than the stake they will win or lose. If a policy is in the common form, it will be considered as a policy on interest. But if the face of the policy plainly shows it is a wager, it will be a wager.<sup>267</sup> Even though the policy does not plainly declare it to be a wager, if it can be proved to be one, it is still a wager.<sup>268</sup> The form of an insurance policy can affect the nature of the contract: if it be one declaring itself to be a wager, it will be deemed to be a wager contract; whereas if it be in the form of a normal insurance contract, it will be regarded as an indemnity policy of insurance. Even though the assured has a real insurable interest, the form of the PPI policy will result in the invalidity of such a policy.

### 1.4.1 Definition of insurance contracts

#### 1.4.1.1 Various definitions

It is acknowledged that it is not easy to give a precise definition of an insurance contract.<sup>269</sup> In English law, no comprehensive definition has been given.<sup>270</sup> A

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<sup>267</sup> *Cousins v Nantes* (1811) 3 Taunt 513

<sup>268</sup> *Lewis v Rucker* (1761) 2 Burr 1167

<sup>269</sup> Nicholas Legh-Jones, Professor John Birds and David Owen, *MacGillivray on Insurance Law* (11th edn, Sweet & Maxwell 2008) 1-001

<sup>270</sup> Rober Merkin, *Insurance Law: An Introduction* (1st edn, Informa Law from Routledge 2007) chapter 1

helpful working definition of indemnity insurance<sup>271</sup> was however provided by Channell J as follows: “a contract of insurance is one whereby the assured pays some consideration (usually the premium) to recover a sum of money or for some corresponding benefit, which becomes due on the happening of an event having the nature of uncertainty and adverse to the interest of the person effecting the insurance.”<sup>272</sup>

A definition of indemnity insurance was also given by Sir Peter Webster in a case<sup>273</sup> concerning fire insurance, that:

“it is an agreement by the insurer to confer on the insured a contractual right which, prima facie, comes into existence immediately when loss is suffered by the happening of an event insured against, to be put by the insurer into the same position in which the insured would have been had the event not occurred, but in no better position.”

The definition, similar to the definition provided by Channell J, noticed that a contract of insurance was an agreement by the insurer to promise to pay the assured on the occurrence of certain events insured. Besides, the nature of insurance contracts, which were kinds of indemnity insurance, was also mentioned: the assured could only be put “into the same position in which the insured would have been had the event not occurred, but in no better position.”

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<sup>271</sup> Nicholas Legh-Jones, Professor John Birds and David Owen, *MacGillivray on Insurance Law* (11th edn, Sweet & Maxwell 2008) 1-001

<sup>272</sup> *Prudential Insurance Co v Inland Revenue Commissioners* [1904] 2 KB 658

<sup>273</sup> *Callaghan v Dominion Insurance Co* (1997) 2 Lloyd's Rep 541, 544

The requirement of insurable interest was nevertheless discussed by this definition.

According to an early publication, “a policy on insurance is a contract between A and B that upon A’s paying a premium equivalent to the hazard run, B will indemnify or insure him against a particular event.”<sup>274</sup> Some have suggested that contracts of insurance could be defined as “a contract for the payment of a sum of money, or for some corresponding benefits, to become due on the happening of an uncertain event of a character adverse to the interest of the person effecting the insurance”.<sup>275</sup> The latter was a better concept, because insurance against what type of particular event was not particularly mentioned by the former.

The definition of insurance was in general set out by a French author, which meant a contract by which one party to the contract, by paying the consideration (the premium), aimed to get indemnified against loss arising from the fortuitous accidents insured against to which something is exposed; the other party to the contract charged himself with the premium as the price of perils and was bound to compensate such loss.<sup>276</sup> Insurable interest was also not required by this definition.

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<sup>274</sup> William Blackstone, *Commentaries on the Law of England* (1st edn, Clarendon Press 1765-1769) vol 4, 458

<sup>275</sup> Robert Surridge, Noleen Dignan, Sara Forrest, Alison Broadberry and Duncan Backus, *Houseman and Davies: Law of Life Assurance* (11 th edn, Butterworths 1994) 17

<sup>276</sup> *Lucena v Craufurd* (1806) B & PNR 269 [300]

Lawrence J<sup>277</sup> summarised that a contract of insurance, in which no requirement of insurable interest was mentioned, could be defined as:

“a contract by which the one party in consideration of a price paid to him adequate to the risk, becomes security to the other that he shall not suffer loss, damage, or prejudice by the happening of the perils specified to certain things which may be exposed to them.”

#### *1.4.1.2 Three requisites of an insurance contract*

In general, to become a contract of insurance, three main elements must be satisfied: promising to pay the premium, an uncertain event, such event characteristic of being against the assured’s insurable interest.<sup>278</sup>

In the first place, commonly, the assured should pay the premium, which is calculated by referring to risk, as the consideration for the insurer’s obligation to indemnify the loss. The first requirement in a contract of insurance considered by Channell J was that “a contract whereby for some consideration, usually but not necessarily for periodical payments called premiums, you secure to yourself some benefit, usually but not necessarily the payment of a sum of money, upon the happening of some event”.<sup>279</sup> However, the requirement of a premium has not been mentioned by the Financial Services and Markets Act 2000 (FiSMA),<sup>280</sup> which is intended to supervise and regulate the effecting and carrying out, as principal, of an insurance contract.<sup>281</sup> An insurance company

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<sup>277</sup> *Lucena v Craufurd* (1806) B & PNR 269 [301]

<sup>278</sup> *Prudential Insurance Co v Inland Revenue Commissioners* [1904] 2 KB 658

<sup>279</sup> *Prudential Insurance Co v Inland Revenue Commissioners* [1904] 2 KB 658

<sup>280</sup> Professor Robert M Merkin, *Colinvaux’s Law of Insurance* (11th edn, Sweet & Maxwell 2016) 4-010

<sup>281</sup> Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 (2001 Order, *infra*), s 10

under the earlier law was supposed to have a profit motive,<sup>282</sup> but nevertheless under common law friendly societies could indeed carry on insurance business.<sup>283</sup> The promise which the insurer has made is to indemnify money or corresponding benefits, and more specifically for the latter, reinstating or replacing damaged or lost property.<sup>284</sup>

Secondly, the event should be characteristic of some amount of uncertainty.<sup>285</sup> In the case of indemnity insurance contracts, the insurer must, under his obligation, compensate the assured on the occurrence of the future uncertain event. Therefore, an insurance contract cannot be held valid which is dependent on a certain event occurring or an event having occurred, other than a policy containing the “lost or not lost” clause,<sup>286</sup> before effecting the insurance contract.

Last but not least, in the marine context, most importantly, the insurance must be against something.<sup>287</sup> In other words, a loss or detriment of the insurable interest possessed by the assured in the subject matter would have taken place. Buckley admitted that, in the cases of indemnity insurance, it was definitely necessary to see “whether there has occurred an event adverse to the person who is insured, such as that, having suffered a loss by reason of that adverse

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<sup>282</sup> *Hall D’Ath v British Provident Association for Hospital and Additional Services* (1932) 48 TLR 240

<sup>283</sup> Professor Robert M Merkin, *Colinvaux’s Law of Insurance* (11th edn, Sweet & Maxwell 2016) 4-006

<sup>284</sup> Professor Robert M Merkin, *Colinvaux’s Law of Insurance* (11th edn, Sweet & Maxwell 2016) 4-007

<sup>285</sup> *Prudential Insurance Co v Inland Revenue Commissioners* [1904] 2 KB 658

<sup>286</sup> This is explained in detail later on: see 2.4.2.

<sup>287</sup> *Prudential Insurance Co v Inland Revenue Commissioners* [1904] 2 KB 658

event, he is to be indemnified by the sum which is guaranteed to him under the policy".<sup>288</sup> Such risks were regarded as one of the determining factors for defining a contract of insurance.<sup>289</sup> Transfer of risk was clearly mentioned in *Arnould*: "A true contract of insurance is one under which, for some consideration, the policyholder secures to himself some benefit upon the happening of an uncertain event beyond his own control and adverse to his interests by transferring some or all of the risk to the insurers".<sup>290</sup> There was therefore no insurance if no risk was transferred from the assured to the insured. Waller J thus stated that a contract under which a broker was authorized to accept risks in the person of an underwriter by binding authorities was clearly not a contract of insurance, as no risk had been transferred by the assured to the underwriter under such a contract.<sup>291</sup>

#### 1.4.2 Concept of a wager contract

##### 1.4.2.1 Wagering contract defined

Hawkins J gave the concept of a wagering contract in *Carlill v Carbolic Smoke Ball Company*,<sup>292</sup> although he conceded that there was difficulty to define precisely a contract of wager and to distinguish a wager from an ordinary contract. He stated that:

"A wagering contract is one by which two persons, professing to hold opposite views touching the issue of a future uncertain event, mutually agree that, dependent on the determination of that event, one shall win from the other, and the other shall pay... a sum of money...; neither of the

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<sup>288</sup> *Gould v Curtis* [1913] 3 KB 84 [95]

<sup>289</sup> Professor Robert M Merkin, *Colinvaux's Law of Insurance* (11th edn, Sweet & Maxwell 2016) 1-030

<sup>290</sup> Jonathan Gilman, Professor Robert M Merkin, Claire Blanchard and Mark Templeman, *Arnould's Law of Marine Insurance* (18th Revised edn, Sweet & Maxwell 2013) 1-09

<sup>291</sup> *Pryke v Gibbs Hartley Cooper* (1991) 1 Lloyd's Rep 602

<sup>292</sup> *Carlill v The Carbolic Smoke Ball Company* [1892] 2 QB 484 (QB) 490–491

contracting parties having any other interest in that contract than the sum or stake he will so win or lose...”.

From the above concept, it seemed that, to constitute a wager contract, four essential factors must be fulfilled as follows. First, the issue of a future uncertain event would decide which party to a wager shall win the stake. The winning or losing of each party was uncertain, because it was dependent on the issue of a future uncertain event. It thus was not a wagering contract due to the certainty of either of the parties' winning or losing; namely, if either or both of the parties were sure to win or lose, it was not a wager contract.<sup>293</sup> Secondly, it was necessary for a wager that each party shall either win or lose.<sup>294</sup> Thirdly, the common purpose to wager by two parties to a wager, or mutuality of intent as to hazard, rather than to an indemnity contract, was indispensable to the definition of a wager contract.<sup>295</sup> Mutuality of wagering should thus be entailed in the concept of a wager contract.<sup>296</sup> If one party desired to make a wagering contract whereas the other did not, such a contract would then not be regarded as a wager contract, but nevertheless be deemed as having no difference with an ordinary contract, where appropriate, which was enforceable by law.<sup>297</sup> Fourthly, in a wager contract, neither party had an interest in the subject matter of the wager other than the stake he shall win or lose.

An example of a bet on a horse-race as a pure wager contract was recited by Hawkins J to explain the above elements of a wager. A had a bet with B, who

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<sup>293</sup> *Carlill v The Carbolic Smoke Ball Company* [1892] 2 QB 484 (QB) 490–491

<sup>294</sup> Edwin W Patterson, 'Insurable Interest in Life' (1918) 18 CLR 381, 385

<sup>295</sup> Opinion prepared for the International Swaps and Derivatives Association (ISDA) by Robin Potts QC, Erskine Chambers, 24 June 1997

<sup>296</sup> *Grizewood v Blane* [1851] 11 CBR 526; *Thacker v Hardy* 4 QBD 685; *Blaxton v Pye* 2 Wils 309

<sup>297</sup> *Grizewood v Blane* [1851] 11 CBR 526

offered odds of ten to one, for £100 to win the Derby. Before the race was over, the outcome of the horse-race was uncertain, which was the first element of a wager. Before that, B may lose £1000, or win £100, and A may lose £100, or win £1000; but each must be a winner or a loser in the event, which satisfied the first element of the above concept. In such a bet, like the third element mentioned above, both parties had clearly known the nature and intention of his engagement, viz. there was mutuality in the bet contract, which was the second element. Lastly, neither party had an interest in the horse wagered on, other than the stake it shall win or lose.

#### *1.4.2.2 What kind of interest do the parties to a wager contract have?*

As to the essential elements of a wagering contract, more attention should be paid to insurable interest, in relation to the definition of a wagering contract, for it is deemed to provide “a dividing line between gambling and insurance”.<sup>298</sup> Interest nevertheless was not mentioned in detail by Hawkins J, although this was mentioned in his definition and in the above example, which reflected his whole definition. In other words, the nature of the interest required above was unclear: a statutory insurable interest or an interest to prove loss. So far as the above definition was concerned, the interest may be “any other interest in that contract” of the contracting parties, not the type of insurable interest which one or both of the parties may have in the property of the wagering object, because the proprietary interest was not the interest mentioned in the definition of a wagering contract. The subject matter of a wagering agreement was the future uncertain destiny of the property, not the property itself.

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<sup>298</sup> 2011 CP, para 10.12

### *1.4.2.3 The concept of a wager policy*

Before the 1845 GA, the validity of a pure wager and wager policy is different. It is thus necessary, except for the above definition of a wager contract, to define a wager policy. The definition of a wager (or honour) policy may be given from two aspects: the form and the nature of such a policy. As to the form, as long as PPI clauses appear on the face of the policy, it will be vitiated by such clauses and rendered void. The following typical clauses may be expressly stipulated on the face of it: “interest or no interest” or “without further proof of interest than the policy itself” or “this policy to be deemed sufficient proof of interest”, or “free of all average and without benefit of salvage to the insurer”.<sup>299</sup> In fact, it will be deemed as a PPI clause as long as it has the effect of dispensing with proof of insurable interest. Relating to the nature of a wager policy, the parties to it must intend to make a wager rather than an indemnity contract:<sup>300</sup> it is taken out to win the stake or money instead of recovering the loss.

### *1.4.2.4 Conclusion*

To be a wager contract, the four elements discussed above must be satisfied. The parties to a wager contract have no interest in the subject wagered on, whereas, even though generally the parties to a wager policy also tend to have no interest, in some situations they do indeed have an insurable interest in the subject matter insured. Thus, to constitute a wager contract, it is not necessary to require that the parties have no interest in the subject other than the stake to win or lose, whereas it is enough to be a wager contract where the parties mutually agree to make a wager on a subject dependent on the outcome of a future uncertain event, as a result of which each party shall either win or lose.

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<sup>299</sup> Jonathan Gilman, Professor Robert M Merkin, Claire Blanchard and Mark Templeman, *Arnould’s Law of Marine Insuranc*, (18th Revised edn, Sweet & Maxwell 2013) 11-03

<sup>300</sup> *Edwards v Motor Union Ins Co* [1922] 2 KB 249 (KB) 255

### 1.4.3 Similarity between contracts of insurance and wager

#### 1.4.3.1 Insurance deriving from wager

There was a close connection between wager and insurance. From the perspective of the historical study, insurance, which was an instrument used to avoid risk, paradoxically evolved to a considerable extent from wagers.<sup>301</sup> Actually, insurance itself was even made a type of wager:<sup>302</sup> “Much insurance in the eighteenth century was indeed underwritten on purely speculative contingencies such as the outcome of sieges, the timing of births, and especially the longevity of individuals.”<sup>303</sup> In the life insurance context, it was argued that insurance on life “was still a form of lottery, because insurance consists essentially of wagering on contingent events”.<sup>304</sup> Furthermore, according to a statistical analysis, during the period from 1759 to 1773, a total of 52 life insurance policies were effected by an underwriter, some of which were pure wagers and eight of which were wager policies by insurance.<sup>305</sup> Wager in the guise of insurance thus quickly became an established feature of the practice of insurance.

#### 1.4.3.2 Grounds for deeming wager policies as insurance

In the eighteenth century, before the 1774 LAA was passed, wager policies in the form of insurance were often, for a time, regarded as a serious method of insurance. Defoe illustrated this view that a wager policy, which was previously

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<sup>301</sup> Geoffrey Wilson Clark, *Betting on Lives: The Culture of Life Insurance in England, 1695-1775* (Manchester University Press 1999) 3

<sup>302</sup> Geoffrey Wilson Clark, *Betting on Lives: The Culture of Life Insurance in England, 1695-1775* (Manchester University Press 1999) 40

<sup>303</sup> Geoffrey Wilson Clark, *Betting on Lives: The Culture of Life Insurance in England, 1695-1775* (Manchester University Press 1999) 4

<sup>304</sup> Geoffrey Wilson Clark, *Betting on Lives: The Culture of Life Insurance in England, 1695-1775* (Manchester University Press 1999) 35

<sup>305</sup> Geoffrey Wilson Clark, *Betting on Lives: The Culture of Life Insurance in England, 1695-1775* (Manchester University Press 1999) 35

identified as a form of gambling, had now switched sides and become a type of insurance.<sup>306</sup> It should not be surprising, for the following two reasons, to find that these two kinds of contracts were often conflated and confused.<sup>307</sup>

In the first place, according to the above definitions of insurance contracts and wager contracts, there was indeed a similarity between the two contracts, because both of them required the consideration of a promise to pay a sum of money dependent upon a future uncertain event.<sup>308</sup> Specifically, both of them had to satisfy the following three elements: (1) A mutual agreement between the parties that according to the issue of a future uncertain event, one shall receive from the other a sum of money; (2) the necessity that each party shall either win or lose; (3) mutuality of intent as to hazard, although the purpose of making the two contracts was different because insurance was intended to recover whereas a wager aimed to win a stake.<sup>309</sup> Therefore, a mere wager contract might become a contract of insurance if the assured could prove he had an insurable interest in the subject matter,<sup>310</sup> which was the key factor in distinguishing these two classes of contracts.

Secondly, the reasons were that both contracts of insurance and wager were often dealt with by insurance companies.<sup>311</sup> In the eighteenth century, the

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<sup>306</sup> Daniel Defoe, *Essay Upon Projects* (Cassell & Company 1887) the chapter of "Of Wagering"

<sup>307</sup> Johann Huizinga, *Homo Ludens: A Study of the Play-Element in Culture* (Routledge & Kegan Paul, 1949) 52-53

<sup>308</sup> Ernest W Huffcut, *Principles of the Law of Contract* (8th edn, New York and Albany: Banks & Bros 1897) 228

<sup>309</sup> Edwin W Patterson, 'Insurable Interest in Life' (1918) 18 CLR 381, 385

<sup>310</sup> *Prudential Insurance Co v Inland Revenue Commissioners* [1904] 2 KB 658

<sup>311</sup> Geoffrey Wilson Clark, *Betting on Lives: The Culture of Life Insurance in England, 1695-1775* (Manchester University Press 1999) 45

business of insurance routinely handled various pure wagers and wager policies: “bets on the movement of stocks and the outcome of battles, the possibility of shipwrecks, and the hour of people’s deaths”.<sup>312</sup> The reasons why insurance offices had taken out wager policies were that “the sporting part of insurance ... is almost as considerable as the [insurance of real property]; and is on the whole much more profitable”.<sup>313</sup> On the other hand, the grounds why wager contracts availed themselves of insurance were that more chances of speculative contingencies could be furnished by the tool of insurance<sup>314</sup> and the English law was reluctant to invalidate the contracts of insurance, especially, life insurance.<sup>315</sup> Besides, by means of insurance, wager policies could obtain an extremely good reputation.<sup>316</sup>

#### 1.4.4 Distinction between insurance and wagers

##### 1.4.4.1 Insurable interest

1.4.4.1.1 Insurable interest is a key factor to distinguish a wager from an insurance contract

Both contracts of insurance and wager were aleatory ones,<sup>317</sup> although Lord Summer agreed that a wager contract was an aleatory contract whereas a marine insurance contract was an indemnity one under which the assured must prove possession of an insurable interest at the time of loss.<sup>318</sup> Notwithstanding the dispute, both included three elements of the concept of wager contracts

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<sup>312</sup> Geoffrey Wilson Clark, *Betting on Lives: The Culture of Life Insurance in England, 1695-1775* (Manchester University Press 1999) 40

<sup>313</sup> Thomas Mortimer, *Every Man His Own Broker* (S. Hooper 1769) 98

<sup>314</sup> Samuel Marshall, *A Treatise on the Law of Insurance* (vol 1, Manning and Loring 1805) 672

<sup>315</sup> The Friendly Society, *Land Security, for Establishing a Perpetual Insurance on Lives of Men, Women and Children* (1715) 12-13

<sup>316</sup> Daniel Defoe, *Essay Upon Projects* (Cassell & Company 1887) the chapter of “Of Wagering”

<sup>317</sup> Professor John Birds, Ben Lynch and Simon Paul, *MacGillivray on Insurance Law* (13th edn, Sweet & Maxwell 2016) 1-012

<sup>318</sup> *Macaura v Northern Assurance Co Ltd* [1925] AC 619 (HL) 632 (Sumner LJ)

summarized by *Patterson*<sup>319</sup> other than the factor of insurable interest. Insurable interest had a significant effect on the distinction between contracts of insurance and wagers,<sup>320</sup> which provided “a dividing line between gambling and insurance”.<sup>321</sup> Colman QC regarded it as an essential feature of a wager contract that neither party had any interest in the subject matter wagered on except for the stake to be won or lost.<sup>322</sup> In the case of *O’Kane v Jones*,<sup>323</sup> it was contended that the introduction of the concept of insurable interest was intended to distinguish “legitimate” contracts of insurance from gaming and wagering contracts. In the indemnity insurance context, the reason why the assured took out a contract of insurance was to avoid the risk of loss adverse to the insurable interest possessed by the assured in the subject matter and to protect such an interest.<sup>324</sup>

The future uncertain event must be adverse to the assured’s insurable interest, otherwise the assured would never be exposed to the risk of loss by perils of the sea and the insurer may have to return the premium because there would be no consideration for the premium.<sup>325</sup> By comparison, none of the parties to wager contracts had any interest in the subject other than the sum wagered. Due to the lack of insurable interest, a wager could never become a contract of insurance. As to the risk of a wager arising from the concluding of wagering contracts, the only risk of loss is that the sum or money wagered would not get

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<sup>319</sup> Edwin W Patterson, ‘Insurable Interest in Life’ (1918) 18 CLR 381, 385

<sup>320</sup> Edwin W Patterson, ‘Insurable Interest in Life’ (1918) 18 CLR 381, 385

<sup>321</sup> 2011 CP, para 10.12

<sup>322</sup> *Sharp v Sphere Drake Insurance Co (The Moonacre)* (1992) 2 Lloyd’s Rep 501, 510

<sup>323</sup> *O’Kane v Jones, The Martin P* [2005] Lloyd’s Rep IR 174, 205

<sup>324</sup> Rober Merkin, *Insurance Law: An Introduction* (1st edn, Informa Law from Routledge 2007) chapters 1 and 7

<sup>325</sup> *Prudential Insurance Co v Inland Revenue Commissioners* [1904] 2 KB 658

paid.<sup>326</sup> Thus, a contract without an insurable interest or an expectation of such an interest would be deemed to be an invalid wager. In a word, insurable interest was of high importance in distinguishing insurance from wagers. The fact of the assured having an insurable interest may transfer a pure wager into an insurance contract. In fact, as long as the assured had an insurable interest in the subject matter, the contract was an insurance contract rather than a wager, even on the occasion where the interest was overvalued, unless there were PPI clauses on the face of it.<sup>327</sup> Contrastingly, a contract without it could only be regarded as a wager.<sup>328</sup>

#### 1.4.4.1.2 A middle kind of interest not necessarily meaning an insurable interest

There was thus a necessity to prove that the assured had an insurable interest to support the validity of the policy. It was argued that the existence of an insurable interest was of itself proved as long as the policy was not a wager because in such a case the assured had an interest in the subject insured which was sufficient to prevent it being a wager and so amount to an insurable interest. There may thus be a dispute as to whether an interest sufficient to prevent a policy being a wager meant an insurable interest or whether the existence of an insurable interest could be fulfilled by the absence of a wager contract. It was on this basis that all contracts for the payment of money on the happening of a future uncertain event could only be divided into two types: wagers without an interest and insurance contracts with an insurable interest.<sup>329</sup> For example, a dictum of Anthony Colman QC stated that “Neither the words of any statute

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<sup>326</sup> Rober Merkin, *Insurance Law: An Introduction* (1st edn, Informa Law from Routledge 2007) chapters 1, 7

<sup>327</sup> *Glafki Shipping Co SA v Pinios Shipping Co No 1, The Maira (No 2)* [1984] 1 Lloyd's Rep 660, 667

<sup>328</sup> *Prudential Insurance Co v Inland Revenue Commissioners* [1904] 2 KB 658

<sup>329</sup> Jonathan Gilman, Robert Merkin, Mr M J Templeman, Claire Blanchard, Julian Cooke, Philippa Hopkins, *Arnould's Law of Marine Insurance* (18th Revised edn, Sweet & Maxwell 2013) 11-01

since 1845 nor any judicial pronouncement suggest that there should be a category of contracts of insurance which were not wagering contracts but which on account of the absence of an “insurable interest” should not be enforceable.”<sup>330</sup> Due to the confusing position, in the case where the question whether the assured has an insurable interest in the subject matter of insurance arose, it may be wrongly argued that there was an insurable interest because the policy was not a wager one or the other party did not contend that the policy was not a wager one.<sup>331</sup>

The dictum was however disapproved of by the Court of Appeal in the *Feasey* case: an interest which was sufficient to preclude a policy being a wager and could take a policy out of the realms of the 1845 GA did not necessarily amount to an insurable interest. In reality, there were some kinds of interest which could prevent a policy being a wager but nonetheless was not sufficient to be an insurable interest. In the case of *Macaura*, even though Sumner LJ confessed that the assured would sustain a loss due to the loss of timber caused by fire, he still held that, because the timber was the company’s assets, the relationship between the assured and the timber in question was thus not one recognised by law or in equity.<sup>332</sup> In this case, even though the interest in question was that the assured suffered a pecuniary loss caused by the loss of the insured timber and it could preclude the policy being a wager, it was not an insurable interest. It was submitted that there was a middle interest which could preclude a policy

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<sup>330</sup> *Sharp v Sphere Drake Insurance Co (The Moonacre)* (1992) 2 Lloyd’s Rep 501, 510

<sup>331</sup> *Feasey v Sun Life Assurance Co* [2003] Lloyd’s Rep IR 637 [53]

<sup>332</sup> *Macaura v Northern Assurance Co Ltd* [1925] AC 619 (HL) 632 (Sumner LJ)

being a wager but however not amount to an insurable interest.<sup>333</sup> The middle interest may include an economic interest or pecuniary interest, i.e. whatever the nature of the interest, the assured would benefit from the preservation of the property or be prejudiced by its loss or damage, which was not an insurable interest in the past although it is now recognised as one type of an insurable interest. Thus, when to test whether an insurable interest existed, the starting point should focus on the existence of an insurable interest or the relationship between the assured and the property insured rather than prove the absence of a wager.<sup>334</sup>

#### 1.4.4.1.3 The mere expectation of future benefit sufficient to prevent a wager

The mere expectation of an insurable interest rather than a valid or actual insurable interest was sufficient to prevent an insurance being a wager.<sup>335</sup> In *Buchanan v Faber*,<sup>336</sup> a mere expectation of obtaining future rights dependent on the preservation of the property insured against which was not a real insurable interest was held sufficient to take the assured out of the realms of a wager, where such an expectation arose from the fact that he would in future make a contract by which in the case of the preservation he would benefit. A contract of marine insurance in which the assured had no real insurable interest at the time of concluding the contract was thus not necessarily void under s 4(2)(a) under the 1906 MIA. However, the mere hope of a future relationship to the subject matter insured was insufficient to prevent a policy being a wager.<sup>337</sup>

Thus, it was the relationship that the assured could in future benefit from the

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<sup>333</sup> Jonathan Gilman, Robert Merkin, Mr M J Templeman, Claire Blanchard, Julian Cooke, Philippa Hopkins, *Arnould's Law of Marine Insurance* (18th Revised edn, Sweet & Maxwell 2013) 11-01

<sup>334</sup> *Macaura v Northern Assurance Co Ltd* [1925] AC 619 (HL) 632 (Sumner LJ); *Lowry v Bourdieu* (1780) 2 Doug KB 468[470], 99 ER 299[300] (Mansfield LJ)

<sup>335</sup> Professor John Birds, Ben Lynch and Simon Paul, *MacGillivray on Insurance Law* (13th edn, Sweet & Maxwell 2016) 1-058; 1906 MIA, s 4(2)(a)

<sup>336</sup> *Buchanan v Faber* (1899) 4 Com Cas 223

<sup>337</sup> *Sharp v Sphere Drake Insurance Co (The Moonacre)* (1992) 2 Lloyd's Rep 501, 511

property rather than of only a future relationship that could distinguish insurance from a wager.

#### *1.4.4.2 The intentions of the parties*

The objects or intentions of contracts of insurance and wager were deemed to be the substantial factor in distinguishing these two kinds of contracts, which were similar in form.<sup>338</sup> Blackburn, J. stated that the distinction between contracts of insurance and wager was that insurance aimed “to indemnify the insured in respect of some interest which he has against the perils which he contemplates it will be liable to”.<sup>339</sup> The parties to a wager contract did not aim to protect an interest, because neither of the parties had any other interest in that contract other than the sum at stake he will win or lose<sup>340</sup> which was the essential feature of a wager,<sup>341</sup> whereas the purpose of the assured was to protect his interest in the subject matter insured by claiming for the loss suffered from the perils insured against.<sup>342</sup> The party taking out an insurance policy was thus attempting to get indemnified in the case of sustaining loss which would be suffered upon the occurrence of perils insured against,<sup>343</sup> while the purpose of a wagerer was nonetheless to benefit from a wager or just to win a stake.

In light of these distinguishable intentions, they were thus beneficial for differentiating the two types of contracts. In addition, without such a clear distinction, the insurer would be given an unfair disadvantage. In the words of Mansfield CJ, “unless there were words to distinguish wagering from other

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<sup>338</sup> Edwin W Patterson, ‘Insurable Interest in Life’ (1918) 18 CLR 381, 386

<sup>339</sup> *Wilson v Jones* (1867) LR 2 Ex 139, 150

<sup>340</sup> *Glafki Shipping Co SA v Pinios Shipping Co No 1, The Maira (No 2)* [1984] 1 Lloyd’s Rep 660, 667

<sup>341</sup> *Sharp v Sphere Drake Insurance Co (The Moonacre)* (1992) 2 Lloyd’s Rep 501, 510

<sup>342</sup> Edwin W Patterson, ‘Insurable Interest in Life’ (1918) 18 CLR 381, 385-386

<sup>343</sup> *Prudential Insurance Co v Inland Revenue Commissioners* [1904] 2 KB 658

policies, there would be a great disadvantage to the underwriters. On a wagering policy, there is no salvage, no abandonment, no return of premium for short interest; it is the interest of the insured that the ship should be lost: but it is the contrary on a policy on interest; there is salvage, there is an abandonment, there is a return of premium for short interest; there it is usually the interest of the merchant to labour for the safety of the vessel".<sup>344</sup>

Now back to the issue as to how to distinguish a wager and an insurance contract. The courts' attitudes were that in order to enforce a wager policy by insurance, the policy must expressly state that there was no requirement for the assured to own or demonstrate an insurable interest in the assured subject.<sup>345</sup> A policy in the normal form would be deemed to be an indemnity one and accordingly the assured was required to show the possession of insurable interest. Where one party to the policy argued it to be a wager policy to dispense with the necessity of proof of interest, the argument would be rejected unless PPI terms appeared on the face of it. Various forms of PPI policies were commonly written on the face of the policy to demonstrate it was just a mere wager, and if be true, there was no necessity of proof of interest. Since there were some similarities between contracts of insurance and wager, it was necessary to show what kinds of policy it belonged to on the face of the policy. A wagering policy and a policy on interest were contracts of different nature. To be a wager policy, there must be express PPI terms on the face of the policy to prove the wagering intention, which if lacking would be otherwise treated as an indemnity policy and the assured must then prove its insurable interest in the

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<sup>344</sup> *Cousins v Nantes* (1811) 3 Taunt 513 [523]-[524]

<sup>345</sup> *Lucena v Craufurd* (1802) 3 B & P 75

subject matter insured. Nonetheless, should a contract be intended to be one of wager, no PPI terms had been written in the contract, namely it was an insurance contract in the common form, the assured then could not recover if no interest could be demonstrated.<sup>346</sup> It was based on the fact that if nothing on the contrary showed that the contract was a wager, it would be deemed as an indemnity contract made on interest.<sup>347</sup>

#### *1.4.4.3 Different origins of risks*

Because under a contract of wager neither party had an interest on the happening of the future uncertain fortuity, except for the sum to be won or lost, nor was there any real consideration for making such a contract,<sup>348</sup> the contract thus of itself created a risk of loss which did not exist prior to the concluding of the contract. The risk of loss thus was only from the contract itself: if the contracting parties had not taken out such a wager, they could never put themselves at risk of losing a stake. By creating such a risk, in order to win the stake, evil resulted, just as was pointed out in the preamble of the 1745 MIA: bringing about moral hazards, encouraging the carrying on of many prohibited and clandestine trades and the introduction of “a mischievous kind of gaming, under pretence of insuring against the risk on shipping and fair trade”.<sup>349</sup> By contrast, the risk of loss on insured property, intended to be transferred from the assured to the insurer by an insurance policy, had existed before the insurance contract was taken out.<sup>350</sup> In the context of indemnity insurance, the risk of loss was derived from the sufficiently close relationship between the assured and the insured subject matter, which could amount to an insurable interest, and such

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<sup>346</sup> *Cousins v Nantes* (1811) 3 Taunt 513 [513]

<sup>347</sup> *Cousins v Nantes* (1811) 3 Taunt 513

<sup>348</sup> *Carlill v The Carbolic Smoke Ball Company* [1892] 2 QB 484 (QB) 490–491, affirmed in AC

<sup>349</sup> Preamble of the 1745 MIA

<sup>350</sup> Malcolm A Clarke, Julian M Burling and Robert L Purves, *The law of insurance contracts* (5th edn, Informa 2006) 131

an interest was not dependent on the conclusion of the insurance contract. Valid insurance was thus an effective method to avoid risk of loss by the perils insured against and to improve the economic prospect.

#### *1.4.4.4 A future held event or not*

There may be a difference between the two types of contracts on the nature of the event as to the question as to whether it must be a future event which could not be within the hold of parties. By and large, wager contracts could not be made upon future events which could be within the control of either of the parties.<sup>351</sup> However, in some cases, wagers could also be made upon an event which had happened and could be decided by either party to the wager.<sup>352</sup> For the former, a horserace “already run” could be made the subject of a wager.<sup>353</sup> For the latter, a wager between A and B could be made upon whether A would wear a red tie tomorrow.<sup>354</sup>

By contrast, the case in insurance was different. The insurance contracts must be taken out on future events which could not be within the hold of the parties. The grounds were that the purpose of an insurance contract was to avert risk of loss caused by the perils insured against which was adverse to the assured’s interest. Had the outcome of the insured event happened, the contract in question could not be deemed to be an insurance contract because the risk did not exist at the outset of the contract which had occurred.<sup>355</sup> An insurance contract made upon a certain event was thus impossible to exist since the

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<sup>351</sup> *Ellesmere v Wallace* [1929] 2 Ch 1 (AC) 29

<sup>352</sup> Professor Hugh Beale, *Chitty on Contracts* (vol II, 32th edn, Sweet & Maxwell 2016) 41-004

<sup>353</sup> *Pugh v Jenkins* [1841] 1 QB 631

<sup>354</sup> *Hampden v Walsh* [1876] 1 QBD 189

<sup>355</sup> *Prudential Insurance Co v Inland Revenue Commissioners* [1904] 2 KB 658

occurrence of an event must have the nature of uncertainty. If the event had already occurred, the assured possibly needed not to insure his interest, which was a waste of a premium where the risk of loss which happened was outside the coverage by the insurer; conversely, the insurer would not accept such an insurance contract, because they would be given an unfair disadvantage from which there may be no possibility of benefiting. Due to insurance not being able to be made on the outcome of a certain event, neither party should totally control the outcome of an insurance event to prevent putting an unfair disadvantage on either party.

## **Chapter 2 Provisions of the 1906 MIA<sup>356</sup> on Insurable Interest**

The 1906 MIA codified two thousand cases<sup>357</sup> and it did not try to create new principles of marine insurance. Although its provisions, where appropriate, apply to insurance contracts on other subject matters,<sup>358</sup> insurable interest is one of the few areas limited in its effect to marine insurance. That is because the terms of s 4 and s 5 plainly provide that: the former states that a contract of “marine” insurance is void if the assured cannot meet the requirement of having an insurable interest at the outset of the contract; and s 5 provides that, broadly speaking, an assured has an insurable interest if it is interested in the “marine” adventure.

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<sup>356</sup> 6 Edw. 7 C. 41

<sup>357</sup> 2011 CP, para 11.18

<sup>358</sup> *Locker & Woolf Ltd v W Australian Insurance Co Ltd* [1936] 1 KB 408 (AC) 415

## 2.1 Necessity of insurable interest

### 2.1.1 The principle of indemnity requiring insurable interest

The requirement of insurable interest is governed in two different ways by s 4 and s 6 of the 1906 MIA.<sup>359</sup> Except for insurable interest, most the Act's regulations apply to other forms of non-marine indemnity insurance.<sup>360</sup> The marine insurance contract is one which aims to let the assured get indemnified from the insurer on the occurrence of agreed marine losses;<sup>361</sup> this shows it is a type of indemnity insurance.<sup>362</sup> As to such an indemnity insurance, the contractual principle of indemnity must be satisfied: in order to make a valid claim, the assured must suffer a loss caused by the perils insured against and cannot recover beyond the amount of loss which he has sustained. In order to prove he has suffered loss, the assured thus needs to show that he has possessed an interest at the date of the loss.<sup>363</sup> Should the assured have no insurable interest in the subject matter of insurance, then no loss will be suffered by him, insurance will thus become a tool for benefits<sup>364</sup> and he cannot recover from a claim raised from such a contract because the insurer will effectively defend himself by averring no insurable interest exists.<sup>365</sup> Insurable interest must therefore be required by "one who on his own account would

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<sup>359</sup> Rhidian Thomas, *The Modern Law Of Marine Insurance: Volume 4* (1st edn, Informa Law from Routledge 2015) 11-12

<sup>360</sup> Professor Hugh Beale, *Chitty on Contracts* (vol II, 32th edn, Sweet & Maxwell 2016) 42-015

<sup>361</sup> 1906 MIA, s 1

<sup>362</sup> Jonathan Gilman, Robert Merkin, Mr M J Templeman, Claire Blanchard, Julian Cooke, Philippa Hopkins, *Arnould's Law of Marine Insurance* (18th Revised edn, Sweet & Maxwell 2013) 11-01; see also Professor Hugh Beale, *Chitty on Contracts* (vol II, 32th edn, Sweet & Maxwell 2016) 42-015

<sup>363</sup> Robert Merkin, 'Reforming Insurance Law: Is there a case for reverse transportation? A report for the English and Scottish Law Commissions on the Australian experience of insurance law reform' [2007] Law Commissions 8.6

<sup>364</sup> Jonathan Gilman, Professor Robert M Merkin, Claire Blanchard and Mark Templeman, *Arnould's Law of Marine Insurance* (18th Revised edn, Sweet & Maxwell 2013) 11-01

<sup>365</sup> *Anderson v Morice* (1876) 1 App Cas 713; *Macaura v Northern Assurance* [1925] AC 619

attempt to enforce a contract of marine insurance”.<sup>366</sup> The purpose of insurance is to put the assured, after the loss, in the same circumstances as before the loss. Insurance thus is a tool to indemnify the assured in the case of loss, not to benefit from making a claim. Insurable interest is thus required as a fundamental principle of marine insurance.

#### 2.1.2 The insurer will have a good defence to the assured without insurable interest

Anthony Colman QC referred to the origins and purpose of the requirement for an insurable interest, and in accordance with his reference, the principle was a useful means to ban invalid claims and wagering contracts.<sup>367</sup> It is thus beneficial to put the insurer in a fair advantageous position. In *Anderson v Morice*, the plaintiff, the assured, purchased a cargo of rice from a vendor in Rangoon and insured the cargo “at and from Rangoon.” While loading at Rangoon, the *Sunbeam* which was chartered for shipping the cargo sank after the larger portion of the cargo was shipped whilst the remaining cargo was in lighters alongside. The insurer defended him on the basis that the assured had no insurable interest in the cargo before the delivery of the whole cargo had been completed, because until then, no cargo was ever at his risk. The court held that the plaintiff could not recover the loss. This was because, under the sale contract, the plaintiff bore no risk at any time until the loading was complete<sup>368</sup> and therefore had no insurable interest in the cargo before that time. This decision was affirmed when an appeal was raised before the House of Lords, where the opinion as to the issue of whether the assured had an insurable interest of the Lords was equally divided.<sup>369</sup>

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<sup>366</sup> David Maclachlan, *Arnould's Law of Marine Insurance* (6th edn, Stevens and sons 1887) vol 2, 55

<sup>367</sup> *Sharp v Sphere Drake Insurance Co (The Moonacre)* (1992) 2 Lloyd's Rep 501, 509-510

<sup>368</sup> *Anderson v Morice* (1874–75) LR 10 CP 609

<sup>369</sup> *Anderson v Morice* (1876) 1 App Cas 713

## 2.2 Avoidance of wagering or gaming contracts

### 2.2.1 Brief history of insurable interest

By the beginning of the eighteenth century, at common law, a contract of marine insurance without insurable interest, which was in effect a wagering contract, could be enforced, save for some exceptions.<sup>370</sup> When considering the submissions in *The Moonacre*,<sup>371</sup> Anthony Colman QC stated such situations where an assured with no interest could enforce a contract of marine insurance in the first half of the eighteenth century: “that is to say even if he stood neither to lose nor to gain from the success or failure of the adventure or the loss or survival of the insured property. These contracts were in substance wagering contracts.” In order to be enforceable, some wager policies, even some policies having a genuine interest, needed to have PPI terms inserted to avoid the inconvenience of being considered a contract of indemnity.<sup>372</sup> Then, prior to 1906, four statutes were passed by Parliament to prohibit wagering contracts in the form of insurance.<sup>373</sup> In terms of these statutes governing indemnity insurance, wagering contracts not only in the guise of marine insurance, but also all classes of contracts, had been rendered void.<sup>374</sup> Thus, after the mid-nineteenth century, the court would not enforce a wagering contract in the guise of insurance unless the assured had an interest in the subject matter insured, namely he would stand to suffer a loss caused by the perils insured against, or benefit from the safety or due arrival of the insured property.

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<sup>370</sup> For details, see chapter 1

<sup>371</sup> *Sharp v Sphere Drake Insurance Co (The Moonacre)* (1992) 2 Lloyd's Rep 501, 509

<sup>372</sup> *Lucena v Craufurd* (1802) 3 B & P 75 [101]

<sup>373</sup> For details, see chapter 1

<sup>374</sup> 1845 GA, s 18

It has been well recognised that insurable interest here has developed to act as the hallmark of a valid insurance policy, without which it is a mere wagering contract.<sup>375</sup> For example, Siberry QC commented that to test if an assured had an insurable interest, what should be borne in mind was that “the concept of insurable interest was introduced as a means of distinguishing ‘legitimate’ contracts of insurance from gaming and wagering contracts”. As for the origin of insurable interest, it was thus argued that it had stemmed from the 1745 MIA which first distinguished valid marine insurance and wager policies by marine insurance by virtue of requiring insurable interest and prohibiting such policies on British shipping and their goods.<sup>376</sup> It has been argued that it may not have been the case that insurable interest was not required until the passage of the 1745 MIA. The reason was that, before the enactment of the 1745 MIA, English law had recognised that, under indemnity contracts, the assured must have an interest in order to procure a legitimate insurance contract. For example, a case in 1711 held that the wagering policy was invalid because the assured possessed no interest in the subject matter.<sup>377</sup> However, that argument may not be right. The interest mentioned in the above argument may be one for the indemnity principle rather than for the requirement of insurable interest. The position was thus probably still unclear, for the nature and ambit of the interest under the two doctrines may not be the same. It thus may not be the case to hold the view that common law requiring the assured to have an interest in essence imposed an insurable interest requirement on the assured.

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<sup>375</sup> *Lonsdale & Thompson v Black Arrow* [1993] Ch 361 (Ch) 368

<sup>376</sup> *O’Kane v Jones, The Martin P* [2005] Lloyd’s Rep IR 174, 204

<sup>377</sup> *Assievedo v Cambridge* (1711) 10 Modern 77

## 2.2.2 Wagering contracts by marine insurance unenforceable

### 2.2.2.1 Wagering policies void

Section 4(1) of the Act provides that every contract of marine insurance by way of gaming or wagering is avoidable. Subject to this provision, the courts will not enforce a deemed wager policy which will be one, as having been described in s 4(2), effected by the assured who cannot satisfy the requirement of insurable interest. An insurable interest thus is “indispensable to one who on his own account would attempt to enforce a contract of marine insurance”.<sup>378</sup> The effect of this section seems to reproduce the relevant provisions of the 1745 MIA and the 1845 GA. The former for the first time avoids marine policies on British ships and their cargos either by way of gaming or wagering or with PPI clauses, “whether in fact they are wagering policies or not”.<sup>379</sup> Even if the assured has a genuine insurable interest, contrary to the Act, for instance, termed with PPI clauses on the face of the policy, the policy would be void. As a result of the effect of the 1745 MIA, the statute requires that the assured has to prove its insurable interest in the subject matter and should not take out PPI policies. On the other hand, it is suggested that s 4 of the 1906 MIA has made two changes to the 1745 MIA relating to the applicable subject matters and areas.<sup>380</sup> First, the 1745 MIA provides that it does merely apply to British ships or cargos and does not extend to foreign vessels.<sup>381</sup> By contrast, a policy will be within s 4 of the 1906 MIA as long as it is one of marine insurance by way of gaming or wagering. Secondly, wager policies by way of insurance against marine risks

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<sup>378</sup> David Maclachlan, *Arnould's Law of Marine Insurance* (6th edn, Stevens and sons 1887) vol I, 55

<sup>379</sup> Sir M D Chalmers and Douglas Owen, *The Marine Insurance Act, 1906* (William Clowes and Sons 1907)

<sup>380</sup> Jonathan Gilman, Robert Merkin, Mr M J Templeman, Claire Blanchard, Julian Cooke, Philippa Hopkins, *Arnould's Law of Marine Insurance* (18th Revised edn, Sweet & Maxwell 2013) 11-06

<sup>381</sup> *Thellusson v Fletcher* (1780) 1 Doug 315, 170 ER 284

were legal at common law in Ireland despite the 1745 MIA having been enacted.<sup>382</sup> In the case of *Keith v Protection Mar Ins Co of Paris*,<sup>383</sup> the Irish court held that the 1745 MIA did not apply to Ireland by the Irish Act, 21 & 22 Geo. 3 c.48 whereas s 4 of the 1906 MIA is now extended to Ireland under which a wagering policy is currently void. The 1845 GA indirectly rendered all wager policies in the form of various insurance void by requiring an interest possessed by the assured, under which the expectation of benefiting from the insured property may nevertheless be sufficient to prevent the policy being a wager.

#### *2.2.2.2 Two classes of insurance policies*

A wager policy of insurance may be deemed to be an insurance contract. Lord Mansfield was of the opinion that, considering their similar form, insurance policies could be divided into two types, at the time when wager policies were popular. One kind was insurance of indemnity, like marine insurance; the other was wager policies in the guise of insurance, with which s 4 of the 1906 MIA was concerned.<sup>384</sup>

As far as s 4(2) of the 1906 MIA is concerned, wager policies furthermore have been divided into two types: the first one relates to a marine insurance contract where the assured has no insurable interest in the subject matter or has no expectation of acquiring one;<sup>385</sup> the second type concerns the policy written on the face of it containing PPI clauses which do not require the assured to prove

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<sup>382</sup> *Dalby v India and London Life Assurance Co* (1854) 15 CBP 365 [365], [388]

<sup>383</sup> *Keith v Protection Mar Ins Co of Paris* (1882) 10 LR Ir 51

<sup>384</sup> *Lowry v Bordieu* (1780) 2 Doug KB 468, 300

<sup>385</sup> *Cousins v Nantes* (1881) 3 Taunt 513; *Wilson v Jones* (1867) LR 2 Ex 139, 141 (Willer J)

he has an interest.<sup>386</sup> Section 4(2)(b) of the 1906 MIA makes it clearer that it applies to policies including “any other like PPI term” than the terms of s 1 of the 1745 MIA which has the same effect but nonetheless is a little ambiguous.<sup>387</sup>

It seems that under s 4(2)(a) the assured can be deemed not to have entered a wagering contract as long as the assured has an insurable interest or an expectation of acquiring one, even though the policy has PPI or like terms. On the other hand, according to s 4(2)(b), the policy will be considered to be a wagering one on the appearance of PPI or like terms in the policy, even though the assured has a genuine insurable interest or a real expectation. The latter shall be correct. It has been suggested that PPI terms or any other like terms dispensing with the necessity of proof of interest will vitiate the policy even though it is manifest that it is not a wagering contract and the assured has a real interest.<sup>388</sup> It has thus been submitted that a policy made by the assured possessing an insurable interest is a valid one unless it contains PPI terms.<sup>389</sup> Bankes LJ for this purpose suggested that the subsection was in effect intended to deal with the problem that, rather than whether the assured had a real insurable interest, certain insurance policies covering marine risks prevented the insurer from inquiring about the question as to whether the assured had an insurable interest. His Lordship thus drew the conclusion that s 4(2)(b) in fact referred to the form of the policy, as a result of which the policy subject to PPI terms or like ones would be made void as a gaming or wagering contract of marine insurance under s 4, even though the assured had a real insurable

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<sup>386</sup> Susan Hodges, *Law of Marine Insurance* (Cavendish Publishing Limited 1996) 2

<sup>387</sup> *Murphy v Bell* (1828) 4 Bing 567 [570]- [571]

<sup>388</sup> *Murphy v Bell* (1828) 4 Bing 567 [570]

<sup>389</sup> Jonathan Gilman, Robert Merkin, Mr M J Templeman, Claire Blanchard, Julian Cooke, Philippa Hopkins, *Arnould's Law of Marine Insurance* (18th Revised edn, Sweet & Maxwell 2013) 11-18

interest in the subject matter of the policy.<sup>390</sup> In other words, a prima facie wager policy in the form of marine insurance tainted by PPI terms cannot be turned into a valid one by reason of the existence of a true insurable interest.

### *2.2.2.3 The first class of wager policies without interest*

#### 2.2.2.3.1 Deemed to be a gaming or wagering contract

The terms are that a policy without interest and with PPI clauses “is deemed to” be rather than is a gaming or wagering contract. To be a real wager contract, four elements must be fulfilled: mutual intention to wager, the outcome of a future uncertain event, one party having to win or lose and having no interest. Willes J dissenting from the rest of the court thus said that the policy in question could not be a gaming policy unless the mutual intention of the parties to it was to wager: “But I cannot think it a gaming policy. It does not appear to me that the parties had an idea they were entering into an illegal contract.”<sup>391</sup> Thus, where the assured has no interest and no expectation of obtaining such or has inserted PPI clauses into the policy, it is not a real wager unless all four elements have been fulfilled. A contract of marine insurance is therefore not necessarily to be a wager contract merely because the assured has not had an insurable interest in the insured subject. For example, the feature of a wager is not fulfilled where, despite lacking insurable interest, the parties to the contract have not professed to hold opposite views on the outcome of the future uncertain event.<sup>392</sup>

Therefore, when to decide whether a marine policy can be deemed to be a wager one and void for the purpose of s 4, the elements for the definition of a

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<sup>390</sup> *Cheshire v Vaughan* [1920] 3 KB 240 (AC) 248

<sup>391</sup> *Lowry v Bordieu* (1780) 2 Doug KB 468, [471]

<sup>392</sup> Professor Hugh Beale, *Chitty on Contracts* (vol II, 32th edn, Sweet & Maxwell 2016) 41-009

wager contract need not to be considered except for the interest by s 4(2)(a) and the appearance of PPI clauses by s 4(2)(b). It may then be correctly said that no mutual intention to wager is required for the purpose of s 4(2), i.e. a policy may be “deemed” as a wager policy even though the parties to the policy have not mutually intended to wager, as long as the assured has no insurable interest or the expectation of acquiring such interest and has made a PPI policy.<sup>393</sup>

Here the doctrine of insurable interest is treated as the hallmark of valid contracts of insurance differing from void wagering contracts. Policies of insurance may be divided into two types by s 4(2): policies of indemnity and wagering. A policy having an insurable interest is a normal indemnity one whereas it will be deemed to be a wagering policy as long as no interest or PPI policies are existing. It is thus not right to say here that a policy cannot be a wagering one until the four elements discussed in Chapter one have been established. Grounds for this approach may be that the only insurable interest is the essential and substantial element of distinguishing indemnity policies from wagering policies, not mutuality nor the other elements.

#### 2.2.2.3.2 No insurable interest or no expectation of such one

A policy will be deemed to be a gaming or wagering policy of insurance against marine perils where the assured cannot satisfy the requirement of insurable interest. In *Kent v Bird*,<sup>394</sup> a surgeon and a passenger in the same ship made an agreement as to whether the ship in question could save her passage to China.

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<sup>393</sup> Professor Robert M Merkin, *Colinvaux's Law of Insurance* (11th edn, Sweet & Maxwell 2016) 4-011

<sup>394</sup> *Kent v Bird* (1777) 2 Cowp 583, 1254

The court held that it was a wager policy because both parties to the policy had no interest in the case, which was deemed to be a gaming and wagering policy. In the case of *Lowry v Bordieu*,<sup>395</sup> the plaintiffs had lent money to the captain of a ship, a common bond was therefore given to them. For the security of the common bond, the plaintiffs took out a policy from the underwriters, the defendant, which was termed as follows: “in case of loss, no other proof of interest to be required than the exhibition of the said bond: warranted free from average, and without benefit of salvage to the insurer”. After the risk of loss had been completely run, the plaintiffs took an action to recover the premium, averring that the policy was void due to their lack of interest. Lord Mansfield said that the plaintiffs had no interest, which rendered the policy a gaming one prohibited by the 1745 MIA, on the ground that “if the ship had been lost, and the underwriters had paid, still the plaintiffs would have been intitled to recover the amount of the bond from” the captain. (Ashhurst J concurred with this view.)<sup>396</sup> Even though the policy was void, the assured nonetheless would not be entitled to recover the premium, because it was an executed contract instead of an executory one.<sup>397</sup> A sum of money could only be recovered when the contract remained executory,<sup>398</sup> whereas it was not recoverable where the contract was executed and the risk had been completely run.

Under s 4(2)(a), a policy by way of gaming or wagering, namely a wagering policy, is a policy that the assured has no insurable interest, or expectation of acquiring one, in the subject matter of the insurance other than the sum to be won or lost. Therefore, this subsection is directed only to the assured who has

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<sup>395</sup> *Lowry v Bordieu* (1780) 2 Doug KB 468

<sup>396</sup> *Lowry v Bordieu* (1780) 2 Doug KB 468, [471]

<sup>397</sup> *Lowry v Bordieu* (1780) 2 Doug KB 468, [471]

<sup>398</sup> *Walker v Chapman* (1773) Lofft 342

no insurable interest, rather than those who possess an insurable interest but have overvalued their interest in the subject. Hobhouse J stated that s 4(2)(a) was “opposed to an insurance by someone who does in truth have such an interest but merely overvalues it or provides for payments to be made in the event of loss which exceed or are likely to exceed the amount of his actual loss.”<sup>399</sup>

Following from s 4(2)(a), a policy taken out without any expectation of insurable interest will be held void. Therefore, such an expectation is sufficient to prevent a policy being unenforceable. If the assured indeed expects an insurable interest at the time of taking out the insurance and finally has not obtained such an interest before the loss, the policy will thus be a valid one.<sup>400</sup> A policy was accordingly held enforceable in which the assured had the hope of acquiring an insurable interest even though the expectation failed because of an accident.<sup>401</sup>

### ***2.2.2. The second class of PPI policies***

#### ***2.2.2.4.1 Useful PPI or honour policies***

The existence of honour policies was recognised by the court,<sup>402</sup> albeit s 4(2)(b) now focuses on forbidding PPI policies.<sup>403</sup> In practice, the effect of honour policies understood by the insurer is not to cover a mere wager but to protect “at least the possible existence of a business interest”,<sup>404</sup> such as advances and

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<sup>399</sup> *Glafki Shipping Co SA v Pinios Shipping Co No 1, The Maira (No 2)* [1984] 1 Lloyd’s Rep 660, 667

<sup>400</sup> Jonathan Gilman, Robert Merkin, Mr M J Templeman, Claire Blanchard, Julian Cooke, Philippa Hopkins, *Arnould’s Law of Marine Insurance* (18th Revised edn, Sweet & Maxwell 2013) 11-07

<sup>401</sup> *Anderson v Morice* (1876) 1 App Cas 713

<sup>402</sup> *Thames & Mersey Mar Ins Co v Gunford Ship Co* [1911] AC 529

<sup>403</sup> Professor Robert M Merkin, *Colinvaux’s Law of Insurance* (11th edn, Sweet & Maxwell 2016) 25-017

<sup>404</sup> *Gedge v Royal Exchange Assurance Corporation* [1900] 2 QB 214, 223

disbursements, in the context of a marine insurance policy, which means “any interest which is outside the ordinary interests of hull, machinery, cargo, and freight”.<sup>405</sup> Honour policies have usually been used in two situations.<sup>406</sup> The first situation is where insurable interest is possessed by the assured; it is nevertheless hard for the assured to prove the amount of the interest.<sup>407</sup> Although PPI policies have strictly been banned by English law, they do not necessarily mean that the assured does not have an insurable interest in the subject matter insured.<sup>408</sup> The other is the situation where there indeed exists some business interest, which, however, cannot be regarded as satisfying the legal requirement of insurable interest.<sup>409</sup> To illustrate this kind of interest, an insurance policy on “disbursements” is in the case. A ship whilst on a voyage was grounded. After the ship had grounded, the assured effected an insurance policy upon disbursements to convey relevant parties’ interests in the commission and brokerage. However, the court was not in favour of the plaintiff and held that no insurable interest could be possessed by the assured.<sup>410</sup>

#### 2.2.2.4.2 The appearance of PPI terms vitiating the validity

However, PPI or honour policies were widely used as a tool to wager. Section 4(2)(b), the effect of which only applies to marine insurance rather than other forms of insurance,<sup>411</sup> thus aims to render void policies written with PPI terms contained in the section. When such terms appear on the face of a marine policy, it will be regarded as a gaming or wagering policy, although the assured

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<sup>405</sup> *Buchanan & Co v Faber* (1899) 4 Com Cas 223

<sup>406</sup> *Gedge v Royal Exchange Assurance Corporation* [1900] 2 QB 214, 223

<sup>407</sup> *Gedge v Royal Exchange Assurance Corporation* [1900] 2 QB 214, 223

<sup>408</sup> *Re London County Commercial Relns Office* [1992] 2 Ch 67

<sup>409</sup> *Buchanan & Co v Faber* (1899) 4 Com Cas 223

<sup>410</sup> *Buchanan & Co v Faber* (1899) 4 Com Cas 223

<sup>411</sup> Professor Robert M Merkin, *Colinvaux’s Law of Insurance* (11th edn, Sweet & Maxwell 2016) 4-011

did not necessarily intend to wager<sup>412</sup> or has not satisfied some element of a wager contract, which leads “to the irresistible inference that these policies were insurances by way of gaming or wagering”.<sup>413</sup> In other words, the assured cannot make a PPI policy enforceable in a court by arguing that it has a real interest. This may be understandable, looked at from the perspective that the subsection is designed to prevent the evils arising out of PPI terms but will exclude enquiry into the existence of an insurable interest rather than relate to whether the assured has a real interest.<sup>414</sup>

The English law, not just under common law but also in the legislation, took a strict view on policies containing PPI terms. Lord Eldon insisted that the 1745 MIA aimed to prohibit PPI policies which did not need an assured to show his interest in the insured subject.<sup>415</sup> Under the 1906 MIA, once such terms appear on the face of the policy, the assured will also be deemed to have the intention of wagering which is contrary to public policy and can bring many evils, and consequently, such a policy will definitely be made void.<sup>416</sup> McCardie J also said that “The subsection constitutes an emphatic condemnation by the Legislature of any gaming contract with respect to marine insurance. ... So early as 1745 the Legislature had perceived the evils of gaming contracts of this description and had provided a measure of legislation to deal with them.”<sup>417</sup>

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<sup>412</sup> *Edwards v Motor Union Ins Co* [1922] 2 KB 249 (KB) 252; Also See Chap 1

<sup>413</sup> *Re London County Commercial ReIns Office* [1992] 2 Ch 67 (Ch) 80

<sup>414</sup> *Cheshire v Vaughan* [1920] 3 KB 240 (AC) 248

<sup>415</sup> *Lucena v Craufurd* (1806) B & PNR 269 (Eldon LJ)

<sup>416</sup> Professor Robert M Merkin, *Colinvaux's Law of Insurance* (11th edn, Sweet & Maxwell 2016) 4-011

<sup>417</sup> *Cheshire v Vaughan* (1919) 25 Com Cas 51, 57; affirmed by *Cheshire v Vaughan* [1920] 3 KB 240

#### 2.2.2.4.3 Reasons

The fact that PPI policies have been contrary to public policy may justify the above strict approach by English law. Before the 1745 MIA, the requirement of insurable interest was first established as a matter of public policy to prevent public problems like mischievous gaming, illegal traffic and making insurance a way of profiting. Although the 1906 MIA had repealed the 1745 MIA and changed the effect of lack of insurable interest from being illegal to being void, the above evils were much the same as when the 1906 MIA was passed.<sup>418</sup> Bankes LJ expressed such a view that “the making of a PPI policy is against public policy” and the reason for the Legislature passing relevant provisions concerning wager policies in the 1745 MIA and the 1906 MIA was to prohibit the evils occurring under such policies.<sup>419</sup> Parliament then held the view that a PPI policy dispensing with proof of interest, which s 4(2)(b) is intended to forbid,<sup>420</sup> had brought many mischiefs and run counter to public policy.

#### 2.2.2.4.4 The term of “Without benefit of salvage to the insurer”

The object of s 4(2)(b) relating to the term seems to be directed merely to insurance on the subject capable of salvage, not to things incapable of salvage.<sup>421</sup> “Without benefit of salvage to the insurer” is one such term regarded as having a similar effect on a policy as a PPI term.<sup>422</sup> Under s 4(2)(b), the policy will be regarded as void as long as the term has been expressly stated on the face of the policy, despite the assured having a real interest, regardless of the intents and purposes of the parties.

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<sup>418</sup> *Cheshire v Vaughan* [1920] 3 KB 240 (AC) 251

<sup>419</sup> *Cheshire v Vaughan* [1920] 3 KB 240 (AC) 251

<sup>420</sup> Professor Robert M Merkin, *Colinvaux’s Law of Insurance* (11th edn, Sweet & Maxwell 2016) 25-017

<sup>421</sup> *Lucena v Craufurd* (1806) B & PNR 269 [311]

<sup>422</sup> *De Mattos v North* (1868) LR 3 CP 185; *Smith v Reynolds* (1856) 1 Hurlstone and Norman 221, 1185

The exception to the above effect relates to the proviso of s 4(2)(b), which states that where there is no possibility of salvage, a policy may be effected without benefit of salvage, which could be understood as without benefit of abandonment to the insurer.<sup>423</sup> Because the nature of some subjects do not allow the assured to abandon the damaged subject to the insurer, a policy falling within the proviso does not intend to dispense with proof of insurable interest. It had thus been stated “that the want of power to abandon was not a certain criterion of insurable interest; that in many cases there might be insurable interest without power to abandon, as in the case of freight, bottomry, and respondentia”,<sup>424</sup> upon which an insurance policy had been taken out by the assured who had nothing in the nature of an insured subject matter to abandon to the insurer in the event of loss.<sup>425</sup> Thus, where the policy provides that, in the event of the total loss (actual or constructive), the freight insured shall be paid “in full”, this clause does not mean without benefit of salvage.<sup>426</sup>

### 2.2.3 The effect of wagering policies on other policies by the same assured on the same adventure

As for the issue as to whether a wagering policy could affect the enforceability of other valid policies entered into by the same assured on the same adventure, a long dictum was made to make void all policies in question although no other direct authority on this issue has been found.<sup>427</sup> In the *Gunford* case, the

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<sup>423</sup> Sir M D Chalmers and Douglas Owen, *The Marine Insurance Act, 1906* (William Clowes and Sons 1907) 8

<sup>424</sup> *Lucena v Craufurd* (1806) B & PNR 269 [310]

<sup>425</sup> Sir M D Chalmers and Douglas Owen, *The Marine Insurance Act, 1906* (William Clowes and Sons 1907) 8

<sup>426</sup> Instituted Time Clause Freight 1983, Clause 15.1; *Coker v Bolton* [1912] 3 KB 315

<sup>427</sup> *Thames & Mersey Mar Ins Co v Gunford Ship Co* [1911] AC 529 (HL) 544

agency effecting the insurance for the assured did not disclose to the insurer that the hull of the ship had been largely over-insured and that the policy on disbursements had contained PPI clauses. Because the agent failed to disclose these two facts, the court held that the insurer was entitled to avoid the policy. In this case, although the entire ground of defence raised by the appellants was non-disclosure, Lord Shaw of Dunfermline made a long dictum which stated that all policies shall be void due to the wager policy taken out by the same assured on the same adventure based on the following two reasons. First, taking the example of a policy on a vessel, the voyage was a single voyage and the ship, the freight, the cargo, and the crew had all been involved in this single one adventure. It can be said that in order to benefit from wagering, the assured would be inclined to damage or destroy the ship. Where the assured made a wagering policy on, for example, the freight and it also made valid policies on the ship and the cargo at the same time, all policies would thus be not enforceable. Secondly, the law would not enforce a contract which put a conflict between duty and self-interest. It was the duty of every party to policies to keep the ship in safety while the party effecting a wagering policy would tend to damage the ship for his own interest. The dictum then referred to an exception to his above view relating to third parties: "the foregoing observations are not directed to the case of insurances upon ships in which third parties have acquired, in ignorance of the other and over insurances and in good faith and for valuable consideration, separate interests. The rights of such parties would require to be separately and fully considered."<sup>428</sup> Leaving aside the dispute as to whether such an adventure is a single one, the legal principle of no conflict between duty and self-interest should be regarded as a strong argument for

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<sup>428</sup> *Thames & Mersey Mar Ins Co v Gunford Ship Co* [1911] AC 529 (HL), 544

supporting the idea that a wager policy will taint all other policies by the same assured on the same adventure.

## 2.3 Insurable interest defined

### 2.3.1 Reasons for the difficulty to define insurable interest

It is hard to define insurable interest in words which are applicable to all types of insurance contracts,<sup>429</sup> even merely in the context of marine insurance for which only a non-exhaustive definition has been provided. Besides, judges hold different criteria of what amounts to an insurable interest.<sup>430</sup> For example, Ward LJ held the view that the test of economic interest, that the assured may benefit from the preservation of the insured subject or may be prejudiced from the loss of or damage to such subjects, is not sufficient to constitute an insurable interest; on the other hand, the assured must have a legal or equitable interest in the subject insured, at least in the realm of marine and property insurance.<sup>431</sup> This was based on two decisions of the House of Lords in which they held that the assured must possess a legal or equitable interest in property.<sup>432</sup> By contrast, Waller LJ held a broader view that the assured did not have to have a legal or equitable interest in the property, whereas a pecuniary interest was sufficient to satisfy the definition of insurable interest under s 5(2) of the 1906 MIA which was thought by him to be a broad definition.<sup>433</sup> The court should thus carefully consider the context and the terms of a policy before them, on the basis that the construction can determine the nature of the policy in question for the purpose of the proper application of the test of insurable interest and

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<sup>429</sup> *Feasey v Sun Life Assurance Co* [2003] Lloyd's Rep IR 637 [66]

<sup>430</sup> Yang Liangyi, *Marine Cargo Insurance* (3rd edn, Law Press China 2013) 114

<sup>431</sup> *Feasey v Sun Life Assurance Co* [2003] Lloyd's Rep IR 637 [195]

<sup>432</sup> *Lucena v Craufurd* (1806) B & PNR 269 [321]; *Macaura v Northern Assurance Co Ltd* [1925] AC 619 (HL) 627-28; cited in *Feasey v Sun Life Assurance Co* [2003] Lloyd's Rep IR 637 [92]

<sup>433</sup> *Feasey v Sun Life Assurance Co* [2003] Lloyd's Rep IR 637 [92]

whether the policy can embrace the insurable interest.<sup>434</sup> Also, the uncertainty of the concept can be attributable to an increasingly changing market: “the definition has changed dramatically over the years to keep up with the changing market.”<sup>435</sup> In conclusion, the definition of insurable interest is one that is not fixed and is continually changing.

### 2.3.2 s 5(1)

#### 2.3.2.1 A wider attitude towards definition by s 5(1)

Section 5 of the 1906 MIA is the only legislation which tries to define insurable interest and none of the other Acts mentioned in Chapter 1 have ever given it a definition. Although the courts have not exactly given it a definition, s 5 is indeed derived from the decisions in case law and there is no difference in definition between these two regimes. This definition is only applicable to marine insurance and not an exhaustive one but a partial concept including illustrations, such as those provided for in ss 7 to 14, which may amount to an insurable interest.<sup>436</sup> Section 5(1) generally requires that a person who can be deemed as having an insurable interest is the one who is interested in a marine adventure.

#### 2.3.2.2 Illustrations

Section 5(1) derives from the judgement of *Wilson v Jones*.<sup>437</sup> In this case, a shareholder in a telegraph cable company, entered into a policy upon a marine adventure of the conveyance and successful laying of the cable. The court held that, by construing the terms of the policy, he had an interest not in the cable, which was the property of the company, but in the success of the adventure,

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<sup>434</sup> *Feasey v Sun Life Assurance Co* [2003] Lloyd’s Rep IR 637 [66]

<sup>435</sup> Robert Merkin, ‘Reforming Insurance Law: Is there a case for reverse transportation? A report for the English and Scottish Law Commissions on the Australian experience of insurance law reform’ [2007] Law Commissions 8.6

<sup>436</sup> The Australian Law Reform Commission, *Review of The Marine Insurance Act 1909* (ALRC Report No 91 2001) ALRC 91 (ALRC 91, *infra*) para 11.5

<sup>437</sup> *Wilson v Jones* (1867) LR 2 Ex 139

from which his share of profits could be derived. After careful examination of the words of the policy, the court identified that the insured subject, intended to be covered, was the marine adventure and then held that the assured, as the shareholder, was entitled to have an insurable interest in such an adventure because he had a pecuniary interest in the laying down of the cable rather than the cable itself. Therefore, although as in the judgement of *Macaura* case, the assured as a shareholder did not have an insurable interest in the timber which was the asset of the company because he would sustain no economic loss from the loss of the timber; in light of the *Wilson* case, a shareholder can have an insurable interest in profits to be derived from the asset which is owned by a company where a court has identified that the subject matter of the policy is the profits rather than the asset owned by the company.

Based on the following two points, s 5(1) represents a broad attitude to the issue as to whether an assured can have an insurable interest in the insured subject because of the approach in the *Wilson* case. First, when deciding whether the assured has an insurable interest in a share of profits, Blackburn J has adopted Lawrence J's test of pecuniary interest. Secondly, after the judgement that the assured had actually had an insurable interest in profits, although the subject insured is seemingly limited to the property of cable, the court, applying a wider view of property by correctly construing the policy, held that the subject matter of the policy was the profits arising from the successful laying of the cable rather than the cable.

### 2.3.3 s 5(2)

#### 2.3.3.1 Two tests for the definition of insurable interest in s 5(2)

Section 5(2) particularly describes the situation where a person can be deemed to be interested in a marine adventure or in property where he has a legal right to, or a legal liability for, the property insured, namely a legal relation to the assured, and on the happening of its loss or damage he will be prejudiced. In the first place, the person must be so situated that he has a legal or equitable right in the insured subject at risk. As to an “equitable relation”, it can be understood as “a close legal relationship between the person insuring and the property insured”.<sup>438</sup> The relation is based on either an equitable ownership to the property or a claim on it, e.g. an equitable possession by a beneficiary of a trust. Thus, a *cestui que trust* has an equitable interest in property and such an interest is insurable.<sup>439</sup> Secondly, due to the nature of a contract of marine insurance which is one of indemnification and the existence of a legal right, the person must have a pecuniary interest in the subject matter insured; that is, “he may benefit by the safety or due arrival of insurable property, or may be prejudiced by its loss, or by damage thereto, or by the detention thereof, or may incur liability in respect thereof”. When explaining the essence of the interest being able to be constituted a valid interest, Sir MD Chalmers noted that an insurable interest must be a legal interest in property exposed to sea perils.<sup>440</sup> The definition provided by s 5(2) has commonly been regarded as one from the judgement of Lord Eldon in *Lucena’s* case. However, without the first point of a legal interest, the second point mentioned above concerning the definition may

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<sup>438</sup> *Cowan v Jeffrey Associates* 1998 SC 496 [502]

<sup>439</sup> *Ex p Yallop* (1808) 15 Ves Jr 60, [67]-[68]; cited by Professor Robert M Merkin, *Colinvaux and Merkin’s Insurance Contract Law* (vol 1, Sweet & Maxwell 2017) A-0401

<sup>440</sup> Sir M D Chalmers and Douglas Owen, *The Marine Insurance Act, 1906* (William Clowes and Sons 1907) 12

now be sufficient on its own to amount to a valid insurable interest.<sup>441</sup> Therefore, after the authority of the case of *Lucena*, there are two tests as to what can constitute a valid insurable interest in property: Lawrence's broad test of moral certainty, or pecuniary or economic test and Eldon's strict test of a legal relation to the subject insured,<sup>442</sup> although it has been argued that Lawrence's test in fact also requires a legal relation to the insured property.<sup>443</sup>

### *2.3.3.2 The requirement of a legal relation*

Since the legal or equitable relation in which an assured stands to the marine adventure or to the property insured can affect the existence of a valid insurable interest, there is thus a necessity to precisely understand such a relation. Besides, the requirement of a legal interest is responsible for the approach adopted in English law that the assured cannot have an insurable interest in property unless it has a legal or equitable interest in it or arising out of a contract relating to it.

It has been suggested that the legal or equitable right in property insured, defined by s 5(2), is derived from Eldon's test and the strict test thus needs to be examined. In the words of Lord Eldon, in order to constitute a valid insurable interest, the legal interest the assured has had must be a proprietary right in property or a right from a contract pertaining to it.<sup>444</sup> Consequently, there are two sources as to what can constitute an insurable interest. The former is a proprietary right to the property. As for the latter, a possessory interest is an

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<sup>441</sup> *Feasey v Sun Life Assurance Co* [2003] Lloyd's Rep IR 637 [89], [92]

<sup>442</sup> Professor John Birds, Ben Lynch and Simon Paul, *MacGillivray on Insurance Law* (13th edn, Sweet & Maxwell 2016) 1-118

<sup>443</sup> *Feasey v Sun Life Assurance Co* [2003] Lloyd's Rep IR 637 [65]; Professor John Birds, Ben Lynch and Simon Paul, *MacGillivray on Insurance Law* (13th edn, Sweet & Maxwell 2016) 1-118

<sup>444</sup> *Lucena v Craufurd* (1806) B & PNR 269 [321]

insurable interest. Also, a creditor can have a legal relation if he has a claim on the property pledged to him for advances. Then any legal liability under an existing contract<sup>445</sup> or relevant law is insurable.<sup>446</sup> As provided by s 5(2), the insurable interest in property arising from a legal right derivable out of a contract in relation to it must also be one that may bring about loss or incur liability to the assured.

However, due to the tendency of the widening of insurable interest, despite the expression of “legal relation” in judgements, it may be sufficient to constitute it if a person has beneficial rights or owns a duty on a contractual basis.<sup>447</sup> Thus, two powers of attorney granted exclusive use and enjoyment of the insured property can constitute an insurable interest, though it may be less than a legal or equitable right. With the two powers of attorney granted by the company owning the yacht in issue, in spite of the lack of a strict legal right in it, the assured could exclusively enjoy and possess the yacht for his own purpose. The court thus held that it was the exclusive use derived from the contract between the company and the assured granting the two powers of attorney that afforded an insurable interest in the yacht.<sup>448</sup> As sub-contractors, the assured who had effected a contract of construction could also have an insurable interest in the plant under construction only because he would suffer pecuniary loss from damage to or destruction of the work, i.e. if the construction of the work failed, he would lose the opportunity to obtain remuneration for doing the

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<sup>445</sup> Such as the liability of a carrier and other bailees.

<sup>446</sup> *Crowley v Cohen* (1832) 3 B & A478; *British Cash and Parcel Conveyors Ltd v Lamson Store Service* [1908] 1 KB 1006 (AC) 1014–15, a case of statutory liability.

<sup>447</sup> *Sharp v Sphere Drake Insurance Co (The Moonacre)* (1992) 2 Lloyd's Rep 501, 513; *Feasey v Sun Life Assurance Co* [2003] Lloyd's Rep IR 637 [92]; *O'Kane v Jones, The Martin P* [2005] Lloyd's Rep IR 174, [156]-[158]

<sup>448</sup> *Sharp v Sphere Drake Insurance Co (The Moonacre)* (1992) 2 Lloyd's Rep 501, 512

work.<sup>449</sup> In light of the strict test, a right derivable from a contract relating to the insured property also had a legal liability; otherwise sub-contractors had no insurable interest in the plant as the subject matter of the policy taken out after the completion of the sub-contractors' construction when there was no contract of construction between them and the owner of the plant, even though they might assume liability for loss of or damage to the work.<sup>450</sup> What should always be borne in mind is that in the modern context of indemnity insurance a legal or equitable relation to the assured has no longer been a necessity to constitute a valid insurable interest in property; whereas a mere pecuniary interest based on a contract is sufficient.<sup>451</sup>

### ***2.3.3.3 No present existing right, no insurable interest***

#### ***2.3.3.2.1 A mere expectation is not insurable.***

Also, in light of what amounts to a legal right, it must first be an existing one rather than a mere hope or expectation.<sup>452</sup> It has been firmly laid down as English law by the courts that a mere expectation of acquiring benefits from the continuing existence of the insured subject cannot confer on the assured an insurable interest in the subject. Where there was only a mere hope of benefiting from the preservation of the insured subject, by taking out a contract relating to it sometime in the future, the court held that the assured had no insurable interest in the property as goods, because the relation between the assured and the property was the bare hope which could not be any right

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<sup>449</sup> *Deepak Fertilisers & Petrochemicals Ltd v Davy McKee (London) Ltd* [1999] 1 All ER (Comm) 69 [85]-[86]

<sup>450</sup> *Deepak Fertilisers & Petrochemicals Ltd v Davy McKee (London) Ltd* [1999] 1 All ER (Comm) 69 [85]-[86]

<sup>451</sup> *Feasey v Sun Life Assurance Co* [2003] Lloyd's Rep IR 637 [92]

<sup>452</sup> Professor John Birds, Ben Lynch and Simon Paul, *MacGillivray on Insurance Law* (13th edn, Sweet & Maxwell 2016) 1-052

recognised at law or in equity.<sup>453</sup> Even though captors at the beginning of the nineteenth century might benefit from capturing enemy's ships by the Naval Prize Acts or by a grant from the Crown, only those having an existing right in ships could insure them. In the case of *Lucena*, the commissioners had insured the vessels at the time of sailing but under the Naval Prize Acts they could not take care of the captured Dutch vessels until their arrival in the UK and until then they had no right to them. The courts thus held that the assured, as the commissioners who only had an expectation of benefiting from the safe arrival of the ships and its goods, had no insurable interest in property because they were not entitled to the vessels until they could exercise their duties to the ships after the safe arrival of the vessels in the UK.<sup>454</sup> Similarly, a captor who had not already captured a ship, and thus only had a mere hope of a grant from the Crown, had no insurable interest in the ship.<sup>455</sup> By contrast, a person who had already captured a vessel could have an insurable interest in its sailing to the UK and thus could insure such a marine adventure because it had a legal interest in the vessel. In a word, in light of the strict test, only those who have already had an existing right can have an insurable interest in property, whereas a mere expectation to insured property or one from a relevant contract cannot.

#### 2.3.3.2.2 A moral obligation is not insurable.

As a consequence of the strict test, a moral obligation cannot amount to an insurable interest either, since it is not an existing right to the subject matter of the policy either at law or in equity. Under honour policies, even though the insurer has honoured the policy and promised to pay the assured in the event of

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<sup>453</sup> *Buchanan v Faber* (1899) 4 Com Cas 223; *Sharp v Sphere Drake Insurance Co (The Moonacre)* (1992) 2 Lloyd's Rep 501, 511

<sup>454</sup> *Lucena v Craufurd* (1806) B & PNR 269 [305]

<sup>455</sup> *Routh v Thompson* (1809) 11 East 428; *Devaux v Steele* (1840) 8 Scott 637

loss of the insured subject (which is however by the nature of the policy only a moral obligation rather than a right or interest recognised by law) the assured hence cannot have a valid insurable interest arising from such a moral obligation. Therefore, an assured cannot have a valid insurable interest in the insured subject only because of having a mere moral obligation over it.

#### *2.3.3.4 Legal Liability and potential liability*

In s 5(2), a person can also possess an insurable interest in insured property where he is so situated in relation to the property that he may assume the legal liability of paying the price or, through his negligence, paying for its loss or damage. In accordance with the strict test, liability must be subject to proprietary or possessory interest. But now, mere potential rather than actual legal liability depending on an existing contract or “proximate physical relationship” to the insured property may be sufficient to give rise to an insurable interest in property, and even possibly an insurable interest in liability.<sup>456</sup> Such a relation must be close enough that a sub-contractor can be materially adversely affected by loss or damage of the property on construction sites.<sup>457</sup> The assured can thus have an insurable interest in property arising from a contract relating to it if damage to or destruction of the property will give rise to liability on their part to the owner of the property. Thus, in cases where the assureds as buyers have taken out a contract of sale of goods on FOB or CIF terms which requires that buyers take the risk of loss after goods have been put on board, those who have no title to or possession of goods could have an insurable interest in the goods since under the binding contract they are so situated to the property that they are legally liable to pay the price whether or

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<sup>456</sup> *National Oil Well (UK) Ltd v Davy Offshore Ltd* [1993] 2 Lloyd's Rep 582, 611

<sup>457</sup> *Stone Vickers Ltd v Appledore Ferguson Shipbuilders Ltd* [1991] 2 Lloyd's Rep 288, 301

not the goods arrive safely.<sup>458</sup> Similarly, a sub-contractor who has a mere potential liability to the property on construction sites has an insurable interest in the whole of the work, even though he has not agreed that the property has been at his risk. Because of the potential liability for a sub-contractor damaging the property of other interested parties under their separate contracts, and even the damage or loss arising from their breach of the contract or from their negligence, the courts held that sub-contractors could thus have an insurable interest in the whole property under construction.<sup>459</sup>

#### *2.3.3.5 Test of moral certainty or pecuniary interest*

There is an insurable interest in cases where the expectation is not a mere hope but a factual expectation or moral certainty of receiving a benefit or incurring potential liability. This kind of expectation was expressed as one so certain that it had never been known to be defeated.<sup>460</sup> Although this kind of relation was not recognised by the courts as a valid insurable interest in the past,<sup>461</sup> it has now been settled on high authority that moral certainty or a pecuniary interest is sufficient to constitute an insurable interest in property.<sup>462</sup> According to Lawrence's test, where a person had a moral certainty or well-founded factual expectation of benefiting from the continuing existence of the subject matter insured or sustaining a loss from, damage to, or destruction of, the insured subject, the assured had an insurable interest in the subject,

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<sup>458</sup> *Anderson v Morice* (1876) 1 App Cas 713; *Stock v Inglis* (1884) 12 QBD 564, affirmed (1885) 10 App Cas 263

<sup>459</sup> *Petrofina (UK) Ltd v Magnaload Ltd* [1984] QB 127; *Stone Vickers Ltd v Appledore Ferguson Shipbuilders Ltd* [1991] 2 Lloyd's Rep 288; *National Oil Well (UK) Ltd v Davy Offshore Ltd* [1993] 2 Lloyd's Rep 582; approved by *Feasey v Sun Life Assurance Co* [2003] Lloyd's Rep IR 637

<sup>460</sup> *Le Cras v Hughes* (1782) 3 Doug 81

<sup>461</sup> *Lucena v Craufurd* (1806) B & PNR 269 [321]–[323] (Eldon LJ); *Routh v Thompson* (1809) 11 East 428, 434 (Ellenborough CJ); *Macaura v Northern Assurance Co Ltd* [1925] AC 619 (HL) 627 (Buckmaster LJ), 630 (Summer LJ)

<sup>462</sup> *Sharp v Sphere Drake Insurance Co (The Moonacre)* (1992) 2 Lloyd's Rep 501; *Deepak Fertilisers & Petrochemicals Ltd v Davy McKee (London) Ltd* [1999] 1 All ER (Comm) 69 [85]–[86]; *Feasey v Sun Life Assurance Co* [2003] Lloyd's Rep IR 637 [89]

regardless of the existence of a right recognised in law.<sup>463</sup> By contrast, Lord Eldon rejected the submission of moral certainty amounting to an insurable interest and thought that there was no intermediate area between the certain right in property, or derivable from a contract relating to it, and the mere expectation or hope. His Lordship then stated that a person could not have an insurable interest in property unless he had a right in property or arising out of a contract pertaining to it and due to such a relation he may suffer a loss arising from the loss of or damage to the property.<sup>464</sup>

#### 2.3.4 Conclusion

In order to match the new development of insurance business, the definition of insurable interest has been continually expanded. Although terms of “legal relation” may be used by the courts to test the existence of insurable interest, which renders it seemingly true that the strict test must be followed, in fact, it has more recently been established that a pecuniary interest or potential liability based on an existing contract may be sufficient to constitute an insurable interest. But it is still good law that a mere expectation or moral obligation cannot invest in an assured an insurable interest. However, where an interest possessed by a person does not fall within the area of s 5 of the 1906 MIA, it does not necessarily mean that the interest is definitely uninsurable, because in s 5 the definition itself is a non-exhaustive one.<sup>465</sup>

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<sup>463</sup> *Lucena v Craufurd* (1806) B & PNR 269 [302]

<sup>464</sup> *Lucena v Craufurd* (1806) B & PNR 269 322 [321]

<sup>465</sup> *O’Kane v Jones, The Martin P* [2005] Lloyd’s Rep IR 174 [158]

## 2.4 When interest must attach

### 2.4.1 Time of an insurable interest

#### 2.4.1.1 At the time of loss matters

This section addresses the issue as to when interest must attach, namely, when the assured must have a valid or actual insurable interest in the subject matter of the policy. In light of s 6 (1) of the 1906 MIA, the timing should be at the time of loss rather than of the taking out of the contract of insurance. In the past, an interest had to be vested in the assured both at the time of the policy and at the time of the loss.<sup>466</sup> Under the former law, it was material to find out whether or not the assured had an interest at the time of effecting the policy.<sup>467</sup> By contrast, in the case of *Rhind v Wilkinson*,<sup>468</sup> it was held that the interest did not need to attach at the time of effecting the policy. Section 6 (1) has now laid down that an insurable interest must be vested in the assured no later than at the time of the loss, and this affects whether the assured can make a successful claim to the insurer; therefore, it is immaterial whether the interest has attached at the date of effecting the policy, which relates to the validity of a contract of insurance.<sup>469</sup> Clause 11(1) of the Institute Cargo Clauses (ICC) therefore restates the words of s 6 (1) that “In order to recover under this insurance the Assured must have an insurable interest in the subject-matter insured at the time of the loss.”<sup>470</sup>

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<sup>466</sup> *Lucena v Craufurd* (1806) B & PNR 269 [295]

<sup>467</sup> *Marsh v Robinson* (1804) 4 Esp 98

<sup>468</sup> *Rhind v Wilkinson* (1810) 2 Taunt 237 [243]

<sup>469</sup> David Hughes, *A treatise on the law relating to insurance: in three parts, viz. I.--Of marine insurance. II.--Of insurance on lives. III.--Of insurance against fire* (1st American edn, with notes and references to American decisions, New York, O Halsted, Collins and Hannay, and Gould and Banks 1833) 42

<sup>470</sup> ICC (A) 2009, clause 11(1)

#### *2.4.1.2 Grounds for such timing*

The reason for requiring that the assured must possess an insurable interest at the time of loss was that it was usually commercial practice to insure goods on a return voyage, long before the goods were bought, which made impossible the averment of having an interest at the time of the policy.<sup>471</sup> The requirement is of particular importance in today's international sale of goods, for the property of goods will frequently be transferred during the insured period.<sup>472</sup> It is sometimes difficult, or even impossible, to ascertain the person who finally is at risk of sea perils before the time of loss. Besides, where an open cover has been taken out that "is widely used to refer to a form of cover that applies to all risks falling within it for a specific period of time, subject to a maximum limit per risk but no overall aggregate",<sup>473</sup> the goods under such a cover often do not exist, let alone the attachment of a valid insurable interest at the date of the contract of insurance.<sup>474</sup> Under the aforesaid situations, requiring that the assured must have an interest at the time of the policy will be unreasonable and not helpful for the market.

#### *2.4.1.3 Different timings meaning different requirements*

The requirement of insurable interest in marine insurance under the 1906 MIA has been provided for in two different ways.<sup>475</sup> Section 4 first requires that at the date of the contract of insurance the assured must have an insurable interest and an expectation of obtaining such an interest and must not take out PPI policies, otherwise the validity of the policy will be rendered void. In the case of

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<sup>471</sup> *Rhind v Wilkinson* (1810) 2 Taunt 237 [243]

<sup>472</sup> Yang Liangyi, *Marine Cargo Insurance* (3rd edn, Law Press China 2013) 126

<sup>473</sup> Jonathan Gilman, Professor Robert M Merkin, Claire Blanchard and Mark Templeman, *Arnould's Law of Marine Insurance* (18th Revised edn, Sweet & Maxwell 2013) 9-15

<sup>474</sup> Yang Liangyi, *Marine Cargo Insurance* (3rd edn, Law Press China 2013) 126

<sup>475</sup> Rhidian Thomas, *The Modern Law Of Marine Insurance: Volume 4* (1st edn, Informa Law from Routledge 2015) 11-12

proving the policy not to be a wager policy, it is material to observe whether the assured has a potential interest at the date of effecting the policy or not. For the purpose of returning premiums under the contracts due to their being void as wager contracts, it will be sufficient to prevent them being void by proving that an expectation of acquiring an interest has existed at the time of the policy. Section 6(1) secondly requires that, in order to recover a loss, the timing when an actual interest must attach is at the time of loss, while a potential interest rather than a valid insurable interest is sufficient to satisfy the requirement of s 4. This reflects the doctrine of indemnity; without proof of an interest the assured are not able to have suffered a loss.<sup>476</sup> However, in light of the strict test, the interest required here is also a legal or equitable interest, rather than one which is just being used to prove a loss but is not sufficient to be an interest recognised at law or in equity. Nowadays, the assureds are entitled to claim against the insurers where they have sustained a mere pecuniary interest.

#### *2.4.1.4 Whether an assured having assigned his interest can recover depending on the timing of assignment*

It is clear from the principle provided by s 6(1) that the assured who has an insurable interest at the time of loss can claim. The assured who has had an insurable interest at the time of loss but later assigns it to a consignee can also be entitled to recovery. Also, the assured who has no insurable interest at the time of loss because they have assigned their interest to a consignee, can sue on a policy as long as they act as trustees of the consignee by a contract of trust or the assignment of the policy. The principle that the assured must be interested at the time of loss has codified the doctrine of indemnity. If the

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<sup>476</sup> Professor Robert M Merkin, *Colinvaux's Law of Insurance* (11th edn, Sweet & Maxwell 2016) 25-021; Rhidian Thomas, *The Modern Law Of Marine Insurance: Volume 4* (1st edn, Informa Law from Routledge 2015) 11-12

assured cannot prove that he has an interest in the subject matter at the time of loss, he could not prove a loss having been sustained by him. Where, therefore, the assured had sold his interest in the ship or goods before the loss, it was held that he could not sue the insurer for the recovery, for he had no interest at the time of loss (the fact that he had an interest at the time of underwriting the insurance was immaterial), he had lost nothing and consequently he was unable to be indemnified.<sup>477</sup> As a result of the requirement that the assured has to possess a valid insurable interest at the time of loss, the assured who has had one at the time of loss, but later loses or assigns his interest, is thus entitled to recover because he can still claim as long as he had an insurable interest at the time of loss.<sup>478</sup> The court then determined in favour of the assured who sued on a policy where they had had an interest at the time of loss but assigned his interest after the loss of the insured subject.<sup>479</sup> Despite the principle of indemnity and the principle that the assured must have an insurable interest at the time of loss, those who have lost interest in the insured subject before its loss can also make a claim as trustees on behalf of consignees with an assignment of policy or an agreement to such an effect. Where the assured did not have an interest at the time of loss, for example, having sold the subject insured to consignees before the time of loss, they could also take an action against the policy as the trustee of the consignee by means of them having handed over the policy to the consignee upon the assignment or by having kept the policy alive for the consignee's benefit by a contract.<sup>480</sup>

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<sup>477</sup> *Powles v Innes* (1843) 11 M &W 10

<sup>478</sup> Malcolm A Clarke, Julian M Burling and Robert L Purves, *The law of insurance contracts* (4th edn, LLP 2002), 4-4

<sup>479</sup> *Sparkes v Marshall* 2 Bing N C 761

<sup>480</sup> *Powles v Innes* (1843) 11 M &W 10

## 2.4.2 “Lost or not lost” terms

### 2.4.2.1 Position under s 6(1) of the 1906 MIA

Subject to the proviso of 6(1) which requires the assured to possess an insurable interest at the time of loss, its terms was laid down as “Provided that where the subject-matter is insured “lost or not lost”, the assured may recover although he may not have acquired his interest until after the loss, unless at the time of effecting the contract of insurance the assured was aware of the loss, and the insurer was not.”<sup>481</sup> The outcome of breaching the duty of disclosure relating to a loss having occurred before effecting the policy is that the insurer may avoid the policy.<sup>482</sup> Although the principle of the timing when insurable interest must attach has been breached by this proviso, according to its first application, the assured who is allowed to recover where he has not acquired insurable interest prior to loss must subsequently have a valid insurable interest after loss.<sup>483</sup> As to its second application, it has also been provided for in Schedule 1 of the 1906 MIA for the construction of a policy that: “Where the subject-matter is insured “lost or not lost”, and the loss has occurred before the contract is concluded, the risk attaches unless, at such time, the assured was aware of the loss, and the insurer was not.”<sup>484</sup> This construction is applicable to a policy which has not been concluded prior to the loss having occurred while the assured had, or had no an existing insurable interest.<sup>485</sup> The form of Ship and Goods (SG) policy was widely used in the past;<sup>486</sup> it was first set out in

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<sup>481</sup> 1906 MIA, s 6 (1)

<sup>482</sup> 1906 MIA, s 18 (1)

<sup>483</sup> Rhidian Thomas, *The Modern Law Of Marine Insurance: Volume 4* (1st edn, Informa Law from Routledge 2015) 12; *NSW Leather Co Pty Ltd v Vanguard Insurance Co Ltd* (1991) 25 NSWLR 699, 710

<sup>484</sup> 1906 MIA, Schedule 1, s 1

<sup>485</sup> *NSW Leather Co Pty Ltd v Vanguard Insurance Co Ltd* (1991) 25 NSWLR 699, 710

<sup>486</sup> It was replaced by a new standard policy wording known as the MAR 91 form and using the Institute Clauses, which was produced by the London market in 1991.

1779 and continued in use until 1982, expressly incorporating “lost or not lost” terms in its first paragraph.<sup>487</sup>

The rule in relation to “lost or not lost” clauses was on the basis of the judgement in *Sutherland v Pratt*,<sup>488</sup> where the assured sued on a marine policy termed with a “lost or not lost” clause; the assured was supported by the court in his claim to recover for the loss of the insured subject of cotton which had been pledged to him in order to secure an advance, though the loss of the cotton damaged by bad weather had occurred before he acquired the interest by virtue of the pledge. Of course, this rule only applied where the assured was not aware of the loss, just as in this case where neither parties to the insurance contract had realised the partial loss from goods in transit at sea. Also, where the parties under the CFR sale contract suffered loss from the damage of cotton as the insured subject before shipment, the court held that the assured was covered under the marine policy, termed with the “lost or not lost” clause.<sup>489</sup> It also should be noted that the “lost or not lost” clause covers partial loss as well as total loss.<sup>490</sup>

#### *2.4.2.2 Two functions or meanings of the “lost or not lost” clause*

Although it is argued that it may not be necessary to set down this rule to avoid a claim against pre-shipment loss being defeated,<sup>491</sup> in the context of cargo insurance, the clause has its main significance in protecting the assured buyer

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<sup>487</sup> In the SG policy, it was provided as “... to be insured lost or not lost...”.

<sup>488</sup> *Sutherland v Pratt* (1843) 11 M & W 296

<sup>489</sup> *Reinhs Co v Joshua Hoyle & Sons Ltd* [1960] 1 Lloyd's Rep 483, 489; affirmed [1961] 1 Lloyd's Rep 346, 355

<sup>490</sup> *Sutherland v Pratt* (1843) 11 M & W 296; *Reinhs Co v Joshua Hoyle & Sons Ltd* [1960] 1 Lloyd's Rep 483, 489

<sup>491</sup> See 2.4.2.3, below.

on CFR or FOB terms to recover such a loss.<sup>492</sup> It has been suggested that the meaning of “lost or not lost” comprises two different meanings: “retrospective declaration” and “retrospective insurable interest”.

The justifiability of its existence is that the clause is required by the business community to prevent pre-shipment loss. In the past, it was difficult for the assured buyers to communicate with sellers abroad as to the condition of goods located abroad and they often could not know such information until they had received the goods.<sup>493</sup> The original purpose of “lost or not lost” clauses was thus to protect the assured being able to recover who did not conclude a policy until a loss had occurred on condition that neither parties to the policy had known the loss.<sup>494</sup> The issue may then be addressed that the buyer on CFR or FOB terms relying on a policy with the clause and having suffered a loss before the loading, intends to get indemnity from the insurer rather than the seller by reference to their contract of purchase and sale. In commercial practice, the buyer is more likely to make a claim against the insurer instead of the seller in the situations, in particular, where the buyer will be confronted with difficulties in recovering from the seller, for example, where the buyer has paid in advance and the seller is now insolvent.<sup>495</sup> The function of retrospective interest in the clause may assist the buyer where the insurer may argue that the assured buyer cannot recover because a risk or policy cannot attach before the cargo insured has been loaded on board the delivering ship, as a result of which the buyer has

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<sup>492</sup> Yang Liangyi, *Marine Cargo Insurance* (3rd edn, Law Press China 2013) 130

<sup>493</sup> Robert Merkin, ‘Reforming Insurance Law: Is there a case for reverse transportation? A report for the English and Scottish Law Commissions on the Australian experience of insurance law reform’ [2007] Law Commissions, fn 411; Yang Liangyi, *Marine Cargo Insurance* (3rd edn, Law Press China 2013) 128

<sup>494</sup> Jonathan Gilman, Professor Robert M Merkin, Claire Blanchard and Mark Templeman, *Arnould’s Law of Marine Insurance* (18th Revised edn, Sweet & Maxwell 2013) 11-26

<sup>495</sup> Howard Bennett, *The Law of Marine Insurance* (2nd edn, OUP Oxford 2006) 3.14

had no interest. Also, it is devised to inhibit policies from being wager policies because the assured has to subsequently possess an insurable interest.<sup>496</sup>

As to “retrospective declaration”, this means that a policy with such a clause can be taken out by an assured who has had, or not had, an existing insurable interest after the loss has occurred, except when the assured had known of the loss while the insurer was ignorant of it.<sup>497</sup> An assured may thus be able to recover in light of retrospective declaration,<sup>498</sup> such as that for facultative or facultative/obligatory open cover.<sup>499</sup>

The meaning of ‘retrospective insurable interest’ is that the “lost or not lost” clause applies where the assured has not acquired an insurable interest before the loss of, or damage to, the insured subject but subsequently has obtained one.<sup>500</sup> For example, it frequently happens in international sales of goods that the goods will not be assigned to the last buyer, by which the interest will be invested in him, until there is only one day left before it arrives at its destination.<sup>501</sup> The last buyer seldom has chance to be aware of the loss of, or damage to the goods, before he checks the goods at the destination. The problem can be avoided in that the assured buyer who has suffered a loss, before obtaining an insurable interest and making a claim against the insurer, is asked to take up the responsibility to prove that he has had an interest at the

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<sup>496</sup> M Mustill and J Gilman, *Arnould’s Law of Marine Insurance and Average* (16th edn, vol I, Stevens & Sons London 1981) 25 fn 89

<sup>497</sup> *Rheinh’s Co v Joshua Hoyle & Sons Ltd* [1961] 1 Lloyd’s Rep 346 (AC) 355

<sup>498</sup> John Dunt, *Marine Cargo Insurance* (1st edn, Informa Law 2009) 4.18

<sup>499</sup> Yang Liangyi, *Marine Cargo Insurance* (3rd edn, Law Press China 2013) 130

<sup>500</sup> John Dunt, *Marine Cargo Insurance* (1st edn, Informa Law 2009) 4.18; *Wünsche Handelsgesellschaft International mbH v Tai Ping Insurance Co Ltd* [1998] 2 Lloyd’s Rep 8

<sup>501</sup> Yang Liangyi, *Marine Cargo Insurance* (3rd edn, Law Press China 2013) 130

time of the loss. The buyer, who may be only able to find out the loss of, or the damage to, the cargo at the time when the cargo has arrived at the discharging port, may be covered by a policy with the clause which allows him to subsequently obtain an insurable interest prior to loss.<sup>502</sup> Thus, in addition to the normal future loss, the assured, having no better knowledge of the loss than the insurer, may also recover the loss covered by a policy with the “lost or not lost” clause before he has acquired an interest but finally does acquire one.<sup>503</sup>

#### ***2.4.2.3 The “lost or not lost” clause not applicable before attachment of risk***

Although the “lost or not lost” clause may entitle an assured, after the loss of, or damage to, the subject matter insured, to conclude a policy or obtain an insurable interest, it cannot assist the assured where the period of risk in property insured has not commenced. Under s 5 (2) of the 1906 MIA, the assured must possess a legal or equitable relation either to the insured property at risk of the assured or to the marine adventure itself. The clause is subject to this provision and can only operate in the foregoing two ways in which risk or policy has attached. The clause however is not relevant to the commencement of the risk the assured bears. Therefore, even though the clause has been incorporated into a policy relating to a contract of sale of goods on FOB or CFR terms and under its provision the assured can make retrospective declaration or cover, the assured has acquired inadequate cover for pre-shipment risks which have not attached.

#### **2.4.3 No act can vest an interest in an assured having no interest at the time of loss**

Subject to s 6(2) of the 1906 MIA, the requirement of insurable interest cannot be satisfied by an assured who has no interest at the time of loss, no matter

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<sup>502</sup> Howard Bennett, *The Law of Marine Insurance* (2nd edn, OUP Oxford 2006) 3.14

<sup>503</sup> *Sutherland v Pratt* (1843) 11 M & W 296 [311]

what measures it has taken after it has been made aware of the loss. In the *Anderson* case, the risk would not pass to the assured until the whole goods had been loaded onto the vessel. However, part of the goods loaded on board had been lost so that the assured could not have an insurable interest in the goods because, pursuant to the policy, risk would not pass until after completion of the loading of the whole goods. In order to obtain the interest, being aware of the loss, it chose to take up the shipping documents after loss. It was held that the assured who had been aware of the loss could not acquire an insurable interest by means of exercising such an option to accept lost goods which was part of the whole goods to which the risk could not attach, until the completion of the whole shipment.<sup>504</sup> In two situations a purchaser might accept an incomplete cargo loaded on board: firstly, it was compelled to do so as the full performance of the contract of purchase and sale: for instance, the vendor had finished his part to perform the contract; secondly, he voluntarily elected to accept such lost cargo and paid the vendor for it.<sup>505</sup> However, such an election to accept under a contract of purchase and sale was different from an election under a policy covering the foregoing contract: where the policy effected would not attach until the whole cargo had been loaded onto the ship and part of that cargo had been lost; as a result, the assured could by no means acquire an interest since it could not have an interest until the full cargo was loaded on board.<sup>506</sup>

Nevertheless, where an interest had been vested in him, a purchaser of goods who had entered into insurance against perils insured against could have the

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<sup>504</sup> *Anderson v Morice* (1876) 1 App Cas 713 (Chelmsford LJ)

<sup>505</sup> *Anderson v Morice* (1876) 1 App Cas 713 (Chelmsford LJ)

<sup>506</sup> *Appleby v Myers* Law Rep 2 C P 651

option to accept or reject those goods which have unfortunately been lost, depending on whoever it was easier for the assured buyer to claim an indemnity from, the insurer or the seller.<sup>507</sup> Therefore, after having been aware of the loss of goods, whether the loading on board was completed or uncompleted, the assured could not recover from the insurer in virtue of exercising the election to accept the lost, so that it could throw the loss onto the insurer and relieve the parties to the contract of purchase and sale, unless an interest had been invested in him.<sup>508</sup> Likewise, even though an assured could obtain retrospective insurable interest in accordance with the “lost or not lost” clause, he still could not acquire an insurable interest by any act or election after he had known, prior to his having attained that interest, the information as to the loss that had occurred.<sup>509</sup>

## 2.5 Both defeasible and contingent interests are insurable

### 2.5.1 Defeasible and contingent interests

Section 7(1) declares that an assured can insure its defeasible interest in the subject matter of a policy, and also its contingent interest. The former is an insurable interest which the assured may lose by subsequent events when the subject is on its voyage at sea. For example, a vendor can have a defeasible interest in goods until title or risk to them has been transferred to a vendee.<sup>510</sup> Also, as stated by s 7(2), a vendee of goods is entitled to have an insurable interest, defeasible at its own option of rejection due to breach of condition<sup>511</sup> or

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<sup>507</sup> *Sparkes v Marshall* 2 Bing N C 761

<sup>508</sup> *Anderson v Morice* (1876) 1 App Cas 713 (Chelmsford LJ)

<sup>509</sup> *NSW Leather Co Pty Ltd v Vanguard Insurance Co Ltd* (1991) 25 NSWLR 699, 711

<sup>510</sup> Robert H Brown, *Dictionary of Marine insurance terms and clauses* (5th edn, Witherby & Company 1989) D8

<sup>511</sup> Sale of Goods Act 1979, s 11(3)

the vendor's delay in delivery.<sup>512</sup> Although the coverage of a contingent interest is not easy to precisely identify,<sup>513</sup> the latter may mean the kind of interest which can attach in transit at sea depending on the occurrence of a contingency or the fulfilment of certain conditions. It is been suggested that the ruling that a contingent interest is insurable is an inherent requirement of the insurance definition because the subject in which the assured has such an interest is exposed to marine perils insured against.<sup>514</sup> Where the title or risk has been passed to a vendee, he may have such an interest.<sup>515</sup> Where a vendee has rejected goods, a CIF vendor, following the transfer of policy from the vendee, may have a contingent insurable interest in the rejected goods and thus claim against the insurer.<sup>516</sup>

## 2.5.2 Contingent interests

### 2.5.2.1 Examples of contingent interests

#### 2.5.2.1.1 Interest in prizes is insurable

Insurable interest in prizes can be a defeasible or a contingent interest.<sup>517</sup> Captors' interest is contingent because after capture they will either attain proprietary rights in ships by condemnation by a British Admiralty Court or have to pay costs to a court for improper capture. If ships are lost or recaptured during homeward voyages or returned to their neutral owners, the interest is

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<sup>512</sup> Sale of Goods Act 1979, s 20(2)

<sup>513</sup> Jonathan Gilman, Professor Robert M Merkin, Claire Blanchard and Mark Templeman, *Arnould's Law of Marine Insurance* (18th Revised edn, Sweet & Maxwell 2013) 11-27

<sup>514</sup> E R Hardy Ivamy, *Chalmer's Marine Insurance Act 1906* (10th edn, Tottel Publishing 2007) 15; citing *Lucena v Craufurd* (1806) B & PNR 269 [295]

<sup>515</sup> Robert H Brown, *Dictionary of Marine insurance terms and clauses* (5th edn, Witherby & Company 1989) C48

<sup>516</sup> *Fooks v Smith* (1924) 30 Com Cas 97, 101; Jonathan Gilman, Professor Robert M Merkin, Claire Blanchard and Mark Templeman, *Arnould's Law of Marine Insurance* (18th Revised edn, Sweet & Maxwell 2013) 370, fn 87

<sup>517</sup> E R Hardy Ivamy, *Chalmer's Marine Insurance Act 1906* (10th edn, Tottel Publishing 2007)

defeasible. In the opinion of Grose J,<sup>518</sup> it seems that a defeasible interest is insurable, from the perspective that having such an interest at the time of the insurance contract was sufficient to trigger risks. By contrast, it was not an absolute property as an actual insurable interest in the insured subject, as this must attach at the time of loss to support a claim.

Captors of enemy ships could have no proprietary rights vested in them before condemnation by a British Admiralty Court, although after such an order they could obtain such retrospective rights back to the date of capture.<sup>519</sup> Thus, the question often arose as to whether a captor could insure his interest in a captured ship pending the condemnation. Lord Mansfield gave a positive submission in his obiter dictum in *Le Cras v Hughes*,<sup>520</sup> on the ground that captors had possessed a well-founded expectancy of a grant from the Crown following condemnation, although in this case, depending solely on the Spanish Prize Act 1708 which declared that captors who had captured Spanish ships could accrue ownership in them, such captors could sufficiently possess an insurable interest in the vessels. In *Boehm v Bell*,<sup>521</sup> the court affirmed Lord Mansfield's submission as to captors' insurable interests in captured enemy vessels pending condemnation. In this case, three captors of British vessels seized Dutch ships and her goods in time of war for the purpose of prize. However, the Court of Admiralty ordered that the vessel and the majority of goods should be restored to the original owners who were neutral to the war. This meant that lack of condemnation of ships to be prizes conferred no proprietary rights on captors. They consequently claimed for a return of

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<sup>518</sup> *Boehm v Bell* (1799) 8 TR 154, per Grose J

<sup>519</sup> *Morrough v Comyns* (1748) 1 Wils K B 211

<sup>520</sup> *Le Cras v Hughes* (1782) 3 Dougl 81

<sup>521</sup> *Boehm v Bell* (1799) 8 TR 154

premium paid, arguing that they had no insurable interest and the risk had never attached. Nevertheless, three judges of the court unanimously held that the captors had an insurable interest in the captured subject because the Court of Admiralty might order them to pay damages and costs if the capture was improperly made and therefore they could not recover the premiums for the insurance.<sup>522</sup>

Though both of the foregoing two cases show that captors of vessels pending condemnation can have an insurable interest, the decisions are based on distinct grounds: the first suggests that an actual expectation or moral certainty can be sufficient while the latter relies on captors' risk of paying damages and costs for unfit capture. The latter view may be more appropriate because the first is a far more remote relationship and is not based on an existing interest. The expectation test by Lord Mansfield has been rejected by Lord Eldon and Lawrence J in *Lucena v Craufurd*<sup>523</sup> and by judges in other courts<sup>524</sup>. Lawrence J's opinion is consistent: in *Boehm v Bell*, succeeding with condemnation, captors would have an insurable interest retroactive to the date of capture due to the Crown's grant; if not, they might also have one because they were at risk of paying costs. Thus, a mere expectation is not insurable.

#### 2.5.2.1.2 Liability and inchoate rights

A contingent interest can also consist of three other types of interest: liability, reinsurance,<sup>525</sup> expectancies or inchoate rights relying on existing rights,<sup>526</sup>

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<sup>522</sup> *Boehm v Bell* (1799) 8 TR 154; Sir M D Chalmers and Douglas Owen, *The Marine Insurance Act, 1906* (William Clowes and Sons 1907) 15; *Barber v Fleming* (1869-70) LR 5 QB 59

<sup>523</sup> *Lucena v Craufurd* (1806) B & PNR 269 [305], [323]

<sup>524</sup> *Routh v Thompson* (1809) 11 East 428, 434 (Ellenborough CJ); *Devaux v Steele* (1840) 8 Scott 637, 660 (Tindal CJ)

<sup>525</sup> See 2.7, below, which relates to reinsurance which has been regulated by 1906 MIA s 9.

such as freight, anticipated profits and commission as are insurable. For such inchoate rights, coupled with present existing rights, only perils insured against can in the ordinary course beat the assured's successful benefits from the marine adventure. Carriers,<sup>527</sup> other bailees other than carriers,<sup>528</sup> insurers<sup>529</sup> pursuant to their respective contracts are all liable to indemnify the goods under their carrying, control or cover on the occurrence of loss of or damage to the subject. Captors are liable to pay damages or costs to the court or retribute the improper vessels to the neutral shipowners.<sup>530</sup> The manager of the ship pursuant to the management contract is exposed to liability to the vessel if it be damaged or lost.<sup>531</sup> It is clear from s 5(2) of the 1906 MIA that an assured who may potentially incur liability for the insured subject matter can have an insurable interest in property; it thus is seemingly unnecessary to deal with insurable interest deriving out of liability from the perspective of contingent interest. However, with the rule that a contingent interest is insurable, it may give good ground for the proposition that contractors and sub-contractors under a co-insurance effected by the main contractors or owners of property have insurable interest not only in their liability for the loss or damage to the property but in the entire contract works, holding the surplus of recovery over the amount of its own liability as trustees of its co-assureds.<sup>532</sup>

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<sup>526</sup> Jonathan Gilman, Professor Robert M Merkin, Claire Blanchard and Mark Templeman, *Arnould's Law of Marine Insurance* (18th Revised edn, Sweet & Maxwell 2013) 11-27

<sup>527</sup> *Crowley v Cohen* (1832) 3 B & A478; *A Tomlinson (Hauliers) Ltd v Hepburn* [1966] AC 451; *Lucena v Craufurd* (1806) B & PNR 269 [295]

<sup>528</sup> *Waters v Monarch Fire and Life Assurance Co* (1856) 5 EL & BL 870; *Dagleish v Buchanan & Co* (1854) 16 D 332

<sup>529</sup> *Mackenzie v Whitworth* (1875) 1 Ex D 36

<sup>530</sup> *Boehm v Bell* (1799) 8 TR 154; *Lucena v Craufurd* (1806) B & PNR 269 [323]

<sup>531</sup> *O'Kane v Jones, The Martin P* [2005] Lloyd's Rep IR 174

<sup>532</sup> *Petrofina (UK) Ltd v Magnaload Ltd* [1984] 1 QB 127; *Stone Vickers Ltd v Appledore Ferguson Shipbuilders Ltd* [1991] 2 Lloyd's Rep 288; *National Oilwell (UK) Ltd v Davy Offshore Ltd* [1993] 2 Lloyd's Rep 582; *State of the Netherlands v Youell* [1997] 2 Lloyd's Rep 440; *Feasey v Sun Life Assurance Co* [2003] Lloyd's Rep IR 637

### 2.5.2.2 *The main problem is relating to whether the interest attaches at the time of loss*

When considering whether there is a right of indemnity arising from a contingent insurable interest, the main issue is to determine whether the assured possesses an insurable interest at the time of loss rather than at the time of contract,<sup>533</sup> despite a restitution of premium possibly requiring the existence of the interest at the time of contract.<sup>534</sup> Freight is one example of a contingent interest and it is accepted that having a charterparty can confer on shipowners an insurable interest and render them at risk of sea. What the court needs to address is thus whether shipowners can have an interest to recover where the loss had happened before the chartered voyage has commenced. In *Barber v Fleming*,<sup>535</sup> the shipowner as the assured had chartered his ship for cargos, then at A, from B to C. When the ship was sailing in ballast from A to B, she suffered loss. Then the shipowner made a claim against the insurer to recover the lost freight under the policy covering the voyage from A to C. The court mainly needed to deal with whether the freight had sustained loss, or the interest had attached, at the time of loss.<sup>536</sup> The court held that the assured could recover the loss of the chartered freight because the interest had attached at the time of the damage to the vessel which under the charterparty had sailed for C and incurred relevant fees. The fact that the shipowner had got a charterparty and had taken action to fulfil such contract made the interest in the freight an inchoate interest rather than a mere expectation.

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<sup>533</sup> E R Hardy Ivamy, *Chalmer's Marine Insurance Act 1906* ( 10th edn, Tottel Publishing 2007) 14; *Barber v Fleming* (1869-70) LR 5 QB 59

<sup>534</sup> *Boehm v Bell* (1799) 8 TR 154

<sup>535</sup> *Barber v Fleming* (1869-70) LR 5 QB 59

<sup>536</sup> *Barber v Fleming* (1869-70) LR 5 QB 59

### 2.5.3 Defeasible interest

#### 2.5.3.1 Insurability of a defeasible interest

Section 7(2) affords an example of an insurable and defeasible interest that an assured buyer, having had an insurable interest, chooses to discontinue the interest, in the stated circumstances of a seller's delay in making delivery, or other reasons like having shipped goods of inferior quality. Thus, this kind of interest is insurable although it is possible that the assured may lose his interest in the subject at his own election because "a defeasible interest is one which is liable to be defeated by subsequent events."<sup>537</sup>

This provision may be based on the judgement in *Sparkes v Marshall*.<sup>538</sup> Under the contracts between the vendor and the vendee, based upon their correspondence, the cargo had been appropriated to the vendee. From this vested right in the vendee, his interest in the cargo arose. In this specific case, the vendee could accept or reject the cargo at his option because the vendor breached the contract and sold the cargo to another purchaser after the cargo had been appropriated to the assured, the original buyer. The original assured could choose to reject the subject of the insurance, which made the interest a defeasible one due to the breach by the vendor. He nonetheless chose to accept the cargo lost in transit and made a claim against the insurer. This option has commercial sense because where the assured buyer has the right to accept or reject the goods insured at the time of loss, he is inclined to accept them to enable him to have a claim against the loss covered by the insurer. Should the goods be rejected, the assured may not claim against the insurer. According to the judgement, the defeasible interest possessed by the assured was held as a

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<sup>537</sup> Robert Merkin, *Marine Insurance legislation* (4th edn, Informa Law 2010) 11

<sup>538</sup> *Sparkes v Marshall* 2 Bing N C 761

sufficient interest to support an action against the insurer. An insurable interest possessed by the assured is defeasible only at the assured's own option.<sup>539</sup> If it is a seller that can decide whether or not to deliver in order to perform a contract, that relation between a buyer and the subject matter of contract of purchase and sale may merely be an expectation rather than an insurable interest. This is also the effect of s 6(1) of the 1906 MIA: a buyer who has none of, or not all of, the insurable interest at the time of loss, because the seller has not totally transferred its interest in goods to the buyer, cannot recover.

Also, where an assured chose to pay, confirming their acceptance, and received the bill of lading for the insured cargo after the loss had occurred, the assured was supported by Bovill CJ and Denman J to insure and recover not only their own interest to the extent of their advance on the cotton but also to its full value.<sup>540</sup>

#### *2.5.3.2 Buyers' election under s 6(2) and s 7(2)*

There is a difference between s 6(2) and s 7(2) of the 1906 MIA as to whether an assured can obtain an insurable interest by its election. Different preconditions have different rules. In accordance with s 6(2), due to an assured at inception having no insurable interest at the time of loss, it therefore cannot obtain one at its election. By contrast, pursuant to s 7(2), it can obtain one because it is in the situation where it has an insurable interest, but with a defeasible nature, at the time of loss. Furthermore, s 6(2) only relates to whether an assured can recover from an insurer, whereas s 7(2), together with s 7 (1), provides for the insurability of these two kinds of interest, namely, it is

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<sup>539</sup> Sir M D Chalmers and Douglas Owen, *The Marine Insurance Act, 1906* (William Clowes and Sons 1907) 15

<sup>540</sup> *Ebsworth v Alliance Mar Ins Co* (1873) LR 8 CP 596, 596-97 and the judgement per Bovill CJ

relevant not only to the issue whether the assured can claim but also to the validity of a contract of insurance.

## 2.6 Partial interest

### 2.6.1 Illustrations for partial interests

Besides the limited interests of defeasible and contingent ones exemplified by s 7(1), s 8 of the 1906 MIA provides another one as a partial interest which of any nature is insurable.<sup>541</sup> It is suggested that an undivided or hotchpot interest is one type of partial interest, as well as, more widely, an interest possessed by the assured who only has partial or limited interests in the insured subjects. In this case it may insure to the full value of the subject, holding the surplus in trust for the others interested in the subject. In relation to the latter, thus, a person having a right to mortgage<sup>542</sup> or lien<sup>543</sup> on the subject matter insured can have such a partial interest in the property; similarly, the interest possessed by a carrier or other bailees;<sup>544</sup> a contractor and subcontractor can have such an interest as well;<sup>545</sup> the same principle also applies to a consignee having a

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<sup>541</sup> Professor Robert M Merkin, *Colinvaux and Merkin's Insurance Contract Law* (vol 1, Sweet & Maxwell 2017) A-0401

<sup>542</sup> *Irving v Richardson* (1831) 2 B & A193

<sup>543</sup> *Godin v London Assurance Company* (1758) 1 Burrow 489, a factor having had a lien on the whole goods of his principal could be entitled to insure the lien, though the case was mainly concerned about double insurance in order to determine whether the sum insured could be apportioned between the two insurers, where two persons having two distinct interests had made two separate policies; *Carruthers v Sheddon* (1815) 6 Taunt 14, the plaintiff, as the agent of D who had made advances and paid what was required and was then held to be the manager of the adventure and the consignee of the goods of coffee, might recover its full value beyond D's personal interest in lien; *Waters v Monarch Fire & Life Assurance Co* (1856) 5 E & B 870, relating to fire policies effected by the warehouseman who only had a very limited personal interest, i.e. only a lien for his charges.

<sup>544</sup> *Waters v Monarch Fire & Life Assurance Co* (1856) 5 E & B 870; *L & NWR v Glyn* (1859) 1 E & E 652, also in relation to a fire policy made by the plaintiff as carriers in whose warehouse the goods were burnt; *Tomlinson v Hepburn* [1966] AC 451; *Ramco (UK) Ltd v International Insurance Co of Hanover Ltd* [2004] Lloyd's Rep IR 606

<sup>545</sup> *Petrofina (UK) Ltd v Magnaload Ltd* [1984] QB 127; *Stone Vickers Ltd v Appledore Ferguson Shipbuilders Ltd* [1991] 2 Lloyd's Rep 288; [1992] 2 Lloyd's Rep 578 (AC); *National Oilwell (UK) Ltd v Davy Offshore Ltd* [1993] 2 Lloyd's Rep 582; *Co-operative Retail Services v Taylor Young Partnership Ltd* [2002] Lloyd's Rep IR 555; *Commonwealth Construction Co Ltd v Imperial Oil Ltd* (1977) 69 DLR (3d) 558

partial interest in a ship<sup>546</sup> or cargo.<sup>547</sup> As to a consignee placing an insurance as a principal, whether it can recover beyond its own interest to the full value of the subject depends on the construction of the policy: it can only be entitled to do this where it has had such an intention at the time of the policy.<sup>548</sup> It would be commercially convenient to allow a person, such as a warehouseman, who has a merely partial interest in property to insure in its own name and recover the whole amount of the insurance.<sup>549</sup>

### 2.6.2 Undivided interests

As to undivided interests, Lord Blackburn in *Inglis v Stock* held that an undivided interest in a parcel of goods on board a ship may be described as an interest in goods just as much as if it were an interest in every portion of the goods.<sup>550</sup> In this case, the assured buyer purchased 200 tons of sugar from the British merchant D and also the same quantity from B who had purchased from D, both on FOB Hamburg condition. To fulfil the two contracts, D's agents engaged space for the shipment of 390 tons of sugar, undivided, from Hamburg to Bristol, during which the ship was lost. D, with the knowledge of the loss, appropriated two parcels of sugar to respective contracts. The assured then brought an action against the insurer under its floating insurance to recover the two parcels. The dispute was whether or not the assured had an insurable interest. Although both the Court of Appeal and the House of Lords held that the

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<sup>546</sup> *Robertson v Hamilton* (1811) 14 East 522

<sup>547</sup> *Ebsworth v Alliance Mar Ins Co* (1873) LR 8 CP 596

<sup>548</sup> *Carruthers v Sheddon* (1815) 6 Taunt 14; it was also held in this case that a person possessing several interests in cargoes might cover them all by one insurance and did not need to specify the number or nature of its interests in the policy; *Irving v Richardson* (1831) 2 B & A193 (a mortgagee of the ship); *Sutherland v Pratt* (1843) 11 M & W 296, held that the construction of the policy was the job of the jury rather than the court; *Waters v Monarch Fire & Life Assurance Co* (1856) 5 E & B 870, in this case Lord Campbell CJ relying on the proper construction of the policy held whether the policy was intended to cover the interest of the general owner of the goods; *L & NWR v Glyn* (1859) 1 E & E 652, 661 and 663; also see *Ebsworth v Alliance Mar Ins Co* (1873) LR 8 CP 596, 608-09.

<sup>549</sup> *Waters v Monarch Fire & Life Assurance Co* (1856) 5 E & B 870, 881

<sup>550</sup> (1885) 10 App Cas 263, 274

assured had an insurable interest in goods under the two contracts of purchase and sale, some of the judges decided on the ground of the FOB terms, which rendered the buyer to be at risk after the sugar was on board the ship<sup>551</sup> while others relied on the reason that the assured was at risk because under the two contracts of purchase and sale it was bound to pay for the price whether the goods arrived or not.<sup>552</sup> Lord Blackburn also expressed the view that an undivided interest was insurable.

### 2.6.3 Hotchpot interests possessed by a part-owner

A part-owner, either a joint-tenant or a tenant in common, can have an insurable interest in the whole of the subject matter of the policy, which thus can entitle an assured to insure and recover to the extent of the full value of the subject, holding the residue in trust for the others interested in the subject insured. In *Page v Fry*,<sup>553</sup> the plaintiff as agent of M purchased a parcel of corn for M who however offered another mercantile house a joint concern in the cargo. This was accepted by the house because they thought that the quantity might be much too large for themselves. M then ordered the plaintiff to effect a policy for the ship and the corn. Lord Eldon held that the plaintiff had an insurable interest in the entirety of the cargo even though it was only a part-owner of the insured subject. Heath J also said that a joint-tenant or a tenant in common should be able to have such an interest in the entirety so that they can insure and recover the full amount of the insurance.

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<sup>551</sup> (1884) 12 QBD 564 (Brett MR, Baggallay LJ); (1885) 10 App Cas 263 (Selborne LJ)

<sup>552</sup> (1884) 12 QBD 564 (Brett MR, Baggallay LJ, Lindley LJ); Professor Robert M Merkin, *Colinvaux's Law of Insurance* (11th edn, Sweet & Maxwell 2016) 25-024

<sup>553</sup> *Page v Fry* (1800) 2 B & P 240

#### 2.6.4 Hotchpot interests owned by shareholders

In *Wilson v Jones*, it was held that a shareholder of the company had an insurable interest in a marine adventure, the successful laying of the submarine cable.<sup>554</sup> This interest can be treated as a hotchpot interest, which is a partial interest, being insurable. However, the court in the case did not rely on this point; nevertheless, it held the assured possessed an insurable interest on the ground that the true subject was the successful laying of the cable rather than the cable itself.

#### 2.6.5 Hotchpot interests in ships and possessed by consignees

Hotchpot interests, whether in ships or cargoes, may be types of partial interests.<sup>555</sup> In *Robertson v Hamilton*,<sup>556</sup> the ship the *Ross* belonging to the assured plaintiff and the *Atlantic* belonging to F, with cargoes on them belonging to other parties, were captured by the Spaniards. In order to restore them, their owners separately authorised C to deal with the captor, which gave C full powers of attorney as to the captured property. By parting with part of the cargoes, the captor agreed to return the captured subjects as one whole lump for their common benefit, which made them hotchpot properties. The plaintiff, the owner of the *Rose* paid C for the expenses of the restoring and outfitting of both ships to London. C then consigned the rest of the captured subjects to the plaintiff, who afterwards insured the *Atlantic*. It was afterwards recaptured by the French and the plaintiff thus claimed in their own names to recover for the total loss of that vessel. The court then needed to consider whether the plaintiff had an insurable interest in the *Atlantic* and to what extent they could recover.

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<sup>554</sup> *Wilson v Jones* (1867) LR 2 Ex 139

<sup>555</sup> Jonathan Gilman, Professor Robert M Merkin, Claire Blanchard and Mark Templeman, *Arnould's Law of Marine Insurance* (18th Revised edn, Sweet & Maxwell 2013) 11-01; see also Professor Hugh Beale, *Chitty on Contracts* (vol II, 32th edn, Sweet & Maxwell 2016) 41-004

<sup>556</sup> *Robertson v Hamilton* (1811) 14 East 522

The court held that every owner interested in the hotchpot properties had an interest not only in its own property but also in the conjoint property restored. The decision was based on two grounds. Firstly, the plaintiffs were owners of the ship the *Rose* which was one part of the hotchpot property restored. Secondly, by having paid the expenses for the restoring and outfitting, they could be treated as the consignees and representatives of their agent C who had advanced money for the restitution and thus had an interest in the whole hotchpot.<sup>557</sup> The court held as well that one owner of part of the hotchpot property could recover to the extent of the full value of the whole mass of the property restored, holding the surplus excess of its own interest in trust for those interested in respective subjects.<sup>558</sup>

#### **2.6.6 Hotchpot interests in cargoes and possessed by consignees**

In the case of *Ebsworth*,<sup>559</sup> the plaintiffs, cotton brokers and agents in London, were undertaking dealings as to consignments of cotton from a merchant B living abroad, making advances thereon by acceptance against the consignments. Two open floating policies after declaration, intended to cover the plaintiffs and B, were effected between the plaintiffs and the defendants. The ship with the cargo of cotton was lost at sea. The judges in the case unanimously decided that the plaintiffs had an insurable interest to the extent of their advance. As to the question whether they were entitled to insure and recover to the whole amount of the insurance in their own names, holding the surplus beyond their own interest in trust for other parties interested, in this

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<sup>557</sup> *Robertson v Hamilton* (1811) 14 East 522, 533-534

<sup>558</sup> *Robertson v Hamilton* (1811) 14 East 522, 532

<sup>559</sup> *Ebsworth v Alliance Mar Ins Co* (1873) LR 8 CP 596, 596-597 and the judgement per Bovill CJ

case B, the court was equally divided. Bovill CJ and Denman J said they were entitled on the ground that the cotton as a whole was the security for the plaintiffs' liability to pay under their acceptance and they were also consignees under their advance to manage the consignments. In this case, the assured had a hotchpot interest, together with B in the cotton and also an interest, not extending to the whole value, of some of the cargo, both of which were insurable partial interests.

## 2.7 Re-insurance

### 2.7.1 An insurer can reinsure his insurable interest in his risk

#### 2.7.1.1 Validity of reinsurance

Section 9(1) says that the reassured can have an interest in the preservation of the subject matter of the primary insurance after it has entered into the contract of the aforesaid insurance and reinsure such an interest by reinsurers under a contract of reinsurance.<sup>560</sup>

In the context of statutory regulation, contracts of reinsurance saw a change from invalidity to recognition by various Acts. Reinsurance in the first place was unlawful until 1864.<sup>561</sup> Section 4 of the Marine Insurance Act 1745 debarred reinsurance: an insurer was not allowed to reinsure unless he was dead or bankrupt or insolvent. This provision was to protect the insurer against a claim as to insurance without insurable interest,<sup>562</sup> because as with original insurance, reinsurance policies were made in the guise of wager and, specifically to

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<sup>560</sup> *Uzielli v The Boston Marine Insurance Co* (1884) 15 QBD (AC) 16 and cf *Bradford v Symondson* (1881) 7 QBD 456 (AC) 463

<sup>561</sup> *Charter Reinsurance Co Ltd v Fagan* [1997] AC 313 (HL) 392

<sup>562</sup> David Hughes, *A treatise on the law relating to insurance: in three parts, viz. I.--Of marine insurance. II.--Of insurance on lives. III.--Of insurance against fire* (1st American edn, with notes and references to American decisions, New York, O Halsted, Collins and Hannay, and Gould and Banks 1833) 17

reinsurance, they were used to speculate in the rise and fall of premiums.<sup>563</sup> In 1864, the ban on reinsurance was removed and reinsurance was thus provided as a valid contract by s 1 of 27 & 28 Vict. c. 56. However, the validity of reinsurance was later expressly recognised by s 92 of the Stamp Act 1896 and s 9 of the Marine Insurance Act 1906.<sup>564</sup> By contrast, at common law, contracts of insurance including reinsurance were always valid.<sup>565</sup>

### 2.7.1.2 *The nature of reinsurance*

It should be noted that reinsurance is generally not an insurance of liability and the subject matter of reinsurance is the same as that of the original insurance for reasons of history.<sup>566</sup> The reassured has an insurable interest in the risk as to the loss of the subject matter of insurance and can recover the loss to the extent of what he has insured.<sup>567</sup> It has long been laid down as law with high authority that reinsurance, which is not a contract of liability insurance, is nevertheless an independent insurance effected by the reassured and the reinsurer on the same subject matter as the primary insurance has covered.<sup>568</sup> The main importance of treating the reinsurance as a separate contract is that the reinsurer only covers “what its own proper law holds it to cover”<sup>569</sup> and third party procedure cannot be applicable.

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<sup>563</sup> Jonathan Gilman, Professor Robert M Merkin, Claire Blanchard and Mark Templeman, *Arnould’s Law of Marine Insurance* (18th Revised edn, Sweet & Maxwell 2013) 11-01; see also Professor Hugh Beale, *Chitty on Contracts* (vol II, 32th edn, Sweet & Maxwell 2016) 42-008

<sup>564</sup> Sir M D Chalmers and Douglas Owen, *The Marine Insurance Act, 1906* (William Clowes and Sons 1907) 17

<sup>565</sup> Sir M D Chalmers and Douglas Owen, *The Marine Insurance Act, 1906* (William Clowes and Sons 1907) 17

<sup>566</sup> *Uzielli v The Boston Marine Insurance Company* (1884) 15 QBD 11 (AC)16; *Wasa International Insurance Co Ltd and AGF Insurance Co Ltd v Lexington Insurance Co* [2009] UKHL 40, [2010] 1 AC 180 [113]

<sup>567</sup> *Uzielli v The Boston Marine Insurance Company* (1884) 15 QBD 11 (AC) 16

<sup>568</sup> *Wasa International Insurance Co Ltd and AGF Insurance Co Ltd v Lexington Insurance Co* [2009] UKHL 40, [2010] 1 AC 180; *Charter Reinsurance Co Ltd v Fagan* [1997] AC 313 (HL) 392

<sup>569</sup> *Wasa International Insurance Co Ltd and AGF Insurance Co Ltd v Lexington Insurance Co* [2008] EWCA Civ 150, [2008] Bus LR 1029; although the judgement was reversed by the

### 2.7.1.3 A different approach in practice

Reinsurance is however often treated as liability insurance and the subject of reinsurance can be contracted in the common course of insurance business. Under such contracts of reinsurance, the reassured can recover at the time when, under terms showing liability insurance, the reassured is liable to pay the primary assured.<sup>570</sup> Lord Griffiths said that “In the ordinary course of business reinsurance is referred to as ‘back-to-back’ with the insurance, which means that the reinsurer agrees that if the insurer is liable under the policy the reinsurer will accept liability to pay whatever percentage of the claim he has agreed to reinsure.”<sup>571</sup> Thus, the reinsurer was held liable to the reassured because the reinsurance was effected by the reassured by wording showing liability insurance: “by the reinsurance policy, the underwriters promised that if Vesta (the reassured) *became liable for a loss* under the insurance policy, then the underwriters would make good 90% of the loss. Vesta became liable for a loss under the insurance policy and the underwriters must perform and observe their promise in the reinsurance policy.”<sup>572</sup> The italicised words are terms showing liability insurance.

As to the extent that the reassured can recover, the cover under reinsurance should not be wider than that of the primary insurance and the reinsurer need only pay the reassured’s legal liability. Therefore, the form of a reinsurance policy is often termed as “being a reinsurance subject to all clauses and conditions of the original policy or policies, and to pay as may be paid

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House of Lords in [2009] UKHL 40, [2010] 1 AC 180, this opinion was recognised by the House of Lords.

<sup>570</sup> *Wasa International Insurance Co Ltd and AGF Insurance Co Ltd v Lexington Insurance Co* [2009] UKHL 40, [2010] 1 AC 180 [114]

<sup>571</sup> *Forsikringsaktieselskapet Vesta v Butcher* [1989] AC 852 (HL) 895

<sup>572</sup> *Forsikringsaktieselskapet Vesta v Butcher* [1989] AC 852 (HL) 892

thereupon.”<sup>573</sup> The exceptions in the original policy should also apply to the contract of reinsurance. Thus, the reinsurer need not pay the reassured where the extent of the cover under the two kinds of insurance is different.<sup>574</sup>

Furthermore, subject to the wording of reinsurance policies, the nature of the reinsurance can be a reinsurance of liability rather than one on the subject matter insured by the original insurance. Thus, in *Feasey*,<sup>575</sup> the court held that the subject matter of the reinsurance between S and the Lloyd’s syndicate was its possible loss for compensating shipowners, as its members, for injury or death of the employees on board the ships, rather than the subject of the original insurance which was its members’ liability for personal injury or death. The reassured S, a Protection and Indemnity club (P&I Club), was entitled to have an insurable interest in its liability because the subject of the reinsurance, its liability, embraced its interest in the liability, that it was at risk of suffering a loss if injury or death of the employees occurred relating to its members. The court further held that it also had an insurable interest in the lives and well-being of the employees. Although it did not necessarily mean that a policy on liability could cover life, where the policy indeed intended to cover life, it should be allowed so to do.

#### *2.7.1.4 Different nature of insurable interest possessed by the assured and the reassured*

The subject matter of a contract of insurance and reinsurance is the same.<sup>576</sup> However, the nature of the insurable interest in the subject of those two different

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<sup>573</sup> Sir M D Chalmers and Douglas Owen, *The Marine Insurance Act, 1906* (William Clowes and Sons 1907) 17

<sup>574</sup> *Uzielli v The Boston Marine Insurance Co* (1884) 15 QBD

<sup>575</sup> *Feasey v Sun Life Assurance Co* [2003] Lloyd’s Rep IR 637

<sup>576</sup> *British Dominions General Insurance Co v Duder* [1915] 2 KB 394 (AC) 400

types of insurance is different.<sup>577</sup> As to the original insurance contract, whether an assured has an insurable interest, and what is its nature, should be tested by common law rules and the relevant provisions under the 1906 MIA. The purpose of a contract of insurance is to protect the assured's insurable interest from being damaged or lost. In the latter context, the reassured has an insurable interest in the liability for the risk to the subject matter insured under the original policy, which has been confirmed by s 9 of the 1906 MIA. The reassured's interest in the risk is a type of contingent interest.<sup>578</sup> However, differing from the purpose of the original insurance, which is to protect the insurable interest of the assured other than the subject, a reinsurance is devised to protect the subject matter of the original policy other than the reassured's insurable interest in the so-described subject.<sup>579</sup> Consequently, the amount being able to be recovered by the assured under the original insurance will not necessarily be the same as the amount recoverable by the reassured under the reinsurance. "For example, the liability of the primary insurer will not necessarily be for the whole loss suffered by the original insured but may be subject to exceptions and limitations."<sup>580</sup> Also, unless the reinsurance specifically provides, the reinsurer generally is only liable for the reassured's legal liability to the original assured and not for the liability outside of the cover of the original insurance, such as ex gratia payments.<sup>581</sup>

#### **2.7.1.5 Distinction between double insurance and reinsurance**

Contracts of reinsurance and that of double insurance are different. The parties

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<sup>577</sup> *Charter Reinsurance Co Ltd v Fagan* [1997] AC 313 (HL) 392

<sup>578</sup> Sir M D Chalmers and Douglas Owen, *The Marine Insurance Act, 1906* (William Clowes and Sons 1907) 15

<sup>579</sup> *British Dominions General Insurance Co v Duder* [1915] 2 KB 394 (AC) 400

<sup>580</sup> *Charter Reinsurance Co Ltd v Fagan* [1997] AC 313 (HL) 392

<sup>581</sup> Robert H Brown, *Dictionary of Marine Insurance Terms and Clauses* (5th edn, Witherby & Co Ltd 1989) R 9

who made the contracts are different: the former is taken out by the reassured for his own account whereas the latter is both effected by or on behalf of the original assured.<sup>582</sup> There is also a difference between the risks to be covered: reinsurance having been entered into, is devised to be obliged to the primary insurer for the whole or part of the risk that it has been bound to pay under the original insurance while for double insurance, the original insurance is on a risk already covered by other contracts of insurance.<sup>583</sup> The extent of cover as to reinsurance is by and large narrower than that of original insurance while the sum insured under double insurance is generally larger than the insurable value under unvalued policies or the fixed value under valued policies.

## **2.7.2 An original assured generally cannot claim directly against the reinsurer**

### **2.7.2.1 Reasons for the rule**

Section 9(2) reflects the doctrine of privity of contract and states that subject to the terms of the original contracts and reinsurance, the original assured cannot bring an action directly against the reinsurer. The original insurance and reinsurance contracts are independent contracts. The former is taken out between the original assured and the primary insurer while the latter is a contract between the primary insurer and reinsurer.<sup>584</sup> Therefore, in light of the general principle relating to the privity of contract,<sup>585</sup> the original assured cannot directly claim against the reinsurer.<sup>586</sup> In *Nelson v Empress Assurance*

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<sup>582</sup> David Hughes, *A treatise on the law relating to insurance: in three parts, viz. I.--Of marine insurance. II.--Of insurance on lives. III.--Of insurance against fire* (1st American edn, with notes and references to American decisions, New York, O Halsted, Collins and Hannay, and Gould and Banks 1833) 46

<sup>583</sup> Sir M D Chalmers and Douglas Owen, *The Marine Insurance Act, 1906* (William Clowes and Sons 1907) 17

<sup>584</sup> *Grecoair Inc v Tilling* [2005] Lloyd's Rep IR 151, 100

<sup>585</sup> Robert Merkin, *Marine Insurance legislation* (4th edn, Informa Law 2010), 12

<sup>586</sup> *Grecoair Inc v Tilling* [2005] Lloyd's Rep IR 151

*Corporation*,<sup>587</sup> which was the first case in relation to whether the third party procedure could apply to the reinsurer, it was held that the third party procedure did not apply to cases in which the reassured tried to take an action against the reinsurer, inasmuch as the contract of original insurance and that of reinsurance were separate ones and the contract of reinsurance was stated as not one of “indemnity” that the reinsurer would be liable to indemnify the reassured for its risk of pecuniary loss under the original insurance. Should that be the case, the reassured would be inclined to indemnify the assured and afterwards seek to get “indemnified” from the reinsurer. Besides, if the third party procedure was allowed, much inconvenience would be incurred: one was that, sometimes, what the reinsurer had insured was, subject to the terms of policy of reinsurance, not necessarily the same as cover accepted by the reassured under the original policy; the other was that it was possible that additional expenses might be incurred because the reassured might again sue on the reinsurance if the previous third party procedure had failed.<sup>588</sup>

#### *2.7.2.2 Contravention of the principle of privity of contract*

According to s 1 of the Contracts (Rights of Third Parties) Act 1999, which overrides the principle of the privity of contract, in two situations, the reinsurer may be sued directly by the assured as the third party.<sup>589</sup> Firstly, by the express agreement of the reinsurance policy, the original assured may change the legal position so as to breach the principle of privity and take an action directly against the underwriter of a policy of the reinsurance.<sup>590</sup> This has been provided for by s 9(2) of the 1906 MIA: without such an agreement, the original assured

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<sup>587</sup> *Nelson v Empress Assurance Corporation* [1905] 2 KB 281

<sup>588</sup> *Nelson v Empress Assurance Corporation* [1905] 2 KB 281 (AC) 286

<sup>589</sup> Jonathan Gilman, Professor Robert M Merkin, Claire Blanchard and Mark Templeman, *Arnould's Law of Marine Insurance* (18th Revised edn, Sweet & Maxwell 2013) 11-01

<sup>590</sup> Contracts (Rights of Third Parties) Act 1999, s 1(a)

was not entitled to sue under the reinsurance policy and recover losses from reinsurers for loss caused by insured perils.<sup>591</sup> Vice versa, the original assured would have had a direct claim against the reinsurer had there been such an agreement.

Secondly, where the original assured can under the terms and intention of the reinsurance contracts gain an advantage, he thus may directly claim against reinsurers.<sup>592</sup> In the ordinary course of business, in order to entitle the assured to directly pursue an action against reinsurers, reinsurance contracts normally include a cut-through clause.<sup>593</sup> The clause is chiefly designed to prevent the original assureds themselves from being unable to recover from reassureds due to their insolvency. Thus, pursuant to s 239 of the Insolvency Act 1986, original assureds may have an advantageous position: where reassureds go into insolvent liquidation, subject to some qualifications, the provision of the clause can have the effect that reassureds give a preference over the original assureds. However, the effect of the clause giving a preference may be in violation of the *pari passu* principle by s 107 of the Act which means that unsecured creditors in a winding up shall be dealt with equally. This may not be accurate because s 107 is subject to s 239 in relation to preferential payments, s 4(a) of which stipulates that original assureds, despite normally being unsecured creditors, may enjoy preferential payments if reassureds are liable to indemnify their loss.

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<sup>591</sup> *Grecoair Inc v Tilling* [2005] Lloyd's Rep IR 151, 98

<sup>592</sup> Contracts (Rights of Third Parties) Act 1999, s 1(b)

<sup>593</sup> Robert Merkin, *Marine Insurance legislation* (4th edn, Informa Law 2010) 12; Jonathan Gilman, Professor Robert M Merkin, Claire Blanchard and Mark Templeman, *Arnould's Law of Marine Insurance* (18th Revised edn, Sweet & Maxwell 2013) 11-01

## 2.8 Bottomry

### 2.8.1 It is the lender that must insure

In this section, it declares that “The lender of money on bottomry or respondentia has an insurable interest in respect of the loan.” The lender of money, not the borrower, can insure the money loaned in pursuance of a bottomry bond or respondentia on the security of ship or cargo, because if the ship or cargo cannot arrive safely, it is the lender that will lose his money advanced,<sup>594</sup> i.e. he bears a sea risk as to the safe arrival of the vessel. He may also possibly possess an insurable interest in the vessel or cargo provided he can in certain circumstances have a lien on the vessel.<sup>595</sup>

### 2.8.2 Obsolete concept

Bottomry and respondentia were early forms of marine policies and have long been obsolete, not only at the present time, but also at the time prior to the Marine Insurance Act 1906.<sup>596</sup> As “essentially a combination of loan, security and insurance”,<sup>597</sup> they are kinds of inchoate rights founded on existing rights and are insurable.<sup>598</sup> To put it simply, in order to complete the voyage, the master was empowered to take a loan from money-lender on the security of the vessel and freight, which was called a bottomry bond, or of cargo, which was referred to as respondentia.<sup>599</sup> Where the ship or goods arrived in safety, the assured had to repay the advance or loan by the lender with interest; in the case of loss as to the security, the lender would recover nothing and the

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<sup>594</sup> Sir M D Chalmers and Douglas Owen, *The Marine Insurance Act, 1906* (Willam Clowes and Sons 1907) 18

<sup>595</sup> Jonathan Gilman, Professor Robert M Merkin, Claire Blanchard and Mark Templeman, *Arnould's Law of Marine Insurance* (18th Revised edn, Sweet & Maxwell 2013) 11-01

<sup>596</sup> Jonathan Gilman, Professor Robert M Merkin, Claire Blanchard and Mark Templeman, *Arnould's Law of Marine Insurance* (18th Revised edn, Sweet & Maxwell 2013) 11-01

<sup>597</sup> Ian Enright and Professor Robert M Merkin, *Sutton's Law of Insurance in Australia* (4th ed, Thomson Reuters 2014) para 22.10

<sup>598</sup> *Lucena v Craufurd* (1806) B & PNR 269 [294], [295]

<sup>599</sup> Robert Merkin, *Marine Insurance legislation* (4th edn, Informa Law 2010) 12

assured did not need to repay the advance.<sup>600</sup> However, the master of the vessel could borrow by bottomry or respondentia when there was really a necessity, for instance, in cases of emergency, and these were limited by some restrictions.<sup>601</sup>

### 2.8.3 The definition of bottomry bonds

Bottomry bonds are contracts in the nature of mortgages on a vessel, i.e. the master of the vessel borrows money from a lender by pledging its keel or bottom, *pars pro toto*, as a security for repayment. The loan is intended to enable the master of the vessel to fit it out to continue the voyage or to purchase a cargo for a specified voyage. The legal effect of the bond is that the lender cannot obtain the repayment of the loan where the vessel has been lost in the course of the specified voyage by maritime perils stipulated in the bond.<sup>602</sup>

To be an effective bottomry bond, one essential of maritime risk must thus be identified<sup>603</sup> at the risk of the lender. In other words, the lender's payment advanced is conditional upon whether the vessel can safely arrive,<sup>604</sup> and is not guaranteed that it can be definitely returned without being exposed to suffer a loss from maritime perils. Under a bottomry bond or respondentia, whether the lender could be repaid the advance is dependent on whether the vessel or cargo exposed to risks at sea specified in the contracts can safely arrive at her destination. Should a ship or its cargo be lost by the perils enumerated, the

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<sup>600</sup> Ian Enright and Professor Robert M Merkin, *Sutton's Law of Insurance in Australia* (4th ed, Thomson Reuters 2014) para [22.10]

<sup>601</sup> Sir M D Chalmers and Douglas Owen, *The Marine Insurance Act, 1906* (William Clowes and Sons 1907) 18

<sup>602</sup> *The Atlas* (1827) 2 Haggard 48 [53]

<sup>603</sup> *The James W Elwell* [1921] P 351, 365-66

<sup>604</sup> *The James W Elwell* [1921] P 351, 365

lender will lose his advance; he will otherwise have repayment of the loan and the premium or relevant interest as agreed with the borrower.<sup>605</sup> As to the essential of maritime risk, Parke, B further states that whether or not the lender is at risk of sea perils can affect the validity of hypothecation.<sup>606</sup> It should be noticed that the word hypothecation has an ambiguous meaning, which could mean bottomry or mortgage only. Parke, B may here refer to the meaning of bottomry in his statement because the security is the ship. Without referring to a sea risk in a bond, it would be rendered invalid.<sup>607</sup>

#### **2.8.4 Voyage must be specified**

To be a valid bottomry bond, the voyage must be specified. Without specifying the voyage, on the part of the borrower, the loan could be repaid too soon, and so would not fulfil the purpose of bottomry for the lender; or the sea risk could not be identified because the duration of the voyage was unclear. On the part of the lender, the payment of money advanced could be indefinitely postponed; as a result, the vessel would be made a secret maritime lien for a long time.<sup>608</sup> In both cases, they are not a valid bottomry bond.

### **2.9 Master's and seamen's wages**

#### **2.9.1 Seamen's wages and goods**

##### ***2.9.1.1 Reasons for previously banning seamen from insuring wages***

Section 11 of the 1906 MIA has made it clear that either the master or a seaman of a ship can have an insurable interest in his wages. At common law, at one time, seamen were not allowed to earn their wages until the vessel had

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<sup>605</sup> Jonathan Gilman, Professor Robert M Merkin, Claire Blanchard and Mark Templeman, *Arnould's Law of Marine Insurance* (18th Revised edn, Sweet & Maxwell 2013) 11-01

<sup>606</sup> *Stainbank v. Shepard* (1853) 13 CB 418, [442]

<sup>607</sup> *The Emancipation* (1840) 1 W Robinson 124 [130]

<sup>608</sup> *The James W Elwell* [1921] P 351, 366

earned her freight,<sup>609</sup> nor could they insure wages and any commodities as substitutes for wages. Where seamen's agents negligently failed to take out an insurance for them, the seamen could not recover the value of their wages by suing the agent.<sup>610</sup> One reason for this rule was that enabling a seaman to insure his wages might be contrary to principles of public policy.<sup>611</sup> For instance, by allowing such insurance, seamen might not try their best to preserve the vessel when a sea risk occurred. Therefore, the wages of a mariner who deserted the vessel before the completion of the voyage had been held to be forfeited.<sup>612</sup> Similarly, there were worries that allowing seamen to insure their wages would encourage certain misbehaviours because they could also recover wages by such a policy in the case of desertion, even though they were not paid by the shipowner.<sup>613</sup> In addition, the above common law rule was in effect evaded if seamen's wages were entitled to be covered by insurance.<sup>614</sup>

Another ground for this rule was that it was also believed that freight was the mother of wages:<sup>615</sup> therefore, "by the law of England it was an implied condition of the seaman's contract with the ship-owner that his wages were dependent on the earning of freight by the ship."<sup>616</sup> Where freight could not be

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<sup>609</sup> *King v Glover* (1806) 2 B & PNR 206 [209]

<sup>610</sup> *Webster v De Tastet* (1797) 7 TR 157

<sup>611</sup> David Hughes, *A treatise on the law relating to insurance: in three parts, viz. I.--Of marine insurance. II.--Of insurance on lives. III.--Of insurance against fire* (1st American edn, with notes and references to American decisions, New York, O Halsted, Collins and Hannay, and Gould and Banks 1833) 14

<sup>612</sup> *The Baltic Merchant* (1809) Edwards 86

<sup>613</sup> David Hughes, *A treatise on the law relating to insurance: in three parts, viz. I.--Of marine insurance. II.--Of insurance on lives. III.--Of insurance against fire* (1st American edn, with notes and references to American decisions, New York, O Halsted, Collins and Hannay, and Gould and Banks 1833) 14-15

<sup>614</sup> *King v Glover* (1806) 2 B & PNR 206 [209]

<sup>615</sup> *Anonymous Case* (1693) 2 Shower KB 283; *Blakey v Dixon* (1800) 2 B & P 321 [322]; *De Silvale v Kendall* (1815) 4 M & S 37 [45]

<sup>616</sup> Jonathan Gilman, Professor Robert M Merkin, Claire Blanchard and Mark Templeman, *Arnould's Law of Marine Insurance* (18th Revised edn, Sweet & Maxwell 2013) 11-01

earned as the ship had been lost before it would have come to a delivering port, wages were also not due.<sup>617</sup> Without the earning of the freight, wages then could not become payable.

#### *2.9.1.2 Goods purchased with wages can be insured*

While wages of seamen were not allowed to be the subject matter of an insurance, the goods have never been debarred: either the goods were bought by seamen with wages they had received or they were shipped on board. This was based on the fact that a seaman's interest in wages was a contingent one while he already possessed a vested title to the goods, which were an insurable interest.<sup>618</sup>

#### *2.9.1.3 Alteration*

The position at common law as to whether a seaman can insure his wages has been changed by statutes cutting the connection between the earning of wages and the receiving of freight. At common law, seamen's wages were not payable until the earning of the freight. They were consequently uninsurable because they were not dependent on an existing entitlement to wages, i.e. they might be lost not only arising from marine perils insured against but the earning of freight. Afterwards, the common law rule as to seamen's wages being uninsurable and dependent upon freight was abolished by statute.<sup>619</sup> Section 183 of the Merchant Shipping Act 1854 provided that wages were totally independent on the earning of freight, though seamen who had not done their best to save the ship in the event of its wreck or loss had no right to claim. Under s 38 of the Merchant Shipping Act 1995, seamen could, on the occurrence of wreck or loss

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<sup>617</sup> *Anonymous Case* (1693) 2 Shower KB 283

<sup>618</sup> David Hughes, *A treatise on the law relating to insurance: in three parts, viz. I.--Of marine insurance. II.--Of insurance on lives. III.--Of insurance against fire* (1st American edn, with notes and references to American decisions, New York, O Halsted, Collins and Hannay, and Gould and Banks 1833) 15

<sup>619</sup> Merchant Shipping Act 1854, s 183 (now Merchant Shipping Act 1995, s 38)

as to the ship in question, attain his wages payable in the two months following the date of the wreck or loss for his unemployment and could thus insure and recover his vested interest by statute in wages. Seamen's wages thus were no longer dependent on the receipt of freight, and no link between freight and wages existed.<sup>620</sup> To sum up, seamen's wages cannot directly be influenced by the earning of freight and are payable as existing rights under the contract of employment, and they are thus insurable, which has been expressly stipulated in s 11 of the 1906 MIA.

### 2.9.2 Wages of the master can always be insured

By contrast, the master could take out an insurance contract upon his wages, and any commissions and privileges to which he was payable.<sup>621</sup> He could also insure any interest that the master might have in the vessel.<sup>622</sup> As to the master's interests in other subjects, besides wages, depending on existing rights, Lord Mansfield stated "that the law allows the captain of a ship to insure goods which he has on board, or his share in the ship, if he be a part-owner; and the captain of a privateer, if he be a part-owner, to insure his share."<sup>623</sup>

### 2.9.3 Grounds on different rules relating to the insurability of wages of seamen and master

The rule of law in relation to the insurance of wages of the master and the seamen was different. In the case of *King*,<sup>624</sup> although the court was concerned to decide the insurability of the captain's commission and privileges and indeed so held, the court also discussed in detail the difference as to insurance of

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<sup>620</sup> Professor Robert M Merkin, *Colinvaux's Law of Insurance* (11th edn, Sweet & Maxwell 2016) 25-027

<sup>621</sup> *King v Glover* (1806) 2 B & PNR 206

<sup>622</sup> Jonathan Gilman, Professor Robert M Merkin, Claire Blanchard and Mark Templeman, *Arnould's Law of Marine Insurance* (18th Revised edn, Sweet & Maxwell 2013) 10-27

<sup>623</sup> *Carter v Boehm* (1766) 3 Burrow 1905

<sup>624</sup> *King v Glover* (1806) 2 B & PNR 206

wages between the master and the seamen. The master's wages, commission and privileges could be deemed to be its investments which were legally insurable. Besides, when explaining the different legal position as to wages of a master and a seaman, Chambre J commented that the shipowner had personal trust and confidence in the master and the latter was liable to the former under the terms of their agreement, due to which the shipowner would not fear that the master would desert its vessel. Also, he said because of such trust and confidence, the master could not take an action against the vessel in the Court of Admiralty, but must pursue his remedy at law. He furthermore added that a master himself was regarded as quasi-owner of the vessel and bound to be tried. By contrast, shipowners have no personal trust and confidence in seamen, and the latter could sue at law and was of course not a quasi-owner.<sup>625</sup>

## 2.10 Advance freight

### 2.10.1 The risk of loss of advance freight can confer on the person having advanced the freight an insurable interest

The principle of insurable interest as regards advance freight is provided by s 12 of the 1906 MIA as follows: a person can have an insurable interest in its advance freight because it is commonly unrepayable in the event of loss.<sup>626</sup> It is settled law that, unless contracts otherwise provide, freight<sup>627</sup> will not become due until the completion of the voyage, so it is the shipowner who generally is at the risk of loss of freight and thus has an insurable interest in freight. However, the position of advance freight can be distinguished due to the express

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<sup>625</sup> *King v Glover* (1806) 2 B & PNR 206 [210]; also see 2.9.1.1, above

<sup>626</sup> 1906 MIA, s 12

<sup>627</sup> For the categories of freight, see Professor Robert M Merkin, *Colinvaux's Law of Insurance* (11th edn, Sweet & Maxwell 2016) 25-028; see also 1906 MIA, schedule 1, rule 16

stipulation arising from the contract:<sup>628</sup> where freight has been advanced by a person, the such as an owner of cargo or charters, to shipowners, such person rather than owners of ships is at risk of loss and has an insurable interest in its advanced freight. The practice of prepaying part of freight was popular in the carriage of goods by sea, because the shipowner might not afford the long voyage, like a long voyage from the UK to India, while freight was not easy to be pledged.<sup>629</sup> In addition, subject to terms of agreement, advanced freight was not repayable in English law. At common law, the law was first set down by Saunders CJ in 1682 and “has remained ever since”<sup>630</sup> and confirmed by *De Silvale v Kendall*<sup>631</sup> that, unless otherwise provided, advance freight could not be repaid to the freighters even though a loss of the vessel had happened before it arrived at its delivering port.<sup>632</sup> Also, unless charterparty otherwise provided, advance freight was not repayable in consequence of the loss of the ship and cargo on the voyage caused by sea perils.<sup>633</sup>

### 2.10.2 Difference between advanced money

The money advanced by charterers, by constructing charterparties, can be a part of freight or otherwise a loan.<sup>634</sup> A difficulty may thus arise when to distinguish them. Be that as it may, the distinguishing is important because such distinction will affect whether the money advanced is insurable<sup>635</sup> and who can effect a policy on the prepayment of money.

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<sup>628</sup> *De Silvale v Kendall* (1815) 4 M & S 37 [42]

<sup>629</sup> *Allison v Bristol Marine Insurance Co* (1876) 1 App Cas 209, 226

<sup>630</sup> Raoul Colinvaux, *Carver's Carriage By Sea* (vol 2, 13th edn, London Stevens & Sons 1982) 1691

<sup>631</sup> *De Silvale v Kendall* (1815) 4 M & S 37

<sup>632</sup> *Anonymous Case* (1693) 2 Shower KB 283

<sup>633</sup> *Allison v Bristol Marine Insurance Co* (1876) 1 App Cas 209, 217; also see *Hicks v Shield* (1857) 7 E & B 633; *De Silvale v Kendall* (1815) 4 M & S 37; *Saunders v Drew* (1832) 3 B & A 445

<sup>634</sup> *Allison v Bristol Marine Insurance Co* (1876) 1 App Cas 209, 217

<sup>635</sup> *The Salacia* (1862) Lush 578 [582]

### 2.10.2.1 Types of advance freight

The kinds of advance freight will be first discussed. It can be divided into repayable freight and unrepayable freight dependent on the charterparty. By making clear different types of advance freight, it will be manifest that who is at risk can have an insurable interest, the shipowner or the charterer. The issue as to whether prepayment of cash can be recovered by the charterer can affect who can effect a policy on such advance. Consequently, a policy on advance freight can be taken out by the right party to the charterparty. Therefore, where the advance money as a part of freight was prepaid and unrepayable by the charterer, meaning it had already been in the shipowner's pocket, which rendered him not being at risk as to such advance, he did not need to make a contract of insurance. By contrast, where such freight was not repayable, the charterer who bore the risk of losing the advance freight due to the loss of the cargo and thus had an insurable interest.<sup>636</sup> At common law, whole freight was not payable before the voyage was completed and the cargo was discharged, apparently, the shipowner had to bear the risk of all the perils of the sea.<sup>637</sup> Advanced freight may thus be meaningful to the shipowner in two respects: one is as disbursements during the course of a long voyage for those who are not competent to afford them; the other is that the shipowner, by asking for an unrepayable advance freight by the charterer, could manage to bear less risk in general.<sup>638</sup> For the latter, Lord Ellenborough CJ was of the opinion that the point of advance freight was to be free from all contingency, the residue was to abide by the contingency during her performing voyage.<sup>639</sup> Conversely, with the express terms of the charterparty stipulating advance freight repayable in the

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<sup>636</sup> *Allison v Bristol Marine Insurance Co* (1876) 1 App Cas 209, 238

<sup>637</sup> *De Silvale v Kendall* (1815) 4 M & S 37 [42]

<sup>638</sup> *Saunders v Drew* (1832) 3 B & A 445 [452]

<sup>639</sup> *De Silvale v Kendall* (1815) 4 M & S 37 [43]

event of the vessel lost, the shipowner may be entitled to insure such freight because it was the shipowner that was at risk of losing the prepaid money if the ship was lost.<sup>640</sup> The key test is the issue of who is at risk.

### *2.10.2.2 Rules for loans*

In the usual event of prepayment of money provided for the ship's disbursements or meeting vessel's expenses, at the loading port, such advance is regarded as a loan to the shipowner.<sup>641</sup> With respect to a loan in the form of repaid money, it should be repaid at any time by an action against the shipowner<sup>642</sup> since the recovery by the charterer must be repaid and does not depend on whether freight has been earned by the shipowner.<sup>643</sup> It thus cannot be insured by either party to the charterparty because neither the shipowner nor the charterer are at risk of loss as to a loan. Thus, where a case respecting an advance of money which might have been insured, by the construction of the instrument, was brought before the court to adjudge whether it was an advance freight or a mere loan, it was held that it was advance freight as it was the repaid money as to advance freight, not a loan, that could be insured.<sup>644</sup> Although the issue whether the advance was a part of freight or a loan was not the main concern in the case, with the appearance of terms such as "owner to insure the amount", Pollock, CB stated that it was advance freight,<sup>645</sup> because it might be reasoned that the advance rather than a loan was insurable.

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<sup>640</sup> *Hall v Janson* 4 E & B 500

<sup>641</sup> Raoul Colinvaux, *Carver's Carriage By Sea* (vol 2, 13th edn, London Stevens & Sons 1982) 1696

<sup>642</sup> *The Salacia* (1862) Lush 578 [582]

<sup>643</sup> Raoul Colinvaux, *Carver's Carriage By Sea* (vol 2, 13th edn, London Stevens & Sons 1982) 1696

<sup>644</sup> *Hicks v Shield* (1857) 7 E & B 633 [639]

<sup>645</sup> *Tamvaco v Simpson* (1866) LR 1 CP 363, 371

### 2.10.2.3 How to distinguish advance freight from a loan

The distinction between advance freight and a loan should be made by properly constructing the charterparty.<sup>646</sup> Only by the interpretation of the “entire” charter, can the intentions of the parties thus be inferred.<sup>647</sup> As to lacking relevant provisions in the charter, the intentions of the parties can also be inferred from the agreement or the conduct of the parties.<sup>648</sup>

Although the distinction mainly relies on the construction of particular contracts in each case, the following common three phrases may be construed as freight in advance. The stipulations such as “*such freight* to be paid as follows” or “*the residue of such freight* to be paid” could be depended on to determine that advanced money was a part of freight,<sup>649</sup> as the italicised words of *freight and residue* plainly meant that advance money was a part of freight.<sup>650</sup> Besides, advanced money including phrases like “not requiring interest or commission” may be interpreted by the courts as advance freight, rather than a loan. In the event of a loan, interest and commission would be charged.<sup>651</sup> Additionally, it was held that the money advanced was a loan because nothing more was stipulated by the charter other than that cash should be paid in advance to meet the vessel’s expenditure or disbursements.<sup>652</sup>

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<sup>646</sup> *The Salacia* (1862) Lush 578 [582]; *Hicks v Shield* (1857) 7 E & B 633 [638]

<sup>647</sup> Raoul Colinvaux, *Carver’s Carriage By Sea* (vol 2, 13th edn, London Stevens & Sons 1982) 1696

<sup>648</sup> *The Karnak* (1867-69) LR 2 A & E 289

<sup>649</sup> *De Silvale v Kendall* (1815) 4 M & S 37

<sup>650</sup> *De Silvale v Kendall* (1815) 4 M & S 37 [43]

<sup>651</sup> *De Silvale v Kendall* (1815) 4 M & S 37 [43]

<sup>652</sup> *Manfield v Maitland* (1821) 4 B & A 582

## 2.11 Charges of insurance

### 2.11.1 The ambit of the charges of insurance

The provision of s 13 of the 1906 MIA is that “The assured has an insurable interest in the charges of any insurance which he may effect.”<sup>653</sup> In the past, around 1811, “the charges of insurance” generally contained three types of charges: the premium, the brokerage (if paid by the assured) and the stamp.<sup>654</sup> This enlarged ambit of interest may be based on the fact that due to the very act of insuring the assured is at risk not only relating to the amount of the invoice price at the loading port, but also to premiums, brokerage and stamp duty.<sup>655</sup>

Due to the repeal of stamp duty on marine policies by the Financial Act 1970 which came into effect on 1 August 1970, charges therefore only consist of the gross premium, including premium and commission.<sup>656</sup> Further, it makes sense that charges of insurance are commonly referred to as net premium. In practice, brokerage is commonly paid by insurers, though it is only obtained by the broker deducting it from the gross premium paid by assureds to him. In this case, charges of insurance only include net premium. Nevertheless, it can be paid by the assured where he has contracted with the broker to pay the latter the commission.<sup>657</sup> In this event, charges of insurance comprise both net premium and brokerage because the latter is at risk of the assured.

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<sup>653</sup> *Usher v Noble* (1810) 12 East 639

<sup>654</sup> Sir M D Chalmers and Douglas Owen, *The Marine Insurance Act, 1906* (William Clowes and Sons 1907) 20

<sup>655</sup> *Usher v Noble* (1810) 12 East 639 [646]; in this case, Lord Ellenborough CJ held that although the valuation of cargo was generally based on the invoice price at the port of loading in favour of the insurer, by specific agreement between the owner of cargo and the insurer, it could be the selling or market price at the port of delivery.

<sup>656</sup> Robert Merkin, *Marine Insurance legislation* (4th edn, Informa Law 2010) 13

<sup>657</sup> *United States Shipping Co v Empress Assurance Co* [1907] 1 KB 259 (KB) 262

## **2.11.2 Charges of insurance being insurable is helpful for ascertaining the insurable value of the subject insured**

The provision of s 13 of the 1906 MIA assists the ascertaining as to the insurable value of the subject matter insured stipulated by s 16, which thus includes charges of insurance based on its being insurable. This section resolves the problem as to how, in the context of an open policy,<sup>658</sup> the value of goods should be estimated. In the context of a valued policy, the approach is clear that the agreed value insured in the policy is the valuation. As to valuation of loss covered by an open policy, the assured needs first to ascertain the value of goods, unlike that of a valued policy which has been fixed at the time of the contract of insurance, in order to get fully indemnified. Where the court was asked to decide the insurable value of cargo under an open cover, it held that the assured could recover the value of goods upon a sound policy, the value of which consists of not only the invoice price at the loading port, but also the premium and the brokerage.<sup>659</sup>

## **2.12 Quantum of interest**

### **2.12.1 Interest in Mortgage**

#### ***2.12.1.1 Two different interests of mortgagor and mortgagee***

As to the amount of interest of a mortgagor and mortgagee, it has been declared in s 14(1) of the 1906 MIA as follows: the mortgagor still has an insurable interest in insured property, though it has been mortgaged to a mortgagee. He can thus take out a separate policy on the property to insure to the extent of its full value. Also, the mortgagee has an insurable interest in the

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<sup>658</sup> i.e. one formal policy which is designed to legally validate a long-term marine insurance contract, generally relating to cargo, because it cannot be recognised by a court without such formal policy.

<sup>659</sup> *Usher v Noble* (1810) 12 East 639 [639]

above property and can make his own contract of insurance. Unless the policy otherwise provides, he can only insure to the extent of his mortgage debt.<sup>660</sup>

Although the property is mortgaged to the mortgagee as security on debt to part of or to its full value, in the event of loss, the mortgagor will lose that part or whole of interest in the property and still be liable for the debt. The interest of the mortgagor was thus held as an equitable interest remaining to him, whereas the mortgagee's interest was regarded as a legal interest.<sup>661</sup> The latter derives from the contract of mortgage. These two distinct types of interests between mortgagee and mortgagor decide the amount they can insure.<sup>662</sup> For the part of a mortgagee, he can insure the amount mortgaged out of the relating contract because his debt is at risk; as for a mortgagor, he still has an interest as to title of the property in its full value, in spite of the property having been mortgaged to its full value.<sup>663</sup> If the insured property be lost, the mortgagor will thus sustain a loss.

### *2.12.1.2 Specific rules*

The rule of s 14 also applies to cases where the transaction was in effect a mortgage, while the form of the transaction was seemingly one of a sale of the vessel, under which the absolute title of the mortgagor would have been transferred.<sup>664</sup> A loss of mortgage debt caused by the barratry of the mortgagor,

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<sup>660</sup> 1906 MIA, s 14(1); *Small v United Kingdom Marine Mutual Insurance Association* [1897] 2 QB 311 (AC) 313

<sup>661</sup> *Smith v Lascelles* (1788) 2 TR 187 [188]

<sup>662</sup> *Small v United Kingdom Marine Mutual Insurance Association* [1897] 2 QB 311 (AC) 313; *Irving v Richardson* (1831) 2 B & A193 [196]

<sup>663</sup> *Alston v Campbell* (1779) 4 Brown's Parl Cas 476; *Hutchinson v Wright* (1858) 25 B 444

<sup>664</sup> *Alston v Campbell* (1779) 4 Brown's Parl Cas 476; *Hutchinson v Wright* (1858) 25 B 444; *Ward v Beck* (1863) 13 CBNS 668

as the master, could also be recovered by a mortgagee.<sup>665</sup> As obiter, A. L. Smith set out that both mortgagor and mortgagee had an insurable interest because where the policy on a mortgagor's interest was assigned to a mortgagee, any defence which would be brought against a mortgagor would also be against a mortgagee.<sup>666</sup> Where the debt from which the mortgagee's interest derived had been paid off, he could not have such interest in the debt any more. In *Levy & Co v Merchants' Marine Insurance Co*,<sup>667</sup> albeit the mortgagee were entitled to recover where mortgaged debt was paid off because of the specific facts, he would ordinarily bear no risk and thus lose the interest in the mortgage once such debt had been paid off.

## **2.12.2 A person having partial interest can insure on behalf of himself and others as well.**

### **2.12.2.1 A person having partial interest can insure on behalf of others**

S 14(2) of the 1906 MIA sets out that a mortgagee, consignee, or other person having an interest in the subject-matter insured may insure on behalf and for the benefit of other persons interested as well as for his own benefit.<sup>668</sup> This principle codified the judgement of Bovill CJ and Denman J where the court held that the assured, who was both the mortgagee and the consignee, having interest, being recoverable by them, in respective part of the insured subject, could insure other beneficiary parties' interest, not limited to their own interest, in the subject and recover the whole value of the subject beyond the mortgage debt and retain such surplus as trustees for other persons interested.<sup>669</sup> A judge thus stated that a person having a limited interest may insure to the extent of

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<sup>665</sup> *Small v United Kingdom Marine Mutual Insurance Association* [1897] 2 QB 311

<sup>666</sup> *Small v United Kingdom Marine Mutual Insurance Association* [1897] 2 QB 311

<sup>667</sup> *Levy & Co v Merchants' Marine Insurance Co* (1885) Cab E11 474

<sup>668</sup> 1906 MIA, s 14(2)

<sup>669</sup> *Ebsworth v Alliance Marine Insurance Co* (1872–73) LR 8 CP 596, 596

the whole value and recover such value.<sup>670</sup> A mortgagee could therefore have insured not only his own interest but that of the mortgagor on the latter's account.<sup>671</sup>

#### *2.12.2.2 A mortgagee, consignee, or other person having an interest*

There was no doubt that a mortgagee could recover upon the policy on a mortgage debt, although the amount covered had not yet been decided by the jury.<sup>672</sup> This has been addressed by s 14(2) of the 1906 MIA. The rules as to the amount recoverable for a mortgagee's interest, which is a type of creditor, are the same as those general rules relating to a creditor: he can have an insurable interest and can recover to the sum of his own limited interest in the subject matter of the policy pledged to him as security on debts, because he may have a lien or claim on it, unless he has at the time of the contract of insurance intended to cover the interests of other persons interested, which can entitle him to cover the whole value of the insured subject, holding the residue as trustees for other persons interested or insurers.<sup>673</sup> A consignee who has advanced money for property consigned to him is also one such creditor; while a naked consignee and one who is authorised by a consignor to sell, dispose of or manage it are not, though the latter may have an insurable interest due to the grant of rights. A naked consignee who only possesses the insured property will be regarded only as an agent and thus has no insurable interest in it because he has no legal rights to it, nor will he suffer an economic loss by its loss. By contrast, a consignee can also be treated as a commission agent due to the grant of power by a consignor to sell or dispose of the insured property, where

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<sup>670</sup> *Castellain v Preston* (1883) 11 QBD 380 (AC) 398

<sup>671</sup> *Smith v Lascelles* (1788) 2 TR 187

<sup>672</sup> *Irving v Richardson* (1831) 2 B & A 193

<sup>673</sup> Jonathan Gilman, Professor Robert M Merkin, Claire Blanchard and Mark Templeman, *Arnould's Law of Marine Insurance* (18th Revised edn, Sweet & Maxwell 2013) 11-62

he can aver an insurable interest in it because with the grant he may lose the commission if it is lost. Of course, he cannot have an insurable interest in an expectancy of commission, which is not a present existing interest.

Other interested persons include those such as a bailee,<sup>674</sup> a carrier with a lien over goods,<sup>675</sup> contractors and sub-contractors having pervasive interests,<sup>676</sup> an owner leasing his land<sup>677</sup> and any joint owner.<sup>678</sup> They may have interests of various natures in insured property, such as partial interests or contingent interests. Although they may merely be interested in their own limited interests, they may be entitled to insure in their own names on behalf of themselves to the amount of their own interests, as well as on behalf of other persons interested to the extent of the total value of the subject, holding the surplus in trust.

### *2.12.2.3 The rule of double insurance protects the indemnity doctrine*

From a theoretical view, such a rule is justified. Over-insurance by double insurance may arise because persons having different interests in property insured may take out their own separate insurance contracts, leading to the sum insured being in excess of the valuation in valued policies or its full insurable value in unvalued policies. However, rules under s 32 of the 1906 MIA can prevent each party having effected insurance from recovering the amount in excess of that in which he is actually interested. Firstly, before recovering from other insurers, he must have given credit against the valuation for the sum

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<sup>674</sup> *Waters v Monarch Fire and Life Assurance Co* (1856) 5 E & B 870

<sup>675</sup> *Tomlinson (Hauliers) Ltd v Hepburn* [1966] AC 451

<sup>676</sup> *Petrofina (UK) Ltd v Magnaload Ltd* [1984] QB 127; *National Oil Well (UK) Ltd v Davy Offshore Ltd* [1993] 2 Lloyd's Rep 582, 608-612

<sup>677</sup> *Mark Rowlands Ltd v Berni Inns Ltd* [1986] 1 QB 211; *Lonsdale & Thompson v Black Arrow* [1993] Ch 361

<sup>678</sup> *Page v Fry* (1800) 2 B & P 240; *Robertson v Hamilton* (1811) 14 East 522; *Griffiths v Bramley-Moore* (1878) 4 QBD 70

having been recovered in valued policies;<sup>679</sup> similarly, where he has made an unvalued policy, he must have given credit against the full insurable value for the sum having been received.<sup>680</sup> Secondly, where he has recovered a sum exceeding the amount he is interested in, he will be trustee for his insurers who have the right of contribution as to surplus.<sup>681</sup>

#### *2.12.2.4 How to treat surplus*

As to the sum exceeding a mortgagee's own limited interest, he as a trustee has to return them to others interested, such as an owner of a ship or cargo, or an insurer. Also, the underwriter may recover back the surplus from him.<sup>682</sup> Rules with regards to other interested persons are, it has been suggested, the same as that of the mortgagee.<sup>683</sup>

#### *2.12.2.5 Conditions as to whether a person having a limited interest can recover the full value*

##### *2.12.2.5.1 Intention at the time of contract determining the amount recoverable*

A person having a partial interest in the insured property can only recover to the amount of his own limited interest. However, where he has satisfied the following three conditions, he can recover the full amount of the property, holding the excess under trust as to the residue. The first condition for his right to recover such amount is the form of the policy, i.e. it has to be one that will not limit him insuring the full value of the insured property.<sup>684</sup>

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<sup>679</sup> 1906 MIA, s 32 (2)(b)

<sup>680</sup> 1906 MIA, s 32 (2)(c)

<sup>681</sup> 1906 MIA, s 32 (2)(d)

<sup>682</sup> *Irving v Richardson* (1831) 2 B & A 193

<sup>683</sup> Professor Robert M Merkin, *Colinvaux's Law of Insurance* (11th edn, Sweet & Maxwell 2016) 25-031

<sup>684</sup> *Castellain v Preston* (1883) 11 QBD 380 (AC) 398

The second is relating to the intention of the assured who must have intended to insure on behalf of other persons interested at the time of making an insurance contract.<sup>685</sup> In the case<sup>686</sup> where the insurer claimed to recover back their proportion of the sum paid to the mortgagee, who had insured the property by double insurance, the issue arose as to whether the mortgagee had received more than the amount he had an interest in. The intention needed to be first dealt with because if he had intended to cover the full value at the time of insurance contract, he was entitled to recover such value. The court thus held that the intention of the mortgagee in effecting the valued policy, i.e. to insure the sum mortgaged only, or the whole value of the vessel on behalf of the owner, should be decided by the jury because it could affect on whose account the insurance had been made. Similarly, where a claim was raised by a lienor to recover the amount on his interest in a cargo, the jury was directed to decide what interests had been intended to be insured effecting the policy.<sup>687</sup> It was a question of construction of the policy as to whether the assured only intended to cover his own interest only or the whole value.<sup>688</sup>

In particular, in the case of a valued policy, the intention of insuring whose interest is important. If the mortgagee intends to insure his mortgage debt only, he can thus recover money amounting to his interest only. By contrast, he may recover the amount to the full extent of the value on the valued policy had he insured the whole value of the vessel. The principle as to an unvalued policy is

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<sup>685</sup> *Castellain v Preston* (1883) 11 QBD 380 (AC) 398

<sup>686</sup> *Irving v Richardson* (1831) 2 B & A193

<sup>687</sup> *Carruthers v Sheddon* (1815) 6 Taunt [17]

<sup>688</sup> *Waters v Monarch Fire and Life Assurance Co* (1856) 5 E & B 870; *Tomlinson (Hauliers) Ltd v Hepburn* [1966] AC 451

said to be the same as the above rules respecting the valued policy, which also depends on the intention of the mortgagee.<sup>689</sup>

#### 2.12.2.5.2 Bilateral agreement between the assured and the insurer may be material.

Apart from the above two conditions, where a person having a limited interest has been regarded as an undisclosed principal in order to recover the full value, the insurer's agreement may be a requisite. Other interested persons having a limited interest may be treated as undisclosed principals to the insurer who had not been notified by the assured to include such an undisclosed principal as a co-assured. The insurer does often not concern himself with the undisclosed principal, subject to the terms of the policy and the situations where it has been taken out, and that is why a person interested can insure on behalf of other persons interested.<sup>690</sup> However, where by construction of the terms of the policy in question an undisclosed principal having a limited interest cannot be covered unless the insurer is willing to cover, bilateral agreement between the assured and him is needed.<sup>691</sup> The agreement is necessary because the inclusion of an undisclosed principal as a co-assured can affect the insurer's right of subrogation, especially where the assured is a shipowner and an undisclosed principal is a shipyard, for the latter is liable for damage to the former's ship. If such undisclosed principal is a co-assured, in the event of the loss of the ship, the insurer after payment to the assured will not be entitled to exercise his right of subrogation on the undisclosed principal. According to a recent authority, it was held that the policy in question could not cover the shipyard as an undisclosed co-assured, unless the insurer had so agreed at the time of

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<sup>689</sup> Jonathan Gilman, Professor Robert M Merkin, Claire Blanchard and Mark Templeman, *Arnould's Law of Marine Insurance* (18th Revised edn, Sweet & Maxwell 2013) 11-64

<sup>690</sup> 1906 MIA, s 14(2)

<sup>691</sup> *Talbot Underwriting Ltd v Nausch Hogan & Murray (The Jascon 5)* [2006] 2 Lloyd's Rep 195

effecting the policy.<sup>692</sup> Also, it may be deduced that the unilateral intention of the assured may be insufficient to entitle him to recover the full value, because the agreement of the insurer to include a co-assured may be necessary. Perhaps that is why it has been suggested that, from more recent authorities, the unilateral intention of the assured without having communicated with the insurer cannot of itself determine the amount recoverable.<sup>693</sup>

### 2.12.3 Quantum of an owner's interest

#### *2.12.3.1 Being able to be remedied by a third party cannot prevent an owner from having an insurable interest in its own property.*

Although a third party may have agreed, or be liable, to indemnify the owner of the subject insured in case of loss, the owner can still insure his property to the total value.<sup>694</sup> This common law point originated from a case as to a charter party in which the charterer had agreed to indemnify the owner of the ship to the extent of the whole estimated value and the court held that the owner had still an insurable interest with regards to the full value of the ship insured.<sup>695</sup> Similarly, the owner of the goods could insure the whole value of his goods, notwithstanding that the shipowner would be liable to remedy the loss caused by his negligence.<sup>696</sup>

#### *2.12.3.2 The right of subrogation*

Where the third party who had agreed to or was liable to indemnify the assured in the event of loss nonetheless did not pay the assured, the insurer of the assured who had then indemnified the latter's loss could thus be subrogated to

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<sup>692</sup> *Talbot Underwriting Ltd v Nausch Hogan & Murray (The Jascon 5)* [2006] 2 Lloyd's Rep 195, [27], [35], [36], [41]

<sup>693</sup> Jonathan Gilman, Professor Robert M Merkin, Claire Blanchard and Mark Templeman, *Arnould's Law of Marine Insurance* (18th Revised edn, Sweet & Maxwell 2013) fn 203

<sup>694</sup> 1906 MIA, s 14(3)

<sup>695</sup> *Hobbs v Hannam* (1811) 3 Camp 93

<sup>696</sup> *Dufourcet v Bishop* (1886) 18 QBD 373

maintain an action to recover the amount having been paid by him to the assured.<sup>697</sup> The right of subrogation could prevent the assured's double indemnity<sup>698</sup> and could make sense of why two persons could insure the same subject to the extent of its whole value<sup>699</sup> because the insurer of the owner might sue against the third party to prevent the assured, after having received cover, again obtaining remedy from the third party. The case in which remedy had been made by the third party would be different: the assured could not claim against the insurer because the loss suffered by him had been recovered from the third party.<sup>700</sup>

## 2.13 Assignment of interest

### 2.13.1 The contract of insurance not running with that of purchase

Section 15 of the 1906 MIA applies to all forms of insurance.<sup>701</sup> It solves the problem as to whether a mere sale of goods can have the effect of automatically assigning a relevant contract of insurance. Pursuant to its provisions, where the assured has assigned or parted with all his interest in the property insured under the contract of purchase, the contract of insurance does not run with the subject matter of insurance unless there is an express or implied agreement with the assignee as to the assignment of the policy to violate the privity of contract: for example, the transferring of the policy with the

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<sup>697</sup> *Dufourcet v Bishop* (1886) 18 QBD 373; also see 1906 MIA, s 79

<sup>698</sup> Professor Robert M Merkin, *Colinvaux's Law of Insurance* (11th edn, Sweet & Maxwell 2016) 25-033

<sup>699</sup> Sir M D Chalmers and Douglas Owen, *The Marine Insurance Act, 1906* (William Clowes and Sons 1907) 22

<sup>700</sup> Robert Merkin, *Marine Insurance legislation* (4th edn, Informa Law 2010) 14

<sup>701</sup> Professor Robert M Merkin, *Colinvaux's Law of Insurance* (11th edn, Sweet & Maxwell 2016) 25-034

assignment of property has been included in the contract for sale.<sup>702</sup> Without such agreement, the assured is the only person who has a right to sue upon the policy to recover under the contract of insurance.<sup>703</sup> Subject to that, where the interest of the assignor in property is transmitted to the assignee by act or operation of law, such as the assignor's death, bankruptcy or subrogation, despite it being without the foresaid agreement for the purpose of assigning the policy to the assignee, he may enjoy the rights under the policy.<sup>704</sup>

After the transferring of insurable interest in property, with no express or implied agreement as to transferring the policy, its enforceability now needs to be discussed. First, the marine policy is assignable: with regards to the assignment of a marine policy, s 50 of the 1906 MIA has provided the time, the effect and the form of its assignment.<sup>705</sup> It is different from the rule in relation to other forms of property insurance against non-marine risks that a policy cannot be assigned without the agreement of the insurer.<sup>706</sup> Secondly, an assured having no interest cannot assign and sue upon a policy: the policy is invalid and not assignable where the assured, before or when he assigns his interest, has not expressly or impliedly agreed to transfer the policy but afterwards assigns the policy, except in a case with relation to the assignment of a policy after loss.<sup>707</sup> Likewise, after the assignment of the insured subject, even though the owner still has the policy in hand, due to his no longer having an interest in the subject,

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<sup>702</sup> *Powles v Innes* (1843) 11 M & W 10; *North of England Pure Oil Cake Co v Archangel Maritime Insurance Co* (1875) LR 10 QB 249

<sup>703</sup> *Rayner v Preston* (1880-81) LR 18 Ch D 1

<sup>704</sup> Sir M D Chalmers and Douglas Owen, *The Marine Insurance Act, 1906* (Willam Clowes and Sons 1907) 22

<sup>705</sup> 1906 MIA, s 50(1)(2)(3)

<sup>706</sup> Professor Robert M Merkin, *Colinvaux's Law of Insurance* (11th edn, Sweet & Maxwell 2016) 25-034

<sup>707</sup> 1906 MIA, s 51

the policy has lapsed since the assignment.<sup>708</sup>

### 2.13.2 Position in a case of non-marine property insurance

Despite being a decision on a non-marine case, the case of *Rayner v Preston* shows the grounds for s 15 regarding the different subject matter of purchase contract and insurance contract and privity of contract. The case was an appeal by the plaintiffs who purchased a house which had been insured by the vendor against fire before the purchase and sale contract was made. The policy of insurance was not mentioned in the contract of purchase. The house purchased was damaged by fire after the date of the contract but before the time fixed for completion. An action was brought by the plaintiff to claim the money received by the vendor from the insurer.

The court held that the plaintiffs, the purchasers, despite having paid the price for the insured house, had no right to the insurance contract effected by the vendor. Cotton LJ stated that there must be appropriate terms under the contract for sale in relation to the assignment of the policy, or the purchasers were not entitled to enjoy the benefits of the vendor under the policy. He distinguished the contract for sale from the contract of insurance, which was expressed to be a collateral contract. Firstly, the policy could not affect whether the purchaser should perform its duty under the contract for sale: even if there had been no policy, where the house had been damaged by fire, the purchaser still had to fulfil its contractual duty. Secondly, the purpose of the policy was to pay the money value of the damage to or loss of property other than a sum to repair property, whereas the assured was free to use its recovery from the

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<sup>708</sup> Robert Merkin, *Marine Insurance legislation* (4th edn, Informa Law 2010) 15

insurer. The judgement from Brett LJ made it clear that by analogy with the rule as to marine insurance and subject to the principle of privity of contract, the contract of insurance did not run with the land. He thought it would be helpful to make a clear understanding of the relationship between vendors and vendees, and vendors and insurers, by distinguishing between the subject matter of the contract of insurance and that of purchase and sale, which were totally different matters. In relation to the former, the vendor and vendee had no relationship as to the subject matter of the contract of insurance, which was money only, because the contract of insurance was a mere personal contract between the vendor and the insurers, to which they were the only parties for the payment of money. Thus, unless the policy had been effectively transferred, the vendee was not entitled to sue on the policy. By contrast, vendor and vendee indeed had a relationship as to the subject matter of insurance and that of the contract of purchase and sale, which was a house, ship, goods, etc. However, under these circumstances, the vendor could not be regarded as the trustee of the vendee and even if he had been a trustee, the benefits under the policy could not be transferred to the vendee because of privity of contract.

### **2.13.3 Position in marine insurance**

Subject to s 15 that the contract of insurance does not run with that of purchase and sale, nevertheless, in the following two situations, the assignee under a contract of purchase can obtain the assured's rights under the contract of insurance: an express or implied agreement should be made in virtue either of an assignment of the policy at the time of the contract of purchase or of the assignor holding the policy as the trustee for the assignee.<sup>709</sup> The interest in a

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<sup>709</sup> Sir M D Chalmers and Douglas Owen, *The Marine Insurance Act, 1906* (Willam Clowes and Sons 1907) 22

policy cannot be transferred merely by the assignment or sale of the subject matter insured, unless there is an agreement as to passing the interest under the policy of insurance. Thus, where there was no express or implied agreement with regard to passing the interest of the policy to the assignee as the purchaser under the contract of purchase, he is not entitled to recover from the insurer.<sup>710</sup> The assignor, who has assigned his interest in the insured property after the making of the contract of purchase and before the loss, cannot sue upon the policy unless he acts as the trustee of the assignee where the policy has already passed to the latter or the former has promised to keep the policy operative on behalf of the latter.<sup>711</sup>

## Chapter 3 Problems Regarding Insurable Interest

### 3.1 Problems with different statutes on insurable interest

The situation of English law on insurable interest has been described as a confusing and illogical mess.<sup>712</sup> The problems and uncertainty arising out of such a situation are as follows, in particular, with respect to the bewildering mixture of statutes and common law:<sup>713</sup> with rulings on the requirement of insurable interest, the effects of the 2005 GA respecting whether the requirement of insurable interest has been repealed by it, and the difference of interest between the indemnity doctrine and the insurable interest doctrine.

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<sup>710</sup> *North of England Pure Oil Cake Company v Archangel Maritime Insurance Company* (1874-75) LR 10 QB 249

<sup>711</sup> *Powles v Innes* (1843) 11 M & W 10 [10]

<sup>712</sup> Robert Merkin, 'Reforming Insurance Law: Is there a case for reverse transportation? A report for the English and Scottish Law Commissions on the Australian experience of insurance law reform' [2007] Law Commissions 8.6

<sup>713</sup> See 3.2

### 3.1.1 Various statutes regulating insurable interest

As far as marine insurance contracts are concerned, there are complex and varied statutes to regulate the effect of not requiring an assured an insurable interest in such contracts.<sup>714</sup> It is stated that the uncertain position of the law as to insurable interest is attributable to a succession of moral hazards caused by wager policies.<sup>715</sup>

#### 3.1.1.1 Marine insurance Acts

Under the 1745 MIA, in light of marine policies, an interest must be possessed by the assured and policies without an interest or those of wagers and PPI will be held null and void.<sup>716</sup> They have also been held illegal.<sup>717</sup> However, the outcome of failing to have an interest under the 1745 MIA can now be ignored: it has been repealed and restated by the Act 1906.<sup>718</sup> The 1788 MIA directly sets out that the names of persons interested in insurance contracts must be inserted into policies.<sup>719</sup> It has also been repealed by the 1906 MIA in the realm of marine insurance.<sup>720</sup> Nowadays, by contrast, it is not the names of all interested persons, but those of the assured or of those who take out the insurance on its behalf that must be inserted into a marine policy.<sup>721</sup> Section 4 of the 1906 MIA declares that contracts of insurance by way of gaming or wagering will be rendered void due to a lack of insurable interest.<sup>722</sup> Later, with

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<sup>714</sup> 2011 CP, para 11.38

<sup>715</sup> 2011 CP, para 11.1

<sup>716</sup> 1745 MIA

<sup>717</sup> *Cheshire v Vaughan* [1920] 3 KB 240 (AC) 251, 256

<sup>718</sup> Sir M D Chalmers and Douglas Owen, *The Marine Insurance Act, 1906* (William Clowes and Sons 1907) 22

<sup>719</sup> 1788 MIA

<sup>720</sup> 2011 CP, para 11.15

<sup>721</sup> 1906 MIA, s 23

<sup>722</sup> 1906 MIA, s 4(1)

respect to an assured effecting a policy lacking an interest, the outcome of an unnecessary criminal offence is created by the 1909 MIA.<sup>723</sup>

### **3.1.1.2 Gambling Acts**

It is imposed by the 1845 GA that all contracts, of course including ones of insurance, by way of wagering or gaming, are void and unenforceable.<sup>724</sup> Since the implementation of the 2005 GA,<sup>725</sup> s 18 of the 1845 GA has no longer any effect: gambling contracts are now enforceable. Interest appears not to be required any more under the 2005 GA, for gambling contracts, where the parties have no interest in the subject other than the sum staked, can be enforced. However, after the passage of the *2016 Draft*, ss 5-6 have made it clear that insurable interest in the realm of insurance is unaffected by the 2005 GA, in particular, the above position in contracts of marine insurance being left unchanged.

## **3.1.2 Whether the requirement of insurable interest has been repealed by accident by the 2005 GA**

### **3.1.2.1 Arguments on the 2005 GA having affected insurance**

The confusing position as to whether an assured must have an insurable interest after the passage of the 2005 GA has brought complaints.<sup>726</sup> All contracts by way of wagering or gaming have been made void by s 18 of the 1845 GA, and by doing so, have created an indirect requirement of insurable interest for all kinds of insurance contract,<sup>727</sup> although there are some doubts that the interest created by s 18, under which an actual prospect of interest is

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<sup>723</sup> 1909 MIA, 1(1)

<sup>724</sup> 1845 GA

<sup>725</sup> 2005 GA

<sup>726</sup> *2008 IP 4*, para 6.2; Professor Robert M Merkin, *Colinvaux's Law of Insurance* (11th edn, Sweet & Maxwell 2016) 4-011; the attitudes of ABI

<sup>727</sup> For details, see chap. 1, 1845 GA

sufficient to make the contract enforceable, is different from the statutory insurable interest or a valid interest.<sup>728</sup> However, the position has become unclear brought about by the abolition of s 18 by s 335 of the 2005 GA,<sup>729</sup> which has made certain gambling contracts legally enforceable since its coming into effect on 1 September 2007.<sup>730</sup> Because s 335 of the 2005 GA makes enforceable all contracts relating to gambling and s 4 of the 1906 MIA involves gambling, it is thus submitted that the latter has been affected by implication. Under gambling contracts, no other interest is needed to be shown by the assured other than the stake.<sup>731</sup> As a result of the aforesaid enforcement of gambling, the requirement of insurable interest has thus been argued to have been repealed.

### ***3.1.2.2 Reasons for no effect on insurance by the 2005 GA***

#### ***3.1.2.2.1 Effect of the 2005 GA on the 1906 MIA***

There has been some debate as to whether the statutory insurable interest in marine insurance has been affected by the enactment of the 2005 GA.<sup>732</sup> The grounds are as follows: s 4(1) of the 1906 MIA states that a marine insurance contract in relation to gaming or wagering is unenforceable, whereas s 335(1) of the 2005 GA states that a contract concerning gaming or wagering should not be rendered unenforceable.<sup>733</sup> There is an exception by way of s 335(2) to s 335(1): 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

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<sup>728</sup> 2011 CP, para 11.34, per Nicholas Legh–Jones QC

<sup>729</sup> 2005 GA, s 334(1)(c)

<sup>730</sup> Clyde & Co LLP, *Reinsurance Practice and the Law* (1st edn, Informa 2014) 54.44

<sup>731</sup> For details, see chapter 1, Concept of a contract of wager

<sup>732</sup> 2008 IP 4, para 2.18

<sup>733</sup> 2005 GA, s 335(1)

relating specifically to gambling).<sup>734</sup> It is thus likely that a marine insurance contract by way of gambling may be enforceable under s 335(1), unless it is preserved by s 335(2). It appears that s 4(1) is not preserved by s 335(2): what s 4(1) renders is the “avoidance” not the “unlawfulness” of any marine insurance contract by way of gambling. Besides, s 4(1) is a rule in respect of gambling, which seems to be the area covered by s 335(1).<sup>735</sup> It is however fallacious to submit that s 4(1) has been influenced by s 335(2), which will be discussed below.

#### 3.1.2.2.2 Four reasons for insurance having not fallen within the regulation of the 2005 GA

Before the passage of the *2016 Draft*, academics strongly argued that the position was unaffected. The requirement of insurable interest, at least in marine insurance, should still remain. It has been suggested that the following four reasons can be adopted to support such a proposition.<sup>736</sup>

First, pursuant to the 1909 MIA, “a contract by way of gambling on loss by maritime perils” is criminal and illegal. Because such a contract relates to gambling and s 335 renders gambling contracts enforceable, it seems that s 335 has affected the 1909 MIA. However, this is incorrect. S 335 only relates to the enforceability of gambling contracts while the 1909 MIA provides that gambling policies on marine perils are not only unenforceable but also illegal

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<sup>734</sup> 2005 GA, s 335(2)

<sup>735</sup> R Merkin, ‘Insurable Interest, the Repeal of the Prohibition on Gambling’ [2005] 12 ILM 4, 4-5

<sup>736</sup> Jonathan Gilman, Robert Merkin, Mr M J Templeman, Claire Blanchard, Julian Cooke, Philippa Hopkins, *Arnould’s Law of Marine Insurance* (18th Revised edn, Sweet & Maxwell 2013) 11-12

and a criminal offence. Accordingly, s 335 cannot affect the operation of the 1909 MIA.

Secondly, s 4 of the 1906 MIA avoids wager policies not only because of gambling but also because they violate public policy. From the point of view of legislative purpose, making void insurance contracts without insurable interest or expectation of obtaining one and containing PPI terms or like ones, a type of wager policy, is not the only purpose of s 4 of the 1906 MIA. The first prohibition on a PPI policy by the 1745 MIA was mainly based on it being against public policy rather than gambling, which was explicit from the preamble to the 1745 MIA. It was held that the preamble of the 1745 MIA showed that preventing wager policies was the least of the evils that the Act intended to remedy; the Act in effect mainly aimed to prohibit persons from carrying on illegal traffic and to stop insurance from being made the means of profiting by the wilful destruction and capture of ships.<sup>737</sup> Although the effect of making a contract contrary to the requirement for insurable interest had been transferred from being illegal by the 1745 MIA to void by the 1906 MIA, the view of the legislature remained unchanged and enactments of the Acts were even believed to merely and mainly be the result of lack of insurable interest being against public policy.<sup>738</sup> Therefore, a wager policy should not be deemed as having been denounced only because of its being a tool to be used in gaming or wagering. S 4 should therefore remain unaffected by the 2005 GA because it aims not only to ban gaming or wagering but also to protect public policy. Admittedly, the

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<sup>737</sup> *Murphy v Bell* (1828) 4 Bing 567 [570]

<sup>738</sup> *Cheshire v Vaughan* [1920] 3 KB 240 (AC) 248, 251

requirement of loss by the indemnity principle can also nullify wager policies.<sup>739</sup>

It has been thus submitted that neither marine insurance contracts nor any other contracts of insurance have been affected by the 2005 GA.<sup>740</sup>

Thirdly, courts may not agree with the interference by the 2005 GA on marine insurance due to there being no such explicit intention from Parliament. From the courts' perspective, the courts will probably incline to the position that the 2005 GA has no effect on s 4 of the 1906 MIA *sub silentio*. According to the mischief rule, the intention of Parliament enacting the 2005 GA should be considered. Nevertheless, the express purpose of the 2005 GA is not for insurance but for regulating certain types of licensed gambling activities and taking account of the effect of the internet and new technology;<sup>741</sup> that is to say, the effects on marine insurance have not been discussed by Parliament.<sup>742</sup> The 2005 GA then does not expressly repeal relevant sections of the 1906 MIA.<sup>743</sup> Taking the example of the approach of New Zealand, where the Gambling Act 2004, s 9 intends to affect insurance by way of gaming or wagering, it manifestly provided that such a wager policy is no longer prohibited. Besides, insurance does not fall within the statutory definition of the 2005 GA.<sup>744</sup> Clearly, as far as marine insurance is concerned, not only at common law,<sup>745</sup> but by virtue of s 4(1) of the 1906 MIA,<sup>746</sup> an assured is nevertheless required to possess an insurable interest. The 2005 GA has no provision to regulate

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<sup>739</sup> 2008 IP 4, para 7.44

<sup>740</sup> Baris Soyer, *Reforming Marine & Commercial Insurance Law* (1st edn, Informa 2008) 195

<sup>741</sup> 2011 CP, para 11.1; see the list of repeals in s 356 of and Schedule 17 to the 2005 GA

<sup>742</sup> 2011 CP, para 11.30

<sup>743</sup> See 2005 GA, s 356 and its Schedule 17

<sup>744</sup> 2011 CP, para 11.32; See 2005 GA, s 3 and 2005 GA, s 9

<sup>745</sup> *Lucena v Craufurd* (1802) 3 B & P 75; *Wilson v Jones* (1867) LR 2 Ex 139

<sup>746</sup> 1906 MIA, s 4

insurance, or the requirement of insurable interest, which “seems to indicate a legislative intention not to change the law with regard to insurance without interest, at any rate with regard to marine insurance, and probably with regard to insurance generally since the provisions of the 1906 MIA are, where appropriate, regarded as applicable to contracts of insurance generally”.<sup>747</sup>

Fourthly, from a regulatory point of view, s 10 of the 2005 GA sets out that “bet” in the Act does not include a bet the making or accepting of which is a regulated activity within the meaning of section 22 of the FiSMA, nor does gambling.<sup>748</sup>

Thus, the 2005 GA does not apply to a regulated activity. In the UK, FiSMA regulates the effecting and carrying out the contract of insurance as principal and insurance is therefore a specified activity by FiSMA. It is therefore desirable to assume that s 335 of the 2005 GA does not overrule s 4 of the 1906 MIA, which means the former does not repeal the requirement of insurable interest in marine insurance.<sup>749</sup>

#### 3.1.2.2.3 The current position

According to the above analysis, s 4 remains unaffected and wagering policies thus are still void. By contrast, s 335 makes gambling contracts enforceable. Pursuant to the definition of gambling by the 2005 GA, wagering policies are included in gambling contracts: wagering policies fall within the definition of a bet, by virtue of s 9, which means making or accepting a transaction which depends on the outcome of an event and the likelihood of anything occurring or

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<sup>747</sup> Professor Hugh Beale, *Chitty on Contracts* (vol 2, 32th edn, Sweet & Maxwell 2016) 41-009

<sup>748</sup> Rhidian Thomas, *The Modern Law Of Marine Insurance: Volume 4* (1st edn, Informa Law from Routledge 2015) 11

<sup>749</sup> Jonathan Gilman , Robert Merkin , Mr M J Templeman, Claire Blanchard, Julian Cooke, Philippa Hopkins, *Arnould's Law of Marine Insurance*, (18th Revised edn, Sweet & Maxwell 2013) 11-12

not occurring; a bet is, by s 3, included in the concept of gambling. It may be confusing that the broader gambling is enforceable while the narrower wagering policies are unenforceable. It has been set out that it may be less surprising if the following two points are observed: first, the insurer is not authorized to carry on a gambling business even though gambling is now enforceable; secondly, the same position existed after the passage of the 1745 MIA but before the enactment of the 1845 GA during which wagering contracts of policies had been made illegal while wagering contracts of other kinds had been legal and enforceable.<sup>750</sup>

### 3.1.3 Whether the indemnity principle can substitute the requirement of insurable interest

#### 3.1.3.1 Indemnity doctrine

The assured uses indemnity insurance contracts to compensate its loss which it has suffered arising from perils insured against. Indemnity doctrine is the very fundamental principle of all indemnity insurance contracts and the foundation of every rule regarding that insurance law.<sup>751</sup> In light of the doctrine, an assured cannot be indemnified against its loss unless he can prove the loss by showing an interest which he has possessed in the subject matter of the indemnity insurance. In other words, he can get fully indemnified up to his own full interest and only be entitled to recover to the extent of his loss, but no more.<sup>752</sup> This principle can therefore prevent the assured from benefiting by way of insurance. Also, the indemnity doctrine requires the insured subject matter or the interest

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<sup>750</sup> Jonathan Gilman, Robert Merkin, Mr M J Templeman, Claire Blanchard, Julian Cooke, Philippa Hopkins, *Arnould's Law of Marine Insurance*, (18th Revised edn, Sweet & Maxwell 2013) 11-13

<sup>751</sup> *Castellain v Preston* (1883) 11 QBD 380 (AC) 386

<sup>752</sup> Jonathan Gilman, Robert Merkin, Mr M J Templeman, Claire Blanchard, Julian Cooke, Philippa Hopkins, *Arnould's Law of Marine Insurance*, (18th Revised edn, Sweet & Maxwell 2013) 31-03; *Castellain v Preston* (1883) 11 QBD 380 (AC) 386

to be exposed to the risk of loss by casualties. That is, although the assured has a type of interest in the subject all the time, where he has suffered a loss before the interest is at risk or the insurer begins to undertake its indemnification liability, the assured can still not be indemnified.<sup>753</sup>

Bowen LJ held that such definition of the doctrine of indemnity should be understood in the widest sense as a non-exhaustive one.<sup>754</sup> Thus, the interest needed by the indemnity principle may be wider than that required by the statutory insurable interest. A legal interest in the insured subject matter can definitely satisfy both principles of indemnity and insurable interest. By contrast, some kinds of interests are not sufficient to constitute an insurable interest but are able to be an interest required by the doctrine of indemnity, such as the mere pecuniary or economic interest, or a factual expectation of acquiring such an interest, first stated by Lawrence J in *Lucena v Craufurd*.

### ***3.1.3.2 Relation between doctrine of indemnity and insurable interest***

The requirement of insurable interest is intended to prohibit moral hazard and wager policies in the guise of insurance<sup>755</sup> and to focus on the relationship between the assured and the insured subject<sup>756</sup> of insurance. In comparison, the indemnity principle is designed to test whether the assured has sustained an actual loss and can be indemnified.<sup>757</sup> Both of the principles can thus prevent no-loss recovery. Besides, both of them can prohibit wager policies because

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<sup>753</sup> Jonathan Gilman, Robert Merkin, Mr M J Templeman, Claire Blanchard, Julian Cooke, Philippa Hopkins, *Arnould's Law of Marine Insurance*, (18th Revised edn, Sweet & Maxwell 2013) 1-08

<sup>754</sup> *Castellain v Preston* (1883) 11 QBD 380 (AC) 404

<sup>755</sup> 1906 MIA, s 4; 2008 IP 4, para 5.6

<sup>756</sup> 2011 CP, para 12.4

<sup>757</sup> Professor Robert M Merkin, *Colinvaux's Law of Insurance* (11th edn, Sweet & Maxwell 2016) 4-006; 2008 IP 4, para 5.7

under the indemnity principle the assured who has suffered no loss cannot get compensated.<sup>758</sup> Clearly, the parties to a gambling cannot suffer a loss in the sense of insurance contracts.

There is no doubt that a marine insurance contract is essentially nothing but one type of indemnity contract to compensate an assured's loss.<sup>759</sup> It has been contended that the principle of insurable interest is derived from the doctrine of indemnity.<sup>760</sup> Marine insurance contracts governed by the indemnity doctrine thus make the need for the requirement of insurable interest,<sup>761</sup> for, without the requirement, the assured cannot prove having sustained a loss incurred by the perils insured against during the cover of the policy.<sup>762</sup> As to a contract of marine insurance, not only must the implied doctrine of indemnity be fulfilled, but also the statutory principle of insurable interest.<sup>763</sup>

As for the situation where an assured only has an expected interest at the time of the contract, which is not successfully acquired during the later course, the outcomes in light of both doctrines are the same: the policy can be enforceable, not being a wager policy, but nonetheless the assured cannot be compensated on the policy for failing to show the loss.<sup>764</sup>

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<sup>758</sup> 2008 IP 4, para 5.24

<sup>759</sup> 1906 MIA, s 1

<sup>760</sup> M Mustill and J Gilman, *Arnould's Law of Marine Insurance and Average* (16th edn, vol I, Stevens & Sons London 1981) para 31, fn 89; cited in *New South Wales Leather Co Pty Ltd v Vanguard Insurance Co Ltd* (1990) 274 LMLN 1

<sup>761</sup> Professor Hugh Beale, *Chitty on Contracts* (vol 2, 32th edn, Sweet & Maxwell 2016) 42-015

<sup>762</sup> 2008 IP 4, para 1.16

<sup>763</sup> 2008 IP 4, para 5.2; Jonathan Gilman, Professor Robert M Merkin, Claire Blanchard and Mark Templeman, *Arnould's Law of Marine Insurance* (18th Revised edn, Sweet & Maxwell 2013) 1-08

<sup>764</sup> 2008 IP 4, footnote 2 at p. 35

The distinction between principles of indemnity and insurable interest has been argued as one without a difference.<sup>765</sup> Under both principles in indemnity insurance, the effect appears to be same that the assured cannot be compensated without the proof of loss.<sup>766</sup> The broader approach to insurable interest by the courts is held as an argument for the similar function of the two principles,<sup>767</sup> i.e. pecuniary interest is sufficient to constitute an insurable interest. As to wager policies, both doctrines can prevent an assured from recovering on wager policies. The moral hazard, in tempting the assured to make benefits by destroying the insured subject, can also be minimized by the principles of indemnity and insurable interest<sup>768</sup>, because under both doctrines the assured can only recover the amount of loss and no more. It has been argued that the doctrine of indemnity can judge the loss and make the contract certain.<sup>769</sup> Consequently the key point with regard to whether an assured can recover under policies is only the contract taken out by the assured and the insurer.<sup>770</sup> It has therefore been argued that there is no necessity for retaining the doctrine of insurable interest. The requirement of insurable interest has been blamed for introducing uncertainty, especially since the 2005 GA.<sup>771</sup> Different conclusions may be made by the following distinction between these two principles.

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<sup>765</sup> 2008 IP 4, para 7.47

<sup>766</sup> Professor Robert M Merkin, *Colinvaux's Law of Insurance* (11th edn, Sweet & Maxwell 2016) 4-006; 2008 IP 4, para 7.46

<sup>767</sup> 2008 IP 4, para 7.47

<sup>768</sup> 2008 IP 4, para 7.44-45

<sup>769</sup> 2008 IP 4, paras 7.46-49

<sup>770</sup> 2008 IP 4, para 7.47

<sup>771</sup> 2008 IP 4, para 7.46

### *3.1.3.3 Difference between the doctrine of indemnity and insurable interest*

There is a need to distinguish these two principles, as it may be confusing as to whether or not the requirement of insurable interest is useless by arguing that the doctrine of indemnity has the same effect.

#### *3.1.3.3.1 Different nature*

Although both principles of indemnity and insurable interest need the assured to show the possession of an interest, each one is of a different nature.<sup>772</sup> The position is unclear as to whether the doctrine of indemnity inherently requires an assured to show the strict statutory insurable interest in the insured subject<sup>773</sup> in order to prove its loss, at least in the realm of non-marine indemnity insurance in England.<sup>774</sup> If the indemnity principle is an implied contractual term, there is no need to consider this issue. Relevant property law can help to decide whether the assured has suffered a loss. The main focus of the indemnity principle is then to look at whether the assured has suffered a loss. And checking the interest under this principle is also aiming to serve this purpose. If it is obvious that, under related property law, the assured has or has not suffered a loss, there is in effect no need to explore the interest at all.

However, for the position of an express contractual term, which can be decided by the parties, it is uncertain whether the interest required by the indemnity principle can go beyond that required by the insurable interest principle. It seems to be right. It has been stated that: for the former, the nature and extent of a mere economic or pecuniary interest is sufficient; by contrast, for the latter,

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<sup>772</sup> 2008 IP 4, para 1.16

<sup>773</sup> Professor Robert M Merkin, *Colinvaux's Law of Insurance* (11th edn, Sweet & Maxwell 2016) 25-014

<sup>774</sup> 2011 CP, para 11.31

only the legal or equitable interest can satisfy the definition in s 5 of the 1906 MIA.<sup>775</sup> According to this statement, if an assured merely suffered an advantage or profit which it could obtain in the ordinary course of things, such as future freight or expected profit, it can be indemnified under the indemnity principle.<sup>776</sup>

Further, seemingly, the parties to an indemnity insurance contract can waive the indemnity requirement as an express contractual term.<sup>777</sup> As a result, the interest has in fact been widened. For example, the reinsurer may have agreed to indemnify the reassured even if he cannot prove to have legal liability to the original assured. In such a case, due to the reinsurer having waived his right to require the legal interest, this method has in fact broadened the interest under the indemnity principle. That is because the right, not sufficient to create a legal liability, can also amount to such an interest. On the other hand, the insurable interest requirement, being an express statutory requirement under s 4 of the 1906 MIA, cannot be altered or waived.

#### 3.1.3.3.2 Insurable interest applies to contracts not governed by the indemnity doctrine.

There are two exceptions to the indemnity doctrine: life policies which have been held not to be a contract of indemnity<sup>778</sup> and valued policies.<sup>779</sup> The assured of the former is entitled to insure an unlimited sum<sup>780</sup> on the occurrence of the specified event because the value of life cannot be measured. For the latter, the assured can recover the value of the insured subject having been

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<sup>775</sup> See Chapter 2. 3: Insurable interest defined

<sup>776</sup> Jonathan Gilman, Professor Robert M Merkin, Claire Blanchard and Mark Templeman, *Arnould's Law of Marine Insurance* (18th Revised edn, Sweet & Maxwell 2013) 1-07

<sup>777</sup> 2008 IP 4, para 5.10

<sup>778</sup> *Dalby v India and London Life Assurance Co* (1854) 15 CBP 365

<sup>779</sup> 1906 MIA, s 27(3)

<sup>780</sup> *Griffiths v Fleming* [1909] 1 KB 805; *M'Farlane v Royal London Friendly Society* (1886) 2 TLR 755

stated in the policy, even though the sum insured on the face of the policy is more than the insurable value of the subject matter. However, the assured of those two kinds of policies must satisfy the requirement of insurable interest. The 1774 LAA creates such a requirement regarding life policies.<sup>781</sup> Taking the example of a valued policy on marine risks, the assured has to fulfil such an insurable interest as well.<sup>782</sup>

Also, again, a bailee who has sustained no personal loss can recover, which is an exception to the indemnity doctrine. He however must fulfil the requirement of insurable interest before he can claim.<sup>783</sup> If there was only the doctrine of indemnity, having abolished the doctrine of insurable interest, a bailee may not be entitled to recover under the policy on the loss of goods of owners because he has suffered no loss.

#### 3.1.3.3.3 Different origins

The doctrine of indemnity is a requirement at common law.<sup>784</sup> The interest needed to be demonstrated under the requirement of indemnity as deriving from the terms of contracts, whether expressly or impliedly.<sup>785</sup> By contrast, the insurable interest principle is a statutory requirement. For marine insurance, it is the 1906 MIA that provides that an assured effecting a contract must possess an insurable interest or expectation of acquiring one.<sup>786</sup> That is, the insurable interest principle is a statutory requirement which cannot be amended or waived. The position is the same concerning the indemnity principle being an implied

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<sup>781</sup> 1774 LAA, s 1

<sup>782</sup> 1906 MIA, s 5

<sup>783</sup> *Hepburn v A Tomlinson (Hauliers) Ltd* [1966] AC 451 (AC) 467

<sup>784</sup> 2008 IP 4, para 5.24

<sup>785</sup> 2008 IP 4, para 5.7

<sup>786</sup> 1906 MIA, s 4

term. Because the related property law will directly decide whether or not a loss arises, there is no scope for parties to change the nature of the interest in the contract in order to better prove a loss. As an express contract term, the indemnity principle may be altered by the parties to an insurance contract.<sup>787</sup> In other words, they may have agreed to insure a subject matter in which the assured has no legal, pecuniary or economic interest. In practice, for example,

“a reinsurance contract can provide that the reinsurer shall pay a reinsured’s claim without forcing it to prove actual legal liability where the reinsured has entered into a bona fide and businesslike settlement.”<sup>788</sup>

#### 3.1.3.3.4 Different outcomes for failing to fulfil the two principles

According to the indemnity principle, the assured simply cannot be compensated in the case where it cannot provide an interest to demonstrate its loss. Thus, it is a matter of focusing on whether there is an actual loss and the assured can recover. For the insurable interest doctrine, by contrast, in the context of marine insurance, under the Act 1906 s 4, the contract will be void if the assured has no insurable interest or expectation at the outset of the contract. It is a matter of the contract’s validity. So in the case where the assured has an expectation of having an insurable interest at the outset of the contract, but he ends up losing it:

- the contract is valid under s 4; and
- the contract is valid as above but the assured cannot be compensated due to no proof of loss according to the indemnity principle.

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<sup>787</sup> Professor Robert M Merkin, *Colinvaux’s Law of Insurance* (11th edn, Sweet & Maxwell 2016) 4-006

<sup>788</sup> *2008 IP 4*, para 5.10

Under s 6(1), additionally, the assured cannot make a valid claim if he has no insurable interest at the time of loss.<sup>789</sup> It is thus a consideration that when the assured must have an insurable interest in order to make a claim, i.e. at the time of loss. More seriously, under the 1909 MIA, failing to possess insurable interest is imposed as a criminal offence.<sup>790</sup>

On the subject of indemnity doctrine, the assured has to suffer an actual loss in order to recover. So as to prove a loss and make a valid claim, he has to demonstrate he possesses an interest in the matter insured. Because of s 6(1), in order to make a claim, the assured must have an insurable interest at the time of loss. Seemingly, the former can replace the latter because it requires the assured to have an insurable interest at the time of loss to make a valid claim. It may not be the case. That is because the former's focus is loss. Furthermore, where the indemnity principle is an implied term and related property law can directly decide whether there is a loss, the requirement of interest at the time of loss may not be considered. On the other hand, s 6(1) deals with the timing of making a claim and there is a need always to take insurable interest into consideration.

#### 3.1.3.3.5 Different timing of acquiring an interest

Under the indemnity principle, having an interest at the time of loss suffices to prove an assured's loss.<sup>791</sup> As to preventing a void policy, the assured must satisfy the statutory insurable interest at the time of effecting the insurance.<sup>792</sup>

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<sup>789</sup> 1906 MIA, s 4

<sup>790</sup> 1909 MIA

<sup>791</sup> Professor Robert M Merkin, *Colinvaux's Law of Insurance* (11th edn, Sweet & Maxwell 2016) 4-006; 2008 IP 4, para 5.7

<sup>792</sup> 1906 MIA, s 4(2)

Besides, with respect to a contract termed with “lost or not lost”, a retrospective interest may be sufficient to enable the assured to recover.<sup>793</sup>

#### *3.1.3.4 Possible effect of the replacement of insurable interest by indemnity doctrine*

##### *3.1.3.4.1 The present situation*

Those arguing for the substitution of the requirement of insurable interest by the indemnity doctrine may have ignored a fact: that is, the reason why there is no necessity of looking at whether a loss, seemingly satisfying the indemnity doctrine, is derived from a legal or equitable interest, is that a loss suffered by the assured has always been tested by the requirement of insurable interest.<sup>794</sup> The illusion of the substitute may not be the case: it is insurable interest that helps the indemnity doctrine to limit the boundary of a loss.

##### *3.1.3.4.2 The effect of the unfortunate substitute*

It is clear that the event will be regulated by relevant property law in the case of the indemnity doctrine being an implied term, not having expressly been termed in the contract.<sup>795</sup> However, having more flexibility arising from the express term of indemnity in the contract, the boundary of the doctrine will be unclear due to the lack of the insurable interest principle.<sup>796</sup> The indemnity doctrine, being an express contractual term, may probably be amended or waived by the parties to the insurance contract.<sup>797</sup> Should the statutory insurable interest or pecuniary interest have been repealed, with the uncertain ambit mentioned above of the indemnity doctrine, the loss possibly being defined by the parties to the insurance may go too far. Remote interest may be used to prove a loss in order to attain recovery. The presumption mentioned by Eldon J may have in effect

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<sup>793</sup> For details, see chapter 2 “Lost or not lost”

<sup>794</sup> *2008 IP 4*, para 5.10

<sup>795</sup> *2008 IP 4*, para 5.8

<sup>796</sup> *2008 IP 4*, para 5.9

<sup>797</sup> *2008 IP 4*, para 5.45

come true: thousands of people, like the dock company, then the dock-master, then the warehouse-keeper, then the porter, who all would have something to do with the property and get something by it may be entitled to insure.<sup>798</sup> It is the principle of insurable interest which requires that the assured must have an insurable interest in order to be entitled to insure.<sup>799</sup>

In the context of marine insurance, the substitute may not bring benefits. Conversely, the problem as to the uncertain boundary of loss under the indemnity doctrine will arise and make the law confusing and uncertain. In the case of something happening outside the doctrine of indemnity or determining whether an assured can get indemnified, it has been suggested one should go back and look at the doctrine itself: apply the broad principle of indemnity, and you have the answer.<sup>800</sup> Under the present law, such a problem with the understanding of the wider interpretation of the indemnity doctrine does not need to be explored just because of the function of insurable interest: a loss must arise out of a legal or equitable interest.<sup>801</sup>

#### 3.1.3.4.3 Relevant examples for the uncertain boundary of loss under the indemnity principle

As a result, it is open to debate whether the assured can mount a claim on such a situation where, for example, a loss caused by the liability to pay a voluntary donation, which is not one that the indemnity doctrine is devised to indemnify. This kind of unusual indemnity may be defined in the contract.<sup>802</sup> In the practice

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<sup>798</sup> *Lucena v Craufurd* (1806) B & PNR 269 [324]

<sup>799</sup> 1906 MIA, s 5

<sup>800</sup> *Castellain v Preston* (1883) 11 QBD 380 (AC) 404

<sup>801</sup> 2008 IP 4, para 5.10

<sup>802</sup> For the details of the example set out to illustrate a loss defined by the contract, see 2008 IP 4, para 5.47

of reinsurance, the law nevertheless seems to recognize a loss stipulated by the contract, not by legal liability: the reassured may be entitled, by the express terms of the contract, to recover the loss not involving his legal liability but he agrees to pay voluntarily,<sup>803</sup> such “as *ex gratia* payment, w.p. (without prejudice) payments or compromised settlements”.<sup>804</sup>

### 3.2 The definition of insurable interest is unclear under both common law and statutes.<sup>805</sup>

There is a debate as to which test for insurable interest has been established by s 5(2) of the 1906 MIA: the narrow one or the broad one. Due to this uncertainty, different British courts and judges held different views on what is sufficient to constitute an insurable interest. In order to deal with this obscure question, the case of *Lucena v Craufurd*<sup>806</sup> needs to be first looked at, as the leading case of insurable interest in marine insurance. It gave the binding classic definition of this doctrine set out by the House of Lords in 1806, arguably from the judgment of Lord Eldon, having been codified in the 1906 MIA.<sup>807</sup> Therefore, it was a concept from common law rather than created by the Acts.<sup>808</sup> In the light of the courts’ attitudes towards what amounts to an insurable interest in at least indemnity insurance, the history has seen a change from Lord Eldon’s narrower test which was the leading judgement in this case to Lawrence J’s broader

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<sup>803</sup> 2008 IP 4, para 5.10

<sup>804</sup> Robert H Brown, *Dictionary of Marine Insurance Terms and Clauses* (5th edn, Witherby & Co Ltd 1989) R 10

<sup>805</sup> 2011 CP, para 10.2

<sup>806</sup> *Lucena v Craufurd* (1806) B & PNR 269

<sup>807</sup> 1906 MIA s 5(2)

<sup>808</sup> 2008 IP 4, para 2.10

test,<sup>809</sup> although someone argued that Lord Eldon's test was not narrower than Lawrence J's.<sup>810</sup>

### 3.2.1 Definitions of insurable interest at common law

#### 3.2.1.1 *The narrow test*

##### 3.2.1.1.1 The facts of *Lucena v Craufurd*

Commissioners, who had been authorised by the King to oversee the marine adventure of several Dutch East Indiamen at and from St. Helena to London, which had been taken by one of His Majesty's ships, insured such a journey. Soon a war was declared between the United Provinces and Britain; as a result, the ships were finally condemned as prizes to His Majesty. Due to the occurrence of a loss of ships during the voyage, the Commissioners, stating the interest was in the King, sought to establish a claim under the policy. The insurer averred that the claim failed under 19 Geo. 2 c.37 as a wager, since the claimant had no insurable interest in the ships. In order to determine whether the Commissioners had a sufficient interest in the ships to insure them, the House of Lords sought the advice of the judges of the lower court.<sup>811</sup>

##### 3.2.1.1.2 The meaning of the narrow test

Lord Eldon held that the policyholder could not have an insurable interest unless a person had a legal or equitable relation to the subject insured, i.e. a right to the property or a right derived from contracts, which was known as the narrow test or the strict test. Lord Eldon here set out the classic definition of insurable interest, which emphasised the legal or equitable relation to the subject, as follows:

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<sup>809</sup> *Feasey v Sun Life Assurance Co* [2003] Lloyd's Rep IR 637 [70]

<sup>810</sup> *Feasey v Sun Life Assurance Co* [2003] Lloyd's Rep IR 637 [65]

<sup>811</sup> 2011 CP, para 11.48

“In order to distinguish that intermediate thing between a strict right, or a right derived under a contract, and a mere expectation or hope, which has been termed an insurable interest, it has been said in many cases to be that which amounts to a moral certainty. I have in vain endeavoured however to find a fit definition of that which is between a certainty and an expectation; nor am I able to point out what is an interest unless it be a right in the property, or a right derivable out of some contract about the property, which in either case may be lost upon some contingency affecting the possession or enjoyment of the party.”<sup>812</sup>

According to this definition, unless the assured has a right in the property or a right or liability under a contract, which is a quite certain and strict relation, it cannot satisfy the requirement of insurable interest. As for the right to the property, it is not limited to the ownership to the property and the limited interest of a mortgagee or consignee is insurable as well.<sup>813</sup> This definition couched as a technical approach<sup>814</sup> may be objective due to the certainty and convenience of the courts to form a judgement. However, in some cases, this test was considered to be too strict.<sup>815</sup> Under the narrow test, the right must be of a nature as such a close relation between the assured and the subject insured as “direct relationship to the property itself”.<sup>816</sup> That is probably the reason why s

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<sup>812</sup> *Lucena v Craufurd* (1806) B & PNR 269 [321]

<sup>813</sup> ALRC 91 para 11.17; 1906 MIA, s 14

<sup>814</sup> K Sutton, *Insurance Law in Australia* (3rd edn, LBC Information Services Sydney 1999) 516

<sup>815</sup> *Macaure v Northern Assurance Co Ltd* [1925] AC 619

<sup>816</sup> K Sutton, *Insurance Law in Australia* (3rd edn, LBC Information Services Sydney 1999) 516; cited by ALRC 91 para 11.8

5(2) also provides that a person having interest in a marine adventure can have an insurable interest.

#### 3.2.1.1.3 The application of the narrow test

The following are the cases prior to the 1906 MIA which have adopted the strict test for insurable interest. In *Lucena v Craufurd*, the court held that the Commissioners had no insurable interests in the ships because they had no existing right to the insured ships before they would have arrived in England. Instead, they only had a mere hope of authority and duty relating to them which was not insurable.<sup>817</sup> In *Anderson v Morice*, the plaintiff as the assured, purchased a cargo of rice from a vendor in Rangoon and insured the cargo “at and from Rangoon.” While being loaded at Rangoon, the *Sunbeam* which was chartered for shipping the cargo sank after the larger portion of the cargo was shipped with the remaining cargo being in lighters alongside. The insurer defended himself on the basis that the assured had no insurable interest in the cargo before the loading of the whole cargo had been completed, because until then, no cargo was ever at his risk. The court held that the plaintiff could not recover the loss because, under the sale contract, the plaintiff bore no risk at any time before the completion of the whole cargo, therefore had no interest in the cargo until the loading was completed.<sup>818</sup> This decision was affirmed when an appeal was raised before the House of Lords, where the opinion as to the issue of whether the assured had an insurable interest of the Lords was equally divided.<sup>819</sup>

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<sup>817</sup> *Lucena v Craufurd* (1806) B & PNR 269

<sup>818</sup> *Anderson v Morice* (1874–75) LR 10 CP 609

<sup>819</sup> *Anderson v Morice* (1876) 1 App Cas 713

Some post-1906 MIA cases have adopted the strict test as well. As to marine policies on cargoes, in the case of *Macaura*,<sup>820</sup> the assured who in effect suffered personal loss failed to seek indemnity for the loss of timber which had been insured by him. The judgement relied upon the narrow test following the judgement of *Lucena* under which an interest in property or derivable from transfer of risk must be had by an assured, and held that the assured had no insurable interest in the timber insured because it was the asset of the company and he as the shareholder thus had no rights to the company's property. In *Fuerst Day Lawson Ltd v Orion Insurance Co Ltd*,<sup>821</sup> the CFR buyers on discharge found that the goods bought by them had been replaced by water and they had paid "against document long before outturn", so they sustained heavy loss by the substitute. The plaintiff buyers, in accordance with the strict test, were held not to be entitled to recover from the defendant insurers and having no insurable interest as they could not prove the attachment of the risk, that the oil in drums they had agreed to purchase from sellers had ever been loaded on board. Besides, it should always be borne in mind that, before determining whether an assured can recover, whether the risk or policy attaches should first be examined.<sup>822</sup> Without further concerns about transfer of property, the fact that no risk has ever attached can alone dismiss the claim.

The strict definition of insurable interest in the context of hull insurance can be demonstrated by the case of *Piper v Royal Exchange Assurance*<sup>823</sup>. On the basis that the damage to the vessel occurred during her voyage to the plaintiff buyer before her arrival at the destination, it was held that the buyer had no

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<sup>820</sup> *Macaura v Northern Assurance Co Ltd* [1925] AC 619

<sup>821</sup> *Fuerst Day Lawson Ltd v Orion Insurance Co Ltd* [1980] 1 Lloyd's Rep 656

<sup>822</sup> *Fuerst Day Lawson Ltd v Orion Insurance Co Ltd* [1980] 1 Lloyd's Rep 656

<sup>823</sup> *Piper v Royal Exchange Assurance* (1932) 44 Lloyd's Rep 103

insurable interest because at the time of loss during the transit the buyer bore no risk which was taken by the seller. Ward LJ held the view that “the economic interest element” that the assured “may suffer a disadvantage from the loss of the thing assured” is not enough and the assured must have a “legal or equitable” interest in the subject insured, at least in the realm of marine and property insurance.<sup>824</sup> It may thus be analysed from the view that a “legal or equitable” interest has been construed as an interest in property or by the passing of risk derived from sale contracts.

Under the narrow interpretation of insurable interest, the legal or equitable relation to property or derivable from contractual right at the time of loss, or an expectation of such relation at the time of the contract must be satisfied, so that the requirement of insurable interest can be fulfilled. Consistent with the technical rule adopted by courts respecting insurable interest, the assured may however unduly be prevented from recovery.<sup>825</sup> In light of this test, economic or pecuniary interest<sup>826</sup> that the assured may benefit by the safety or due arrival of insurable property and be prejudiced by loss of or damage to the insured subject<sup>827</sup> is not sufficient to amount to insurable interest.<sup>828</sup> Thus, the following test of economic or pecuniary interest has its rationality.

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<sup>824</sup> *Feasey v Sun Life Assurance Co* [2003] Lloyd's Rep IR 637 [195]

<sup>825</sup> *Macaura v Northern Assurance Co Ltd* [1925] AC 619

<sup>826</sup> Terms in Australian 1984 ICA, s 17

<sup>827</sup> 1906 MIA, s 5(2)

<sup>828</sup> *Anderson v Morice* (1876) 1 App Cas 713; *Piper v Royal Exchange Assurance* (1932) 44 Lloyd's Rep 103; *Fuerst Day Lawson Ltd v Orion Insurance Co Ltd* [1980] 1 Lloyd's Rep 656

### 3.2.1.2 *The broad test*

#### 3.2.1.2.1 The meaning of the broad test

By contrast, Lawrence J defined the requirement of insurable interest that a person may have an insurable interest if he could have a moral certainty of benefiting or sustaining loss due to the preservation or loss of the insured subject matter exposed to insured risks.<sup>829</sup> An interest under this view thus did not necessarily imply a right to a property or under a contract, but nonetheless a moral certainty of benefiting from the preservation of the insured subject exposed to perils insured against was sufficient for the policyholder to establish an insurable interest. The following was his words, which were also thought to have been incorporated in the terms of s 5(2) of the Act 1906:<sup>830</sup>

“A man is interested in a thing to whom advantage may arise or prejudice happen from the circumstances which may attend it; ...And whom it importeth, that its condition as to safety or other quality should continue: interest does not necessarily imply a right to the whole, or a part of a thing, nor necessarily and exclusively that which may be the subject of privation, but the having some relation to, or concern in the subject of the insurance, which relation or concern by the happening of the perils insured against may be so affected as to produce a damage, detriment, or prejudice to the person insuring: and 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 for those risks or dangers he may be said

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<sup>829</sup> K Sutton, *Insurance Law in Australia* (3rd edn, LBC Information Services Sydney 1999) 516; cited by *ALRC 91* para 11.7

<sup>830</sup> Jonathan Gilman, Professor Robert M Merkin, Claire Blanchard and Mark Templeman, *Arnould's Law of Marine Insurance* (18th Revised edn, Sweet & Maxwell 2013) 11-20

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

However, even though the foresaid words by Lawrence J are commonly understood as the definition of insurable interest, it has been submitted that they are in effect not because the concept of moral certainty is obscure and taking his whole decision into consideration he has expressed the opinion that the insurable interest must be one dependent on an existing concern in the subject matter insured.<sup>831</sup> Due to this disagreement, it may be arguable that the Lawrence J’s test may not be broader than that of Lord Eldon. Be that as it may, the former should be construed as a test broader than that of the latter and as the present test for insurable interest under current English law. It has been the settled law that even though in relation to an insurable interest in property the legal right test is not needed, the mere expectation is not insurable. Pursuant with it, there should be something between them to test the existence of insurable interest, that is, the Lawrence J’s test; whereas Lord Eldon has rejected the intermediate concept as insurable interest and only accepted the certain right as one. An insurable interest under the Lawrence J’s test is not a legal or equitable right to the insured subject nor a mere expectation, but a moral certainty or well-founded expectation of being economically interested in the subject. Although such a certainty needs to be ascertained by a court by reference to the facts of the case in question, it can be literally understood as some relation closer than a mere expectation but not necessarily being

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<sup>831</sup> Professor John Birds, Ben Lynch and Simon Paul, *MacGillivray on Insurance Law* (13th edn, Sweet & Maxwell 2016) 1-118

sufficient to be a legal right, i.e. a moral certainty is also dependent on present existing rights but not necessarily on legal rights. Therefore, the test of Lawrence J may be wider than that of Lord Eldon, which means that even though the two tests have both been relied on for existing rights to the subject they are in effect different tests as to what can constitute an insurable interest.

#### 3.2.1.2.2 Whether a moral certainty is sufficiently certain to be an insurable interest.

Lord Buckmaster in favour of the narrow test states that the element of “moral certainty” as to the definition given by Lawrence J cannot be made an essential part of a definite legal concept.<sup>832</sup> It however may be not right when analysing insurable interest from a broader view. The “moral certainty” may be understood from the view that the insurable interest, as the intermediate thing between a strict right and a mere expectation, must be ascertained. If the interest in a thing intended to be insured can be deprived by many risks other than the perils insured against, such an object cannot be the subject matter of insurance.<sup>833</sup>

The broader definition focuses not only on the relationship between the assured and the insured subject matter, but also on the possibility of contingency, some risks independent of perils insured against, which can affect whether an object is the subject matter of insurance. Loss suffered by the assured should merely be caused by the perils insured against, not by the variety of events independent of insured perils. As a result, the assured can only recover the loss caused by the insured perils, rather than by all the other contingencies. In Lawrence J’s opinion, without the possibility of weighing the odds of its being intercepted by fortuitous accidents, which are risks independent of specified ones in the policy, due to such uncertainty of interest, the object may not be the subject of insurance. The interest in such a subject of course cannot be

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<sup>832</sup> *Macaura v Northern Assurance Co Ltd* [1925] AC 619 (HL) 627

<sup>833</sup> *Lucena v Craufurd* (1806) B & PNR 269 [301]

insurable because the property able to be the subject matter of insurance is the precondition as to deciding whether an interest is insurable.

Thus, in *Pole v Fitzgerald*,<sup>834</sup> the court held that the subject matter of insurance was the ship, not the voyage, for it was impossible to value the loss of the voyage possibly caused by various uncertain events. This can also be explained by an interesting example. An uncle has told his niece that he will send her his ship as her eighteenth birthday present. And he has not insured the ship. If the niece wanted to take out an insurance on the ship, under the current law, she cannot have an insurable interest, for that is so uncertain that there may be various contingencies besides specified risks to defeat the oral promise: the uncle may just be making a joke or he may cancel his promise and sell this ship. Even under the wide test, this situation moves too far.<sup>835</sup> Therefore, if the relation can be morally ascertained that, without the occurring of perils insured against the assured will benefit, the court should be in favour of his having an insurable interest. It is the courts' duty to determine whether the relation is close enough to amount to the moral certainty of insurable interest.

Lord Eldon refused the proposition of "moral certainty", deeming it as so wide that a person having a very remote relation to the insured subject can insure. Perhaps Lawrence J's test was not as uncertain as Lord Eldon had thought because taking the whole judgement of Lawrence J into consideration an insurable interest must be also based on a present existing right and a mere expectation was not insurable. Besides, "moral certainty" would of course not

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<sup>834</sup> *Pole v Fitzgerald* (1750) Willes 641 [648]

<sup>835</sup> 2011 CP, paras 12.30-12.31

allow hundreds, even thousands to insure a subject because it was the court's duty to weigh the odds of its being interrupted by fortuitous accidents, i.e. without the certainty of the contingency to which the subject was exposed, such a thing cannot be a subject of insurance and the assured accordingly has no insurable interest and is not entitled to insure.

### 3.2.2 The test for insurable interest provided by s 5(2) of the 1906 MIA

#### 3.2.2.1 Debates on which test s 5(2) has provided

##### 3.2.2.1.1 Different understandings as to s 5(2)

According to s 5(2) of the 1906 MIA, when to test whether an assured possesses an insurable interest, two elements must be satisfied: the strict interest of “a legal or equitable interest”, which derives from Lord Eldon's test, and the broad interest of “economic interest”,<sup>836</sup> which originates from Lawrence J's advice.<sup>837</sup> There has thus been a debate as to which test s 5(2) really refers to: supporters of Lord Eldon's test argue that the test should be a narrow one because the strict interest of “a legal or equitable relation” must be satisfied and a merely moral certainty of benefit or prejudice or a mere expectation of interest is not sufficient.<sup>838</sup> It is argued that the reason why the first element has been added is on the basis that the latter is too wide. As it has been said, without the former requirement, an “economic interest” test may carry us into “the land of dreams”.<sup>839</sup>

On the other hand, those who uphold Lawrence J's test argue that s 5(2) in substance refers to the broader test, by which the fact has been emphasised

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<sup>836</sup> Terms in 1984 ICA, s 17

<sup>837</sup> *Lucena v Craufurd* (1806) B & PNR 269 [301]

<sup>838</sup> *Feasey v Sun Life Assurance Co* [2003] Lloyd's Rep IR 637 [195]; cited by John Dunt, *Marine Cargo Insurance* (1st edn, Informa Law 2009) 4.4

<sup>839</sup> *Knox v Wood* (1808) 1 Camp 543

that the “economic interest” is sufficient to constitute an insurable interest and then whether the “economic interest” may be affected by the perils insured against.<sup>840</sup>

3.2.2.1.2 That a person interested in a marine adventure has an insurable interest reflects the wider test.

Section 5(2) has non-exhaustively defined the principle of insurable interest and has particularly given two examples of the subject matter of the marine adventure policy, that is, “the adventure” or “any insurable property at risk”.<sup>841</sup> In terms of the two different subjects, the tests for insurable interest in them are also different.

As for the subject regarding “the adventure” at risk, it may be an illustration of the broad approach adapted by the courts for the market need at that time, which extends the ambit of the interest limited to the right to an item of property and its being at risk. In the view of Sir Chalmers, who drafted the 1906 MIA, it seems that s 5(2) should be understood broadly, which reflects the broad test. He expresses in terms that “The definition of insurable interest has been continuously expanded, and dicta in some of the old cases, which would tend to narrow it, must be accepted with caution.”<sup>842</sup> A relationship, recognisable by law, to the insured subject, can certainly be sufficient to constitute insurable interest.<sup>843</sup> The relationship nevertheless may not necessarily be limited to a right to the property or at risk. In addition, s 5(2) is intended to further describe s

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<sup>840</sup> *Feasey v Sun Life Assurance Co* [2003] Lloyd’s Rep IR 640 [92]; cited by John Dunt, *Marine Cargo Insurance* (1st edn, Informa Law 2009) 4.4

<sup>841</sup> John Dunt, *Marine Cargo Insurance* (1st edn, Informa Law 2009) 4.4; Terms come from 1906 MIA, s 5(2)

<sup>842</sup> Sir M D Chalmers and Douglas Owen, *The Marine Insurance Act, 1906* (William Clowes and Sons 1907) 12

<sup>843</sup> Sir M D Chalmers and Douglas Owen, *The Marine Insurance Act, 1906* (William Clowes and Sons 1907) 12

5(1) as to who can be an assured or who can have an interest or what is sufficient to satisfy insurable interest.

Section 5(1) relies on the decision of *Wilson v Jones*<sup>844</sup>; the broadening of insurable interest is achieved by way of correctly identifying the subject matter of insurance at risk as a marine adventure rather than an item of property. In this case it was held that the assured under a form of marine policy in common form could possess an interest in the marine adventure, although he had no interest in the insured subject of cable as the asset of the company. It may be deduced from the case that the relationship should be construed widely by correctly identifying that the subject matter of insurance was the adventure of laying the cable rather than the cable. With the cover for the adventure, the assured possesses an insurable interest in the adventure because the usual form of a marine policy under its terms can be widely construed by the court to extend beyond the property to cover the loss of adventure.<sup>845</sup> This rule is convenient for the commercial practice of insurance, in particular, cargo insurance policies, because the assured can be better insured by a marine policy being able to cover both the loss of cargo and adventure.<sup>846</sup>

#### 3.2.2.1.3 The test to insurable interest in an item of property at risk: the change from the narrow to the wider one

Although as above submitted the definition in virtue of s 5 should be widely construed, it has been argued that an assured cannot have an insurable interest in an item of property unless he has a legal relation to it. Where the assured has an ownership to, or possession of the insured subject, or is at risk of loss on the

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<sup>844</sup> *Wilson v Jones* (1867) LR 2 Ex 139

<sup>845</sup> *Feasey v Sun Life Assurance Co* [2003] Lloyd's Rep IR 637 [82]

<sup>846</sup> *Wilson v Jones* (1867) LR 2 Ex 139; John Dunt, *Marine Cargo Insurance* (1st edn, Informa Law 2009) 4.5

happening of the perils insured against, he can certainly be entitled to be interested in the subject.<sup>847</sup> It has thus been held that a buyer can have an insurable interest due to goods at his risk, even though no property has been transferred to him.<sup>848</sup> A buyer can be deemed as taking risk only at the time he is obliged, under contracts of sale, to pay for goods, regardless of whether or not the goods will arrive in safety. Such types of interest are the narrow ones which are set out by Lord Eldon in terms of “a right in the property, or a right derivable out of some contract about the property”.<sup>849</sup> The change of attitudes by the courts to an insurable interest in property from the strict test to the wide one has been discussed below.<sup>850</sup>

#### 3.2.2.1.4 Conclusion

Since it may be right that both Lord Eldon and Lawrence J have agreed that an insurable interest must be one on an existing interest, s 5(2) may in effect reflect both judges’ opinion.<sup>851</sup> Thus, Farwell LJ held that the insurable interest under the test of Lawrence J must be a legal interest rather than a mere expectation of acquiring one.<sup>852</sup> In addition, the debate may be solved because Sir Chalmers has pointed out that the definition under s 5 is a continually expanding one and Waller in *Feasey* has held that the definition of insurable interest by s 5(2) should be widely interpreted.<sup>853</sup> Thus, in the modern context, s 5(2) should be regarded as having reflected Lawrence J’s economic test.

#### 3.2.2.2. *Distinction of subject, insurable interest and value*

The elements of the subject matter of insurance, insurable interest in it and its

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<sup>847</sup> John Dunt, *Marine Cargo Insurance* (1st edn, Informa Law 2009) 4.4

<sup>848</sup> *Stock v Inglis* (1884) 12 QBD 564

<sup>849</sup> *Lucena v Craufurd* (1806) B & PNR 269 [321]

<sup>850</sup> See 3.2.3

<sup>851</sup> *Lucena v Craufurd* (1806) B & PNR 269 [321]; Professor John Birds, Ben Lynch and Simon Paul, *MacGillivray on Insurance Law* (13th edn, Sweet & Maxwell 2016) 1-118

<sup>852</sup> *Griffiths v Fleming* [1909] 1 KB 805 (AC) 820

<sup>853</sup> *Feasey v Sun Life Assurance Co* [2003] 2 All ER 587 [97]

value are different concepts and confusing. They are separate but can impact one on the other.<sup>854</sup> A subject matter of insurance in the marine insurance context is every lawful marine adventure<sup>855</sup> and a subject in which an assured can have an insurable interest has been non-exclusively enumerated by the 1906 MIA from s 5 to s 14, such as a marine adventure, a property, wagers, or freight. The element of insurable interest which is nonetheless a specific kind of relation between the assured and this subject has been analysed above in the concept of insurable interest.<sup>856</sup> In relation to the value of the subject, whether valued or unvalued, it may generally refer to the price of the property, i.e. where damage to or loss of the subject occurs, the money that the insurer is liable to pay the assured. It is in effect the subject matter of a contract of insurance which is mere money. Consequently, the liability of the insurer is to pay money to the assured, rather than to repair or restore ships or cargoes. Lawrence J gave the differences between the property of a subject as a kind of value of the subject and the interest in it, which would be helpful to the understanding of the requirement of insurable interest. The value or property can generally be measured by the price, while insurable interest means every benefit and advantage arising from the subject.<sup>857</sup> The insurable interest is thus different from and not limited to the property of the subject.

### *3.2.2.3 A mere expectation cannot amount to an insurable interest*

Insurable interest has to be an interest depending on the present existing right to the subject matter of insurance, which is not a mere expectancy on such subject. A mere expectation, according to the analysis of above paragraph, is a kind of too remote relation between the assured and the subject matter, which is

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<sup>854</sup> *Feasey v Sun Life Assurance Co* [2003] Lloyd's Rep IR 637 [75]

<sup>855</sup> 1906 MIA, s 3(1)

<sup>856</sup> See 2.3 in chapter 2 and 3.2 in chapter 3

<sup>857</sup> *Lucena v Craufurd* (1806) B & PNR 269 [302]

not sufficient for the requirement of insurable interest.<sup>858</sup> The interest in a mere hope cannot be insurable because such interest is so uncertain which may be intercepted by too many contingencies other than the insured perils. The court may thus not decide that the assured has moral certainty that perils insured against can bring it benefits or prejudice. In Lawrence J's words, the assured must have a relation that could amount to "moral certainty" of advantage or benefit, but for perils insured against rather than other contingencies he could benefit from the insured subject's preservation. "Moral certainty" thus amounts to an insurable interest and is a concept to distinguish "a strict right, or a right derived under a contract, and a mere expectation or hope",<sup>859</sup> which the assured must have at the time of loss, if the assured wants to recover under a claim. Therefore, a person could not merely insure an expectation in a thing.

This could be illustrated by the case of *Knox v Wood*,<sup>860</sup> where the assured had insured the commission on freight for the guarantee of the cargo and the commission upon the sale of the cargo which would be delivered by a ship back from Jamaica to Dublin. However, the adventure was frustrated by the capture of the ship on her way from St. Thomas's to Jamaica. The court held that the assured possessed no insurable interest in both commissions, since they were merely based on expectation of obtaining homeward cargo, having depended on no existing rights, i.e. there was no contract of commission and sale for the cargo. According to Lord Ellenborough, the insurance was just an expectation of an expectation. Such expectation should not be supported, otherwise "This case carries us into the land of dreams; and, if supported, would introduce the

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<sup>858</sup> *Macaura v Northern Assurance Co Ltd* [1925] AC 619; cited by *ALRC 20*, para 11.17

<sup>859</sup> *Lucena v Craufurd* (1806) B & PNR 269 [321]

<sup>860</sup> *Knox v Wood* (1808) 1 Camp 543

practice of insuring a 20,000 pounds prize in the lottery without purchasing a ticket!” Although the policy embraced the so-called PPI clause “without benefit of salvage”, which was prohibited under the 1745 MIA,<sup>861</sup> the authority on the test for insurable interest still applied. Besides, this verdict was also based on the requirement of the indemnity principle, viz. the purpose of marine insurance contracts was to indemnify the assured’s loss incurred by insured perils; therefore, the assured could not make profits by insurance contracts.

An exception to the above rule, that a mere expectation is not insurable, is expected profits.<sup>862</sup> In this case, an interest in such profits is deemed as an insurable interest contingent on the completion of shipment and safe delivery of cargo rather than a mere expectation. Unless clearly expressed in a policy, the profits are not covered under a policy on property. Thus, in *Anderson*,<sup>863</sup> Lord Chelmsford set out that the purchaser assured would have been entitled to recover the loss of the profits in which he had an insurable interest if he had specified the profits as the subject of insurance.

### 3.2.3 Later decisions in favour of Lawrence J’s test

Lawrence J’s test was merely included in an advice, which was different from Lord Eldon’s which was contained in a speech pronouncing the decision. However, the former “has been approved many times in later decisions”.<sup>864</sup> Subsequent courts tend to have moved from the narrower test to the broader test that a factual expectation of economic benefit from preservation or loss on

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<sup>861</sup> This case was thought to be a case leading to this provision.

<sup>862</sup> Professor Robert M Merkin, *Colinvaux and Merkin’s Insurance Contract Law* (vol 1, Sweet & Maxwell 2017) A-0402

<sup>863</sup> *Anderson v Morice* (1876) 1 App Cas 713 (HL) 723

<sup>864</sup> *Feasey v Sun Life Assurance Co* [2003] Lloyd’s Rep IR 637 [65]

destruction is sufficient to amount to the requirement of insurable interest, which has been approved by the Court of Appeal in *Feasey*<sup>865</sup> and now seems to represent the current law. Furthermore, the courts will look for ways to find an insurable interest by properly construing policies, i.e. if the underwriter, having known the assured's circumstances, takes out an insurance with the assured who has paid a premium, the courts will usually extend the concept of insurable interest to confer on the assured an interest.<sup>866</sup> That is possibly one of the reasons why in the past insurers rarely use the lack of an insurable interest as a defence, except in the context of fraud.<sup>867</sup>

For example, where the insurer argued that the assured had no interest in the cargo prior to shipment but who clearly suffered loss occurring prior to shipment due to the payment for the cargo, the court leaned in favour of the assured having an interest before the loading by broadly understanding the test of insurable interest.<sup>868</sup> Be that as it may, it is not the invariable approach adopted by the court. Similar to the judgement of the pre-1906 MIA case of *Anderson v Morice*,<sup>869</sup> where to decide whether the assured had an interest, the fact as to whether goods were at his risk was carefully examined, and the strict approach was approved by a court in the modern context.<sup>870</sup>

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<sup>865</sup> *Feasey v Sun Life Assurance Co* [2003] 2 All ER 587; cited by *2015 IP 10*, para 2.38

<sup>866</sup> *2011 CP*, paras 11.46-59

<sup>867</sup> *Western Trading Limited v Great Lakes Reinsurance (UK) PLC* [2015] EWHC 103 [60]; This decision was reversed on appeal, but on other grounds, leaving the judgement on the insurable interest issue unaffected: [2016] EWCA Civ 1003 [53], [60]

<sup>868</sup> *Wünsche Handelsgesellschaft International mbH v Tai Ping Insurance Co Ltd* [1998] 2 Lloyd's Rep 8; *NSW Leather Co Pty Ltd v Vanguard Insurance Co Ltd* (1991) 25 NSWLR 699; John Dunt, *Marine Cargo Insurance* (1st edn, Informa Law 2009) 4.3

<sup>869</sup> *Anderson v Morice* (1874–75) LR 10 CP 609; (1876) 1 App Cas 713

<sup>870</sup> *Fuerst Day Lawson Ltd v Orion Insurance Co Ltd* [1980] 1 Lloyd's Rep 656 (QB) 664

### 3.2.4 Conclusion

Despite the tendency of the broad test of insurable interest, judges have different views as to whether the requirement of insurable interest should be construed strictly or widely.<sup>871</sup> Confusion will arise: the parties to insurance policies are not sure whether the assured has an interest before shipment and the courts are unclear with respect to which decision they should follow. Besides, there is no agreement on which test has been provided for by s 5. The unclear and confusing state for the definition of insurable interest both under common law and the 1906 MIA has been causing trouble to the market and the courts, leading to disrespect for the law itself.

However, in the context of marine insurance, an assured may have an insurable interest in the following situations.<sup>872</sup>

- where he has a legal or equitable title to a marine adventure;
- where he has a legal or equitable title to the property;
- where he has a legal or equitable right to the possession of the property;
- where the property is not in his possession, but under a contract he will be benefitting from the safety of the property.

## 3.3 Problems in the marine insurance practice

### 3.3.1 The statutory pre-loading clause of “lost or not lost”

The meaning of the “lost or not lost” clause is unclear. Due to clause 11 of ICC 1982 and 2009, it appears that only the function of retrospective declaration has now operated. This change can in practice have an effect on CIF buyers who

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<sup>871</sup> *Feasey v Sun Life Assurance Co* [2003] Lloyd's Rep IR 637 [92], [195]

<sup>872</sup> Professor Robert M Merkin, *Colinvaux and Merkin's Insurance Contract Law* (vol 1, Sweet & Maxwell 2017) A-0397

have suffered a loss during the period after the assignment of policy by a seller and before the transfer of risk. Furthermore, despite a policy including such a clause, dispute often arises on whether risk has attached, and whether an assured has suffered a loss and can recover such loss, not of the insured subject matter of goods, but of financial loss.<sup>873</sup> In addition, it may be confusing as to whether the clauses of “lost or not lost” and “warehouse to warehouse” in isolation can protect a buyer from pre-shipment loss.

### *3.3.1.1 Changes to the “lost or not lost” clause*

#### *3.3.1.1.1 Distinct understanding with respect to the “lost or not lost” clause*

Before the change by clause 11 of ICC 1982, there has existed different understandings as to the meaning of the clause “lost or not lost”. Relying on the provision of Schedule 1, s 1 of 1906 MIA, some argue that it only means retrospective declaration: an assured in ignorance of loss may recover where loss has occurred before the insurance contract is concluded but nevertheless an interest must have been acquired by him.<sup>874</sup> In contrast, it has been submitted that the meaning of the clause also includes retrospective interest.<sup>875</sup>

The “lost or not lost” clause should operate in the foregoing two distinct ways. This is not only relied on in the provisions under s 6 (1) and Schedule 1 of the 1906 MIA, but also by high authorities: it was held that the assured could recover against the policy with a “lost or not lost” clause which was concluded after a loss, sustained by his having had or not had an insurable interest, had already arisen, i.e. after the loss but prior to his obtaining an insurable

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<sup>873</sup> *Sutherland v Pratt* (1843) 11 M & W 296; *Reinhs Co v Joshua Hoyle & Sons Ltd* [1961] 1 Lloyd’s Rep 346; *NSW Leather Co Pty Ltd v Vanguard Insurance Co Ltd* (1991) 25 NSWLR 699

<sup>874</sup> Associated Marine Insurers Agents Pty Ltd *Correspondence* 17 April 2000; cited by ALRC 91 para 11.36

<sup>875</sup> *Broker Consultation* Perth 23 November 2000; Gault Armstrong & Kemble *Submission* 18; cited by ALRC 91 para 11.36; John Dunt, *Marine Cargo Insurance* (1st edn, Informa Law 2009) 4.18

interest.<sup>876</sup> It may not be right to contend that it is different understandings that make cases worse where buyers, who have paid for goods before acquiring an interest, cannot recover from insurers because they have no interest at the time of loss of the goods before shipment although they have sustained financial loss. It is still good law that an assured not aware of loss may recover loss occurring before he acquires an interest.<sup>877</sup>

#### 3.3.1.1.2 Exceptions to general rules regarding time of having interest

By and large, as for marine insurance, an assured must show his possession of insurable interest at the time of the loss.<sup>878</sup> It means that an assured cannot benefit from the clause unless he has already suffered loss.<sup>879</sup> Although the rule is straightforward, under contracts termed with clauses of “lost or not lost”, because an assured who can only require his insurable interest after loss may still be entitled to recover, this seems to be a breach of the indemnity doctrine. It has been admitted that the “lost or not lost” clause is a point of law with difficulty.<sup>880</sup> The rule is particularly important in occasions of international sales of goods, for property in goods may be transferred many times during the period of cover, involving various transfers of risk.<sup>881</sup> As well as the principle of “lost or not lost”, there is another exception to the general principle as to the timing of insurable interest: a person can acquire an insurable interest by the assignment of the policy even though the loss occurred before the assignment.<sup>882</sup>

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<sup>876</sup> *Sutherland v Pratt* (1843) 11 M & W 296; *Reinhs Co v Joshua Hoyle & Sons Ltd* [1960] 1 Lloyd's Rep 483, 489; affirmed [1961] 1 Lloyd's Rep 346, 355; *NSW Leather Co Pty Ltd v Vanguard Insurance Co Ltd* (1991) 25 NSWLR 699; *Wünsche Handelsgesellschaft International mbH v Tai Ping Insurance Co Ltd* [1998] 2 Lloyd's Rep 8

<sup>877</sup> *Sutherland v Pratt* (1843) 11 M & W 296; Proviso of 1906 MIA, s 6(1)

<sup>878</sup> 1906 MIA, s 6(1); ICC (A) 1982, clause 11.1; ICC (A) 2009, clause 11.1

<sup>879</sup> *New South Wales Leather Co Pty Ltd v Vanguard Insurance Co Ltd* (1990) 274 LMLN 1

<sup>880</sup> *Fuerst Day Lawson Ltd v Orion Insurance Co Ltd* [1980] 1 Lloyd's Rep 656 (QB) 664

<sup>881</sup> Yang Liangyi, *Marine Cargo Insurance* (3rd edn, Law Press China 2013) 126

<sup>882</sup> ALRC 91 para 11.16; 1906 MIA, s 51

### 3.3.1.1.3 Distinct effect under the “lost or not lost” clause and clause 11 of ICC 1982 and 2009

The issue needs to be discussed as to whether the effect of s 6(1), and Schedule 1, of the 1906 MIA and that of clause 11 of ICC 1982 and 2009 is the same. So far as that set out in s 6(1), and Schedule 1, of the 1906 MIA is concerned, an assured can recover despite retrospective insurable interest<sup>883</sup> and retrospective declaration.<sup>884</sup> The assured nonetheless cannot by any act or election recover after being aware of the loss in virtue of accepting shipping documents.<sup>885</sup> In light of clause 11 of ICC 1982 and 2009, it says that subject to the precondition that an assured has an insurable interest at the time of loss, he can recover the loss occurring before insurance contracts are concluded unless they have already known the loss whereas the insurer has not.<sup>886</sup> Without this precondition, it seems that these two clauses have the same effect that obtaining of retrospective interest is available to assureds.

Therefore, it is not right to say that “the lost or not lost” clause in the 1906 MIA has the same effect as clause 11 does, but nevertheless the latter is in effect narrower than the former.<sup>887</sup> The former has been held being able to operate in two different manners: it provides both retrospective declaration and retrospective interest.<sup>888</sup> In contrast, according to the latter, an assured can only make a retrospective declaration, but cannot acquire a retrospective interest.<sup>889</sup> That is because the latter commences with the terms subject to the general rule

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<sup>883</sup> Proviso of 1906 MIA, s 6(1)

<sup>884</sup> 1906 MIA, Schedule 1, s 1

<sup>885</sup> *Anderson v Morice* (1876) 1 App Cas 713

<sup>886</sup> ICC (A) 2009, clause 11; Wording of clause 11 provided in ICC (A) 1982 and 2009 are the same.

<sup>887</sup> Jonathan Gilman, Professor Robert M Merkin, Claire Blanchard and Mark Templeman, *Arnould's Law of Marine Insurance* (18th Revised edn, Sweet & Maxwell 2013) 11-04

<sup>888</sup> *NSW Leather Co Pty Ltd v Vanguard Insurance Co Ltd* (1991) 25 NSWLR 699; 1906 MIA, s 6 (1); 1906 MIA, s Schedule 1, s 1

<sup>889</sup> John Dunt, *Marine Cargo Insurance* (1st edn, Informa Law 2009) 4.19

that the assured must possess an interest at the time of loss. That is to say, the prerequisite condition for recovery is that policyholders have an insurable interest at the time of loss. Conversely speaking, unlike the effect of “lost or not lost” terms, under clause 11 of ICC 2009, policyholders cannot get recovery who do not obtain an interest until loss or damage has happened. In a word, clause 11 is within the ambit of the general rule: clause 11.2 may mean that it only provides retrospective declaration, but does not admit the acquisition of retrospective interest. By contrast, the “lost or not lost” clause goes so far as to be outside the realm of general rules: the assured may still recover his loss occurring before his acquirement of insurable interest.

#### 3.3.1.1.4 Effects of the change on CIF buyers

CIF buyers appear to have been affected by the narrowing change caused by clause 11,<sup>890</sup> under which they need to consider how to get an advantageous position. Two cases of loss will be discussed, i.e. loss before the transfer of risk and loss after its transfer. As to the latter, an assured is entitled to recover if the loss occurs after the transfer of risk and that of the policy, by which he has an insurable interest and a valid transfer of policy. Thus, the more sophisticated situation requiring more attention is that where the loss occurs after the transfer of risk but before the assignment of policy. In this case, a seller will, subject to particular agreement, have no insurable interest in goods any more but will still hold the policy, whereas a buyer has had an insurable interest by way of the transferring of risk but no policy, depending on the assignment of policy by the seller. Both of them thus cannot recover if a loss occurs. However, with the incorporation of the “lost or not lost” clause, the buyer can recover because its effect of retrospective declaration renders valid the obtaining of the policy after

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<sup>890</sup> Jonathan Gilman, Professor Robert M Merkin, Claire Blanchard and Mark Templeman, *Arnould's Law of Marine Insurance* (18th Revised edn, Sweet & Maxwell 2013) 11-26

cover, provided that the seller has agreed to pass the policy to the buyer before the loss. Obviously, under clause 11 of ICC 2009 which has the same effect of retrospective declaration a buyer on CIF in this case is unaffected. The buyer should thus apply this clause in a policy in order to get a better cover.

More sophisticated events will arise as to loss occurring before the transfer of risk. As to a loss occurring during the period before the seller has passed the policy to the buyer and before the transfer of risk, the buyer can recover as the consignee of the policy by the seller even though he has no insurable interest at the time of loss. Thus, there is no need to incorporate the "lost or not lost" clause and clause 11 into the policy. The case is different where the loss has happened during the period after the seller has passed the policy to the buyer and before the transfer of risk. In this event, the seller cannot recover because despite having the right of title to goods, he has assigned the policy to the buyer; nor can the buyer recover since he is not at risk in spite of holding the policy. With the assistance of the "lost or not lost" clause, the buyer may however recover because it has the effect that enables him to obtain an insurable interest after the occurrence of loss. However, with the operation of clause 11 which has no such effect, the CIF buyer may be in a more disadvantageous position than that under the "lost or not lost" clause. He thus should be aware of this change to avoid the mere hope of recovery under a policy with clause 11 inserted when he cannot recover.

#### 3.3.1.1.5 Construction of terms of sale contracts can determine the transferring of risk.

It is noteworthy that terms of sale contracts can affect the passing of risk, which has an effect on the application of the "lost or not lost" clause. It is in the practice of cargo insurance that the issue often arises as to whether the

assured has an interest at the time of loss.<sup>891</sup> It has been suggested that, in order to address this issue by exactly ascertaining the timing regarding transfer of risk or ownership, careful examination of the terms of sale of goods contracts is needed.<sup>892</sup> Terms of contracts of sale can influence passing of risk, i.e. when goods have been loaded on board ships under contracts. Therefore, when by the construction of contract of sale of goods, property or risk would not have been passed until the whole goods had been on board the carrying vessel, it was approved by the House of Lords that the plaintiff as the FOB buyer bore no risk at any time, thus had no interest in the cargo.<sup>893</sup> In this case, the cargo was a whole thing: it did not exist at the time of effecting the insurance contract and would not exist until it had been passed over the ship's rail (now loaded on board).<sup>894</sup> However, with similar facts that only a portion of goods was loaded on board when the vessel and such goods sunk, but with distinct policy terms as "wheat cargo now on board or to be shipped", it was held that the buyer had an insurable interest in the lost part of the goods, for the risk of loss regarding the portion of goods attached when any part of the goods were on board.<sup>895</sup>

Also, whether the total or partial loss occurred, by way of a "warehouse to warehouse" clause, after risk has attached but before insurance having been concluded can be recovered is dependent on the construction of policies. Loss occurring before risk or policy has attached cannot be recovered, simply

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<sup>891</sup> ALRC 91, para 11.17

<sup>892</sup> ALRC 91, para 11.17

<sup>893</sup> *Anderson v Morice* (1874–75) LR 10 CP 609; (1876) 1 App Cas 713

<sup>894</sup> *Colonial Insurance Company of New Zealand v Adelaide Marine Insurance Company* (1886) 12 App Cas 128 (AC) 136

<sup>895</sup> *Colonial Insurance Company of New Zealand v Adelaide Marine Insurance Company* (1886) 12 App Cas 128

because the loss is not within the cover of the policy.<sup>896</sup> As discussed above, where a loss has occurred during the period before the passing of risk and after the assignment of policy to the buyer, both CIF sellers and CIF buyers may not be entitled to recover such a loss.<sup>897</sup> Therefore, with reference to contracts termed with a “warehouse to warehouse” clause, it has been held that damaged goods are entitled to be recovered by CIF buyers while lost goods are not, where both damage and loss has happened in transit from factory to Shenzhen before the insurance is concluded.<sup>898</sup> Waller LJ takes the view that the policy does not attach when the loss has occurred: the lost goods, which should have been the subject, cannot be appropriated to the insurance contract, because the lost goods do not exist when concluding the contract; in contrast, in spite of the damage, those damaged goods still exist so as to be assigned to the contract.<sup>899</sup> Nevertheless, it is not right to say that the assured cannot recover the loss occurring before any appropriation to a binding insurance contract. It is a matter of construction of the policies. The court has thus held that the policies have covered the loss of the goods destroyed by fire in their unassigned state by construing the terms of policies.<sup>900</sup>

However, where pre-loaded goods have suffered total loss or destruction, the position is still uncertain relating to whether FOB or CFR buyers are entitled to claim for such total loss.<sup>901</sup> They may be entitled to claim because a “lost or not

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<sup>896</sup> *Reinhs Co v Joshua Hoyle & Sons Ltd* [1961] 1 Lloyd’s Rep 346 (AC) 355

<sup>897</sup> See 3.3.1.1.4

<sup>898</sup> *Wünsche Handelsgesellschaft International mbH v Tai Ping Insurance Co Ltd* [1998] 2 Lloyd’s Rep 8, 14

<sup>899</sup> *Wünsche Handelsgesellschaft International mbH v Tai Ping Insurance Co Ltd* [1998] 2 Lloyd’s Rep 8, 14

<sup>900</sup> *Niger Co Ltd v The Guardian Assurance Co Ltd* [1920] 4 Lloyd’s Rep 292

<sup>901</sup> ALRC 91, para 11.42

lost” clause includes both partial loss and total loss.<sup>902</sup> With admittedly no direct authority on this issue, it has been suggested that, on principle, they can acquire the property in the pre-shipment loss, of at least part of the goods, at the time and in the manner in which it would have passed had the containers not been lost.<sup>903</sup>

### *3.3.1.2 The clause must be consistent with the principle of indemnity*

The “lost or not lost” clause only applies to cases in which the assured suffers a genuine loss, which is also a requirement of the doctrine of indemnity.<sup>904</sup> The question can arise when to examine whether the assured has sustained a loss covered by the policy. As to loss occurring before loading and suffered by buyers FOB who had paid for the cargo, the Supreme Court of New South of Wales held that they could not call in aid the “lost or not lost” clause to be indemnified, on the ground that they had no interest in the goods before loading on board the vessel and thus they suffered no loss.<sup>905</sup> The Court of Appeal agreed with the opinion that the buyer had no interest in goods before shipment, but nonetheless set aside the judgement for it held that the buyers had an interest in financial loss regarding those pre-shipment goods paid by them. It followed the decision that the assured was entitled to recover the financial loss as to the advance on the security of damaged goods, not the loss in respect of goods in which it had no interest at the time of loss but acquired an interest by pledge after the loss.<sup>906</sup> The fact that buyers have contractual remedies against

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<sup>902</sup> *Reinhs Co v Joshua Hoyle & Sons Ltd* [1960] 1 Lloyd's Rep 483 (QB) 489; 1 Lloyd's Rep 346 (AC) 355

<sup>903</sup> *NSW Leather Co Pty Ltd v Vanguard Insurance Co Ltd* (1991) 25 NSWLR 699

<sup>904</sup> Robert Merkin, 'Reforming Insurance Law: Is there a case for reverse transportation? A report for the English and Scottish Law Commissions on the Australian experience of insurance law reform' [2007] Law Commissions 8.6

<sup>905</sup> *NSW Leather Co Pty Ltd v Vanguard Insurance Co Ltd* (1990) 103 FLR 70, 88

<sup>906</sup> *Sutherland v Pratt* (1843) 11 M & W 296

sellers cannot prevent buyers from recovering from insurers.<sup>907</sup> This is consistent with the decision that the plaintiff pledgee who had contractual remedies against the pledger could also make a successful claim under the policy.<sup>908</sup>

### *3.3.1.3 Risk must attach before applying the “lost or not lost” clause*

As with the foregoing discussion, subject to the doctrine of indemnity, an assured can thus claim only where risk has attached and consequently has sustained loss. Under s 5(2) of the 1906 MIA, the assured must possess a legal or equitable relationship either to the insured property at risk of the assured or to the marine adventure itself. The clause is subject to this provision and can only operate in the foregoing two ways in which risk or policy has attached. It has thus been argued that the effect of the “lost or not lost” clause is not that an assured can recover the loss or damage before the policy attaches.<sup>909</sup> To wit, loss able to be recovered must occur at the time the insured subject has been exposed to the risk of loss by the perils insured against,<sup>910</sup> generally when goods are on board the carrying vessel.<sup>911</sup> The effect of the “lost or not lost” clause has extended the normal timing of insurable interest under a normal marine insurance policy, i.e. the assured may recover the loss of which they are not aware even though they can have an interest only after such loss.<sup>912</sup> Without the possibility of such acquisition of insurable interest, under contracts termed with the “lost or not lost” clause, the assured cannot recover.<sup>913</sup> Indeed, the “lost or not lost” clause is an exception to the principle that an assured

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<sup>907</sup> *NSW Leather Co Pty Ltd v Vanguard Insurance Co Ltd* (1991) 25 NSWLR 699, 711

<sup>908</sup> *Sutherland v Pratt* (1843) 11 M & W 296

<sup>909</sup> *Reinhs Co v Joshua Hoyle & Sons Ltd* [1961] 1 Lloyd's Rep 346 (AC) 358

<sup>910</sup> Jonathan Gilman, Professor Robert M Merkin, Claire Blanchard and Mark Templeman, *Arnould's Law of Marine Insurance* (18th Revised edn, Sweet & Maxwell 2013) 1-08

<sup>911</sup> *Reinhs Co v Joshua Hoyle & Sons Ltd* [1961] 1 Lloyd's Rep 346 (AC) 358

<sup>912</sup> *Sutherland v Pratt* (1843) 11 M & W 296; Proviso of 1906 MIA, s 6(1)

<sup>913</sup> *New South Wales Leather Co Pty Ltd v Vanguard Insurance Co Ltd* (1990) 274 LMLN 1

should have an interest at the time of loss.<sup>914</sup> Such extension and exception nevertheless cannot change the position that the clause can operate only after the risk or policy attaches.

In cases of deciding whether buyers can derive assistance from clauses of “lost or not lost” and “warehouse to warehouse”, the problem should first be addressed as to when the cover provided by policies is available or when risk specified in policies attaches. Under a sale of goods contract CFR termed with clauses of “lost or not lost” and “warehouse to warehouse”, buyers could not be permitted to recover country damage occurring prior to shipment from sellers unless they could not be indemnified by their insurers. Buyers then made a claim against sellers to reimburse the country damage. In the Queen’s Bench Division (Commercial Court), it was held that the assured buyers’ claim failed who had been covered by the policy because they may recover the loss occurring before they obtained an interest and because “lost or not lost” clause includes both partial loss and total loss.<sup>915</sup> In the Court of Appeal, the judgement agrees with Sellers LJ, obiter, by giving similar grounds.<sup>916</sup> Willmer LJ and Donovan LJ held, obiter, the opposite view as to the effect of insurance clauses that loss occurring before shipment had not been covered because a “lost or not lost” clause did not include loss occurring “before the period of risk specified in the policy has ever commenced”.<sup>917</sup> Although the four judges had the same view that the clause could operate in the manner of the proviso of s 6(1) of the

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<sup>914</sup> M Mustill and J Gilman, *Arnould’s Law of Marine Insurance and Average* (16th edn, vol I, Stevens & Sons London 1981) 25 and fn 89

<sup>915</sup> *Reinhs Co v Joshua Hoyle & Sons Ltd* [1960] 1 Lloyd’s Rep 483 (QB) 489

<sup>916</sup> *Reinhs Co v Joshua Hoyle & Sons Ltd* [1961] 1 Lloyd’s Rep 346 (AC) 355

<sup>917</sup> *Reinhs Co v Joshua Hoyle & Sons Ltd* [1961] 1 Lloyd’s Rep 346 (AC) 358 and 361

1906 MIA, opinions have divided into two parts concerning whether risk has attached.<sup>918</sup>

Again, before considering the problem as to the passing of property, the issue as to whether the risk has attached should be addressed first.<sup>919</sup> The judge would not contemplate the wider period of cover provided by the clause of “lost or not lost” and “warehouse to warehouse” if the risk was not borne by buyers and did not attach.<sup>920</sup> Upon the fact that the assured, the CFR buyers, could not succeed in proving the impossibility with respect to the loss incurred by the substitution of water for essential oil occurring prior to the shipment, the court held that the CFR buyers could not make a claim for they undertook no risk.<sup>921</sup> However, where risk had commenced from the sellers’ warehouse, i.e. “the warehouse to warehouse” clause had been invoked, loss that had occurred before shipment was held to be recoverable with the assistance of the “lost or not lost” clause.<sup>922</sup>

#### ***3.3.1.4 The “lost or not lost” clause of itself cannot improve a buyer’s position***

3.3.1.4.1 Cases where FOB or CFR buyers may benefit from the “lost or not lost” clause  
Consistent with two meanings of the clause, FOB or CFR buyers, not aware of loss, may call in aid the clause in the following two situations: where loss has occurred before the insurance contract is concluded but after the attachment of risk, or after such attachment where the assured can acquire an interest only after the loss and the interest consequently is indeed transferred to him.<sup>923</sup> For the latter, dispute may arise as to whether buyers can obtain an interest in the

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<sup>918</sup> *NSW Leather Co Pty Ltd v Vanguard Insurance Co Ltd* (1991) 25 NSWLR 699

<sup>919</sup> Susan Hodges, *Cases and Materials on Marine Insurance Law* (Cavendish London 1999) 55

<sup>920</sup> *Fuerst Day Lawson Ltd v Orion Insurance Co Ltd* [1980] 1 Lloyd’s Rep 656

<sup>921</sup> *Fuerst Day Lawson Ltd v Orion Insurance Co Ltd* [1980] 1 Lloyd’s Rep 656

<sup>922</sup> *NSW Leather Co Pty Ltd v Vanguard Insurance Co Ltd* (1991) 25 NSWLR 699

<sup>923</sup> Proviso of 1906 MIA, s 6(1); Michelle Taylor, ‘Is the Requirement of an Insurable Interest in the Marine Insurance Act Still Valid?’ (2000) 11 ILJ 147, 155

insured subject of lost goods occurring before shipment. It has been suggested that they can acquire the property in the pre-shipment lost goods, at the time and in the manner in which it would have passed had the containers not been lost.<sup>924</sup>

#### 3.3.1.4.2 The “lost or not lost” alone cannot assist FOB or CFR buyers to recover pre-shipment loss

However, the “lost or not lost” clause cannot advance the timing as to the attachment of risk. In terms of FOB or CFR buyers, who have paid against documents, risk passes to buyers at the time goods are loaded on board and so, even under the “lost or not lost” cover, they may not be permitted to recover the loss occurring before such a time, i.e. goods are at sellers’ risk, not at buyers’ risk, which means they have no interest at that time.<sup>925</sup> In such case, loss occurring before shipment is not within cover because policy or risk has not attached.

#### 3.3.1.4.3 Combination of “lost or not lost” and “warehouse to warehouse” clauses

In order to protect a buyer of goods on FOB or CFR terms against pre-shipment loss at an earlier point of time, the “warehouse to warehouse” clause is thus needed which prescribes that the insurer starts to be liable for loss from the inland place, warehouse or place of storage named in the policy, where the subject matter insured is first moved for the purpose of commencing transit.<sup>926</sup> Moreover, the “warehouse to warehouse” clause may serve to avoid “the difficult and often expensive investigation of where the damage claimed in fact occurred whether it fell within the ambit of a normal marine cover”.<sup>927</sup>

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<sup>924</sup> *NSW Leather Co Pty Ltd v Vanguard Insurance Co Ltd* (1991) 25 NSWLR 699

<sup>925</sup> John Dunt, *Marine Cargo Insurance* (1st edn, Informa Law 2009) 4.21

<sup>926</sup> ICC (A) 2009, clause 8.1

<sup>927</sup> *Reinhs Co v Joshua Hoyle & Sons Ltd* [1961] 1 Lloyd’s Rep 346 (AC) 353

It should be noted that the clause is not triggered where goods leave a place inland, rather than commencing transit, but for storage elsewhere or packing. Consequently, the insurance can commence at an earlier time when goods in effect leave the warehouse to initiate transit to the termination place specified in the policy.<sup>928</sup>

However, it is noteworthy that, although policies also include the “warehouse to warehouse” clause which intends to extend the cover period to risks occurring before goods are on board the moving vessel,<sup>929</sup> the clause does not necessarily mean that the insurer will be bound under the policy for the extended time goods are sent off from the factory,<sup>930</sup> nor for the limited time only goods are delivered at the warehouse in the shipping port.<sup>931</sup> The nature and area of the clause thus are not invariable: when to identify the extension of the clause, terms of every particular contract must be carefully construed.<sup>932</sup>

As the foregoing discussion shows, the “warehouse to warehouse” clause is also one tool to protect FOB or CFR buyers of goods against pre-shipment risks. However, despite its incorporation into a policy, an assured may still not be adequately protected without the assistance of the “lost or not lost” clause. Where the loss has occurred prior to loading onto the ship which means that the loss has occurred before the assured can acquire its insurable interest, even

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<sup>928</sup> Robert H Brown, *Dictionary of Marine Insurance Terms and Clauses* (5th edn, Witherby & Co Ltd 1989) T23

<sup>929</sup> *Wünsche Handelsgesellschaft International mbH v Tai Ping Insurance Co Ltd* [1998] 2 Lloyd's Rep 8, 11

<sup>930</sup> *Re Traders & General Insurance Association Ltd* [1924] 18 Lloyd's Rep 450, 451

<sup>931</sup> *Symington v Union Insurance Society of Canton Ltd* [1928] 31 Lloyd's Rep 179, 183

<sup>932</sup> *Wünsche Handelsgesellschaft International mbH v Tai Ping Insurance Co Ltd* [1998] 2 Lloyd's Rep 8, 11

though the policy has attached before that time by reference to the effect of the “warehouse to warehouse” clause, the assured may not be entitled to recover because he has no insurable interest before risk has passed to him which happens after goods have been loaded on board. However, the assured may be covered under a policy also with the “lost or not lost” clause which allows retrospective interest which renders it irrelevant that the assured had no insurable interest at the time of loss but has subsequently attained one.

Thus, the Court of Appeal held that the assured, as the CIF buyers who sued on the policy entered into by the insurer and the seller which had been assigned to the buyers, were entitled to recover with the incorporation of the two clauses.<sup>933</sup>

Furthermore, where policies contained both clauses of “lost or not lost” and “warehouse to warehouse”, the latter was nevertheless argued, obiter, by two judges not to be invocable, for the goods were never in the warehouse; it was submitted that buyers could not derive assistance from the former to recover the pre-shipment loss.<sup>934</sup> FOB or CFR buyers having paid against documents may thus recover pre-loading at least part of the loss of, or damage to, insured goods by incorporating those two clauses under the authority of *NSW Leather*.<sup>935</sup> In this case, *New South Wales Leather Co Pty Ltd v Vanguard Insurance Co Ltd*<sup>936</sup>, FOB buyers effected an open policy on goods containing “lost or not lost” and the “warehouse to warehouse” clause. Goods of leather were found missing after buyers collected the containers at the port of

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<sup>933</sup> *Symington v Union Insurance Society of Canton Ltd* [1928] 31 Lloyd’s Rep 179

<sup>934</sup> *Reinhs Co v Joshua Hoyle & Sons Ltd* [1961] 1 Lloyd’s Rep 346, 358 and 361

<sup>935</sup> ALRC 91, para 11.33; *Reinhs Co v Joshua Hoyle & Sons Ltd* [1961] 1 Lloyd’s Rep 346, 355

<sup>936</sup> *NSW Leather Co Pty Ltd v Vanguard Insurance Co Ltd* (1991) 25 NSWLR 699

destination. The court found that the leather goods had been missing before they were passed over the ship's rail because the seals were found to be intact on the containers. As to the pre-loading loss of goods, buyers suffered no loss because they bore no risk derived from the fact that they had no obligation to pay for such loss. However, they suffered a financial loss arising from paying for the goods stolen before loading, because risk had commenced at the beginning of the transit under the "warehouse to warehouse" clause. The court held that, such a financial loss was sufficient and the assured buyers, would be entitled to claim for recovery from the insurers because under the policies including the "lost or not lost" term, they acquired insurable interest after the loss.<sup>937</sup>

In short, without the combination of these two clauses, the "lost or not lost" term of itself cannot assist FOB or CFR buyers who have suffered loss occurring prior to loading because it only operates in ways of retrospective interest and retrospective declaration and not of moving up the time of transfer of risk, which is the function of a "warehouse to warehouse" clause.

#### 3.3.1.4.4 Insurers are reluctant to offer cover with "lost or not lost" clause and "warehouse to warehouse" clauses

As discussed above, neither the "lost or not lost" clause nor the "warehouse to warehouse" term can of itself protect FOB or CFR buyers having suffered pre-shipment loss in all situations.<sup>938</sup> What is even worse is that, in the insurance industry, it is difficult for FOB or CFR buyers to get cover containing the two clauses, although a "warehouse to warehouse" clause was incorporated into the transit clause of the Institute Cargo Clauses (All Risks) 1963 and has now

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<sup>937</sup> *NSW Leather Co Pty Ltd v Vanguard Insurance Co Ltd* (1991) 25 NSWLR 699

<sup>938</sup> ALRC 91, para 11.42

been clause 8 of both ICC 1982 and 2009.<sup>939</sup> The “lost or not lost” clause cannot assist them despite its having been termed into policies because the time of passing risk cannot be advanced. It is not only that the “warehouse to warehouse” policy is difficult to obtain: “the lost or not lost” clause has not been included in most standard insurance policies,<sup>940</sup> like the MAR Form of policy, and now the Market Reform Contract.<sup>941</sup> Clause 11 of the ICC 1982 and 2009 (A) has denied its function of retrospective interest and only accepted that of retrospective declaration. Nor is the “lost or not lost” clause stipulated in any sets of the Institute Hull Clauses in the modern context.<sup>942</sup> The “lost or not lost” clause was provided for in the SG Form,<sup>943</sup> i.e. both policies on ship and cargo include this clause, which was nonetheless replaced by the Lloyd’s MAR Policy Form. The latter has no “lost or not lost” clause any more.

### 3.3.1.5 Conclusion

It can thus be concluded that neither the “warehouse to warehouse” clause nor the “lost or not lost” clause can separately allow an insured as FOB or CFR buyers of goods to recover goods lost or damaged prior to being loaded on board the ship.<sup>944</sup> In light of FOB or CFR terms, the time and place at which risk passes to the purchaser are ascertained, namely, at the time of goods being loaded on board the ship.<sup>945</sup> The purchaser cannot have an insurable interest unless risk has passed to him from the seller. Although the combination of the

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<sup>939</sup> ICC (All Risks) 1963, s 1

<sup>940</sup> Michelle Taylor, ‘Is the Requirement of an Insurable Interest in the Marine Insurance Act Still Valid?’ (2000) 11 ILJ 147, 155

<sup>941</sup> John Dunt, *Marine Cargo Insurance* (1st edn, Informa Law 2009) 4.14

<sup>942</sup> Robert H Brown, *Dictionary of Marine Insurance Terms and Clauses* (5th edn, Witherby & Co Ltd 1989) L 45

<sup>943</sup> Howard Bennett, *The Law of Marine Insurance* (2nd edn, OUP Oxford 2006 ) 3.15

<sup>944</sup> Rhidian Thomas, *The Modern Law Of Marine Insurance: Volume 4* (1st edn, Informa Law from Routledge 2015) 12

<sup>945</sup> *NSW Leather Co Pty Ltd v Vanguard Insurance Co Ltd* (1991) 25 NSWLR 699, 705; Michelle Taylor, ‘Is the Requirement of an Insurable Interest in the Marine Insurance Act Still Valid?’ (2000) 11 ILJ 147, 155-56

above two clauses may assist the assured to recover pre-shipment loss, it does not necessarily mean that either of them can change the ascertained time and place. The former clause relates to extension of period of cover which normally attaches after goods have been loaded onto the ship.<sup>946</sup> An assured who has suffered a loss before shipment is not covered by a policy including just this clause because has not had an insurable interest during this period nor even acquired one after loss. The latter deals with the problem as to whether, after the loss has occurred, a policy can be retrospectively made and an insurable interest can be retrospectively attained where both parties to the policy have not realised the loss. As discussed, it can do so. It also does not change the position as to the timing of risk passing and is not applicable prior to the attachment of risk. Besides, even the combination of these two clauses cannot assist such a buyer if it does not subsequently acquire a real insurable interest in the cargo.<sup>947</sup>

### 3.3.2 Owners of goods on CIF, FOB or CFR terms

#### 3.3.2.1 Positions under CIF contracts

##### 3.3.2.1.1 Loss of or damage to goods sold CIF occurs before shipment

**The timing of the passing of risk.** In international sales of goods, the most important thing is to ascertain the time and place of transfer of risk from sellers to buyer, which is convenient to help both parties make clear their contractual obligations and which party should effect the insurance.<sup>948</sup> Under standard forms of FOB, CFR and CIF contracts, the last of which are most frequently used in international sales of goods, the timing of transfer of risk from seller to

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<sup>946</sup> Michelle Taylor, 'Is the Requirement of an Insurable Interest in the Marine Insurance Act Still Valid?' (2000) 11 ILJ 147, 155-56

<sup>947</sup> Rhidian Thomas, *The Modern Law Of Marine Insurance: Volume 4* (1st edn, Informa Law from Routledge 2015) 12

<sup>948</sup> *NSW Leather Co Pty Ltd v Vanguard Insurance Co Ltd* (1991) 25 NSWLR 699

buyer is very clear: when goods are on board vessel at the shipment port.<sup>949</sup> A buyer, on whose behalf an insurance contract has been effected by the seller, has property to goods as soon as they are dispatched from or on board the vessel at the port of shipment so goods are at his risk and he will bear the risk of loss from that time onward.<sup>950</sup> The timing of transfer of risk is different from that of the passing of property in goods by way of the buyer paying sellers against bills of lading that represent the property of goods.<sup>951</sup> However, it has been stated that buyers tend to contract on FOB or CFR terms for the benefits as to “control of premium costs, policy conditions and claims handling” and for developing the insurance industry in importers’ nations.<sup>952</sup>

**Problems may be encountered by buyers on CIF sales.** All buyers on the mentioned three terms may be in trouble when they attempt to recover financial loss as to lost goods having paid for them, other than with loss of goods occurring before shipment.<sup>953</sup> Under CIF contracts, it may be confusing to ascertain whether a purchaser can recover the loss of or damage to goods occurring prior to passing of risk, i.e. the purchaser neither takes the risk of loss nor has title to or possession of goods.<sup>954</sup> In particular, containerised goods<sup>955</sup> have been damaged before loading on board the carrying vessel, on which a clean bill of lading has been issued. The shipment by containerisation has the

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<sup>949</sup> Incoterms 2010, FOB, CFR and CIF

<sup>950</sup> *Fragano v Long* (1825) 4 B & C 219

<sup>951</sup> John Dunt, *Marine Cargo Insurance* (1st edn, Informa Law 2009) 4.13

<sup>952</sup> *ALRC 91*, para 11.51

<sup>953</sup> *ALRC 91*, para 11.52

<sup>954</sup> For details as to the problems with CIF buyers before shipment, see 3.3.1.1.4

<sup>955</sup> See below for detailed discussion as to *Containerisation*.

further inconvenience of the goods not being able to be inspected when they are passed over the ship's rail.<sup>956</sup>

**How to resolve such problems.** With the combination of the “lost or not lost” and “warehouse to warehouse” clauses, an assured may recover a pre-shipment loss.<sup>957</sup> Where policies incorporated the words “including from ex factory” and an express insurable interest clause which provided retrospective cover, it was held that CIF buyers to whom insurance policies had been assigned by sellers, were entitled to recover the damage which had occurred in inland transit during the period after the policies had attached but before they had been concluded and before any appropriation of the goods to any particular affreightment or insurance contracts.<sup>958</sup>

#### 3.3.2.1.2 Loss or damage under contracts on CIF terms occurs after shipment

Both sellers and buyers under contracts on CIF terms may encounter a difficulty in recovering a loss happening during the period after the transfer of risk and before the assignment of policy.<sup>959</sup> Besides the assistance by clauses of “lost or not lost” or clause 11 of the ICC 2009,<sup>960</sup> the above-mentioned problem may also be addressed by CIF buyers claiming as assureds in their own right, which can be achieved by these clauses having specifically been stipulated in policies,

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<sup>956</sup> The position of containerised goods under FOB contracts is the same: *New South Wales Leather Co Pty Ltd v Vanguard Insurance Co Ltd* (1990) 274 LMLN 1; see 3.3.2.3.1 for further problems with containerisation.

<sup>957</sup> For details as to how a CIF buyer can recover under two different periods before transfer of risk, see 3.3.1.1.4

<sup>958</sup> *Wünsche Handelsgesellschaft International mbH v Tai Ping Insurance Co Ltd* [1998] 2 Lloyd's Rep 8; *Niger Co Ltd v The Guardian Assurance Co Ltd* [1920] 4 Lloyd's Rep 292; That is to say, risks with regards to goods prior to shipment may be within the cover of insurance contract construed from its terms.

<sup>959</sup> See also 3.3.1.1.4

<sup>960</sup> For details as to the problems with CIF buyers and their relevant answers after shipment, see 3.3.1.1.4

for they have insurable interest because of the risk having been transferred to them. CIF buyers can be included in policies as assureds by means that policies have been taken out wide enough to describe them as assureds. This is what London market open covers frequently do when placing insurance and clause 15.1 of ICC 2009 provides for an insurance which can cover a person by or on whose behalf the policy has been made.<sup>961</sup> By this method to enlarge the ambit of “assureds”, CIF buyers can claim for loss or damage occurring during any period in transit as assignees and assureds.<sup>962</sup>

### *3.3.2.2 Whether CFR or FOB buyers have interest in pre-shipment loss*

#### 3.3.2.2.1 The predicament encountered by FOB or CFR buyers.

**Difficulty of recovering from insurers.** Under sales on CFR or FOB terms, risk of loss or damage passes from sellers to buyers after goods have been loaded on board the carrying vessel and it is buyers that take out contracts of insurance.<sup>963</sup> It has been established that FOB buyers have an insurable interest when goods are at their risk after goods are loaded on board.<sup>964</sup> Before shipment, during the transit from the sellers’ factory or warehouse to vessel, without provision of pre-shipment clauses in policies, it is sellers that are at risk<sup>965</sup> and in this period, should a loss occur, a buyer generally has no obligation to pay for the cargo.<sup>966</sup> As they are not liable to pay for goods, they are not at risk,<sup>967</sup> whereas they can definitely have an insurable interest in cargo due to their liability to the seller, i.e. they have to pay the price whether or not

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<sup>961</sup> Such enlargement of “assureds” is not mentioned in ICC (A) 1982

<sup>962</sup> Yang Liangyi, *Marine Cargo Insurance* (3rd edn, Law Press China 2013) 128

<sup>963</sup> Incoterms 2010, FOB & CFR

<sup>964</sup> *Stock v Inglis* (1884) 12 QBD 564; *Anderson v Morice* (1874–75) LR 10 CP 609; (1876) 1 App Cas 713

<sup>965</sup> Templeman Frederick and R J Lambeth, *Templeman on Marine Insurance : Its Principles and Practice* (6th ed, Pitman 1986) 74

<sup>966</sup> *NSW Leather Co Pty Ltd v Vanguard Insurance Co Ltd* (1991) 25 NSWLR 699, 389

<sup>967</sup> *NSW Leather Co Pty Ltd v Vanguard Insurance Co Ltd* (1991) 25 NSWLR 699, 387

the cargo will safely arrive.<sup>968</sup> Before transfer of risk and title to or possession of property, they thus possess no interest. However, it is not unusual to see that CFR or FOB buyers have paid for goods against documents prior to transfer of risk, which however is not necessarily the contractual obligation of buyers. Insurers thus may refuse to indemnify them by arguing that they have no insurable interest in the subject matter insured at the time of loss because they have borne no risk until the goods have been loaded on board. It is evident that they have sustained financial loss arising out of the payment for lost goods, they however cannot recover such loss under a valid policy due to failing to satisfy the requirement of insurable interest. Sellers are also not entitled to recover from the buyers' insurers, despite having an insurable interest, for they are not assureds under the policies effected by FOB or CFR buyers.

**Difficulty of recovering from sellers.** In theory, FOB or CFR buyers can recover the purchase price from sellers who bear such risk of loss but paid for by buyers in order to get shipping documents. They may be remedied by sellers relying on a contractual right of the contract of sale and sales of goods legislation, trade practices legislation and the tort of negligence (where the damage to the goods can be reasonably foreseeable by the seller).<sup>969</sup> It may nonetheless in practice be difficult for them to obtain contractual remedies. The reasons why they are only able to do this in theory not in practice are that, firstly, it is difficult and costly to conduct litigation in sellers' foreign jurisdictions; secondly, buyers may worry about sellers' financial viability. Besides, contracts of purchase and sales agreed by them prohibit buyers from recovering from

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<sup>968</sup> Professor John Birds, Ben Lynch and Simon Paul, *MacGillivray on Insurance Law* (13th edn, Sweet & Maxwell 2016) 1-059

<sup>969</sup> *ALRC 91*, para 11.62

sellers before they have exhausted all means of recovery from their insurers<sup>970</sup>. On this basis, the court held that buyers could not obtain contractual remedies from sellers because of contractual terms.<sup>971</sup> The dilemma is set out as a misfortune that FOB or CFR buyers have to bear.<sup>972</sup>

#### 3.3.2.2.2 How to get recovery from insurers<sup>973</sup>

**Insure the right subject matter.** As a result of the above-mentioned predicament, FOB or CFR buyers' position are not well protected. It has been submitted that, in order to entitle buyers to claim for loss occurring prior to the shipment, buyers are well advised to take out policies on "anticipated profits of goods" or "in the nature of a guarantee of the seller's obligation to deliver".<sup>974</sup> The submission is on the basis that the policy on profits can also cover the loss of the cargo. Also, an assured is interested in the advance on security deriving from his liability, i.e. having to pay the price and thus being at risk of losing the prepayment in good faith for containerised cargo lost before the shipment.<sup>975</sup>

**Usage of the pre-shipment clauses.** Besides the statutory "lost or not lost" clause and the "warehouse to warehouse" clause under ICC 2009<sup>976</sup>, buyers may also be entitled to recover from insurers for loss or damage prior to shipment according to other wide cover clauses of pre-shipment.<sup>977</sup> Two examples of such clauses can illustrate this point of view. The first kind of

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<sup>970</sup> *Reinhs Co v Joshua Hoyle & Sons Ltd* [1961] 1 Lloyd's Rep 346; Michelle Taylor, 'Is the Requirement of an Insurable Interest in the Marine Insurance Act Still Valid?' (2000) 11 ILJ 147, 161-66; cited by *ALRC 91*, para 11.64

<sup>971</sup> *Reinhs Co v Joshua Hoyle & Sons Ltd* [1961] 1 Lloyd's Rep 346

<sup>972</sup> *New South Wales Leather Co Pty Ltd v Vanguard Insurance Co Ltd* (1990) 274 LMLN 1

<sup>973</sup> For the protection provided by the "lost or not lost" cover, see 3.3.1.4

<sup>974</sup> Susan Hodges, *Cases and Materials on Marine Insurance Law* (Cavendish London 1999) 58

<sup>975</sup> *NSW Leather Co Pty Ltd v Vanguard Insurance Co Ltd* (1991) 25 NSWLR 699

<sup>976</sup> John Dunt, *Marine Cargo Insurance* (1st edn, Informa Law 2009) 4.21; see also 3.3.1.4.3, which sets out how the combination of clauses of "lost or not lost" and "warehouse to warehouse" protects the assured.

<sup>977</sup> *ALRC 91*, para 11.44

clause, similar to the “warehouse to warehouse” clause, is devised to bring forward the point in time at which buyers are at risk under sale contracts. In general, the buyers can have an interest, according to the sale contracts, only after the shipment. With this advance of timing, they can bear risk at the beginning of transit prior to acquiring an insurable interest by shipment.<sup>978</sup> The second kind of clause will deem any loss found at the port of unloading as having occurred during the transit within the cover. It may therefore be convenient for buyers to recover from insurers for they do not need to prove the time of loss.<sup>979</sup> With these pre-shipment clauses, it may not be necessary to address the complex and difficult problem as to when the loss has occurred or whether FOB or CFR buyers have an insurable interest at the time of loss.

**Appropriate price terms agreed.** When buying containerised goods, FOB buyers may overcome the disadvantageous position caused by the requirement of insurable interest by virtue of an FCA term.<sup>980</sup> By this term the risk to be borne by buyers can start at an early point of time at which the risk passes to them when goods are first loaded into containers, which is certainly prior to the point in time of loading on board the vessel.<sup>981</sup> However, inconvenience may be brought to both parties to the contract of sale attributable to the continuing use of FOB terms, regardless of the fact that goods will be loaded into containers first not on board ship, where the FCA term should be applied. As with the inappropriate inserting terms of FOB, buyers cannot claim for loss occurring before shipment while sellers will take additional risk during the period after the

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<sup>978</sup> ALRC 91, para 11.44

<sup>979</sup> ALRC 91, para 11.44

<sup>980</sup> ALRC 91, para 11.54

<sup>981</sup> Incoterms 2010, FCA; “Free Carrier” means that the seller delivers the goods to the carrier or another person nominated by the buyer at the seller’s premises or another named place. The parties are well advised to specify as clearly as possible the point within the named place of delivery, as the risk passes to the buyer at that point.

container's reception of goods and before loading.<sup>982</sup> It may also be difficult for them to contract on terms that they fully inspect the cargo first before payment. It is impractical to inspect containerised goods during the period after the sealing of goods into the container and before they are loaded.<sup>983</sup> The case is the same for the period after shipment and before delivery at the port of unloading due to the common practice of inserting "cash against documents". Before paying cash to attain their documents of title, buyers have no right to inspect cargoes.

**Difficulty as to the application of pre-shipment clauses.** In order to recover the loss occurring before shipment at the time FOB or CFR buyers have no interest, pre-shipment clauses have been provided by the market. It has nonetheless been contended that there are problems with these pre-shipment clauses, at least in the Australian market: "when cover first attaches and the extent of the obligation on the insured to use all reasonable means to first recover from the exporter or supplier".<sup>984</sup> It has also been argued that there is no legal basis, neither by statute nor under common law, for the existence of pre-shipment clauses.<sup>985</sup> What is worse, commercial practice of such clauses is contrary to the requirement of insurable interest of the 1906 MIA, which renders void policies with no interest.<sup>986</sup> Under the statute, such policies termed pre-loading clauses, not including the "lost or not lost" clause, required to acquire retrospective interest, should be void because buyers have no interest before shipment. In cases in Scotland, policies having no interest which have

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<sup>982</sup> *Incoterms 2000*, FOB; cited by *ALRC 91*, para 11.54

<sup>983</sup> Michelle Taylor, 'Is the Requirement of an Insurable Interest in the Marine Insurance Act Still Valid?' (2000) 11 ILJ 147, 159–60; cited by *ALRC 91*, para 11.56

<sup>984</sup> Michelle Taylor, 'Is the Requirement of an Insurable Interest in the Marine Insurance Act Still Valid?' (2000) 11 ILJ 147, 156–57; cited by *ALRC 91*, para 11.46-47

<sup>985</sup> *ALRC 91*, para 11.47

<sup>986</sup> 1906 MIA, s 4; *ALRC 91*, para 11.46

nevertheless been honoured by insurers are held enforceable.<sup>987</sup> The Law Commission has expressed its concern about this inconsistency between the practice and the statute: “It leads to uncertainty, and may bring the law into disrepute if it is seen to be flouted.”<sup>988</sup>

**The existence of a contract of sale being sufficient proof of insurable interest.** It has been submitted that if there is a contract of purchase and sale, an assured buyer may be deemed as having been at risk and thus has an insurable interest in goods.<sup>989</sup> This opinion is based on the nature of insurable interest as a continually expanding concept and on the wide approach adopted by English courts.

#### 3.3.2.2.3 How to protect FOB or CFR sellers’ interest in the adventure

Under sales of goods on FOB or CFR terms, after goods have been loaded on carrying vessels, sellers may have lost both the property in the goods and the position of being at risk to the goods. However, since they can have an interest in the adventure by the modern broader construction of insurable interest,<sup>990</sup> they may thus conclude a contract of insurance against contingencies that the goods have been lost or damaged and buyers fail to pay.<sup>991</sup> For example, under the London market open cover which normally includes a Seller’s Interest Clause, sellers can do this.<sup>992</sup>

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<sup>987</sup> *Haddon v Bryden* (1899) 1F 710; cited by 2011 CP, para 10.5

<sup>988</sup> 2011 CP, paras 10.5, 13.68

<sup>989</sup> Susan Hodges, *Cases and Materials on Marine Insurance Law* (Cavendish London 1999) 55

<sup>990</sup> *Wilson v Jones* (1867) LR 2 Ex 139; *O’Kane v Jones, The Martin P* [2005] Lloyd’s Rep IR 174; The 1906 MIA, s 7(2)

<sup>991</sup> ALRC 91, para 11.63

<sup>992</sup> John Dunt, *Marine Cargo Insurance* (1st edn, Informa Law 2009) 4.22

### 3.3.2.3 Containerisation

#### 3.3.2.3.1 Difficulty caused by containerisation as to timing of having an interest<sup>993</sup>

With the new development of containerisation, the previous law as to individually packed goods cannot adapt to the commercial practice so far as the timing of transfer of risk is concerned. Unlike with the case of bulk cargo being shipped in a loose condition where buyers will be protected by transporters refusing to issue a clean bill of lading as to goods damaged inland, buyers of containerised goods may only find out the loss or damage at the port of destination.<sup>994</sup> In the insurance industry, it is not common practice to adequately inspect goods which have been sealed into containers before loading because “the goods often pass through numerous transit entities prior to shipment”.<sup>995</sup> As a result, the insurer may contend that the buyer has no insurable interest in insured goods during the inland transportation prior to taking the risk. In other words, confusion and dispute may occur because, due to this incapacity for inspection, it will be unclear when and where loss of, or damage to goods has happened, which will determine whether an assured can recover by comparing the timing of loss with that of transfer of risk.<sup>996</sup>

#### 3.3.2.3.2 Whether buyers attain insurable interest when cargo loaded into containers

Containerisation, which has been widely used in international trade, has thus caused complex problems as to insurable interest. The confusion may be resolved by deeming the timing of transfer of risk as when goods have been first loaded into a container, just like their having been shipped on board. There is

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<sup>993</sup> For further discussion on problems caused by containerisation, see 3.3.2.1.1

<sup>994</sup> Yang Liangyi, *Marine Cargo Insurance* (3rd edn, Law Press China 2013) 126-127; The position of containerised goods under FOB contracts is the same: *New South Wales Leather Co Pty Ltd v Vanguard Insurance Co Ltd* (1990) 274 LMLN 1

<sup>995</sup> Michelle Taylor, ‘Is the Requirement of an Insurable Interest in the Marine Insurance Act Still Valid?’ (2000) 11 ILJ 147, 159–60; cited by *ALRC 91*, para 11.56

<sup>996</sup> *Fuerst Day Lawson Ltd v Orion Insurance Co Ltd* [1980] 1 Lloyd’s Rep 656; *NSW Leather Co Pty Ltd v Vanguard Insurance Co Ltd* (1991) 25 NSWLR 699; *Wünsche Handelsgesellschaft International mbH v Tai Ping Insurance Co Ltd* [1998] 2 Lloyd’s Rep 8

no such law ruling as to whether risk can pass to buyers at the point in time goods are loaded into containers before being loaded on board the vessel.<sup>997</sup> Kirby P raised this issue but reserved his opinion as to whether buyers purchasing containerised goods have an insurable interest in the goods, never mind the profits derivable from goods, once they were first placed in the sealed containers.<sup>998</sup> It has been however submitted by the judge that there should be a legal ruling as a response to the new technological and commercial development concerning containerisation.<sup>999</sup> The ground for the submission is that containers, in certain contexts, could be functionally deemed as part of a vessel,<sup>1000</sup> as held by the United States Supreme Court that “the container is a modern substitute for the hold of the vessel”.<sup>1001</sup>

Nonetheless, without international acceptance, containerisation as a way of international shipping may not change the timing of transfer of risk. Although there is an FCA term, buyers are inclined to insert FOB terms into contracts of international sale of goods. It may be inferred from this fact that FCA terms have not obtained widespread international acceptance, which is necessary for the wide use of terms. Consequently, in practice, risk would not be deemed as being transferred to buyers when goods are first loaded into containers.

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<sup>997</sup> *NSW Leather Co Pty Ltd v Vanguard Insurance Co Ltd* (1991) 25 NSWLR 699 (Kirby P J)

<sup>998</sup> *NSW Leather Co Pty Ltd v Vanguard Insurance Co Ltd* (1991) 25 NSWLR 699 (Kirby P J)

<sup>999</sup> *NSW Leather Co Pty Ltd v Vanguard Insurance Co Ltd* (1991) 25 NSWLR 699 (Kirby P J)

<sup>1000</sup> ALRC 91, para 11.58

<sup>1001</sup> *Northeast Marine Terminal Co Inc v Caputo* 432 US 249, 270 (1977); cited by *NSW Leather Co Pty Ltd v Vanguard Insurance Co Ltd* (1991) 25 NSWLR 699 (Kirby P J)

### 3.3.3 Various insurable interests

#### 3.3.3.1 Users of the property having a legal right

The issue as to whether a user of property has an insurable interest in it needs to be looked at. In a case concerned with a hull policy, *The Moonacre* has somewhat expanded the definition of insurable interest,<sup>1002</sup> despite objections that it is a reflection of the narrow test.<sup>1003</sup> According to this case, the question was considered as to what relationship can amount to an insurable interest when a person uses the insured subject matter by powers of attorney, in consequence of which he may benefit from preservation or be prejudiced by the loss. In this case, also, the requirement of insurable interest is not construed according to the strict test of legal or equitable title to property but as the test that a manager in possession of yacht who has enjoyed a pecuniary interest can also have an interest in the vessel. The case is an authority for saying that a pure duty of taking care is sufficient. Thus, the case has not applied the proprietary interest test. In short, although the case has expanded the concept of insurable interest, he still has to use the terms of “legal relation” depending on existing rights which seemingly reflects Lord Eldon’s strict test. However, the terms above used in this case are so wide that the insurable interest based on powers of attorney and duty has actually reflected the broader test and they cannot be regarded as having represented the strict test.

The case of *Sharp v Sphere Drake Insurance Co*<sup>1004</sup> was concerned with the constructive total loss of a yacht, *The Moonacre*, caused by fire in the context of a hull insurance policy. Mr. Sharp bought a yacht, but the registered owner of

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<sup>1002</sup> 2011 CP, para 11.59

<sup>1003</sup> *Feasey v Sun Life Assurance Co* [2003] 2 All ER 587 [97] (Ward LJ); also see 3.3.3.2.3, below

<sup>1004</sup> *Sharp v Sphere Drake Insurance Co (The Moonacre)* (1992) 2 Lloyd’s Rep 501

this ship was an off-the-shelf company for tax-efficiency reasons. Later, he insured the ship in his name through a broker. After the fire, Mr. Sharp claimed against his insurers for the loss, but the claim was rejected by the insurers on several grounds, one of which was that Mr. Sharp had no insurable interest in the vessel.

It was held that he had an insurable interest in the vessel by analysing three sources of insurable interest, each of which could entitle Mr. Sharp to an insurable interest in the yacht. Firstly, because with two powers of attorney conferred by the registered company he had a legal relation regarding enjoyment of exclusive use of the boat for his own purposes. Such powers were a valuable benefit and thus were sufficient to give him an insurable interest in the assured.<sup>1005</sup> Secondly, of course, under such powers, the yacht is actually in possession of Mr. Sharp as the bailee of it. Despite being examined by the strict test, such a bailee was entitled to have an insurable interest in light of the fact that it is not a mere bailment, but the user had pecuniary rights in the yacht, that was, the exclusive use of it.<sup>1006</sup> Thirdly, he took responsibility for the registered company to exercise reasonable care over the management and navigation of the boat on the occurrence of loss of the vessel.<sup>1007</sup>

His claim failed for other reasons, but the comment on insurable interest was the settled law. Therefore, an user who merely has a duty of exercising reasonable care, founding on an existing right, may have an insurable interest.

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<sup>1005</sup> As regards two powers of attorney, also see Group 4 in 2.3.2.3; *Sharp v Sphere Drake Insurance Co (The Moonacre)* (1992) 2 Lloyd's Rep 501, 512

<sup>1006</sup> *Sharp v Sphere Drake Insurance Co (The Moonacre)* (1992) 2 Lloyd's Rep 501, 513

<sup>1007</sup> *Sharp v Sphere Drake Insurance Co (The Moonacre)* (1992) 2 Lloyd's Rep 501, 513

### 3.3.3.2 Shareholders

#### 3.3.3.2.1 The strict approach to shareholders

In *Macaura v Northern Assurance Co Ltd*,<sup>1008</sup> Mr. Macaura was the sole shareholder in an estate company, which was formed by himself; he sold a quantity of timber estate to the company in the forms of shares in the company which made him the company's sole shareholder and its creditor. Later he took out a policy of insurance on the timber against fire in his own name with an insurer. The timber was soon destroyed by a fire. Mr. Macaura sought to make a claim under the policy; nevertheless, the insurer declined to indemnify him, averring that he had no insurable interest in the timber, which was the property of the company.

This authority following that of *Lucena* by the House of Lords sets out the strict test. Both the Court of Appeal and the House of Lords held that Mr. Macaura, as either the sole shareholder or simple creditor, had no insurable interest in the timber, because he stood in no legal or equitable relation to the timber owned by the company at all despite the fact that he had been materially adversely affected by the fire. Three kinds of interest have been explored, but not one is sufficient. In the first place, as a shareholder, he could not establish an insurable interest in the timber which was the property of the company based on the principle that a company was an independent entity. He had, therefore, no legal or equitable interest in the company's property or a right under a contract. As a shareholder, he had an insurable interest in profits from his shareholding and he could have rightly taken out an insurance contract on profits. However, he failed to do so. Secondly, as far as the position of creditor was concerned, a creditor could have insurable interest in property of his debtor only where he

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<sup>1008</sup> *Macaura v Northern Assurance Co Ltd* [1925] AC 619

had a claim on the property mortgaged or pledged to him for advances<sup>1009</sup> while a simple creditor had no interest.<sup>1010</sup> Although he had a pecuniary interest in the company, such a claim could still not be supported by a court, because if it were, it would follow that any creditor would be at liberty to insure the furniture of his debtor; but no such claim had ever been recognised.<sup>1011</sup> Thirdly, this case also shows that a person having mere possession of a property does not necessarily enable him to have an insurable interest in the property. The timber in issue was still on the estate of Mr. Macaura on the occurrence of fire. Thus, in order to defeat a mere bailment, the bailee must have beneficial rights or a duty to goods bailed to him.<sup>1012</sup>

#### 3.3.3.2.2 Shareholders may insure its company's adventure<sup>1013</sup>

By contrast, in *Wilson v Jones*,<sup>1014</sup> the court relaxed the concept of insurable interest and found an insurable interest in favour of the assured, as a shareholder of the company, by identifying the subject of insurance as the marine adventure not the cable. The different outcomes are due to different conditions stipulated in the policies and to a careful reading of the policies. Thus, in order to correctly ascertain the subject matter, the terms of the policies must be carefully examined.<sup>1015</sup> Besides, this case has approved that a shareholder's interest may well be insured by an insurance on profits rather than the property of its company from which profits derive.

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<sup>1009</sup> Jonathan Gilman, Professor Robert M Merkin, Claire Blanchard and Mark Templeman, *Arnould's Law of Marine Insurance* (18th Revised edn, Sweet & Maxwell 2013) 11-37

<sup>1010</sup> *Macaura v Northern Assurance Co Ltd* [1925] AC 619 (HL) 628

<sup>1011</sup> *Moran Galloway & Co v Uzielli* [1905] 2 KB 555 approved, *Godsall v Boldero* (1807) 9 East 72 considered.

<sup>1012</sup> *Macaura v Northern Assurance Co Ltd* [1925] AC 619 (HL) 628

<sup>1013</sup> See the first step to identify the insured subject in 3.3.3.6.2 and hotchpot interests owned by shareholders in 2.6.4

<sup>1014</sup> *Wilson v Jones* (1867) LR 2 Ex 139

<sup>1015</sup> *Feasey v Sun Life Assurance Co* [2003] Lloyd's Rep IR 637 [92]

### 3.3.3.2.3 Property of a company may be insured by a natural person

In light of *The Moonacre*, a shareholder may even have an insurable interest in his company's asset merely because of a duty or economic interest.<sup>1016</sup> There are some similarities between *The Moonacre* and *Macaura* that the insured subject is the property of their companies not belonging to themselves. The loss to a shareholder is not due to his relation to the insured property but derived from his relation to the company.

Even though it is argued that the decision of *The Moonacre* has been seemingly based on that of *Macaura* because the former sticks to the terms of "legal relation" to the insured yacht,<sup>1017</sup> it may not be the case. The former case tries to relax the definition of insurable interest by recognising that a proprietary interest is not necessarily required in insurance on property while a shareholder having economic benefits is entitled to recover. By contrast, the latter has put a limitation on that concept by holding that the shareholder has no insurable interest in timber unless he has a proprietary interest in the company's property.

Furthermore, as to the specific explanation of the nature of insurable interest, Anthony Colman QC has distinguished that in *The Moonacre*, averring that the relationship of Mr. Sharp to the vessel and of Mr. Macaura to the timber are different, because Mr. Sharp has beneficial rights and duties to the vessel in consequence of which he may stand to benefit by the safety of the vessel, and be prejudiced by damage thereto, whereas Mr. Macaura has no legal or equitable relation to the company's asset. Thus, the existence of and different

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<sup>1016</sup> See 3.3.3.1 for facts and judgement of this case; Professor Robert M Merkin, *Colinvaux and Merkin's Insurance Contract Law* (vol 1, Sweet & Maxwell 2017) A-0397

<sup>1017</sup> *Feasey v Sun Life Assurance Co* [2003] Lloyd's Rep IR 637 [184] (Ward LJ)

construction of terms of contracts between a shareholder and a company and approaches adopted by the courts will lead to totally distinct outcomes as to whether the assured has an insurable interest.

#### 3.3.3.2.4 Conclusion

A commentator observed that *Macaura* still “continues as the law in the United Kingdom”,<sup>1018</sup> despite the tendency towards the wide explanation of insurable interest. It is approved by English law that a shareholder is not entitled to have an insurable interest in assets of its company and thus cannot insure. Although it is submitted that the rule by *Macaura* should be applied there, the question whether a person has an insurable interest needs to be addressed, because although it is a decision of the House of Lords,<sup>1019</sup> later cases either do not refer to *Macaura* or are not following it after making reference to it,<sup>1020</sup> nor do authorities in other jurisdictions.<sup>1021</sup>

Even in the context of shareholder cases, subsequent courts have inclined to confer a broader insurable interest on the shareholder. Four methods have been adopted. First, because he can have an insurable interest in profits deriving from his company’s property, the court can hold that he has such an interest on conditions of policy by construing the subject insured as the adventure of the company rather than its property. Secondly, even though the House of Lords has held that a shareholder has no proprietary interest in the company’s property, again, an economic interest or a duty with an existing right

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<sup>1018</sup> *Constitution Insurance Co v Kosmopoulos* (1987) 34 DLR (4th) 208

<sup>1019</sup> *Feasey v Sun Life Assurance Co* [2003] Lloyd’s Rep IR 637 [181] (per Ward LJ)

<sup>1020</sup> No reference to: *Petrofina (UK) Ltd v Magnaload Ltd* [1984] QB 127; *Stone Vickers Ltd v Appledore Ferguson Shipbuilders Ltd* [1991] 2 Lloyd’s Rep 288; Referred to but no following: *National Oilwell (UK) Ltd v Davy Offshore Ltd* [1993] 2 Lloyd’s Rep 582

<sup>1021</sup> *Constitution Insurance Co v Kosmopoulos* (1987) 34 DLR (4th) 208

is sufficient to constitute an insurable interest. Thirdly, where a shareholder is in possession of the company's property and has a vested beneficial right to it, his pecuniary loss can be protected. Last but not least, a creditor can have an insurable interest if he has a lien or security on the company's property.

### **3.3.3.3 Bailees**

#### **3.3.3.3.1 The subject a bailee can insure**

Interest in bailment is one of the earliest extensions of the concept of insurable interest. A bailee, who is in charge of the custody or care of the property of insurance, may insure either its liability for his risks as to the loss of or damage to the property incurred by sea perils insured against or insure directly on the property, the subject matter of insurance. In order to determine which type of insurance has been taken out by a bailee, terms of insurance contracts should be referred to. Thus the fact that a bailee, being responsible for property in bailment, commonly effects a liability insurance does not necessarily mean that he cannot take out an insurance on the property.<sup>1022</sup>

The leading case is *Hepburn v A Tomlinson (Hauliers) Ltd*<sup>1023</sup> in which the assured as carriers, Tomlinson, had the policy. It then made a claim for the owner of the cigarettes lost by theft in transit. The insurer rejected it arguing that the carriers had no liability because the theft had not occurred through its negligence but by the owner's negligence. Roskill J held, which was approved by the Court of Appeal and the House of Lords, that the "all risks" insurance policy at issue should be construed as insurance on goods rather than merely

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<sup>1022</sup> *Feasey v Sun Life Assurance Co* [2003] 2 All ER 587 [120]

<sup>1023</sup> *Hepburn v A Tomlinson (Hauliers) Ltd* [1966] AC 451 (AC) 467

on liability. Thus, the bailees had an insurable interest in goods and could claim as trustees of owners though they had suffered no loss.

#### 3.3.3.3.2 The amount a bailee can recover

As to the amount a bailee, or others who have an analogous position to it, like a mortgagee or sub-contractor,<sup>1024</sup> on the occurrence of loss, a bailee can recover to the extent of the whole value of the property, not limited to the amount for which it should be responsible, even though the loss or damage is not occasioned by its actionable fault.<sup>1025</sup> If a bailee had suffered no loss or the amount he had recovered exceeded what he should be responsible for, then he would be regarded as the trustee of the owner of the property who had suffered a loss and the rest should be paid by the bailee to the owner.<sup>1026</sup>

#### 3.3.3.3.3 Mere possession

By contrast, a mere bailment cannot confer on a bailee an insurable interest. In both cases of *The Moonacre* and *Macaura*, the assured was thought to be a bailee of the insured subject. However, the result as to ability of recovery is different. In *Macaura*, the claim was not upheld by the court on the ground that he could not insure as a bailee of the timber because he took no liability or duty for the safe custody of the timber; he had merely permitted their remaining upon his land.<sup>1027</sup> In *The Moonacre*, Mr. Sharp was nevertheless entitled to have an insurable interest based on bailment because he had enjoyed beneficial rights to the insured yacht.<sup>1028</sup>

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<sup>1024</sup> *Hepburn v A Tomlinson (Hauliers) Ltd* [1966] AC 451 (AC) 481; *Petrofina (UK) Ltd v Magnaload Ltd* [1984] QB 127 (QB) 136

<sup>1025</sup> *Waters v Monarch Fire & Life Assurance Co* (1856) 5 E & B 870, 880-881

<sup>1026</sup> *O'Kane v Jones, The Martin P* [2005] Lloyd's Rep IR 174, [154]

<sup>1027</sup> *Macaura v Northern Assurance Co Ltd* [1925] AC 619

<sup>1028</sup> *Sharp v Sphere Drake Insurance Co (The Moonacre)* (1992) 2 Lloyd's Rep 501

#### 3.3.3.3.4 Reason for the wide construction

Lord Campbell CJ points out that a bailee can insure “without orders from the owner, and even without informing him that there was such a policy.”<sup>1029</sup> In commercial practice, bailees usually insure the subject matter under their custody, at their own expense, and keep a floating policy for its potential customers. In a line of authorities, the court has in the latter case adopted a broader version of the test with regard to bailees,<sup>1030</sup> i.e. they may take out a policy on the owner’s interest besides their own.<sup>1031</sup> Furthermore, the broad approach to bailees’ insurable interest is in effect contrary to, or at least an anomaly of, the fundamental doctrine of indemnity because a bailee has either suffered no loss or recovered more than the amount of his own interest.<sup>1032</sup>

There are four grounds for the principle that a bailee can insure and recover in excess of his own interest up to the full value of the subject matter insured.<sup>1033</sup> Of course, there must have been an existing contract of bailment. In the first place, historically, the possessory interest of a bailee is such that he can recover the full value of property bailed to him in trover. Due to such possession, he is interested in the whole property bailed. Secondly, such an insurable interest is derived from his responsibility, not necessarily the legal liability, for property bailed. Then, commercial convenience justified a bailee’s right to

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<sup>1029</sup> *Waters v Monarch Fire & Life Assurance Co* (1856) 5 E & B 870, 880-881

<sup>1030</sup> *Hepburn v A Tomlinson (Hauliers) Ltd* [1966] AC 451; [1966] 1 Lloyd’s Rep 309, 314; *Sharp v Sphere Drake Insurance Co (The Moonacre)* (1992) 2 Lloyd’s Rep 501; *Ramco (UK) Ltd v International Insurance Co of Hannover Ltd* [2004] Lloyd’s Rep IR 606

<sup>1031</sup> Nicholas Legh-Jones, Professor John Birds and David Owen, *MacGillivray on Insurance Law* (10th edn, Sweet & Maxwell 2003) 23-8

<sup>1032</sup> *Ramco (UK) Ltd v International Insurance Co of Hannover Ltd* [2004] Lloyd’s Rep IR 606 [32]

<sup>1033</sup> *Petrofina (UK) Ltd v Magnaload Ltd* [1984] QB 127 (QB) 135

insure up to the full value of the insured subject.<sup>1034</sup> Furthermore, such practice has not been banned under British law.

### **3.3.3.4 Pervasive insurable interest**

#### **3.3.3.4.1 Parties who can have a pervasive interest**

**A sub-contractor can have a pervasive interest.** In modern context, it is of high importance to determine whether a sub-contractor who is involved in a construction project has an interest in the whole contract works. In the entire contract works, like contracts of building or engineering, it is the usual practice that a single policy is required to be effected by the head contractor to cover site owners, all contractors and sub-contractors in connection with the entire risk to the whole contract site.<sup>1035</sup> Those parties having a pervasive interest should have the quality that “all the parties, with their joint efforts, have one common goal, e.g. the completion of the construction”.<sup>1036</sup> It has been settled that a sub-contractor can have a pervasive insurable interest in the entire property, including that of others on site, not limited to his own property or for which he is responsible.<sup>1037</sup>

A sub-contractor can thus insure and recover the entire works insured. As for the amount he can recover, the position is the same as others having a limited

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<sup>1034</sup> *Petrofina (UK) Ltd v Magnaload Ltd* [1984] QB 127 (QB) 136 cited *Waters v Monarch Fire & Life Assurance Co* (1856) 5 E & B 870, 880; *Hepburn v A Tomlinson (Hauliers) Ltd* [1966] AC 451 (AC) 481

<sup>1035</sup> *Petrofina (UK) Ltd v Magnaload Ltd* [1984] QB 127 (QB) 136; 2011 CP, para 11.60

<sup>1036</sup> *Commonwealth Construction Co Ltd v Imperial Oil Ltd* (1977) 69 DLR (3d) 558, 560; cited by *Petrofina (UK) Ltd v Magnaload Ltd* [1984] QB 127

<sup>1037</sup> *Petrofina (UK) Ltd v Magnaload Ltd* [1984] QB 127; *Mark Rowlands Ltd v Berni Inns Ltd* [1986] 1 QB 211; *Deepak Fertilisers & Petrochemicals Ltd v Davy McKee (London) Ltd* [1999] 1 All ER (Comm) 69; *Stone Vickers Ltd v Appledore Ferguson Shipbuilders Ltd* [1991] 2 Lloyd's Rep 288; *National Oilwell (UK) Ltd v Davy Offshore Ltd* [1993] 2 Lloyd's Rep 582; *Hopewell Project Management Ltd v Ewbank Preece Ltd* [1998] 1 Lloyd's Rep 448; *Co-operative Retail Services Ltd v Taylor Young Partnership Ltd* [2000] 2 All ER (Comm) 865; [2002] UKHL 17, [2002] 1 All ER (Comm) 918, [2002] 1 WLR 1419

interest, such as a bailee or a mortgagee.<sup>1038</sup> Thus a co-assured sub-contractor can insure the entire contract works in addition to its own property which is supplied to constitute a part of the works being performed, and recover up to the full value of the entire subject in its own name on the occurrence of loss by the perils insured against, holding the surplus on trust for other interested parties.

**Nature of interest insured.** In terms of what the nature of sub-contractors' interest is, i.e. an interest in their liability only for the part which they are responsible for or, in the case of the entire construction works, based on the liability that they may negligently damage property belonging to other persons interested having its source from their contracts, the court will rely on terms of the policy to determine the nature of the interest insured.<sup>1039</sup> Thus, should a policy comprise terms of "all risks of loss or damage to the insured property", the subject matter of insurance will be construed as on property rather than on liability.<sup>1040</sup> Although liability can be covered by an insurance on it, by way of correctly formulating a policy, there is no rule to prevent a person, including a sub-contractor, from insuring such liability by a cover on property.<sup>1041</sup>

**Illustration.** Due to the lack of English authority, an important decision as regards a non-marine subject from the Supreme Court of Canada consisting of the Chief Justice and eight judges, was cited.<sup>1042</sup> The issue was so difficult to

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<sup>1038</sup> Regarding the amount a bailee can recover, see 3.3.3.3.2; *Petrofina (UK) Ltd v Magnaload Ltd* [1984] QB 127 (QB) 136

<sup>1039</sup> *Petrofina (UK) Ltd v Magnaload Ltd* [1984] QB 127 (QB) 134-135; *Feasey v Sun Life Assurance Co* [2003] 2 All ER 587 [95]-[96] (Waller LJ)

<sup>1040</sup> *Petrofina (UK) Ltd v Magnaload Ltd* [1984] QB 127 (QB) 134; *Commonwealth Construction Co Ltd v Imperial Oil Ltd* (1977) 69 DLR (3d) 558

<sup>1041</sup> See 2.3.2.2, above

<sup>1042</sup> *Commonwealth Construction Co Ltd v Imperial Oil Ltd* (1977) 69 DLR (3d) 558

address that every court had a different judgement. The Supreme Court restored the decision of the trial court which had been reversed by the Court of Appeal and held that the insurers were not entitled to pursue a subrogated claim in the name of the plaintiff against the sub-contractor for loss caused by its negligence because the latter had a pervasive insurable interest in the entire works and was also a co-assured under the policy taken out by the plaintiff. In the case of *Petrofina*,<sup>1043</sup> with similar facts to the above case, an insurance policy had been effected by the main contractors for the entire construction works. The policy stipulated the main contractors, sub-contractors and other relevant parties as assureds. The main contractors employed sub-contractors for the heavy lifting operations. Damage was caused when the equipment provided by sub-contractors was dismantled. The insurer who had indemnified the plaintiffs sued and exercised the right of subrogation in the plaintiffs' name against the sub-contractors' negligence. For the first time the English court clearly set down the law that sub-contractors could have a pervasive interest in the whole contract work and thus be included in the single policy taken out by the main contractors as co-assureds, just like the position of a bailee.<sup>1044</sup> Such a policy was an insurance on property rather than on liability.

#### 3.3.3.4.2 Reasons for recognising a pervasive interest

Firstly, after examining the legal principles by analogy with that on bailment<sup>1045</sup> and the authorities on pervasive interest,<sup>1046</sup> despite not being English

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<sup>1043</sup> *Petrofina (UK) Ltd v Magnaload Ltd* [1984] QB 127; for more authorities, see *Mark Rowlands Ltd v Berni Inns Ltd* [1986] 1 QB 211; *Deepak Fertilisers & Petrochemicals Ltd v Davy McKee (London) Ltd* [1999] 1 All ER (Comm) 69; *Stone Vickers Ltd v Appledore Ferguson Shipbuilders Ltd* [1991] 2 Lloyd's Rep 288; *National Oilwell (UK) Ltd v Davy Offshore Ltd* [1993] 2 Lloyd's Rep 582; *Hopewell Project Management Ltd v Ewbank Preece Ltd* [1998] 1 Lloyd's Rep 448; *Co-operative Retail Services Ltd v Taylor Young Partnership Ltd* [2000] 2 All ER (Comm) 865; [2002] UKHL 17, [2002] 1 All ER (Comm) 918, [2002] 1 WLR 1419

<sup>1044</sup> *Petrofina (UK) Ltd v Magnaload Ltd* [1984] QB 127, 136-137

<sup>1045</sup> *Waters v Monarch Fire & Life Assurance Co* (1856) 5 E & B 870; *Hepburn v A Tomlinson (Hauliers) Ltd* [1966] AC 451

authorities, there was no reason why sub-contractors should be prevented from insuring the whole of the construction works.<sup>1047</sup> Secondly, from the perspective of commercial convenience, the reasons for recognising a pervasive insurable interest in sub-contractors are as follows. It firstly can at least lessen extra paperwork. Then, by extending the definition of insurable interest so as to make a single policy covering all the relevant parties and entitle a sub-contractor to have an interest in the whole project, overlapping claims and cross-claims on the occurrence of an accident between them can be avoided.<sup>1048</sup> Relevant parties also do not need to pay for costly premiums which may be quite uneconomic for them if they are just a small sub-contractor while they themselves have to insure their liability.<sup>1049</sup> Thirdly, depending on the wide concept of insurable interest, a sub-contract can have an insurable interest in entire contract works, because sub-contractors have had sub-contracts of construction which on the occurrence of an accident will come to an end and they will consequently lose the opportunity of remuneration.<sup>1050</sup> Fourthly, even though under the strict test, they may still have an insurable interest by analogy with bailees being held to have an interest up to the full value of goods insured by them,<sup>1051</sup> a sub-contractor under a sub-contract has been held to have part of the value, despite not having the whole possession of the whole contract project.<sup>1052</sup> It thus can have a possessory interest. Fifthly, in terms of a partial

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<sup>1046</sup> *Commonwealth Construction Co Ltd v Imperial Oil Ltd* (1977) 69 DLR (3d) 558

<sup>1047</sup> *Petrofina (UK) Ltd v Magnaload Ltd* [1984] QB 127

<sup>1048</sup> *Commonwealth Construction Co Ltd v Imperial Oil Ltd* (1977) 69 DLR (3d) 558, 560

<sup>1049</sup> *Petrofina (UK) Ltd v Magnaload Ltd* [1984] QB 127 (QB) 136

<sup>1050</sup> Also see relevant discussion relating to the expansion of insurable interest by recognising a pervasive interest in Group 4 of 2.3.2.3

<sup>1051</sup> *Hepburn v A Tomlinson (Hauliers) Ltd* [1966] AC 451 (AC) 467; *Waters v Monarch Fire & Life Assurance Co* (1856) 5 E & B 870. In these two cases, bailees under the contracts with the owners of the property insured by bailees have whole possession of goods.

<sup>1052</sup> *Commonwealth Construction Co Ltd v Imperial Oil Ltd* (1977) 69 DLR (3d) 558

interest being insurable, a sub-contractor's interest may also be insurable by way of regarding it as a partial interest.<sup>1053</sup>

However, there is doubt in relation to whether the rule on the interest had by a bailee can be analogous to the one on pervasive interest under co-insurance.<sup>1054</sup> The reason for attempting the analogy is because a bailee is liable to the owner of goods while he is entitled to have an insurable interest in the whole goods and recover the full value, which is an issue needing to be dealt with regarding sub-contractors. However, it has been argued that the ground may be inaccurate for a bailee has possession of the insured subjects whereas contractors and sub-contractors do not possess other parties' property.<sup>1055</sup> Be that as it may, it may not be accurate, in light of the fourth reason of the above paragraph. Besides, the above argument has obviously reflected the strict test as to possessory interest, which does not match the current approach by the courts. Again, the objection to the analogy sets out that the nature of interest possessed by a bailee and sub-contractor is different: the former relates to its liability to the owners of the subjects while the latter is regarding the proprietary interest of other parties.<sup>1056</sup> Actually, both interests in the property are based on their potential liability and where a bailee intends to insure the owner's interest, he in fact insures the owner's proprietary interest. Such is the case of a sub-contractor. In addition, the rule relating to the partial interest can help to deal with the doubt as to the rationale of the above analogy.

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<sup>1053</sup> See the paragraph below, for further details as to regarding a pervasive interest as a partial interest.

<sup>1054</sup> *Feasey v Sun Life Assurance Co* [2003] 2 All ER 587 [182]

<sup>1055</sup> Jonathan Gilman, Professor Robert M Merkin, Claire Blanchard and Mark Templeman, *Arnould's Law of Marine Insurance* (18th Revised edn, Sweet & Maxwell 2013) 11-37

<sup>1056</sup> *North British & Mercantile Insurance Co v Moffat* (1871) LR 7 CP 25; *Engels v Lancashire & General Assurance Co* (1925) Com Cas 202; *Ramco v International Insurance Co of Hannover* [2004] EWCA Civ 675 [12]–[32]; [2004] 2 Lloyd's Rep 595, 598–602

Even though property on sites may belong to other parties, from the perspective of partial interests, because of the construction contract, the entire work has become a new whole property. Every contractor and sub-contractor who has a partial interest in the entire work can thus have an insurable interest in every party owned by other parties, despite having no possession or proprietary interest in other parties' properties.<sup>1057</sup>

#### 3.3.3.4.3 Insurers cannot exercise their right of subrogation against a co-assured sub-contractor

**General rule and exceptions.** When to decide whether a sub-contractor can defend itself because an insurer cannot exercise its right of subrogation against co-assureds, two steps need to be looked at. First, insurers are not empowered to exercise their right of subrogation against a co-assured sub-contractor following the fact that they have a pervasive interest in the entire project and have been so insured. This is the fundamental rule. The next step relating to the following two exceptions needs to be investigated in order to decide whether the general rule applies. Should co-assureds have committed wilful misconduct, or they have not been covered by the policy in issue, the general rule is not applicable and insurers can exercise their rights of subrogation.<sup>1058</sup> As to the first exception, the policy will not cover a claim deriving from wilful misconduct and putting forward such a claim will be fraudulent, which can discharge insurers from all liability for losses covered by the policy. As regards the second, it is manifest that in order to recover, co-assureds should get cover beforehand. Thus, on the evidence and the construction of the policy, the Court of Appeal

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<sup>1057</sup> *Robertson v Hamilton* (1811) 14 East 522, 530; *Ebsworth v Alliance Mar Ins Co* (1873) LR 8 CP 596, 615; even though the two cases are not relating to co-insurance but respectively to hotchpot interests in the ship and cargo, the reason given to explain why a partial interest is insurable should be applicable to the interests in co-insurance because such interests are also hotchpot interests.

<sup>1058</sup> *National Oilwell (UK) Ltd v Davy Offshore Ltd* [1993] 2 Lloyd's Rep 582, 616

found that the sub-contractor was not covered by the policy and held that the fundamental rule was not applicable to this situation.<sup>1059</sup>

**Reasons.** In *Petrofina*, two reasons have been offered as follows. It is first on the basis that the right of subrogation cannot be exercised against the assured itself. Either in cases of joint insurance under a same policy or co-insurance under several policies, relevant assureds having either inseparable or pervasive interests should be treated as one.<sup>1060</sup> In particular, the policy on the whole contract work is a single policy generally taken out by the head contractor to cover the whole risk, leaving other contractors or sub-contractors as co-assureds free from effecting other policies.<sup>1061</sup> All relevant site owners, contractors or sub-contractors thus are co-assureds who should be treated as one, which prohibits the operation of rights of subrogation. Secondly, principles of circuitry can prevent an insurer from suing a co-assured in the name of another.<sup>1062</sup>

**Illustrations.** In *National Oilwell (UK) Ltd v Davy Offshore Ltd*<sup>1063</sup>, the defendants (DOL) employed the plaintiffs (NOW) as a sub-contractor to supply a system for the construction of a floating oil production facility. NOW took an action against DOL for unpaid invoices, whereas DOL alleged that the loss was caused by the breaches of NOW, who delivered them defective goods and delayed in delivery, which far exceeded NOW's claim for unpaid invoices. While the insurers of DOL, who had paid for most of its losses, exercised rights of

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<sup>1059</sup> *Stone Vickers Ltd v Appledore Ferguson Shipbuilders Ltd* [1992] 2 Lloyd's Rep 288

<sup>1060</sup> *Simpson v Thompson* 3 App Cas 279; cited in *Commonwealth Construction Co Ltd v Imperial Oil Ltd* (1977) 69 DLR (3d) 558, 561

<sup>1061</sup> *Petrofina (UK) Ltd v Magnaload Ltd* [1984] QB 127 (QB) 136; 2011 CP, para 11.60

<sup>1062</sup> *Petrofina (UK) Ltd v Magnaload Ltd* [1984] QB 127 (QB) 140

<sup>1063</sup> *National Oilwell (UK) Ltd v Davy Offshore Ltd* [1993] 2 Lloyd's Rep 582

subrogation against NOW, NOW alleged that it had rights to waive the insurers' subrogation rights, because it was a co-assured under the policy.

Colman J held that, without wilful misconduct and failing to be covered under co-insurance, sub-contractors have a pervasive interest in the whole property on sites and thus insurers were not able to excise a right of subrogation by paying one assured against any other co-assureds. The judge also gave two explanations for not permitting such a right of subrogation. Firstly, such permission would be in breach of the express terms included in the policy, i.e. it covered all the assureds' loss or damage caused by all risks, despite their incurring them by their negligence or breach of contract.<sup>1064</sup> Secondly, the principle of circuitry of action also prevents insurers from recouping the sum paid to one co-assured but against other ones. It is meaningless to allow insurers to excise rights of subrogation against other co-assureds for the loss being paid by them to plaintiff co-assureds while the loss had been covered by them on the policy which has also covered other co-assureds.<sup>1065</sup> Again, Lloyd J in *Petrofina* held the same rule in relation to the exercising of the right of subrogation by insurers in the name of co-assureds against other sub-contractors based on the similar two reasons discussed above.<sup>1066</sup>

### ***3.3.3.5 Managers of a vessel***

Regarding hull insurance, the issue may arise as to whether or not the manager, who had no shares or insurable interest as enumerated in s 5(2) of the 1906 MIA in a vessel, had insurable interest. In *O'Kane v Jones*,<sup>1067</sup> the definition of insurable interest was also enlarged as to managers of the vessel, which was

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<sup>1064</sup> *National Oilwell (UK) Ltd v Davy Offshore Ltd* [1993] 2 Lloyd's Rep 582, 613

<sup>1065</sup> *National Oilwell (UK) Ltd v Davy Offshore Ltd* [1993] 2 Lloyd's Rep 582, 613-14

<sup>1066</sup> *Petrofina (UK) Ltd v Magnaload Ltd* [1984] QB 127 (QB) 139

<sup>1067</sup> *O'Kane v Jones, The Martin P* [2005] Lloyd's Rep IR 174

supported by the court; they could have an insurable interest. *The Martin P*, which was under the management of ABC, although the managers of the vessels retained a residual management role, was insured by a policy led by the underwriter of Wellington. ABC Maritime, who was the vessel's sub-managers, took out an insurance on it with Jones after receiving the threat of cancellation of cover by the broker because of non-payment of the premium. Later, the vessel ran aground. The assured claimed for a constructive total loss against Wellington and the insurer paid the claim, but the insurer argued that Jones was a co-insurer and was liable to contribute because there was the Jones policy. One issue which needed to be decided was whether ABC had insurable interest in the vessel.

Siberry QC held that the legal relationship between the assured manager and the vessel was satisfied as to the requirements of s 5(2) of the 1906 MIA: i.e. under the management contract, in the case of any loss of the vessel, it would suffer a loss of earning remuneration or incur a liability. In the details, he still used the legal relationship to test whether the manager had an insurable interest or not. The right, derived from the Management Agreement, authorising ABC to manage and own a duty, was sufficient for the legal relation in s 5(2). Besides, should the vessel be lost or damaged thereto, the manager would lose the chance to work and be remunerated.<sup>1068</sup> By contrast, whether an assured had an insurable interest did not necessarily depend on possession of insured property. In other words, insurable interest should not be confined as possessory interest. He also held that being insufficient to satisfy s 5(2) could

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<sup>1068</sup> *O'Kane v Jones, The Martin P* [2005] Lloyd's Rep IR 174 [154]

not prevent a person from having an insurable interest because s 5(2) itself was a non-exhaustive concept.

Siberry QC by referring to authorities on insurable interest has observed the tendency to adopt the broader test.<sup>1069</sup> Therefore, according to his judgement, a mere economic interest based on an actual contract may be sufficient to confer on an assured an insurable interest. Similar to that of *The Moonacre*, although terms of “legal relationship” have been expressed in order to satisfy s 5(2), *The Martin P* has substantially broken through the limitation imposed by Eldon’s test and broadened the concept of insurable interest. It has been suggested that the wide approach to insurable interest in hull insurance should be applied in marine cargo insurance.<sup>1070</sup>

### **3.3.3.6 P&I club’s interest**

#### **3.3.3.6.1 Basic facts**

The most important case in the current context in relation to the principle of insurable interest is the *Feasey* case, in which the authorities relating to the requirement of insurable interest have been thoroughly examined in order to find out the attitude of the courts to the requirement and the approach adopted by the courts to decide whether an assured can have an insurable interest in the subject matter of the policy of insurance. Despite it being concerned with a policy on life, many authorities on insurable interest in property have been examined. In this case, the court was concerned with the dispute as to whether the assured, a P&I club, who had an insurable interest in its potential liability to its members for personal injury or death of the “Original Persons” and had made

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<sup>1069</sup> *O’Kane v Jones, The Martin P* [2005] Lloyd’s Rep IR 174 [154]

<sup>1070</sup> John Dunt, *Marine Cargo Insurance* (1st edn, Informa Law 2009) 4.4

a contract of insurance between it and a Lloyd's syndicate to cover such a liability, could have an insurable interest in the lives and well-being of such persons as the subject matter of the policy.<sup>1071</sup> By analysing pervasive insurable interest in property,<sup>1072</sup> the Court of Appeal affirmed the decision of Langley J<sup>1073</sup> who ruled that the assured was entitled to have such an insurable interest. Thus, a person only having potential liability rather than legal liability can have an insurable interest in insured property.

#### 3.3.3.6.2 The three-steps approach as to a court analysing insurable interest

When a case regard whether an assured has an insurable interest is put before a court, the court will first try to identify the subject of the insurance by analysing the terms of the policy; then to analyse the nature of the assured's interest therein; and finally to consider whether the subject embraces that interest or the assured has an insurable interest in the subject.<sup>1074</sup> The principle has in fact been provided for in s 26 of the 1906 MIA which rules that the subject which must be reasonably ascertained in a marine policy shall apply to the interest intended to be protected by the policy, although the nature and extent of the interest need not to be specified in the policy. The arguments were based on non-disclosure and lack of insurable interest that the insurer was not liable for recovery because the number or nature of the interest possessed by the assured thus could not be upheld by the courts.<sup>1075</sup> In other words, under some authorities, the assured must stand in an interest recognised by law in property at risk of sea perils,<sup>1076</sup> although a legal or equitable interest in property insured

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<sup>1071</sup> *Feasey v Sun Life Assurance Co* [2003] 2 All ER 587

<sup>1072</sup> As to detailed discussion relating to pervasive interest, see 3.3.3.4

<sup>1073</sup> *Feasey v Sun Life Assurance Co* [2002] Lloyd's Rep IR 807

<sup>1074</sup> *Feasey v Sun Life Assurance Co* [2003] 2 All ER 587

<sup>1075</sup> *Carruthers v Sheddon* (1815) 6 Taunt 14; *Crowley v Cohen* (1832) 3 B & A478

<sup>1076</sup> Sir M D Chalmers and Douglas Owen, *The Marine Insurance Act, 1906* (William Clowes and Sons 1907) 12

has currently been held as unnecessary. It is thus necessary to carefully look at the subject insured and insurable interest which are different but can impact one on the other.<sup>1077</sup>

As to the first step to identify the subject, by and large, it cannot be ascertained unless the terms of the policy have been examined. Sir M.D. Chalmers mentioned that the issue regarding whether the subject from which an interest arises was sufficiently described in the policy could cause confusion.<sup>1078</sup> It was laid down as law that the subject matter of a policy described in it in general terms could be specified and identified by asking what interest he had or what he had at risk without contrary evidence.<sup>1079</sup> The manner of observing which part of freight was at risk was used by the court to decide what subject the shipowner in effect insured.<sup>1080</sup> Where the court had to decide whether the insurance in issue was one on the ship or on the voyage, it was held that the subject matter insured was the ship, based on the help of insurable interest which must have the nature of being capable of valuation.<sup>1081</sup> In the *Wilson* case, the court was concerned with identifying the subject matter insured: if it be the cable, the assured as the shareholder of the company would have no insurable interest in the company's asset; if however it be a share of the profits from the cable, it would have. Blackburn J held that the policy in question was one on shares owned by the assured by reference to its insurable interest actually in the shares rather than the cable because the assured would have

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<sup>1077</sup> *Feasey v Sun Life Assurance Co* [2003] 2 All ER 587 [80]

<sup>1078</sup> Sir M D Chalmers and Douglas Owen, *The Marine Insurance Act, 1906* (William Clowes and Sons 1907) 10

<sup>1079</sup> *Allison v Bristol Marine Insurance Co* (1876) 1 App Cas 209, 216

<sup>1080</sup> *Allison v Bristol Marine Insurance Co* (1876) 1 App Cas 209, 238

<sup>1081</sup> *Pole v Fitzgerald* (1750) Willes 641 [648]

obtained benefits from the success of the adventure and been prejudiced due to the failure.<sup>1082</sup> Therefore, despite the fact that where the terms are not certain enough to ascertain the subject, it sometimes may be helpful that the courts first look at what insurable interest the assured has,<sup>1083</sup> and what should always be borne in mind is that the subject is decisively defined by the terms of the policy.

The nature of the interest the assured has therein shall be analysed so that the question as to whether the subject can embrace the insurable interest can be dealt with. In addition to deciding whether the assured has an insurable interest, it is thus also of importance to find out whether the insured subject matter includes such interest.<sup>1084</sup> The policy should cover the loss which arises out of the loss of or damage to the insured subject; in other words, the insurable interest should be appropriate to the policy by which the interest can be covered.<sup>1085</sup> According to the strict test of insurable interest that the assured must stand in a legal or equitable relationship to the property, where the assured has insurable interest in something other than the subject, i.e. the subject cannot embrace the insurable interest the assured had, the assured cannot recover. Where the policy was on ships and its goods, even though the assured who only had a mere expectation might gain profits in which they had insurable interest, for the subject insured could not embrace insurable interest in profits, the court thus held they had no insurable interest in the subject.<sup>1086</sup> A

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<sup>1082</sup> *Wilson v Jones* (1867) LR 2 Ex 139, 150-51

<sup>1083</sup> *Feasey v Sun Life Assurance Co* [2003] 2 All ER 587 [80], [94]

<sup>1084</sup> *Anderson v Morice* (1874–75) LR 10 CP 609, 622; (1876) 1 App Cas 713 (HL) 723; *Royal Exchange Assurance v M'Swiney* (1850) 14 QB 646; 117 ER 250; *Maurice v Goldsbrough Mort and Co Ltd* [1939] AC 452 (AC) 460-61; *NSW Leather Co Pty Ltd v Vanguard Insurance Co Ltd* (1991) 25 NSWLR 699

<sup>1085</sup> *Anderson v Morice* (1874–75) LR 10 CP 609, 615-16; cited by *NSW Leather Co Pty Ltd v Vanguard Insurance Co Ltd* (1991) 25 NSWLR 699

<sup>1086</sup> *Lucena v Craufurd* (1806) B & PNR 269 [315]

policy taken out to cover goods of rice could not be construed to cover the interest in profits arising out of the sale of goods.<sup>1087</sup> Consequently, for the purpose of a successful claim, the assured should insure the right interest because there was a good distinction between the insurance on goods and profits deriving from goods.<sup>1088</sup> In the *Anderson* case, it was held that albeit the assured had an insurable interest in profits on the rice, according to the true construction of the policy, the assured had no insurable interest in the rice which was the subject insured because the rice did not embrace the interest in profits deriving from another contract.<sup>1089</sup> Similarly, in *Macaura's* case, due to the subject matter insured being the timber, although the assured as the shareholder had an insurable interest in shares of profits, the assured had no insurable interest to support recovery because the timber could not embrace such an interest in the shares. In line with the above authorities, by reference to the nature of insurable interest the assured had, even though the assured had insurable interest in profits, the courts held the assured could not recover because the clearly specified subjects of the policies could not embrace the insurable interest they had.<sup>1090</sup> The cases of *Lucena* and *Macaura* are binding House of Lords authorities, and they have adopted a strict approach to defining insurable interest. That explains why in some cases the courts uphold the proposition that the assured must have a legal or equitable interest in the subject, although some authorities are in favour of economic interest being sufficient to constitute an insurable interest. As argued by Ward LJ, judges may be forced to adopt such a narrow attitude because of such authorities unless

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<sup>1087</sup> *Anderson v Morice* (1874–75) LR 10 CP 609, 621; cited by *NSW Leather Co Pty Ltd v Vanguard Insurance Co Ltd* (1991) 25 NSWLR 699

<sup>1088</sup> *Anderson v Morice* (1874–75) LR 10 CP 609, 621; *Maurice v Goldsbrough Mort and Co Ltd* [1939] AC 452 (AC) 460-461; cited by *NSW Leather Co Pty Ltd v Vanguard Insurance Co Ltd* (1991) 25 NSWLR 699

<sup>1089</sup> *Anderson v Morice* (1874–75) LR 10 CP 609, 621-22

<sup>1090</sup> *Feasey v Sun Life Assurance Co* [2003] 2 All ER 587 [80]

the House of Lords changes the principles.<sup>1091</sup> Besides, where the assured only has a mere expectation of advantage or profits from the safety of the subject insured, which is not insurable in all cases for it is too remote a relationship between the assured and the subject, the subject definitely does not embrace this too remote interest which the assured has.

#### 3.3.3.6.3 The courts nowadays tend to refuse the technical defence of insurable interest

A court will lean in favour of the assured having an insurable interest in the subject matter of the insurance, despite the situations where the subjects or terms of the policy are so specific, they could not embrace the insurable interest the assured had.<sup>1092</sup> Thus, the defence by the insurer that the assured cannot recover due to lack of insurable interest in the subject insured nowadays will not be accepted by a court. Taking the example of a pervasive interest, although the common practice for the assured, as the sub-contractors who have an insurable interest in potential liability arising from the contract made between it and the main contractor or the owner of the property, is to effect an insurance policy on liability, and the subject of the policy made by the main contractor or the owner has been specifically identified as the whole property under construction, where by correct construction of the policy on the property its true intention includes to protect potential liability, the court will favour the view that the property embraces the insurable interest in potential liability and the assured thus has an insurable interest in the property.<sup>1093</sup>

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<sup>1091</sup> *Feasey v Sun Life Assurance Co* [2003] 2 All ER 587 [181]

<sup>1092</sup> *Stock v Inglis* (1884) 12 QBD 564 (AC) 571; affirmed *Inglis v Stock* (1885) 10 App Cas 263; *Feasey v Sun Life Assurance Co* [2003] 2 All ER 587 [97]

<sup>1093</sup> *Petrofina (UK) Ltd v Magnaload Ltd* [1984] QB 127; *Stone Vickers Ltd v Appledore Ferguson Shipbuilders Ltd* [1991] 2 Lloyd's Rep 288; *National Oil Well (UK) Ltd v Davy Offshore Ltd* [1993] 2 Lloyd's Rep 582; approved by *Feasey v Sun Life Assurance Co* [2003] 2 All ER 587

The above authorities may rely on the following reasoning. First, the courts regard the defence of lack of insurable interest by the insurer as a mere technical defence which has no merits and does not relate to the loss when a claim is raised by the assured.<sup>1094</sup> This technical defence thus will not be upheld by the courts at present, even by many of those prior to the implementation of the 1906 MIA.<sup>1095</sup> It has been established by the court that when it decides whether the assured can recover, what they intend to look for is whether or not the assured has bona fide suffered loss, not at little technical objections.<sup>1096</sup> Where the insurers are able to decide whether to cover a risk and have then received the premium, with the true intention of fulfilling the insurance contract, such defence should not arise.<sup>1097</sup> Secondly, it is from the perspective of social advantage that the courts tend to validate a contract by virtue of supporting an insurable interest rather than to avoid it due to lack of such an interest.<sup>1098</sup> The courts would thus, as the authority of common law, tend to hold the assured as having met with the insurable interest requirement wherever possible.<sup>1099</sup>

## **Chapter 4 Proposals for Reform of Insurable Interest in Indemnity**

### **Insurance by the English Law Commissions**

#### **4.1 Introduction of the project**

The UK had waited a long time for the reform of insurance contract law before the English and Scottish Law Commissions launched its reform project in 2006.

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<sup>1094</sup> ALRC 91, para 11.22

<sup>1095</sup> *Stock v Inglis* (1884) 12 QBD 564

<sup>1096</sup> *Hutchinson v Wright* (1858) 25 Beav. 444

<sup>1097</sup> D Galbraith, 'An Unmeritorious Defence — The Requirement of Insurable Interest in the Law of Marine Insurance and Related Matters' (1993) 5(3) *Insurance Law Journal* 177; *Stock v Inglis* (1884) 12 QBD 564; *Feasey v Sun Life Assurance Co* [2003] Lloyd's Rep IR 637 [6]; *Cepheus Shipping Corporation v Guardian Royal Exchange Assurance PLC (The Capricorn)* [1995] 1 Lloyd's Rep 622, 641

<sup>1098</sup> *Constitution Insurance Co v Kosmopoulos* (1987) 34 DLR (4th) 208, 218

<sup>1099</sup> ALRC 91, para 11.22

In 1957, the Law Reform Committee, the forerunner of the Law Commission, had proposed the reform of specific areas of insurance law.<sup>1100</sup> There was however no response. The English Law Commission then examined insurance contract law on the subjects of non-disclosure and breach of warranty in 1980.<sup>1101</sup> In 1997, the National Consumer Council considered these two issues and subrogation as well.<sup>1102</sup> Both of them thought that there was a need for reforming insurance contract law. However, neither of their proposals was implemented. The Law Reform Committee of the British Insurance Law Association in 2002 published a report and then brought the Law Commission back to looking again at the reform.

In the area of insurable interest, the Law Commissions have produced the *Issues Paper 4: Insurable Interest (IP 4)* in January 2008, Chapter 3 in *Insurance contract law: post contract duties and other issues (2011 CP)*, the *Issues Paper 10 (IP 10)* in March 2015, the draft Insurable Interest Bill 2016 (*2016 Draft*). The *IP 4* was just aiming to seek views on whether the requirement of insurable interest should be repealed and “promote discussion before the formal consultation process begins” and therefore only set out the Law Commissions’ tentative proposals for the reform of insurable interest.<sup>1103</sup> Consultees responded to *IP 4* by strongly arguing that the insurable interest requirement should be retained. They thought the requirement could play a role in preventing moral hazard, gambling in the guise of insurance, invalid claims

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<sup>1100</sup> Law Reform Committee, *Conditions and Exceptions in Insurance Policies* (Cmnd 62, 1957)

<sup>1101</sup> Law Commission, *Insurance Law, Non-Disclosure and Breach of Warranty* (Law Com No 104, 1980)

<sup>1102</sup> National Consumer Council, *Insurance Law Reform: the consumer case for review of insurance law* (1997)

<sup>1103</sup> *IP 4*, paras 1.3-1.5

and reinforcing market discipline.<sup>1104</sup> In 2011, they published their second consultation paper<sup>1105</sup> as *2011 CP* on insurable interest, in addition to the other three topics of: damages for late payment, insurers' remedies for fraudulent claim, and policies and premiums in marine insurance.<sup>1106</sup> They proposed to retain the requirement of insurable interest but to plainly restate it.<sup>1107</sup> They then published an analysis of responses in 2012 to Chapter 3 and concluded that it was not a priority to reform insurable interest.<sup>1108</sup> However, in 2014, the Investment and Life Assurance Group (ILAG), on behalf of life insurers, requested the English Law Commission to revisit insurable interest. After revisiting this issue, ILAG hoped that their members need not consider the issue of life policies void for lack of insurable interest when taking out useful covers, such as policies on children, cohabitants and key employees.<sup>1109</sup> Besides, the English Law Commission was not satisfied with the moribund law and worried that the outdated law on insurable interest may lead to disrepute of the law. They thus decided to return to it by publishing *IP 10*. They intended to consult on whether there was a need to reform insurable interest and whether their new updated proposals could get wide support.<sup>1110</sup> Those undated proposals received very good support. In order to echo those, the Law Commissions then published the *2016 Draft*.<sup>1111</sup>

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<sup>1104</sup> Law Commissions, *Insurance Contract Law, Summary of Responses to Issues Paper 10: Insurable Interest*

<sup>1105</sup> In 2007 they published their first consultation paper relating to pre-contract issues including both consumer and business insurance.

<sup>1106</sup> *2011 CP*, para 1.15

<sup>1107</sup> Law Commissions, *Summary of Responses to Second Consultation Paper: Post Contract Duties and other Issues, Chapter 3: Insurable Interest (2013) (2013 Summary)*; Ian Enright and Professor Robert M Merkin, *Sutton's Law of Insurance in Australia* (4th ed, Thomson Reuters 2014) para 22.10

<sup>1108</sup> *2013 Summary*

<sup>1109</sup> *2015 IP 10*, para 1.4

<sup>1110</sup> *2015 IP 10*, paras 1.1-1.6

<sup>1111</sup> Law Commissions, *Short Consultation on Draft Bill: Insurable Interest (2016) (2016 Notes)*

In this chapter, proposals for each topic on insurable interest by the Law Commissions in their various papers will be discussed. Furthermore, analysis on the topic mainly occurs in the *2016 Draft*, representing decisive proposals.

## **4.2 Whether the requirement for insurable interest in indemnity insurance should be retained**

### **4.2.1 Attitudes to abolition in the IP 4**

The *IP 4* did not represent the Law Commissions' fixed views on this issue. Responses to it and stakeholders' opinions included in it were nonetheless thought-provoking. It is thus meaningful to carefully study them. The problem as to whether the requirement of insurable interest was necessary to indemnity insurance must be primarily solved before exploring other issues relating to this principle. In *IP 4*, the English Law Commission seemed to be in favour of abolishing the requirement, instead only requiring the assured to show his possession of interest required by the indemnity principle at the time of loss. In order to explain it, the Law Commissions firstly recognised two functions of insurable interest and then denied them as follows. Firstly, they looked at whether insurable interest was necessary to define insurance. If not, the requirement of insurable interest may be abolished. If it was useful to distinguish insurance and other kinds of risk transfer contracts, such as wager and credit derivatives, it could then also help to identify the regulatory and tax regimes within which the insurance should fall. They tentatively stated that insurable interest was not needed to identify an insurance contract. They further set out the FSA's conclusion that factors like assumption of risk by the insurer, the consideration of a premium for the transfer of risk and the insurer undertaking a risk of loss only, not including that of profits, were more important

to define insurance contracts.<sup>1112</sup> Secondly, they examined whether insurable interest was helpful to reduce the risk of moral hazard and prevent gambling under the guise of insurance, which were the initial reasons for the requirement of insurable interest.<sup>1113</sup> The provisional proposal seemed to be that the common law doctrine of indemnity could replace the statutory principle of insurable interest<sup>1114</sup> because the former could also serve that purpose and could help to distinguish insurance from gambling as well.

#### *4.2.1.1 Whether statutory insurable interest is necessary to distinguish insurance from other contracts*

The issue may arise as to whether the strict insurable interest is a defining element of the concept of insurance so that without such an interest it will be difficult to distinguish insurance from other contracts.<sup>1115</sup> Some consultees expressed the opinion that the insurable interest principle was an essential part of the insurance contract and that its repeal might have a negative effect on the common understanding of insurance and the development of useful insurance products.<sup>1116</sup> In *IP 4*, following the Australian experience,<sup>1117</sup> the English Law Commission stated that it was merely some kind of interest rather than the requirement of insurable interest that was essential to defining insurance.<sup>1118</sup> Definitions of contracts of insurance have been explored as set out below in the areas of regulation, the risk transfer market, the common law and accounting and tax.<sup>1119</sup>

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<sup>1112</sup> Robert Merkin, *Colinvaux's Law of Insurance* (11th edn, Sweet & Maxwell 2016) 4-025

<sup>1113</sup> *IP 4*, para 7.2

<sup>1114</sup> *IP 4*, paras 7.34 and following

<sup>1115</sup> *IP 4*, para 7.3

<sup>1116</sup> *IP 4*, para 7.11

<sup>1117</sup> Since 1995 the requirement of insurable interest is no longer used to distinguish insurance from other contracts in Australia. See *IP 4*, para 7.33

<sup>1118</sup> *IP 4*, paras 7.31-7.33

<sup>1119</sup> *IP 4*, para 7.31

#### 4.2.1.1.1 Not necessary for regulatory purposes and other financial contracts

The position was unclear as to whether the insurable interest requirement was necessary for the purpose of FiSMA to define an insurance contract. It seemed that FiSMA did not need insurable interest to identify an insurance contract. FiSMA was “the current governing legislation for insurance” and “regulates the ‘effecting and carrying out [of] contracts of insurance’”.<sup>1120</sup> It however did not try to define insurance contracts. Nor did the Financial Services and Market Act 2000 (Regulated Activities) Order 2001.<sup>1121</sup> Instead, the latter only listed examples of insurance contract: any contract falling within its list of insurance contracts could be regarded as a contract of insurance.<sup>1122</sup> It thus did not try to define insurance but listed types of insurance instead.<sup>1123</sup> Thus, FiSMA seemingly did not need the requirement of insurable interest to identify contracts of insurance.

For regulatory purposes, in light of the response to the Law Commissions’ scoping paper,<sup>1124</sup> the Financial Services Authority (FSA)<sup>1125</sup> plainly set out that insurable interest recognised by law was not necessary for regulatory authorities to distinguish insurance from other contracts.<sup>1126</sup>

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<sup>1120</sup> *IP 4*, para 7.6

<sup>1121</sup> 2001 Order, s 3(1); cited in *IP 4*, para 7.6

<sup>1122</sup> 2001 Order, s 3(1); cited in *IP 4*, para 7.6

<sup>1123</sup> *IP 4*, para 7.8

<sup>1124</sup> Law Commissions, *Analysis of Responses and Decisions on Scope* (Law Com No 353, 2006)

<sup>1125</sup> The FSA has been replaced from 1 April 2013 with the Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA) due to its failure of financial regulation during the 2008 financial crisis. The PRA will take the responsibility of regulating insurers, banks and large investment companies and the FCA is aiming to regulate the markets, protect investors and promote competition.

<sup>1126</sup> *IP 4*, para 7.4

Besides, in a policy statement published in 2004 which aimed to provide guidance concerning whether a particular contract could be identified as a contract of insurance,<sup>1127</sup> the FSA expressed the same view. Although the requirement of insurable interest was not a topic covered by the guidance, it also pointed out that insurable interest was necessary for an insurance contract to be valid, but thought that insurable interest was not helpful to define the contract of insurance.<sup>1128</sup> However, this was only the FSA's test and did not consider the position as to this issue at common law or under statute.<sup>1129</sup>

According to the FSA's test, in order to be an insurance contract, the following factors must be included, that:

- the insurer undertakes risk;
- the consideration for the above duty is estimated based on the possibility of occurrence;
- the parties assert to have entered into an insurance contract which has classic factors of insurance;
- the risk has a nature of loss only rather than including that of whether profits can be earned.<sup>1130</sup>

How can the risk be understood here? In light of the policy statement, if an uncertain event occurs as a result of which the assured will inevitably suffer an adverse outcome regarding their interests, it can be called a risk.<sup>1131</sup> It however should be noted that the "interests" consisting of the "risk" do not necessarily

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<sup>1127</sup> FSA Policy Statement, 2004

<sup>1128</sup> FSA Policy Statement, 2004, para 2.10; cited in *IP 4*, para 7.15

<sup>1129</sup> FSA Policy Statement, 2004, para 2.10

<sup>1130</sup> FSA Policy Statement, 2004, para 6.6.2; cited in *IP 4*, para 7.16

<sup>1131</sup> *Prudential v Commissioners of Inland Revenue* [1904] 2 K. 658; cited in FSA Policy Statement, 2004, para 2.18

mean an insurable interest as a statutory requirement.<sup>1132</sup> It may be just an interest required under the indemnity principle. The nature of the interest required by these two principles is still unclear. Therefore, it is not right to say that the “assumption of risk” term is another expression of the requirement of insurable interest. However, according to Lawrence J’s test, an interest is insurable, where it has the nature of moral certainty, i.e. it cannot be beneficially affected, other than the perils insured against. Under the FSA’s test, the risk may imply that it has the nature of moral certainty. Firstly, according to the first limb, a policy commonly specifies the perils insured against, outside which an insurer is not liable to indemnify loss caused by other uncovered casualties. Secondly, the fourth limb may mean that a subject matter of insurance should embrace an interest an assured has. For example, a subject matter insured as profits can include an interest in goods. In short, for the regulatory purpose, insurable interest may be required to define an insurance contract.

For the purpose of distinguishing insurance from credit derivatives,<sup>1133</sup> the opinion of Robin Potts QC should be firstly considered. He clearly stated that those were two different types of contracts for FiSMA and common law. But was insurable interest helpful to this distinction at common law? Life and non-life insurance are needed to be separately considered. In his opinion, as to an insurance contract:

- the insurer only indemnifies an assured suffering a loss; and
- the contract is thus to protect the assured’s insurable interest in the insured subject matter.

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<sup>1132</sup> *IP 4*, para 7.17

<sup>1133</sup> Credit derivatives are swap or option contracts which are “designed to lay off credit risk on loans, debt securities or other assets in relation to a particular reference entity or country in return for either swap payments or payment of premium”. Opinion prepared for the ISDA by Robin Potts QC, *Erskine Chambers*, 24 June 1997; cited in *IP 4*, para 7.9

For non-life insurance, insurable interest may not be necessary to identify insurance and the indemnity principle may be sufficient. That was because where the policyholder had only suffered loss, needing no further exploration of insurable interest, this can distinguish credit derivatives from indemnity insurance. However, it should be noted that this definition has used terms of “insurable interest”. By contrast, for non-indemnity insurance, it may be difficult to distinguish insurance and credit derivatives only using the loss test but without the insurable interest test: under both contracts one party would pay out an amount of money to the other party on the occurrence of a defined event rather than loss.<sup>1134</sup> Therefore, the concept of insurable interest may be needed, in order to differ insurance from credit derivatives.

#### 4.2.1.1.2 No necessity at common law

At common law, the statutory insurable interest is seemingly not necessary to define a contract of insurance. Instead merely some kind of interest, loss or adverse effect is needed. This can be demonstrated in the case of *Prudential Insurance v Inland Revenue Commissioners*.<sup>1135</sup> Although the court dealt with the subject of a life insurance policy, three critical features of an insurance contract have been given as following:

- payment;
- uncertainty;
- interest.

Firstly, the insurer for some consideration of payment promises to pay some benefit to the assured on the occurrence of the uncertain event insured against. Secondly, the event should have the nature of uncertainty. Thirdly, the

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<sup>1134</sup> *IP 4*, para 7.17

<sup>1135</sup> *Prudential Insurance v Inland Revenue Commissioners* [1904] 2 KB 658

occurrence of the uncertain event should adversely affect the interest of the assured.<sup>1136</sup> It is not the case that the insurable interest is necessary to define an insurance contract due to an interest needed in the third aspect. Similar to the interest required by the indemnity principle, the range of such an interest here is different from and much wider than that of insurable interest. Nevertheless, as discussed above,<sup>1137</sup> insurable interest may also be needed for the concept of insurance contract at common law.

#### 4.2.1.1.3 Not needed for the purpose of accountancy and tax

In light of both definitions of accountancy and tax, despite complexity, the statutory insurable interest may not be essential for the definition of insurance contracts. The position, as that under common law, is clear as to the definition of insurance for accounting: the policyholder's interest will be adversely affected.<sup>1138</sup> Confusion may arise as to an insurance contract in relation to tax. Although the terminology of "insurable interest" is used as a description in tax guidance,<sup>1139</sup> it in effect differs from the requirement of insurable interest. That is because the former is one to prove the loss suffered by the assured while the latter is one, besides, that can affect the validity of the insurance.<sup>1140</sup> However, from the perspective of moral certainty of interest, avoiding to be too remote, insurable interest is necessary for accountancy and tax.

#### 4.2.1.1.4 Conclusion

According to the above analysis, for the purpose of regulation, FiSMA and the FSA appears not to need insurable interest to define an insurance contract. The

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<sup>1136</sup> Professor John Birds, Ben Lynch and Simon Milnes, *MacGillivray on Insurance Law* (12th edn, Sweet & Maxwell 2012) 1-1, 1-5; Malcolm A Clarke with Julian M Burling and Robert L Purves, *The Law of Insurance Contracts* (4th edn, LLP 2002) 1-1

<sup>1137</sup> See 4.2.1.1.1

<sup>1138</sup> International Financial Reporting Standards 4: *Insurance contracts*; cited in *IP 4*, para 7.26

<sup>1139</sup> *IP 4*, para 7.29

<sup>1140</sup> *IP 4*, para 7.20

former does not try to define it. The latter however adopts the test of interest, not insurable interest, to define it. Such are the positions under the risk transfer market, the common law, tax and accountancy. The interest here is just used to prove a loss and one required by the indemnity doctrine. In Potts' opinion, it seems nevertheless that insurable interest is needed to distinguish a life insurance contract from credit derivatives. Although the above analysis is not the Law Commissions' fixed proposals, they indeed reflect stakeholders' attitudes to whether the requirement of insurable interest is necessary to define insurance contracts. Nonetheless, in light of the fact that an insurer is only liable to compensate a loss deriving from perils insured against, rather than other uncovered contingency: that is, an interest has to be ascertained, the definition of insurable interest may be indispensable for that of insurance contract.

#### *4.2.1.2 Whether the statutory insurable interest is still necessary to prevent moral hazard and gambling in the guise of insurance*

The *IP 4* proposed that the indemnity principle could guard against gambling and moral hazard. The requirement of statutory insurable interest was originally aiming to reduce moral hazard and to ban gambling being disguised as contracts of insurance,<sup>1141</sup> which was different from gambling itself.<sup>1142</sup> Thus, both initial purposes should be considered in the modern context as to whether insurable interest can still achieve them, even though gambling itself appears to have been widely accepted currently and has been enforceable since the passing of the 2005 GA.<sup>1143</sup>

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<sup>1141</sup> *IP 4*, para 7.34

<sup>1142</sup> *IP 4*, para 7.35

<sup>1143</sup> *IP 4*, para 7.35

As far as indemnity insurance is concerned, the statutory requirement of insurable interest was regarded as no longer necessary for the protection against moral hazard and gambling by insurance<sup>1144</sup> and however was able to be substituted by the indemnity principle.<sup>1145</sup> According to the doctrine of indemnity, policyholders could get indemnified only if they had suffered a loss; to suffer the loss, they must show some kind of financial interest.<sup>1146</sup> Therefore, a loss sustained by policyholders on its own or with interests loosely defined was likely to provide such protection.<sup>1147</sup> Without them, policyholders also could not get recovery, which had the same effect as that of the insurable interest principle. Consequently, moral hazard can be reduced and gambling under the guise of insurance can be prevented.<sup>1148</sup> Putting aside the nature of interest at the time of loss, requiring an interest at such time appears to be able to play such a role.

However, as discussed above,<sup>1149</sup> the indemnity principle cannot replace insurable interest. Besides, despite the approval of economic interest as insurable interest, it should not be explained as coming under the indemnity principle. It is because the former must depend on an existing right, like a contract, whereas the latter can be sufficient if the assured has suffered a loss.

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<sup>1144</sup> *IP 4*, para 7.48

<sup>1145</sup> *IP 4*, paras 7.46-7.48

<sup>1146</sup> *IP 4*, para 7.44

<sup>1147</sup> *IP 4*, para 7.44

<sup>1148</sup> *IP 4*, paras 7.44-7.45

<sup>1149</sup> See 3.1.3

#### **4.2.1.3 Whether to check the expectation of loss at the time of contract**

In light of the effects of the expectation of such an interest,<sup>1150</sup> the Law Commissions consulted, in order to avoid worthless policies, on whether or not insurers should be legally required to check that insurance was entered into with an expectation of an interest loosely defined at the outset of the indemnity insurance.<sup>1151</sup>

#### **4.2.2 Opinions about retaining in the 2011 CP**

In the *2011 CP*, the Law Commissions further analysed consultees' responses to the issue as to why the principle of insurable interest should be retained in indemnity insurance contracts.<sup>1152</sup> They tended to retain the requirement of insurable interest in indemnity insurance<sup>1153</sup> because only 2 of the 15 consultees (13%) had agreed with the repealing of the requirement of insurable interest.<sup>1154</sup> Other consultees argued strongly that the common law doctrine of indemnity could not be a substitute for the statutory doctrine of insurable interest<sup>1155</sup> and the latter was important for a number of reasons, which would be thoroughly explored below.<sup>1156</sup> The following five reasons for retaining the insurable interest requirement were again mentioned using similar wording from the *2011 CP* in *IP 10*.<sup>1157</sup> There is thus no need to look in detail at that in the latter paper.

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<sup>1150</sup> For details as to the functions of the requirement of an expectation of interest at the outset of contracts, see *IP 4*, para 7.52

<sup>1151</sup> *IP 4*, para 7.54; 8.5; see the last paragraph of 4.2.2.2; also referring to 4.2.3.2

<sup>1152</sup> *2011 CP*, para 12.1

<sup>1153</sup> *2011 CP*, para 12.34

<sup>1154</sup> *2011 CP*, para 12.3

<sup>1155</sup> Grounds for this position have been explored in 3.1.3 of chapter 3.

<sup>1156</sup> *2011 CP*, paras 12.4-12.5

<sup>1157</sup> Law Commissions, *Insurable Interest: updated proposals* (ICL Issues Paper 10, 2015) (henceforth, *2015 IP 10*) para 2.3

#### *4.2.2.1 Critical features of definitions of insurance contracts*

Consistent with several responses as to whether insurable interest should be retained, it was argued that it was necessary to define a contract of insurance. The Association of British Insurers was in favour of this view.<sup>1158</sup> Contracts of insurance could thus be distinguished from other types of contracts by the requirement of insurable interest, such as gambling<sup>1159</sup> and credit derivatives.<sup>1160</sup> Different types of contracts had different operating systems, such as provisions of law, regulation, tax and accountancy. Insurable interest was thus necessary to distinguish insurance from other financial products for such purposes.<sup>1161</sup>

Nearly all of foreign law and some regulation regarded the requirement of insurable interest as part of the definition of insurance. Had the insurable interest been repealed, the Lloyd's Market Association was concerned about the reduction of market shares caused by the inconsistency of rules regarding insurable interest.<sup>1162</sup>

#### *4.2.2.2 Market discipline*

The Law Commissions' preliminary thinking on the issue in *IP 4* appeared to be that insurable interest was not necessary for market discipline;<sup>1163</sup> the market could operate well even without the requirement of insurable interest.<sup>1164</sup> This was based on the fact that the insurers sometimes, for instance with honour policies, did not need the assureds to show the possession of insurable

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<sup>1158</sup> 2011 CP, para 12.6

<sup>1159</sup> 2011 CP, para 12.11

<sup>1160</sup> 2011 CP, para 12.9

<sup>1161</sup> 2011 CP, para 12.6

<sup>1162</sup> 2011 CP, para 12.10

<sup>1163</sup> *IP 4*, para 7.48; 2011 CP, para 12.14

<sup>1164</sup> 2011 CP, para 12.14

interest.<sup>1165</sup> The insurers seldom raised the lack of insurable interest as a defence to reject a policyholder's claim; even in the case of being raised as a technical defence, the courts tended to strive to find an insurable interest.<sup>1166</sup>

However, there was an argument by the ABI that market discipline could be reinforced by requiring the assured to have an insurable interest.<sup>1167</sup> The ABI<sup>1168</sup> and Aviva<sup>1169</sup> shared the same view that the requirement of insurable interest could guard against moral hazard and gambling in the guise of insurance. The insurers felt that "the doctrine of insurable interest has some underlying psychological effect in constraining the policies they were prepared to write".<sup>1170</sup> Besides, the requirement of insurable interest was thought possibly to be helpful to guard against the insurance industry being involved in overly speculative products, not limited to the market of insurance.<sup>1171</sup> It was alleged that one reason for the 2008 financial crisis was that kinds of trading products were too speculative; in other words, no interest in them was needed to be shown.<sup>1172</sup>

In relation to the matter as to whether the insurers should be obliged to check the existence of the assureds' expectation of loss or an interest in the subject matter, the Law Commissioners pointed out that no further review would be conducted regarding this issue for they did not regard it as a proper subject for

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<sup>1165</sup> 2011 CP, para 12.14

<sup>1166</sup> 2011 CP, para 12.14

<sup>1167</sup> 2011 CP, para 12.13

<sup>1168</sup> 2011 CP, para 12.11

<sup>1169</sup> 2011 CP, para 12.13

<sup>1170</sup> 2011 CP, para 12.14

<sup>1171</sup> 2011 CP, para 12.15; 2015 IP 10, para 2.3

<sup>1172</sup> 2011 CP, para 12.15

primary legislation and most respondents thought that it was an issue that should be left to regulation.<sup>1173</sup>

#### *4.2.2.3 Invalid claims can be prevented*

Opinions were divided as to the issue as to whether insurable interest could prevent unrelated third parties from claiming under contracts of insurance. The Law Commissioners argued that the statutory requirement of insurable interest provided by section 5 of the 1906 MIA which provided a specific, limited relation to the subject matter could prohibit invalid claims.<sup>1174</sup> For instance in a marine insurance policy on goods, the benefits of policies could be assigned while only those to whom the risk had transferred could make a claim.<sup>1175</sup> Royal & Sun Alliance similarly set out that the statutory requirement of insurable interest could set a barrier against invalid claims.<sup>1176</sup> By contrast, the Law Commissioners disagreed<sup>1177</sup> with the opinion of the Lloyd's Market Association that the interest or some kinds of interest could have the same function.<sup>1178</sup>

#### *4.2.2.4 Other uses of the requirement*

The insurable interest doctrine, it was argued, was a useful tool to identify the location of insurance, which was crucial for the regulation of insurance.<sup>1179</sup> Where an international parent company had specified its legal insurable interest in the loss of its “subsidiaries, affiliates and joint ventures”,<sup>1180</sup> the loss of them could be compensated for by the insurance effected by the parent company in the case of their loss, even though the insurer was not authorised in

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<sup>1173</sup> 2011 CP, para 12.33

<sup>1174</sup> 2011 CP, para 12.17

<sup>1175</sup> 2015 IP 10, para 2.3

<sup>1176</sup> 2011 CP, para 12.18

<sup>1177</sup> 2011 CP, para 12.17

<sup>1178</sup> 2011 CP, para 12.16

<sup>1179</sup> 2011 CP, paras 10.12; 12.20

<sup>1180</sup> Suresh Krishnan and Brendan Hammond, ‘Structuring Multinational Insurance Programmes: Current Challenges in Australia, New Zealand and the Asia-Pacific Region’ (2011) ACE Progress Report 1, 2

jurisdictions where its “subsidiaries, affiliates and joint ventures” were located.<sup>1181</sup> The location of insurance was becoming increasingly important in the context of continuing globalisation because it would have an effect on which insurance, tax law and regulator the insurer should be subject to.<sup>1182</sup>

#### *4.2.2.5 Few benefits from repealing insurable interest*

Differing from the tentative proposal in *IP 4*, the Law Commissioners in the *2011 CP* proposed not to abolish the requirement of insurable interest because its repeal was not a priority.<sup>1183</sup> Consultees argued that had the principle of insurable interest been repealed, no significant and clear benefits would be brought; undesirably disruptive effect might be caused as well.<sup>1184</sup> What is more, the statutory insurable interest, in spite of the problems with it, produced few problems in practice:<sup>1185</sup> insurers seldom raised it as a defence to defend a claim and the courts strived to find an insurable interest in favour of assureds.<sup>1186</sup> Thus, it was argued that many problems with the law on insurable interest were more theoretical than practical.<sup>1187</sup>

### **4.2.3 Rules for retaining under the 2016 Draft**

#### *4.2.3.1 Different ways to divide insurance policies*

Different rules of law on insurable interest are subject to different statutes: for marine insurance, the 1906 MIA and 1909 MIA govern this issue; the 1774 LAA applies to the requirement of insurable interest in life insurance; as regards non-marine indemnity insurance, prior to its repeal by the 2005 GA, the 1845 GA

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<sup>1181</sup> Suresh Krishnan and Brendan Hammond, ‘Structuring Multinational Insurance Programmes: Current Challenges in Australia, New Zealand and the Asia-Pacific Region’ (2011) ACE Progress Report 1, 2; cited in *2011 CP*, para 12.21

<sup>1182</sup> *2011 CP*, para 10.12

<sup>1183</sup> *2011 CP*, para 12.25

<sup>1184</sup> *2011 CP*, para 12.22

<sup>1185</sup> *2011 CP*, paras 12.22-12.23

<sup>1186</sup> *2011 CP*, para 12.24

<sup>1187</sup> *2015 IP 10*, para 1.3

indirectly requires the assured to possess an insurable interest in the subject matter insured.<sup>1188</sup> It is thus important to clarify the types of insurance contracts in order to decide which category an insurable interest in question belongs to. Before the *2016 Draft*, the insurance contracts have been typically divided by the English Law Commission into indemnity insurance and contingency insurance. It has been argued that there is no clear boundary between these two types of insurance: a key employee insurance, a type of contingency insurance, has a characteristic of the former, while a valued policy over property can recover a fixed sum of money on the occurrence of the insured perils.<sup>1189</sup> The *2016 Draft* has thus divided insurance into life-related insurance and non-life insurance. As for the former formulation, only if an insurance contract relates to a human life, the requirement of insurable interest should be governed by s 2 of the *2016 Draft*, which only applies to life-related insurance. By contrast, for the requirement for non-life insurance, rather than marine insurance which is still subject to the 1906 MIA, s 3 should apply. It is clear that the *2016 Draft* has now created different regimes for different types of cover.

#### *4.2.3.2 The retaining of insurable interest in a non-life insurance context*

In light of the functions of the insurable interest principle recognised by the English Law Commission in the *2011 CP*, s 3(1) retains the requirement of insurable interest in non-life insurance. Under s 3(1), it sets out that it is at the outset of the non-life insurance contracts that the assured must have an insurable interest or a reasonable prospect of obtaining such an interest during the life of the policy. The consequence of failing to comply with this requirement will make the policy void. This is the answer to the question as to whether the insurer should have imposed on him a legal duty to check the expectation of

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<sup>1188</sup> *2011 CP*, para 11.26

<sup>1189</sup> *2016 Notes*, para 1.5

loss at the time of contract.<sup>1190</sup> It should be thus noted that the timing affecting the validity of a policy is at the time of taking out the contract. Also, it does not necessarily need the assured to possess an actual insurable interest at the outset of the contract, instead, it would be sufficient to show a reasonable prospect of acquiring an insurable interest at that time. This provision is in fact consistent with the requirement for marine insurance under the combination of s 4(1) and s 4(2)(a) of the 1906 MIA apart from the formulation of 'reasonable prospect' in s 3(1) which intends not to show a too high threshold of the requirement which may prohibit the development of innovative commercial insurance products.<sup>1191</sup>

#### **4.2.3.3 Conclusion**

Several live issues will be addressed after the passage of the Insurable Interest Bill. After the enforcement of the Draft, the English law on insurable interest in non-life insurance makes it clear that an assured must meet the requirement of insurable interest at the time of effecting an insurance contract. In addition, s 3(1) solves the unclear situation as to the consequence of lack of insurable interest in non-life insurance at the outset of the contract through providing that breaking the requirement will make the contract void. It is now consistent with the position in marine insurance. On the account of the requirement for insurable interest in three types of insurance policies by the Draft, the 2005 GA has not affected life-related insurance, non-life insurance or a marine insurance policy. Besides, s 5 of the *2016 Draft* further provides that, after the enforcement, rules of this Act will replace those concerning the insurable interest principle, certainly including rules made in the 2005 GA even though it has affected the principle. As discussed below as to s 4(1) of the *2016 Draft*,

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<sup>1190</sup> See 4.2.1.3, above.

<sup>1191</sup> *2015 IP 10*, para 2.14

due to the consequence of it being void not illegal, there is the potential for the assured to recover the premium paid if it did not make untrue statements relating to its insurable interest at the time of taking out the contract.

### 4.3 Providing a clear statutory requirement of insurable interest

#### 4.3.1 Necessity

The UK law on the requirement of insurable interest has been described as “a bewildering mixture of common law and statute”.<sup>1192</sup> There is no certain and precise legal base for the requirement.<sup>1193</sup> The position is unclear as to whether common law requires an insurable interest for an assured to obtain a valid contract of insurance.<sup>1194</sup> For the position in statute law, many problems have arisen: the principle of insurable interest is required by varied statutes, in which the 1788 MIA and the 1909 MIA are regarded as outdated and moribund and thus it is proposed for them to be abolished.<sup>1195</sup> It is uncertain as to whether the 1845 GA indirectly imposes the requirement for non-marine indemnity insurance<sup>1196</sup> and whether the requirement has been repealed by accident by the 2005 GA.<sup>1197</sup> To make the position clear, it was proposed by the Law Commissioners that, leaving the common law aside, it was the statute on its own that should clarify that a policyholder effecting all kinds of insurance contracts<sup>1198</sup> must have an insurable interest to obtain a valid insurance.<sup>1199</sup>

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<sup>1192</sup> 2011 CP, para 10.2

<sup>1193</sup> 2015 IP 10, para 2.4

<sup>1194</sup> 2011 CP, para 11.6

<sup>1195</sup> 2011 CP, para 10.15

<sup>1196</sup> 2011 CP, paras 11.26, 11.29, 12.36; also see 1.2.3.1: Indirect requirement of insurable interest under 1845 GA

<sup>1197</sup> 2011 CP, para 10.2; as for a detailed discussion on this topic, see 3.1.2

<sup>1198</sup> Including both indemnity insurance and contingency insurance.

<sup>1199</sup> 2011 CP, para 12.38

### 4.3.2 Rules

Based on the statistics concerning this issue that 23 out of 30 (or 77%) respondents supported statutory clarification, in *IP 10*, the Law Commissioners again proposed that the statute should clearly require the assured to have some form of insurable interest in the subject matter in every kind of insurance.<sup>1200</sup>

The statutory requirement of insurable interest for the purpose of non-marine indemnity insurance has thus been provided for by the *2016 Draft* that a contract of insurance is void unless, at the time of entering the contract, the assured has an insurable interest or a reasonable prospect of acquiring such an interest during the life of the contract.<sup>1201</sup>

### 4.3.3 Responses to the necessity

By this method, as with the non-marine indemnity insurance, it is the first time that the insurable interest is required by statute. The confusing situation where the insurable interest has been governed by various statutes has also been resolved. After the enactment of the *2016 Draft*, the 1788 MIA and 1909 MIA will be repealed and the Bill will be the only statute to provide the law on insurable interest in the area of non-marine insurance.<sup>1202</sup> Hence, there is no need to consider the effect of the 1845 GA and its abolition by the 2005 GA and it is certain that s 335 of the 2005 GA does not affect the rules of insurable interest, at least in the realm of non-marine indemnity insurance.<sup>1203</sup>

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<sup>1200</sup> *2015 IP 10*, para 2.6

<sup>1201</sup> *2016 Draft*, s 3(1)

<sup>1202</sup> *2016 Draft*, s 5 and s 7

<sup>1203</sup> *2016 Draft*, s 5

## 4.4 Timing and consequences

For different reasons, in marine insurance there is a difference in relation to the timing and the extent of insurable interest. To make a claim, the assured must have an insurable interest at the time of loss, not at the outset of the insurance contract.<sup>1204</sup> To prevent a policy of insurance from being void, it is sufficient for the assured to show an expectation of insurable interest at the time of effecting the contract.<sup>1205</sup>

### 4.4.1 Timing

An example of non-marine indemnity insurance was given by the Law Commissioners to illustrate the case relating to timing of insurable interest:

In January a second-hand car dealer enters into a year's contract to insure a garage which it intends to buy in February. The purchase is delayed until 31 March. From 1 April to 31 October, the policyholder owns the garage, but sells it again on 1 November.<sup>1206</sup>

From January at the outset of the contract of insurance, the policy was enforceable and not avoidable for the dealer had a real expectation of acquiring an insurable interest in the garage.<sup>1207</sup> From January the premium was payable and the insurer was entitled to sue for it until the end of the insurance on the basis that the insurance policy attached from then.<sup>1208</sup> The dealer could only claim the loss which had occurred from 1 April to 31 October because it could only have insurable interest during this period after the completion of the

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<sup>1204</sup> 1906 MIA, s 6(1)

<sup>1205</sup> 1906 MIA, s 4, s 6(1)

<sup>1206</sup> 2011 CP, para 12.43

<sup>1207</sup> 2011 CP, para 12.48

<sup>1208</sup> 2015 IP 10, para 2.12

sale.<sup>1209</sup> For the loss of premiums suffered by the dealer during the period from January to 31 March and from 1 November to the end of the insurance when it was obliged to pay premiums but not entitled to claim the loss, it was the risk that the dealer had to take by effecting the insurance in advance.<sup>1210</sup> As to how to test the validity of an indemnity insurance contract in terms of insurable interest and when a policyholder may claim for the loss, these two issues will be discussed below.

#### *4.4.1.1 The validity of insurance in terms of insurable interest*

In the *2011 CP*, the Law Commissioners proposed how to identify those contracts of non-marine indemnity insurance which would be deemed as void for lack of insurable interest: only where the contract is taken out without a real probability of acquiring some kind of insurable interest at any stage during the life of the contract.<sup>1211</sup> Thus, to obtain a valid contract of indemnity insurance in terms of the insurable interest principle, the policyholder must demonstrate that at the time of the contract it has a real probability of acquiring insurable interest at some time.

This proposal for non-marine indemnity insurance is different from the position in marine insurance. For the latter, a policy of marine insurance would be deemed as void that is in the guise of a gaming or wagering agreement as provided for in subsection 4(2) of the 1906 MIA.<sup>1212</sup> Possibly to avoid being affected by the 2005 GA making gambling enforceable,<sup>1213</sup> unlike in the Act

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<sup>1209</sup> *2011 CP*, para 12.45

<sup>1210</sup> *2011 CP*, para 12.47

<sup>1211</sup> *2011 CP*, paras 12.38, 12.46

<sup>1212</sup> 1906 MIA, s 4

<sup>1213</sup> 2005 GA, s 335

1906,<sup>1214</sup> the proposal did not involve gambling contracts and directly provided which kind of non-marine indemnity contract could be regarded as void.<sup>1215</sup>

The Law Commissioners stated that the majority of consultees (18 of 26, or 69%) who responded were in favour of their proposal on this problem. In order to answer queries from some consultees as to how to test that an indemnity insurance contract was void for lack of insurable interest in particular circumstances, the Law Commissioners further studied this issue in detail in the following three subtitles.<sup>1216</sup>

Under the *2016 Draft*, it has been made clear that the timing which can affect the validity of a contract of non-marine insurance is the very outset of the contract and that a “reasonable prospect” (not “expectation” expressed in the 1906 MIA or “real probability” proposed in the *2011 CP*) of an insurable interest during the term of the contract is sufficient to support an assured having an insurable interest.<sup>1217</sup>

#### 4.4.1.1.1 Whether the term of “real probability” is too high a bar

In the *2011 CP*, the Law Commissioners used the wording of “real probability” to describe an indemnity insurance void for lack of insurable interest.<sup>1218</sup>

In *IP 10*, the terminology of “real probability” was, it was argued, to be substituted by terms of “reasonable expectation” or “reasonable prospect” because the former may imply an overly high threshold than that of the latter,

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<sup>1214</sup> 1906 MIA, s 4(2)

<sup>1215</sup> *2011 CP*, para 12.38

<sup>1216</sup> *2015 IP 10*, para 2.13

<sup>1217</sup> *2016 Draft*, s 3(1)

<sup>1218</sup> *2011 CP*, paras 12.38, 12.46

which was agreed by the Law Commissioners.<sup>1219</sup> They thought however that, the differences between terms of “real probability” and “reasonable expectation” or “reasonable prospect” were more “presentational than substantive” for if occasionally raised by the insurer, the courts would strive to find an insurable interest for the policyholder.<sup>1220</sup> Despite that, the Law Commissioners recognised that the proper wording of “reasonable expectation” or similar should be made by them to prevent “real probability” from being understood by the parties as an overly high threshold leading to the insurer reluctant to provide useful insurance products.<sup>1221</sup> In a word, to make an insurance contract valid, it was proposed by the Law Commission that the policyholder must have an insurable interest at the outset of the contract or at that time have a reasonable expectation (or similar) of acquiring such an interest at some stage during the life of the contract.<sup>1222</sup>

#### 4.4.1.1.2 Never actually acquiring an interest

In the circumstance where the assured might have acquired an insurable interest at the time the insurance contract was taken out but eventually did not obtain it because of non-gambling reasons, such as the failure of the trade, the issue was raised as to whether the contract was valid and consequently whether the insurer was entitled to sue for premiums. In the *2011 CP*, the Law Commissioners thought that the key to the test was whether there was a real probability at the time of the contract.<sup>1223</sup> If there was, it was a valid contract and the assured had to pay premiums to the insurer even though the trade for which the assured had effected insurance later failed because of which it could not

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<sup>1219</sup> *2015 IP 10*, paras 2.14-2.15

<sup>1220</sup> *2015 IP 10*, para 2.15

<sup>1221</sup> *2015 IP 10*, paras 2.14-2.16

<sup>1222</sup> *2015 IP 10*, Proposal 1

<sup>1223</sup> *2011 CP*, para 12.48

obtain an insurable interest.<sup>1224</sup> This proposal was again affirmed by the Law Commissioners in *IP 10*.<sup>1225</sup>

By contrast, where the assured could never have a “real expectation” or “reasonable expectation” (or similar) of acquiring an insurable interest at the outset of the policy and ultimately did not do so, what the proper consequences of such a case should be was considered. The Law Commissioners in the *2011 CP* gave an example of gambling upon an agreement as to whether the Eiffel Tower would fall down, effected by an assured having no intention of obtaining an interest.<sup>1226</sup> The outcome was proposed by the Law Commission in this paper that the policy was void for lack of insurable interest because there was no real expectation of acquiring some kind of insurable interest at the time of the contract.<sup>1227</sup> This contract was effectively worthless.<sup>1228</sup> As a result, the assured could not make a claim for the loss and the insurer could not sue for premiums not received. Besides, for those having been paid, the assured was entitled to get them refunded.<sup>1229</sup> It thus appears true that the insurance, in particular the requirement of insurable interest, has not unintentionally been affected by the 2005 GA because the above gambling contract, it is suggested, is void and unenforceable.

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<sup>1224</sup> *2011 CP*, para 12.48; see the example of the second-hand car dealer, above

<sup>1225</sup> *2015 IP 10*, para 2.12

<sup>1226</sup> *2011 CP*, para 12.49

<sup>1227</sup> *2011 CP*, paras 12.38, 12.46, 12.49

<sup>1228</sup> *2011 CP*, paras 12.38, 12.46

<sup>1229</sup> *2011 CP*, paras 12.38, 12.49

In *IP 10*, the Law Commission still agreed with the above proposal; albeit being consistent with their new thinking, they replaced “real probability” with “reasonable expectation” or similar.<sup>1230</sup>

S 3(1) of the *2016 Draft* provides that it is at the outset of the contract that the assured must acquire at least a reasonable prospect in the subject matter in the non-life insurance, breach of which would affect the validity of a contract. Thus, in order to not be void, the timing of effecting the contract is crucial. Then, as long as the assured has an insurable interest or a reasonable prospect of an insurable interest, in spite of the fact that he later loses or assigns it, the contract is still valid because the insurer has assumed risks in such a situation. Due to the insurers having taken risks, the assured has to pay the premium which acts as the risk transfer mechanism.

#### 4.4.1.1.3 Actually acquiring an insurable interest

In *IP 10*, the Law Commissioners discussed the validity as to a new circumstance, which was not mentioned in the *2011 CP*, where there was no “real probability” or “reasonable expectation” or similar of obtaining an insurable interest at the outset of the contract, the policyholder however somehow indeed did so during the life of the insurance contract.<sup>1231</sup> Under such a circumstance, according to the test relating to the validity of an insurance contract in the *2011 CP*, it would be void and thus would be unfair to both parties to the insurance where the dispute that the insurance is void for lack of insurable interest is put forward before a court. To put it simply: where the assured has known that no loss occurs, the insurer may be asked by the other party to the contract to

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<sup>1230</sup> *2015 IP 10*, paras 2.14-2.17

<sup>1231</sup> *2015 IP 10*, para 2.18; For examples illustrating this circumstance, see *2015 IP 10*, paras 2.19-2.20

return premiums because it is argued that the contract is void for lack of insurable interest; where a loss has occurred, being faced with a claim made by the assured to compensate its loss, the insurer may decline to do so by arguing the invalidity of the insurance for lack of an interest.<sup>1232</sup>

To address such a difficulty, the Law Commissioners made a proposal in *IP 10* as follows: in general, similar to the test raised in the *2011 CP*, an indemnity insurance contract would be regarded as void where the assured at the time the contract was made had no insurable interest and at that time no “reasonable expectation” or similar of acquiring an insurable interest at any stage during the duration of the contract; for the case in which it was difficult to test the existence of such an expectation of an interest at the outset of the policy, the fact that the assured had obtained an insurable interest at any time during the life of the contract was the conclusive proof of its existence.<sup>1233</sup>

However, the *2016 Draft* does not encompass the proposal for the validity of an insurance contract which is described as a theoretical case where the assured has no reasonable prospect of having some form of insurable interest at the outset of the contract but in the end somehow acquires such an interest:

a company acting optimistically by insuring a property it wished to acquire even though it did not have the resources to do so. If it received an unexpected windfall, the sale might go ahead.<sup>1234</sup>

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<sup>1232</sup> *2015 IP 10*, para 2.21

<sup>1233</sup> *2015 IP 10*, para 2.22, Proposal 1, Proposal 2

<sup>1234</sup> *2015 IP 10*, fn14

Due to the ‘timid’<sup>1235</sup> reform in the *2016 Draft*, the law on this case remains unclear. This approach may leave the assured and the insurer hopeless: for the assured, the insurer may assert the avoidance of the contract because the assured has no reasonable expectation of interest at the time of taking out the contract; for the insurer, the assured may claim for recovering the premium paid by asserting the avoidance of the contract after having known there was no occurrence of loss, despite the fact that he has effectively obtained an interest. The proposal could have asserted that the policy is not void for lack of insurable interest only if the assured can acquire an interest during the policy term.<sup>1236</sup>

#### *4.4.1.2 When the assured can make a claim for loss*

##### *4.4.1.2.1 At the time of loss in the 2011 CP*

The Law Commissioners proposed the same position for marine insurance, as to the timing of insurable interest which the assured must have in order to claim for the loss, to be applied to non-marine indemnity insurance. For non-marine indemnity insurance, the assured could not make a claim and get indemnified unless it could show the possession of insurable interest at the time of loss.<sup>1237</sup>

##### *4.4.1.2.2 Same in the IP 10*

Identical to the proposal in the *2011 CP* that the assured could make a claim conditional on it having an insurable interest in the subject matter at the time of loss, the Law Commission said this proposal represented the current law as to when the assured under an indemnity insurance could claim and it would be beneficial if this position could be clarified in a statute.<sup>1238</sup>

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<sup>1235</sup> Professor Robert M Merkin, *Colinvaux’s Law of Insurance* (11th edn, Sweet & Maxwell 2016) 4-029

<sup>1236</sup> *2015 IP 10*, para 2.22

<sup>1237</sup> *2011 CP*, paras 12.38, 12.45

<sup>1238</sup> *2015 IP 10*, paras 2.26, Proposal 3

#### 4.4.1.2.3 Same in the 2016 Draft

For such reasons, the *2016 Draft* makes it a clear statutory rule that the conclusive timing to determine whether an assured can claim to be compensated by the insurer is at the time of the insured event.<sup>1239</sup> While it was not clear as regards when an insurable interest must be possessed in the non-life insurance context, it has been expressly set out in s 3(2) that, in order to make a claim, the assured must obtain an insurable interest at the time of loss. It finally shares the clear position concerning the timing of having an actual interest as that of marine insurance provided for in s 6(1) of the 1906 MIA: the actual interest must attach at the time of loss. So it does not matter whether the assured has an actual insurable interest at the outset of the contract or it has lost or assigned its interest after the loss.<sup>1240</sup> However, the rule of “lost or not lost” in marine insurance is not included in the Draft. Retrospective interests and declaration thus cannot apply to non-marine indemnity insurance.

#### 4.4.1.2.4 The consequences of lack of insurable interest are different

A breach of the requirement of insurable interest by s 3(1) will render a contract void. By contrast, lack of insurable interest at the time of the insured perils will render the assured not able to make a claim, with nothing relating to the validity of the contract. Different types of interest are required. For the former, a reasonable expectation of obtaining an insurable interest meets the provisions by s 3(1). However, to satisfy the insurable interest required by s 3(2), an actual interest is essential.

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<sup>1239</sup> 2016 Draft, s 3(2)

<sup>1240</sup> Malcolm A Clarke, Julian M Burling and Robert L Purves, *The law of insurance contracts* (5th edn, Informa 2006) 4-4

4.4.1.2.5 The rule in s 3(2) is different from the indemnity principle.

The English Law Commission stated that the insurable interest required at the time of loss is different from the indemnity principle. The former is designed to show who can make a claim and when. However, the latter focuses on the matter as to whether the assured has suffered a loss. And the Commissioners thought that the requirement of insurable interest by s 3(2) will not conflict with the indemnity principle because the latter also needs the proof of an interest in order to show its loss.<sup>1241</sup>

#### 4.4.2 Consequences of being void for lack of insurable interest

##### 4.4.2.1 Proposals in the 2011 CP

###### 4.4.2.1.1 Premium not payable in the event of avoidance

In indemnity insurance, in light of the proposal by the 2011 CP, the premium should be paid to the insurer unless the insurance was void.<sup>1242</sup> An indemnity insurance policy would be regarded as void if the policyholder at the time of the insurance could not acquire a real probability of insurable interest at any stage during the insurance period.<sup>1243</sup> As long as the insurance contract is valid for having a real probability of insurable interest, the insurer is entitled to sue for his premium.<sup>1244</sup> For the above example of the second-hand car dealer, it was recommended that from the outset of the insurance the insurer could retain the premium because since that time the insurance was valid, because the assured possessed a real probability of obtaining insurable interest and then the insurer ran the risk, even though the sale did not effectively happen.<sup>1245</sup> It should be highlighted again that although the insurer could sue for the premium because

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<sup>1241</sup> 2016 Notes, para 3.6

<sup>1242</sup> 2011 CP, paras 12.38, 12.46

<sup>1243</sup> 2011 CP, para 12.38

<sup>1244</sup> 2011 CP, paras 12.46-12.49

<sup>1245</sup> 2011 CP, paras 12.47-12.48

of the validity of insurance contracts it did not mean that the assured for the consideration of the premium could get indemnified which could only be compensated where the assured could show its possession of insurable interest at the time of loss. The risk of premium loss, caused during the period from the insurance effected to that of the sale contract completed, fell on the assured.<sup>1246</sup>

#### 4.4.2.1.2 Different from the position in marine insurance

In other words to set out the above proposal, if a policy was void owing to lack of a real expectation of acquiring insurable interest, either in the cases of gambling or failure of consideration, the outcome was the same: the insurer could not sue for the premium<sup>1247</sup> and the assured could retain the unpaid premium and recover those having been paid.<sup>1248</sup> The grounds for this proposal may rely on the fact that the consideration for the payment of the premium totally fails and the policy thus is totally worthless.<sup>1249</sup> The rule under the proposal is different from the position relating to marine insurance by section 84(3)(c) in the 1906 MIA. Section 84(3)(c) regulates marine insurance policies as follows: if the policy is void due to it being in the guise of gambling contracts, the premium received by the insurer is not returnable.<sup>1250</sup> This reflects the legislative intention of the 1906 MIA, one aim of which is to prohibit wager policies. However, without a wager policy, the insurer should return the premium received where the policy is void due to the assured not acquiring an interest during the policy term. The premium being returnable is based on the

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<sup>1246</sup> 2011 CP, paras 12.47, 12.48

<sup>1247</sup> 2011 CP, paras 12.38, 12.46

<sup>1248</sup> 2011 CP, paras 12.38, 12.49

<sup>1249</sup> 2011 CP, paras 12.46, 12.38

<sup>1250</sup> 1906 MIA, s 84(3)(c)

consideration of the premium failing: the insurer need not pay anything for the policy or the risk that never attaches.<sup>1251</sup>

#### 4.4.2.2 Proposals in IP 10

##### 4.4.2.2.1 Same

Similar to the proposal to address the consequences of insurance contracts being void due to the assured having no real expectation of insurable interest in the 2011 CP, it was set out as follows: “if the insured shows that an insurance contract is void for lack of (actual or anticipated) insurable interest, the insurer should not be entitled to sue for the premium and the insured should be entitled to a refund of premiums already paid.”<sup>1252</sup> As long as the insurance is valid, the insurer is entitled to sue for unpaid premiums.<sup>1253</sup>

##### 4.4.2.2.2 Reasons

This proposal was based on three grounds. In the first place, consideration for the insurance contract fails.<sup>1254</sup> Seeking to be compensated on the occurrence of loss, the assured, having no actual or anticipated insurable interest in the insured subject, has paid the premium as consideration for the indemnity.<sup>1255</sup> However, consideration on the part of the insurer fails because the assured cannot suffer a loss; the insurer thus needs to indemnify no loss.<sup>1256</sup> Secondly, the concept of premium is regarded as “a risk transfer mechanism”.<sup>1257</sup> In

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<sup>1251</sup> 1906 MIA, s 84(3)(c); Jonathan Gilman, Professor Robert M Merkin, Claire Blanchard and Mark Templeman, *Arnould’s Law of Marine Insurance* (18th Revised edn, Sweet & Maxwell 2013) 1-08

<sup>1252</sup> 2015 IP 10, paras 2.23, Proposal 4

<sup>1253</sup> 2015 IP 10, para 2.25

<sup>1254</sup> 2015 IP 10, para 2.24

<sup>1255</sup> 1906 MIA, s 84(3)(c); Jonathan Gilman, Professor Robert M Merkin, Claire Blanchard and Mark Templeman, *Arnould’s Law of Marine Insurance* (18th Revised edn, Sweet & Maxwell 2013) 1-05

<sup>1256</sup> 1906 MIA, s 84(3)(c); Jonathan Gilman, Professor Robert M Merkin, Claire Blanchard and Mark Templeman, *Arnould’s Law of Marine Insurance* (18th Revised edn, Sweet & Maxwell 2013) 1-08

<sup>1257</sup> 2015 IP 10, para 2.24

circumstances where the assured takes no risk for lack of insurable interest, a premium should not be involved. Thirdly, it can act as a barrier against the insurer effecting overly speculative contracts because the premium received will be returned to the assured should those contracts be deemed as void for lack of insurable interest.<sup>1258</sup> Thus, both parties of the assured and the insurer will strive to take out valid insurance contracts. In virtue of this proposal, benefits of the insurance parties can be better balanced and the market discipline can be constrained.

#### *4.4.2.3 Provisions under the 2016 Draft*

##### *4.4.2.3.1 Not including rules as to return of premium*

The *2016 Draft* does not provide the proposal in *IP 10* which stated that the premium paid should be returned to the assured where the policy was void for breaking the insurable interest requirement. The English Law Commission considered the proposal as the subject of the general law which should not be governed by the *2016 Draft*. Subject to general rules, a void contract is as if it had never existed. So the parties to the contract should go back to the pre-contract state. If the contract is void for lack of insurable interest, the assured then should be entitled to recover the premium paid. The function of the premium playing the role of risk transfer mechanism also decides this position. If the contract is void for having no interest at the outset, then the insurer has never been at risk, then the consideration of the premium fails; the premium should thus be returned to the assured.<sup>1259</sup> The court held that the assured

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<sup>1258</sup> *2015 IP 10*, para 2.25

<sup>1259</sup> *2016 Notes*, paras 4.1-4.4

could recover the paid premium where the reinsurance contract was void because the contract included the PPI term.<sup>1260</sup>

#### 4.4.2.3.2 Premium not being returnable caused by assureds' untrue statement in the event of a policy's avoidance

Section 4(1) instead sets out that the premium paid by the assured is not recoverable from the insurer where not only the contract concerned is void for lack of insurable interest but, although the assured already knows or does not care about the nature of his interest, he still makes an untrue statement about his interest in the insured subject matter at the time of taking out the contract. This principle is consistent with that under s 84(1) of the 1906 MIA: if the contract is void for lack of insurable interest and the assured acts fraudulently or illegally, the insurer can retain the premium paid and not need to return them to the assured. In light of s 4(1), the debate can stop now that s 84(1) does not apply to non-marine insurance based on the common law principle that, despite the assured making a fraudulent statement relating to insurable interest, he seems to be able to recover the premium.<sup>1261</sup>

#### 4.4.2.3.3 Whether s 4(1) of the 2016 Draft can be replaced by the Consumer Insurance (Disclosure and Representations) Act 2012 (CIDRA 2012, below) and the Insurance Act 2015

Both CIDRA 2012 and the Insurance Act 2015 have set out that the insurer need not return the premium paid in the case where the assured has known that it is in breach of the duty of disclosure or does not care whether or not it is in such a breach. There is a debate that the above two Acts may apply to the situation governed by s 4(1) because the assured has known that the statement

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<sup>1260</sup> *Re London County Commercial Reins Office* [1992] 2 Ch 67

<sup>1261</sup> *Spence v Crawford* [1939] 3 All ER 271, 288-89

of its interest is untrue or does not care whether or not the statement is true. It may be not the case. The nature of the disclosure is a pre-contractual duty and the precondition for breach of the duty of disclosure is that the contract must in fact exist. However, the fact of the untrue statement as to insurable interest will render the contract void, meaning the contract has not ever existed. It is meaningless to assert the breach of the pre-contractual disclosure duty. The two Acts thus do not apply to a contract void for lack of interest and s 4(1) is then required.

#### 4.4.2.3.4 The problem with s 4(1) and possible improvement

It should be noted that s 4(1) may create rigid outcomes against the assured, like the one in joint insurance. In this case, a joint assured may be left without cover and unable to recover premiums paid although it has acted honestly but other joint parties have fraudulently carried out the policy. Clause 4 of CIDRA 2012 assists to limit the harsh outcomes in consumer insurance by ruling that if the assured of a consumer insurance contract has made deliberate or reckless misrepresentations, the insurer need not return the premium paid, except to the extent (if any) that it would be unfair to the consumer to retain them. However, the business assured in the situation in question is left vulnerable. Firstly, CIDRA 2012 does not apply to business insurance. Secondly, clause 4 does not apply in relation to a contract void for lack of interest because there is no need to discuss the effect of the assured's misrepresentation as to a void contract. Thirdly, although the English Law Commission has recognised this issue, the *2016 Draft* does not provide rules to better address this harsh situation. It may be a good choice, to be consistent with CIDRA 2012, clause 4, by adding terms like 'except to the extent (if any) that it would be unfair to the assured to retain them' to mitigate the harsh results. In short, the *2016 Draft* should have

separately treated the parties to some kind of insurance, like the joint insurance, where one policyholder deliberately has made untrue statements as to the nature of his interest while others have acted honestly.

#### 4.5 Whether the 1909 MIA should be abolished

In relation to marine insurance contracts, *IP 4* tentatively proposed to repeal section 1(1) of the 1909 MIA which provides that it is a criminal offence against those policyholders who have taken out marine insurance contracts without insurable interest.<sup>1262</sup> The Law Commissioners gave three reasons for repealing the 1909 MIA as follows: the first was to be consistent with their previous proposal using the general interest in the indemnity principle to replace that under the insurable interest principle; the other was that no prosecution had ever arisen under the 1909 MIA.<sup>1263</sup> Besides, the English Law Commission thought the 1909 MIA had imposed unnecessary criminal penalties on the basis that financial services regulation, not criminal methods, should govern the issue of insurable interest in insurance contracts.<sup>1264</sup> In addition, the 2005 GA enforces a wager contract which is the reason for imposing the criminal offence. It is clearly no longer outlawed.<sup>1265</sup> Thus, the 1909 MIA was again proposed by the Law Commissions in the *2011 CP* and *IP 10* to be entirely abolished.<sup>1266</sup> To reflect the above-mentioned proposal, the *2016 Draft s 7(1)* states that it will, if enacted, abolish the 1909 MIA.

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<sup>1262</sup> *IP 4*, para 7.97, 8.21

<sup>1263</sup> *IP 4*, para 7.96

<sup>1264</sup> *2011 CP*, para 12.52

<sup>1265</sup> *IP 4*, para 5.35

<sup>1266</sup> *2011 CP*, para 12.52

## 4.6 Names of interested parties under the 1788 MIA

### 4.6.1 Arguments at to the above rule and its repealing in *IP 4*

As to the issue as to whether the names of interested parties should be written in a policy, before the 1906 MIA repealed the 1788 MIA insofar as it affected marine insurance, it seemingly varies in different types of insurance: there was a need for “life, goods and marine insurance but not for land, buildings or liability insurance”.<sup>1267</sup> Some supported the insertion of the names by arguing that it was necessary for insurers to assess the risk. Others nevertheless took the opposite view on such a necessity: the assured’s disclosure or presentation could help to fulfil this function.<sup>1268</sup> The provisional proposal in *IP 4* thus was that the names of those interested in every kind of insurance need not be entered into a policy and affect the enforceability of contracts of insurance.<sup>1269</sup>

### 4.6.2 Abolition in the 2011 *CP* and *IP 10* and the position in marine insurance

In the 2011 *CP*, the English Law Commission proposed abolishing the 1788 MIA in its entirety, which *IP 10* confirmed.<sup>1270</sup> As a result of the repeal, names of interested parties both in marine insurance and non-marine insurance on “goods, merchandizes, effects or other property” were not needed to be written into policies. The position is clear in marine insurance because the 1788 MIA has been repealed by the 1906 MIA to the extent of marine policies<sup>1271</sup> and the 1906 MIA provides that only the names of the assured or of one effecting insurance on its behalf must be specified in the policy.<sup>1272</sup> After the abolition, the assured may feel safer writing policies without being concerned that the insurer

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<sup>1267</sup> *IP 4*, para 7.98

<sup>1268</sup> *IP 4*, paras 7.99-7.100

<sup>1269</sup> *IP 4*, para 7.101, 8.22

<sup>1270</sup> 2011 *CP*, para 12.55

<sup>1271</sup> 2011 *CP*, para 12.55

<sup>1272</sup> 1906 MIA, s 23

was being relieved from its liability due to failing to insert names. This seems to be the practice of the market<sup>1273</sup> on the basis that the 1788 MIA, despite applying to non-marine insurance on goods, has no practical effects on such insurance<sup>1274</sup> and is regularly ignored by insurers.<sup>1275</sup>

#### **4.6.3 Same position in the *Draft 2011* and reasons**

As a result, s 7(1) of the *Draft 2011* entirely abolishes the 1788 MIA. As for a contract of non-life insurance, the law no longer requires the assured to insert the names of those interested in the insurance contract. Taking the view of the Law Commissioners, there is no need to provide this requirement in law because it is a matter of contract and the insurer is free to contract with the assured to incorporate the interested peoples' names into its contract. It may also be harsh to allow the insurer to be relieved from its duty because of the assured not inserting the interested parties' names.<sup>1276</sup> After this repeal, for policies on goods, land and buildings, and liability, it will be unnecessary for the assured to insert the interested names into these policies. Breach of inserting interested names into policies also no longer renders such a policy void. Rules for different kinds of insurance are now consistent. Section 23 of the 1906 MIA nevertheless demands the assured, or some person who has effected the insurance on its behalf under a marine insurance policy, to do so. It seems that s 23 is also applicable to non-life indemnity insurance.

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<sup>1273</sup> 2011 CP, para 12.55

<sup>1274</sup> 2011 CP, para 11.15

<sup>1275</sup> 2015 IP 10, para 2.30

<sup>1276</sup> 2016 Notes, para 5.10

## 4.7 Should the provisions on insurable interest in the 1906 MIA be affected?

### 4.7.1 The position in *IP 4* and the *2011 CP* and reasons

Sections 4 to 15 in the 1906 MIA relate to the law on insurable interest for insurance policies governed by the Act. In *IP 4*, the issue regarding those sections was not discussed. In the *2011 CP*, according to the Law Commissions' proposals, in the realm of marine insurance, no change should be made to ss 4 to 15 of the 1906 MIA.<sup>1277</sup> In the first place, those sections were considered to be operating satisfactorily according to the responses from consultees.<sup>1278</sup> For instance, the RSA argued that the definition of insurable interest regarding marine insurance on goods, which was provided for in s 5 of the 1906 MIA<sup>1279</sup> operated well up until now.<sup>1280</sup> Secondly, any reform may affect the limited specific definition of insurable interest, differing from that of loosely defined interest.<sup>1281</sup>

### 4.7.2 No change in *IP 10* and the *2016 Draft*

The Law Commissioners proposed in *IP 10* to leave, in the marine insurance context, ss 4 to 15 of the 1906 MIA unaffected by their reform.<sup>1282</sup> By restating that those provisions were deemed to operate well and there was no strong and urgent reason to reform them, s 6 in the *2016 Draft* excludes marine insurance contracts from the ambit of the Draft's regulation.<sup>1283</sup> It means that ss 4 to 15,

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<sup>1277</sup> *2011 CP*, para 12.58

<sup>1278</sup> *2011 CP*, para 12.58

<sup>1279</sup> 1906 MIA, s 5

<sup>1280</sup> *2011 CP*, para 12.18

<sup>1281</sup> *2011 CP*, para 12.18

<sup>1282</sup> *2015 IP 10*, Proposal 7

<sup>1283</sup> *2016 Notes*, paras 5.3-5.5

governing insurable interest, still applies to a contract of marine insurance<sup>1284</sup> and the law on insurable interest in marine insurance is left unchanged.

## 4.8 Definition of insurable interest

### 4.8.1 Proposal in the 2011 CP

#### 4.8.1.1 Law Commissioners in favour of the broader test

The *IP 4* did not consider that the reformed definition of the statutory insurable interest should include what were critical elements or whether the concept of the statutory insurable interest was operating well. In the *2011 CP*, some respondents did not seem satisfied with the narrow test of the legal or equitable interest; instead, they argued in favour of the broader test of economic or pecuniary interest being sufficient that the assured would, in the ordinary course of practice, benefit from the preservation of the insured subject matter and suffer an economic disadvantage should the subject matter of insurance be lost.<sup>1285</sup> In light of the approach of the broader test of insurable interest by the courts, the Law Commissioners agreed to this argument.<sup>1286</sup> However, the insurers were less concerned about the test of insurable interest because they seldom raised the argument of the assured lacking insurable interest.<sup>1287</sup> The English Law Commission thought that the issue of mere expectation to be at risk, still consistent with the current law, was a relationship too far to comprise an insurable interest.<sup>1288</sup>

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<sup>1284</sup> 2016 Draft, s 5

<sup>1285</sup> *2011 CP*, paras 12.27-12.28

<sup>1286</sup> *2011 CP*, para 12.29

<sup>1287</sup> *2011 CP*, para 12.26

<sup>1288</sup> *2011 CP*, paras 12.30-12.31

#### *4.8.1.2 Two methods of reforming the definition*

Despite differing opinions regarding the elements of the requirement of insurable interest expressed by the responses, the Law Commissioners recommended no major reform for the definition of insurable interest in indemnity insurance.<sup>1289</sup> They instead considered whether the definition of insurable interest for non-marine indemnity insurance should be provided for in the statute, similar to the approach of section 5 in the 1906 MIA or whether, with a statutory basis for the requirement of insurable interest, it should be totally left to the courts, as it is now.<sup>1290</sup> For marine insurance, s 5 of the 1906 MIA provides a non-exhaustive definition for insurable interest, which codifies pre-1906 cases on insurable interest. As far as non-marine indemnity insurance is concerned, the current state is unclear and the test of insurable interest is totally reliant on case law authorities.

#### *4.8.1.3 Three kinds of interest can be regarded as insurable.*

To count it as insurable interest in non-marine indemnity insurance, three kinds of relations between the assured and the insured subject were proposed by the Law Commissioners.<sup>1291</sup> The law on insurable interest in marine insurance is nowadays recognised by these three types of interest.<sup>1292</sup> The first was the same as that of marine insurance in the 1906 MIA: a legal or equitable interest in the subject matter of insurable interest.<sup>1293</sup> The assured had to demonstrate a right to the property insured or a right deriving out of the contract relating to

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<sup>1289</sup> 2011 CP, para 12.35

<sup>1290</sup> 2011 CP, para 12.40

<sup>1291</sup> 2011 CP, para 12.61

<sup>1292</sup> 1906 MIA, s 5; *Feasey v Sun Life Assurance Co* [2003] Lloyd's Rep IR 637; *Hepburn v A Tomlinson (Hauliers) Ltd* [1966] AC 451 (AC) 467

<sup>1293</sup> 1906 MIA, s 5; *Lucena v Craufurd* (1806) B & PNR 269; *Anderson v Morice* (1874–75) LR 10 CP 609; (1876) 1 App Cas 713; *Macaura v Northern Assurance Co Ltd* [1925] AC 619

it.<sup>1294</sup> Secondly, the interest of possession is one kind of insurable interest, for instance, a carrier or other bailees.<sup>1295</sup> The third reflected the continually expanding tendency of insurable interest held by Lawrence J: a factual expectation or economic disadvantage could comprise insurable interest.<sup>1296</sup> Although this wider test was argued by Ward LJ as having no legal basis,<sup>1297</sup> it has most recently been approved as one type of insurable interest in *Feasey*.<sup>1298</sup>

#### 4.8.2 Proposals in *IP 10*

##### 4.8.2.1 Further limitation of the above two methods in the 2011 CP by *IP 10*

Differing from the proposal of the two options for the definition of insurable interest recommended in the 2011 CP, the Law Commission in the *IP 10* only proposed an approach similar to how the requirement of insurable interest has been defined in the 1906 MIA, namely, the statute should provide for all types of non-marine indemnity insurance, a non-exhaustive definition including examples of kinds of interest which could comprise the requirement of insurable interest.<sup>1299</sup>

##### 4.8.2.2 Similar definition as that in the 2011 CP

In respect to the three types of insurable interests proposed in the 2011 CP which was recommended as part of the non-exhaustive list of examples of the requirement of insurable interest, by and large, the Law Commission in *IP 10* was satisfied with the proposal, with minor amendments.<sup>1300</sup> Again, three kinds

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<sup>1294</sup> 2011 CP, para 12.61

<sup>1295</sup> For the law on insurable interest concerning bailees, see 3.3.3.3.1 in Chapter 3

<sup>1296</sup> *Lucena v Craufurd* (1806) B & PNR 269

<sup>1297</sup> *Feasey v Sun Life Assurance Co* [2003] Lloyd's Rep IR 637 [186]; cited in 2011 CP, para 12.62

<sup>1298</sup> *Feasey v Sun Life Assurance Co* [2003] Lloyd's Rep IR 637; cited in 2011 CP, para 12.61

<sup>1299</sup> 2015 IP 10, paras 2.32, Proposal 8

<sup>1300</sup> 2015 IP 10, paras 2.34-2.43, Proposal 9

of interest could be deemed as examples of the non-exhaustive definition. The first kind is the classic definition by Lord Eldon in *Lucena v Craufurd*: to have an insurable interest, the assured must have a legal or equitable interest in the property. Secondly, the interest of possession or custody can amount to insurable interest. As to the possession interest, the English Law Commissioners retained the same situation as the current law.<sup>1301</sup> In addition, more than the only interest of possession proposed in the *2011 CP*, this category also added custody, a broader conception than possession, of the subject matter of insurance as one type of insurable interest. Thus, a manager who did not possess the insured vessel, but owed a duty of care, could have an insurable interest in the vessel.<sup>1302</sup> Thirdly, a reasonable prospect (or similar) of benefit or loss can meet the requirement.<sup>1303</sup> Regarding the “factual expectation” of economic benefits or loss, the Law Commissioners still proposed that this type of interest could count as an insurable interest, but they used the term “reasonable prospect” instead of “factual expectation” to avoid the insurable interest requirement being treated as an overly high bar.<sup>1304</sup>

#### 4.8.3 Provisions in the *2016 Draft*

##### 4.8.3.1 Rules

###### 4.8.3.1.1 Four examples of insurable interest in the *2016 Draft*

The above three forms of insurable interest in *IP 10* has been incorporated into the *2016 Draft* with no substantial amendments but enlarging the form of the list into four limbs.<sup>1305</sup> Section 3(3) sets out that the assured can have an insurable

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<sup>1301</sup> *A Tomlinson (Hauliers) Ltd v Hepburn* [1966] AC 451

<sup>1302</sup> *O’Kane v Jones, The Martin P* [2005] Lloyd’s Rep IR 174

<sup>1303</sup> *2015 IP 10*, Proposal 9

<sup>1304</sup> *2015 IP 10*, para 2.40

<sup>1305</sup> *2016 Draft*, s 3(3)

interest in non-life insurance, other than marine insurance governed by the 1906 MIA, if it:

- has a right in the insured subject matter;
- has a right arising from a contract as regards it;
- has possession or custody of it; or
- will suffer economic loss on the occurrence of the perils insured.

The first three kinds of insurable interest mainly apply to property insurance and echo the current state of the law while the last type aims to widen the concept of insurable interest, although the English courts have in effect adopted the broader test.<sup>1306</sup> After the adoption of the wider economic loss test, the assured will not be under pressure of insurable interest concerns as to when to write covers on liability, D&O and business interruption. For example, under the proper terms of the policy, a person can recover under a policy on property although he has mere potential liability. Despite being unclear in non-marine indemnity insurance before this reform, the definition of insurable interest in non-life insurance is now certain. Thus, there has been a statutory definition of insurable interest in the realm of non-life insurance.

#### 4.8.3.1.2 The definition in the 2016 Draft echoing that in *Feasey*

This definition actually reflects that in *Feasey*:

- it has a legal or equitable relation to the insured subject matter;
- it is in possession of the subject;<sup>1307</sup> or
- it has no possession but has a mere economic loss by damage to the subject.<sup>1308</sup>

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<sup>1306</sup> 2016 Notes, paras 3.12-3.13; *Sharp v Sphere Drake Insurance Co (The Moonacre)* (1992) 2 Lloyd's Rep 501

<sup>1307</sup> *Feasey v Sun Life Assurance Co* [2003] 2 All ER (Comm) 587 [81], as to Group 1

With the last two limbs being the same, the first limb in *Feasey* representing the strict test in fact includes the first two types of insurable interest defined in s 3(3). Therefore, s 3(3) has just codified the law on insurable interest in *Feasey*, there is nothing new, which in effect mainly reflects Lawrence J's factual expectation of loss test. However, due to this codification, the nature and ambit as to insurable interest in non-life insurance is to some extent plain now.

#### *4.8.3.2 Benefits from the non-exhaustive concept*

The definition of the insurable interest in non-life insurance under s 3(3) is a partial, non-exhaustive one, with the form of a list of examples of the assured having an insurable interest. In the *2016 Draft* s 3(3) takes the method of s 5 of the 1906 MIA setting out the concept of insurable interest in marine insurance. By providing a non-exhaustive list of examples concerning some types of interest being regarded as an insurable interest in non-marine indemnity insurance, the parties can better understand what can constitute an insurable interest and the current attitudes by courts. In the meantime, it shows a flexible approach to satisfy the future development as to definitions of insurable interest caused by more new products of insurance, intended to conform to the needs of the future insurance market.<sup>1309</sup> Thus, it is improper for the list to provide some interests relating to which the law is still developing and not closed, such as that of sub-contractors' pervasive interest in the whole contract works:<sup>1310</sup> i.e. it should not be confined to interests of sub-contractors under contracts of construction. If it included other specific types of interest other than the four forms of interest in the list, it might have caused the problem of a narrowing understanding of the definition. As for those interests not included in the list, it

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<sup>1308</sup> *Feasey v Sun Life Assurance Co* [2003] 2 All ER (Comm) 587 [87]-[96], as to Group 3 and Group 4

<sup>1309</sup> 2011 CP, paras 12.62-12.64

<sup>1310</sup> 2011 CP, para 12.62

does not necessarily mean they are not insurable; and the partial definition will allow the courts to, just like the present state, continually expand the concept of insurable interest.<sup>1311</sup>

#### *4.8.3.3 Possession rather than lawful possession*

Although the English Law Commission did not state “lawful” possession in its proposals for the reform of the definition of insurable interest, they did consider doing so. But they have omitted it by setting out that possession, but mere possession even though unlawful, is one of an insurable interest in the *2016 Draft* s 3(3). Two reasons have resulted in this decision. Firstly, the doctrine of indemnity can inhibit an assured, unlawfully possessing the insured subject, from benefiting. As for the indemnity doctrine, the assured can be indemnified only if it has suffered a loss. In a case of unlawful possession, the assured cannot possibly suffer a loss, which leads to it being impossible to get recovery. In addition, the term of possession can put such an assured into a disadvantageous position. The assured cannot sue for the return of the premium paid due to the untrue statement. Secondly, the term of “lawful” possession may lead to the situation where the lawful owner cannot be compensated despite the unlawful possessor having cover for it.<sup>1312</sup> Suppose that A being poor has stolen an expensive car from the owner B and then took out a policy on the car. The car then crashed. If the unlawful possession is not one form of insurable interest, the contract will be void and the assured A will not get indemnification. Due to A being poor, the owner B cannot be indemnified without the insurer’s compensation.

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<sup>1311</sup> *2011 CP*, para 12.62

<sup>1312</sup> *2016 Notes*, para 3.12

#### *4.8.3.4 Whether the economic loss test will lead to overly speculative insurance*

The wider test of economic interest concerned some people who had argued that the wider test would induce the insurance market to trade overly speculative products, which could destroy the market's reputation. However, the English Law Commission thought it was essential to take a wider test for the requirement of insurable interest to meet the needs of the insurance market. Firstly, despite the wide test, an insurable interest must be based on an existing interest. Admittedly, as discussed above, many authorities have established that the concept of insurable interest should be widely construed as an economic interest. However, it could not be ignored that a limitation of the existence of a contract had been imposed on the economic test. Additionally, according to Lawrence J's test in *Lucena*, the risk has to be ascertained. That is, loss of, or damage to, the insured subject matter cannot derive from other uncovered contingency. Thus, the wider test seems to some extent ascertained. Secondly, the assured needed the economic interest in the subject insured to be protected and such an agreement should be allowed where the insurer was also willing to effect the contract. Thus, it was now clear that if the assured had an interest in the subject matter of the insurance of liability, D&O and business interruption, it satisfied the definition of insurable interest. Thirdly, the insurer of itself could decide not to underwrite an overly speculative risk by investigating the material circumstances disclosed by the assured. Fourthly, the common law had recognised the wider test and no evidence of problems had ever arisen.<sup>1313</sup> Fifthly, the experience from the reform of Australia relating to the Insurance Contracts Act 1984 (1984 ICA) s 16 or s 17 had shown that it brought about

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<sup>1313</sup> 2016 Notes, para 3.14

neither more litigation nor uncertainty as to case law principles.<sup>1314</sup> It thus seems to be proper to approve the wider test of insurable interest.

## Chapter 5 Insurable interest in Australia and in New Zealand

### 5.1 Insurable interest in Australia

#### 5.1.1 Introduction

In Australia, there are two different regimes in respect of the law on insurable interest: one for marine insurance, which is governed by the Marine Insurance 1909 MIA (Cth) (1909 MIA(Cth)); and the other for non-marine insurance, which is subject to the 1984 ICA.<sup>1315</sup> The changes to the law of insurable interest in Australia by the 1984 ICA have not been extended to the marine area and have not affected the 1909 MIA (Cth).<sup>1316</sup> Sections 10-21 of the 1909 MIA (Cth)<sup>1317</sup> involves the law on insurable interest in marine insurance, which uses almost the same terms as those in the 1906 MIA (UK).<sup>1318</sup> Hence, relating to the detailed law on insurable interest in the 1909 MIA (Cth), Chapter 2 above, can be referred to. With regard to that in general insurance or non-marine indemnity insurance, under the 1984 ICA, the requirement that the assured must have an actual or potential insurable interest has been repealed and the pecuniary or economic interest test, rather than the strict legal or equitable interest test, is

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<sup>1314</sup> ALRC 91, para 11.89

<sup>1315</sup> Ian Enright and Professor Robert M Merkin, *Sutton's Law of Insurance in Australia* (4th ed, Thomson Reuters 2014) para [22.10]

<sup>1316</sup> Robert Merkin, 'Reforming Insurance Law: Is there a case for reverse transportation? A report for the English and Scottish Law Commissions on the Australian experience of insurance law reform' [2007] Law Commissions 8.9

<sup>1317</sup> 1909 MIA (Cth), ss 10-21

<sup>1318</sup> Ian Enright and Professor Robert M Merkin, *Sutton's Law of Insurance in Australia* (4th ed, Thomson Reuters 2014) para 22.140

sufficient for the assured to make a claim at the time of the loss of or damage to the insured subject matter.<sup>1319</sup>

Dissatisfied with the inconvenience caused by the existence of the above two regimes and problems deriving from the strict test of insurable interest, the Australian Law Reform Commission (ALRC) thus issued *ALRC 91* in May 2001. Despite the title of the report, studies and proposals for reform were made not only to the 1909 MIA (Cth) but also to the 1984 ICA.<sup>1320</sup> In respect of insurable interest in marine insurance, it in the first place reviewed ss 10 to 12 of the 1909 MIA (Cth).<sup>1321</sup> *ALRC 91* then examined two types of occasions where the statutory insurable interest possibly gave rise to problems: one particularly focused on was where goods buyers, the assured, on FOB, CIF or CFR terms, despite having paid the goods, had no insurable interest required by the 1909 MIA (Cth) in the subject matter of marine insurance prior to the shipment and thus could not recover the pre-shipment loss unless both clauses of “lost or not lost” and “warehouse-to-warehouse” had been included in the marine policy;<sup>1322</sup> the other was the problem with the assignment of policies of marine insurance.<sup>1323</sup> Finally, two sets of recommendations were proposed for the reform of insurable interest in marine insurance.<sup>1324</sup>

The discussion in respect to the law on insurable interest in Australia is hereinafter divided into four parts. Firstly, the current provision as to the

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<sup>1319</sup> *ALRC 91*, paras 11.22-11.26. For the better logic, the law on insurable interest in non-marine indemnity insurance contracts under the coverage of the ICA 1984 will be discussed in the following paragraphs of 5.1.2

<sup>1320</sup> *ALRC 91*, para 1.3

<sup>1321</sup> *ALRC 91*, paras 11.1-11.21

<sup>1322</sup> *ALRC 91*, paras 11.27-11.66

<sup>1323</sup> *ALRC 91*, paras 11.67-11.70

<sup>1324</sup> *ALRC 91*, Recommendations 28-29 and Recommendations 30-31

requirement of insurable interest in the 1909 MIA (Cth) has been briefly introduced. From two aspects relating to the arguments of abolition and retention, the issue as to whether the insurable interest should be repealed then has been explored. The two sets of recommendations for reform of requisite insurable interest by the ALRC have eventually been set out. This discussion is mainly based on but not limited to *ALRC 91*. The insurable interest requirement, in the context not only of marine insurance but of general indemnity insurance, has been explored.

### 5.1.2 Ss 10-12 of the 1909 MIA (Cth)

#### 5.1.2.1 *Origins of the principle of insurable interest*

It was set out in *ALRC 91* that there were two sources for the requirement of insurable interest. The first were statutes governing insurance which directly required insurable interest and others as to gambling contracts which indirectly imposed the requirement.<sup>1325</sup> The other source was the indemnity doctrine.<sup>1326</sup> As for various statutes regulating insurance and wagers which imposed on the assured the requirement of insurable interest, Chapter 1 above can be referred to. The 1745 MIA (UK) was the first statute requiring insurable interest in the subject matter of marine insurance<sup>1327</sup> in virtue of prohibiting policies by way of gaming or wagering on British ships and goods.<sup>1328</sup> In order to obtain a valid policy of marine insurance and avoid being deemed as wagering policies, the

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<sup>1325</sup> *ALRC 91*, para 11.1; however, Arnold does not agree with this opinion by setting out that, historically, there had been a requirement of insurable interest in contracts of insurance, as one set of indemnity contracts, under English law prior to the passage of the 1745 MIA (UK). For details, see Jonathan Gilman, Professor Robert M Merkin, Claire Blanchard and Mark Templeman, *Arnould's Law of Marine Insurance* (18th Revised edn, Sweet & Maxwell 2013) 11-01

<sup>1326</sup> *ALRC 91*, para 11.3; M Mustill and J Gilman, *Arnould's Law of Marine Insurance and Average* (16th ed, vol I, Stevens & Sons London 1981) 25 footnote 89

<sup>1327</sup> *ALRC 91*, para 11.1

<sup>1328</sup> Ian Enright and Professor Robert M Merkin, *Sutton's Law of Insurance in Australia* (4th ed, Thomson Reuters 2014) para 22.140

assured had to show the possession of insurable interest in the insured property, otherwise the policies would be rendered null and void.<sup>1329</sup> Although the Acts of 1745 and 1788 (UK) (the latter had been repealed by the Insurance Contract Act 1984<sup>1330</sup>) was not repealed by the 1909 MIA (Cth), those two Acts were not applicable to marine insurance contract within the scope of the 1909 MIA (Cth).<sup>1331</sup>

Under the other source of the principle of indemnity, the assured could not be compensated until it had suffered a loss caused by the insured perils; a loss could probably be suffered only where it had an insurable interest in the insured subject.<sup>1332</sup> Therefore, the requirement of insurable interest must be satisfied in order to prove the loss, without which the doctrine of indemnity could not be met. Be that as it may, the above paragraphs have concluded that these two kinds of interest are different.<sup>1333</sup> The nature of the interest required by the indemnity principle is in the realm of the 1909 MIA (Cth), differing from that under the 1984 ICA, which will be examined below.<sup>1334</sup>

#### *5.1.2.2 Ss 10-11 of the 1909 MIA (Cth)*

The *ALRC 91* stated that wagering policies were void and unenforceable under s 10 of the 1909 MIA (Cth) and the following two sets of marine insurance contracts would be deemed to be policies by way of gaming or wagering:

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<sup>1329</sup> Ian Enright and Professor Robert M Merkin, *Sutton's Law of Insurance in Australia* (4th ed, Thomson Reuters 2014) para 22.140

<sup>1330</sup> Insurance Contract Act 1984, s 3; as far as the general insurance was concerned, it also abolished the 1774 LAA

<sup>1331</sup> 1909 MIA (Cth) , s 5

<sup>1332</sup> *ALRC 91*, para 11.3

<sup>1333</sup> See 3.1.3

<sup>1334</sup> See 5.1.3.4, hereinafter

policies having no actual or potential insurable interest and those with PPI terms.<sup>1335</sup>

S 11 and ss 13-20 of the 1909 MIA (Cth) listed the parties who could be held as having an insurable interest.<sup>1336</sup> The *ALRC 91* mentioned the two classic definitions derived from *Lucena v Craufurd*<sup>1337</sup> and analysed cases<sup>1338</sup> separately based on the two tests.<sup>1339</sup>

In terms of the strict criteria provided by s 11 of the 1909 MIA (Cth), the test as to an insurable interest in the subject matter insured was based on whether the assured could establish a legal or equitable interest in the subject matter. Namely, an insurable interest has to be one in law or in equity. As to both insurance of cargo<sup>1340</sup> in which such problems frequently arise and of hull,<sup>1341</sup> in order to ascertain whether the assured possessed such an interest, the fact as to whether the property or risk in the subject matter had passed to, or was possessed by, the assured was often needed to be ascertained by careful investigations of the contracts of sale.<sup>1342</sup> The *ALRC 91* criticised the fact that the statutory requirement was so strict that the assured to whom no property or

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<sup>1335</sup> 1909 MIA (Cth), s 10; *ALRC 91*, para 11.2

<sup>1336</sup> *ALRC 91*, paras 11.4-11.6; for the detailed examination of examples of insurable interest, see Chapter 2, above.

<sup>1337</sup> *Lucena v Craufurd* (1802) 3 B & P 75

<sup>1338</sup> *Macaura v Northern Assurance Co Ltd* [1925] AC 619; *Truran Earthmovers Pty Ltd v Norwich Union Fire Insurance Society Ltd* (1976) 17 SASR 1; *Sharp v Sphere Drake Insurance Co (The Moonacre)* (1992) 2 Lloyd's Rep 501

<sup>1339</sup> *ALRC 91*, paras 11.7-11.12

<sup>1340</sup> *Anderson v Morice* (1874-75) LR 10 CP 609; (1876) 1 App Cas 713; *Colonial Insurance Company of New Zealand v Adelaide Marine Insurance Company* (1886) 12 App Cas 128 (AC) 136; *Fuerst Day Lawson Ltd v Orion Insurance Co Ltd* [1980] 1 Lloyd's Rep 656. See *ALRC 91*, paras 11.18-11.19. For details, see Chapter 3, above.

<sup>1341</sup> *Piper v Royal Exchange Assurance* (1932) 44 Lloyd's Rep 103; *Sharp v Sphere Drake Insurance Co (The Moonacre)* (1992) 2 Lloyd's Rep 501. See *ALRC 91*, para 11.20. For details, see Chapter 3, above.

<sup>1342</sup> *ALRC 91*, para 11.17

risk had passed, according to the interpretation of the sale contracts, notwithstanding that it had suffered an economic or pecuniary loss, would still not be entitled to recover such loss.<sup>1343</sup>

#### *5.1.2.3 S 12 of the 1909 MIA (Cth)*

To prevent the insurance contract being void, the assured had to have either actual or expected insurable interest at the outset of the contract of marine insurance; but to make a claim it must be able to prove the possession of having an actual insurable interest at the time of loss except on occasions where a “lost or not lost” clause had been included in the policy.<sup>1344</sup> The rule that the assured must possess an insurable interest at the time of loss was derived from the requirement of the fundamental doctrine of indemnity,<sup>1345</sup> which should nevertheless not be narrowly understood as the principle of insurable interest.<sup>1346</sup> For illustration, two provisions can be used which infringe the principle of insurable interest but not of indemnity: “lost or not lost” with the meaning of “retrospective interest”, not the meaning of “retrospective declaration”,<sup>1347</sup> and the assignment of a marine policy after loss.<sup>1348</sup> In both cases, the assured can acquire an insurable interest after a loss but still be subject to the indemnity principle.

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<sup>1343</sup> *ALRC 91*, para 11.21

<sup>1344</sup> 1909 MIA (Cth), s 12; *ALRC 91*, para 11.13

<sup>1345</sup> Ian Enright and Professor Robert M Merkin, *Sutton’s Law of Insurance in Australia* (4th ed, Thomson Reuters 2014) para 22.300; *ALRC 91*, para 11.3

<sup>1346</sup> *ALRC 91*, para 11.3; M Mustill and J Gilman, *Arnould’s Law of Marine Insurance and Average* (16th ed, vol I, Stevens & Sons London 1981) 25, fn 89

<sup>1347</sup> See 2.4.2, as for the study on “lost or not” clause above.

<sup>1348</sup> 1909 MIA (Cth), proviso of s 57

### 5.1.3 Arguments for abolition

#### 5.1.3.1 *The statutory requirement preventing the buyers on FOB or CFR terms from recovering pre-shipment loss*

By analyzing the case of *NSW Leather Co Pty Ltd v Vanguard Insurance Co Ltd*,<sup>1349</sup> ALRC 91 focused in particular on the prevailing problem with the practice in marine cargo insurance so that a vendee purchasing cargo on FOB or CFR terms might not be able to recover the pre-loading loss from its payment for the goods because of the insurer arguing that it did not possess the insurable interest in the insured subject of the goods at the time of loss occurring prior to the shipment.

The strict test for insurable interest was thus submitted as possibly giving rise to problems with FOB or CFR purchasers exposed to no cover who had even contracted insurance policies on terms of pre-loading clauses, which were deemed by the assured and their brokers as an effective cover for the pre-shipment loss.<sup>1350</sup> As seen in Chapter 3, above, in light of clauses of “lost or not lost”, notwithstanding its diverse understanding and usage,<sup>1351</sup> and “warehouse to warehouse”, in isolation, neither of them could help the buyer FOB or CFR who had intended to recover his pre-shipment loss; but nevertheless the combination of them might assist such buyers<sup>1352</sup>, at least in the event of the goods being damaged or lost in part<sup>1353</sup>. Where the insured goods had been totally lost or destroyed, the contract of sale of goods might be frustrated and

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<sup>1349</sup> *NSW Leather Co Pty Ltd v Vanguard Insurance Co Ltd* (1991) 25 NSWLR 699, for the facts and judgement as to which see Chapter 3, above

<sup>1350</sup> ALRC 91, para 11.87

<sup>1351</sup> ALRC 91, paras 11.36-11.38; for the discussion as to the two meaning of “lost or not lost clause”, see 2.4.2, above.

<sup>1352</sup> ALRC 91, para 11.40

<sup>1353</sup> ALRC 91, para 11.42

the insurer thus might argue to decline to compensate the assured buyer on the ground that it could never have acquired the insurable interest: it was one case where the “lost or not lost” clause was applicable, in spite of the provisions as to both clauses above provided for in the insurance policy.<sup>1354</sup>

### *5.1.3.2 Reform needed by the market*

Despite the requirement of insurable interest, it appeared that Australian insurers “commonly enter contracts of insurance — using either FOB and CFR pre-shipment clauses or, more rarely, a “lost or not lost” clause”.<sup>1355</sup> This practice at present could be deemed to be evidence that the Australian insurer would provide the pre-loading cover to meet the buyer’s needs.<sup>1356</sup>

Unless the insurable interest requirement was abolished, the Australian insured importers could not legally obtain the adequate and valid policy of covering the pre-shipment loss.<sup>1357</sup> For the purpose of being able to legally acquire insurance cover for the post-shipment loss, exporters in Australia also supported the abolition of the insurable interest requirement. Where it might occur that overseas purchasers declined to pay for goods damaged or lost after they had been loaded on board the ship during the transit at sea, Australian exporters might observe that under the 1909 MIA (Cth) they were not entitled to cover such loss by means of its insurance contracts because they were no longer at risk after the shipment of goods had been insured.<sup>1358</sup>

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<sup>1354</sup> ALRC 91, paras 11.41-11.42; for details of clauses of “lost or not lost” and “warehouse to warehouse”, see Chapter 3, at 3.3.1.4

<sup>1355</sup> ALRC 91, para 11.66

<sup>1356</sup> ALRC 91, para 11.66

<sup>1357</sup> ALRC 91, para 11.86; as to detailed discussion for buyers’ difficulty in recovering pre-shipment loss, see 3.3.2, above

<sup>1358</sup> ALRC 91, para 11.86; also see 3.3.2.2.3 How to protect FOB or CFR sellers’ interest in the adventure, above.

### 5.1.3.3 No prospect of uncertainty

If the requirement was to be repealed, the Insurance Council of Australia (the Council) was concerned that the competitiveness of the Australian insurance market would be reduced and, consequently, the premium would be largely increased.<sup>1359</sup> The *ALRC 91* disagreed with the submission that uncertainty would arise<sup>1360</sup> caused by the extensive rise in premiums<sup>1361</sup>.

If the requirement of insurable interest was removed which was a legal impediment inhibiting the recovery for the pre-shipment loss, the assured FOB buyer might legally insure its pre-shipment interest.<sup>1362</sup> The seller might want to insure the goods as well to cover the post-delivery loss. Consequently, overlapping insurance might commonly arise and the seller might thus reject claims made against it under the contract of sale by arguing the existence of buyer's cover from Australia, which was argued to be disadvantageous to the Australian insurers and assureds.<sup>1363</sup> To respond to such a situation, the Australian insurers might extensively increase the premium.<sup>1364</sup> In the view of *ALRC 91*, however, the competitive position of the insurance industry in Australia would not get worse. As for the overlapping insurance, it could be addressed in virtue of a contract of sale providing that it was the obligation of the exporter who should firstly claim for the pre-shipment loss from its insurer and the importer should claim against its Australian underwriters only where the

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<sup>1359</sup> Insurance Council of Australia *Submission 11*; Michelle Taylor 'Is the Requirement of an Insurable Interest in the Marine Insurance Act Still Valid?' (2000) 11 ILJ 147; *ALRC 91*, para 11.76

<sup>1360</sup> *ALRC 91*, para 11.66

<sup>1361</sup> See 5.1.1.4.5, below.

<sup>1362</sup> At the moment, there is no legal basis for the pre-shipment clauses, see above 3.3.2.2.2 as to various methods available for assured buyers to recover the pre-shipment loss.

<sup>1363</sup> *ALRC 91*, paras 11.71, 11.74

<sup>1364</sup> *ALRC 91*, para 11.74

exporter had no cover or had insured inadequately.<sup>1365</sup> In other words, the insurance effected by the exporter was the primary cover, to which the insurance by the importer was subsidiary.<sup>1366</sup>

On the other hand, it was held by *ALRC 91* that, by providing the service of pre-shipment insurance, the Australian insurance market could obtain an advantageous position over the regimes where strict insurable interest was required.<sup>1367</sup> The *ALRC 91* confessed that the premium for the cover for pre-loading risk might increase to more than that for cover not including pre-loading insurance but unlikely to the extent of the general rise in that.<sup>1368</sup> Also, the higher premium was commercially reasonable.<sup>1369</sup>

#### *5.1.3.4 Positive experience as to reform of insurable interest in non-marine indemnity insurance from the 1984 ICA*

The *ALRC 91* concluded that the reform of the law in relation to the insurable interest requirement of general insurance by the enactment of the 1984 ICA did not give rise to problems.<sup>1370</sup> As a result, there seemed to be no justification as to why this successful experience could not be applied to the context of marine insurance.<sup>1371</sup>

##### *5.1.3.4.1 Ss 16-17 of the 1984 ICA*

In 1984 the Australians abolished insurable interest at the time of contract and recognised a pecuniary or economic interest as insurable, no longer limiting that

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<sup>1365</sup> *ALRC 91*, para 11.71

<sup>1366</sup> *ALRC 91*, para 11.74

<sup>1367</sup> *ALRC 91*, para 11.75

<sup>1368</sup> *ALRC 91*, para 11.74

<sup>1369</sup> *ALRC 91*, para 11.74

<sup>1370</sup> *ALRC 91*, para 11.89

<sup>1371</sup> Ian Enright and Professor Robert M Merkin, *Sutton's Law of Insurance in Australia* (4th ed, Thomson Reuters 2014) para 22.300

at law or in equity for non-marine indemnity insurance. Section 16 of the 1984 ICA provides that a contract of general insurance is not void merely because the assured does not have an interest at the time of entering into the contract.<sup>1372</sup> For the purposes of this Act, a contract of general insurance is a contract of insurance that is not a contract of life insurance.<sup>1373</sup> However, s 18 adds that policies on life insurance, personal accident and sickness do not require insurable interest currently.<sup>1374</sup> Therefore, a general insurance means a non-marine and non-life indemnity one, and thus ss 16-17 apply to the non-marine and non-life insurance.<sup>1375</sup>

As to the 1984 ICA s 17<sup>1376</sup> which deals with the problem with the nature of interest required by the indemnity principle in the realm of general insurance contracts,<sup>1377</sup> the proof that the assured possesses a pecuniary or economic interest other than the strict insurable interest in the insured subject matter at the time of loss is sufficient for them to make a claim against their insurers.<sup>1378</sup> According to this modified doctrine of indemnity, the sole shareholder in the case of *Macaoura* would be entitled to recover the company's loss because he had sustained an economic loss.<sup>1379</sup> Further, s 17 deals with the timing when an

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<sup>1372</sup> 2008 IP 4, A 28

<sup>1373</sup> 1984 ICA, s 11(6)

<sup>1374</sup> 1984 ICA, s 18 as the amendment by the *Life Insurance (Consequential Amendments and Repeals) Act 1995* (Cth), prior to which, under the ICA 1984, for life policies, insurable interest was requisite.

<sup>1375</sup> Robert Merkin, 'Reforming Insurance Law: Is there a case for reverse transportation? A report for the English and Scottish Law Commissions on the Australian experience of insurance law reform' [2007] Law Commissions 8.7

<sup>1376</sup> This section does not apply to life insurance.

<sup>1377</sup> Ian Enright and Professor Robert M Merkin, *Sutton's Law of Insurance in Australia* (4th edn, Thomson Reuters 2014) para 22.300; *Advance (NSW) Insurance Agencies Pty Ltd v Matthews* (1988) 12 NSWLR 250 (AC) 168

<sup>1378</sup> Suresh Krishnan and Brendan Hammond, 'Structuring Multinational Insurance Programmes: Current Challenges in Australia, New Zealand and the Asia-Pacific Region' (2011) ACE Progress Report 1, 3

<sup>1379</sup> David St Leger Kelly, Michael L Ball, *Principles of Insurance Law in Australia and New Zealand* (Sydney: Butterworths 1991) para 2.53

interest must attach, failing to be consistent with which the assured cannot make a claim.

This test of economic loss has also been recently adopted by the English courts,<sup>1380</sup> which is deemed to be a strong support for the wide reform. After the abolition of the insurable interest requirement, there is no longer need for arguing which kind of interest constitutes the insurable interest required by the 1909 MIA (Cth) and the controversy as to the definition of insurable interest would no longer exist; it has been substituted by the question as to whether the assured has sustained a pecuniary loss caused by insured perils during the period of cover.<sup>1381</sup> However, the ALRC also warned that merely proving that the buyer suffered the economic loss could not entitle him to get indemnified; as in general situations, the insurer was only liable for losses that were proximately caused by marine perils insured against.<sup>1382</sup>

#### 5.1.3.4.2 Few cases relevant to ss 16-17 occur

Pursuant to the case search during the period after the enactment of 1984 ICA up to the report of *ALRC 91*, only three cases relating to ss 16-17 were brought before the courts, which was evidence that the reform in marine insurance might not lead to more legal disputes.<sup>1383</sup> As to the authorities, it was held by Samuels JA in the *Advance (NSW) Insurance Agencies Pty Ltd* case that the husband was entitled to have an insurable interest in his wife's personal effects or clothing due to the economic loss he might suffer by being possibly bound to

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<sup>1380</sup> *ALRC 91*, para 11.90; *Sharp v Sphere Drake Insurance Co (The Moonacre)* (1992) 2 Lloyd's Rep 501

<sup>1381</sup> Robert Merkin, 'Reforming Insurance Law: Is there a case for reverse transportation? A report for the English and Scottish Law Commissions on the Australian experience of insurance law reform' [2007] Law Commissions 8.8

<sup>1382</sup> *ALRC 91*, para 11.92; 1909 MIA (Cth), s 61(1); Robert Merkin, 'Reforming Insurance Law: Is there a case for reverse transportation? A report for the English and Scottish Law Commissions on the Australian experience of insurance law reform' [2007] Law Commissions, fn 408

<sup>1383</sup> *ALRC 91*, para 11.104

pay for replacing or repairing them in the event of loss or damage.<sup>1384</sup> The Federal Court was required, pursuant to ss 16-17 of the 1984 ICA, to decide whether an insured company having contracted to maintain and crew the aircraft had an economic interest, or would sustain an economic loss. No decision was made in this litigation due to lack of evidence, but the economic test was relied upon.<sup>1385</sup> The uncertainty as to whether the third parties, satisfying specific qualifications who were not a party to the contract of the general insurance and not the assured for the purposes of ss 16 and 17, could derive assistance from s 17, was considered by the Supreme Court of Victoria.<sup>1386</sup> It appeared that the courts might agree to do so for those non-parties having been specified or referred to in the insurance contract.<sup>1387</sup>

#### 5.1.3.4.3 Recommendations by the *ALRC 20* for ss 16-17

Sections 16-17 of the 1984 ICA followed recommendations by the *ALRC 20* which had advised that the strict insurable interest requirement should be replaced<sup>1388</sup> and proof of the economic loss was sufficient for the assured to make a claim in its application to all contracts of indemnity.<sup>1389</sup> Both documents did not extend to marine insurance.<sup>1390</sup> The *ALRC 20* argued to abolish the requirement due to deciding this was a result of “a combination of imprecise drafting and historical accident” and it could be substituted by the doctrine of indemnity, which was the basic principle governing indemnity insurance.<sup>1391</sup> From the historical perspective, it was argued that the 1774 LAA (UK) might not

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<sup>1384</sup> *Advance (NSW) Insurance Agencies Pty Ltd v Matthews* (1988) 12 NSWLR 250 (AC) 168

<sup>1385</sup> *Howard v Australian Jet Charter Pty Ltd* (1991) 6 ANZ Ins Cases 61-054

<sup>1386</sup> *Pacific Dunlop Limited v Maxitherm Boilers PL* (1997) 9 ANZ Ins Cases 61-357

<sup>1387</sup> Peter Mann, *Mann's Annotated Insurance Contracts Act* (5th edn, Thomson Reuters 2012) 107; 1984 ICA, s 48; *Trident General Insurance Co Ltd v McNiece Bros Pty Ltd* (1988) 165 CLR 107; 62 ALJR 508; 5 ANZ Ins Cas 60-873

<sup>1388</sup> *ALRC 20*, para 117

<sup>1389</sup> *Advance (NSW) Insurance Agencies Pty Ltd v Matthews* (1988) 12 NSWLR 250 (AC) 167; *ALRC 20*, para 120

<sup>1390</sup> Rob Merkin, 'Australia: Still a Nation of Chalmers?' (2011) 30 U Queensland LJ 189, 189

<sup>1391</sup> *ALRC 20*, para 117

have existed if statutes relating to gambling had been enacted prior to its passage.<sup>1392</sup> The provisions in relation to legislative requisite interest under the Acts of 1774 and 1788 (UK) were also suggested to be repealed.<sup>1393</sup> It was contended as well that many difficulties had arisen because of the strict proprietary interest. Due to the merely technical construction of this test, an assured could not recover for loss under its adequate policy, if he had been economically and actually disadvantaged caused by the insured event.<sup>1394</sup> By this modification of the economic interest test required by the indemnity doctrine, it was said that Australian insurers and assureds would be more flexible to place insurance and no adverse consequence would arise such that a moral risk or the risk of wilful destruction would be promoted<sup>1395</sup> since, pursuant to the indemnity doctrine, the recovery was not available to the assured unless it could show the loss<sup>1396</sup>.

#### 5.1.4 Grounds for retention

##### 5.1.4.1 *The requirement of the special nature of marine insurance on goods*

Both in submissions to the Attorney-General's Department in 1997<sup>1397</sup> and to the current consultations for the *ALRC 91*<sup>1398</sup> in respect of reforming the insurable interest requirement, the Council held the same view that the principle

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<sup>1392</sup> *ALRC 20*, para 117

<sup>1393</sup> *ALRC 20*, para 117

<sup>1394</sup> *ALRC 20*, paras 118-119; *Macaoura v Northern Assurance* [1925] AC 619; also see the judgement by the case of *Truran Earthmovers Pty Ltd v Norwich Union Fire Insurance Society Ltd* (1976) 17 SASR 1: a purchaser was held as having no insurable interest in the subject matter insured, as a result of which it could not even not recover for the economic loss deriving from the sum lent to the seller which had been arranged to be deducted from the sale price.

<sup>1395</sup> *ALRC 20*, para 120

<sup>1396</sup> *ALRC 91*, para 11.24

<sup>1397</sup> Insurance Council of Australia *Submission 29 May 1997*

<sup>1398</sup> Insurance Council of Australia *Submission 11*

of insurable interest should be retained and the provisions concerning insurable interest in the 1909 MIA (Cth) should remain unchanged.<sup>1399</sup>

One argument for opposition to reform of insurable interest was due to the distinctive nature of marine cargo insurance:<sup>1400</sup> that is, contracts of marine insurance followed the contracts of sales of goods,<sup>1401</sup> the ownership of which might change many times during the transit at sea.<sup>1402</sup> It was thus argued that no reform should be made for the requirement of insurable interest in marine insurance law as the approach had been adopted in the 1984 ICA for general insurance contracts, because these were two different sets of insurance contracts. Marine insurance cover would continue to be effective after changes of title many times, which was deemed to be the noticeable characteristic of marine cargo insurance.<sup>1403</sup> In general insurance contracts, in comparison, once the assured disposed of the subject insured, it would generally lose its insurable interest in the insured subject and the policy would be cancelled.<sup>1404</sup> The *ALRC 91* was not persuaded by the preceding argument, and on the other hand, stated that under both insurance contracts, the assignment of insurance policies could occur and title to the goods might be changed on a number of occasions during the transit.<sup>1405</sup> The argument based on the specific nature of marine cargo insurance thus was not convincing.

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<sup>1399</sup> *ALRC 91*, paras 11.76-11.77

<sup>1400</sup> Insurance Council of Australia *Submission 11*; cited in *ALRC 91*, para 11.76

<sup>1401</sup> Insurance Council of Australia *Submission 11*; Michelle Taylor 'Is the Requirement of an Insurable Interest in the Marine Insurance Act Still Valid?' (2000) 11 *ILJ* 147

<sup>1402</sup> *ALRC 91*, para 11.76

<sup>1403</sup> Insurance Council of Australia *Submission 11*; cited in *ALRC 91*, para 11.82

<sup>1404</sup> *ALRC 91*, para 11.76

<sup>1405</sup> *ALRC 91*, para 11.82

#### *5.1.4.2 Confusion arising for the parties to the contract of marine insurance*

Because of the rapid changing of title to cargo following the cover of marine cargo insurance, concerns were also expressed that, if insurable interest requirement was not required at the time of loss, uncertainty might have arisen that more than one party might have claimed for the loss.<sup>1406</sup> The *ALRC 91* however disagreed with this argument based on the analysis that, notwithstanding that there might be a long chain of owners of goods insured, there was frequently only one party sustaining an economic loss as to goods themselves because there was only one party who would have paid for the goods.<sup>1407</sup> Other interested parties in the chain could not claim for the value of goods themselves but might recover other forms of loss regarding the goods from their respective insurers, such as the anticipated profits which had been recognised as one form of insurable interest.<sup>1408</sup>

#### *5.1.4.3 The seller should not be let off the hook considering indemnity to the buyer*

Concerns were also expressed that, if strict insurable interest was no longer required at the time of loss, the fundamental nature of contracts of international sales of goods would have been altered<sup>1409</sup> and the seller might be relieved of its obligations relating to compensating the assured buyer on FOB or CFR terms under contracts of sale because the buyer might incline to recover from its insurer.<sup>1410</sup> The ALRC was not in favour of this argument: after the reform, the seller would still not be relieved of its duties to remedy the buyer notwithstanding the abolition of requisite insurable interest. Besides, in spite of

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<sup>1406</sup> Michelle Taylor 'Is the Requirement of an Insurable Interest in the Marine Insurance Act Still Valid?' (2000) 11 ILJ 147, 149 and 151

<sup>1407</sup> *ALRC 91*, para 11.83

<sup>1408</sup> *NSW Leather Co Pty Ltd v Vanguard Insurance Co Ltd* (1990) 103 FLR 70; *ALRC 91*, para 11.84

<sup>1409</sup> Law Society of WA *Submission 7*

<sup>1410</sup> P Grieve *Submission 6*; *ALRC 91*, para 11.78

amendments to insurable interest, where the buyer chose to claim against its insurer other than the seller and the insurer had consequently indemnified the buyer's loss, the seller could not possibly be let off the hook regarding its liability to the buyer unless the insurer gave up its right of subrogation as to the buyer's claim against the seller.<sup>1411</sup>

#### *5.1.4.4 Commercial risk differing from insurance risk*

The problem that the FOB or CFR buyer could not claim against its insurer for the pre-shipment loss on the insured goods, caused by the insured marine perils within the coverage of insurance contract, was justified by the insurer, stating that such loss was caused by "trade or commercial" risks not by insurance risks.<sup>1412</sup> In the ALRC's opinion, this artificial distinction between risks had no merits. Firstly, it was a matter of market consideration rather than that of the law in respect of whether the insurer provided the insurance cover for pre-shipment risks.<sup>1413</sup> Secondly, it was common insurance practice that the insurer would provide insurance cover for so-called trade risks and that was why, in the event of losses, they exercised their right of subrogation against third parties, such as vendors and carriers.<sup>1414</sup>

#### *5.1.4.5 Existence of several means to remedy the buyer's pre-loading losses*

Oppositions to reforming the insurable interest requirement were stated that the FOB or CFR buyer might be able to claim against its insurer for its pre-loading loss by relying on FOB or CFR pre-shipment clauses,<sup>1415</sup> which allowed the buyer to elect to recover from either the seller or the insurer.<sup>1416</sup> It was also

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<sup>1411</sup> Associated Marine Insurers Agents Pty Ltd *Correspondence* 17 April 2000

<sup>1412</sup> *ALRC 91*, para 11.81

<sup>1413</sup> *ALRC 91*, para 11.81

<sup>1414</sup> *ALRC 91*, para 11.81

<sup>1415</sup> *ALRC 91*, para 11.44; for examples in relation to "FOB or C&F pre-shipment clauses", referring to 3.3.2.2.3 in Chapter 3, above

<sup>1416</sup> *Advisory Committee meeting* 18 December 2000; *ALRC 91*, para 11.45

argued that the buyer could protect the pre-shipment loss by means of contracting proper terms of trade. They might also derive assistance from “the Trade Practices Act 1974 (Cth) and equitable doctrines of estoppel, unjust enrichment and restitution”.<sup>1417</sup> Besides, the courts would seemingly tend to favour the FOB or CFR buyer’s claim for recovery of the pre-shipment loss against its insurer.<sup>1418</sup> Thus, insofar as such problem with pre-loading loss was concerned, it was argued that there was no necessity to amend the requirement by the way of legal reform.<sup>1419</sup>

#### 5.1.4.5.1 Problems with FOB or CFR pre-shipment clauses

However, it was argued that there were three noticeable problems as to the policies providing the insured buyer with “FOB or CFR pre-shipment clauses” offered by Australian marine insurers.<sup>1420</sup> At the beginning, it was ambiguous as to when the cover would commence to attach.<sup>1421</sup> Secondly, such clauses usually included terms in respect of requiring the buyer to use “all reasonable means to first recover the full amount of the loss or damage from the exporter or supplier”, but there was no certain and clear interpretation for the term of “reasonable”; consequently, the buyer’s such duty was uncertain.<sup>1422</sup> Last but not least, notwithstanding such clauses being provided for in policies, in the event of loss of or damages to the insured cargo, the insurer might also be reluctant to compensate the buyer by arguing that such commercially enforceable clauses, not including the type of the deeming cover for the pre-

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<sup>1417</sup> ALRC 91, para 11.48

<sup>1418</sup> ALRC 91, para 11.48

<sup>1419</sup> ALRC 91, paras 11.44, 11.49

<sup>1420</sup> Michelle Taylor ‘Is the Requirement of an Insurable Interest in the Marine Insurance Act Still Valid?’ (2000) 11 ILJ 147, 156-57; ALRC 91, para 11.48; for other problems, see Difficulty as to the application of pre-shipment clauses in 3.3.2.2.2, above.

<sup>1421</sup> Michelle Taylor ‘Is the Requirement of an Insurable Interest in the Marine Insurance Act Still Valid?’ (2000) 11 ILJ 147, 156; cited in ALRC 91, para 11.46

<sup>1422</sup> Michelle Taylor ‘Is the Requirement of an Insurable Interest in the Marine Insurance Act Still Valid?’ (2000) 11 ILJ 147, 156; cited in ALRC 91, para 11.46

loading loss,<sup>1423</sup> were legally void for inconsistency with the statutory requirement of s 11 of the 1909 MIA (Cth).<sup>1424</sup> Grounds were also given that the validity as to “FOB or CFR pre-shipment clauses” was uncertain because the courts had not yet had the chance to consider it.<sup>1425</sup>

#### 5.1.4.5.2 Terms of contracts of sale

Putting aside reasons for the buyer, especially the Australian importers, preferring to purchase on FOB or CFR rather than on CIF,<sup>1426</sup> the *ALRC 91* argued that it might not be right to say that CIF buyers were in a better position so as to protect their pre-loading economic loss due to payment before shipment than that on FOB or CFR terms in terms of the same time at which the risk passed to the buyer under both terms.<sup>1427</sup> Thus, although the purchase terms of CIF might help the buyer to recover loss occurring before the assignment of the policy as assignee, it might not be helpful to losses occurring after that assignment.<sup>1428</sup>

It might be argued that Australian buyers on FOB terms could protect their pre-loading interests in goods by negotiating the following two terms of contracts for sales of goods. Firstly, the contract could entitle risk of loss of or damage to the insured cargo passing from sellers to buyers at an earlier point in time than that of shipment,<sup>1429</sup> such as the FCA term, which was designed for cargo loaded

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<sup>1423</sup> Namely, regardless of the timing of loss, the loss would be deemed to have occurred during the transit insured, but not one purported to be able to be covered due to the extension of the cover period. See *ALRC 91*, paras 11.44, 11.47

<sup>1424</sup> Michelle Taylor ‘Is the Requirement of an Insurable Interest in the Marine Insurance Act Still Valid?’ (2000) 11 *ILJ* 147, 156; cited in *ALRC 91*, para 11.46

<sup>1425</sup> Michelle Taylor ‘Is the Requirement of an Insurable Interest in the Marine Insurance Act Still Valid?’ (2000) 11 *ILJ* 147, 157; cited in *ALRC 91*, paras 11.47-11.48

<sup>1426</sup> *ALRC 91*, para 11.51; reasons have been discussed in 3.3.2.1.1, above.

<sup>1427</sup> *ALRC 91*, para 11.52

<sup>1428</sup> For detailed discussion on recovery of a CIF buyer, see 3.3.2.1

<sup>1429</sup> *ALRC 91*, para 11.53

into containers.<sup>1430</sup> However, as discussed above,<sup>1431</sup> the FCA term cannot now be widely used. Secondly, terms could entitle buyers to inspect insured goods prior to the goods being loaded on board ship.<sup>1432</sup> But it was not the current practice to entitle buyers to examine the conditions of goods prior to payment for them.<sup>1433</sup>

#### 5.1.4.5.3 Recovery rights against sellers and the carriers

In practice, it may be difficult to obtain compensation from sellers and carriers. It was argued that numerous contractual, statutory and tortious remedies against sellers could assist buyers on FOB or other terms.<sup>1434</sup> It might be right in certain situations,<sup>1435</sup> but nevertheless wrong where FOB buyers suffered loss incurred by theft or wilful destruction prior to transfer of risk.<sup>1436</sup> There were no certain and consistent authorities for the preceding situation<sup>1437</sup> and nor was there in respect of tortious remedies.<sup>1438</sup> From the perspective of statutes, the Sale of Goods Act 1896 (QLD) and the Trade Practices Act 1974 (Cth) could also not be available to assist FOB buyers to recover such loss from the sellers.<sup>1439</sup> In particular, with regards to those three remedies, it might in effect be commercially difficult for an FOB buyer to bring an action against overseas

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<sup>1430</sup> *ALRC 91*, para 11.54

<sup>1431</sup> See appropriate price terms agreed in 3.3.2.2.2

<sup>1432</sup> *ALRC 91*, para 11.56

<sup>1433</sup> *ALRC 91*, para 11.56

<sup>1434</sup> *ALRC 91*, para 11.62-11.63; Michelle Taylor 'Is the Requirement of an Insurable Interest in the Marine Insurance Act Still Valid?' (2000) 11 ILJ 147, 161-64

<sup>1435</sup> For instance, concerning the loss caused by insufficient packaging, buyers might avail themselves of contractual and statutory remedies. Provided that buyers could satisfy the proximate test, they might derive help from tort remedies as well. For details, see Michelle Taylor 'Is the Requirement of an Insurable Interest in the Marine Insurance Act Still Valid?' (2000) 11 ILJ 147, 161-63

<sup>1436</sup> *ALRC 91*, para 11.64; Michelle Taylor 'Is the Requirement of an Insurable Interest in the Marine Insurance Act Still Valid?' (2000) 11 ILJ 147, 161-64

<sup>1437</sup> *ALRC 91*, para 11.64; Michelle Taylor 'Is the Requirement of an Insurable Interest in the Marine Insurance Act Still Valid?' (2000) 11 ILJ 147, 161-64

<sup>1438</sup> *ALRC 91*, para 11.64; Michelle Taylor 'Is the Requirement of an Insurable Interest in the Marine Insurance Act Still Valid?' (2000) 11 ILJ 147, 162

<sup>1439</sup> *ALRC 91*, para 11.64; Michelle Taylor 'Is the Requirement of an Insurable Interest in the Marine Insurance Act Still Valid?' (2000) 11 ILJ 147, 162-63

sellers.<sup>1440</sup> Similarly, by reason of the contractual and statutory exclusions or immunities to the carriers, namely, that provided by the Carriage of Goods by Sea Amendment Act 1997 (Cth) in the Australian context, the contractual, statutory and tortious recovery rights against them for the pre-shipment loss might also not be viable to an FOB buyer.<sup>1441</sup>

### 5.1.5 Wide and narrower recommendations by the ALRC 91

In order to solve the problems as to the insurable interest requirement, particularly the FOB or CFR buyers' pre-shipment risk, the ALRC 91 proposed two options for reforming the 1909 MIA (Cth), both of which might entitle the buyer to recover pre-loading transit loss.<sup>1442</sup> Although the ALRC was urged to reform insurable interest in the 1909 MIA (Cth) and the wide proposal was bold enough, neither options came into force, leaving the area of insurable interest in marine insurance unaffected.<sup>1443</sup>

The wider recommendations were that the requirement for insurable interest should be repealed to coincide with that under the 1984 ICA: namely, ss 10–12 of the 1909 MIA (Cth) would be substituted by and in terms of ss 16–17 of the 1984 ICA;<sup>1444</sup> as a necessary consequence of this wider reform, ss 13–21, 57 and 90(3)(c)–(d) of the 1909 MIA (Cth), setting out various examples of insurable interest, should be repealed as well.<sup>1445</sup> Consequently, the repealing of the strict interest test might simplify the application of the insurable interest

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<sup>1440</sup> ALRC 91, para 11.64; Michelle Taylor 'Is the Requirement of an Insurable Interest in the Marine Insurance Act Still Valid?' (2000) 11 ILJ 147, 163

<sup>1441</sup> ALRC 91, para 11.64; Michelle Taylor 'Is the Requirement of an Insurable Interest in the Marine Insurance Act Still Valid?' (2000) 11 ILJ 147, 163-66

<sup>1442</sup> ALRC 91, para 11.88

<sup>1443</sup> Rob Merkin, 'Australia: Still a Nation of Chalmers?' (2011) 30 U Queensland LJ 189, 189

<sup>1444</sup> ALRC 91, Recommendation 28

<sup>1445</sup> ALRC 91, Recommendation 29

principle and the economic loss test might clarify the interest required as being that of the indemnity principle.<sup>1446</sup>

The other recommendation was narrower by way of inserting a new rule, as a substitute for the former, in the event of which was not accepted, that the point in time when the buyer could obtain insurable interest in the insured subject of marine cargo should be “when it pays for the property or when it becomes bound to pay for the property provided that it subsequently pays for it” prior to the passing of risk at the time of it being loaded on board the ship under the contract of sale<sup>1447</sup> and s 16 of the 1909 MIA (Cth) should be extended, beyond the obsolete bottomry and respondentia, to cover secured loans over insurable property.<sup>1448</sup>

Although the two narrow proposals advance the timing and are clearer than that set out in the 1909 MIA (Cth), they are possibly not needed to be included in the MIA. The first proposal in fact has reflected the well-established authority that a buyer under an existing contract has an insurable interest in goods if it is liable to pay, whether or not goods have safely arrived. The second has actually echoed the general principle that a creditor having a claim on property pledged to him has an insurable interest.

## **5.2 Insurable interest in New Zealand**

### **5.2.1 Three stages of reform as to Insurable interest in New Zealand**

The Contracts and Commercial Law Reform Committee (the CCLRC) in 1983 proposed, for the purpose of the reformed Insurance Law Reform Act, that:

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<sup>1446</sup> ALRC 20, para 118

<sup>1447</sup> ALRC 91, Recommendation 30

<sup>1448</sup> ALRC 91, Recommendation 31

- a life insurance requires no insurable interest (s 6);
- as to other kinds of insurance contracts rather than life insurance, the requirement of insurable interest is needed, and such contracts cannot be made in guise of gaming or wagering (s 7(1));
- the violating of s 7(1) will render such contracts void (s 7(2));
- a person under a marine policy must possess an insurable interest (s 7(3));
- the 1774 LAA shall be repealed, meaning that contingency insurance can have no insurable interest and be made by way of gaming or wagering (s 7(4)).

In the Insurance Law Reform Act 1985 (1985 Act) ss 6-8 then remain the same provisions as the above proposals, except for one addition, as s 7(1), that an assured effecting a non-marine indemnity insurance needs no insurable interest based on the fact that the indemnity principle can replace the requirement of insurable interest.

Furthermore, in 2003, it was proposed that s 374 of the Gambling Act 2004 (2004 Act) should repeal s 7(2), after its coming into force, having the effect that insurable interest under contracts of insurance rather than marine insurance is not needed any more and wagering insurance is now enforceable.

### **5.2.2 Need for insurable interest requirement in marine insurance**

The insurable interest requirement in marine insurance is prescribed in ss 5-16 of the Marine Insurance Act 1908 (1908 MIA).<sup>1449</sup> Notwithstanding the above changes to the requirement of insurable interest in other insurance contexts, the

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<sup>1449</sup> 1908 MIA, ss 5-16

law on insurable interest in marine is left unaffected.<sup>1450</sup> The 1908 MIA abolishing the Acts of 1745 and 1788 (UK) is identical with the 1906 MIA (UK).<sup>1451</sup> Therefore, Chapter 2 supra can be referred to when the detailed provisions of ss 5-16 need to be examined. The following discussion will focus on the issues as to what changes have been made to the requirement of insurable interest in non-marine indemnity policies in New Zealand and the reasons why they have adopted such steps.

S 7(4) of 1985 Act prescribes the following: “Nothing in this section limits the provisions of the Marine Insurance Act 1908”.<sup>1452</sup> It has hence been submitted that the effect of s 7(4) on marine insurance is uncertain: the provision can mean either that it has no application to marine insurance or that both Acts govern marine insurance but s 7(4) would not place a limit on the provisions of the 1908 MIA.<sup>1453</sup> Notwithstanding the ambiguity of the word “limits”, in the context of the provisions of s 7 in respect of the requirement for insurable interest, in particular, s 7(1) having excepted its application to the 1908 MIA, s 7(4) thus appears to mean that nothing in this section affects the provisions of the 1908 MIA and ss 5-16 of the 1908 MIA shall be left unaffected.

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<sup>1450</sup> Robert Merkin, Chris Nicoll, *Colinvaux’s Law of Insurance in New Zealand* (Thomson Reuters New Zealand Ltd 2014)

<sup>1451</sup> David St Leger Kelly, Michael L Ball, *Principles of Insurance Law in Australia and New Zealand* (Sydney: Butterworths 1991) para 2.10

<sup>1452</sup> 1985 Act, s 7(4)

<sup>1453</sup> David St Leger Kelly, Michael L Ball, *Principles of Insurance Law in Australia and New Zealand* (Sydney: Butterworths 1991) para 2.15

## 5.2.3 Non-marine insurance now not requiring insurable interest

### 5.2.3.1 The 1774 LAA

5.2.3.1.1 The 1774 LAA seemingly applicable to non-marine insurance prior to the 1985 Act

It appeared that, prior to the enforcement of the 1985 Act, it was the 1774 LAA (UK) (in force in New Zealand<sup>1454</sup>) that governed the issue as to whether the assured having effected non-marine insurance contracts had to prove the possession of insurable interest. A non-marine insurance may mean a contingency insurance and a non-marine indemnity insurance. Under this Act, the assured under such contracts must have a legal or equitable interest in the insured property at the time of the contract,<sup>1455</sup> contrary to which it would be rendered null and void; consequently, the premium paid to the insurer may be returned to the assured due to the failure of consideration.<sup>1456</sup>

5.2.3.1.2 The 1774 LAA actually applicable only to contingency insurance

As for the present position, the 1774 LAA has been repealed by s 8 of the 1985 Act which came into effect as part of the law in New Zealand in 1 April 1986. The effect of the repeal is that an assured under certain insurance contracts is not required to show insurable interest and he can make an insurance by way of wagering or gaming, which will not be rendered void. There is thus a need to discuss when the Act applies to what insurance before the effect of the repeal on insurance is discussed.<sup>1457</sup>

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<sup>1454</sup> Contracts and Commercial Law Reform Committee, *Aspects of Insurance Law* (2), 19 May 1983; recited hereinafter as *Aspects of Insurance Law* (2)

<sup>1455</sup> David St Leger Kelly, Michael L Ball, *Principles of Insurance Law in Australia and New Zealand* (Sydney: Butterworths 1991) para 2.32

<sup>1456</sup> *Fibrosa SA v Fairbairn Lawson Combe Barbour Ltd* [1943] AC 32; *Cheers v Pacific Acceptance Corp Ltd* [1960] SR (NSW) 1, 6-7; *Shaw v Shaw* [1965] 1 WLR 537,539

<sup>1457</sup> See 1.2.2.2 whether the 1774 LAA applies to indemnity insurance.

Seemingly, there had been controversy relevant to which kind of insurance contracts were within the scope of the 1774 LAA. Section 1 required insurable interest in all forms of insurance “on the life or lives of any person, or persons, *or on any other event or events whatsoever*”. The words in italic seemed to make void all types of insurance without insurable interest or by way of gaming or wagering,<sup>1458</sup> including all contingency insurance and indemnity insurance.<sup>1459</sup> In light of s 4 which excluded its application to insurance on ships, goods, or merchandise, it thus appeared that the statutory insurable interest in the 1774 LAA was applicable to all types of insurance policies apart from that on marine ships, goods, or merchandise<sup>1460</sup>. Non-marine insurance on buildings, life or accidents thus seemed to be within its application. A minority of the CCLRC also took this view.<sup>1461</sup> In the obiter of the *In re King, decd* case,<sup>1462</sup> a similar view was expressed that the 1774 LAA was designed to apply to ‘any other event’ as well as life.

Nevertheless, the common law made it clear that the 1774 LAA did not apply to indemnity insurance but only to contingency insurance. Thus, where an employer effected an indemnity insurance against claims by its employees, the court held that such insurance was not within the ambit of the 1774 LAA.<sup>1463</sup> It was also held by the Court of Appeal in the UK that the 1774 LAA aimed to govern insurance which provided that a certain sum of money would be paid on the occurrence of the event insured against, not that of indemnity.<sup>1464</sup> In favour

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<sup>1458</sup> David St Leger Kelly, Michael L Ball, *Principles of Insurance Law in Australia and New Zealand* (Sydney: Butterworths 1991) para 2.3

<sup>1459</sup> 1774 LAA, s 1

<sup>1460</sup> 1774 LAA, s 4

<sup>1461</sup> Aspects of Insurance Law (2), para 4.4

<sup>1462</sup> *In re King, decd* [1963] Ch 459, 485

<sup>1463</sup> *New Zealand Insurance Co Ltd v Tyneside Pty Ltd* [1917] NZLR 569

<sup>1464</sup> *Mark Rowlands Ltd v Berni Inns Ltd* [1986] 1 QB 211

of this judgement, in the opinion of the Privy Council, the 1774 LAA merely applied to non-indemnity insurance.<sup>1465</sup> Of course, nowadays there is no longer any necessity of arguing whether the 1774 LAA applied to non-marine indemnity insurance, as it has been repealed by the 1985 Act.

#### 5.2.3.1.3 The effect of repealing the 1774 LAA on insurance contracts

Therefore, as the result of the repeal and the clarification of insurance contracts within the ambit of the 1774 LAA, no contingency insurance is subject to insurable interest. Consequently, such insurance is not void only for having no insurable interest at the time of the contract or for being made in the guise of wager. This is identical with the rule in s 6 of the 1985 Act and the repeal of s 7(2).

#### 5.2.3.2 Recommendations for the reform of insurable interest in non-marine insurance by the CCLRC

In its second report from which the 1985 Act was derived, the requirement of insurable interest was considered by the CCLRC.<sup>1466</sup> Although it mainly focused on the issue as to whether the insurable interest requirement in life policies should be abolished,<sup>1467</sup> recommendations for insurable interest in other contracts of insurance were also proposed by them.

##### 5.2.3.2.1 Reasons for repealing the requirement of insurable interest

As far as non-life insurance was concerned, the CCLRC pointed out five problems with insurable interest provisions. Firstly, at the time of the raising of the dispute as to the existence of insurable interest, the courts would always lean towards supporting an assured having one.<sup>1468</sup> Secondly, the insurer

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<sup>1465</sup> *Siu v Eastern Insurance Co Ltd* [1994] 1 All ER 213

<sup>1466</sup> Aspects of Insurance Law (2), s 4

<sup>1467</sup> Aspects of Insurance Law (2), para 4.1

<sup>1468</sup> Aspects of Insurance Law (2), para 4.3.3; *Stock v Inglis* (1884) 12 QBD 564

tended not to require insurable interest: they might waive the insurable interest and indemnify the assured regardless of whether they had an insurable interest.<sup>1469</sup> In such a case, the parties' rights to the payment were the same as those under the normal valid policies.<sup>1470</sup> Thirdly, the majority of the CCLRC argued that the then prevailing contracts of gaming or wagering did not exist in the current insurance market anymore.<sup>1471</sup> Fourthly, the requirement of insurable interest was not helpful to prevent moral hazard. Fifthly, the indemnity doctrine could prevent a person who has suffered no loss from recovering.

#### 5.2.3.2.2 Grounds for the retention

A minority of the CCLRC supported the retention of the requirement by arguing that there were two policies served by the requirement: notwithstanding insurable interest at present possibly not needed to forbid gaming or wagers, it was still required to minimise the risk of wilful destruction of the insured subject matter by the assured insofar as the insurance of indemnity was concerned. This argument was not favoured by the *ALRC 91*, in which it was said that the preceding two problems, without requiring insurable interest, could be addressed by the indemnity doctrine itself.<sup>1472</sup>

#### 5.2.3.2.3 Recommendations<sup>1473</sup>

The requirement of insurable interest in life insurance was by a majority of the CCLRC recommended to be abolished in s 6 of the draft bill by the CCLRC.<sup>1474</sup> The proposed s 7 recommended the retention of the law then in force as to the

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<sup>1469</sup> *Hadden v Bryden* (1899) 1 F (Ct of Sess) 710

<sup>1470</sup> *Carter Bros v Renouf* (1963) 111 CLR 140, 167; *Carpark Holdings Ltd v The Commissioner of Taxation* (1966) 115 CLR 653, 664-665

<sup>1471</sup> Aspects of Insurance Law (2), para 4.3.4

<sup>1472</sup> *ALRC 91*, para 24

<sup>1473</sup> Also see 5.2.1

<sup>1474</sup> Aspects of Insurance Law (2), Appendix A, Clause 6

requirement of insurable interest governing non-life insurance as follows:<sup>1475</sup>  
every contract of non-life insurance effected without interest or by way of gaming or wagering shall be null and void; this section was not intended to extend to marine insurance within the meaning of s 3 of the 1908 MIA; the 1774 LAA should be repealed after s 7 came into effect.<sup>1476</sup>

### *5.2.3.3 The 1985 Act*

#### 5.2.3.3.1 No requirement for contingency and non-marine indemnity insurance and reasons

The counterpart of the 1985 Act followed the recommendation for s 6 in the proposals by the CCLRC, but added one rule to s 7 in the proposals. The new rule as to repealing the requirement in non-marine indemnity insurance was proposed by the Statutes Revision Committee during its passage through Parliament.<sup>1477</sup> Under s 7 of the 1985 Act prior to the 2004 Act, life insurance and non-marine indemnity insurance needed no requirement of insurable interest.<sup>1478</sup> However, a person effecting insurance other than life or non-marine indemnity insurance must have an insurable interest and no kind of insurance could be made by way of gaming or wagering.<sup>1479</sup> Prior to the repealing of s 7(2), it seemed that contingency insurance<sup>1480</sup> was no longer needed to be supported by showing the possession of insurable interest. However, it might not be the case. There seemed a need for insurable interest in contingency insurance other than life insurance, such as policies on health and personal

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<sup>1475</sup> Aspects of Insurance Law (2), para 4.6

<sup>1476</sup> Aspects of Insurance Law (2), Appendix A, Clause 7

<sup>1477</sup> Julian Long, 'The Concept of Insurable Interest and the Insurance Law Reform Act 1985' (1992) 7 *Auckland University Law Review* 80, 93

<sup>1478</sup> 1985 Act, s 7(1)

<sup>1479</sup> 1985 Act, s 7(2)

<sup>1480</sup> Contingency insurance includes insurance of life and personal accident, although the latter has elements of indemnity insurance.

accident,<sup>1481</sup> because s 7(2)(a) dictated that other contracts of insurance, except that of life and non-marine indemnity, required insurable interest. Without the insurable interest in its application to other contingency insurance, s 7(2)(a) appeared to be meaningless. S 7(3) rendered void insurance in violation of s 7(2)(a). Section 7(4) retained insurable interest in the realm of marine insurance untouched.

In addition, the requirement of insurable interest was also imposed by legislation against gambling. Gaming contracts were not prevented until the passage of the 1845 GA (UK).<sup>1482</sup> Then, under s 128 of the Gaming and Lotteries Act 1977, non-marine indemnity insurance required insurable interest: wagers on buildings, goods and legal liabilities were also illegal and void.<sup>1483</sup> It was then repealed by the 2004 Act in s 9 providing that gambling could be legally made with some restrictions.<sup>1484</sup> Specifically, insurance by way of gaming or wagering was not forbidden by s 374 in New Zealand.<sup>1485</sup> In short, under the current 1985 Act, all non-marine insurance contracts are not subject to the requirement of insurable interest and such contracts in the guise of gaming or wagering are not void.

Reasons for the addition of s 7(1) of 1985 Act to proposals by the CCLRC were as follows. Firstly, indemnity insurance was governed by the doctrine of indemnity, which was again argued to be able to be a substitute for the insurable interest principle: under the former doctrine, the assured could not

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<sup>1481</sup> David St Leger Kelly, Michael L Ball, *Principles of Insurance Law in Australia and New Zealand* (Sydney: Butterworths 1991) para 2.15

<sup>1482</sup> For details, refer to Chapter 1, *supra*

<sup>1483</sup> Gaming and Lotteries Act 1977, s 128

<sup>1484</sup> Gambling Act 2004, s 9

<sup>1485</sup> Gambling Act 2004, s 374

recover unless a loss suffered could be shown; in order to prove a loss, an interest was needed. Although the 1985 Act had repealed the requirement of insurable interest in non-marine insurance, such insurance were still governed by the indemnity doctrine.<sup>1486</sup> However, on the other hand, it was held by a judge that the requirement that the assured must have an interest at the time of the insurance contract was different from the matters that must be supplied to prove a loss suffered by the assured under the doctrine of indemnity,<sup>1487</sup> although the distinction between those two principles was not easy to be drawn.<sup>1488</sup> In conclusion, the insurable interest requirement was contended to serve no useful purpose. Secondly, it was argued that by the above replacement the technical defence that the assured could not satisfy the requirement of insurable interest at the time of the contract could be prevented.<sup>1489</sup>

#### 5.2.3.3.2 The concept of insurable interest in New Zealand

Indeed, s 7 of the 1985 Act only concerns the necessity of interest, there is nothing respecting the nature of the interest. However, under the current 1985 Act, as to non-marine insurance, there is no need to consider the elements of the concept of insurable interest. Nowadays, it is only the interest under the indemnity principle or the loss, and that is required to be tested.

As to marine insurance, due to its being subject to the requirement of insurable interest, the concept of insurable interest thus needs to be examined.

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<sup>1486</sup> David St Leger Kelly, Michael L Ball, *Principles of Insurance Law in Australia and New Zealand* (Sydney: Butterworths 1991) para 2.53

<sup>1487</sup> *Davjoyda Estates Pty Ltd v National Insurance Co of New Zealand Ltd* (1965) 69 SR (NSW) 381,428

<sup>1488</sup> David St Leger Kelly, Michael L Ball, *Principles of Insurance Law in Australia and New Zealand* (Sydney: Butterworths 1991) para 2.31

<sup>1489</sup> Department of Justice letter to the Chairman of the Statutes Revision Committee (16 April 1984) 5

Previously, in New Zealand, the common law rule was still regarded as good law, based on the judgement of *Macaura* that the assured must have the interest in law or in equity.<sup>1490</sup> However, it is still unclear as to what constitutes an insurable interest in New Zealand. In light of the wider approach to construe insurable interest adopted by the courts in the UK<sup>1491</sup> and Australia,<sup>1492</sup> the New Zealand courts at present may lean toward adopting the economic interest test. To address the uncertainty as to the nature of the interest, the legislative approach to the 1984 Act in Australia can be drawn on. In this Act, s 16 removes the insurable interest requirement in general insurance; s 17 subsequently provides that an economic or pecuniary interest rather than the strict interest is sufficient to amount to the interest required by the indemnity principle at the time of loss. Alternatively, the court in New Zealand can provide a judicial interpretation as to this issue where appropriate.

## **Chapter 6 Insurable interest in marine insurance in China**

### **6.1 Applicable statutes for marine insurance**

#### **6.1.1 No provisions concerning insurable interest in the CMC**

In China, there is no separate Marine Insurance Act. As its counterpart, Chapter 12, entitled Contract of Marine Insurance, in the Maritime Code of the People's Republic of China (the PRC, *infra*)<sup>1493</sup> (the CMC) regulates the area of marine insurance. Chapter 12 does not deal with the principle of insurable interest<sup>1494</sup> in addition to the question as to whether the original assured has no interest in the

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<sup>1490</sup> Julian Long, 'The Concept of Insurable Interest and the Insurance Law Reform Act 1985' (1992) 7 *Auckland University Law Review* 80, 97

<sup>1491</sup> *Feasey v Sun Life Assurance Co* [2003] Lloyd's Rep IR 637

<sup>1492</sup> *Advance (NSW) Insurance Agencies Pty Ltd v Matthews* (1988) 12 NSWLR 250

<sup>1493</sup> It came into force on July 1, 1993 and is still effective.

<sup>1494</sup> Peng-nan Wang, 'Prospects of Chinese Law of Marine Insurance' (2003) vol 14(1) *Annual of China Maritime Law* 199, 206

contract of reinsurance.<sup>1495</sup> Having the same meaning as that under s 9 of the 1906 MIA (UK),<sup>1496</sup> it follows that “The insurer may reinsure its risk out of its cover for the assured’s subject matter enumerated in the preceding paragraph.<sup>1497</sup> Unless otherwise agreed in the contract, the original assured shall not be entitled to the benefits of the reinsurance.”<sup>1498</sup> In light of this provision, it can be said that the insurer has an insurable interest in the risk arising from its liability to compensate under the original insurance contract for the original assured’s interests in the subject matter insured. However, limited to the principle of contract privity, the original assured may not be allowed to recover its loss by the contract of reinsurance which was taken out between the original insurer and the reinsurer.

### 6.1.2 Other applicable law

Before the passage of the CMC and the Insurance Law (IL) of the PRC<sup>1499</sup>, it is the 1983 Regulation<sup>1500</sup> which has been repealed by the 1995 IL that governs the area of property insurance business, including marine insurance. In this Regulation, although there are no detailed provisions on insurable interest, the terms of it have been referred to for the purpose of providing who can take out an insurance. Then, in handling cases concerning disputes over contracts of

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<sup>1495</sup> CMC, s 218

<sup>1496</sup> 1906 MIA, s 9:

(1) The insurer under a contract of marine insurance has an insurable interest in his risk, and may reinsure in respect of it.

(2) Unless the policy otherwise provides, the original assured has no right or interest in respect of such reinsurance.

<sup>1497</sup> i.e. (1) Ship; (2) Cargo; (3) Income from the operation of the ship including freight, charter hire and passenger’s fare; (4) Expected profit on cargo; (5) Crew’s wages and other remuneration; (6) Liabilities to a third person; (7) Other property which may sustain loss from a maritime peril and the liability and expenses arising therefrom.

<sup>1498</sup> CMC, s 218

<sup>1499</sup> So far, there are five insurance statutes in China: the IL 1995, the IL 2002 Amendment, the IL 2009, the IL 2014 Amendment and the IL 2005 Amendment. Generally speaking, the law on insurable interest is the same in the IL 1995 and the IL 2002 Amendment; and the other three statutes have the same provisions on insurable interest.

<sup>1500</sup> Regulations of the People’s Republic of China on Property Insurance Contracts 1983 (1983 Regulation)

marine insurance, the enacted CMC shall apply. Where there are no relevant provisions in the CMC, such as that on insurable interest, the activities of insurance shall be in compliance with the IL, in which the law on insurable interest has been prescribed.<sup>1501</sup> In other words, as far as the law on contracts of marine insurance is concerned, the application of the Chapter 12 of the CMC rather than the IL prevails.<sup>1502</sup> In China, the Supreme People's Court (the SPC, *infra*) is entitled to interpret the application of law and guide the trial of the lower courts, and despite its interpretation and guidance being rules not law it has legal effect. It has further clarified rules on insurable interest. Therefore, its opinions on the insurable interest will be explored hereafter. Where there are no relevant provisions in the CMC and the IL, other relevant law, such as Contract Law of the PRC<sup>1503</sup> (the Contract Law, *infra*), shall apply.<sup>1504</sup> Also, if there is a lack in the above provisions, contracts of marine insurance which are a specific kind of civil legal act, should also be within the ambit of the General Principles of the Civil Law of the People's Republic of China (Civil Law, *infra*).<sup>1505</sup> In short, as for the law on insurable interest in marine insurance which has not been prescribed by the rules of Chapter 12, the IL and the SPC's Interpretation and Guidance shall apply, as well as other general statutes such as the Contract law and the Civil Law which have provided assureds' legal interests. In other words, there is only one regime as to the indemnity insurance, including the marine

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<sup>1501</sup> IL 1995, s 147; SPC, *Summary of the Second National Working Conference on Foreign-related Commercial and Maritime Trials* (SPC No 26, 2005) (SPC 2005 Summary, *infra*), published and came into effect on 26 December 2005, s 115; IL 2009, s 184

<sup>1502</sup> Peng-nan Wang, 'Prospects of Chinese Law of Marine Insurance' (2003) vol 14(1) *Annual of China Maritime Law* 199

<sup>1503</sup> Contract Law of the PRC (came into force on 1 October 1999, Contract Law *infra*) is still effective.

<sup>1504</sup> SPC, *Regulations of the SPC concerning some matters on the trial of cases involving the disputes over marine insurance* (Interpretation No 10 [2006] of the SPC)(SPC 2007 Regulations), came into effect in 2007, s 1

<sup>1505</sup> Nian-hong Zhang, *The Theory and Practice of Maritime Law* (China Legal Publishing House 2013) 115

insurance; unlike that in Australia and New Zealand, where there are two regimes to respectively regulate marine insurance and non-marine insurance.

## **6.2 Arguments that s 216 of the CMC has required insurable interest.**

As mentioned above, the law on contracts of marine insurance has been provided by Chapter 12 of the CMC. Nevertheless, the principle of insurable interest, either in general insurance or in marine insurance, has not been prescribed therein.<sup>1506</sup> However, it has been argued that s 216 which defines the contract of marine insurance, notwithstanding not by its express terms, has indirectly included the principle of insurable interest. According to s 216, a contract of marine insurance is a contract whereby, as the consideration of the premium paid by the assured, the insurer undertakes, as thereby agreed, to indemnify the loss of the subject matter insured and the liability of the assured caused by perils insured against it.<sup>1507</sup> There is no doubt that the contract of marine insurance is one of indemnity, to which the indemnity principle applies. Therefore, s 216 may impliedly require insurable interest, which is required by the indemnity principle to prove the assured may sustain a loss. However, since the interest required by the requirement of insurable interest and the doctrine of indemnity is different, the above submission may not be right. In addition, it relates neither to the concept and requirement of insurable interest, the time when the insurable interest must attach nor to the legal effect of contravening the requirement of insurable interest, etc. Section 218 of the CMC exemplifies eight kinds of objects which can be the subject matter of the insurance. Since the concept of insurable interest is different from the insured subject, it is not right to say that this Section has been involved in insurable interest.

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<sup>1506</sup> Ping-yang-dan-ke, 'Insurable Interest in Modern Marine Insurance' (2012) Study of Maritime Law 333, 333

<sup>1507</sup> CMC, s 216

## 6.3 Insurable interest under the 1995 IL

### 6.3.1 Section 11

The 1995 IL, coming into operation on 1 October 1995, was adopted at the 14th Meeting of the Standing Committee of the Eighth National People's Congress on November 7, 1992. The 1995 IL was afterwards amended by the IL 2002.<sup>1508</sup>

Although the Section governing the law on insurable interest has been changed from s 11 to s 12, the provisions of the law on insurable interest were not altered. The law on insurable interest in all kinds of insurance, including indemnity insurance (containing marine insurance) and life insurance, has been dictated by s 11 as follows:<sup>1509</sup>

ss 1 An insurant shall have an insurable interest in the subject matter insured.

ss 2 Every insurance made contrary to s 1 is void.

ss 3 An insurant has an insurable interest where it stands in any legal relation to the subject matter of insurance.

ss 4 The subject matter of the insurance refers either to the property of the assured and related benefits associated therewith, or to the life and the body of the assured, which is the object of the insurance.

As can be seen, s 11 involves the statutory requirement of insurable interest, the outcome of violating the requirement, the concepts of insurable interest and the subject matter of life and non-life insurance.

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<sup>1508</sup> Amendment of law is one form of legislation in China, other forms include enactment, recognition and repeal of law. See Zong-ling Shen, *Jurisprudence* (Peking University press 2001) 248

<sup>1509</sup> Peng-nan Wang, *The Theory and Practice of the Modern Marine Insurance Law* (Dalian Maritime University Press 2004) 131

### 6.3.2 The timing

Insurable interest has been required by ss 1-2 because a contract of insurance is void if the assured has no insurable interest. Where the court found that the insured respondent, the buyer, had no insurable interest in the insured goods which had been stolen by finding that the risk had still been borne by the seller and had not been passed to the insured buyer, under ss 11(2) of the 1995 IL, such contract, with its lack of insurable interest, was void; as a result of this the appellant, the insurer, was entitled to resist the claim against it.<sup>1510</sup>

However, there are two requirements for insurable interest: the first is that an assured must have an actual or potential interest at the time of contract, otherwise the contract is void; the other is that an actual insurable interest must attach at the time of loss otherwise the assured cannot validly claim. Thus, the time when the assured must have an insurable interest in indemnity insurance is uncertain: at the time of the contract or of the loss.<sup>1511</sup> In light of the consequence of breaching the requirement, as a void contract, it may be reasonable to deduce that the assured must have an actual or potential insurable interest at the time of effecting the contract. It thus seems likely that it is consistent with the rule under s 4 of the 1906 MIA (UK), which was to a large extent drawn on, when the CMC was drafted. Also, considering the fact that the requirement of insurable interest is imposed on the insurant who is involved in taking out the contract, the timing of the requirement may be the time when the

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<sup>1510</sup> *The People's Insurance Company of China, Hubei Branch v Technical Imp & Exp Co in Hubei Province*, No 11 [2002] of No 4 Civil Tribunal of Hubei Higher People's Court

<sup>1511</sup> Wei-qing Huang, 'Insurable Interest in International Marine Cargo Insurance' (2001) vol 12 Annual of China Maritime Law 15, 27

contract is entered into.<sup>1512</sup> However, it is uncertain as to whether the fact that an assured only has a potential insurable interest at the time of contract can prevent the contract from being void. The insurable interest in ss 11(2) should be widely construed: i.e. the policy will be void if the assured has no actual insurable interest; but will be enforceable if has an expectation of acquiring one. Consequently, the requirement that insurable interest must attach at time of loss and the effect of breaching is not provided for in the 1995 IL, which can be governed by the indemnity principle.

### **6.3.3 The assured rather than the insurant**

Unlike the term of “the assured” under s 4 of the 1906 MIA (UK), in the 1995 IL, the requirement of insurable interest is imposed on “the insurant”. Under s 9 of the 1995 IL, the term “insurant” means a person who has concluded the contract of insurance with the insurer and who under the contract has the obligation to pay the premium. Therefore, in indemnity insurance, the insurant means the assured then effecting the contract of insurance. Additionally, in terms of marine insurance, the insurant could be commonly understood to be the assured because there is no concept of the former in the CMC.<sup>1513</sup> In the 2009 IL s 12(2) thus uses the term “assured”.

### **6.3.4 The concept of insurable interest**

#### **6.3.4.1 An economic interest recognised by law**

The insurable interest in s 11 is defined as a legal interest possessed by the assured in the subject matter of insurance. Accordingly, the nature of the insurable interest must be an interest recognised by law. It has been argued

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<sup>1512</sup> Nian-hong Zhang, *The Theory and Practice of Maritime Law* (China Legal Publishing House 2013) 117; Li-ying Zhang, Jing-song Zhao, Lu-jun Zhao, *The Comparative Study of Principles and Cases on Marine Insurance Law between China and the UK* (Dalian Maritime University Press 2006) 20

<sup>1513</sup> Li-ying Zhang, *The Theory of Maritime Law* (Higher Education Press 2006) 437

that, in marine insurance, the term “recognised by law” is designed to limit the extent of economic interest so as to render it certain.<sup>1514</sup> For example, a buyer’s expectation of profits may be insurable only if it has been based on an existing title, such as having had a contract of sale. This test is by and large in accordance with the approach adopted by s 5 of the 1906 MIA (UK):<sup>1515</sup> the interest should be a legal relation, such as a right to the property or deriving from the contract, due to which the assured may suffer a loss.

#### **6.3.4.2 Wide construction**

##### **6.3.4.2.1 Not limited to ownership**

The interest is insurable as long as it is an economic interest recognised by law and it is not limited to ownership. The 1983 Regulation provides that a person cannot be the assured unless he is the owner, operating manager of the insured property or other persons interested in it. Thus, a proprietary interest is an insurable interest. A person who operates the insured property, either having or not having possession of it, can have an insurable interest if the interest is relying on an existing right, such as that from a contract of management. To leave space for new products of insurance, other interests may also be insurable. In line with this, the 1990 Reply by the SPC held that the contract of insurance was valid because the assured at the time of contract had an insurable interest in the vessel, on the basis that the assured legally possessed the vessel although the assured was not the owner of the vessel. Accordingly the possessory interest was also an insurable interest.<sup>1516</sup> In the case where the

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<sup>1514</sup> Ping-yang-dan-ke, ‘Insurable Interest in Modern Marine Insurance’ (2012) Study of Maritime Law 333, 336

<sup>1515</sup> Wei-qing Huang, ‘Insurable Interest in International Marine Cargo Insurance’ (2001) vol 12 Annual of China Maritime Law 15, 18

<sup>1516</sup> SPC, *Reply of the Supreme People’s Court on the Letter of Arbitration Letter from the People’s Insurance Company of China on the “Tug Terry No 3”* (1990)

insured ship, in which the assured in effect had the ownership, for the consideration of tax and as the qualification for operating the business, had been registered as the property of another company, it was held that the assured who was in possession of the ship had an insurable interest in this ship.<sup>1517</sup> It is noteworthy that mere possession, or operating is not sufficient to be an insurable interest, such an assured must be pecuniarily affected by the perils insured against.

Furthermore, in the case of *Shanghai Zhongfu Shipping Co*,<sup>1518</sup> the assured, the operator of the vessel, took out the contract of insurance with the insurer on the vessel which subsequently sank in transit. Then the assured made a claim for its loss which was however rejected by the insurer arguing that the contract was void due to lack of insurable interest because the assured was not the owner of the ship, and thus had no rights or interests in the insured ship. The court leaned toward the assured having an interest on the following grounds. Firstly, the assured had an economic interest in the ship. It might incur liability on the occurrence of the insured perils. Besides, it could get remuneration from its operating work. This proved that it would be prejudicially affected due to the perils insured against. Secondly, the assured stood in a legal relation to the vessel. In this case, as the operator, the assured had made a contract with the owner to manage the vessel. Also, the assured possessed the vessel. Both relations could be recognised by law. Therefore, insurable interest was not limited to the possessory interest. The judgement of this case is similar to that for the assured manager in *The Martin P* and the assured user in *The Moonacre*.

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<sup>1517</sup> “Rongsheng”, see Peng-nan Wang, *Summary and Comments On Cases of China’s Maritime Insurance* (Dalian Maritime University Press 2003) 20

<sup>1518</sup> *Shanghai Zhongfu Shipping Co v The People’s Insurance Company of China, Shaihai Branch* (2003) Civil Judgment of Shanghai Maritime Court, PRC, First Instance Judgment of the Commercial Tribunal No 77

Both cases have tried to widen the definition of insurable interest. Therefore, it is definite that in China insurable interest is not limited to proprietary interest and can include possessory interest, at least a legal one. Seemingly, with the existence of a contract, a person who will be economically affected or will incur liability on the occurrence of an insured peril has an insurable interest.

In addition, two steps should be taken to test the existence of insurable interest: it can be firstly examined as to whether the assured has an economic interest in the insured subject, in consequence of which it will benefit from its preservation or be prejudiced by its destruction, then whether such interest is recognised by law. Admittedly, there are many kinds of insurable interest which are impossible, or at least difficult, to exhaustively enumerate. This is an approach in line with s 5(2) of the 1906 MIA which illustrates the types of insurable interest.

#### 6.3.4.2.2 Shareholder interest

Unlike in the judgement of *Macaura*,<sup>1519</sup> Beihai Maritime Court held that the shareholder, the assured, had an insurable interest in the insured cargo, as the asset of its private enterprise, which had been lost during the inland water transit because it had a shareholder interest in the property of the company, which had been recognised by law.<sup>1520</sup> This judgement should not be construed that a shareholder can insure its company's asset, but by the specific facts of this case, i.e. the nature of the company being a private enterprise, it can have an insurable interest.

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<sup>1519</sup> *Macaura v Northern Assurance Co Ltd* [1925] AC 619

<sup>1520</sup> *Cai Guimu v China Pacific Insurance Co, Guigang Office*, Civil Judgment of Beihai Maritime Court, PRC, First Instance Judgment of the Commercial Tribunal No 22 (2000)

#### 6.3.4.2.3 Conclusion

The definition in s 11(3) of the 1995 IL is a rather abstract one and needs further construction. It seems to be consistent with the strict test. The elements of it are unclear, such as what the legal relation is. However, it seems that the definition needs to be widely construed, at least being the approach adopted by the courts in China. Although the law has not further explained the definition of insurable interest, as will be discussed below, academics, courts and the SPC have all tried to make it clear; in particular, the SPC's Interpretation and Guidance can have legal effect and should be followed by all the lower courts in China.

### **6.4 Certainty as to the timing when an insurable interest must attach in marine insurance by the SPC Summary 2005**

The provisions respecting insurable interest under s 11 of the 1995 IL have been deemed to be obsolete.<sup>1521</sup> However, for marine insurance, the above controversy has been solved by the SPC Summary 2005.<sup>1522</sup> Although it is not part of the law in China, it is used by the SPC to guide the lower courts respecting marine trials. Under this guidance, the insurer shall be liable to compensate the assured who has no insurable interest in the subject of insurance at the time the contract was entered into but has one at the time of the occurrence of the event insured against. By contrast, the insurer can be relieved from its liability by reason only that the assured has lost its insurable interest at the time of loss, notwithstanding that it had an insurable interest at the time of entering into the contract. In terms of this judicial guidance, the time when the assured must have an insurable interest is unequivocal and clear: the

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<sup>1521</sup> Peng-nan Wang, 'Prospects of Chinese Law of Marine Insurance' (2003) vol 14(1) Annual of China Maritime Law 199, 206

<sup>1522</sup> SPC 2005 Summary, s 123

interest must attach at the time of loss. It does not matter whether the assured has an insurable interest at the time of taking out the contract, and not having an actual one at such time will not render the contract void. This is because an expectation of interest is sufficient to prevent a policy from being void. This rule reflects the indemnity doctrine. Also, it echoes the principle of contractual freedom and adjusts itself to the common commercial practice, i.e. the assured frequently concludes contracts of marine insurance prior to the passing of risk.

However, it may be argued that the insurable interest is required at the time of contract because although the actual interest is not needed at such time, an expectation of acquiring it may be needed, and consequently lack of such an expectation will avoid the contract. Therefore, as far as this Summary is concerned, the proposition is arguable.

In conclusion, as to contracts of marine insurance, it is established that the assured must have an actual insurable interest at the time of loss, which affects whether he can make a valid claim and no actual interest is needed at the time of contract. It is at least arguable that a potential one is required at the time of contract, which will decide the enforceability of the contract.

## **6.5 Arguments for reform of insurable interest**

### **6.5.1 Functions of insurable interest**

Despite the arguments for repealing the insurable interest requirement in marine insurance, it has been thought by the majority that this doctrine should be retained with revisions, for it could serve the following three purposes.<sup>1523</sup> As

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<sup>1523</sup> Peng-nan Wang, *The Theory and Practice of the Modern Marine Insurance Law* (Dalian Maritime University Press 2004) 96; cited in Lin-qing Jia, 'The perfection of the marine

mentioned supra, requiring the assured to have an interest at the time of the contract could prevent the insurance being a tool for gambling and could minimise the moral hazard that the assured might be tempted to deliberately damage the subject matter of the insurance or incur liabilities thereon.<sup>1524</sup> In addition, some have argued that the requirement of insurable interest could prevent the assured from recovering the payment from the insurer in excess of the indemnity<sup>1525</sup> because the assured is only entitled to recover its loss which is limited to insurable interest owned by the assured in the insured subject.<sup>1526</sup>

## 6.5.2 Reasons for amendment

### 6.5.2.1 Easy substitutes to ban gaming and wagering contracts

Nevertheless, opinions have been stated that functions of the insurable interest requirement do not withstand scrutiny. The aim of prohibiting gaming and wagering contracts may be achieved by directly providing that every contract of insurance in the guise of gambling is void. Thus, the concept of insurable interest, which is deemed to be complex, would be excluded from the provision respecting banning gambling.<sup>1527</sup>

### 6.5.2.2 Moral hazards may not be able to be prevented

It has been considered to be illogical that the risk of moral hazard could be discouraged by the requirement of insurable interest. It is the assured rather

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insurance regime in China within the context of the Insurance Law of the People's Republic of China' (2010) Annual of China Maritime Law 21(1) 89, 90

<sup>1524</sup> Yuquan Li, *The Insurance Law* (Beijing Press 1997) 72-77; (2nd edn Beijing Publishing House 1997) 75-88; Answers to questions of the reporters on the SPC 2013 Interpretation by the person in charge of Civil Adjudication Tribunal No 2 of SPC (2013 Answers)

<sup>1525</sup> Yi Xiao, 'Analysis of the Legislation on Insurable Interest' (2003) China's insurance quote Section 3

<sup>1526</sup> 2013 Answers

<sup>1527</sup> Peng-nan Wang, *The Theory and Practice of the Modern Marine Insurance Law* (Dalian Maritime University Press 2004) 95

than those without insurable interest that have a much easier opportunity to dispose of the insured subject matter. This could be illustrated by the common marine practice of the valued policy: where the actual value of the subject matter insured is lower than the value fixed by the policy, it is not uncommon to witness the wilful destruction by the assured. By reason of the various regimes as to the legal outcome of deliberately damaging the insured subject, the assured may be tempted to do so because he may just be disallowed recover payment from his insurer while others having done so may be punished by the Criminal Law.<sup>1528</sup> In addition, while it may be expected that the assured having an insurable interest in the insured subject should take good care of such subject, the reality may be that the assured may be more likely to be negligent due to the cover provided by the insurer.<sup>1529</sup>

#### *6.5.2.3 Other measures to fulfil the purpose of prohibiting the assured from profiting*

It has been said that there seems little point in adopting the insurable interest requirement to preclude the assured from benefiting by the insurance. Such aim having been argued might be achieved by means of the indemnity doctrine (the assured can only claim against the insurer for the loss sustained) or provisions under the insurance policy (a prudent agreement may avoid compensation under the insurance contract being the economic incentive for pursuing benefits, e.g. the assured is required to partly insure itself). The requirement of insurable interest has been considered as being able to be substituted by the indemnity principle as well because the former is inherently required by the latter.<sup>1530</sup>

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<sup>1528</sup> Criminal Law of the PRC (came into effect on 1 October 1997), ss 275, 314

<sup>1529</sup> Peng-nan Wang, *The Theory and Practice of the Modern Marine Insurance Law* (Dalian Maritime University Press 2004) 96

<sup>1530</sup> *Constitution Insurance Co v Kosmopoulos* (1987) 34 DLR (4th) 208 (Wilson J), cited in Peng-nan Wang, *The Theory and Practice of the Modern Marine Insurance Law* (Dalian Maritime University Press 2004) 97

#### *6.5.2.4 Difficult to define the insurable interest*

There have been complaints that the test to insurable interest is so ambiguous that it is not easy to test whether an assured has an interest in practice and no provisions of any statute ever provide the essentials to constitute an insurable interest,<sup>1531</sup> which renders the rules under ss 11(3) of the 1995 IL difficult to be apply. In addition, as mentioned above, the timing when the assured must have an interest is also unclear under the 1995 IL.

Based on the above objections to the functions of the insurable interest principle, it is submitted that the law on insurable interest under the 1995 IL should only be amended not repealed. In particular, in the realm of insurance on marine adventures, concerns have been expressed that related provisions, such as insurable value,<sup>1532</sup> the sum of money being able to be recovered,<sup>1533</sup> and the right of subrogation,<sup>1534</sup> may be affected.

### **6.5.3 Recommendations**

#### *6.5.3.1 Concepts of insurable interest*

##### 6.5.3.1.1 Academic proposals

**Similar to the approach in UK.** It has been submitted that Chapter 12 of the CMC should provide the law on insurable interest in marine insurance so as to resolve the problems in the practice and theory of marine insurance.<sup>1535</sup> This provision leading to two regimes as to insurable interest in marine and non-marine insurance may not be favourable. Despite the particularity of marine

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<sup>1531</sup> Wei-qing Huang, 'Insurable Interest in International Marine Cargo Insurance' (2001) vol 12 Annual of China Maritime Law 15, 17

<sup>1532</sup> CMC, s 219

<sup>1533</sup> CMC, s 238

<sup>1534</sup> CMC, s 252

<sup>1535</sup> Wei-qing Huang, 'Insurable Interest in International Marine Cargo Insurance' (2001) vol 12 Annual of China Maritime Law 15, 30

insurance, the better choice may be to integrate the law on insurable interest in all indemnity insurance and then to provide for them in the IL.

The proposal for the reform of insurable interest defined in marine insurance on cargo has been set out as following: the assured shall stand in a legal relation to the insured subject, in consequence of which it may be prejudiced or incur liability by reason of the occurrence of the perils insured against. Such prejudice or liability is an economic interest which has been covered by the contract. Examples of such interests are as follows: ownership in the cargo, lien therein, risk on the cargo borne by the assured and of the insurer when the policy attaches, pledge on the bill of lading at the time when it has been delivered to the creditor.<sup>1536</sup> Besides the above, it has also been submitted that the interest recognised by law should be clearly provided as the real right or the creditor's right.<sup>1537</sup> Actually, this step to define insurable interest is similar to that adopted by ss 5-15 of the 1906 MIA: section 5 generally defines insurable interest, various examples of which have been provided for in ss 7-14. It can be helpful to understand insurable interest by the above illustrations. It however cannot reflect the current trend of widely interpreting insurable interest. The above examples should include an additional very wide example, e.g. that the assured can have an insurable interest if, based on a present contract, it will be economically affected.

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<sup>1536</sup> Wei-qing Huang, 'Insurable Interest in International Marine Cargo Insurance' (2001) vol 12 Annual of China Maritime Law 15, 19

<sup>1537</sup> Lin-qing Jia, 'The perfection of the marine insurance regime in China within the context of the Insurance Law of the People's Republic of China' (2010) Annual of China Maritime Law 21(1) 89, 90

**Similar to Australian approaches.** It is also contended that, similar to the wide test adopted by the Australians,<sup>1538</sup> the assured has an insurable interest if it may suffer economic loss of or damage to the insured subject by the perils insured against during the cover of insurance.<sup>1539</sup> Although there should be no legal relation to limit the concept of insurable interest, it should not be allowed to go so far as to be considered to be speculative.

#### 6.5.3.1.2 Opinions of the SPC

##### 6.5.3.1.2.1 *The concept of insurable interest*

In light of the uncertainty as to the definition of insurable interest under s 12 of the IL 2002 Amendment and the problems with the understanding concerning its concept in the courts,<sup>1540</sup> the SPC 2003 CP further interprets insurable interest.<sup>1541</sup> It first generally states that an insurable interest is an economic interest which can be ascertained.<sup>1542</sup> Examples of insurable interest in indemnity insurance are then provided: the assured has an insurable interest where it has economic interests which are derived from real right, a contract, or a civil liability to compensation according to the rules of law.<sup>1543</sup> The two rules should be understood in their combination and it is not right to regard a mere economic interest as an insurable interest. The examples have actually imposed limitations on the test of economic interest because they are relationships recognised by law. The definition here may still have adopted the strict test.

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<sup>1538</sup> ICA 1984, s 17

<sup>1539</sup> Peng-nan Wang, *The Theory and Practice of the Modern Marine Insurance Law* (Dalian Maritime University Press 2004) 106

<sup>1540</sup> Yan-bin Wang, 'Impacts of the revised Insurance Law on the current marine insurance contact law regime of China' [2011] 22(1), *Annual of China Maritime Law* 60, 61

<sup>1541</sup> SPC 2003 CP, s 1

<sup>1542</sup> SPC 2003 CP, s 1

<sup>1543</sup> SPC 2003 CP, ss 1, 2

In the SPC 2012 Consultation Paper (SPC 2012 CP),<sup>1544</sup> it has been proposed that the insurable interest in property insurance contains interests recognised by law: the existing interests and interests in liability and in expectancies relying on an existing interest. However, there are no detailed interpretations of those three interests in this consultation paper, which will be explored *infra*.<sup>1545</sup>

#### *6.5.3.1.2.2 Various assureds owning their several interests*

In addition, ss 1(3) of the SPC 2003 CP stipulates that various assureds who have their own several interests in the same subject insured can take out their respective contracts of insurance to the extent of their own interest, which has been proposed as well in the SPC 2012 CP.<sup>1546</sup> This rule has been made into law by the SPC's interpretation in 2013.<sup>1547</sup>

#### **6.5.3.2 The timing**

##### 6.5.3.2.1 Proposals by scholars

**Need for making the timing clear by law.** As to the time when the insurable interest must attach, it has been argued that the timing, by s 11(1) of the 1995 IL, of interest in marine cargo insurance is ambiguous and it thus should be made clear that, in line with the provision under s 6 of the 1906 MIA,<sup>1548</sup> the assured is only required to show the possession of insurable interest at the time of loss to support the claim for recovery and cannot obtain an interest which it

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<sup>1544</sup> SPC, *The SPC 2013 Interpretation concerning several matters on Application of the Insurance Law of the People's Republic of China (Consultation Paper)* (SPC 2012 CP, *infra*), s 1

<sup>1545</sup> See 6.6.3.2, *infra*

<sup>1546</sup> Consultation Paper 2012, s 1

<sup>1547</sup> SPC, *The SPC 2013 Interpretation concerning several matters on Application of the Insurance Law of the People's Republic of China (2013)* (SPC 2013 Interpretation, *infra*) s 1, s 1; For detailed discussion, see 6.7.2.3.5

<sup>1548</sup> 1906 MIA, s 6(1)

has not had at the time of the loss, by any act or election after it is of the loss.<sup>1549</sup>

**Incorporation of the effect of retrospective declaration.** It has been argued that there should be incorporated into the CMC an effect similar to that of retrospective declaration: the assured who at the time of contract was not aware of the loss occurring prior to the contract may be entitled to recover the loss by the perils insured against during the period of cover; however, the assured still must have an interest at the time of loss.<sup>1550</sup> It has been contended that this term may assist the buyer on FOB or CFR terms to recover the loss occurring prior to the transfer of risk.<sup>1551</sup> Apparently, the ALRC holds different views.<sup>1552</sup> This proposal has been made law by the SPC 2007 Regulation.<sup>1553</sup>

**Legal effect.** Unlike the effect contrary to the requirement of insurable interest that such a contract would be void, it has been recommended that the assured lacking insurable interest at the time of loss will render it unentitled to sue for recovery.<sup>1554</sup>

#### 6.5.3.2.2 The SPC's recommendation concerning the timing

The SPC 2003 CP contends that the assured shall own an insurable interest at the time of loss rather than at the time of the contract: the insurer can be relieved of its liability to indemnify the assured who had an interest at the time of

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<sup>1549</sup> Wei-qing Huang, 'Insurable Interest in International Marine Cargo Insurance' (2001) vol 12 Annual of China Maritime Law 15, 23-24

<sup>1550</sup> Peng-nan Wang, *The Theory and Practice of the Modern Marine Insurance Law* (Dalian Maritime University Press 2004) 106

<sup>1551</sup> Ping-yang-dan-ke, 'Insurable Interest in Modern Marine Insurance' (2012) Study of Maritime Law 333, 336

<sup>1552</sup> ALRC 91, paras 11.40 and the following

<sup>1553</sup> SPC 2007 Regulations, s 1

<sup>1554</sup> Peng-nan Wang, *The Theory and Practice of the Modern Marine Insurance Law* (Dalian Maritime University Press 2004) 106

contract but who lost it at the time of loss, while the insurer is not relieved of its liability to compensate the assured who had no interest at the time of the contract but nonetheless acquired one at the time of loss.<sup>1555</sup> As with the above opinion, in the SPC 2005 Draft,<sup>1556</sup> it is proposed that, in property insurance, the courts shall support the insurer's arguments that they are able to be relieved of liability under the contract because the assured had no insurable interest in the insured subject on the occurrence of the event insured against. The timing for the time of loss has been adopted by the SPC 2005 Summary to guide the trial of the lower courts<sup>1557</sup> and provided for in the 2009 IL.<sup>1558</sup> In light of the above proposals by the SPC, the insurable interest must attach at the time of loss. However, it is still arguable whether an expectation of obtaining one is required to prevent the contract from being void.

## 6.6 Insurable interest under the 2009 IL

### 6.6.1 Provisions regulating insurable interest under this Act

The following is the reform of the law on insurable interest under s 12 of the 2009 IL, which amended the requirement of insurable interest in the 1995 IL. The 2009 IL has been amended by the IL 2014 Amendment.<sup>1559</sup> Nonetheless, the reform does not extend to the law on insurable interest, which is identical with that under s 12 of the 2009 IL. For the property insurance, the requirement of insurable interest at the time of the contract is not imposed on the assured by

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<sup>1555</sup> SPC 2003 CP, s 2

<sup>1556</sup> SPC, *Interpretation of the SPC on some matters about the application of law in the trial of cases involving the disputes over insurance (Draft Standard for Examination)* (SPC 2005 Draft) s 1

<sup>1557</sup> SPC 2005 Summary, s 123

<sup>1558</sup> IL 2009, s 12 (2)

<sup>1559</sup> It has been partly altered by the IL (2015 Amendment), which does not involve the law on insurable interest.

the 2009 IL.<sup>1560</sup> Thus, a contract of property insurance will not be void only because the assured has no insurable interest at the time of contract. Instead, on the occurrence of the event insured against, the assured shall possess an insurable interest in the subject matter of insurance to support the claim for recovery.<sup>1561</sup> For property insurance, the concept of insurable interest is identical with that under s 11 of the 1995 IL.

In addition, this section distinguishes property insurance from personal insurance by means of the subject matter of insurance: the former is one on property and related interest therein; by contrast, the latter is an insurance on the life or the body of a person.<sup>1562</sup> The term “assured” is also defined by this section as the person whose property or whose life or body is protected by the insurance contract and who has the right to claim for recovery.<sup>1563</sup> The relation between “the insurant” has been again defined in the 2009 IL:<sup>1564</sup> the insurant may be the assured. Besides, the definition of the subject matter of insurance is not provided for in the 2009 IL, which has been prescribed in the 1995 IL. However, it has been specified and incorporated into the concept of the property insurance, for which it should be the property or the related interest therein.<sup>1565</sup>

### 6.6.2 The timing

The most significant change is the timing when the assured must own an insurable interest. Under s 12(2), the assured must have an insurable interest at

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<sup>1560</sup> There is an insurable interest requirement for personal insurance: the proposer must have an insurable interest in the assured at the time of effecting the contract. See IL 2009, ss 12(1)

<sup>1561</sup> IL 2009, ss 12 (2)

<sup>1562</sup> IL 2009, ss 12 (3), (4)

<sup>1563</sup> IL 2009, s 12 (5)

<sup>1564</sup> IL 2009, s 12(5); it has been dictated in IL 1995, s 21.

<sup>1565</sup> IL 2009, s 12(4)

the time of loss and there is no strict legislative insurable interest requirement at the time when the contract of insurance on property, including marine insurance, is taken out. The issues have thus been made clear in relation to the timing when the assured needs to show the possession of insurable interest and the subject of the possession.<sup>1566</sup> As a result, lack of insurable interest at the time of all indemnity contracts will not lead to the avoidance of the contract. By contrast, under s 48 of the 2009 IL, the assured is not entitled to make a valid claim if it has no insurable interest at time of loss. As can be seen, the provision of s 12(2) in effect incorporates proposals in the SPC 2003 CP and the SPC 2005 Draft and reflects the guidance of the SPC 2005 Summary.

Although s 12 of the 2009 IL has not provided the timing at the time of contract and the consequence of breaching, it is however clear that an assured is not required to have an actual insurable interest at time of contract. Then here comes the question: whether an expectation of obtaining one is required or not required, the breaching of which will render the contract void. It may be right that the requirement at time of contract is abolished and is only retained at time of loss. Since in s 11 of the 1995 IL it involves the enforceability of contract whereas in s 12 of the 2009 IL that is not referred to and only the timing of loss and its consequence of violation has been provided. In short, in China, the timing when insurable interest must attach is at time of loss, violation of which will lead to the assured not being able to claim. It may also be deduced that in China the requirement at time of contract has been removed. However, a policy should be void if an assured cannot obtain an insurable interest during the life of a policy. As a result, an insurer who has received premiums of such an assured

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<sup>1566</sup> IL 2009, s 12(2)

cannot retain them. It does not necessarily mean that this rule has to be provided for in insurance law, because it is just a general principle of law.

As can be seen, the law on insurable interest in indemnity insurance and life insurance has been divided into two regimes under s 12 of the 2009 IL, which is different from that under s 11 of the 1995 IL in which the requirement of insurable interest for both insurance has been provided for in the same provision,<sup>1567</sup> in consequence of which the timing and the person who is required to have the interest has been rendered unclear.

### **6.6.3 Definition of insurable interest**

The concept of insurable interest remains unchanged in the 2009 IL since its first provision in the 1995 IL: insurable interest is an interest recognised by law which is owned by the assured. However, the concept, especially the meaning of “recognised by law”, has been argued as being too general to be understood by the parties to the cover and to be applied by the courts. Therefore, the following discussion, especially the opinion from the courts and the SPC,<sup>1568</sup> may be helpful to better understand the concept.

#### **6.6.3.1 The definition from the judgement of a court**

Section 12 seems to show that the 2009 IL adopts the narrower test of insurable interest given by Lord Eldon: the interest is insurable only if it is one that the assured has a legal right in the property or a right under the contract concerning property.<sup>1569</sup> It has been submitted that the legal relation required by s 12

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<sup>1567</sup> IL 1995, s 11(1), (2)

<sup>1568</sup> See 6.7, below.

<sup>1569</sup> *Lucena v Craufurd* (1806) B & PNR 269 [321]

generally includes the interest either in the real right or creditor's right.<sup>1570</sup> From another perspective, one court held that, generally speaking, there were three kinds of insurable interest: existing interests, interests on expectancies and interests derivable out of liability arising from an existing interest.<sup>1571</sup> They actually both refer to the strict test but only use different terms from the different perspectives.

#### 6.6.3.1.1 Existing interests

The phrase existing interest refers to that which has been had by the assured.<sup>1572</sup> In China, the rights to property are generally divided into four categories: ownership in the property, possession right, usufruct and real rights granted by way of security, consisting of mortgage, pledge and lien.<sup>1573</sup> Therefore, the court held that the assured who had the title to the property possessed an insurable interest in the insured cargo.<sup>1574</sup> Those four categories of rights to property are non-exhaustive examples of existing interests.<sup>1575</sup> Having a contract can be deemed to confer on the assured an existing right. It was thus held that the insured manager of a vessel had an insurable interest

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<sup>1570</sup> Peng-nan Wang, *The Theory and Practice of the Modern Marine Insurance Law* (Dalian Maritime University Press 2004) 97; Li-ying Zhang, *The Theory of Maritime Law* (Higher Education Press 2006) 438

<sup>1571</sup> *Huang Chunfa Co Ltd v China Pacific Insurance Co, Guangzhou Branch* (2001) The Higher People's Court of Guangdong Province, PRC, Final Judgement of the 2nd Economic Tribunal No 147

<sup>1572</sup> *Huang Chunfa Co Ltd v China Pacific Insurance Co, Guangzhou Branch* (2001) The Higher People's Court of Guangdong Province, PRC, Final Judgement of the 2nd Economic Tribunal No 147

<sup>1573</sup> Property Law of the PRC (coming into effect on 1 October 2007), s 2

<sup>1574</sup> *Sanhe Trade Co Ltd v Ping An Insurance Company of China, Ltd* (1999) Civil Judgment of Beihai Maritime Court, PRC, First Instance Judgment of the Commercial Tribunal No 10

<sup>1575</sup> *Huang Chunfa Co Ltd v China Pacific Insurance Co, Guangzhou Branch* (2001) The Higher People's Court of Guangdong Province, PRC, Final Judgement of the 2nd Economic Tribunal No 147

because he had under the contract possession of the insured vessel and was liable to the insured ship if damaged.<sup>1576</sup>

#### 6.6.3.1.2 Expectancies

Expectancies may be insurable interests: though they are inchoate at the time of the contract of insurance, they are already founded on an existing right;<sup>1577</sup> and they will in the ordinary course of things be achieved but for maritime perils. Two instances of interests from expectancies can be given. Freight is insurable where safe arrival may be expected under the charterparty, due to which mere expectancies turn out to be those based on existing interests. Also, profits are good examples of expectancies which can be obtained by the owner of the cargo due to the existence of the contract of sale; only perils from the voyage will prevent him from benefiting from the sale.<sup>1578</sup>

#### 6.6.3.1.3 Liability

A person has an interest in the insured property if he might be responsible for it on the occurrence of its loss or damage.<sup>1579</sup> It was held the liability of the assured incurred by loss or damage to the insured subject of insurance was insurable when that liability was generally derived from the assured's acts in tort, or under contract or statute.<sup>1580</sup> For example, a carrier and other bailees could have an insurable interest in goods under their control because on the

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<sup>1576</sup> *Shanghai Zhongfu Shipping Co v The People's Insurance Company of China, Shaihai Branch* (2003) Civil Judgment of Shanghai Maritime Court, PRC, First Instance Judgment of the Commercial Tribunal No 77

<sup>1577</sup> *Huang Chunfa Co Ltd v China Pacific Insurance Co, Guangzhou Branch* (2001) The Higher People's Court of Guangdong Province, PRC, Final Judgement of the 2nd Economic Tribunal No 147

<sup>1578</sup> Jonathan Gilman, Robert Merkin, Mr M J Templeman, Claire Blanchard, Julian Cooke, Philippa Hopkins, *Arnould's Law of Marine Insurance* (18th Revised edn, Sweet & Maxwell 2013) 11-28

<sup>1579</sup> *Huang Chunfa Co Ltd v China Pacific Insurance Co, Guangzhou Branch* (2001) The Higher People's Court of Guangdong Province, PRC, Final Judgement of the 2nd Economic Tribunal No 147

<sup>1580</sup> *Huang Chunfa Co Ltd v China Pacific Insurance Co, Guangzhou Branch* (2001) The Higher People's Court of Guangdong Province, PRC, Final Judgement of the 2nd Economic Tribunal No 147

occurrence of insured perils they were liable to the owner of goods. In the case of *Eleonora No. 8*, the actual assured on CFR terms, in the view of the people's court of second instance, had an insurable interest in the insured cargo which had been loaded on board the vessel because the assured was liable to pay whether or not the cargo arrived safely.<sup>1581</sup> Additionally, where it is necessary to test whether the assured has an insurable interest, the key is to test whether the assured is at risk of possibly being liable to pay rather than whether the assured has paid for the insured cargo.<sup>1582</sup> Where a buyer under the contract of sale of goods who has borne the risk of its loss has not paid the price for the insured goods which had been lost, but is still responsible for the payment thereof,<sup>1583</sup> in such a case of non-payment, the assured has still an insurable interest in this liability.<sup>1584</sup>

#### *6.6.3.2 Essential elements of an economic interest recognised by law*

To constitute an insurable interest, the following three essentials containing both tests for insurable interest<sup>1585</sup> i.e. the strict test and the economic test, must be met. In other words, an interest is insurable where there is a pecuniary interest recognised by law which can be used to ascertain such an interest.

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<sup>1581</sup> *Huang Chunfa Co Ltd v China Pacific Insurance Co, Guangzhou Branch* (2001) The Higher People's Court of Guangdong Province, PRC, Final Judgement of the 2nd Economic Tribunal No 147

<sup>1582</sup> Wei-qing Huang, 'Insurable Interest in International Marine Cargo Insurance' (2001) vol 12 Annual of China Maritime Law 15, 28-30

<sup>1583</sup> Under UN CCISG, s 66: Loss of or damage to the goods after the risk has passed to the buyer does not discharge him from his obligation to pay the price, unless the loss or damage is due to an act or omission of the seller; Contract Law of PRC, ss 8, 44, 60

<sup>1584</sup> Wei-qing Huang, 'Insurable Interest in International Marine Cargo Insurance' (2001) vol 12 Annual of China Maritime Law 15, 29

<sup>1585</sup> Peng-nan Wang, *The Theory and Practice of the Modern Marine Insurance Law* (Dalian Maritime University Press 2004) 97

#### 6.6.3.2.1 Interest recognised by law rather than matters on legality

Firstly, the interest should be a lawful relation, for instance, a right to the property or arising from a contract,<sup>1586</sup> between the assured and the subject matter of insurance.<sup>1587</sup> In China, unless otherwise provided by the 2009 IL, concluding the contract of the indemnity insurance, which is an act of civil law, shall be governed by related legislation, which stipulates that civil activities should not contravene the social ethics and the public interest.<sup>1588</sup> Therefore, the interest in forbidden activities, such as smuggled goods, stolen goods, is not an insurable interest.<sup>1589</sup> But it does not necessarily mean that the assured is deemed to have no insurable interest where its acts have contravened certain laws. To test whether an interest is recognised by law or not, the key point is to explore whether the relation between the assured and the insured subject has been provided by law, rather than to see the legality of the assured's relevant act or the insurance contract.

**Two decisions on this same dispute.** In the case of *Sun Richie 3*,<sup>1590</sup> a dispute was brought to the court as to whether the insured buyer who had not yet paid the price of the insured cargo had an insurable interest in such cargo at the time of loss when it did not obtain the import licence for the cargo. Guangzhou Maritime Court held that the assured had been entitled to have an insurable interest in the insured cargo at the time when it passed the rail of the

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<sup>1586</sup> Peng-nan Wang, *The Theory and Practice of the Modern Marine Insurance Law* (Dalian Maritime University Press 2004) 97; Li-ying Zhang, *The Theory of Maritime Law* (Higher Education Press 2006) 438

<sup>1587</sup> Nian-hong Zhang, *The Theory and Practice of Maritime Law* (China Legal Publishing House 2013) 116; Peng-nan Wang, *The Theory and Practice of the Modern Marine Insurance Law* (Dalian Maritime University Press 2004) 17

<sup>1588</sup> Civil Law, s 7; Contract Law, ss 6-7; 52

<sup>1589</sup> Nian-hong Zhang, *The Theory and Practice of Maritime Law* (China Legal Publishing House 2013) 115

<sup>1590</sup> For the detailed facts of this case, see <http://www.110.com/ziliao/article-38236.html>

carrying ship. Whether the assured had paid the price, which was a matter of the contract of sale, did not relate to the matter as to whether it was able to have an interest.<sup>1591</sup> The Guangzhou High People's Court held that it favoured the appellant, the insurer, on the grounds that the interest in the cargo, as illegally imported goods, which was contrary to the legislation,<sup>1592</sup> was unlawful, although the respondent, the assured, had borne the risk of loss thereof.<sup>1593</sup> The first judgement may be correct.

**Reasons for respective decisions.** It can be seen that the various judgements above are due to a differing understanding of the insurable interest. It is thus essential to precisely understand the conception of insurable interest under the IL, especially as to the meaning of the term "recognised by law". There is controversy in respect of the meaning of "recognised by law". Taking the instance of the above judgements, the trial court held that an interest was insurable as long as the interest owned by the assured was one provided for in law and the assured's action contrary to the law did not necessarily render its interest not insurable, unless its action severely contravenes public interest. By contrast, in the opinion of the higher court, it has been argued that the phrase should be understood that the assured's legal action should be consistent with the law, namely, the phrase actually involves the issue of legality. In this view, any interest is not insurable which derives from the object of insurance involved in any of the assured's unlawful acts, although the assured has taken the risk. Such submission may not be right.

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<sup>1591</sup> Peng-nan Wang, 'Prospects of Chinese Law of Marine Insurance' (2003) vol 14(1) Annual of China Maritime Law 199, 207

<sup>1592</sup> See Foreign Trade Law of the PRC(Revised in 2004), ss 9, 19

<sup>1593</sup> Wei-qing Huang, 'Insurable Interest in International Marine Cargo Insurance' (2001) vol 12 Annual of China Maritime Law 15, 25

**An interest provided for in law.** As to this problem with the term of “recognised by law”, some argue that these are two different problems: that whether an interest is recognised by law and that whether the assured’s act is legal or not.<sup>1594</sup> The following view may be the correct understanding of the term: to test whether an interest is recognised by law, the point should be focused on whether the relation between the assured and the insured subject is recognised by law,<sup>1595</sup> not on the respect of the legality regarding the relation between the assured and administrative organs<sup>1596</sup> or on the contract concluded between the assured and the insurer.<sup>1597</sup> As long as the risk having passed to the assured is recognised by law, as in the facts of the above case, the assured is entitled to have an interest in the cargo. Other acts of the assured, such as in the above case not having paid the price or contravening the provisions of the Foreign Trade Law, did not necessarily have an effect on the issue as to whether the assured is entitled to have an interest. Even though, where the assured might be punished with a penalty for not having obtained the import licence,<sup>1598</sup> the assured’s insurable interest in the subject of insurance may not be deprived by such penalties because the decision by an administrative organ, to adjust its

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<sup>1594</sup> Peng-nan Wang, ‘Prospects of Chinese Law of Marine Insurance’ (2003) vol 14(1) Annual of China Maritime Law 199, 208

<sup>1595</sup> Peng-nan Wang, ‘Prospects of Chinese Law of Marine Insurance’ (2003) vol 14(1) Annual of China Maritime Law 199, 208

<sup>1596</sup> Wei-qing Huang, ‘Insurable Interest in International Marine Cargo Insurance’ (2001) vol 12 Annual of China Maritime Law 15, 25-26

<sup>1597</sup> Peng-nan Wang, *The Theory and Practice of the Modern Marine Insurance Law* (Dalian Maritime University Press 2004) 102

<sup>1598</sup> According to s 5 of Provisions for the Punishment of Offences Against the Import and Export Licence Control System, in case of failure to produce the relevant licence in declaring licence-controlled import goods, the goods shall be confiscated or ordered to be shipped back, or, a fine shall be imposed.

relation with the assured, may not necessarily influence the relation between the assured and the insured subject.<sup>1599</sup>

**Two cases.** Identical with the above analysis, the court held that whether the shipowner had the ocean shipping business licence did not affect the test as to whether he was entitled to have an insurable interest in the vessel.<sup>1600</sup> Also, a bare boat-charterer who had not registered had an insurable interest in the insured vessel.<sup>1601</sup> Clearly, although the assured's act is inconsistent with related rules, the assured's interests having been provided for and recognised by law is not affected.

**Conclusion.** Therefore, where an assured's act has been inconsistent with law, it is not right to say that the interest owned by the assured is definitely uninsurable. By contrast, to test whether an interest is recognised by law, the emphasis should be put on the key issue as to whether the interest in question has been provided as one right of real right or creditor's right, by law,<sup>1602</sup> regardless of other issues such as the legality of the insurance contract or the assured's act.

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<sup>1599</sup> Wei-qing Huang, 'Insurable Interest in International Marine Cargo Insurance' (2001) vol 12 Annual of China Maritime Law 15, 25-26

<sup>1600</sup> *Weiyang* (1998) the Higher People's Court of Shandong Province, PRC, Final Judgment of the Commercial Tribunal No 639; see Peng-nan Wang, *Summary and Comments On Cases of China's Maritime Insurance* (Dalian Maritime University Press 2003) 26

<sup>1601</sup> *Yuhang* (1999) Civil Judgment of Dalian Maritime Court, PRC, First Instance Judgment of the Commercial Tribunal No 130; see Peng-nan Wang, *Summary and Comments On Cases of China's Maritime Insurance* (Dalian Maritime University Press 2003) 24

<sup>1602</sup> Peng-nan Wang, *The Theory and Practice of the Modern Marine Insurance Law* (Dalian Maritime University Press 2004) 102

#### 6.6.3.2.2 Interest able to be ascertained

Secondly, an insurable interest must have some degree of certainty,<sup>1603</sup> either the actual interest which has been possessed by the assured<sup>1604</sup> or the expected interest relying on an existing interest.<sup>1605</sup> In other words, an assured can only be economically affected by loss of, or damage to, the subject matter of insurance, only caused by perils insured against, rather than by other contingencies. Otherwise, without such certainty, “a speculative profit, which was unlikely to eventuate”<sup>1606</sup> might be a proposed subject to insure, which is a departure from the indemnity principle. As to the latter which are expectancy interests, it may be concluded that the interest arising out of the “factual expectancy” of benefits or loss<sup>1607</sup> which is based upon an existing interest is insurable. Illustrations of such expected interest may be as follows under the CMC: income from the operation of the ship including freight, charter hire and passenger’s fare or expected profit on cargo,<sup>1608</sup> the interests in which must be based on existing interests. This approach to test the existence of an insurable interest has been currently adopted by the English courts.<sup>1609</sup>

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<sup>1603</sup> Nian-hong Zhang, *The Theory and Practice of Maritime Law* (China Legal Publishing House 2013) 116; Peng-nan Wang, *The Theory and Practice of the Modern Marine Insurance Law* (Dalian Maritime University Press 2004) 17; Li-ying Zhang, *The Theory of Maritime Law* (Higher Education Press 2006) 439

<sup>1604</sup> Peng-nan Wang, *The Theory and Practice of the Modern Marine Insurance Law* (Dalian Maritime University Press 2004) 97; see 6.6.3.2.1, *supra*

<sup>1605</sup> Nian-hong Zhang, *The Theory and Practice of Maritime Law* (China Legal Publishing House 2013) 115; see 6.6.3.2.1, *supra*

<sup>1606</sup> 2011 CP, para 11.49

<sup>1607</sup> *Lucena v Craufurd* (1806) B & P (NR) 269 [301]

<sup>1608</sup> CMC, s 218; Li-ying Zhang, *The Theory of Maritime Law* (Higher Education Press 2006) 438

<sup>1609</sup> 2011 CP, para 11.51

### 6.6.3.2.3 An economic interest

Thirdly, the economic or pecuniary interest is also required to amount to an insurable interest.<sup>1610</sup> As a result of such interest having been prejudicially affected, the assured would sustain an economic loss. If that is the case, then the reform of insurable interest requirement appears to be similar to that in Australia by the 1984 ICA: section 16 has repealed the statutory requirement at the outset<sup>1611</sup> and s 17 provides the economic or pecuniary test for what amounts to an insurable interest and thus makes it clear as to the nature of insurable interest required by the indemnity doctrine as an economic interest other than one at law or equity<sup>1612</sup>. The above assumption seems to be wrong when it has been noticed that such economic interest is not insurable unless it is also an interest which can be recognised by law.<sup>1613</sup> In conclusion, the requirement of insurable interest shall mean an interest arising from the indemnity principle that the assured must possess an economic interest which would be recognised by law. That explains why mere possession is not sufficient to be an insurable interest.

The insurer under the contract is liable to indemnify the pecuniary loss in virtue of money other than the insured subject. It thus may not be right to conclude that the insurable interest is the subject matter of the insurance contract.<sup>1614</sup> In light of the s 12(4) of the 2009 IL, despite the confusion caused by translation, it is in effect the “benefits” rather than the “interest” that can be the insured

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<sup>1610</sup> Nian-hong Zhang, *The Theory and Practice of Maritime Law* (China Legal Publishing House 2013) 116; Peng-nan Wang, *The Theory and Practice of the Modern Marine Insurance Law* (Dalian Maritime University Press 2004) 97; Li-ying Zhang, *The Theory of Maritime Law* (Higher Education Press 2006) 439

<sup>1611</sup> ICA 1984, s 16

<sup>1612</sup> ICA 1984, s 16

<sup>1613</sup> SPC 2012 Reply

<sup>1614</sup> Yu-zhuo Si, *New Maritime Law* (China Communications Press 1991) 424

subject. Accordingly, profits or freight are the insured subject rather than the insurable interest in them. Thus, it may be wrong to deem the insured subject as the insurable interest because the latter is some type of legal relation between the assured and the subject matter of the contract, as a consequence of which it may be economically beneficial or prejudicial.<sup>1615</sup> That explains why, at the time of loss of the insured subject, the insurer indemnifies the assured by money to the extent to which it has sustained loss rather than by the replacement of a new subject matter. Additionally, if the insurable interest was the insured subject, after the loss thereto, the assured would also have lost the possession of its interest. Due to the loss of the insured subject owned or possessed by the assured, consequently, the assured would be unable to prove its insurable interest; the insurer could thus certainly be entitled to reject the claim against it. Obviously, it may be unjust to the assured.

#### *6.6.3.3 Various interests can exist in the same subject insured.*

##### *6.6.3.3.1 A seller may have an insurable interest after the transfer of risk*

It is common commercial practice in the international trade of cargo that, under the wide use of FOB, CFR and CIF terms, passing of risk and the transfer of ownership are different issues. Where the risk has passed to the buyer while the seller still owns the title to the cargo, i.e. in the case of separation of ownership and risk, the fact that the buyer has an insurable interest due to its being at risk cannot prevent the seller from having an insurable interest based on the possibility that the latter may again be at risk of loss due to the former legally rejecting goods or payment.

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<sup>1615</sup> 1906 MIA, s 5; Peng-nan Wang, *Contract Law of Marine Insurance* (Dalian Maritime University Press 1996) 46

Thus, where a total loss occurred after the risk had passed to the buyer who afterwards refused to pay the price after being aware of the loss, the problem arose as to whether the seller could claim. The insurer who argued that the assured, the seller on CIF terms, had no interest in the lost cargo rejected the claim made by the seller due to his bearing no risk. The court held that the assured had an interest and thus had a right to make a claim because, after the buyer resisted the payment, the risk of loss then reverted to the seller. Such an interest may be a contingent one and insurable, and has been covered by the marine insurance market.<sup>1616</sup> Also, in the case where the insured seller held the through bill of lading concerning the insured goods but the risk of which had transferred to the buyer, the court held that the seller still possessed the proprietary interest in the cargo.<sup>1617</sup> Similarly to the facts and judgement of the preceding case, Shanghai Maritime Court held that the seller on CIF terms possessed an insurable interest in the cargo which had been lost during the transit at sea because it still had ownership to it.<sup>1618</sup> The judgement relied upon its understanding as to the concept of insurable interest, viz. that the interests were various economic relationships protected by law, such as not only a person being at risk but having a title. In this case, in light of the fact that the seller still might bear the risk of loss, the court was thereby in favour of the seller.

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<sup>1616</sup> See 3.3.2.2.3

<sup>1617</sup> *China Drawnwork (Shanghai) Imp. & Exp. Co v China Pacific Insurance Co, Shanghai Branch*, reported in Gazette of the SPC of the PRC (2001) vol 3

<sup>1618</sup> *Jiangsu Hualin Chemical Co, Ltd v China Pacific Insurance Co, Property Co Ltd, Jiangsu Branch and China Pacific Insurance Co, Property Co Ltd* (2009) Civil Judgment of Shanghai Maritime Court, PRC, First Instance Judgment of the Commercial Tribunal No 335

6.6.3.3.2 The assured has an insurable interest where the agent in its own name took out an insurance

In a case of an unnamed agency<sup>1619</sup> which had been known by the insurer, the buyer in its own name purchased the cargo on behalf of the actual buyer who was responsible for the payment of the cargo. On the occurrence of the damage to the insured subject, the assured, the actual buyer, claimed for recovery which was rejected by the insurer based on lack of insurable interest. The court held that the assured had an insurable interest deriving from the contract of sale because it was the actual buyer.<sup>1620</sup> This is consistent with the rule in s 14(2) of the 1906 MIA that a person having an insurable interest can insure on behalf of other interested parties.

Similarly, in the case of *Eleonora No. 8*, the agent who had been authorised by the actual buyer took out a contract of insurance in its own name for the benefit of the actual buyer with the insurer. The trial court held that the assured had no insurable interest in the insured subject on the basis that it, as the agent of the actual buyer, bore no risk of losses.<sup>1621</sup> However, the people's court of second instance, based on the evidence found, reversed the original judgment and delivered a new judgment that the actual buyer as the actual assured had an interest in the cargo because it was at risk after the cargo had passed the rail of

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<sup>1619</sup> i.e. under Contract Law s 402, Where the agent, acting within the scope of authority granted by the principal, enters into a contract in its own name with a third party who is aware of the agency relationship between the principal and agent, the contract is directly binding upon the principal and such third party, except where there is conclusive evidence establishing that the contract is only binding upon the agent and such third party.

<sup>1620</sup> <http://www.sea-law.cn/html/6193453622.html>

<sup>1621</sup> *Huang Chunfa Co Ltd V China Pacific Insurance Co, Guangzhou Branch* (2000) Civil Judgment of Guangzhou Maritime Court, PRC of the Commercial Tribunal No 1

the ship.<sup>1622</sup> It also held that where the agent who had been authorised by the principal of the buyer, concluded an insurance contract in its own name on behalf the principal with the insurer who was not aware of the agency relationship between the agent and the principal, and the insurer rejected its obligation of indemnification, the buyer had the right to exercise the agent's rights against the insurer, unless the insurer would have refused to enter into the contract had it known the true principal.<sup>1623</sup>

#### 6.6.3.3.3 Conclusion

There are different kinds of insurable interest and it is the definition that is needed when testing for its existence. The fact that a buyer has paid or not is not the test, but the liability for paying not dependent on the safe arrival is an insurable interest. Besides, it is possible that there exists various insurable interests in the same insured subject at the same time. Such a fact cannot prevent others interested from insuring. Also, if a person has an insurable interest in the insured property, it can insure its own interest as well as insure for the benefit of other interested parties, subject to their agreement. Although this rule has not been provided for in the 2009 IL, it has been established in the judgements of the courts. Like the effect of s 14(2) of the 1906 MIA, the SPC 2013 Interpretations have provided a similar rule.

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<sup>1622</sup> *Huang Chunfa Co Ltd v China Pacific Insurance Co, Guangzhou Branch* (2001) The Higher People's Court of Guangdong Province, PRC, Final Judgement of the 2nd Economic Tribunal No 147

<sup>1623</sup> *Huang Chunfa Co Ltd v China Pacific Insurance Co, Guangzhou Branch* (2001) The Higher People's Court of Guangdong Province, PRC, Final Judgement of the 2nd Economic Tribunal No 147; Contract Law, s 403

## 6.7 SPC's rules as to insurable interest

### 6.7.1 The timing

#### *6.7.1.1 Insurable interest must attach at time of loss*

Section 123 of the SPC 2005 Summary provides that the insurer shall be liable to indemnify the assured where the latter has no insurable interest at the time of the contract but has a real interest at the time of loss. In contrast, the insurer is not liable where the assured has one at the time of the contract but not one at the time of loss. This rule should be followed in the inferior courts. Thus, the SPC points out that the assured must have an actual insurable interest at time of loss. The consequence of violating the above requirement is that the assured cannot claim against the insurer. It thus seems that the requirement of insurable interest which will affect the enforceability of the contract of insurance has been repealed in China. The SPC 2013 Interpretation has not mentioned the timing as to the requirement of insurable interest. The 2013 Answers however showed that the effect of whether or not having an insurable interest is whether an assured can claim, which also means the assured only needs an insurable interest at the time of loss.<sup>1624</sup>

#### *6.7.1.2 The SPC 2007 Regulation<sup>1625</sup> may have the effect of retrospective declaration*

The effect of the "lost or not lost" clause, which may be used in the common floating policy, incorporated in the contract of insurance, is not provided for in the 2009 IL, although it has been argued that the effect of retrospective declaration may be implied from s 224 of the CMC.<sup>1626</sup> Notwithstanding not using the terms of the "lost or not lost" clause, the similar above effect of it has

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<sup>1624</sup> 2013 Answers

<sup>1625</sup> SPC 2007 Regulations, s 1

<sup>1626</sup> Ping-yang-dan-ke, 'Insurable Interest in Modern Marine Insurance' (2012) Study of Maritime Law 333, 336

been provided for by the SPC 2007 Regulations: the effect of the contract of marine insurance is not be affected where neither the assured nor the insurer at the time of contract has been aware of the loss of the insured subject which has been suffered by the event insured against, or of the impossibility that the insured subject may be lost on the occurrence of the perils insured against. As the “lost or not lost” clause may not assist the buyer on FOB or CFR terms and not be provided by the insurer,<sup>1627</sup> for the purpose of better balancing profits of parties to the insurance contracts, the approach proposed by the ALRC can be considered that such buyers can have an insurable interest when they are liable to pay the insured cargo whether or not they arrive in safety.<sup>1628</sup>

## 6.7.2 The definition

### 6.7.2.1 Definition in the SPC 2004 Solutions

The SPC 2004 Solutions<sup>1629</sup> set out that insurable interest means the pecuniary interest recognised by law between the assured and the insured subject. These persons can have an insurable interest, such as owners, insurers and mortgagees of a ship, buyers, sellers, carriers and insurers of goods, and a person who has a lien on a bill of lading. Thus, interests deriving from ownership, claims on property pledged and liability are insurable. It in effect echoes that in the SPC 2003 CP, although the terms and examples are different. They just express the same meaning and the examples are also subject to the strict test.

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<sup>1627</sup> ALRC 91, paras 11.40 and the following

<sup>1628</sup> ALRC 91, paras 11.97-98

<sup>1629</sup> SPC, *Solutions to Practical Issues in Trials on Foreign-related Commercial and Maritime* (SPC 2004 Solutions), s 157

### *6.7.2.2 Definition in the SPC 2012 Reply*

According to the Reply of the SPC, the assured can be deemed to have an insurable interest where it has been at risk.<sup>1630</sup> However, it is noteworthy that the ambit of application of this reply is limited only to this specific case rather than guiding all inferior cases. However, the attitudes of the SPC may be helpful to understand the concept. The question in a case arose as to whether the seller on the modified FOB term under which the seller, not the buyer under the common practice, who actually took out the insurance and bore the risk of loss, had an insurable interest in the insured cargo which had been lost during transit at sea. The factual matters were that the seller, after the loss, agreed that the buyer could deduct the value of the goods lost from the payment for the goods. In the Reply, the SPC guided the lower court that, in light of the facts of the case, the FOB seller in the question had an insurable interest because it was the assured seller other than the buyer that actually bore the risk of damage after the cargo had passed the rail of the shipping vessel, which was an interest recognised by law.<sup>1631</sup>

This guidance makes it clear that the actual performance of the parties to the contract can affect the true construction of the FOB terms. Thus, even though the risk seemingly passes to the buyer FOB, after finding that the seller actually bears the risk, the latter can have an insurable interest. Also, a person at risk can have an insurable interest. This Reply actually reflects the rule in s 12(6) of the 2009 IL. This opinion is similar to the provision under s 5 of the 1906 MIA.<sup>1632</sup> Thus, the strict test for insurable interest in property insurance is

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<sup>1630</sup> SPC, No 44 [2012] of the Civil Division IV of the SPC (SPC 2012 Reply)

<sup>1631</sup> SPC 2012 Reply

<sup>1632</sup> 1906 MIA, s 5

distinct from that under the 1984 ICA in Australia, which has adopted the economic test.

### *6.7.2.3 Definition in the SPC 2013 Interpretations*<sup>1633</sup>

#### 6.7.2.3.1 Issues to be solved

The second judicial interpretations<sup>1634</sup> for the problems arising out of the application as to the 2009 IL, one of which relates to insurable interest, are enacted by the 1577th Meeting of the Trial Committee of the Supreme People's Court on 6 May 2013. It addresses the issue as to whether different proposers can have their several insurable interest in the same subject matter of insurance and whether they can severally obtain a cover on this subject and representatively be indemnified to the extent of their own interest in the case of the event insured against occurring. The answer is positive. Consequently, the insurer is not relieved of liability under the contract by reason only that, at the time of the loss, the assured does not have a proprietary interest in the property.<sup>1635</sup>

#### 6.7.2.3.2 Reasons

The grounds for the necessity of making this problem clear are as follows. Firstly, there is a market demand.<sup>1636</sup> In the practice of indemnity insurance, it is not uncommon to see that various parties who have no ownership in the property but have some kind of interest in it, such as user, renter and carrier, have created the demand by effecting contracts of insurance for transferring risk arising from the loss of or damage to the property. Even where the insurer has received the premium paid by the assured and has provided the cover against

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<sup>1633</sup> SPC 2013 Interpretation, s 1

<sup>1634</sup> In China, the judicial interpretation by SPC also has the legal effect.

<sup>1635</sup> 2013 Answers

<sup>1636</sup> 2013 Answers

the loss of or damage to the same subject matter of insurance, they may also use the insurable interest as the technical defence by stating that the assured who has no strict proprietary insurable interest cannot make a claim against the loss.<sup>1637</sup> It was commented by a judge that such defence was contrary to the principle of the utmost good faith and to the reasonable expectancy of the assured.<sup>1638</sup> Secondly, clarifying the law on insurable interest can assist to establish trading rules and also reduce transaction costs. Market efficiency can be improved because the parties to insurance contracts can predict their outcomes of cover.

#### 6.7.2.3.3 Definition

The SPC 2013 Interpretation may have widened the concept of insurable interest so that an economic interest under an existing contract is an insurable one. Firstly, in the SPC 2012 CP, the strict test has been proposed. However, the former has not included the proposal by the latter. It seems that the SPC is not in favour of the strict test. Secondly, the 2013 Answers set out that it is in violation of the utmost good faith doctrine that the insurer has received premiums but refuses to compensate the assured's claim on the basis that the latter has no strict legal interest at the time of loss. Thirdly, one principle of the SPC 2013 Interpretation is to protect the assured. There is no doubt that the broadening of insurable interest can assist to eliminate its claim barrier. Fourthly, the SPC 2013 Interpretation is intended to encourage the innovation of insurance products and promote the development of insurance business. The wide test of insurable interest contributes to this goal. Last but not least, although the SPC 2013 Interpretation has not referred to the definition of insurable interest, the 2013 Answers give examples of persons who can have

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<sup>1637</sup> 2013 Answers

<sup>1638</sup> 2013 Answers

an insurable interest, such as users, tenants and carriers. It is a wide test that a user who despite having no possessory interest may benefit from the enjoyment under a contract can now also be entitled to possess an insurable interest. This is similar to the judgement of the *Moonacre* and the 2013 Answers purports to draw on foreign experience.

#### 6.7.2.3.4 The extent of recovery

The SPC 2013 Interpretation s 1 clarifies that the assured under the policy can recover only to the extent of its own insurable interest, which is also the requirement of the indemnity principle. This rule purports to prevent moral hazards. Although the above purpose cannot be denied, it may bring about commercial inconvenience. Similar to the approach in UK, it may be the commercial practice that a person having a limited interest can, subject to bilateral agreement with the other party to the insurance contract, insure and recover to the full value of the insured property; of course he can only be indemnified to the extent of his own interest but he can hold the surplus in trust for other interested persons. The reason for this has been discussed above.<sup>1639</sup> Thus, s 1 may truly mean that identical with the indemnity principle the assured can only recover his own loss but he may act as a trustee of other interested persons.

### 6.7.3 Conclusion

The SPC seemingly has repealed the requirement of insurable interest at the time of the contract and requires that an insurable interest must attach at the time of loss, in breach of which will render an assured unable to claim. An economic interest dependent on a contract may be insurable. Nonetheless, it may not mean that it could be understood as economic or pecuniary interest

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<sup>1639</sup> See 3.3.3.3.4 and 3.3.3.4.2

under the Australian ICL 1984 because it still has to be one which relies on a contract.

## **Conclusion**

### **One regime**

By the above analysis, it may be concluded that it will be more certain and commercially convenient if a single statute can provide a unified law on insurable interest in all indemnity insurance, just like the approach adopted by China.

In the UK, the Law Commissions' reform has to a large extent successfully addressed the problems raised in Chapter 3: the forthcoming Bill will uniformly govern the law as to insurable interest in life insurance and non-life insurance, not including marine insurance, without considering other statutes or common law; the definition has been widely explained, which has left space for the development of new insurance products; and in commercial practice a buyer can have an insurable interest just with an existing contract due to which it has an economic interest.

It however cannot be denied that some minor problems may still exist, such as the following two problems. Firstly, cases such as joint insurance have not been considered in s 4(1) of the Draft. Secondly, after the enactment of the *2016 Draft*, there will be two regimes for the requirement of insurable interest in insurance contracts: one for marine insurance governed by sections 4 to 15 of the 1906 MIA and the other for life insurance and non-life insurance other than marine policies provided for in the *2016 Draft*. It may be confusing when

choosing which law on insurable interest applies in different types of insurance policies.

It may be better to encompass them into one regime. Firstly, the effect of the *2016 Draft*, if enacted, has been to bring the non-marine regime into line with the marine regime, as the requirements for insurable interest are now in effect the same. Both of these two types of insurance now have a clear statutory basis for the requirement that the assured must possess an insurable interest or a reasonable prospect of obtaining that interest at the time of making contracts. Failing to satisfy the requirement will render the contract void.

However the Draft does widen the scope of insurable interest for non-marine insurance. Although the English courts have expanded the definition for marine insurance to the extent of being effectively similar to the provisions of s 3(3) under the Draft and they will try to find some kind of interest for the assured in most situations when encountering the issue of insurable interest, s 6 leaves the unsatisfactory position that s 5 of the 1906 MIA seemingly continues to provide a narrow definition for marine insurance but the forthcoming Bill has provided a much wider definition for non-marine insurance. Despite the reasons mentioned above for retaining sections 4-15 of the 1906 MIA, it is still difficult to understand why the Draft has not applied the same rules provided by it to marine insurance and non-marine insurance.

Both in Australia and in New Zealand, there are two regimes as to the requirement of insurable interest. As for marine insurance, respective Marine Insurance Acts identical with those in the UK is applicable in both countries,

requiring the assured to have an insurable interest. Although the ALRC proposed reform to the requirement of insurable interest so as to have the same rules as that of ss 16-17 under the 1984 Act, the proposals have not been effected. In New Zealand, the Law Commission has not even recommended reform for insurable interest in marine insurance. Despite no change of provision in statute law, the common law has continually expanded the insurable interest. In the area of non-marine indemnity insurance, the 1984 Act has abolished the requirement of insurable interest and provided that a pecuniary interest is sufficient. By contrast, the 1985 Act has only repealed the requirement, but not mentioned what kind of interest can constitute interest under s 7. It should be same as that under the 1984 Act because subject to s 7 of the 1985 Act the interest sufficient to satisfy the indemnity doctrine, i.e. an economic interest, is enough. The abolition of the requirement of insurable interest in non-marine insurance has not caused any problems in either Australia or New Zealand.<sup>1640</sup> Thus, as to marine insurance, both countries, by retaining the requirement, seem to have left its expanding concept to the courts to decide.

### **Retaining the requirement of insurable interest at the time of loss**

The requirement of insurable interest at the time of the contract can be abolished while an insurable interest is required at the time of loss. From the perspective of insurable interest, it should be a valid policy, as long as an assured can acquire such an interest during the life of a policy. An assured who has no insurable interest at the time of loss is not entitled to claim. There are four reasons for retaining the requirement of insurable interest at the time of loss as follows. In the first place, admittedly, insurance by way of wagers and

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<sup>1640</sup> ALRC 91, para 11.89

moral hazards may not be too popular nowadays. From a deeper perspective, the assured's motive or the greed of man, gambling and moral hazards nevertheless cannot be avoided but can only be controlled. It may be right to say that most people want to receive a windfall without working hard. It is not surprising to see people pursuing rich benefits, better, with no cost or effort involved. And this has happened in the history of insurance. Therefore, the possibility of gambling and moral hazards still exists and the requirement of insurable interest at time of loss can indeed help to reduce that possibility. Secondly, too much speculative practice in insurance will lead to disrepute in the industry. The requirement of insurable interest, rather than a mere interest, can prevent a policy from going too far. Thirdly, the requirement of insurable interest only at the time of loss can prevent speculative activities contrary to public policies. Where the contract is void for being inconsistent with the requirement of insurable interest, the insurer generally needs to return the premiums to the assured. However, if insurable interest is only required at the time of loss, an assured without it cannot make a claim and premiums are not returnable, due to untrue statement of insurable interest. Apparently, the latter is more severe than the former and can prevent an assured making more speculative insurance. Hence, it would be an unfortunate outcome if policies by way of wagering or other speculative activities against public policies came back, attributable to the fact that an effective method, i.e. the requirement of insurable interest, cannot fully operate as it should do.

In terms of the requirement of insurable interest, in China, part of it has been abolished and part retained: the insurable interest rather than a mere interest by the indemnity principle has been required only at time of loss. As a

consequence, the fact that the assured has no insurable interest at the time of the contract will not make the contract void.<sup>1641</sup> It may be provided for that a policy is a valid one, provided that an assured can obtain an insurable interest during the life of a policy. By contrast, the assured who had no insurable interest at the time of loss will lose his right to sue the insurer.<sup>1642</sup> Section 1 of the SPC 2007 Regulations may have the effect of retrospective declarations.

### **Adoption of the wider test to insurable interest**

In indemnity insurance, the definition should be continually widely construed to match the development of insurance products in the future. A person as a party to the contract of an indemnity insurance can have an insurable interest in property should he under an existing contract be beneficially affected or incur a liability by the fate of the property. In other words, no matter how wide the concept is, the policy should be based at least on a contract. For the certainty of insurable interest under such a definition, a subject matter of insurance cannot be affected by other casualties, other than those specified in a policy. Without it, the relation between the assured and the property insured seems far too remote or the policy is much too speculative. Thus, when testing for the existence of loss, a purely economic interest which can be sufficient for the indemnity doctrine will not be enough.

In the UK, the most important significance of *Feasey* is that, in a modern setting, the courts' attitudes to insurable interest have been expressly shown that the test should be interpreted broadly. In order to make it clear as to whether the assured could have an insurable interest in the subject insured, Waller LJ<sup>1643</sup> in

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<sup>1641</sup> IL 1995, ss 11(2)

<sup>1642</sup> IL 2009, s 48

<sup>1643</sup> *Feasey v Sun Life Assurance Co* [2003] 2 All ER 587 [76]-[85]

this case summarized the cases relating to insurable interest into four groups by analyzing the case law of the past 200 years. Group 1, Group 3 and Group 4 related to the insurance of property, which had witnessed a change of attitude from the strict one to the now broader one.

Group 1 was concerned with the strict test of insurable interest that the assured must stand in legal or equitable relation to the property specified as the subject matter of the policy, the value of which it was intended to recover on the occurrence of loss of the subject matter of the policy.<sup>1644</sup> The subject insured had to embrace the insurable interest the assured had had in consequence of which the assured might suffer a loss arising from damage to or destruction of the subject. Therefore, the assured could not have a valid insurable interest in the property, the subject matter of the insurance, even though they might have an insurable interest in profits or benefits which however could not be embraced by the subject.

Group 3 included cases which held that a pecuniary interest suggested by Lawrence J could constitute a valid insurable interest and that the subject matter could embrace the interest, as the assured had had where the subject was unclear, by truly identifying the subject intended to be covered.<sup>1645</sup> In light of this test, the strict legal interest was not needed but the assured could have an insurable interest in the subject matter of a policy where they might benefit from its preservation or be prejudiced by its loss or by incurring liability for damage or loss of the subject. Waller LJ referred to the *Wilson* case to illustrate

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<sup>1644</sup> *Lucena v Craufurd* (1806) B & PNR 269; *Anderson v Morice* (1874–75) LR 10 CP 609; (1876) 1 App Cas 713; *Macaura v Northern Assurance Co Ltd* [1925] AC 619

<sup>1645</sup> *Wilson v Jones* (1867) LR 2 Ex 139

this group, when deciding whether or not the assured had an insurable interest in profits from the success of the adventure, Blackburn J citing the pecuniary interest test held that the assured had an insurable interest in the adventure rather than in the cable because the shareholder would benefit from the success of the adventure.<sup>1646</sup> In this group, in order to make the subject insured embrace the proper insurable interest, by means of a correct construction of the policy in question, the court had to identify the right subject of the policy with the help of identifying insurable interest intended to be insured where there was confusion as to which the subject was. In short, the court attempted to favour the existence of insurable interest by the following two steps: the court first identified broadly the subject as profits; the Lawrence test was then adopted.

Group 4 also set out the broader insurable interest test, which reflected the attitude of the modern courts, that an interest less than a legal interest under Eldon's test or a mere pecuniary interest was sufficient to satisfy the requirement of insurable interest.<sup>1647</sup> In *The Moonacre* case, even though the words of "legal relation" to the vessel had been used to test whether the assured had an insurable interest in the vessel, the meaning of the words did not necessarily have the same one amounting to a legal interest in the subject matter in light of the strict right of ownership because the court held the assured had an insurable interest in the vessel based on the fact Mr. Sharp had been given two powers of attorney by the company totally owned by him allowing him to exclusively enjoy and use the subject insured.<sup>1648</sup> It could be observed that the relation between the assured and the vessel relied on by the court was not a

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<sup>1646</sup> *Wilson v Jones* (1867) LR 2 Ex 139, 150-51

<sup>1647</sup> *Sharp v Sphere Drake Insurance Co (The Moonacre)* (1992) 2 Lloyd's Rep 501

<sup>1648</sup> *Sharp v Sphere Drake Insurance Co (The Moonacre)* (1992) 2 Lloyd's Rep 501, 512; for facts relating to this case, see 3.3.3.1, above.

proprietary interest while a beneficial right to property was sufficient. Further, it was settled on high authority that a pecuniary interest was a valid insurable interest, on condition that there is an existing contract or close physical relation to the insured property.<sup>1649</sup> Thus, in the *Deepak* case, the Court of Appeal ruled that sub-contractors could have an insurable interest in the work as a whole under construction because they might lose the opportunity to do the work and to be remunerated for it on the occurrence of loss of or damage to the work.<sup>1650</sup> However, the test as to the assured being “substantially affected” by the loss of or damage to the property has been criticized as going beyond the potential liability for occasioning the loss of or damage to the property.<sup>1651</sup>

As can be seen, both group 3 and 4 have reflected the test of pecuniary interest but the difference between them is that the subject of the policies falling within the former is unclear while the one of the latter is clear. As to the subject of the former, with assistance in identifying the insurable interest the shareholder really has, the court has widely construed the subject as profits. Both of them have tried to relax the definition of insurable interest, by which a change from the narrower test to the broader test can be witnessed. The courts, by properly construing terms of the policy, thus tend to be in favour of the assured having an insurable interest in the subject insured where an economic interest dependent on an existing contract is possessed by an assured.<sup>1652</sup>

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<sup>1649</sup> *National Oilwell (UK) Ltd v Davy Offshore Ltd* [1993] 2 Lloyd's Rep 582, 611

<sup>1650</sup> *Deepak Fertilisers & Petrochemicals Ltd v Davy McKee (London) Ltd* [1999] 1 All ER (Comm) 69 [85]-[86]

<sup>1651</sup> Nicholas Legh-Jones, Professor John Birds and David Owen, *MacGillivray on Insurance Law* (11th edn, Sweet & Maxwell 2008) 1-163

<sup>1652</sup> *Western Trading Limited v Great Lakes Reinsurance (UK) PLC* [2015] EWHC 103

In China, as to the definition of insurable interest, a person can have an insurable interest if, under an existing contract, it can have a pecuniary or economic interest in the insured property. The strict test may not be applicable in China. Consequently, the position has been recognised by the SPC 2013 Interpretation that various assureds are entitled to have their respective interests in the same subject insured.<sup>1653</sup>

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<sup>1653</sup> SPC 2013 Interpretation, s 1

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