

An Evaluation of the Necessity of Insurable Interest in Property Insurance Contracts

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I. INTRODUCTION

English insurance law is shaped by historical context. Namely, the demands of the sea-trading industry in the 18th and 19th centuries significantly influenced the creation and development of property insurance, which is insurance for pecuniary or economic loss suffered by the insured by reason of damage to the insured property. Property insurance is a type of indemnity insurance, in which the measure of recovery is actual loss meaning that, as per Brett LJ in *Castellain v Preston*, “the assured in case of a loss is to receive full indemnity, but is never to receive more.”¹ In other words, the purpose of property insurance is to transfer the risk of loss onto the insurer. This is known as the principle of indemnity. Insurance of this type can be distinguished from non-indemnity insurance such as life insurance, in which a specific agreed-upon sum of money is paid to the insured upon the occurrence of a stipulated event regardless of the value of the loss suffered.

On top of and complementing the indemnity principle that demands actual loss is the doctrine of insurable interest that the insured must satisfy in order to successfully recover under the policy. Non-existent at the inception of the concept of insurance, this requirement was later imposed by the Marine Insurance Act 1745 to distinguish property insurance policies from wagering contracts, to alleviate anxieties about perceived evils of wagering and the concern that those lacking interest in the insured property will bring about its destruction, a risk known as moral hazard. The orthodox approach to the doctrine stipulates that one must

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¹ [1881–1885] All ER Rep 493.

demonstrate a legally enforceable interest in the subject matter of the policy,² but this strict legal interest test has been criticized for being out of date and leading to commercially unfair results. Even further, many observe that the doctrine is redundant as it serves the same objective as the principle of indemnity in that both mechanisms determine the insured's liability,³ and that policies can be achieved by more specific and coherent rules.⁴ In response to the view that insurable interest is an anachronistic doctrine, courts have shown a tendency towards adopting a broader conception of insurable interest in which a factual expectation short of a legally enforceable right is sufficient to enforce an insurance policy.⁵ In addition, in the past twenty years the doctrine has garnered increasing attention from the English and Scottish Law Commissions in considering whether the doctrine is in need of reform.

Against this context, this paper will consider to what extent, if at all, insurable interest should be considered a necessary characteristic of valid property insurance contracts. First, this paper will explore the emergence and scope of the legal interest test for insurable interest, followed by a look at how the law has developed since the doctrine's inception. This will demonstrate that a recurring theme in judicial debate about expanding the scope of the doctrine is the recognition of modern commercial practice and bringing this 18th century doctrine into a 21st century context. After establishing the current legal position vis-à-vis case law and reform developments, this paper will closely examine the original policy reasons for the doctrine's inception. Specifically, this paper will ask whether these policy considerations – relating to wagering, moral hazard, and invalid claims – remain relevant today, and whether the doctrine is effective in satisfying these policies. In doing so, this paper will engage in a comparison of the two conflicting tests for determining the presence of insurable interest, that being the legal interest test and the factual expectation test.

The analysis concludes with the view that the factual expectation test is the more appropriate measure, as it is less invasive but equally effective in meeting policy considerations as they manifest in the modern commercial landscape. This paper, however, goes further to argue that rather than simply adopting the more flexible factual expectation test, because the policy reasons for a narrow conception of insurable interest are either no longer applicable or no longer a priority, the

² *Lucena v Craufurd* (1806) 2 Bos & PNR 269 [321] (Lord Eldon).

³ See, for example, John Lowry and Philip Rawlings, 'Rethinking Insurable Interest', *Commercial Law and Commercial Practice* (1st edn, Hart Publishing 2003).

⁴ Sharo Atmeh, 'Regulation Not Prohibition: The Comparative Case Against The Insurable Interest Doctrine' (2011) 32 *Northwestern Journal of International Law & Business* 93, 94.

⁵ (n 2) [302] (Lawrence J).

requirement of insurable interest should be abolished entirely because the principle of indemnity achieves the same results as the factual expectation test. To this end, so long as the indemnity principle exists, there is no reason for the existence of redundant technical rules requiring that the insured has an insurable interest in the insured property and it should not be considered a necessary characteristic of property insurance contracts.

II. DEFINING INSURABLE INTEREST

A. EMERGENCE OF INSURABLE INTEREST

The concept of insurable interest was conceived to address the policy of preventing the evils of wagering and the concern that those without any interest in the property might bring about loss in order to gain the proceeds. Legislative intervention started in the 18th and 19th centuries, with the enactment of the Marine Insurance Act 1745. Prior to 1745, insurance contracts were upheld notwithstanding that the insured had no interest in the insured property, giving such policies the character of a wager. The Marine Insurance Act 1745 was passed to address this issue of ships being lost or destroyed in fraudulent or suspicious circumstances, disincentivizing the intentional loss of ships and cargo by virtue of the requirement that the insured must have a genuine interest in the existence of the subject matter. This was followed by the Life Assurance Act 1774 that extended the doctrine of insurable interest beyond marine insurance, requiring that an insured entering a life insurance policy must possess insurable interest in the insured life at the date of entering into the contract, to prohibit gambling on the lives of individuals. These legislative measures did not provide a definite understanding of what constitutes sufficient insurable interest, leaving it to the courts to determine the meaning of the concept.

Early cases considered the scope, for example Lord Mansfield in *Le Cras v Hughes*⁶ considered that interest is necessary, but no particular kind of interest is required. On the facts, Lord Mansfield held that the crew of the Royal Navy Squadron had an insurable interest in the two enemy ships they had seized because of the moral certainty that the Crown would grant onto them the prize ships. Subsequent cases followed similar reasoning, but English case law saw a departure from this view upon the setting out of the classic definition of insurable interest by Lord Eldon in *Lucena v Craufurd*⁷ as a “right in property, or a right derivable out of some contract about the property, which in either case may be lost upon some

⁶ (1782) 3 Dougl 79.

⁷ (n 2).

contingency affecting the possession or enjoyment of the party.”⁸ In this case, the Commissioners were authorized to take possession of ships and goods belonging to subjects of the United Provinces. Upon taking possession of ships belonging to Dutch East Indiamen and taking them to St. Helena, the Commissioners insured the ships for the journey from St. Helena to London. However, war broke out against the United Provinces and the ships were declared as prizes to his Majesty. Loss occurred and the Commissioners brought an action on the policy, declaring that the interest was in the King. Had the ships reached the shore, the Commissioners would have had a straightforward insurable interest, so the issue was whether such interest existed before arrival. Lord Eldon, characterizing insurable interest as a legally enforceable right, held that the Commissioners had no such right and therefore no interest in the ships.

Lord Eldon’s judgment, in the majority, is of utmost importance as it provided the classic definition of insurable interest. What has come to be known as the legal interest test was justified on the basis that a restrictive definition would provide certainty and avoid illusory insurance. Lord Eldon was of the view that allowing moral certainty to be a ground of insurable interest as in *Le Cras* would entitle thousands to insure as “every other person who to a moral certainty would have anything to do with property, and of course get something by it.”⁹ Insurable interest was therefore limited to some legally enforceable right in the insured property, anything short of a legal right or interest was considered to be “speculation.”¹⁰ Inevitably, this excludes, for example, a beneficiary under a will or a next of kin who are deemed to hold a mere expectation rather than an insurable interest, as *Lucena* was clear authority that an “expectation of profits and some other specifics of interest”¹¹ are not insurable.

In the case of *Lucena*, two judges in the House of Lords dissented and Lawrence J’s judgment is of influence. Lawrence J distinguished between property and interest devisable from property, clarifying that when measured by property “the price is generally the measure, but [when measured] by interest in a thing every benefit and advantage arising out of or depending on such thing, may be considered as being comprehended.”¹² To this end, Lawrence J advanced the factual expectation test, contending that rather than a right to the subject of insurance, interest can also be the moral certainty of an advantage or benefit relating to the insured property though requiring more than a mere expectation

⁸ *ibid* [321].

⁹ *ibid*.

¹⁰ *ibid* [325].

¹¹ *ibid* [321].

¹² *ibid* [302].

of such advantage or benefit. Incidentally, both Lord Eldon and Lawrence J's tests arrived at the same outcome on the facts of *Lucena* – as Lawrence J held that the commissioners in the case only had a mere expectation rather than an actual interest in the safe arrival of several Dutch ships and therefore could not recover on the insurance policy – but Lawrence J's formulation nevertheless offers a wider test than that of Lord Eldon's, emphasizing the question of concern in the subject of insurance over the nature of the interest from which such concern is derived. Lawrence J's formulation provides great guidance in later cases.

Thereafter, the Gaming Act 1845 extended the scope of insurable interest to all forms of indemnity insurance by stating that gaming or wagering is null and void.¹³ Subsequently, the Marine Insurance Act 1745 was repealed and replaced with the amended Marine Insurance Act 1906, which finally provided a statutory definition of insurable interest by codifying Lord Eldon's legal interest test and not Lawrence J's factual expectation test. This expressly demonstrated preference for a more legalistic point of view. Section 5 of the Marine Insurance Act conclusively defines insurable interest as an interest "in a marine adventure where he stands in any legal or equitable relation... in consequence of which he may benefit by the safety or due arrival of insurable property or may be prejudiced by its loss." Though the definition only applied to marine policies, it is a useful guide in the requirement of insurable interest generally.¹⁴

The case of *Macaura v Northern Assurance Co Ltd*¹⁵ was decisive in the application of Lord Eldon's formulation of insurable interest beyond marine insurance to a non-marine insurance context. In *Macaura*, it was held that the plaintiff who was the sole shareholder of a company and under whose name was the policy did not have any insurable interest in the company's assets that were destroyed in a fire. He was unable to recover on the ground that he did not own the timber and therefore lacked a legally enforceable right. The decision was explained by the fact that the plaintiff, whose legal interest was in the shares of the company, was "directly prejudiced by the paucity of a company's assets, not by the fire."¹⁶ The underlying principle influencing this decision was the notion of separate legal personality, and the fact that in substance the plaintiff and the company were one and the same made no difference to the decision. Similarly, irrelevant was the fact that the timber was in the plaintiff's possession at the time, as this constituted a mere factual expectation of loss. Evidently, the House of Lords in *Macaura* favored

¹³ s 18, Gaming Act 1845.

¹⁴ See John Lowry, Philip Rawlings and Robert Merkin, *Insurance Law: Doctrines And Principles* (3rd edn, Hart Publishing 2011) 177–180.

¹⁵ [1925] AC 619.

¹⁶ *ibid* [630] (Lord Sumner).

Lord Eldon's narrow test and confirmed both acceptance by the English courts of the legal interest test and its application beyond the marine insurance sphere. Moreover, this case is illustrative of the technicality and legality of Lord Eldon's orthodox approach to the doctrine.

B. WIDENING THE TEST OF INSURABLE INTEREST

In recent cases, Lord Eldon's legal interest test has been met with criticism and there has been a marked shift in attitude towards a more flexible approach to insurable interest that resonates more closely with Lawrence J's factual expectation test set out in *Lucena*. The Canadian case of *Constitution Insurance Company of Canada v Kosmopoulos*¹⁷ is significant in the move towards a wider scope for insurable interest and is especially useful given the analogous facts yet contrasting decisions between *Kosmopoulos* and *Macaura*, as this reveals the benefits of and rationale behind expanding the scope of the doctrine.

Similar to *Macaura*, the case of *Kosmopoulos* involves a plaintiff sole shareholder of a company under whose name was the insurance policy who claimed under this policy after destruction of property belonging to the company, namely an office space that was damaged in a fire. This case is distinguishable from *Macaura* and is notable for the reasoning of the Supreme Court of Canada in rejecting the Eldon formulation. Wilson J criticized Lord Eldon's legal interest test for leading to "harsh justice",¹⁸ finding that there was no policy basis for a restrictive and legalistic definition. Accordingly, Wilson J held that the plaintiff could recover for loss suffered because he "was so placed with respect to assets of the business as to have benefit from their existence and prejudice from their destruction,"¹⁹ reasoning which resembles Lawrence J's factual expectation test. In drawing this conclusion, Wilson J did not pierce the corporate veil that *Macaura* sought to uphold but instead recognized substance over form and the proximity of the shareholder with the company's assets to find sufficient interest, despite such interest being short of a legally enforceable right.

The judgment of Wilson J is insightful in deconstructing Lord Eldon's reasoning for advocating for a restrictive legal interest test. Citing Lord Brett MR in *Stock v Inglis*,²⁰ Wilson J viewed the restrictive definition of insurable interest as merely a "technical objection... which has no real merit"²¹ and opined that the "reasons advanced in its favor are not persuasive and the policies alleged to underlie it do not appear to require it."²² Additionally, citing Brown and Menezes

¹⁷ (1987) 34 DLR (4th) 208.

¹⁸ *ibid* [14].

¹⁹ *ibid* [43].

²⁰ (1884) 12 QB 564 (CA).

²¹ *ibid* 571.

²² (n 17) [42].

in *Insurance Law in Canada* (1982), Wilson J acknowledged that the certainty that insurable interest supposedly provides is “totally illusory because the new formulation makes no concessions either to the reasons for which insurable interest is a component of insurance law or for commonplace business transactions,”²³ but that an adoption of Lawrence J’s views avoids such concerns.

Equally illusory is the anxiety that adopting a factual expectation test would lead to too much insurance as Wilson J pointed out that there are other “effective curbs on excessive insurance” in place to avoid this concern of an influx of insurance. For instance, the duty of disclosure requires the insured to disclose all material circumstances for the insurer to assess the risk, after which the insurer can elect not to write the policy if they find no interest or adjust its liability within the policy by inserting protective clauses. Given that insurers are competent and able to control their own policies, it is not for the court to “substitute its own judgment for the sound business judgment and expertise of insurance companies by holding that certain classes of policies should not be made because it will result in too much insurance.”²⁴ In contrast, Wilson J considered that there was in fact too little insurance and that broadening the concept of insurable interest would “allow for the creation of more socially beneficial insurance policies... with no increase in risk to the insurer.”²⁵ Wilson J’s analysis and adoption of a broader view is important in demonstrating a distinct shift in legal opinion that acknowledges the various types of interests one can have in insured property in the context of modern commercial practice.

Kosmopoulos was a Canadian case, but occasionally English law too showed signs of adopting a more flexible approach to insurable interest to recognize a wider variety of interests. For example, a wider approach was critical in the context of construction contracts and subcontractors in *Petrofina (UK) v Magnaload Ltd.*²⁶ The contract works in the case were insured under a contractors’ all risks policy in which the policy defined the insured persons as the owners and “contractors and/or subcontractors” and the insured property as “the works and temporary works... in performance of the... construction, erection, and testing of an extension to the refinery.” Under the policy, the insurers agree to indemnify the insured persons against loss and damage to the property. Following destruction caused to the work in progress, the insurers brought an action in the name of the plaintiffs against the defendant subcontractors claiming damages for negligence resulting in the loss. The defendants denied the insurer’s right to subrogation on the basis that the defendants were within the meaning of the insured under the same policy. Lloyd J found for the subcontractors and held that owners, head contractors, and

²³ *ibid* [22].

²⁴ *ibid* [23].

²⁵ *ibid* [24].

²⁶ [1983] 2 Lloyd’s Rep 91.

subcontractors were all within the meaning of “insured persons” under the policy and had a pervasive interest in the entire property regardless of whether they were only working on limited parts of the site. In finding the root of this interest, Lloyd J considered the judgment of Grandpre J in *Commonwealth Construction Co Ltd v Imperial Oil Ltd* that in the context of construction sites “there is ever present the possibility of damage by one tradesman to the property of another and to the construction as a whole,”²⁷ thus each subcontractor has an interest in the continued existence of the whole of the works and the property.

An underlying policy that influenced Lloyd J’s approach was the consideration of commercial convenience, in particular that holding to the contrary that subcontractors did not have an insurable interest would be commercially inconvenient because each sub-contractor would need to take out a separate policy for the same works. Instead, a single policy allows for “all parties whose joint efforts have one common goal [to] be spared necessity of fighting between themselves should an accident occur.” Lloyd J’s approach and emphasis on commercial convenience was endorsed in *National Oilwell Ltd v Davy Offshore (UK) Ltd*²⁸ by Colman J, who observed that there is:

“no reason in principle why such a supplier should not, and every commercial reason why he should, be able to insure against loss of or damage to property involved in the common project not owned by him and not in his possession.”

He went on to criticize as “misconceived” the view that lack of proprietary or possessory interest in the property means a lack of insurable interest. In this way, notwithstanding the House of Lords decision in *Macaura*, cases such as *Petrofina* and *National Oilwell* indicate a move towards a different approach that is more compatible with modern commercial circumstances and arrangements such as that of construction contracts.

Various rulings culminated in the Court of Appeal decision in *Feasey v Sun Life Assurance Corporation of Canada*,²⁹ where Waller J stressed that there is no one definition of insurable interest and that “context and the terms of the policy with which the court is concerned will be all important.”³⁰ Following a summary of existing authorities, Waller J advocated for a flexible approach to determining insurable interest through the classification of insurable interest into four groups of legal or equitable interest in, possession of, not in possession but responsible for, or potential to suffer loss but for, the existence of the subject matter. The decision in

²⁷ (1976) 69 DLR (3d) 558, 561.

²⁸ [1993] 2 Lloyd’s Rep 582.

²⁹ [2003] 2 All ER (Comm) 587.

³⁰ *ibid* [71] (Waller J).

Feasey was based on the fact that at the inception of the relevant policy the interest did not resemble a wager. With this mischief addressed, a pecuniary interest should be enough to justify recognizing an insurable interest and the validity of the insurance policy. The judgment in *Feasey* is a significant departure from the traditional definition of insurable interest, and reinforces the view that a definition based on strict legal interest is incompatible with modern commercial practice.

C. CURRENT LEGAL POSITION

Despite indications to expand the definition of insurable interest in cases such as *Feasey*, the orthodox approach relating to insurable interest still appears to be the narrow legal interest test in *Lucena* and *Macaura*. However, the insurable interest doctrine was impliedly repealed by the enactment of the Gambling Act 2005 when it repealed the Gaming Act 1845, as it removed the statutory requirement of insurable interest in indemnity insurance under section 18 of the 1845 Act. Instead and in order to enable regulation of gambling in the United Kingdom, section 335 of the 2005 Act provided that the fact that a contract relates to gambling shall not prevent its enforcement, though separately it remains that it is a criminal offence to take out a contract of marine insurance without interest under the Marine Insurance (Gambling Policies) Act 1909.

With recent litigation adopting a more flexible approach to insurable interest and the apparent abolition of the doctrine, the law on insurable interest has become a mixture of conflicting common law decisions and statutory provisions that leads to considerable commercial uncertainty. The unclear state of the current legal position motivated the English and Scottish Law Commissions to consider the doctrine in today's landscape and discuss whether or not it should be repealed. In an initial Scoping Paper in 2006, the Law Commissions asked whether insurable interest should be included in its review of the field of insurance law.³¹ Subsequently, the Law Commissions published a joint Issues Paper in 2008 that explored the necessity of insurable interest and concluded that, following the inadvertent abolition of the doctrine of insurable interest by the [UK] Gambling Act 2005, insurable interest in indemnity insurance should not be reinstated because the indemnity principle can and should govern the insured's right to recover.³²

In 2011, however, the Commissions' released a Joint Consultation Paper

³¹ English Law Commission and Scottish Law Commission, *Insurance Contract Law – A Joint Scoping Paper* (January 2006).

³² English Law Commission and Scottish Law Commission, *Issues Paper 4 – Insurable Interest* (January 2008).

that reversed the recommendation as a result of the backlash from consultees.³³ The Commissions instead proposed a widened definition as compared to the orthodox view. Updated proposals for consultation were then published again in 2015, which were well supported, and to this effect, the draft Insurable Interest Bill was published in April 2016.³⁴ Implementing the 2015 recommendations, the Bill proposed the continuing existence of the doctrine with a focus on creating legal certainty and consistency, by providing a non-exhaustive statutory definition of insurable interest that includes where the insured has a right in the property, has a right arising out of a contract in respect of it, has possession or custody of it, or will suffer economic loss if the insured event relating to it occurs. Save for the notion of economic loss, the categories appear to be restatements and subcategories of the legal interest test.³⁵ The category of suffering economic loss resonates with the factual expectation test, consequently resolving conflict between the varying decisions by confirming the application of a wider definition of economic loss.

However, after review of all the consultation responses, the Law Commissions decided that the real need for reform existed only in life-related insurance and came to the conclusion that it is not appropriate to recommend reform of indemnity insurance where there is no such demand by the industry nor stakeholders.³⁶ The Insurable Interest Bill was redrafted in 2018, focusing mainly on life-related insurance and no longer making proposals for non-life insurance other than to repeal obsolete statutes.³⁷ Non-life insurance, that includes property insurance, was therefore deprioritized.

After several consultations over the years, the law on insurable interest in indemnity insurance still remains a “confusing and illogical mess.”³⁸ Competing tests coexist, but the existence of insurable interest requirements at all in the context of property insurance is disputed given its accidental repeal. As far as codification is concerned, the most recent definition to be statutorily accepted is Lord Eldon’s legal interest test, so perhaps this remains the orthodox approach. Regarding

³³ English Law Commission and Scottish Law Commission, *Consultation Paper ‘Insurance Contract Law: Post Contract Duties and Other Issues’* (December 2011).

³⁴ English Law Commission and Scottish Law Commission, *Draft Insurable Interest Bill for Consultation* (April 2016).

³⁵ Franziska Arnold-Dwyer, ‘Insurance Law Reform By Degrees: Late Payment And Insurable Interest’ (2017) 80 *The Modern Law Review* 489, 504.

³⁶ English Law Commission and Scottish Law Commission, *Reforming insurance contract law: Updated draft Insurable Interest bill for review* (Accompanying Notes on draft Insurable Interest Bill) (June 2018) para 1.12.

³⁷ *ibid.*

³⁸ 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’ (2006) para 8.6.

the coexisting and contrasting approaches to identifying insurable interest, a comparison between *Macaura* and *Kosmopoulos* underlines that the technicality of the restrictive doctrine can give rise to seemingly unjust outcomes that are neither consistent with reasonable expectations of the parties nor commercial reality, a conclusion into which the following section will provide deeper insight.

III. THE CASE AGAINST INSURABLE INTEREST

Given the confusing state of the law on insurable interest, the fact that it is largely based on past circumstances, and the fact that the orthodox legal interest view has come under scrutiny, an examination of the original policies for the inception of insurable interest is necessary in order to determine the appropriate scope of the doctrine moving forward. If the policy considerations that gave rise to the doctrine no longer apply and on the understanding that the purpose of property insurance and indemnity insurance in general is to protect the insured from pecuniary loss, the doctrine of insurable interest in its legal interest form appears unjustified in barring recovery and instead seems to frustrate legitimate expectations of the insured. The preceding exposition of the history of insurable interest already elucidates that the extent that insurable interest is considered a necessary characteristic is in Lawrence J's factual expectation sense, and a further analysis on the policies that form the basis of the insurable interest doctrine corroborates this finding.

A. DIVIDING LINE BETWEEN GAMBLING AND INSURANCE

The original mischief that the requirement of insurable interest sought to prevent was not the activity of gambling itself but gambling in the guise of insurance.³⁹ Now that gambling is a widely accepted and legitimate activity, it stands alone from insurance and there is less need to prevent gambling as an activity in general. It follows that the activity's legitimacy significantly removes the motive to gamble in the guise of insurance and so, though it is "easy to overestimate the risk of insurance being used in today's world to create a wagering transaction,"⁴⁰ there are more convenient ways of creating wagers and the law of insurance need not be as concerned with risks of gambling or wagering in the guise of insurance policies. In any case, maintaining the dividing line between the two activities appears redundant because the measure of recovery being that of indemnity already prevents wagering from being disguised as insurance policies, because one cannot be compensated unless they suffer loss. Where one cannot profit from a policy and

³⁹ (n 32).

⁴⁰ (n 17) [32] (Wilson J).

can only gain back what was lost, one cannot be said to be gambling or wagering.

Although there is less reason to gamble in the guise of insurance, this may not guarantee the absence of such risk in its entirety. But where there are still risks of false claims for recovery in an attempt to benefit from the policy, legislation and regulation reduce the need to rely on insurable interest as a distinction between gambling and insurance. The recognition of gambling as a legitimate activity allows for its enforcement, and the combined statutory powers of regulatory bodies that govern gambling and regulatory bodies that govern insurance and financial contracts indicate that these bodies are equipped with the knowledge and expertise to differentiate between the two activities without the need for lack of insurable interest as an automatic bar to recovery. The existence of these regulatory bodies demonstrates a level of regulation and regulatory competence that was “unthinkable when the original legislation requiring insurable interest was passed,”⁴¹ which was the rationale for Lord Eldon prioritizing the regulation of gaming over the public interest of ensuring contracting parties perform their obligations.⁴² In these modern circumstances of enhanced regulation, even if the policy concern is still relevant and there are in fact risks of gambling in the guise of insurance, alternative means of maintaining the policy exist without imposing such strict requirements on the types of interests that can recover under an insurance policy. This is pertinent given difficulties that the dividing line causes as collateral to upholding the policy of regulating gambling,⁴³ and the need in modern commercial practice to recognize new commercial arrangements that were not previously well-established.⁴⁴

The reason that the dividing line exists at all is to protect the rationale of property insurance that such policies indemnify for loss. In order to have incurred a loss, the insured must have a pre-existing interest in the property, as distinguished from gambling in which one does not have an interest beyond the profit they seek to gain. But the effectiveness of the dividing line as an enforcement mechanism to ensure that only those with an interest can recover comes under scrutiny. This doubt rests on the basis that understanding “interest” to be legal interest places an emphasis on form over substance which perhaps leads to inaccurate and unfair

⁴¹ (n 32).

⁴² (n 2).

⁴³ See, for example, James Davey, ‘The Reform Of Gambling And The Future Of Insurance Law’ (2004) 24 *Legal Studies* 507, 512. Davey opined that the increased enforcement of gambling would ‘diminish the need to distinguish insurance contracts from wagers for the purposes of enforcement in the courts at a time when insurance law is struggling with the narrow confines of the distinction it developed.’

⁴⁴ For example, subcontractor arrangements as in *Petrofina (UK) v Magnaload Ltd* [1983] 2 Lloyd’s Rep 91.

results. For example, a person with the correct type of legal right but no pecuniary interest would be permitted to recover and receive “pure enrichment”, yet this mechanism would exclude someone with a pecuniary interest if they did not possess the type of legal interest required.⁴⁵ The authoritative case of *Macaura* itself is evidence, as the sole shareholder of a company was unable to recover for damage to company property on the basis that it was the company and not he who was the owner of the destroyed timber. In every way but form, the sole shareholder and the company were one and the same. In *Kósmopoulos*, Wilson J raised another example of the ineffectiveness of the dividing line in the Canadian case of *Guarantee Co. of North America v. AquaLand Exploration Ltd.*,⁴⁶ citing commentary by Brown and Menezes that:

“a corporation that has advanced \$30,000 to designers of a marine drilling rig are not affronting any social antigambling norms by insuring the rig. If there is a “gamble” involved, it is in backing technological development a highly regarded activity.”⁴⁷

Arguably, the dividing line does not achieve what it sets out to do. Rather than lack of legal interest being an effective indicator of gambling or wagering, the doctrine appears misconceived in the type of interest that must be demonstrated to alleviate anxieties over gambling. Wilson J contends that the presence of a “valuable relationship”⁴⁸ or lack thereof is the true test to satisfy the policy, regardless of the legal nature of that relationship. Where a party stands to suffer pecuniary loss, it is difficult to argue that the desire to insure against potential loss is tantamount to wagering. Therefore, not only is the restrictive definition set out in *Macaura* not necessary because issues of gambling are no longer as prevalent in today’s context, but it may even cause harm in that it can hinder genuine satisfaction of this policy by allowing those with no real pecuniary interest to profit yet prohibiting those with a pecuniary interest that falls short of a legal interest to do the same.

B. SAFEGUARDS AGAINST MORAL HAZARD

The second reason for the initial formation and an argument for the retention of insurable the doctrine is that insurable interest guarantees that the insured has a genuine interest in the continued existence of the insured property, such that it prevents entry into “morally abhorrent” contracts that encourage the deliberate loss of property. The guard against this concern, which is known as moral hazard, is twofold – first, the doctrine sets out to protect insurers from

⁴⁵ (n 17) [33] Wilson J.

⁴⁶ [1966] SCR 133.

⁴⁷ *ibid* [71].

⁴⁸ (n 17) [34] (Wilson J).

themselves by disincentivizing insurers from entering into risky contracts; second, the doctrine seeks to protect the insurer from the insured by nullifying the insured's motives to cause intentional destruction of insured property and recover under the policy. However, the effectiveness of insurable interest rules to prevent entry into policies with high risk of moral hazard can be significantly undermined on empirical grounds, such as by the observation that insurance fraud is nevertheless still possible and prevalent.

On a theoretical basis too, the correlation between insurable interest and the prevention of moral hazard is unconvincing. First, in terms of effectiveness in protecting insurers from themselves, the fact that insurable interest deters insurers from entering into "overly speculative" contracts is suspicious, because insurers can so easily waive the insurable interest requirement. The ability to waive the requirement, while undermining the effectiveness of the doctrine as a guard against moral hazard, is necessary in the interest of maintaining freedom of contract. Recognizing the value placed on freedom of contract can even lead to the question of why the policy to protect insurers from themselves was considered at all, as insurers should be able enter into insurance contracts at their own risk especially given that they possess the expertise to make informed decisions.

Although the effectiveness of the safeguard is questionable considering the ease of waiving the requirement, the Law Commissions in the Joint Consultation Paper provided evidence of the effectiveness of this mechanism by positing that insurable interest rules did in fact restrain the industry during the 2008 financial crisis.⁴⁹ The Commissions' paper contended that the Financial Crisis was purportedly caused by the growth in securitization, with banks and investors involving themselves in financial arrangements with qualities that resembled insurance policies except without requirements of direct interest.⁵⁰ It has been pointed out, however, that the International Monetary Fund has expressly stated that securitization itself was not to blame, and literature regarding the financial crisis also associates problems to credit agencies' failure to properly value what was being traded.⁵¹ A holistic look at the financial crisis therefore does not find a strong causal link between the doctrine of insurable interest and restraint of the insurance industry during the financial crisis, so the function of market discipline as an argument supporting the necessity of insurable interest is unconvincing and arguably far-fetched. To this end, the usefulness of insurable interest to constrain the market and protect insurers from themselves is unpersuasive.

⁴⁹ (n 33).

⁵⁰ Gary Meggitt, 'Insurable Interest – The Doctrine That Would Not Die' (2015) 35 *Legal Studies* 280, 292.

⁵¹ *ibid.*

Alternatively, some consultees have claimed that the effect of the rule is psychological in constraining insurers,⁵² but retaining an already questionable restriction on the ground of a psychological effect is unjustified particularly because, as above, insurers should have the expertise to make calculated decisions and rely on their own agency without the need to be subjected to arbitrary legislative requirements.

Second, in addition to protecting insurers from themselves, the policy against moral hazard also aims to protect the insurer from the insured by disincentivizing any abuse of insurance policies by destroying the insured property to claim under the policy, but this is similarly ineffective. The connection between the strict legal interest test and moral hazard is questionable, because an interest that disincentivizes destruction is not necessarily “legally enforceable.” For example, one who seeks to make a profit from the insured property would not bring about its loss despite lacking a legal right in the property,⁵³ nor would a legally enforceable right always guarantee that an insured would not cause deliberate destruction of the insured subject-matter as people may burn down their houses regardless of the presence of insurance.⁵⁴ Furthermore, it is possible that a legal interest in the insured property might actually increase the insured’s capacity to cause destruction of property. This is exemplified by Harnett and Thornton who explain that it is significantly more difficult to burn down a building in which one lacks an interest because it indicates less access and opportunity to plan and carry out the fraud.⁵⁵ Similarly, Wilson J in *Kosmopoulos* advocated for the factual expectation formulation of insurable interest, on the basis that the legal interest formulation is no better in alleviating concerns of moral hazard, especially given the reality that a legal interest in the insured property may actually increase possession and control of the property and, as a corollary, the chances for the insured to bring about its destruction.⁵⁶

It becomes apparent that the strict legal interest test is not necessary to property insurance contracts as it does nothing more than the factual expectation test does to prevent moral hazard, and may even make it easier to destroy the insured property. Hence, a broader conception does not increase harm to the insured because of the established ineffectiveness of the existing narrow conception, and so this policy cannot be advanced to support the restrictive scope of the doctrine.

⁵² (n 33).

⁵³ See, for example, *Petrofina (UK) v Magnaload Ltd* [1983] 2 Lloyd’s Rep 91 and *National Oilwell Ltd v Davy Offshore (UK) Ltd* [1993] 2 Lloyd’s Rep 582. See also *Glengate-KG Properties Ltd v Norwich Union Fire Insurance Society Ltd* [1996] 1 Lloyd’s Rep 614 and *Deepak Fertilisers & Petrochemical Corporation v Davy McKee (London) Ltd and ICI Chemicals and Polymers Ltd* [1999] 1 Lloyd’s Rep 387.

⁵⁴ (n 35).

⁵⁵ Bertram Harnett and John V Thornton, ‘Insurable Interest In Property: A Socio-Economic Reevaluation Of A Legal Concept’ (1948) 48 *Columbia Law Review* 1162.

⁵⁶ (n 17) [37] (Wilson J).

In light of this, the factual expectation test is welcome because it increases fairness to the insured at no additional risk of moral hazard to the insurer.

C. PROTECTING INSURERS FROM INVALID CLAIMS

The third policy consideration that supports the necessity of insurable interest is that the doctrine protects insurers from invalid claims. According to consultees, validity is a matter of policy wording which in turn is based on customary understandings of drafting and entering into contracts and the requirement of interest in such contracts. Radical change by expanding the scope, therefore, would interfere with these understandings and open insurers up to invalid claims. This consideration has two bases⁵⁷ – the first is based on customary understandings, and the second is based on the floodgates principle.

First, the Consultation Paper, against abolishing insurable interest, puts forward that it is common practice based on customary understanding to stipulate in the insurance policy who can claim, under which circumstances, and the subject matter that is insured. As such, major changes to insurable interest would unnecessarily interfere with these customary practices and understandings that protect insurers from a lack of interest in the insurance policy. This assertion is correct to the extent that specifying such matters in the insurance contract affords the insurer protection. The point of contention is that this practice is rooted not in customary understandings of insurance law but in understandings of general principles of contract law concerned with giving effect to the intentions of the parties as objectively ascertained. This is because, ultimately, insurance contracts are still contracts, thus principles of construction are operative independent of the existence of the insurable interest doctrine in any form.⁵⁸ Considering Stuart-Smith LJ judgment in *Yorkshire Water Services Ltd v Sun Alliance and London Insurance plc*,⁵⁹ contracts should reflect the intention of the parties and the commercial sense of the agreement. In this way, general contract law principles apply – for example, the *contra proferentum* rule demands that ambiguous language be interpreted against the draftsman insurer, or *ejusdem generis* dictates that individual words are construed according to the context within which they are used. The application of principles such as these to insurance contracts are important to uphold freedom of contract and maintain legitimate expectations of all parties. For instance, if on an objective assessment of the contract, those with less than a “legally enforceable interest” can recover under the policy, it is only right that the court must give effect to it, within the limitations of the indemnity principle. Therefore, even without the requirement of insurable interest and customary understandings, it is always in the best interest of the insurer to identify in the insurance policy certain matters such as who can

⁵⁷ (n 50) 293.

⁵⁸ *ibid.*

⁵⁹ [1997] 2 Lloyd’s Rep 21.

claim, under which circumstances, and the subject matter that is insured, to protect themselves and limit liability to that which they intend.

Nevertheless, even where insurers do not stipulate intentions with utmost clarity, it is doubtful that but for the requirement of legal interest courts would be compelled to hold that the insurer intended for strangers to benefit.⁶⁰ Yet, in the off chance that insurers were actually willing or so negligent so as to draft a policy to this effect and allow strangers to make a claim, they should be held liable within the bounds of the indemnity principle, because holding to the contrary would unfairly interfere with the other party's legitimate expectations. In this way, customary understanding should not affect these practices because insurers should have to stipulate these matters regardless.

Second, on the assumption that Lord Eldon's formulation of insurable interest affords insurers protection, insurers expressed concern that broadening the scope of insurable interest to recognize factual expectations or abolishing the doctrine completely would result in an influx of claims. This concern, which is essentially the floodgates argument, is not factually incorrect because one less prerequisite to recovery would inevitably increase the number of potential claims. However, widening the scope of the doctrine in this way would only increase the number of claims insofar as it is fair and consistent with commercial reality, because an insured attempting to claim under an insurance policy still needs to meet a standard of interest that is in accordance with the factual expectation required under the indemnity principle. To the extent that it satisfies the indemnity principle, it cannot be said that these claims are invalid and that insurers should be protected. As per Wilson J, "broadening of the concept of insurable interest would allow for the creation of more socially beneficial insurance policies than is the case at present with no increase in risk to the insurer."⁶¹ Either way, the floodgates argument solely relied on is an unsound basis for the retention of any restriction because, quoting Lord Roskill in *Junior Books Ltd v Veitchi*, a "remedy should not be denied simply because it will... become available to many rather than to few."⁶² This reasoning is even more compelling given that widening the scope would increase fairness, as demonstrated by the difference in outcomes of *Macaura* and *Kosmopoulos* despite the similarity in circumstances.

Though the policy consideration claims that a strict legal interest protects insurers from invalid claims, it is more likely that industry consultees protest changes to insurable interest for reasons of commercial value to the advantage of

⁶⁰ Estian Botes and Henk Kloppers, 'Insurable Interest As A Requirement For Insurance Contracts: A Comparative Analysis' (2018) 26 *African Journal of International and Comparative Law* 130, 148.

⁶¹ (n 17) [23] (Wilson J).

⁶² [1983] 1 AC 520, 539.

the insurer, namely that it provides a technical defence. First, it provides a technical defence for circumstances where insurers fail to demonstrate that the insured has committed fraud because insurable interest rules will avoid these evidential burdens, such as in the case of *Macaura*,⁶³ but using the doctrine in this way lacks justification in circumstances in which no original policy objectives are being achieved. A better solution to evidential burdens, rather than advocating for the existence of an unrelated doctrine that brings harm to the insured, is the greater use of claims investigators and other investigative or fraud-related resources.⁶⁴ Second, it provides a technical defence to either or both circumstances where insurers have failed to adequately identify the scope of the policy and where it is difficult to assess the risk covered. Instead of ensuring clarity in the drafting, insurable interest provides an out. The more appropriate way for insurers to protect themselves in these circumstances is not to avoid liability upon the insured attempting to recover, but to ensure better pre-contractual procedures and better drafting. Instead of protecting insurers, the strict threshold of insurable interest unjustly advantages them by affording insurers an escape from a bad bargain or carelessness on their part when entering into high-risk policies. This unfairness is accentuated upon considering the power imbalance between the insurer and the insured to realize that, if anything, consumers are the ones that require protection to ensure that their legitimate expectations are met and that they are on equal footing in the transaction, protection that the more flexible factual expectation test is able to fulfill.

IV. MOVING ON FROM THE LEGAL INTEREST TEST

A. FACTUAL EXPECTATION AS THE NEW TEST?

The preceding analysis demonstrates that the contention that the legal interest test is necessary in order to satisfy policy considerations does not hold truth. While some level of interest is necessary in recovering under insurance policies, the factual expectation test can serve to satisfy original policy concerns⁶⁵ as these policy considerations are evidently not at risk by widening of the scope of insurable interest. On the contrary, it has been evidenced that legal interest can in fact be detrimental to achieving the goals of insurance law as it fails to recognize genuine interests that come in forms other than legally enforceable rights. Already, evolution of case law has demonstrated the demand for a more liberal approach to meet modern commercial needs. Statutory and common law concepts of

⁶³ (n 15).

⁶⁴ (n 50) 300.

⁶⁵ See Chris Nicolls, 'Insurable Interest: As Intended?' (2008) 5 *Journal of Business Law* 432, 433.

insurance and insurable interest and seemingly obsolete original policies point to this shift towards Lawrence J's factual expectation test and demonstrate that there are no real dangers in adopting a more flexible approach⁶⁶ as the new test.

The statutory adoption of the more appropriate factual expectation test for insurable interest would eliminate the confusion and uncertainty that has been created by the conflicting approaches in statute and case law and the accidental and disputed abolition of the doctrine in 2005, but the use of this test raises concerns that it alleviates unfairness of the legal interest test and uncertainties of the current state of the doctrine but gives rise to others uncertainties. Specifically, the factual expectation test brings with it issues of causation in determining whether, but for destruction of the insured property, the insured sought to benefit or would not have suffered loss. Nonetheless, uncertainty brought about by the widened test is arguably justified on the basis that it no longer excludes deserving claims by the insured. In this respect, it is important to recognize that the appeal of a wider test is not doctrinal integrity; rather, priority of such a change is to give effect to legitimate expectations of both parties in the context of modern commercial practices and diverse commercial arrangements. While Lord Eldon prioritized regulation of gaming over ensuring performance and preservation of expectations, this was against a very different regulatory landscape and now more of a priority can and should be afforded to maintaining the reasonable expectations of the parties.⁶⁷ Accordingly, concern towards uncertainties in exercises of causation should not be too extreme as the benefits outweigh such uncertainty, and causation is in any case a common element in law.

Therefore, adopting the factual expectation test increases certainty as well as fairness at no unjustified detriment to the insurer and without interfering with valid policy, given that the existing policies are outdated, ineffective, or disproportionate. In this way, the extent that insurable interest should is a necessary characteristic of insurance law is in the Lawrence J formulation of factual expectation.

B. IS THE INDEMNITY PRINCIPLE SUFFICIENT?

Where the factual expectation test is the appropriate standard, the principle of indemnity can satisfy the same objectives. Indemnity principle and insurable interest in the factual expectation test is a "distinction without a difference"⁶⁸ as the doctrine has been so widened in recent case law that the two have significantly overlapped in scope. The factual expectation test is effectively a component of the

⁶⁶ See Kyriaki Noussia, 'Insurable Interest In Marine Insurance Contracts: Modern Commercial Needs Versus Tradition' (2008) 39 *Journal of Maritime Law and Commerce* 81, 87.

⁶⁷ (n 35) 507.

⁶⁸ (n 32).

indemnity principle that demands loss, as there is no loss without a preexisting interest. While there is a prima facie compelling reason that insurable interest on a wider conception should be considered a necessary characteristic of insurance, the indemnity principle achieves the same results and suffices to alleviate any concerns, rendering insurable interest redundant.

(i) *Contemporary Policy Considerations*

This conclusion that the indemnity principle is sufficient is based on the fact that the original policies are either no longer relevant or are satisfied on the factual expectation test and therefore the indemnity principle. The question then becomes whether the doctrine of insurable interest achieves policies other than the original policies for its inception that the indemnity principle cannot achieve. Consideration must be given to modern perspectives of original policies to determine the adequacy of the indemnity principle in satisfying updated concerns. For example, proponents for the doctrine contend that for the very reason that gambling contracts are now enforceable, the dividing line is all the more important as it offers a reliable solution to differentiate between the two because of its focus on interest. An absence of interest other than the in the sum that they win or lose is a defining characteristic of a wager,⁶⁹ so the doctrine's focus on interest serves to "delineate the general boundaries within which the insurance industry operates."⁷⁰ However, a direct focus on interest is not required to achieve this delineation as the fact that one must bear a loss in accordance with the indemnity principle already adequately characterizes and differentiates insurance from wagering.

Separately, the 2011 Consultation Paper explains that insurable interest as a dividing line is a defining feature of insurance, so in addition to differentiating between the activities of gambling and insurance for the initial policy considerations, the doctrine has come to be beneficial for regulatory, tax, and social purposes. However, the submission that it is a "defining feature" is doubtful, given that the insurable interest requirement was introduced as a direct response to concerns over wagering and not because interest was discovered to define insurance contracts in any way. Today, the doctrine's fundamentality to the concept of insurance is even more doubtful given that the original policy for the inception of the doctrine is no longer relevant, as it logically follows that the characteristic of insurable interest is likewise no longer relevant. Definitions of insurance in practice are revealing – the Financial Services and Markets Act 2000 that governs insurance in the United Kingdom, for instance, defines insurance by providing examples that fall within

⁶⁹ *Carlill v Carbolic Smoke Ball Company* [1892] 2 QB 484, 490–491 (Hawkins J).

⁷⁰ Association of British Insurers (ABI), cited by The Law Commission and the Scottish Law Commission in CP 201 (n 33) para 12.6.

the definition of insurance rather than setting out defining characteristics such as insurable interest.⁷¹ Additionally, a policy statement issued by the Financial Services Authority, the regulatory body at the time Issues Paper 4 was released, provides guidance on how to identify a contract of insurance but does not mention insurable interest. Surely, if the doctrine of insurable interest was so defining to the character of insurance, regulatory bodies and instruments would at the very least have made some reference to it. Even the courts have provided definitions that do not refer to legal interest. For example, Channell J's three features of insurance policies in *Prudential Insurance v Inland Revenue Commissioners*⁷² consist of payment, uncertainty, and interest, where the interest component was described as an interest in the subject matter such that upon an uncertain event that interest would be adversely affected. This notion of "adverse" effect on the insured more closely resonates with Lawrence J's factual expectation test than it does to Lord Eldon's legal interest test, as it makes no reference to the requirement of a legally enforceable right. In this way, only a factual expectation is a defining feature of insurance, which is already ensured by the principle of indemnity.

Furthermore, the doctrine's retention can be supported by an updated conception of the policy of preventing moral hazard, that ensuring an insured's vested interest in the insured subject-matter is not for the sake of avoiding destruction per se, but to align the interests of the insurer and the insured in the preservation of the insured subject-matter.⁷³ While the insurance industry is engaged in the transfer of risk in exchange for a premium, the doctrine is said to ensure that the insured party shares in and retains some degree of this risk to align the interests of the parties to the insurance contract. This alignment is to act as a mechanism to ensure that the insured has a stake in the insured property and as a corollary be more likely to safeguard the property. This nuanced perspective on the matter makes it more apparent why a legally enforceable interest is desirable, as this often connotes possession or custody which makes it all the more convenient to take effective measures against loss. However, given the concerns to which legal interest requirements gives rise, such as accessibility to bring about destruction,⁷⁴ and the fact that the indemnity principle already disincentivizes destruction of property by the insured on the ground that the insured is barred from gaining anything more than what they have lost by such destruction, this contention is not persuasive enough to retain the requirement by whatever test is adopted. The indemnity principle is sufficient in alleviating anxieties that the factual expectation

⁷¹ s 3(1), Financial Services and Markets Act 2000 (Regulated Activities) Order 2001.

⁷² [1904] 2 KB 658.

⁷³ (n 35) 502.

⁷⁴ See III.B above.

test seeks to relieve.

Where insurers are concerned that the indemnity principle is not adequate in protecting against invalid claims, there are far more effective means of ensuring the validity of claims than relying on insurable interest as a technical defence, namely that the insured should take reasonable steps to enquire about interest at the pre-contractual stage. Most simply, the insured can directly ask the insured to state in the proposal what their interest in the insured property is or will be; such a direct and express approach would avoid ambiguity and would not unfairly hinder recovery by the insured. If that interest is deemed insufficient, the insurer can decide not to enter into the contract on the outset, rather than later invoking a defence when the insured attempts to recover. This prevents the insured from ending up in a situation in which they seek to claim under the policy but cannot do so for lack of insurable interest, without other alternatives nor time to make alternative arrangements as loss has already occurred. Moreover, it may even be beneficial for the law of insurance to impose pre-contractual duties on the insurer that corresponds with the insured's pre-contractual obligations such as the insured's duty of disclosure. A corresponding duty on the insurer to actively seek out information would promote the insured's compliance with the requirement and reduce incidences of lack of insurable interest. In turn, this would increase fairness to the insured and maintain a more equal power balance by virtue of these parallel duties. It would additionally create greater legitimacy to what can currently be viewed as a purely technical defence,⁷⁵ because the insurer would already have mitigated risks of lack of interest. The fact that these measures would rid the industry of a commercially convenient defence is not a loss, rather it adds to the industry by restoring fairness between parties and ensuring better practice.

(ii) *Interests Still Beyond the Scope?*

Sole reliance on the indemnity principle may not be an all-encompassing solution as there may be interests still out of its scope. In particular, the application of the indemnity principle does not remedy problems relating to insurance covering interests of third parties.⁷⁶ This applies, for example, in the context of householder's policies in which one member of a household takes out a policy intended to cover goods of the household including those of other members even though they are not privy to the contract. Where loss is borne by a member of the household other than the one insured, the insured may be unable to recover on another's behalf as the insured himself cannot prove personal loss that satisfies the

⁷⁵ (n 35) 508.

⁷⁶ Australian Law Reform Commission, *Insurance Contracts* (1982).

indemnity principle.⁷⁷ Likewise, the same can be said for liability insurance such as in the case of *Vandepitte v Preferred Accident Insurance Corporation of New York*⁷⁸ where the policy purported to indemnify any person using the insured's vehicle with the insured's permission. Following the daughter causing loss to the plaintiff while driving the insured's car, the Privy Council upheld the objection that the insured had no insurable interest in his daughter's liability as "natural love and affection does not give an interest in law." In such circumstances, the insured himself suffers no economic loss and cannot satisfy the indemnity principle.

However, concerns over these issues miss the point, as the real concern is not the insured's potential to suffer personal loss that enables recovery but the insurer's right to renege on promises to indemnify third parties. The focus on issues of third party recovery should be on the wording of such policies, and whether these third party claimants fall within the policy's description of those entitled to indemnity. It follows that bringing third parties within the scope of property is facilitated by abolishing the legal interest rule but ultimately is a matter of drafting the policy. While indemnity does not resolve this restriction, it aids in the process and there are other means to satisfy this concern. Therefore, concerns for these interests should not be viewed not as a reason against the sufficiency of the indemnity principle, as it still remains a step towards acceptance of other valid interests not previously recognized.

(iii) *Case Study on Australia*

Perhaps the most convincing case in favor of the sufficiency of the indemnity principle is the fact that Australian insurance law has abandoned the doctrine of insurable interest entirely and now rely solely on indemnity. In 1984, Australian insurance law departed from the UK position with the enactment of the Insurance Contracts Act 1984, as section 16 provided that "contract of general insurance is not void by reason only that the insured did not have, at the time when the contract was entered into, an interest in the subject-matter of the contract" and section 17 provided that an insured can recover "if he has suffered pecuniary or economic loss." Prior to the enactment of the 1984 Act, the Australian Law Reform Commission released a paper proposing the abolition of insurable interest, containing similar arguments as to those set out in this paper. In sum, the Commission argued that first, the nature of indemnity contracts prevent gaming and wagering in the form of insurance; and second, that the requirement of insurable interest does not help lower risk of destruction of property and that the

⁷⁷ *ibid.*

⁷⁸ [1993] AC 70.

indemnity principle was sufficient because no profit can be made by destruction.⁷⁹ The Commission further pointed out the potential for the strict legal interest test to give rise to socially and commercially undesirable results.

What is notable in the context of Australian law reform is that the elimination of the doctrine of insurable interest came with the creation of comprehensive regulatory schemes – the Australian Prudential Regulation Authority was created to administer the Life Insurance Act 1995, and the Australian Securities and Investments Commission was assigned to administer the Insurance Contracts Act 1984. This observation supports preceding contentions that with significantly stronger regulatory schemes in place than at the inception of insurable interest, there are competent alternative protections in place for the insured and therefore the law of insurance can afford to abolish insurable interest. The abolition of insurable interest in Australia without harmful effects to insurance law serves as a model to English law that it is entirely possible to rely on the principle of indemnity alone without it being a cause for concern.

Resultingly, insurable interest need not be a characteristic of insurance at all. Interest precedes loss, and as loss is ensured by the indemnity principle that requires actual loss before a claim can be made, the requirement of insurable interest is redundant. In examining the sufficiency of the indemnity principle, it can be observed that the indemnity principle satisfies original policy considerations and modern policy considerations, and while there are anomalies outside the scope of indemnity, there are means of facilitating recovery that would not have been possible with the existence of the legal interest test. As a result, it can be said that the indemnity principle is sufficient to cover concerns relating to insurable interest and the doctrine insurable interest should be abolished.

V. CONCLUSION

The doctrine of insurable interest in property insurance came about to address concerns about evils of wagering and that those lacking interest in the insured property will intentionally bring about its destruction for their own gain. But notwithstanding the concerns which gave rise to the doctrine in the 18th century, modern case law over the years demonstrates that the strict legal interest test of insurable interest is problematic and has become inconsistent with modern commercial reality. Namely, the lack of flexibility in demanding nothing short of a legally enforceable interest excludes deserving claimants and cannot adapt to more novel commercial arrangements.

Given these shortcomings, the question arises whether these policy

⁷⁹ (n 76).

considerations that the doctrine seeks to address are still relevant today and whether the doctrine is effective in satisfying these policies. Upon deeper examination, the following conclusions were drawn – first, regarding the use of insurable interest as a dividing line between gambling and insurance, the fact that gambling is now a legitimate activity significantly reduces the need to guard against this risk. While a reduced risk remains, regulations are in place to distinguish between the two and bar recovery in cases of gambling in the guise of insurance. Separately, the use of insurable interest as a dividing line in the first place is questionable, as placing too much emphasis on the legal nature of interests can lead to unfairness, and an economic interest short of a legal interest in property suffices to show that an insured is not seeking to gamble on the insurance policy. Second, regarding guarding against moral hazard, the narrow definition of insurable interest affords no added protection as compared to the factual expectation test in terms of protecting insurers from themselves and from the insured, and in light of this there is no reason to maintain disproportionately strict rules. Third, regarding protection from invalid claims, widening the scope will expose insurers to more claims but not unfairly so. If insurers want to prevent an influx of claims, they can do so more directly in the drafting of their policies.

For these reasons, the existing policies are outdated, ineffective, or disproportionate and the factual expectation test would be the more appropriate measure for insurable interest that adequately addresses the policy concerns as they manifest today. The fact that adopting a more flexible approach may give rise to its own problems, specifically uncertainties of causation, is an arguably proportionate consequence to the benefits it brings by increasing the fairness of recovery under property insurance policies and better reflecting modern commercial practice. The more regulated legal landscape enables the prioritizing of commercial interests and legitimate expectations over the previously prioritized doctrinal integrity, and ensures that the consequences of doing so are not disproportionate nor unfair.

Yet where the factual expectation test is the more desirable test to adopt, this paper goes one step further to submit that the function of insurable interest under this formulation is already satisfied by the indemnity principle. This paper additionally considered the possibility that new policy considerations have replaced the original anxieties that gave rise to the inception of the requirement – namely, that the dividing line is now used to delineate boundaries within which the industry operates and has become a defining feature of insurance, and that safeguards against moral hazard are not to avoid destruction in itself but in place in order to align the parties' interests and uphold the sanctity of the purpose of transferring risk. However, it is demonstrably resolved that the indemnity principle is more than capable of satisfying these newly developed policy concerns. Concerns over

the inadequacy of the indemnity principle alone to protect from invalid claims were also addressed and dismissed as the insurers should be capable of protecting themselves, and this would be more beneficial to increase legitimacy of what is currently a purely technical defence. However, it was acknowledged that sole reliance on the indemnity principle is not an all-encapsulating solution to ensure complete fairness, as there still remains situations in which third parties who have valid interests cannot recover because the insured under the policy did not suffer loss. In this respect, while the indemnity principle does not resolve all concerns, it is more compatible with other solutions that address these concerns as compared to the legal interest test.

Although consultees of Issues Paper 4 contend that the principle of indemnity focuses on whether there was a loss and insurable interest focuses on the relationship of the insured to the subject matter of the contract, these considerations are simply two sides of the same coin and protect the same policy considerations. Even though English law has already demonstrated indications of sidestepping the Lord Eldon's formulation of insurable interest in property indemnity insurance in favor of a wider formulation of factual expectation, the matter should be taken one step further in the statutory repeal of insurable interest altogether in the interest of legal certainty. The fact that Australian insurance law has abolished insurable interest entirely at no detriment is a useful demonstration of the viability of this course of action. Based on these findings, to answer the question set out at the beginning of this paper, insurable interest should not be considered a necessary characteristic of valid property insurance contracts because the principle of indemnity can be solely relied on to alleviate interest-related concerns.