LAW OF MARINE INSURANCE

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CHAPTER 2

INSURABLE INTEREST

INTRODUCTION

An assured has to have an insurable interest in the subject-matter insured before he would be allowed to claim under a policy. Aside from defining insurable interest, s 5 does not explain its relevance to the scheme of things. Thus, for a proper understanding of the subject, it is necessary to refer to the basis or foundation of the notion; and only by reading s 5 with ss 1 and 4 of the Act does the picture become clearer.

A contract of indemnity

The requirement of insurable interest emanates from the cardinal principle of insurance law that a contract of insurance is a contract of indemnity: s 1 defines a contract of marine insurance as a contract whereby the insurer undertakes to indemnify the assured against marine losses. Thus, before an assured can seek for indemnity under any policy, it has first to be shown that he has in fact suffered a loss. To prove this, he has to show that he is 'interested in a marine adventure' as defined by s 5(1). Without going into a detailed study at this stage as to what constitutes 'insurable interest', it is sufficient to say, in simple terms, it signifies the relationship, if any, which the assured has with the subject-matter insured against.

If the assured has no interest whatsoever in the marine adventure, the contract which he has entered into will be deemed to be by way of gaming or wagering. Section 4(2)(a) states:[1]

> 'A contract of marine insurance is deemed to be a gaming or wagering contract –
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> Where the assured has not an insurable interest as defined by this Act, and the contract is entered into with no expectation of acquiring such an interest ...'

It would appear from the above that the assured, in not having an insurable interest in the subject-matter insured at the time of loss, would be caught not only by the fundamental principle of marine insurance, that of indemnity, but also by s 4, that every contract of marine insurance by way of gaming or wagering is void. Thus, his claim is not indemnifiable on both of these grounds.

DEFINITION OF INSURABLE INTEREST

Section 5 first defines insurable interest in general terms, and then proceeds to amplify its nature in more specific terms. It states: 'Subject to the provisions of this Act, every person has an insurable interest who is interested in a marine adventure'. Subsection 5(2) then goes on to elaborate that:[2]

> 'In particular a person is interested in a marine adventure where he stands in any

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1 Section 4(2)(b) relates to an 'honour' policy, eg, a ppi policy.

2 This is derived from the words of Lawrence J in *Lucena v Craufurd* (1806) 2 Bos & PNR 269 at p 302.

> legal or equitable relation to the adventure or to any insurable property at risk therein, in consequence of which he may benefit by the safety or due arrival of insurable property, or may be prejudiced by its loss, or by damage thereto, or by the detention thereof, or may incur liability in respect thereof.'

The persons who may stand in 'any legal or equitable relationship to the adventure or to any insurable property at risk therein' may be broadly divided into three main categories, the most obvious of which is the owner of the insurable property, whether it be ship, goods or freight. The second class covers persons who have lent money, in any emergency or otherwise, on the security of the ship and/or on her cargo; and, lastly, an insurer whose position clearly falls within the wording of the section. Besides these three categories, there are also other parties who, though they are not specifically mentioned in the Act, are generally recognised in the law of marine insurance to have an insurable interest: agents,[3] carriers, lien holders, pawnors and pawnees; trustees and executors;[4] captors; and, basically, any person who is to profit from a marine adventure. As the underlying principle is the same in all cases, it is unnecessary to examine the position of each and every one of these persons.

The simplest form of insurable interest is ownership of the subject-matter insured.[5] The position of the owner is laid down in s 14(3) which states that:

> 'The owner of insurable property has an insurable interest in respect of the full value thereof, notwithstanding that some third person may have agreed, or be liable, to indemnify him in case of loss.'

The interest of a part owner is by s 8 also insurable.

OWNER OF SHIP

The second limb of s 14(3) was enacted to take care of the situation, for example, where a charterer has agreed to indemnify the owner in case of loss. The fact that a third party may have agreed to indemnify the owner in case of a loss would not disentitle him of the right to claim that he still has an insurable interest in his ship. Needless to say, it would be highly dangerous for any owner to rely solely on such an undertaking to protect his interest.

OWNER OF GOODS

In the majority of cases, proof of ownership should not pose any problems. But having said that, it is not always easy to discern, especially in relation to cargo which has been the subject of a sale, whether the buyer or seller has the insurable interest at the time of loss. Most of the disputes which have arisen in

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3 See s 14(2).

4 See *Stirling v Vaughan* (1809) 11 East 619.

5 See *Piper v Royal Exchange Assurance* (1932) 44 LlL Rep 103, KBD, where the dispute was in relation to the ownership of a vessel which was bought 'as she lies' by the plaintiff who, in the case, was the assured. Under the contract of sale, she was at the risk of the seller until she arrived in London. During the voyage to London, the vessel sustained some damage for which the plaintiffs claimed against their insurers. The claim for this loss was not recoverable under the policy, because at the time of the loss the property in the vessel had not passed to the plaintiffs.

this area of law relate to circumstances in which there is a change of ownership at some stage of the policy. The crucial question in each case is: which party (buyer or seller) is the owner of the subject-matter insured at the time of loss? The answer to this is dependent upon the answer to a further question: at what point in time is the property in the goods to pass from buyer to seller? This, naturally, depends upon the terms of the sale.[6] As the matter is purely a question of fact, no useful purpose could be served by going into the details of the cases.[7] The subject of contingent and defeasible interest, however, requires some comment.

Contingent and defeasible interests

Section 7 was especially framed to accommodate the concepts of contingent and defeasible interests which are peculiar to the law of sale of goods. These concepts are not defined by the Act. Looking at the subject from the point of view of the buyer, s 7(2) offers two examples of contingencies which could cause the reversion of the interest from him to the seller:

> 'In particular, where the buyer of the goods has insured them, he has an insurable interest, notwithstanding that he might, at his election, have rejected the goods, or have treated them as at the seller's risk, by reason of the latter's delay in making delivery or otherwise.'

A buyer of goods has always the right to reject the goods if they are found on arrival not to comply with the terms of the sale, for example, that they are not of merchantable quality. Thus, even though the interest in the goods may already have passed to the buyer, nonetheless, it could still revert to the seller should the buyer exercise his right of election to reject the goods. It is in this sense that the buyer's interest in the goods is contingent:[8] his interest is dependent upon certain contingencies.

The buyer's interest, as it is contingent, is also defeasible. Until the transit is completed, the seller may wish to exercise his right of stoppage in transit should he be unpaid. The buyer's interest could be defeated or forfeited by the action of the seller. Even though his interest may be defeasible, at the option of the unpaid seller, this does not prevent him from insuring his interest.

The seller is more concerned with the reversion of his interest than with the loss of his interest. In one sense, his interest is the mirror image of that of the buyer. Should he exercise the right of stoppage in transit, or the buyer the right of rejection, there would be a resumption of his interest in the goods.

In each case, the major difficulty is not whether there is an interest but where the interest lies (in the buyer or the seller) at the time of the loss.

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6 See *Re National Benefit Assurance Co Ltd, Application of H L Sthyr* (1933) 45 Ll L Rep 147, Ch D, where it was held that the seller had the insurable interest in the goods since the sale was not an outright sale, but conditional on the arrival of the goods.

7 Moreover, it could well take us into the realms of the law on contract of sale of goods which is clearly outside the scope of this work.

8 A simple but clear definition of 'contingent' is, 'That which awaits or depends on the happening of an event': see *A Concise Law Dictionary*, P G Osborn.

OWNER OF FREIGHT

There is no specific provision in the Act on the subject of insurable interest as regards freight. The earning or acquisition of freight, however, falls within s 3(2)(b) in which it is declared that it is capable of being made the subject-matter of a contract of marine insurance. Read with s 14(3), the owner of freight clearly has an insurable interest in freight, if it is endangered by exposure to maritime perils.

There are basically three types of freight: ordinary freight or bill of lading freight; chartered freight; and owner's trading freight. Ordinary freight and chartered freight may be payable in advance, in which case it is called 'advance freight'.

The moment a ship commences her voyage with cargo on board, not only both ship and cargo but also ordinary freight and chartered freight are at risk. If ship and/or cargo are prevented by any peril from arriving at the agreed port of destination, a loss of cargo and freight would occur. The earning of ordinary bill of lading freight (but not advance freight) is dependent upon the performance of the adventure and the arrival of the cargo, albeit in a damaged state, at its proper destination.[9] Thus, should the cargo, by reason of a peril insured against, fail to arrive at its proper destination, a loss of ordinary freight would accrue.

The subject of advance freight is relatively straightforward. Section 12 states that:

> 'In the case of advance freight, the person advancing the freight has an insurable interest, in so far as such freight is not repayable in the case of loss.'[10]

Obviously the recipient of advance freight cannot claim that he has suffered a loss, for regardless of whether or not the cargo arrives at its proper destination, he has already been rewarded for the carriage. He will not be indemnified because he has not suffered a loss: the insurable interest lies with the party who has advanced the freight.

MORTGAGOR AND MORTGAGEE

Section 14(1) states that:

> 'Where the subject-matter insured is mortgaged, the mortgagor has an insurable interest in the full value thereof, and the mortgagee has an insurable interest in respect of any sum due or to become due under the mortgage.'

The mortgagor has an insurable interest in the mortgaged property in the capacity as owner of the ship. The case of *Samuel v Dumas*[11] has settled the principle that even if the mortgage is unregistered, the mortgagee would still

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9 Under the law of contract of affreightment, if goods are landed at some port other than the agreed port of destination, freight is not payable. But it has to be emphasised that as a general rule, freight is payable even if the goods arrive in a damaged state at its proper port of destination.

10 See *Allison v Bristol Marine Insurance Co* (1876) 1 App Cas 209 at p 235.

11 [1924] AC 431.

have an insurable interest in the ship.[12] As he had an 'equitable' right in the mortgaged property, his case fell within the description of a person who is 'interested in a marine adventure'. Though not standing in any legal relation to the adventure or to any insurable property at risk therein, he clearly had an 'equitable relation' thereto.

A mortgagee may protect his interest in the security of the ship or a share in her in one or more of three ways. He may either:

- take out, as an original assured, his own standard hull policy incorporating the ITCH(83) or the ITCH(95);[13]
- take out his own mortgagee's interest policy – incorporating the Institute Mortgagee's Interest Clauses, Hulls [IMIC];[14] and/or
- obtain an assignment of the shipowner's hull policy.[15]

In the first two cases, as an original assured, the mortgagee would have no difficulty in showing that he has an insurable interest in the subject-matter insured. In the third, his position is critically dependent on the position of his assignor, the shipowner, of the policy.[16] It is to be remembered that his position is no better than that of the assignor. Following from this, it is significant to note the terms of s 51. A shipowner who does not have an insurable interest in the ship at the time of the assignment obviously cannot pass on to the mortgagee, the assignee, an interest which he does not possess. An assignment would therefore be inoperative, if the shipowner were to sell his ship before entering into an agreement to assign the policy to the mortgagee; for once he parts with his interest in the ship he would have nothing left to assign.[17]

Lender of money on bottomry and *respondentia*

Section 10 states that, 'The lender of money on bottomry and *respondentia* has an insurable interest in respect of the loan'. A lender on 'bottomry' is, as its name suggests, a person who advances money to a shipowner on the security of (the bottom) the ship. Unlike a mortgage, the loan has to be made in a time of urgent necessity at a port of distress. As the loan is secured, the lender, like a mortgagee, has an insurable interest to the extent of the loan. The term '*respondentia*' refers to an advance obtained on the security or pledging of only the cargo.

INSURER

The position of an insurer is governed by s 9 of the Act, which states that: 'The insurer under a contract of insurance has an insurable interest in his risk, and may reinsure in respect of it.' He is not bound to state that he is reinsuring. As a

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12 An unregistered mortgage is void by Greek law.

13 See Appendices 6 and 7.

14 See Appendix 23.

15 A marine policy is as a general rule assignable: see s 50(1).

16 See s 50(2) on the legal effects of an assignment.

17 See *Alston v Campbell* (1799) 4 Bro Parl Cases 476.

contract of re-insurance is a also contract of indemnity, the insurer, who is now an assured in the re-insurance, would not be indemnified for more than his share of loss under the original policy.[18]

WHEN INTEREST MUST ATTACH

Section 6(2) states that:

> 'Where the assured has no interest at the time of the loss, he cannot acquire interest by any act or election after he is aware of the loss.'

The above must be read with ss 4(2)(a) and 5, for they all relate to the time as to when an assured must be interested in the subject-matter insured.

An assured must be interested in the subject-matter insured at the time of the loss, though he is not required to have an insurable interest at the time when the insurance was effected. The concluding words of s 4(2)(a)[19] have, in a somewhat obscure manner, indicated that though the assured does not have to have an insurable interest at the time of the loss, nevertheless, if he had entered into the contract with an expectation of acquiring an interest, that would suffice.

In *Buchanan and Co v Faber*,[20] a policy was effected by the insurance brokers and the managing owners of the ship for the purpose of insuring the brokerage fee and the commission which they had hoped and expected to continue to earn from the ship. One of the issues was whether the interests of the brokers and managing owners were insurable at law. The court did not have to answer this question because the ship was unseaworthy at the commencement of the voyage; this ground alone was sufficient for the court to dismiss the plaintiffs' claim. However, Mr Justice Bingham chose to answer the question in the following terms:

> '... I think they had none. They had nothing more than a hope that, if the vessel lived, they might continue to earn their commissions and brokerage. No contract ... was produced to show that they had a permanent right to be employed as managing owners. Every ship's husband and insurance broker has a right to entertain a similar hope, perhaps not so likely to be realised, but in its character the same.'

It is to be stressed that at the time of the loss, all that the plaintiffs had was a mere hope or expectation of earning a commission or brokerage fee. This 'hope' did not materialise into a contract. A hope is not in itself sufficient to establish that they had an insurable interest at the time of loss.

The insurable interest clause

To emphasise the importance of the requirement of insurable interest, the ICC has inserted its own provision, known as the 'insurable interest clause', echoing

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18 See *British Dominions General Insurance Co Ltd v Duder and Others* [1915] 2 KB 394; *Uzielli v Boston Marine Insurance Co* (1884) 15 QBD 11; and *Western Ass v Poole* [1903] 1 KB 376.

19 'A contract of marine insurance is deemed to be a gaming or wagering contract – where the assured has not an insurable interest as defined by this Act, and the contract is entered into with no expectation of acquiring such an interest.'

20 (1899) 4 Com Cas 223.

the terms of s 6. The nature of a sale of goods, particularly an international sale, as was seen earlier, is such that the property in the goods may well 'move' from seller to buyer, and *vice versa*,[21] from time to time. Clause 11.1 was drafted to drive home the point that the crucial moment at which the assured must have an insurable interest is at the time of the loss; in simple but clear terms it states:

> '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.'

Exceptions

There are, however, two exceptions to the general rule that the assured must have an interest in the subject-matter at the time of loss. The first relates to a 'lost or not lost' policy and the other to the position of an assignee.

'Lost or not lost'

A loss, whether of ship or goods, may well occur before the contract of insurance was concluded, or before an assured acquires his interest in the subject-matter insured. In the days when communication technology was undeveloped, it was not always possible, at any given time, for any person on shore to obtain information as regards the whereabouts or safety of his property at sea. A buyer, for example, may have purchased goods which, unbeknown to both him and the seller, had already been lost at sea. In such an event, the buyer would have acquired his interest only after the loss of the goods. And if he were to take out a standard policy on goods, he would not be able to claim for the loss by reason of s 6(1). To overcome this difficulty, a 'lost or not lost' policy, which is recognised by the proviso to the said section, could be effected:

> '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.'

An assured of a 'lost or not lost' policy is allowed to recover for a loss even though he may not have acquired his interest in the subject-matter insured until after the loss. The only condition which would bar him from recovery is if, at the time of effecting the contract of insurance, he was aware of the loss and the insurer was not.

Needless to say, if only the assured was aware of the loss, and the insurer was not, the assured would have committed not only a breach of the duty to observe utmost good faith, but also the duty to disclose all material facts. On either ground, the insurer is entitled to avoid the contract.[22]

An assured of goods, as was seen, is particularly susceptible to these problems. This perhaps explains why the ICC have found it necessary to repeat the statutory rules on the subject. Clause 11.2, even though it does not use the

21 See *Anderson v Morice* (1876) 3 Asp MLC 290.

22 If the insurer was aware that the subject-matter insured had arrived safely, and the assured was not, then the assured is entitled to a return of premium: the subject-matter insured was never at risk – s 84(3)(b) read with s 82.

expression 'lost or not lost', is, in effect, a reiteration of the rule contained in the proviso to s 6. It states:

> 'Subject to 11.1 above, the Assured shall be entitled to recover for insured loss occurring during the period covered by this insurance, notwithstanding that the loss occurred before the contract of insurance was concluded, unless the Assured were aware of the loss and the Underwriters were not.'

The above is in fact a clearer exposition of the law, for the words 'that the loss occurred before the contract of insurance was concluded' are helpful as they clarify the time of loss.

Assignee

A policy of insurance may be assigned before and even after a loss. It is to be remembered that by s 51:

> '...an assured who has parted with or lost his interest in the subject-matter insured, and has not, before or at the time of so doing, expressly or impliedly agreed to assign the policy, any subsequent assignment of the policy is inoperative.'

It is significant to note that an assignee can acquire no better right than the assignor. Thus, the policy is of benefit to the assignee only if the assignor has an insurable interest in the subject-matter insured at the time of loss. The policy may be assigned after a loss, but the assignor must have an insurable interest at the time of loss.[23]

23 See ss 15, 50 and 51.