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Résumé de l'article

La définition d'intérêt d'assurance a récemment fait l'objet d'une réforme jurisprudentielle majeure. En effet, dans l'arrêt Constitution Insurance Co. of Canada c. Kosmopoulos, la Cours Suprême a revisé cette notion en profondeur. Le présent article vise à démontrer la justesse de la décision rendue par le Cour suprême. A cette fin, l'auteur étudie tour à tour le fondement social puis l'évolution historique de cette règle. Aux termes de cette étude, le lecteur sera en mesure de mieux saisir et apprécier l'importance de ce changement radical dans le domaine du Droit des assurances.

INSURABLE INTEREST IN PROPERTY INSURANCE LAW: Policy and History

by Daniel DUMAIS*

La définition d'intérêt d'assurance a récemment fait l'objet d'une réforme jurisprudentielle majeure. En effet, dans l'arrêt Constitution Insurance Co. of Canada c. Kosmopoulos, la Cours Suprême a revisé cette notion en profondeur. Le présent article vise à démontrer la justesse de la décision rendue par le Cour suprême. A cette fin, l'auteur étudie tour à tour le fondement social puis l'évolution historique de cette règle. Aux termes de cette étude, le lecteur sera en mesure de mieux saisir et apprécier l'importance de ce changement radical dans le domaine du Droit des assurances.

The definition of insurable interest has been recently modified by the Supreme Court of Canada. Indeed, in the case of Constitution Insurance Co. of Canada c. Kosmopoulos, the Court has drastically and deeply reviewed and reformed this rule. This article is aimed at establishing the correctness of this decision. To this end, the author examines the policy and the history of this principle. This will allow the reader to better understand and appreciate the importance of this evolution in the area of insurance.

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SOMMAIRE

INTRODUCTION

There has been, over the last decade, a major and significant increase of legal literature. More and more cases are reported. Meanwhile, the publication of books and articles, by numerous scholars is endless. This proliferation of legal material is certainly welcome since it contributes to a better understanding and criticism of the current law. This trend is also characterized by the specificity of the studies. Indeed, the authors focus on very very specialized and narrow topics which, whenever possible, have never been taken up before. As a result of this concentration, the general principles of law are often taken for granted or merely ignored.

Insurance law does not escape from this reality. Most publications are oriented toward new developments, new theories. This allows the law to evolve. There exist, however, some old doctrines that deserve more attention than they generally receive.

Insurable interest, in property insurance, is one of these rules which needed, until very recently, a major review. Fortunately, such a revision has been deeply accomplished by the Supreme Court of Canada in the case of *Constitution Insurance Co. of Canada v. Kosmopoulos*[1]. This case has drastically changed the canadian law of insurable interest. I submit that the Highest Canadian Court has globally and consistantly reevaluated this important feature of insurance law. It is the goal of this article to show that the current definition of insurable interest, as adopted by the Supreme Court, is in perfect relation with its policy and that it is the only logical conclusion of its history.

Section one analyses the policy of insurable interest. It discusses the reasons given to support the existence of this rule in insurance law. It questions its requirement and its rationale. Doing so, it concentrates on the elements that must be taken into account in the elaboration of the doctrine.

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1. (1987) 1 R.C.S. 2.

Chapter two is devoted to the historical evolution of insurable interest. It traces the main events that influenced the development of the concept of insurable interest in Common Law, especially in Canada. It does not examine these developments in detail but gives an overview of the theory in order to better understand the solution reached by the landmark decision of the Supreme Court.

This article is not restricted to civil law. On the opposite, it is a general study of the notion of insurable interest in the light of canadian insurance law. In fact, it is more inspired from common law authorities than from Quebec sources. However, it seems applicable to Quebec law since this rule has been imported, in Quebec, from common law principles.

1- The foundation of insurable interest

The concept of insurable interest is unique to insurance law. This does not mean, however, that it has no relation with the other domains of law. If the name is proper to insurance, the idea it conveys is more universal. In fact, as we will see later, the requirement of insurable interest in an insurance contract mainly stresses a general policy of common law: the nullity of a gambling transaction hereafter called as *The policy against gambling*. So insurable interest is a rule that has been developped in order to avoid gambling in insurance contracts. Its policy is therefore linked to the legalization of gambling.

To this principal policy most authors add two other reasons to justify the doctrine of insurable interest: the caracter of indemnity of property insurance and the moral hazard. Although there are some opposing views about the division and the importance of each of these factors[2], it appears doubtless, according to the autorities,

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2. For instance, Richards, *Law of Insurance* (New York, Voorhis and Co., 1952, 5th ed) relies on these three factors that he clearly divides. On the other and, B. Harnett, and J. Thornton, «Insurable Interest in Property: A Socio-Economic Re-evaluation of a Legal Concept» (1948) 48 Colum L.R. 162, merge these three elements in the policy against gambling which according to them, includes the Rule of indemnity. They do not accept the moral hazard as a valid criterion to justify the insurable interest. Finally, R. Pinzur, «Insurable Interest: A Search for Consistency» (1979) 46 Ins. L.J. 109 refers to both elements of gambling and moral hazard.

justify the doctrine of insurable interest: the caracter of indemnity of property insurance and the moral hazard. Although there are some opposing views that all or part of them constitute the roots of the concept. As a result, the study of the policy of insurable interest must begin by an analysis of the three elements.

1.1- The policy against gambling

> Gaming is the mother of all lies and deceit and cursed villanies Manslaughter, blasphemy and wasteful sore of cattle and time. And furthermore 'tis shameful and repugnant to honour to be regarded as hazarder.[3]

Gambling is a universal word which embraces others such as gaming, betting and wagering[4]. It should therefore be used to design the whole concept of hazard and will be utilized in this sense in the present article.

David Allen has studied the nature of gambling and has concluded that gambling is natural, harmful and suppressible[5]. First it is natural because it is a fundamental activity which is found whenever group life is found and among any kind of people. Secondly, it is harmful because it leads to ruins of persons, disrupts families, causes crime and so on. Thirdly, Allen points out that gambling is susceptible to social control both of the suppressive and regulatory type.

The importance and the impact of gambling has been deeply observed and demonstrated by a major study conducted by the

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3. G. Chancer in O. Newman, *Gambling: Hazard and Reward* (London, 1972) at 109.
4. J. Chenery, *The Law and Practice of Bookmaking, Betting, Gaming and Lotteries* , 2nd ed. (London: Sweet and Maxwell, 1963) at 1.
5. D. Allen, *The Nature of Gambling* (New York: Coward-McCann Inc., 1952).

University of Michigan in 1975[6]. This research determined the extent of gambling in the United States and in Nevada State in order «to estimate the Government revenue that could result from various changes in gambling laws and to examine the social consequences of these changes[7]».

The survey established that 61% of all American adults placed some kind of money bet «legal ou illegal» in 1974 for an average of 387 $ per bettor. The commercial bets amounted to a total of 22.4 billion of which 5 billion was gambled illegally. It was also concluded that participation rates in gambling rose in those areas where it is legally accepted. For instance, Nevada residents took part in more gambling than the rest of the U.S. «78% versus 61% in the nation». Furthermore, there was a higher rate of compulsive gamblers in Nevada «2.6%» than in the country «0.7%».

Concerning a softening of the gambling legislation toward more legalization, there was strong support from the pulic for the preservation of the status quo. It is probably due to the fact that people are afraid that they will gamble more if gambling laws become more lenient. This fear is certainly not unfounded since the study observes that «the strongest indication we have that legalization of gambling can induce the non-gambler to gamble is that as more activities become legal within the state, the total number of non-gamblers decreases[8]».

Other figures on the importance of gambling in society are given by Wiston and Harris in their book *Nation of Gamblers*[9]. According to them, $10 million were gambled legally, daily, in February 1984 in New York City[10] «$5 million on the race track, $4 million on off-track betting and $1 million on lottery». In addition,

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6. M. Kallick et al, *A Survey of American Gambling Attitudes and Behaviour* (University of Michigan, 1979).
7. *Ibid.* at IX.
8. *Ibid.* at 2.
9. S. Winston and H. Harris, *Nation of Gamblers* (New Jersey: Prentice-Hall Inc., 1984).
10. *Ibid.* at 2.

there were $5 million bet illegally, everyday on sporting events and $5 million bet on the numbers. These statistics show that gambling became an enormous industry which deals with million of dollars and attract more and more people[11]. Far from remaing an unorganized leisure for individuals, gambling evolved to a point where it is now institutionalized and constitutes an important sector of business in the society.

Fortunately, most of these people gamble within their means. But there are also those who go over and gamble much more than they can afford. When one looks at the above statistics, it becomes obvious that gambling is more than an illusory phenomenon limited to a small group of citizens. It has become an important activity which reaches the majority of the population to different degrees. Hence, the state must be concerned by its popularity and especially by its consequences.

Gambling is generally seen as a terrible activity and as harmful and perhaps as destructive as alcoholism. However, the Courts have rarely dealt in detail with the vices associated with gambling. They usually take for granted that gambling is socially unacceptable without insisting on the reasons[12]. In these circumstances, we must rely mainly on the explanations and critics given by the non-legal analysts in order to understand the policy against gambling. Most of these criticism pertain to gambling as an industry. They are usually not concerned by private gambling.

A first set of objections concerns the effects gambling can have on the gambler himself and his family. It denies steady work and discipline. It teaches a reliance on chance and a searching after easy money. It creates false hopes that can encourage the dreamer. It can open the door to over-commitment and debts. So doing, it undermines the gambler's character who can become aggressive, alcoholic or liar. Then comes the loss of a legitimate job or business. Often, familiar problems follow. In fact, disruption of various sorts can occur[13].

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11. See e.g. The three articles devoted to lotteries in Canadian Taxation, A Journal of Tax Policy, 1979, Vol. 1 at 16.
12. For an exception see *Amory v. Gilman* 2 Mass, 1, 11 (1806).
13. See Allen, *supra*, note 5 at 9, 24.

This scenario may seem exaggerated and extreme. However, one must not forget that there are more losers than winners. Otherwise, the incentive to operate a casino or to be a bookmaker would be absent. The creation of an association called Gamblers Anonymous modeled on Alcoholics Anonymous, constitutes an additional proof. This association is aimed at aiding the addicted gambler whose life has disintegrated. It is described as «the most expensive club in the world where to join you pay your membership fee long before you arrive[14]».

A second group of objections is linked to the impact gambling has on society. As Patterson puts it:

> «A sense of antagonism is aroused in a community of workers against persons who obtain a means of livehood without participating in the machinery of social or economic production and distribution, in short against slackers. More specifically, unearned gains lead to illness and the wagerer becomes a social parasite. Useful business and industry are thereby discouraged. On the moral side, illness leads to vice; and the impoverishment of the loser entails misery and in consequence crime[15].

We can add that gambling enlarges the unequal distribution of wealth. The rich have better chances of making money than the poor since they can support a loss while avoiding immediate ruin. The poor do not have this opportunity and are often misled by the temptation. Even when legalized, lotteries are usually more expensive for the poor because they are a regressive tax[16]. Gambling does not only lead to crime, it supports it. According to Lester, it is one of the major sources of profit for organized crime in America[17]. It gives rise to corruption of officials and causes gang wars. It can corrupt a whole community.

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14. D. Lester, *Gambling Today* (Springfield, Charles C. Thomas, 1979) at 115.
15. E.W. Patterson, «Insurable Interest in Life Insurance» (1918) 18 CLR 381 at 386.
16. *Supra*, note 11.
17. See Lester, *supra*, note 14 at 30.

The third category of objections pertain to economics. Gambling is not socially productive. Indeed, every time a gambler wins, another loses. There is nothing productive for society. For Samuelson, it involves sterile transfers of money and goods which absorb time and resources[18]. In this sense, gambling does not contribute to anything of value. The loser is poorer and the winner did nothing useful for his recent gains.

Even for the gambler who has a 50% chance of winning, the decision is monetarily irrational. The explanation comes from the concept of decreasing marginal utility of income which is a basic tenet of economic theory[19]. The fundamental premise of this theory is that the marginal utility of money tends to decrease when the fortune increases. In other words, each additional dollar earned, although contributing to a greater satisfaction, produces proportionally less and less satisfaction. Consequently, the utility obtained from extra money is inferior to the satisfaction loss in giving up the same amount.

As Adam Smith pointed out, gamblers overvalue their chance of gain and undervalue the chance of loss. They forget that:

> «... the world neither saw nor will ever see a perfectly fair lottery or one in which the whole gains compensated the whole loss because the undertaker could make nothing by it... there is not however, a more certain proposition in mathematics that the more tickets you adventure upon, the more likely you are a loser[20].»

One cannot help but wonder if there is any room for possible advantages to gambling. The answer seems positive for a certain type of gambling. When practiced with restraint, based on the participant's fortune, it can have a certain value. It procures a little

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18. P. Samuelson in W.R. Eadington, *Gambling and Society* (Springfield: Charles C. Thomas, 1976) at 72.
19. This theory began with Daniel Bernoulli (1738) and was developed by Alfred Marshall (1920) and Paul Samuelson (1971). For more details see Eadington, *Ibid.* at 69-71 and D. Weinstein and L. Deitch, *The Impact of Legalized Gambling* (New York: Praeger Publishers, 1974) at 130-131.
20. A. Smith (1937) in Weinstein and Deitch, *Ibid.* at 130.

diversion to persons who often have no other leisure. It satisfies the individual's desire for entertainment, excitement and risk. In a sense, it corresponds to the expectations of the libertarians.

Morally, gambling is not rejected when it keeps to a level of social distraction. The tolerance and even encouragement of bingo by «the church» provides a good example of this position. When legalized, it constitutes an enjoyable means of voluntary taxation and helps to build hospitals[21] or finance sporting events.

On the economic point of view, Friedman and Savage[22] showed that, under certain circumstances, gambling can be a rational decision. They gave birth to the theory of the increasing marginal utility which states that if the gambler can change his socio-economic class by winning the bet, the utility is going up as long as if he loses he stays at the same economic level. For instance, a person of the average class who wagers $10 to win $1 million is in a situation of increasing marginal utility because the gain will allow him to change his socio-economic class but the loss will not.

Having analyzed the nature of gambling and its pros and cons, it appears quite clear that it is not generally speaking a desirable activity for society[23]. The summation of critics and dangers deriving from its existence outweigh the few benefits it procures. Those who argue in favor of a liberalization of gambling are rare and they always recognize that some boundaries must govern its development. As a matter of fact, I recognize that some forms of gambling are acceptable. Thus the private gambling between friends and relatives is rarely harmful. It is simply a way of recreation. The current system of lottery, in addition to the money it provides to the Government, allows people to dream and very rarely opens the door to

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20. A. Smith (1937) in Weinstein and Deitch, *Ibid.* at 130.
21. Allen, *supra*, note 5 at 11. However, this voluntary taxation appears to be more expensive for the poor than for the rich. *supra*, note 11.
22. M. Friedman and L. Savage, «The Utility Analysis of Choices Involving Risk» Journal of Political Economy (1948) 56 279-304.
23 In this article, we are concerned with the civil aspect of gambling, not its criminal dimension.

the real problems. If we tolerate these types of gambling, we take into account and meet the arguments in favour of gambling. For the rest, we cannot go further without falling into the evils[24] and these evils are too strong to be accepted. In general, gambling must be contained in the social interest. Consequently, there is no justification for getting rid of the actual policy against gambling. All in all, it seems that gambling must be severely controlled by law. It is the current law against gambling that will now be studied.

1.2 Current law of gambling

In Canada the criminal law prohibits certain forms of gambling. Thus, Part V of the criminal code entitled «Disorderly Houses, Gaming and Betting» creates numerous offenses related to operation and organization of such activities (keeping a betting house[25], bookmaking[26], etc.) It seems that the criminal code distinguishes between the different forms of gambling and their effects on society. It tolerates the less damaging situation[27] and controls or prevents gambling as an industry. However, the criminal aspect of gambling is outside the scope of this article.

At the civil level the position has evolved. At the beginning, the playing of games and the staking of money were not illegal in common law[28]. It is understandable since there was no organized gambling. For instance, in 1771 Lord Mansfield and a special jury brought in a verdict for a plaintiff who had wagered with the

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24. Lester, *supra,* note 14 at 22 writes: «Critics are quick to point out several aspects of the Nevada experience. The crime rate for the state is in the top 5 in the country; gambling is even more regressive in the state with welfare rolls inflated because those who can least afford it gamble (and lose); the population is very mobile, with high turnovers among those employed in gambling-related jobs, and the moral decadence resulting from legalization is symbolized by the tawdry nature of the Las Vegas Strip».
25. Sect. 185 (i) CR.C.
26. Sect. 186 CR.C.
27. Sect. 188 CR.C. concerning sporting events, horse races and private bets. Sect. 190 CR.C. on permitting.
28. At least in England. *Walcott v. Tapping* (1673), 83 E.R. 808. In the U.S. they were usually contrary to public order.

defendant that the father of the latter would die before a certain Sir Codrington. In fact, the father was already dead when the bet was decided, without the knowledge of the parties. The court decided there was a valid bet and the plaintiff collected his 500 guineas and costs[29].

Six years later, Lord Mansfield still had to judge such an incredible case. This time the bet concerned the sex of the Chevalier d'Eon, formerly ambassador to England from the Court of France[30]. Lord Mansfield expressed his abhorrence for this kind of case and wished he could have made the two parties lose. Nevertheless, the law did not exclude gambling contracts. So he decided on the merits of the case and found that the Chevalier was a woman and that the jury should give a verdict for the plaintiff. This case was reversed on appeal, not on the ground that gambling contracts are all illegal but because the inquiry revealed indecent evidence and tended to disturb the peace of the Chevalier and of the society. When the Chevalier later died, it was proven without a doubt, that he was a man[31].

As we can see, gambling was liberal but limited though. The courts were reluctant to enforce gambling contracts which were contrary to public policy or morality[32]. As Colinvaux states: «It has been the general policy of the courts to declare contracts with a tendency to lead to crime, immorality or other effects prejudicial to

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29. J. Ashton, *History of England* (New York, Burt Franklin, 1968) at 158-159 Affirmed in appeal by *Earl of March v. Pigot* (1771) 98 E.R. 43. See also *Jones v. Randall* 98 E.R. 954 (H.L.) upholding the validity of a wager upon the result of a case being heard by the House of Lords.
30. *Da Costa v. Jones* 98 E.R. 1331 (1778).
31. Ashton, *supra,* note 29 at 160-162.
32. *Egerton v. Brown* (1853) HL CAS 1 *Gilbert v Sykes* 16 East 150 (1812) 4 E.R. 1045, *Good v. Elliot* (1790) 3TR 693 695, *Da Costa v. Jones,* supra, note 30, *Rodrick et al. v. Hammerton* 98 E.R. 1335 (1835) see also *Perking v. Eaton* (1825) 3NH152. In U.S.A. all contracts of gambling were held contrary to public order, see MacGillivry and Parkington, *Insurance Law* (London, Sweet and Maxwell, 1975, 6th ed) at 17. *Collamer v. Day* (1829) 2 VT 144.

the public, void on the ground of public policy[33].

The results obtained in the two cases just referred to, indicate the uncertainty of such a general policy. Nobody has the same conception of public order. This relativity of public policy probably led to the intervention of the English legislator and the adoption of the *Gaming Act* of 1845[34]. The purpose of this Act was to clearly establish that gaming, in general, is not acceptable and that it must be regulated in order to protect the public from its consequences. Section 18 of the act nullifies and voids the contract of gaming or wagering so that no action can be brought upon it against the loser or against a stakeholder for the recovery of money. It enacts an exception for the «winners of any lawful game, sport, past-time or exercise».

While in England, the policy against gambling was developed through legislation, in Canada and in the United States, it was formulated by the judicial process. Thus, in these countries, any wagers were voided and invalidated on the grounds of public policy[35]. Gambling transactions were said to be unenforceable for the

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33. R. Colinvaux, *The Law of Insurance* (London, Sweet and Maxwell,1979, 4th ed) at 55. Also R. MERKIN, *Gambling by Insurance: A Study of the Life Assurance Act* (1980) AALR 331.
34. (1845) 8 and 9 Victoria C-109. It must be noted that many judges expressed their approbation of this law and regretted that gambling contracts have already been tolerated in common law.
35. *Supra,* note 32, R. Keeton, *Basic Text on Insurance Law* (St. Paul, West Publishing Co., 1971) at 98, *Connecticut ML INs. Co. v. Schaefer* 94US 457, *Washington v. Atlanta L. Ins. Co.* 175 TENN 529, Richards, *supra,* note 2 at 329, *Warnock v. Davis* 104 US 775. See also the Canadian case of *Anctil v. Manufacturers Life Ins. Co.* (1889) AC 604.

reasons already examined[36]. In 1912, the Ontario legislature adopted the *Gaming Act* which specifically deals with this matter and is quite similar to its British counterpart.

In Quebec, Section 1927 of the *Civil Code* specifically denies the right of action for money or other things claimed under a gaming contract or a bet. The section does not render the gambling contract illegal in itself but it forbids the recovery of the debt which flows from it. To illustrate, in *Zemelman v. Williams*,[38] an action taken on a cheque given to cover the gambling debts of another party was dismissed. To be denied his right of recovery, the lender must be interested in the game[39] and not be only a third party without knowledge or interest in the gambling[40].

1.3- The rule of indemnity in insurance

The caracter of indemnity in property insurance is a second element given by the legal authorities to explain the requirement of insurable interest in an insurance policy. Keeton refers to this rule as the principle of indemnity[41]. Nobody quarrels that property insurance is linked to indemnity[42]. However, there is sometimes confusion on the origin of this relation versus the need of insurable interest. As we will see later, indemnity does not exist in insurance

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36. In addition, as Harnett and Thorton, *supra*, note 2 at 1180 explain: The possibility of adding to the calendar of the already overburdened courts a considerable number of cases involving the enforcement of socially unproductive and unnecessary contracts has also received consideration. Also *Gilbert v. Sykes supra*, note 32.
37. RSO 1980 C-183.
38. (1949) CA 253. Also *Desjardins v. Cadieux* (1946) CS 366.
39. *Hendy v. Bertrand* (1969) RL 567, *Guérin v. Bourgouin* (1944) CS 245, *Poirier v. Bergeron* (1945) CS 332.
40. *Amesse v. Latreille* 7 LN 366, Rock et Paré, *Traité de droit civil du Québec*, t. 13, Montréal, Wilson et Lafleur, 1942 at 586.
41. Keeton, *supra*, note 35 at 88.
42. Richards, *supra*, note 2 at 29, Keeton, *supra*, note 35 at 137- W.R. Vance, *Handbook on the Law of Insurance* (St. Paul, West Publishing Co., 1951, 3rd ed) at 160.

without reasons. It was developed in order to control in insurance matters, the public policy against gambling. It serves as a guide for the definition and the application of the test of insurable interest which ultimate goal is to control gambling. Therefore, the concept of indemnity is not a satisfactory explanation to the requirement of insurable interest. It is simply a rule which has grown up from the policy against gambling and which orients the doctrine of insurable interest accordingly.

The link between indemnity and property insurance means that the insured cannot obtain a benefit greater than the value of its loss. As set out in the case of *Crisp v. Security National Ins. Co.*: «Indemnity is the basis and foundation of insurance coverage not to exceed the amount of policy, the objective being that the insured should neither reap a gain nor incur a loss if adequately insured»[43]. Hence, the insured's recovery is limited to the loss he would have sustained, had the insurance been non-existent[44]. If there is no such loss there will be no valid claim against the insurer. It would be contrary to the nature of indemnity if the insured was entitled to make a profit following the destruction of the subject-matter of the insurance policy.

Indemnity being a controlling principle of property insurance, it can be used to solve many problems which arise from the interpretation and application of insurance policies[45] such as the principle of subrogation, rule of co-insurance, etc. Besides the restriction of property insurance to indemnity against loss is in accordance with the layman's conception of insurance. People take out insurance to avoid a financial calamity. They want to protect their assets and prevent the consequences of their negligence. They seek protection, not windfalls. Their frustations do not normally come from the indemnization approach of insurance but arise from the legal defi

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43. 369 SW (2d) Texas (1963) 326 at 327, see also *Castellain v. Preston* (1882) 11 Q.B.D. 380. 386. *Matthew v. Curling* (1922) A.C. 180 at 219. *Banker and Traders v. Gravel* (1978) C.A. 1316.
44. E.R. Ivamy, *Fire and Motor Insurance* (London: Butterworths, 1973) at 9. Richards, *supra*, note 2 at 326. Keeton, *supra*, note 35 at 88.
45. J.B. Porter, *Law of Insurance* 8th ed. (London: Sweet and Maxwell, 1933) at 1. *Glynn v. Scottish Union and National Insurer Co. Ltd.* (1963) 40 D.L.R. (2d) 929.

nition and calculation of this indemnity[46]. As Fischer[47] points out, the legal criteria of recovery are not always in accordance with the principle of indemnity.

We have seen that the principle of indemnity implies that the insured cannot make profit from his insurance contract. He will be indemnified only if he suffers a loss. Now, how can we determine the existence of such a loss? How can we know if the insured is entitled to recover money from the realization of an event he is insured for? How can we establish the amount of the recovery if there is any? In other words, how do we satisfy the rule of indemnity?

To answer these questions, the doctrine refers to the criterion of interest. There will be a contract of indemnity if the insured has an interest[48] in the property at risk and the part of this interest, lost from the destruction of the insured property, determines the amount of indemnity. Marshall sums it up: «there cannot be an indemnity without a loss nor a loss without an interest[49]». Strict indemnity means that the insured gains an advantage from the existence of the property insured and that the destruction of the property will cause him an assessable loss. In the last situation it is said that the insured has an interest which equals the amount of his loss. This is, in a nutshell, the principle of indemnity from which must be elaborated the doctrine of insurable interest.

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46. The calculation is often disputed because the insurance contract does not involve indemnity for the insurer who is in business and desires to maximize his profits. The indemnity feature is for one party only, the insured.
47. E. Fischer, *The Rule of Indemnity and the Principle of Insurable Interest: Are They a Measure of Damages in Property Insurance?* (1981) 56 Ind. L. Rev. 445.
48. Richards, *supra*, note 2 at 326. Also MacGillivery and Parkington, *supra*, note 32.
49. A. Marshall, *A Treatise on the Law of Insurance* vol. 1 (London: Butterworths, 1823) at 101.

1.4- The moral hazard

The third justification given to the requirement of insurable interest is called moral hazard. It rests on the affirmation that the insured who has no interest in the property insured is more likely to destroy it, in order to collect insurance proceeds than if he has an interest in it[50]. Thus a moral hazard is a condition that increases the chances, or temptation for the insured, to intentionally cause the loss. For example, arson can be inspired by the possibility of an insurance recovery if the initiator is insured. Williams and Heins[51] also discuss a morale hazard in which persons are less careful toward insured property than they would normally be in the absence of insurance. The expression moral hazard usually includes these two distinctions.

Richards summarized the relation generally made between the voluntary destruction of the property and insurable interest:

> «... a person with insurable interest has nothing to gain in burning the property. Thus, the requisite of insurable interest to validate the policy is designed to prevent crime especially arson by rewarding a person who has no relation to the insured property or any interest in preserving it[52].»

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50. See preamble to *The Marine Insurance Act (1746)* which requires an insurable interest in marine insurance. «It hath been found by experience that the making of insurances, interest or no interest, or without further proof of interest than the policy, hath been productive of many pernicious practices, whereby great numbers of ships with their cargos, have... been fraudulently lost or destroyed.» Also Merkin, *supra*, note 33 at 334.
51. W.C. Arthur and R.N. Heins, *Risk Management and Insurance* 5th ed. (New York: McGraw-Hill Book Co., 1985).
52. Richards, *supra*, note 2 at 330. Also Brown and Menezes, *Insurance Law in Canada* (Toronto: The Carswell Co. Ltd., 1982) at 67.

1.5- The rationale of insurable interest

After having analyzed the three fundamentals of insurable interest one can answer the question whether this doctrine is necessary or not. We have seen that gambling is a popular and harmful activity which must be regulated by law. Indeed, institutionalized gambling offends public policy and is, in common law, unenforceable neither by statute nor by the court. As explained before, this position appears justified.

This public policy of prohibiting gambling contracts must obviously apply to the sector of insurance which is subject, albeit with many variations, to the principles of common law. There is no reason why the general policy against gambling should not bind the insurance world. Who would suggest that insurers favor gambling, at least for themselves, the way they play the game of insurance? They search certainty and secure their profit. The government acknowledges the need for protection of the insured by imposing severe regulations on the reserves to be kept by the insurers.

We cannot allow insurance to wander from this policy. If we do so, we will give rise to specific doctrines forged by the insurance industry. Yet, experience teaches us that these tenets are generally neither known, nor understood and expected from the consumers who are disadvantaged at the end. These insured legitimately believe that their insurance policy is a protection against their liability or for something they have an interest in. This search for protection constitutes the true rationale of the requirement of insurable interest. Laymen do not think that insurance can open the door to gambling, except maybe in life insurance with the clause of double indemnity in the case of accidental death. Consequently, it would be incomprehensible and unacceptable that the law refuses to prevent such a trap. The common law indicates and regulates a danger that insurance law must have the wisdom to avoid.

The application of the policy against gambling is especially founded in insurance, when one considers the essence of such a contract. Insurance is an aleatory contract, for the rights of the parties are contigent upon the realization of a risk which is uncertain. As Pinzur writes:

> «An insurance contract and a wager share some similar characteristics. Both are contracts upon a condition and entail some risk. Both are aleatory contracts

> whereby the obligation becomes obligated only upon the occurrence of the specific event. Furthermore, the purchaser in both contracts pays a relatively small amount of money in exchange for the possibility of receiving something of much greater value or, alternatively, nothing at all[53].»

Thus, if a gambling contract and an insurance policy present prima facie the same profile[54], it reinforces our need to distinguish them and ensure that what is socially unacceptable in the former will not be accepted and valid in the latter case. The nature of the insurance contract and its similarity to a gambling relationship forces the law to adopt a rule which will enable one to determine if we are in the presence of gambling or not. In that sense, insurable interest becomes the test to a valid contract of property insurance where the insured seeks a financial protection of his belongings not a profit.

To put it differently, the operation of insurance, at first glance, resembles gambling. In this situation, we must set forth conditions to be sure that any insurance policy differs from gambling. These conditions have been put together and are called the rule of insurable interest. So the purpose of the rule is to avoid the evils inherent in gambling. Now, this rule of insurable interest must be analyzed in accordance with the expectations of the insured who seek financial protection through an insurance policy. The definition of insurable interest must recognize this goal and be interpreted accordingly.

The principle of indemnity is born from the requirement of insurable interest. It constitutes the measure and the consequence of the policy against gambling as applied to property insurance. If

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53. R.S. Pinzur, *supra*, note 2. The last sentence is questionable since the gamblers can risk more money «or an equivalent amount» than he can win, all depending on the odds. In addition, we think that both get something even if the rist is not realized. The insured get protection while the gamblers get excitement «or stomach ulcers».
54. Colinvaux, *supra*, note 33 at 3-4.

gambling was allowed in insurance law, there would be no need for the indemnity feature. Furthermore, indemnity corresponds to the understanding and expectation that the insured have of a property insurance policy. Indemnity is issued from the need of the insurable interest test of which it ends up to be the main element. Indemnity and insurable interest must stick together.

Concerning the role of moral hazard as a pillar of insurable interest, the issue remains. The argument suggests that if you require an interest in the property insured, you diminish the chances that the insured will voluntarily destroy the property since they will not be left any better off than they were before the event[55]. Theoretically, it seems to be true. However, we do not have any statistics to prove it. On the contrary, arson and other destructive acts are often done on property in which the insured does have an interest. Indeed, it is unrealistic to assume that people will buy insurance on the neighbour's house, set it on fire and claim money from the insurer. Would it not look suspicious? Instead of that, the insured will burn his own goods, especially during a period of economic depression. As Harnett and Thornton point out, we have no evidence to support the notion that the requirement of insurable interest minimizes the temptation to destroy. It may well be that it increases it[56].

On the other hand, Pinzur suggests that moral hazard is a distinctive foundation «in addition to the policy against gambling» because this concept exists even where the gambling is legalized[57]. This argument is not conclusive because the States and Provinces that have made gambling legal, are few in number. There is always a certain control and even where it is more liberal, we find some restrictions.

I do not argue that a general policy against destruction of property is not good and desirable. Nevertheless, there is no practical proof that it is reached, in insurance, by the requirement of insurable interest. It is therefore improper, at this stage to state

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55. Brown and Menezes, *supra*, note 52 at 74.
56. Harnett and Thorton, *supra*, note 2 at 1183.
57. Pinzur, *supra*, note 2 at 110.

that the doctrine of insurable interest rests on this last policy. I do not say that the doctrine has never been built on moral hazard. I express the view that these fears are not supported by evidence.

In conclusion, the only serious foundation of the doctrine of insurable interest originates from the general policy against gambling. It does not, at the origin, come from the principle of indemnity and we have actually no evidence that it is justified by the existence of moral hazard. In the next sub-section, I will discuss the criteria of application of this doctrine.

1.6- The measure of insurable interest

We have determined that the doctrine of insurable interest is required in insurance law, in order to distinguish a valid insurance contract from a mere wager. To this end, authorities have looked for a test that could be used to make this distinction. They found the answer in the concept of indemnity which they developed as a major characteristic of property insurance issued primarily from the rule of insurable interest. As Richard enunciates: «The doctrine of indemnity and the necessity of an insurable interest are correlative and complementary in all branches of the law of insurance[58]».

As we saw before, every time a person insures a property from which he can suffer a loss in case of destruction, he is not gambling since he is not seeking a profit but pecuniary protection. In this sense, the limit of recovery must be subject to the assessment of the interest of the insured affected by the loss. Over this amount, we quit the indemnity world to enter the world of gambling. Thus, the principle of indemnity becomes the criterion of measurement of insurable interest in property insurance. If there was no requirement of insurable interest, there would be no rationale for the principle of indemnity. Indemnity does not exist in itself but constitutes the criterion of evaluation of the policy against gambling. In other words, indemnity has been created as the means to measure the existence of insurable interest. It corresponds to the security desired by the insured. Unfortunately, this reality has been, until very recently, forgotten and misapplied by those who developed the rule of insurable interest.

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58. Richards, *supra*, note 2 at 328.

This notion of indemnity can also be expressed differently. We can distinguish two kinds of risk; firstly, the pure risk which involves a possibility of losing without any opportunity of gaining and secondly, the speculative risks which implies possible gain or loss. Only the former can be protected by a valid insurance contract because it is aimed at indemnifying the insured and simply consists of transferring the risk of economic loss to the insurer. While the speculative transaction creates it own risk «win or lose» and becomes gambling, the insurance contract is found upon dispersion of pure risks between insureds who all want to avoid an eventual loss without seeking any profit[59]. To phrase it differently, «the gambler courts fortune; the insured seeks to avoid misfortune[60]».

Now the obligation to estimate if the insured is making a profit from the realization of the risk, negating indemnity, leads to another question: the assessment of this indemnity. One can suffer a loss but quite inferior to the amount of its coverage. How can we know if one suffers a real loss and how can we quantify it? We must determine the limits of indemnity itself. We have already indicated that this second step can be referred to as the search of the indemnity becomes the measure of insurable interest while the appreciation and evaluation of this indemnity is given by the economical interest of the insured in the property. Ultimately, the doctrine of insurable interest must be linked to the determination of the insured's interest in the property, in a context of indemnity. Therefore, the formulation of the tenet of insurable interest consists of defining the boundaries of this interest while keeping in mind, the guidelines of indemnity which also express the expectation of financial protection of the insured. These two notions merge and form the rule to be used to prevent gambling in insurance.

1.7- Conclusion

The concept of insurable interest can be rationalized. Its policy can be summarized as follows:

The phonomenon of gambling is, in general, undesirable in our society. Hence, most gambling contracts are unenforceable in *Common Law* and especially in insurance which presents many features

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59. Fisher, *supra*, note 47 at 446. Porter, *supra*, note 45 at 4. *Cousins v. Nantes* 128 Eng. Rep. 203 (1811).
60. Vance, *supra*, note 42 at 93.

similar to gambling. The necessity to distinguish valid insurance contracts from mere wagers forced the law to create the concept of insurable interest, a rule aimed at making such a distinction[61]. The elaboration of this concept gave rise to the principle of indemnity which corresponds to the financial protection that insured look for when they buy insurance. Indemnity means that the insured must suffer a loss in order to recover from the insurer. He can never seek a profit. From there, must flow the definition of insurable interest and, more generally, the elaboration of its doctrine.

2- The history of insurable interest

In order to survey the historical evolution of the concept of insurable interest, I divided this section in periods corresponding to major events which forged its doctrine. My intention is not to comment extensively these historical peaks but rather to provide the reader with the basic knowledge necessary to appreciate the concept of insurable interest as redifined by the Supreme Court.

2.1- The Life Assurance Act of 1774

We saw that, in England, gambling contracts were lawful[62] until the general prohibition issued from the *Gaming Act of 1845*[63]. There existed an earlier anti-gambling legislation but is was specifically confined to particular sports[64].

There was also, before 1845, a possibility of intervention of the courts which sometimes refused to enforce certain gambling contracts that they believed contrary to public order[65]. Besides, many judges expressed their disapprobation with the general policy of tolerance of wagers[66]. In Canada and in the United States, the

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61. Merkin, *supra*, note 33 at 331.
62. *Supra*, note 28.
63. *Supra*, note 34.
64. *The Gaming Act* (1664) 16 Charles II c-7, *The Gaming Act* (1710) 9 Anne c-14 *DAnvers v. Thistlewaite* (1669) 1 LV 244.
65. *Supra*, notes 32 and 33.
66. Patterson, *supra*, note 15 at 392 *Da Costa v. Jones*, *supra*, note 30 and *Gilbert v. Sykes*, *supra*, note 32, a suit upon a wager concerning the life of Napoleon 1.

courts were less reluctant to invalidate gambling transactions, holding that they were all against public policy[67].

The recognition of most gambling contracts by the English law obviously led to the acceptance of any kind of insurance policies as long as they were not offensive to the public interest. Thus, contracts in form similar to insurance policies were enforced by Common law without requirement of insurable interest[68]. Lord Kenyon wrote: «I think that at Common law a person might have insured without insurable interest[69]».

In fact, wager policies were valid if gambling was proved to be the intention of the parties. By opposition, the insurance contracts where the parties clearly agreed to indemnify the insured for a real loss were void in the absence of interest for the insured. This trend was specially noticed in fire insurance. For instance in *Sadler's Co. v Badcock*[70], it was held that a lessee had no interest in the house when the lease's term was over even if the insurance policy remained in force. To overcome any problem of interest it became usual to add p.p.i. «policy proof of interest» on each policy. It was a clause aimed at indicating that the parties had an interest in the policy and that the bargain was not voidable on this basis. However, the validity of such wager policies gave rise to great abuse, «a mischievous kind of gambling[71]» and faudulent destruction, especially in Marine insurance. «The abuse of the p.p.i. policy became so extensive in marine insurance that it was felt to be against the best interests of sound business[72]...»

This situation caused the English legislators to enact, in 1746, *The Marine Insurance Act*[73] which was a first attempt to stop the

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67. *Supra*, note 35.
68. A.J. Campbell, «Some aspects of insurable interest» (1949) 27 C.B.R. 1.
69. *Crawford v. Hunter* (1798) 8 TR 13 at 23 and J. Roche in *Williams v. Baltic Ins. Ass. of London* (1924) 2 K.B. 282 at 288 «There is nothing in the Common law of England which prohibits insurance even if no interest exists».
70. 26 Eng. Rep. 463 (1743).
71. See *infra*, note 74.
72. MacGillivray and Parkington, *supra*, note 32 at 6.
73. 1746 19 Geo. II c-37.

proliferation of speculation under the form of insurance and, apparently, tried to prevent the moral hazard[74]. This statute concerned only Marine insurance. It forbade wagering policies, requiring the insured to prove his interest[75]. For the first time, an interest, not defined, was needed in order to validate marine insurance contracts. The p.p.i. clause ceased to be a proof or even a presumption of such an interest[76]. According to the Act, the interest had to be shown at the time of the loss and not at the time the contract was made[77]. Nevertheless, the adoption of this Act did not affect the possibility of gambling on lives and other property besides ships.

The *Marine Assurance Act* was subsequently followed by the *Life Assurance Act of 1774*[78] which, notwithstanding its name applies to all kinds of insurance except on «ships, goods or merchandise» exempted by section 4 and except mere wagers not expressed in the form of a policy[79]. This Act contains a preamble almost similar «although it does not refer to the voluntary destruction of the property insured» to its predecessor. It also provides that no greater amount shall be recoverable from the insurer than the amount and value of the insured's interest. Section 1 prevents the making of any policy on the life of any person or other event wherein the persons

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74. See the preamble to the Act: «Whereas hath been found by experience that the making assurances, interest or no interest... hath been productive of many pernicious practices, whereby great numbers of ships... have been fraudulently lost... and by introducing a mischievous kind of... wagering under the pretense of assuring the risk on shipping... the institution and laudable design of making assurances hath been preseved...»
75. Brown and Menezes, *supra*, note 52 at 107.
76. *Re London County Commercial Re Ins. Office Ltd* (1922) 2 C. 67.79. These p.p.i. clauses are today illegal in England. See e.g. *Cheshire v. Gaughn Bros.* (1920) 3 K.B. 240.
77. *Sparkes v. Marshall* (1836) 3 Scott 172: «The assured having interest at the time of the loss could sue notwithstanding that he had subsequently parted with his interest before action was brought». Also: *Powles v. Innes* (1843) 11 M and W 10.
78. 1774 14 Geo. III c.48.
79. *Good v. Elliott* (1970) 3 Term Rep. 693. For a discussion of the application of this act, see E.R. IVAMY, *General Principles of Insurance Law* 4th ed. (London: Butterworths, 1979) at 25.

for whose, or on whose, account such policy shall be made, shall have no interest or by way of gaming or wagering. Section 2 specifies that the name of the persons having an interest must be inserted in every policy. Hence, the policy against gambling and the requirement of an insurable interest, in an insurance contract, becomes obvious.

After this intervention of Parliament, gambling contracts were still tolerated but they were no longer acceptable under the form of insurance policies. Section 1 clearly indicates the negative correlation that the legislators established between gambling and interest. According to Merkin, «the paramount purpose of the 1774 Act was to stamp out gambling hidden by a notionel insurance[80]». The prohibition, started in the field of insurance, would eventually extend to any kind of gambling. «Given this lead, the courts began a century of seeking ways to avoid their own basic rules as to the legality of wagers[81]» which would end up with the *Gaming Act of 1845*[82].

In Canada and in the United States, the unenforceability of all gambling contracts on the basis of public interest inevitably contributed to the nullity of any insurance policy made without interest. From the beginning, these countries had joined the policy against gambling and the need for insurable interest in insurance contracts[83].

2.2- From the Life Assurance Act of 1774 to Lucena v. Craufurd (1806)

We have seen that the *British Life Assurance Act of 1774* did not apply to insurance policies on «ships, goods and merchandises». On the other hand, the *Marine Insurance Act* (1746) covered only insurance on ships and goods laden or to be laden on board these ships. Consequently, there remained a gap concerning goods unconnected with ships which could be insured without interest. This gap

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80. Merkin, *supra*, note 33 at 331.
81. *Ibid.* at 334.
82. *Supra*, note 34.
83. MacGillivray and Parkington, *supra*, note 32 at 17-18.

was filled by *The Marine Insurance Act of 1788*[84] which extended the rule of both precursors to insurance policies made «upon any ship, vessel or upon any goods, merchandise, effects or other property whatsoever...».

Despite the requirement of an insurable interest by these numerous statutes, the courts did not, initially, analyze the nature of this interest. They were mainly concerned by the prohibition of wagering in insurance and did not elaborate a definition of interest. For them, there was an insurable interest in the absence of gambling. In this sense, they were correctly searching to negate any wagering policy instead of insisting on the positive proof of an insurable interest[85].

However, it was sometimes difficult to find out the intent of the insured and to rule if he was gambling. Therefore, the jurisprudence began to describe the kind of interest needed to have an insurable interest in a policy. From this moment, some opposing views conflicted and unfortunately, resulted in a wrong choice of solution. The rule of insurable interest was disassociated from gambling. This misconception of the test of the insurable interest has lasted for almost two hundred years until the Supreme Court of Canada rules otherwise in the Kosmopoulos case[86].

Le Cras v. Hughes[87] was one of the first cases to discuss, to some extent, the concept of insurable interest. An action, based on an insurance policy, was taken by English naval officers and the crew who had captured the Spanish ship «St. Domingo». The ship was lost by perils of the sea during the trip intended to be covered. The insurers denied coverage alleging lack of insurable interest. Lord Mansfield rejected this defence on two grounds: the naval personnel having participated in the capture of the enemy vessel had a legal right on it, conferred by the *Prize Act* and secondly, the insured had an expectation of benefits from the ship originating from the universal practice of grants by the crown. He held consequently that the insured had a sufficient interest in relation to *The Marine Insurance Act*.

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84. 28 Geo. III c.56.
85. A.J. Campbell, «Some aspects of insurable interest» (1949) J7 C.B.R. 1, *Mohring v. Glen Falls Ins. Co.* (1930) D.L.R. 456.
86. *Supra*, note 1.
87. 99 Eng. Rep. 549 K.B. 1782.

In his judgement, Lord Mansfield found two definitions of insurable interest: a legal right in the property insured and an expectation of benefits from this property. Which of these two criteria constituted an insurable interest? This is one of the questions asked in the famous case of *Lucena v. Craufurd*[88] where an inaccurate definition of insurable interest was elaborated and accepted. History bet on Lord Eldon's opinion while J. Lawrence's view was the solution to the gambling in insurance.

Lucena v. Craufurd is another case arising out of the capture of a foreign vessel. Lucena and other Royal Commissioners were authorized by statute to take possession and to sell and dispose of any ships and goods belonging to the subjects of the United Provinces «the Netherlands» when they were brought into British ports. Several Duch vessels were captured and forced into St. Helena «not an English port». The commissioners decided to insure these ships from St. Helena to London, during which voyage they were lost. Meanwhile, there was a declaration of hostility against the United Provinces which happened to be before the loss of the «Zeeleyle» but after the loss of the other ships. Given the war, the Zeeleyle was condemned by law, as a prize to the King.

The insurers refused to pay for the loss of the «Zeeleyle» invoking want of insurable interest for the Commissioners insured. The latters won on the ground that they had acted as agents of the Crown, the new owners of the vessels, following the declaration of war. But the real debate comes from another count, the insurable interest of the Commissioners in their own right a question which all the judges were asked to give their advice.

Lawrence J. concluded that insurance «is applicable to protect men against uncertain events which may in any way be of disadvantage to them[89]». He refused to link interest to property and observed that to confine insurance «to the protection of the interest which arise out of the property» would add «a restriction to the contract of insurance which does not arise out of its nature[90]». Thus, Lawrence enunciated a theory based on indemnity «does the

88. (1806) Bos and Pul 269, 127 Eng. Rep. 630.
89. *Ibid.* at 310.
90. *Ibid.* at 302.

insured economically suffer from the loss?» without requiring that this insured had any property or other legal right in the subject-matter. This theory is now known as the factual expectation test based, according to Keeton, «on a broadly conceived expectation of advantage from non-occurrence of a peril insured against or, conversely, factual expectation of loss from its occurrence[91]».

Lord Eldon chose another avenue. For him, there could never be an insurable interest «unless it be a right in the property, or a right derivable out of some contract about the property[92]». Lord Eldon's conception of insurable interest refers to a right in the property which must be legally enforceable even if it has no value[93]. His narrow position seems motivated by the fear that the factual expectation test of his brother Lawrence, if adopted, would open the door to an invasion of insurance contracts where everybody will seek coverage for anything. For instance, the seamen will insure the ship to protect their wages. The frivolousness of this assertion deserves very little attention. Who can imagine that the seamen will pay twice their annual salary to protect this income or that the insurers will accept the risk?

To sum up the case, Lord Eldon ruled that Lucena et al. had only an insurable interest as agents of the Crown «who became the owner of the ship by virtue of the Prize Act» and not of their own account. For Lawrence, there was insurable interest on both grounds.

These two irreconcilable statements indicate the dualistic definition of insurable interest which took place at the origin. The first view required a legal relationship or property interest enforceable by a court. The other view, the factual expectation theory, rests on one criterion: the loss the insured can suffer from the property destroyed whithout relation to any legal interest in it. Graham B. and six other justices represented a third approach. For them, both aspects had to be present in order to find an insurable interest. This requirement of an expectancy, added to a legal right, was adopted by Professor Vance[94]. It is however a middle-ground

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91. Keeton, *supra*, note 35 at 99.
92. *Lucena v. Caufurd*, *supra*, note 88 at 321.
93. *Ibid.* at 322, 323, 324.
94. Vance, *supra*, note 42 at 157-158.

solution which falls within the two major definitions and does not help to clarify the basic debate on the rule of insurable interest.

What happened to this division? Afterwards, most of the Common law jurisdictions opted for the illogical approach of Lord Eldon. I can see two explanations to this choice. First, the test of Lord Eldon is very simple to apply. It is a test based on property which consists to determine if the insured has a right, a whether legal or equitable. The solution described by Lawrence J. seems, a priori, more complex. Second, Eldon was Lord Chancellor, which was the highest judicial office in England at that period. Lawrence J. was less known and famous. In these circumstances it was held in subsequent English cases, that the captors of ships could insure their new vessel as long as they had a vested right under the *Prize Act*. But if they lacked such right, they had no insurable interest even if they had an expectation of profit from a grant by the Crown[95]. It was the triumph of his Lordship whose theory would be applied in England, in Canada and in the vast majority of American States and whose view would lead to an incoherent and inappropriate doctrine of insurable interest.

2.3- From Lucena (1806) to the Gaming Act (1845)

The next important step was the adoption of *The Gaming Act* in 1845[96]. *The Life Insurance Act of 1774* applied only to insurance policies and every gaming contract expressed under another form than insurance was outside its scope[97]. By *The Gaming Act*, all contracts by way of gaming or wagering were held void, irrespective of their form and nature. This intervention was welcomed by the English judges who had manifested their disagreement with the jurisprudence validating the gambling transactions.

There was no reason to distinguish between a gambling contract in insurance or in another form. The evils of gambling had clearly appeared in insurance and they led the way to a general consensus that any gambling contract was against public policy and should therefore be unenforceable. The institutionalization and industrialization of gambling, in modern society, was obviously not

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95. *Routh v. Thompson* (1809) 11 East 428, *Deveaux v. Steele* (1840) 8 Scott 637.
96. *Supra*, note 34.
97. *Supra*, note 79. Also *Roebucks v. Hammerton* (1778) 2 CowP 737, *Paterson v. Powell* (1832) 9 BING 320.

stranger to this policy. The British had finally reached the same conclusion as the Americans. From now on, the policy against gambling was clearly connected to the requirement of an interest in an insurance policy. The *Act of 1845* was the logical consequence of the position taken in 1746, 1774 and 1788. For the future, insurance contracts other than marine, were subject to *The Life Assurance Act of 1774* and to the more general *Gaming Act of 1845*.

2.4- From the Gaming Act (1845) to the Decision of Macaura (1925)

The law of insurable interest kept on developing on the concept of property. A simple expectation of benefit from the preservation of the insured property «or an expectation of loss from its destruction» was not enough unless it was founded on legal rights[98].

However, an American case, *National Filtering Oil Co. v. Citizen's Insurance Co.*[99], decided that a personal contractual right linked to the insured property could be sufficient if the former was so related to the latter and «so much dependent for value upon the continued existence of it alone, as that a loss of the property will cause pecuniary damage to the holder of the right against it[100]».

In that case, a patentee, entered into an agreement with a manufacturer. In exchange for the patent rights, the manufacturer was paying him some royalties. To secure his income, the patentee insured the manufacturer's plant. The court held that the patentee had an insurable interest in the plant since its contractual rights to royalties were directly contingent upon the continued existence of the plant.

Keeton commented that the absence, by the patentee, of a legal or equitable interest in the plant amounted to an acceptance of the factual expectation test by the court. Nevertheless, it must not be forgotten that there was a specific contractual relationship between the parties. This important aspect considerably influenced the judgement. It seems therefore doubtful that this case relies

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98. *Royal Exchange v. Swiney* (1850) 14 Q.B. 646, 117 E.R. 250.
99. (1887) 13 N.E. 337' 106 N.Y. 535.
100. *Ibid.* at 541.

categorically on Lawrence's approach. Instead, it describes a contractual right as supporting an insurance policy on property when there is a close link between this property and the object of the contract. It seems that such a contractual relationship had already been accepted by Lord Eldon in *Lucena*[101].

A better example of broad acceptance of the expectation test comes from a Massachusetts case where a consignee of goods to be sold on commission had no contractual or legally enforceable commission rights, but was held to have an insurable interest in the goods shipped[102].

Apart from a very few cases, Lord Eldon's statement was generally applied in most States. For instance, in two judgements from Maine, it was ruled that the insured had to prove the existence of an insurable interest in the nature of a legal or an equitable right over the property insured[103]. The specter of the seaman was still present.

In a Pennsylvanian case[104], the court denied recovery to a turnpike compagny that had obtained an insurance policy on a bridge. The bridge was not owned by the company but it was an essential means of access to the turnpike and the company had voluntarily contributed to a third of its cost of erection. After the destruction of the bridge, the insurer pleaded absence of insurable interest because the company had no right enforceable in law or in equity, on this property. This defence was maintained by the court.

Notwithstanding this, most American cases recognized an insurable interest to the shareholder of a company on the assets belonging to the latter. It was justified on the grounds that the shareholder had a legal and distinct right to receive dividents and to share the value of the company in the case of dissolution[105]. Still,

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101. *Supra,* note 92.
102. *Putnam v. Mercantile Marine Ins. Co.* (1843) 46 MASS 386.
103. *Clark v. Dwelling House Ins. Co.* 81 Me 373 (1889); *Trott v. Woolwich Mutual Fire Ins.* 83 Me 362 (1891).
104. *Farmer's Mut. Ins. Co. v. New Holland Turnpike Co.* 122 PA ST 37 (1888).
105. *Actna Ins. Co. v. Kennedy* (1909) 161 ALA 600; *Seaman v. Ins. Co.* CCMO (1883) 18 F 250: *Warren v. Davenport F. Ins. Co.* (1871) 31 Iowa 464; *Riggs v. Commercial M. Ins. Co.* (1890) 125 N.Y. 7, 25.

it is a situation of narrow relationship between the shares, on which the insured has a contractual right, and the property insured. In this sense, it derivates from a contractual right as found in *National Filtering*.

During that time, in England, the courts had softened their position. In two successive cases[106], the courts allowed two shareholders to recover the insurance proceeds following the destruction of a sub-marine cable. This cable was built and owned by the compagny but the shareholders had insured it in their own name[107]. It is in one of these decisions that Blackburn J. endorsed the position of Lawrence J.:

> I know no better definiton of an interest in an event than that indicated by Laurence J. in *Barclay v. Cousins* EAST 544 and more fully stated by him in *Lucena v.Cauford* 2 Band P.N.R. at p. 301, that if the events happens, the party will gain an advantage; if it is frustrated, he will suffer a loss[108].

In Canada, there was no specific case of factual expectation at that period. In *Clark v. Scottish Imperial Ins. Co.*[109], the Supreme Court accepted the test of Lord Eldon and held that: «an insurable interest is not confined to a strict legal right of property[110]» but can be any interest, in the property insured that a court of law or equity would recognize. In other words, a legal or an equitable right originating from a valid and enforceable contract between the parties was held sufficient while a mere expectancy or probable interest was not accepted.

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106. *Paterson v. Harris (1861) 121 E.R. 740; Wilson v. Jones* (1867) L.R. Exch. 139.
107. It seems that in *Patterson*, the shareholder had insured the cable while in *Wilson* he had insured his interest in the adventure (the company).
108. *Wilson v. Jones, supra*, note 106 at 150.
109. (1879) 4 SCR 192.
110. *Ibid.* at 204.

In that case Clarke had advanced money to the builders of a vessel. There was a verbal agreement by which Clarke would have a security on the vessel when completed. Clarke took out an insurance policy on the vessel which was burned when unfinished. The Court held that he had an equitable interest, thus an insurable interest in the ship.

Then in 1906 the British Parliament enacted a new *Marine Insurance Act*[111] which repealed totally the precedent Act of 1746 and the part of the 1788 Act pertaining to Marine Risk. The 1906 Act voids any contract of marine insurance made by way of gaming and wagering and, for the first time, defines the insurable interest. Section 5 insists upon «a legal or equitable relationship» which, in marine insurance, seems to exclude the factual expectation theory although the definition is far from being clear and exhaustive. Section 6 of the Act specifies that an insurable interest must exist at the time of the loss without necessity of interest when the insurance is effected.

As we saw before, it was in 1912 that Ontario adopted its own *Gaming Act* which was a codification of the existing jurisprudence.

2.5- The Macaura case (1925)

Until the judgement of the House of Lords in *Macaura v. Northern Assurance Company Ltd.*[112] there was some hope that the factual expectation test would be adopted in England and in Canada as the basic rule of insurable interest. Unfortunately the Macaura case put an end to this expectation and brought out a harsh reality, the requiem of Lawrence J.'s view on the law of insurable interest. While it did not explicitly mention it, the House of Lords overruled its previous decisions in *Wilson v. Jones* and *Patterson v. Harris*[113].

In that case, the plaintiff, Mr. Macaura, was the owner of the new Killy-moon estate. He sold the timber on this estate to a new company of which he and his nominees were the only shareholders. The price of the sale, 42,000 £, was paid to Macaura by emission of

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111. (1906) 6 Edw. 7 C-41.
112. (1925) A.C. 619.
113. *Supra*, note 106.

42,000 shares. Then macaura advanced 19,000 £ to the company for the falling operations. He did not take a lien on the timber to secure payment of his debt. Macaura obtained five policies of fire insurance on timber situated on the estate. The greater part of the timber was later destroyed.

Macaura claimed from the insurer for the value of its loss. The insurer refused to pay alleging a lack of insurable interest. The House of Lords agreed with the contention of the defendant. Their Lordships ruled that the plaintiff had no insurable interest in the timber either as a shareholder or unsecured creditor of the company since it was the company's assets, in which Macaura personally had no legal or equitable interest.

For Lord Buckmaster, there was a need for a legal right on the property and a factual expectation of loss was not sufficient: «I find... a difficult in understanding how a moral certainty can be so defined as to render it an essential part of a definite legal proposition[114]».

Curiously, one of the main reasons given by his Lordship to reject the right of a shareholder to insure the company's assets pertains to the almost impossible calculation of the interest of the shareholder in the whole property. It is true that this evaluation can sometimes present some difficulties but certainly not in this specific case where Macaura was the sole shareholder. Yet more amazing is the contradiction in Lord Sumner's judgement who found that «no gaming contract was ever made[115]» but who ruled that Macaura had no interest in the insurance policy[116]. He kept on saying that gambling has no relation to the requirement of an insurable interest but that in insurance, the latter comes from the notion of indemnity. Lord Sumner should have explained why an insurance contract sticks to indemnity. Maybe he would have seen the foundation missing to his reasoning and could have reached Lawrence's solution which is far more rational.

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114. *Supra*, note 112 at 627.
115. *Ibid.* at 632.
116. As Brown and Menezes write: «... a Common law rule aimed at preventing an insured recovering more than he lost is to be applied without reference to one of the principal reasons for which the rule exists, namely ot ensure that the insured does not recover more than his actual loss». *Supra*, note 52 at 82.

It must be noted that this case involved charges of fraud which possibly influenced the result. If so, it is really sad to find that such a basic case of the law of insurable interest originates from a desire of the court to deprive a suspected fraudulent insured of its claim.

Macaura clearly relies on the property concept as criterion of insurable interest. It rejects the factual expectation test. Thus, a shareholder has no insurable interest in the company's assets and an unsecured creditor has no insurable in his debtor's properties. This decision would be later specifically referred to by the Canadian courts[117]. Nevertheless, it has been ignored by most American States which without adopting the factual expectation test, hold that a shareholder may insure the property of the company[118].

2.6- From Macaura (1925) to Aqua-Land (1966)

Following the decision in *Macaura*, we can summarize the law of insurable interest as follows: An insured will be held to have an insurable interest if he has a contractual or proprietary right, whether legal or equitable, in the property insured which will be enforceable by the courts. In Canada, the contractual right applies only if the insured is a secured creditor or if he is allowed to specific performance upon the property in the case of breach of obligation. In the United States, the definition of contractual right is less restrictive[119].

Another type of insurable interest has also been developed during that period, the legal liability. An insured has an insurable interest in the property if the destruction of this property causes him an economic disadvantage in the form of legal liability[120]. In other words, the fact that an insured can be held legally liable toward another person as a result of the event insured confers him an insurable interest. It is not a policy of liability insurance but a

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117. *Guarantee Co. of North America v. Aqua-Land Exploration Ltd.* (1966) S.C.R. 133 *Zimmerman v. St. Paul Fire and Marine Ins. Co.* (1967) 63 D.L.R. (2d) 282.
118. *Supra*, note 105.
119. *National Filtering Oil Co., supra*, note 99.
120. Harnett and Thorton, *supra*, note 2 at 1170-1171.

«legal liability» insurable interest in the property. For instance, the builder legally liable to the owner for the completion of the contract has an insurable interest which is sufficient to support a builder's risk policy covering the premises during the construction[121]. Most of the times, this category of insurable interest comes from a contractual duty of the insured «vis-à-vis» the property.

As we can see, an insurable interest was not strictly confined to an interest arising out of the strict ownership. It must however be more than a mere expectation of loss in case of destruction of the property insured. Except in some rare cases[122], the factual exception of Lawrence was rejected. In 1948, Harnett and Thorton[123], in an excellent article, argued in favor of a change in the doctrine of insurable interest. They re-evaluated the existing law and showed that the factural expectation of damage test, which embraces all other, should be adopted as the only real test of insurable interest. Doing so, these learned American authors exposed the theory of Lawrence J. Unfortunately, their criticism was ignored by most Common law jurisdictions. The state of New York was one of the rare states to define broadly enough the concept of insurable interest to include the factual expectation approach[124].

In Canada, any hesitation to this effect was dissipated by the *Aqua-Land* case[125]. In that decision, the Supreme Court of Canada

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121. *Liverpool and London Globe Ins. Co. v. Crosby* 299 US 587 (1936), 83 F (2d) 647; *Brooklyn Clothing Corp. v. Fidelity Phoenix Ins. Co.* 200 N.Y. Supp. 208 (1923); *Rice Oil Co. v. Atlas Ass. Co.* 102 F (2d) 561 (1939).
122. *Spencer v. Continental Ins. Co.* (1945) 4 D.L.R. 593 (BCSC). *Hecker v. Commercial State Bank* 159 N.W. 97 (1926). Also *supra*, note 133. *Washington Fire RElief Ass. v. Albro* 241 Pac. Rep. 356.
123. *Supra*, note 2.
124. (1985) N.Y. Insurance Law, Vol. 18A sect. 340: «... the term insurable interest shall include any lawful and substantial economic interest in the safety or preservation of property from loss, destruction or pecuniary damage». See also: California Insurance Code, para. 281, Louisiana Insurance Code R.S. 22: 614 para. 614 b) and Utah Insurance Code S. 31 a) 21-104 (2d).
125. *Supra*, note 117.

had the opportunity to express its view on the whole concept of insurable interest in property. It was an occasion for the court, to reverse the narrow definition of insurable interest given earlier. The result was a disaster. The court fully relied on Lord Eldon's opinion in *Lucena* and consequently concurred with the judgement in *Macaura.*

The facts were the following: The plaintiff Aqua-Land Inc., agreed with Messrs. Bodi and Bowland to execute a contract by which a new company, M. Ltd, would be incorporated in order to take delivery, from A. Co., of a drilling tower to be used for Aqua-Land's operations. This tower, built by A. Co., was to be transferred in absolute property to the new company for the sum of $39,200. This sale was never approved by the shareholders of M. Ltd. It was further agreed that, in return of preference shares Aqua-Land would contribute $39,000 in the new company while Bodi and Bowland would transfer all their rights, title and interest in the new invention «the tower». An advance of $30,000 on the tower was made by Aqua-Land to the builder A. Co. The plaintiff, Aqua-Land, took out an insurance policy, in its own name, with the defendant insurance companies. The policy covered, among other things, the tower under construction. Six days later, before it had been delivered by A. Co. to M. Ltd, the tower was destroyed during a storm.

Aqua-Land filed a proof of loss saying that the tower was owned by A. Co. but that it had an insurable interest by reason of its monetary interest in the tower either as shareholder of M. Ltd or as creditor. The trial judge and the Ontario Court of Appeal found that Aqua-Land had such an insurable interest in the tower, more specifically «a right derivable out of some contract about the property». This decision was reversed by a majority (3-2) of the Supreme Court. However, it seems that even the two dissenting judges were not willing to accept the factual expectation test.

Writing for the majority, Ritchie J. relied on the definition of insurable interest as given by MacGillivray. It is the definition of Lord Eldon expanded to cover the legal liability foundation. He concluded that M. Ltd, the new company, was the only person, except A. Co. who could have an interest in the tower given the agreement with the builder A. Co. Aqua-Land had no right in respect of the tower since it had no interest on it which would be enforced by a court of law or equity. He was simply a shareholder of M. Ltd. Furthermore, he was not a creditor of A. Co. since the

payment, at the end, came from M. Ltd, to whom Aqua-Land had paid the partial cost of its shares. Even if the $30,000 received by A. Co. were to be treated as a loan made by Aqua-Land on its own behalf, the latter was not secured by a lien or charge on the tower. Following *Macaura*, there was no legal insurable interest for Aqua-Land.

The two dissenting judges held that Aqua-Land had an insurable interest derived out of a contract. For them, there was no contract between A. Co. and M. Ltd but between the former and Aqua-Land, Bodi and Bowland. Thus, one of the three partners could have sued A. Co. for specific performance if it had refused to deliver. Consequently, Aqua-Land had a contractual right enforceable by equity and therefore, an insurable interest on the subject-matter of the contract. The court analyzed the whole case in the context of legal or contractual enforceable right. It did not question the origins and the intent of the rule of insurable interest. Where was the gambling? With that case, the discrepancy between gambling and insurable interest increased at the same speed as the irrationality of the doctrine.

2.7- Insurable interest in Quebec Civil Law

What happened during that time in Quebec? The requirement of an interest, in an insurance contract, appeared when Civil Code was drafted in 1866[126] Section 2472, which was applicable to all kinds of insurance at this time stipulated: «All persons capable of contracting may insure objects in which they have an interest and which are subject to risk». With the insurance reform of 1974[127], the necessity of insurable interest in property insurance was specifically acknowledged by Section 2582 cc which says that «The Insurance of a property in which the insured has no insurable interest is without effect».

By contrast with Common law jurisdictions, the Civil law legislation gave a definition of insurable interest. Adopted in 1866 and almost unchanged in 1974, this definition, specific to property

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126. Although the codifiers did not explain the reason of this rule, we can imagine that it was adopted to prevent gambling like elsewhere. This view is supported by the old section 2480 c.c.
127. *Insurance Act*, L.Q. 1974 c. 7.

insurance, is found in section 2580 of the Civil code: «A person has an insurable interest in a property whenever he may sustain direct and immediate damage by its loss and deterioration. Future property and incorporeal property may be the subject of a contract of insurance».

Until 1976, this definition was more detailed, in fire insurance, by section 2571 c.c.: «The interest of an insured against loss by fire may be that of an owner, or of a creditor, or any other interest appreciable in money in the thing insured; but the nature of the interest must be specified». This latter section has been abolished.

As one can see, the Civil code did not restrict the meaning of insurable interest to a property test. In fact, the definition given by the code was more linked to Lawrence J's conception it was related to the strict view of Lord Eldon. Hence, I submit that the statutory definition of insurable interest was broad enough to adopt the factual expectation of loss as the sole test of insurable interest in the province of Quebec. The Courts had, in their hands, the legislative tool necessary to implement this radical change toward rationality. Unfortunately, this apparent facility offered more resistance than if it were non-existent.

Indeed, the insurable interest, in Quebec, rested on the same property test than in the Common Law provinces. The Courts frequently refered to the views of Lord Eldon, sometimes by quoting him expressly[128] sometimes by adopting its basic idea[129]. This was probably due to the fact that property insurance policies had developed earlier in England than in France forcing the Codifiers to introduce English sources. Beaudoin notes:

> C'est dans le droit anglais, dans le droit américain et parfois dans les vieux auteurs du droit français, qu'ont été tirées les règles fondamentales, notamment celles de

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128. See e.g. *Cie Equitable d'ass. Contre le Feu v. Bédard* (1959) B.R. 870; *Desrochers v. Cie d'Ass. Guardian du Canada* (1978) C.S. 7; *Diotte v. Guardian Ass. Ltée* (1977) C.S. 306.
129. *Comm. D'Ecoles de St-Eugène d'Argentenay v. Baloise Fire Ins. Co.* (1944) C.S. 19; *Tremblay v. La Protection Universelle* (1975) C.S. 20.

> l'intérêt du contrat d'assurance. Les codificateurs notent en effet que: «nos polices sont invariablement dans la même forme de celles qui sont en usage en Angleterre[130]».

Although it had been mainly developed through the property channel, the insurable interest, in Quebec civil law, was not in perfect harmony with its Common law counterpart. The main reason comes obviously from the difference in the property law theory of both systems. The Civil law does not distinguish between legal and equitable title. It recognizes some «démembrement du droit de propriété» but they differ from the Common law concepts. Therefore, every person having, in Common law, a legal or equitable title as source of insurable interest, does not necessarily have an equivalent proprietary right in Civil law. Thus, the representative of a deceased has no property rights in the assets he administers. Equally, the concept of trust does not exist in Civil law unless specifically created by a law, which is very rare.

Secondly, the property requirement, in Quebec, had been motivated by other devices than those known in Common Law. For instance, in the *North Empire Fire Ins. Co. v. Vermette*[131], the Supreme Court of Canada denied an insurable interest to a person acting as nominee for another. In doing so, the Court referred to Statutory Condition 10 of the policy[132] and held that the insured must own «à titre de propriétaire» the insured property. By such reasoning, the Court implied that an insured must be the owner of the property «unless he otherwise specified», something quite far from the factual expectation test. In *Morrissette v. Cie d'Assurance Les Provinces-Unies*[133], MacKay J., after referring to *Vermette*, wrote:

> «... the word possedee as used in statutory condition no. 10 of a fire insurance policy means owned as owner, and therefore a policy which covers property which is not

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130. L. Baudoin, *Les Assurances Terrestres* (Montréal: Les Editions Scientifiques, 1960) at no. 33. See also opinion of Monet J. in *American Home v. Champagne* (1981) CA 1 at 10.
131. (1943) S.C.R. 189.
132. The exact equivalent of Statutory Condition 2 in Ontario.
133. (1973) C.S. 102.

owned by the insured as its real owner lacks a material element essential to its validity and is null and void in virtue of the provisions of articles 2480 c.c.[134]»

It is interesting to see how this condition, aimed at limiting insurance on behalf of others, served to qualify the test of insurable interest that one must satisfy to insure a property. Moreover, the old section 2571 c.c. used to require that the nature of the interest be specified. The Courts decided that when this interest was not disclosed, it was presumed to be that of an owner[135], making this quality compulsory for every insured lacking to let on his real interest.

As we can see, the need of a property interest was not very convincing in Civil law. Its grounds were doubtful. In fact, the Civil law tried to copy a Common law rule which was irrational in its own system. The result is easy to imagine. It created a case by case doctrine. For example, in *Comm. d'écoles de St-Eugène d'argentenay v. Baloise Fire Ins. Co.*[136], the owner of a house in construction was not allowed to insure it because it was under the responsibility of the builder while in *Alliance Ass. Co. v. McLean*[137], the owner was allowed to insure up to the amount he had previously paid to the builder.

Futhermore, Statutory condition 10 had been abolished in 1976 by the *Insurance Act*[138]. Section 2571 had been subjected to the same destiny. Hence, there were no reasons to keep the irrational property rule. The Courts should have stopped referring to the property test. They should have gotten rid of it and interpret section 2580 c.c. as a factual expectancy test. They did not do so except for Mr. Justice Pigeon which, in 1977 in the *West-End*[139]

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134. *Ibid.* at 104. This interpretation has been contested by The Supreme Court in *Commerce and Industry Ins. Co. of Canada v. West-End Ins. Co.* (1977) 25 C.R. 103.
135. *Cie d'Ass. Stanstead and Sherbrooke v. Fabi* (1960) B.R. 601.
136. *Supra*, note 129.
137. (1920) 27 R.G. 8 (B.R.).
138. *Supra*, note 127.
139. *Supra*, note 134.

case, seemed to open the door to Lawrence's view given the test of Section 2580 c.c. This was a prelude to the *Kosmopoulos* case. In this case, Mr. Pigeon recognized that a possessor, here a tenant, may have an insurable interest in the property of others when he may be found liable.

2.8- The Kosmopoulos case

Until the Kosmopoulos[140] case, the canadian law of insurable interest rested on views expressed in the *Aqua-Land* case. Thus, a valid policy of insurance required that the insured have a proprietary or a contractual right, whether legal or equitable, upon the property insured, which would be enforceable by the courts. An insured also had an insurable interest on a property which could make him legally liable toward third parties if the risk was realized. A simple expectation of loss resulting from the destruction of the property insured, without legal interest, was not sufficient to confer an insurable interest to the insured.

Until then, Canadian Insurance Law had endorsed the view of Lord Eldon instead of the more realistic solution of Lawrence J. This situation gave rise to injustices suffered by the insured. The case of *Chadwick*[141], buyer in good faith of a stolen car, provided a good illustration of the incorrectness and the inequity of this former rule. The legislator did not seem preoccupied by these problems. Thus, the *Insurance Act*[142] of Ontario contained no section on insurable interest in property. The lack of intervention of Parliament in this field remained unexplained. In Quebec, the factual expectation seemed to fit the Civil Code's definition but he Courts had always ruled otherwise[143].

But, then, came the litigation opposing M. Kosmopoulos to its insurer. At first glance, the case seemed clear. Mr. Kosmopoulos had no chance to win given his lack of insurable interest according to the existing definition. But he went to court fought and finally got

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140. *Supra*, note 1.
141. *Chadwick v. Gibraltar Insurance Co.* (1981) 34 O.R. (2d) 488.
142. R.S.O. (1980) c. 218.
143. Except for a certain opening by Mr. Justice Pigeon in *Commerce and Industry Ins. Co. of Canada v. West-End Investment Co.*, *supra*, note 134.

judgment in his favour. Not one time but three times from the Supreme Court of Ontario up to the Supreme Court of Canada. This was the end of Lord Eldon's test and resurrection of Lawrence J. definition. This was a complete reverse of the canadian law of insurable interest.

The facts were as follows: Mr. Kosmopoulos, a Greek immigrant, opened a leather good store in Toronto. To carry on his business he incorporated a company of which he was the sole shareholder and director. The store was known as Spring Leather Goods. In order tor protect the company's «therefore his» assets, he obtained insurance coverage by its insurance agent. On the policy issued, the insured was described as Andreas Kosmopoulos o/A Spring Leather Good. A fire destroyed part of the leather goods store and Mr. Kosmopoulos claimed from the loss. The insurance company refused to pay invoking that only the company and not Kosmopoulos, had an insurable interest in such a policy.

The trial judge gave judgement for the insured. This decision was confirmed by the Court of Appeal. In its judgement, Zuber J. first referred to the definition of Lawrence J. in *Lucena*[144]. Then he analyzed *Macaura*[145] and distinguished that case on the ground that there were three shareholders while here Mr. Kosmopoulos was the sole shareholder of the business he owned entirely. He further added that the Supreme Court of Canada, in *Aqua-Land*[146], had accepted the «ratio decidendi» of *Macaura*[147] only to the extent necessary to decide it, that is to say that one shareholder out of three have no insurable interest in the assets of the corporation. He then stated: «I do not read the Aqua-Land judgement to exclude the concept that the sole owner of a corporation can have an insurable interest in the assets of the corporation[148]».

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144. *Supra*, note 88.
145. *Supra*, note 112.
146. *Supra*, note 117.
147. *Supra*, note 112.
148. *Ibid.* at 82.

Mr. Justice Zuber quoted an American case[149] and stated that the unique shareholder should be held to have an insurable interest in the company's assets. For him, the rigidity of the *Macaura* rule was not indicated in that specific case. Curiously, he mentioned that its principle was in perfect agreement with *Lucena v. Craufurd*[150].

Although he avoided the strict definition of Lord Eldon, M. Justice Zuber did not really overrule his Lordship. He dealt with the specific facts of the case and did not expressly state a new general definition of insurable interest. In other words, the old theory was still alive.

The decision was appealed to the Supreme Court of Canada. There, the opposing views of Lawrence and Eldon were at stake and the Court had an opportunity to either confirm its position in *Aqua-Land* or litteraly modify the concept of insurable interest applied in Canada. The argument was heard on November 6, 1985 and judgment came out on January 29, 1987.

The Court did take a long time to render its decision. But the result was worth the expectation. The Court adopted Lawrence J.'s factual expectancy test as the sole definition of insurable interest. In doing so, the Court reversed the existing Canadian Law and consequently its own position on the subject. It rejected the precedent established by the English case of *Macaura*[151] which had been followed by the Canadian cases of *Clarke*[152], *Aqua-Land*[153] and *Wandlyn Motel Ltd*[154].

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149. *American Indemnity Co. v. Southern Missionary College* (1953) 260 S.W. (2d) 269.
150. *Supra*, note 88.
151. *Supra*, note 112.
152. *Supra*, note 109.
153. *Supra*, note 117.
154. *Wandlyn Motel Ltd v. Cie d'Assurance Générale de Commerce* (1970) S.C.R. 992.

The decision is unanimous. It was written by Madame Justice Wilson. Four other judges concurred entirely with her position. Even if he agreed with the result, Mr. Justice McIntyre did not suscribe to the total rejection of Lord Eldon's theory. Instead he adopted the approach taken by Mr. Justice Zuber in the Court of Appeal.

The judgment is quite extensive and well reasoned. It recognizes that the fundamental rule of insurable interest has never been deeply analysed, in the past, by the Canadian Appellate Courts. Mme Wilson leaves no doubt on her intention to examine and modify it when she writes:

> «... it is my view that if the application of a rule leads to harsh justice, the proper course to follow is to examine the rule itself rather than affirm it and attempt to ameliorate its ill-effects on a case-by-case basis[155]».

I think that this affirmation illustrates very well the status of the law of insurable interest as it was before and the need there was to examined and modify it. This approach is welcomed and should be repeated whenever possible in order to reevaluate some other concepts of insurance which tolerate «harsh justice».

The insured invoked three arguments before the Court. The first one deals with coporate law and was rejected on the basis of *Salomon v. Salomon*[156]. In the second one the insured took the position that he was bailee. The Court dismissed this argument considering that the bailor was still in possession negating any bailment. The dismissal of this second argument allowed the Court to consider the main and the most interesting argument, the third one. Thus the question became: Is the definition of Lord Eldon the law in Ontario and if yes, should we change this law?

The first part of the answer was not a surprise. The Court reviewed the history of the rule of insurable interest in Canada and concluded that Lord Eldon's definition was the one adopted by the Canadian courts.

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155. *Supra*, note 1 at 10.
156. (1897) A.C. 22.

However, this analysis allowed the Court to discuss the arguments raised by Lord Eldon to justify its restrictive definition: certainty of the rule and control of insurance contracts. On the first count, Mme Wilson noted that the actual test produced more uncertainty and technical objection that would have produced a factual expectancy test. On the second one, she correctly observed that insurance contracts are socially good given their indemnity goal and that insurers can directly control this activity in refusing coverage or asking for larger premium.

Then, Mme Wilson showed how the problem evaluation of shareholder's interest, expressed by Mr Justice Buckmaster in *Macaura*[157], did not justify the legal right definition. She concluded that if it had been done in the past, it can certainly be done again. Further more, she insisted on the fraud connotation that there was in *Macaura* and which «weakens the authority of *Macaura* as precedent». We can add the fact that the calculation problem is not present when there is only one shareholder as there was in the present case. Finally, Mme Wilson quoted the presumption established in *Stock v. Inglis*[158] indicating that this presumption was an answer to the «arbitrariness and harshness of the *Macaura* principle».

It is with these elements in mind that Mme Wilson studied the second question. To decide if *Macaura* is good law, she examined the policies it underlies. She did not discuss the correctness of these three policies. But she clearly made the proof that these policies do not support Lord Eldon's definition. On the opposite, these policy are better served by the factual expectancy test. Hence, she concluded that Laurence J.'s approach was a better definition of insurable interest and she accepted it as the new test of insurable interest in Canada getting rid of the legal and equitable title requirement[159].

This is now the law of insurable interest in Canada and, according to me, in Quebec.

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157. *Supra,* note 112.
158. (1884) 12 Q.B. 464, 571.
159. For a more detailed analysis of this case, see D. Dumais, «L'arrêt Kosmopoulos de la Cour Suprême: une réforme majeure de la notion d'intérêt assurable» (1987) 47 R. du B. 482.

CONCLUSION

As we can see, the conclusion reached in *Kosmopoulos* is in perfect relation with the policies it pursues. It is aimed at preventing gambling in the insurance industry. It consists of answering the following question: Does the insured have an economic advantage of the existence of the insured property or to put it differently will he suffer an economic loss if the property is damaged? The measure of this economic interest constitutes the extent of the insurable interest, and, of course, it negates gambling.

The Supreme Court of Canada has deeply reevaluated the concept of insurable interest through its policy and its history. No doubt that this reform was welcomed. It put the definition of insurable interest in perfect harmony with its raison d'être. Hence, the test of insurable interest should stay the same as long as the policy remains unchanged. If ever gambling is totally accepted in our society, the rule should certainly be reevaluated. But until then, we have no reasons to modify it.

Finally, let us hope that the approach taken by the Supreme Court will be repeated whenever possible in order to reevaluate some other concepts of insurance law which tolerate «harsh justice».