Kosmopoulos Case: Reevaluating the Requirement of Insurable Interest

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For centuries, people of this land have been prevented from purchasing life or property of strangers because such insurance incentivizes policyholders to end the life or destroy the property in order to collect insurance monies. The law thus creates a requirement of 'insurable interest' in the life or property so insured without which any contract or policy agreement would be rendered invalidated and unenforceable as againstpublic policy considerations[2]. The present note attempts to analyze the case of *Constitution Insurance Company of Canada v. Andreas Kosmopoulos and Kosmopoulos Leather Goods Limited*,[3] which broadens the definition of insurable interest while rejecting the long established narrow approach of Macaura Principle in Ontario. The first part of note analyses the definition of insurable interest in property and critiques the Macaura principle in light of the case. The second part of note while praising the expansive definition of insurable interest as adopted in the case also pinpoints certain loopholes in the same which the judges should have given due consideration. The note in light of present case proceeds to question the requirement of insurable interest itself and argues that the doctrine creates perverse incentives and inefficiency byencouraging the very practice, which it seeks to deter. It concludes on the note that the best way to address this problem would be to remove such requirement in the first place.

In Kosmopoulos case, the respondent Kosmopoulos incorporated his leather and goods business into a company and became sole director and shareholder of the company. All the documentation and lease agreement continued in the name of the respondent with no reference to the company. The fire insurance policy on the assets of the business premises was also obtained in the name of respondent even though the insurance agency was well aware that the incorporated company carried on the business. Later on account of fire,the appellant company refused payment for damages on the ground that the respondent had no insurable interest in the asset of the company. The court of appeal while ascertaining the true nature of insurable interest adopts the broader test of 'factual expectancy' stated by Lawrence

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2 J Loshin, *Insurance Law's Hapless Busybody: A Case against the Insurable Interest Requirement,* 117(3) TYLJ 474, 474(2007),

3 (1987) 1 S.C.R. 2.

J. and rejects the restrictive approach of Lord Eldon, a precedent strictly followed in previous cases on insurable interest.

The governing principle as stated by Lord Eldon in the case of *Lucena v. Craufurd*,[4]which also served as a precedent in *Macaura*[5]and other cases was that the insurable interest must be enforceable in nature. Thus the contingency of advantage or loss must depend on some right, contractual or proprietary, legal or equitable which is more than a mere expectation or hope and is enforceable in the court of law. The Court was right in rejecting this principle because firstly, as the court pointed out that the implementation of underlying public policies behind the requirement of insurable interest i.e. (i) the policy against wagering (ii) policy favoring limitation of indemnity (iii) to prevent destruction of property insured only favors the broadening of the definition of insurable interest. The MacauraPrinciplefail to show as to how by showing some kind of valuable relationship to the property instead of a particular legal nature of relationship will not be able to advance such policies. Secondly, it is a narrower approach because of the fact that it does not cover all kinds of insurance whereas the factual expectancy test tends to cover cases in the field of life and health insurance too.[6] Thirdly,it could be observed that the rigidness of the definition has itself seem to be dilute with time as depicted by later cases like*Zimmerman v. St. Paul Fire and Marine Insurance Co*,[7] Here, it was observed that the only effect of Macaura definition in such a case would be to 'trap the unwary person whose principle truly satisfies the principle of indemnity rather than to advance that principle'.

I also feel that the definition should be expanded or restricted keeping in mind the contemporary world changes and implication of such approach on business. Modern Company laws (even in India) now permit creation of companies with only one shareholder and director. In such cases it will be unreasonable to state that the sole proprietor does not have an insurable interest in the company's assets. The implication of the same on the business would also be grave and arbitrary because the restrictive definition, by recognizing only certain kinds of rights and interest claimable only proves to be detrimental to the insured, which certainly has some sort of valuable/ pecuniary relationship to the property and has a genuine cause if seen from a broader lens.Lastly, such restrictive approach goes against the settled law that court should lean in favor of finding insurable interest where possible. It is quite unattractive position for insurers to take the premium and later deny the existence of

[4](1806) 2 Bos&Pul MR 269.
[5]Macaura v. Norther Insurance Co Ltd,(1925) AC 619.
[6]*Ibid.*
[7](1968) 1 D.L.R. (3d) 277.

insurable interest when faced with in otherwise legitimate claim. Thus, the definition should not be rigid to the extent that it deliberately ends up causing detriment to the innocent insured.[8]

Hence the Court was right in adopting the 'factual expectancy test,' which was broader, rational and more practical in terms of determining insurable interest. According to the test insurable interest implies'to be interested in the preservation of a thing, is to be so circumstanced with respect to it as to have benefit from its existence and prejudice from its destruction'. Thus a moral certainty of profit or loss in a property was seen as a sufficient interest. Based on this definition, the court in the Kosmopoulos case observed that the respondent had an insurable interest in the assets of the company. The judgment is praiseworthy primarily because of three reasons. Firstly, it takes into accountsociological implications of the same on insured's business. It analyses as to how sole proprietorship and other forms of property insurances claimed by insured would be prejudiced with such restrictive approach. Secondly, the judgment puts additional liability on the insurer companies and tends to lean in favor of insured by stating that 'excessive insurance and difficulty in calculation of risk to determine their potential liability cannot become an argument to deny insurance on certain class of policies. The court does not see the broadening of definition being in detrimental to the insurer because it has always had the option to limit its liability in the cases where it is unable to ascertain risks. Lastly, it is more practical and will serve as a significant precedent for future cases. The positive impact of 'factual expectancy test' can be seen through the case of *Liverpool & London & Globe Insurance Co v.Bolling.*[9] In this case a womanoccupying a property for the purposes of business was able to recover a fee simple from the owner when the property was destroyed due to fire. The court reached this conclusion by putting interest in terms of deriving economic support from the productivity of premises even though there was no promise enforceable in equity.

However, the judgment is open to criticism on certain broader aspects which the judges should have given due consideration while analyzing the definition of insurable interest. It can be observed that the judgment does not delve into the question of - whether the requirement of insurable interest in the contemporary world exists or not. The judges analyze the fact that broadening of the definition will not in any way affect the three policy considerations underlying insurable interest but they fail to delve into the fact that the same

[8]A. MCGEE, THE MODERN LAW OF INSURANCE 36 (2nd ed. 2011).

[9] 176 Va 182 (1940).

will not be effected even when there is no requirement of insurable interest in the first place. In fact, certain cases suggest that principle of indemnity might be sufficient to recover the extent and quantum of loss (neither more nor less) suffered by the insured since the principle is applicable to all kinds of insurance policies excluding contingent policies (Ex – life and personal accident). Also the justification of the policy against wagering and gambling stems out from the rationale of preventing moral hazard – of killing someone or destroying the insured property. But it could be easily proved that the doctrine of insurable interest itself incentivizes moral hazard. This has been dealt in subsequent later paragraphs.

Secondly, the court fails to look in to the fact that there still exits uncertainty and ambiguity over interpretation of the doctrine of insurable interest because of different interpretations of the same by the Court of law. For example, the recent case shows that the courts are still debating and divided over the fact the whether insurable interest should involve a legal or equitable interest or only factual expectation of economic gain. The court fails to see that the problem with regard to uncertainty is not settled by broadening the definition. The problem with the 'factual expectancy test' is that it requires the economic interest to be 'substantial'. The question as to what counts as substantial has been left on the subjective case – to- case approach and the standard of the same has varied with the interpretation of courts. Secondly, the principle of indemnity puts an additional requirement by stating that the amount of the insurance should be no greater than the 'value' of the insurable interest.[10]The question of valuation undoubtedly remains still in controversial and is not resolved by the present casesince the Court ends up relying upon the sound business judgment of insurer companies without interfering in the same.

The greater policy reason behind highlighting such uncertainty is to show that such uncertainty and ambiguity in the doctrine itself is encouraging moral hazard,which it aimed to discourage. This is because when the contract is invalidated for lack of insurable interest it the insurer is relieved of his obligation and is no more liable to repay for the damages to the policyholder. This indirectly creates incentive for the insurer, to over insure or to continue issuing such policies in future for its own personal gain. The factual circumstance of the present case also depict that the policy holders were aware that asset insured by the respondent belonged to the company but still chose to go ahead with the same at the cost of it being detrimental to the shareholder. This in a way also leads to unfairness and inefficiency in the insurance market since it allows the insurer to issue policies, which appear valid to the

[10]*Supra Note 2.*

policyholders but might be later invalidated by courts[11]. This only leads us to conclude that this age old doctrine of insurable interest should be done away with because it no longer serves the economic and moral rationale, which it intended to serve in the first place.

Thus even though the Kosmopoulos case is praiseworthy of rejecting Macaura, the present note demands reconsideration on the aspect of completely eliminating the requirement of insurable interest. This is because it is no longer able to justify the policy considerations and economic rationale, which it intended to encourage in the first place. Also, the broader definition cannot prevent the exploitation of policyholders, unfairness and its adverse practical implication on the insured. This is because the requirement of insurable interest itself incentivizes moral hazard. Thus, scraping out the requirement seems the only option to prevent invalidation of unobjectionable and mutually favorable insurance contracts,which will only further the aim of economic efficiency in the insurance market.

[11]*Supra Note 2.*