1. INTRODUCTION

1.1 Insurable Interest (Pre Insurance Contracts Act)

The term “insurable interest” is defined by Ivamy, Dictionary of Insurance Law, as describing “the legal or equitable relation in which the insured stands to the subject matter insured in consequence of which he may benefit by it’s safety and be prejudiced by its loss”.

In other words, an insured must own something entirely or have some interest recognised by the Courts to be entitled to insure it.

It is a general principle of insurance law that no policy is valid unless it is effected by or on behalf of a person who has an insurable interest in the subject matter. Every Contract of Insurance requires an insurable interest to support it – otherwise it is invalid.

This requirement has historically been said to serve 3 main policies:

1. To discourage gaming and wagering in the form of insurance, i.e. betting somebody else’s property is damaged during a particular period;

2. To minimise the risk of destruction by the insured of the subject matter of the insurance, i.e. somebody talking steps to improve the prospects of the bet winning; and

3. To restrict the insured to no more than full indemnity for it’s loss, i.e. if insurance was not restricted to interest it’s value would be unlimited.

This rule has, however, been substantially amended by laws which apply to a majority of insurance contracts in Australia, most significantly the Insurance Contracts Act 1984 (as amended).

As you are aware, the Insurance Contracts Act was the product of recommendations from the Australian Law Reform Commission. That Commission, having reviewed the history and roots of the insurable interest principle, resolved that “if a loss has been suffered, the lack of interest either at the date of the contract or at the time prior to the loss should not prevent recovery”.

1.2 Insurable Interest (Post ICA)

The common law rule of insurable interest was amended by Sections 16 and 17 of the Insurance Contracts Act which read as follows:

“16. Insurable Interest Not Required”
A contract of general insurance is not void by reason only that the insured did not have, at the time when the contract was entered into, an interest in the subject matter of the contract.

17. Legal or Equitable Interest Not Required At Time of Loss

Where the insured under a contract of general insurance has suffered a pecuniary or economic loss by reason that property the subject matter of the contract has been damaged or destroyed, the insurer is not relieved of liability under the contract by reason only that, at the time of the loss, the insured did not have an interest at law or in equity in the property.”

The reason the ALRC gave for this substantial reform to the common law rule requirement of insurable interest was that it’s operation was seen to result in injustice in certain circumstances. A quoted example involved the case of Macoura v Northern Insurance Co Limited 1925 AC619 where the major shareholder and creditor of a company could not recover under a policy he had effected over timber which lay on his land but was owned by the company. Problems were also experienced where the insured had only a limited interest in the property insured. The previous law was that other interests were not automatically covered.

The requirement for strict proprietary interest (legal or equitable) has therefore been replaced by a test based on economic loss. It was anticipated by the ALRC that this would allow a greater degree of flexibility to insurers and insureds without promoting gaming and wagering in the form of insurance or adding to the risk of destruction of insured property. The Commission said that:-

“Legislation should provide that, where an insured is economically disadvantaged by damage to or destruction of the insured property, the insurer should not be relieved of liability by reason only that the insured did not have a legal or equitable interest in the property.”

“Economically disadvantaged is expressed in Section 17 as the insured having suffered a “pecuniary or economic loss”. Guidance as to the application of Section 17 is provided in the Notes To Draft Insurance Contracts Bill 1982 by way of the following example:-

“A is employed in this father’s business which is left to him under his father’s will. The father refuses to insure the property of the business, so A insures it in his own name. The property is destroyed by fire before the father dies. Under the existing law [pre ICA] A would be prevented from recovering anything under the contract because he had no legal or equitable title to the property. Section 17 allows him to recover the amount of his economic loss (up to the limit of the insurer’s liability under the contract) as a result of the destruction of the property.”
The prospective inheritance in the example demonstrates the width of the term “has suffered a pecuniary or economic loss”.

As a consequence of Sections 16 and 17, the failure of an insured to hold a legal or equitable interest in property will not render a contract of insurance void. Rather, provided that the insured suffers “pecuniary or economic loss” as a consequence of damage or destruction of the property the subject matter of the contract, it is entitled to recover under the policy up to the amount of its economic loss.

Another Section of the ICA which recognises the fact that more than one person may suffer pecuniary or economic loss as a result of damage to property is Section 49. It reads as follows:-

1.3 Section 49 - Where sum insured exceeds value of insured’s interest

“(1) This section applies where:-

(a) A loss occurs in respect of property that is the subject-matter of a contract of general insurance; and

(b) The insured and some other person each have an interest in the property:

but does not apply where:-

(c) The contract of insurance does not provide insurance cover in respect of an interest in the property that is not the insured’s interest; and

(d) Before the contract was entered into, the insurer clearly informed the insured in writing that the insurance cover provided by the contract would not extend to such an interest.

(2) A reference in this Section to the amount of the insurer’s notional liability is a reference to the amount for which the insurer would have been liable to the insured in respect of the particular claim if the insured had been the only person who had an interest in the property.

(3) Where:-

(a) The amount of the insurer’s notional liability exceeds the amount of the insurer’s liability to the insured in respect of the loss; and

(b) Within 3 months after the day on which the loss occurred, a person who is not the insured but has an interest in the property gives to the insurer a notice in writing informing the insurer of the person’s interest;
The insurer is liable at the expiration of that period, to pay to that person an amount equal to the amount by which the amount of the insurer’s notional liability exceeds the amount of the insured’s loss.

(4) Where 2 or more persons have served notices under the section, the amount ascertained under subsection (3) shall be divided between them in proportion to the values of their interests in the property.

(5) Nothing in subsection (3) renders the insurer liable to pay to a person an amount exceeding the amount of the loss suffered by that person.

(6) Where:-

(a) The amount of the insurer’s notional liability exceeds the amount of the liability to the insured in respect of the loss;

(b) The insurer had paid to the insured the amount of the notional liability; and

(c) The insurer did not know and could not reasonably be expected to have known that a person other than the insured had an interest in the property.

Subsection (3) does not apply but a person who is not the insured may recover from the insured an amount that bears to the amount of the notional liability the same proportion as the value of that person’s interests in the property bears to the total value of all persons interests in the property.”

This provision was enacted in response to problems perceived by the ALRC to arise from usual common law indemnity principles and the doctrine of privity of contract. Those problems were said to be exemplified by a decision of the High Court in British Traders Insurance Co Ltd v Monson 1964 111CLR 86. In that case, a tenant of an insured property had insured it for it’s full value. The owners of the property had cancelled their own insurance, effected with the same insurer on the faith of the tenants policy. The High Court found, however, that by insuring the premises, the tenant had no intention to benefit the lessor. The ALRC noted that in the result the insurer, which had presumably accepted premiums based on the full value of the property, was able to avoid liability for it’s destruction notwithstanding it’s promise to the contrary. The ALRC noted that an insurer is readily able to limit it’s liability by indicating in the Contract of Insurance the nature of the interest which it is insuring. It recommended that in the absence of clear limitations specifically brought to the attention of the insured, the insurer should be required to fully indemnify the loss regardless of the involvement of third party loss sufferers.
Therefore, if property is insured for its full value, then, subject to agreement to the contrary an insurer is obliged to indemnify all those interested in the property up to the limit of indemnity. The Section rather than effecting a named insured’s insurable interest, statutorily includes entities unknown to the insurer as insureds subject of course to strict notice requirements.

2. VENDOR & PURCHASER

Against that background, it falls upon me to consider issues of insurable interest in the context of the vendor/purchaser relationship.

In terms of ICA insurable interest, it is clear that both a vendor and purchaser possess the necessary interest to insure. For the purposes of this paper, I shall concentrate on the buying and selling of land or real property.

2.1 The Purchaser

The Purchaser under a valid contract for the sale of goods has an insurable interest whether either the property or the risk has passed or it has taken possession or paid part of the contract price for the goods. So long as the purchaser can establish actual pecuniary or economic loss by reason of damage to or destruction of the goods which it has agreed to buy, the purchaser will have an insurable interest under the Insurance Contracts Act. If either the property in the goods or the risk is passed to the purchaser, it has an insurable interest to the full value of the goods, either as owner or because it is liable to pay the full price, notwithstanding the destruction or damage of the goods.

2.2 The Vendor

Likewise, the vendor of a property retains an insurable interest so long as it is in a position to suffer loss by its damage or destruction. Even where both risk and property has passed, the vendor retains an insurable interest so long as it continues in possession. If the vendor is unpaid, it has an interest in respect of the lien for the price.

That of course represents a departure from the common law where in circumstances of possession, risk and property having all passed to the purchaser and the vendor retaining no security over the goods, the vendor would have no insurable interest in them whatsoever as an unpaid seller. An 1883 New Zealand decision of Mollison v Victoria Insurance 1883 2NZLR SC177 held that the fact that the failure to receive the price would make the vendor insolvent did not give the vendor an insurable interest; nor did the fact that the destruction of the goods might make the purchaser insolvent and thereby lessen the chances of payment in full.
Consistent with by earlier comments, this position has now been remedied by Section 17 of the ICA whereby proof of pecuniary or economic loss is enough to establish an insurable interest. The vendor will, notwithstanding the existence of a binding Contract of Sale, retain an insurable interest to the extent of the purchase price by virtue of it’s situation as an unpaid seller.

2.3 Problems not cured by Sections 16 & 17 of the ICA

Notwithstanding the benefits derived from Sections 16 and 17, problems specific to the vendor/purchaser relationship were still perceived to exist. They arose from the following legal positions:-

- A purchaser was not entitled to refuse to complete or settle a transaction on the basis that between the date of the contract and the date fixed for completion any building on the land had been destroyed by fire;

- A purchaser was not entitled to take advantage of any insurance cover effected by the vendor. In the absence of a special stipulation of the contract the purchaser was not entitled either against the vendor or an insurer to the payment of the monies under a policy of insurance taken out by the vendor;

- A contract of insurance is a personal contract and unless assigned with the consent of the insurer, no action can be brought on it by a person who was not an original party to it; and

- Generally speaking, the risk passes to a purchaser at or about the execution of the contract (prior to settlement). That certainly is the case pursuant to the standard REIQ Residential Conveyancing Terms & Conditions applicable in Queensland.

In those circumstances, an insured vendor who had been indemnified by an insurer was not required at common law to hand over the insurance monies to a purchaser who subsequently paid the balance of the purchaser price in accordance with a contract of sale. Even though the insured would have to account to its insurer for the overpayment, an uninsured Purchaser would be left in the unenviable position of having paid over all purchase monies for a damaged property with no rights against the vendor whatsoever.

Prior to the ICA, various states including Queensland attempted to deal with these perceived problems in different ways. I shall only deal with Queensland.
2.4 Queensland Statutory Intervention

2.4.1 Property Law Act 1974 (as amended)

Section 58:–

"Where a building is destroyed or damaged by fire a person who has granted a policy of insurance for insuring it against fire may, and shall, on the request of a person interested in or entitled to the building, cause the money for which the building is insured to be laid out and expended, so far as it will go, towards rebuilding, reinstating or repairing the building, unless:–

(a) the person claiming the insurance money within 30 days next after the person’s claim is adjusted, gives sufficient security to the person who has granted that policy that the insurance money will be so laid out and expended; or

(b) the insurance money is in that time settled and disposed of to and amongst the contending parties to the satisfaction and approbation of the person who has granted the policy of insurance."

Basically, the Section is designed to put persons who insure buildings against destruction or fire under a statutory obligation to spend the insurance monies on reinstatement or repair if requested to do so by persons interested.

A person “interested in or entitled to the building” would include a purchaser under an uncompleted contract for sale and in that context the section is designed to avoid a situation where the vendor successfully makes a claim against the insurer and pockets the cash without effecting the repairs. It is also designed in certain circumstances to protect a tenant’s position under a lease.

2.4.2 Application of Insurance Money on Completion of a Sale of Exchange

Section 63 relevantly reads:–

(1) “Where after the date of any contract for sale or exchange of property, money becomes payable under any policy of insurance maintained by the vendor in respect of any damage to or destruction of property included in the contract, the money shall, on completion of the contract, be held or receivable by the vendor on behalf of, and, on the completion of the sale or exchange or so soon afterwards as the same shall be received by the vendor, paid:–
to any person entitled to the money because of an encumbrance over or in respect of the land; and

(b) as to any balance remaining, to the purchaser.

(2) For the purpose of this Section, cover provided by such a policy maintained by the vendor extends until the date of completion, and money does not cease to become payable to the vendor merely because the risk has passed to the purchaser.

(3) This Section shall apply only to contracts made after the commencement of this Act, and shall have effect subject to:-

(a) any stipulation to the contrary contained in the contract; or

(b) the payment by the purchaser of the proportionate part of the premium from the date of the contract;

(4) This section shall …"

Basically, Section 63 seeks to modify the rights of parties to a contract for sale in relation to the entitlement to an application of insurance monies on completion. As Section 63 relates to insurance, it seems that it is ousted by the effect of Section 50 of the Insurance Contracts Act (to be discussed shortly) and for that reason I do not propose to speak about it at length.

Suffice to say for the moment is that whilst it sets about to regulate the application of insurance monies payable to a vendor, it has certain limitations including stipulations to the contrary in the contract. It would also appear only to operate subsequent to completion of the Contract of Sale.

2.4.3 Right to Rescind on Destruction of or Damage to Dwelling House

Section 64 relevantly reads:

(1) “In any contract for the sale of a dwelling house where, before the date of completion or possession whichever earlier occurs, the dwelling house is so destroyed or damaged as to be unfit for occupation as a dwelling house, the purchaser may, at the purchaser’s option, rescind the contract by notice in writing given to the vendor or the vendor’s solicitor not later than the date of completion or possession whichever the earlier occurs.
Upon rescission of a contract under this section, any money paid by the purchaser shall be refunded to the purchaser and any documents of title or transfer returned to the vendor who alone shall be entitled to the benefit of any insurance policy relating to such destruction or damage subject to the rights of any person entitled to the insurance policy because of an encumbrance over or in respect of the land;

Again, this provision represents a significant departure from the position at common law and provides a purchaser with an ability to successfully call off the deal in the event of significant damage. The purchaser now has the option of either:-

1. Facilitating rectification or repair subsequent to concluding the contract; or
2. Pulling out altogether.

If the purchaser does elect to terminate the contract, then the Vendor's insurable interest extends to the value of the whole property and it may claim upon its insurer to that extent.

**2.5 Commonwealth Statutory Intervention – Insurance Contracts Act**

**Section 50 – Sale of Insured Property**

Section 50(1) (Purchaser of building to the insured under vendor’s insurance)

Where:-

“(a) A person (in this section called the “purchaser”) agrees to purchase, or to take an assignment of, property and in consequence the purchaser has, or will have, a right to occupy or use a building;

(b) The building is the subject matter of a contract of general insurance to which the vendor or assignor under the agreement is a party; and

(c) The risk in respect of loss of or damage to the building has passed to the purchaser, the purchaser shall be deemed to be an insured under the contract of insurance, so far as the contract provides insurance cover in respect of loss of or damage to the building and such of the contents of the building as are being sold or assigned to the purchaser at the same time, during the period commencing on the day on which the risk so passed and ending at whichever of the following times is the earliest:

(d) The time when the sale or assignment is completed;
(e) The time when the purchaser enters into possession of the building;

(f) The time when insurance cover under a contract of insurance effected by the purchaser in respect of the building commences;

(g) The time when the sale or assignment is terminated.

Section 50 overrides the various States legislative attempts to mitigate the hardship caused to purchasers by the common law approach.

Rather than imposing limitations on the vendor’s application of insurance monies like the PLA, the solution adopted by Section 50 is for the purchaser to be deemed, for a limited period of time, to be an insured under the vendor’s contract of insurance. This effectively creates a kind of statutory contractual nexus between the purchaser and the vendor’s insurer which the insurer is unable to avoid, however much it would wish to do so. The ALRC recognised that it was contrary to principle to force an insurer to insure a risk that it was unable to assess, and to compel it to accept as an insured a person who might be completely unsatisfactory from a moral hazard point of view.

Nevertheless, it concluded that that concern about the purchaser’s fitness as an insured would be minimised if it were to be given the benefit of the vendor’s insurance for a limited period of time only (i.e from the making of the Contract of Sale until the completion of the transaction, or entry into possession or the effecting of cover by the purchaser). The ALRC pointed out that this solution would not effect the desirability of the purchaser arranging its own insurance, for the vendor might have cover which provides inadequate protection for the purchaser or indeed might have no cover at all.

Moreover, where a purchaser is deemed an insured pursuant to Section 50, the insurer would appear able to rely upon the same remedies available to it under the Act with respect to matters such as disclosure, good faith or breach of policy conditions insofar as the vendor is concerned. In those circumstances, the purchaser may be left with no insurance whatsoever solely because the vendor’s actions disentitle it from cover.

In a nutshell, Section 50 means that a purchaser or person taking an assignment of a building to whom the risk for loss or damage is passed will be deemed to be an insured under any contract of general insurance taken out by the vendor or assignor in relation to that building and any contents being sold, for the period commencing upon the date the risk passed until the earliest of the following events:

(a) The completion of the contract;

(b) The purchaser entering into possession;
(c) The commencement of insurance effected by the purchaser; or

(d) Termination of the sale.

Unlike certain parts of the Property Law Act, the provisions of Section 50 cannot be excluded, restricted or modified in any way, other than to the prejudice of the insurer – Section 52(1) ICA.

2.6 What does it all mean?

Having regard to what I have said about the law of insurable interest, in the context of vendor and purchaser transactions it is now worth pausing to consider the positions that parties to contracts for sale find themselves in where loss is suffered post-contract but prior to completion. Two threshold issues to consider are:

1. Whether the contract for sale is binding (if it is not many of the issues evaporate); and

2. Whether the purchaser wishes to proceed with the purchase having regard to the option it may have pursuant to Section 64 of the Property Law Act.

For today’s purposes, I shall assume that the contract is binding and the purchaser wishes to proceed.

With those assumptions in mind, it seems that 1 of 3 scenarios are likely to prevail:

1. Where the vendor has insurance and the purchaser does not;

2. Where the purchaser has insurance but the vendor does not;

3. Where both the vendor and purchaser have insurance.

2.6.1 Only Vendor has Insurance:

In that situation, Section 50 of the ICA would apply to provide the purchaser with a statutory policy of insurance. The statutory insurance provided under the Section, however, is no better than the insurance enjoyed by the vendor itself and if the policy is struck down by non-disclosure, fraud or breach of policy conditions on the part of the vendor then the purchaser shall also be without cover.

Both parties to the contract are of course entitled to claim under the policy to the extent of their interest as defined by Section 16 and 17 of the Insurance Contracts Act (i.e. economic interest). Assuming that the contract settles however (which is the only reason why the purchaser would pursue a statutory claim) then of course the vendor’s interest upon completion would be extinguished.
2.6.2 Only the Purchaser Insures the Property:

The purchaser may insure for the full value of the property and recover the full amount of any damage occasioned to it even though this may be more than the value of his or her own interest provided that the purchaser intended to insure for the benefit of all persons interested.

Strictly speaking a purchaser’s insurer is not entitled to delay payment until after completion of the contract although it can presumably wait until it is established that the contract is a valid one and that the vendor is able to show good title. If after payment of the insurance monies to the purchaser the contract were to be rescinded through it being shown to be invalid or through the vendor’s inability to make title, the purchaser’s insurer could no doubt recover the amount paid over and above any loss suffered by the purchaser.

Ordinarily, however, as conveyances in Queensland involve 30 day completion dates, if the transaction proceeds, completion is usually well and truly effected prior to the claim being adjusted and payment is made.

2.6.3 Where Both Parties are Insured:

Prior to settlement, both parties to the contract have an insurable interest in the insured property. We shall deal with their rights in turn in that scenario where there are two polices:

2.6.3.1 Vendor’s Insurer

Until completion the vendor retains an insurable interest at least to the extent of the price unpaid. That interest is maintained even if the contract is unconditional, for the purchaser might never carry out the contract – see Kern Corporation v Walter Retrading 1987 163 CLR 164. In those circumstances notwithstanding the existence of an uncompleted contract the vendor strictly speaking is entitled to pursue its claim for indemnity from its insurer.

Moreover, the purchaser notwithstanding the existence of his own cover would appear entitled to call upon the vendor’s insurer to apply the monies for rectification under Section 58 of the Property Law Act if a claim is being made by the vendor.

Section 63(1) of the Property Law Act would appear to have no application to the pre-completion stage.

If a vendor’s insurer did pay out prior to completion then:

(i) The insured vendor is not obliged at law to hand over the insurance monies to the purchaser notwithstanding the subsequent payment of the balance of the purchase monies;
(ii) The insurer can, however, pursue to recover the monies from its insured for overpayment (all monies are likely to be recoverable upon settlement); and

(iii) The insurer can also subrogate to the insured’s rights with regard to enforcing the settlement of the transaction by the purchaser where appropriate.

Insofar as the vendor’s position post-completion is concerned, whilst Section 63 of the PLA would appear to have application it would be of no particular moment as at that stage it would be left with no insurable interest.

2.6.3.2 Purchaser’s Insurers

As mentioned previously:-

(i) A purchaser may insure for the full value of the property and recover the full amount of any damage occasioned to it; and

(ii) A purchaser’s insurer is not entitled to delay payment until after completion of the contract.

Based upon the previously made assumptions of a valid contract and a keen purchaser, provided that there is no delay in settlement, the conventional position is that the purchaser settles the contract and thereafter claims under its policy. That of course avoids complications which have the potential to arise from claims payments initially being made by a vendor’s insurer to the vendor which subsequently have to be disgorged.

In my experience, when there are insurers of both parties to a transaction involved and the transaction is proceeding, common sense shall ensure that the only policy called upon is that of the purchaser.

Naturally, Section 50 of the ICA would have no relevant application where the purchaser has its own insurance. Query, however, what if the purchaser has taken out cover but its claim is rejected, thereby leaving the vendor’s policy as the only policy with the potential to respond.

Whilst I don’t know the answer to the question, if one is faithful to the language used in Section 50(1)(f), so long as the purchaser’s policy is not void ab initio by reason of fraud or the like, Section 50 would not apply. The statutory cover afforded relevantly ends at the time when insurance cover effected by the purchaser commences. Therefore, provided that the cover exists and therefore has commenced, then even though the claim is rejected no statutory cover under Section 50 is available.
3. Conclusion

That is where I propose to conclude my paper for today’s purposes. It will be clear to you that the position with regard to insurable interest in the context of vendor and purchaser transactions is one quite heavily regulated by statute. To the extent that there are inconsistencies between state and commonwealth statutes, obviously the Commonwealth’s provisions prevail.

Generally speaking, all legislatures have endeavoured to ensure that all parties “interested” in a property are entitled to the protection of insurance to the extent that the damage to property insured causes that entity pecuniary or economic loss. Indeed, in the context of the vendor and purchaser transaction, in order to avoid the unattractive situation prevailing where loss occurs without cover, a purchaser’s policy is deemed in certain circumstances to exist.

Matters may be complicated even further when interested third parties are taken into account but I do not propose to develop that here.

I hope that you got something from my paper and thank you for the invitation today.