RECENT DEVELOPMENT

INSURANCE: NECESSITY FOR PECUNIARY INTEREST HELD TO PROVIDE A PRACTICAL LIMITATION ON THE EXPANSIVE DOCTRINE OF INSURABLE INTEREST

In *Royal Insurance Co. v. Sisters of the Presentation*,[1] the Court of Appeals for the Ninth Circuit held that an insured who has no *pecuniary*[2] interest in real property has no *insurable* interest[3] in that property, even though he holds undisputed legal title. The Sisters, whose convent building was in need of repair, contracted with the Bishop of Oakland, California, to hold their property in perpetuity for the future construction of a high school. In return, the Bishop agreed to convey to them an adjoining parcel of land and to erect a new convent. Pursuant to this contract, the Sisters acquired the Bishop's land and, upon completion of the new convent, moved out of their prior dwelling. Preparation for demolition of the unoccupied convent was commenced immediately. Four days later, when only the shell of the building remained intact, a fire of undetermined origin razed the structure. The Sisters sued for recovery of the loss under a fire insurance policy written by Royal. The federal district court found that the Sisters held a sufficient insurable interest in the destroyed property and awarded them $174,000.[4] The Ninth Circuit reversed, finding the insurance contract void on the ground that the Sisters had no insurable interest in that property.

The doctrine of insurable interest, although basic to the law of insurance, is elusive in character.[5] Unless the policy holder has an insurable interest, an insurance contract is void.[6] Due to the import of

1. 430 F.2d 759 (9th Cir. 1970).

2. Pecuniary is defined as: "Involving money or money's worth. Financial; pertaining or relating to money; capable of being estimated, computed, or measured by money value." BALLENTINE'S LAW DICTIONARY 927 (3d ed. 1969).

3. *See generally* Salzman, *The Law of Insurable Interest in Property Insurance*, 1966 INS. L.J. 394 [hereinafter cited as Salzman].

4. 430 F.2d at 760.

5. *See* Stoekton, *An Analysis of Insurable Interest Under Article Two of the Uniform Commercial Code*, 17 VAND. L. REV. 815 (1964).

6. *E.g.*, Crotty v. Union Mut. Life Ins. Co., 144 U.S. 621 (1892) (life insurance policy); Nelson v. New Hampshire Fire Ins. Co., 263 F.2d 586 (9th Cir. 1959); CAL. INS. CODE § 280

this concept, one might expect that both the purpose and the nature of the insurable interest requirement would be settled, but such is not the case. As to the former, the purpose, legal writers generally agree that if the insured does not have the requisite insurable interest, three harmful effects may result: the insured may be tempted to bring about the insured event; the insurance contract may, in reality, be a mere wager; or the insured may receive more than simple indemnification for his loss.[7] However, as to the latter, the nature of insurable interest, there is little agreement. For example, it has been defined by one statute to include "[e]very interest in property, or any relation thereto, or liability in respect thereof, of such a nature that a contemplated peril might directly damnify the insured. . . ."[8] It has otherwise been defined as: that interest in property which, if the property were destroyed, would cause a loss to to the interest holder, depriving him of possession, enjoyment, or profit from the property;[9] whatever furnishes a reasonable expectation of pecuniary benefit from the continued existence of the subject of the insurance;[10] or an interest whose destruction would cause the suffering of a loss.[11] Insurable interest has on different occasions been based upon: a property right;[12] a contract right;[13] a potential legal liability;[14] or a factual expectation of damage.[15] While a sufficient property right may consist of legal

(West 1955). *See generally* W. VANCE, LAW OF INSURANCE 156-61 (3d ed. 1951) [hereinafter cited as VANCE].

7. E. PATTERSON, ESSENTIALS OF INSURANCE LAW § 22 (1935) [hereinafter cited as PATTERSON]; VANCE 156-57; Harnett & Thornton, *Insurable Interest in Property: A Socio-Economic Reevaluation of a Legal Concept*, 48 COLUM. L. REV. 1162, 1178-83 (1948).

8. CAL. INS. CODE § 281 (West 1955).

9. German Ins. Co. v. Hyman, 34 Neb. 704, 708, 52 N.W. 401, 402 (1892). *See* VANCE 161-63.

10. American Equitable Assur. Co. v. Powderly Coal & Lumber Co., 225 Ala. 208, 212, 142 So. 37, 40 (1932).

11. Harrison v. Fortlage, 161 U.S. 57, 65 (1896); Hooper v. Robinson, 98 U.S. 528, 538 (1878).

12. *See, e.g.*, Milwaukee Mechanics' Ins. Co. v. B.S. Rhea & Son, 123 F. 9 (6th Cir. 1903); Convis v. Citizens' Mut. Fire Ins. Co., 127 Mich. 616, 86 N.W. 994 (1901); Farmers' Mut. Fire & Lightning Ins. Co. v. Crowley, 354 Mo. 649, 190 S.W.2d 250 (1945).

13. *See, e.g.*, Planters' & Merchants' Ins. Co. v. Thurston, 93 Ala. 255, 9 So. 268 (1891); Fire Ins. Ass'n v. Merchants' & Miners' Transp. Co., 66 Md. 339, 7 A. 905 (1887); National Filtering Oil Co. v. Citizens' Ins. Co., 106 N.Y. 535, 13 N.E. 337 (1887); Graham v. American Fire Ins. Co., 48 S.C. 195, 26 S.E. 323 (1897).

14. *See, e.g.*, Home Ins. Co. v. Baltimore Warehouse Co., 93 U.S. 527 (1876); Liverpool & London & Globe Ins. Co. v. Crosby, 83 F.2d 647, *cert. denied*, 299 U.S. 587 (1936); National Fire Ins. Co. v. Kinney, 224 Ala. 586, 141 So. 350 (1932).

15. *See, e.g.*, Hecker v. Commercial State Bank, 35 N.D. 12, 159 N.W. 97 (1916); Liverpool & London & Globe Ins. Co. v. Bolling, 176 Va. 182, 10 S.E.2d 518 (1940); Tischendorf v. Lynn

title, equitable title, or a substantial property interest,[16] most jurisdictions recognize the inadequacy of a mere expectant property interest.[17] The second basis, a contract right, may be found in any binding contract creating rights which will be injuriously affected by the destruction of any designated property.[18] In most cases in which the third basis—potential legal liability—has been recognized as a sufficient insurable interest, the interest could also have been tied to either the contract or property concept.[19] The fourth basis, the factual expectation of damage concept, is the broadest and most inclusive, resting on the very general theory that one should have an insurable interest in any property which, if lost, damaged, or destroyed, might result in his economic disadvantage.[20]

Insurable interest has been found in bailees,[21] executors or administrators,[22] pledgees,[23] pledgors in possession,[24] lessors,[25] lessees,[26] mortgagors,[27] mortgagees,[28] receivers,[29] remaindermen,[30] stockholders,[31] trustees,[32] contractors,[33] and even sharecroppers.[34] This

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Mut. Fire Ins. Co., 190 Wis. 33, 208 N.W. 917 (1926). Although no statute expressly refers to the factual expectation of damages concept, the definitions of insurable interest in some state statutes are sufficiently broad to encompass this doctrine. *See, e.g.*, CAL. INS. CODE §§ 281-84 (West 1955); N.Y. INS. LAW § 148 (McKinney 1966). *See generally* Stockton, *supra* note 5, at 816; PATTERSON 23-26.

16. Salzman 399-400.

17. *See, e.g.*, Baldwin v. State Ins. Co., 60 Iowa 497, 15 N.W. 300 (1883); Lucena v. Craufurd, 127 Eng. Rep. 630 (H.L. 1806); CAL. INS. CODE § 283 (West 1955). Vance states that this proposition is true, "however likely and morally certain of realization [the expectancy] may be." VANCE 157.

18. *See* Getchell v. Mercantile & Mfrs' Mut. Fire Ins. Co., 109 Me. 274, 277, 83 A. 801, 803 (1912).

19. *See* Stockton, *supra* note 5, at 817; Harnett & Thornton, *supra* note 7, at 1170-71. *But see* PATTERSON 94-95.

20. *See* Harnett & Thornton, *supra* note 7, at 1171-72.

21. *See, e.g.*, Rice Oil Co. v. Atlas Assur. Co., 102 F.2d 561, 573 (9th Cir. 1939).

22. *E.g.*, Providence Washington Ins. Co. v. Stanley, 403 F.2d 844, 849 (5th Cir. 1968).

23. *E.g.*, Dunsmore v. Franklin Fire Ins. Co., 299 Pa. 86, 89, 149 A. 163, 164 (1930).

24. *Id.*

25. *See, e.g.*, Alexander v. Security-First Nat'l Bank, 7 Cal. 2d 718, 723, 62 P.2d 735, 737 (1936).

26. *Id.*

27. *E.g.*, Insurance Co. v. Stinson, 103 U.S. 25, 29 (1880).

28. *E.g.*, Alexander v. Security-First Nat'l Bank, 7 Cal. 2d 718, 723, 62 P.2d 735, 737 (1936).

29. *See, e.g.*, Liverpool & London & Globe Ins. Co. v. Crosby, 83 F.2d 647 (6th Cir.), *cert. denied*, 299 U.S. 587 (1936).

30. *E.g.*, Jones v. Harsha, 233 Mich. 499, 503, 206 N.W. 979, 980 (1926).

31. *E.g.*, Providence Washington Ins. Co. v. Stanley, 403 F.2d 844, 848-49 (5th Cir. 1968).

32. *E.g.*, California Ins. Co. v. Union Compress Co., 133 U.S. 387, 409 (1890).

wide range of persons permitted recovery evidences a constant liberalization in determining the existence of the requisite property interest.[35] In the more recent cases concerned with insurable interest, the courts have continued to broaden the class of persons who have an insurable interest. For example, in *Martin v. State Farm Mutual Auto Insurance Co.*,[36] the court held that purchasers of an automobile under a conditional sales contract had an insurable interest in the automobile even though they held no legal title; the insureds were in possession, had equitable title, and were liable on the sales contract for the automobile. Similarly, vendors of real property, who had conveyed legal title to the property, given up possession, and retained only the right to dismantle a dwelling house thereon, were found to have an insurable interest in the structure.[37] One judge, in attempting to sum up the various bases for insurable interest which his jurisdiction recognized, stated:

> We have held that one can have an insurable interest although he has no property in the thing insured, or an estate, legal or equitable; that the term "insurable interest" is more extensive than property or estate; that a qualified or limited interest in the subject of insurance is sufficient; that any reasonable expectation of legitimate profit is sufficient to support an insurable interest; that whatever furnishes a reasonable expectation of pecuniary benefit from the continued existence of the subject of insurance is a valid insurable interest.[38]

In *Royal* the Ninth Circuit reversed the district court's finding that at the time of the fire the Sisters retained sufficient insurable interest in the destroyed property on two principal grounds. The first was that the lower court had applied an erroneous definition of insurable interest.[39] Citing *Davis v. Phoenix Insurance Co.*[40] and *Martin v. State Farm Mutual Auto Insurance Co.*,[41] the court held

33. *E.g.*, Clarke v. Charles B. Hartman Co., 105 Pa. Super. 118, 121, 159 A. 460, 461 (1932).

34. *E.g.*, Hudson v. Glens Falls Ins. Co., 218 N.Y. 133, 137, 112 N.E. 728, 730 (1916).

35. *See* Salzman 399.

36. 200 Cal. App. 2d 459, 19 Cal. Rptr. 364 (4th Dist. Ct. App. 1962).

37. Woodruff v. Southeastern Fire Ins. Co., 426 F.2d 555, 561 (5th Cir. 1970). The insureds, however, were denied recovery under an insurance policy in spite of the finding that they retained the requisite interest. The court held that the use of the structure at the time of its loss was different from the use which both parties to the insurance contract had considered when the bargain was made. *Id.* at 562.

38. North British & Mercantile Ins. Co. v. Sciandra, 256 Ala. 409, 416, 54 So. 2d 764, 770 (1951).

39. 430 F.2d at 761-62.

40. 111 Cal. 409, 43 P. 1115 (1896).

41. 200 Cal. App. 2d 459, 19 Cal. Rptr. 364 (4th Dist. Ct. App. 1962).

that the cases decided under California's statutory definition "have established that insurable interest consists of pecuniary interest."[42] Although acknowledging the fact that the Sisters held undisputed legal title to the property, the court felt that this was insufficient to constitute insurable interest because "the existence of insurance interest hinges on economic interests rather than upon legal title."[43] As the second ground for its decision, the court relied on the nature of the contractual obligations which the Sisters owed the Bishop. The Sisters had vacated the premises in performance of their duty under a contract which dealt with land, a unique property. The Bishop could have specifically enforced the contract, and, even if the Sisters had desired to reenter the premises, they could have done so only with the Bishop's acquiescence. Having abandoned the building under a specifically enforceable contract and thus having divested themselves of beneficial interest in the premises, the Sisters had no pecuniary interest in the property at the time of the fire. Lacking pecuniary interest, the Sisters had no insurable interest in the destroyed property; thus, the contract for insurance was void, and the Sisters could not recover.

With apparently unswerving consistency from the time of its inception in England, the applicability of the doctrine of insurable interest has been broadened. In an effort to provide for recovery by insureds who, under a narrow definition of insurable interest, might be denied recovery yet suffer a pecuniary loss when the insured property is damaged or destroyed, the law has expanded the bases which might constitute insurable interest.[44] To date the bases recognized as constituting the requisite interest have been categorized as a property right, a contractual right, a potential liability, and a factual expectation of damages.[45] If an insured could show that he qualified under any one of the four tests, he was believed to have an insurable interest which the courts would enforce.[46] No statute presently in effect, nor holding in a reported case, has redefined the concept of insurable interest as the Ninth Circuit has done in *Royal Insurance Co. v. Sisters of the Presentation.* The court cites *Davis v. Phoenix Insurance Co.*[47] and *Martin v. State Farm Mutual Auto*

42. 430 F.2d at 761.
43. *Id.* at 762.
44. *See* Salzman 395.
45. See notes 12-20 *supra* and accompanying text.
46. *See generally* 2 J. JOYCE, LAW OF INSURANCE § 888 (2d ed. 1917).
47. 111 Cal. 409, 43 P. 1115 (1896).

Insurance Co.[48] for the proposition that "insurable interest *consists* of pecuniary interest,"[49] implying that pecuniary interest is either a new, fifth basis for insurable interest or a hybrid of the four bases previously recognized. Neither case so holds. In both the *Davis* and *Martin* cases, the courts relied upon the established bases of property right and contractual right to substantiate their findings that the insureds had a pecuniary interest and consequently an insurable interest.[50] Neither of these cases holds, as *Royal* does, that one who has undisputed, legal title in real property does not have an insurable interest in that property. Nor does *Woodruff v. Southeastern Fire Insurance Co.*[51] or *Smith v. Jim Dandy Markets, Inc.*,[52] cited by the court, hold that one who has only legal title in real property lacks an insurable interest in that property. In *Leggio v. Miller National Insurance Co.*,[53] the other case upon which the Ninth Circuit relied, the court indicated that it would hold that one who has legal title in real property does not *necessarily* have an insurable interest in that property, but resolution of that issue was not required for the decision.[54]

Although the Ninth Circuit implies that it is following an established line of cases in *Royal*, in actuality the court has expressly reached a conclusion which other courts have merely hinted at as a possible revision of the doctrine of insurable interest. In so doing the Ninth Circuit has imposed a long-overdue, meaningful limitation on what previously had been a consistently expanding concept. Where, prior to *Royal*, undisputed legal title in real property had been recognized as a property right capable of constituting an insurable interest,[55] undisputed legal title by itself is now insufficient. Heretofore, the courts have been forced either to apply vague, general "definitions" of insurable interest[56] or to choose among highly

48. 200 Cal. App. 2d 459, 19 Cal. Rptr. 364 (4th Dist. Ct. App. 1962).

49. 430 F.2d at 761 (emphasis added).

50. Davis v. Phoenix Ins. Co., 111 Cal. 409, 414, 43 P. 1115, 1117 (1896); Martin v. State Farm Mut. Auto Ins. Co., 200 Cal. App. 2d 459, 468-70, 19 Cal. Rptr. 364, 369-70 (4th Dist. Ct. App. 1962).

51. 426 F.2d 555 (5th Cir. 1970).

52. 172 F.2d 616 (9th Cir. 1949).

53. 398 S.W.2d 607 (Tex. Civ. App. 1965).

54. *Id.* at 611-12.

55. *See* Salzman 399, 400.

56. *E.g.*, Harrison v. Fortlage, 161 U.S. 57, 65 (1896); Hooper v. Robinson, 98 U.S. 528, 538 (1878); American Equitable Assur. Co. v. Powderly Coal & Lumber Co., 225 Ala. 208, 212, 142 So. 37, 40 (1932); CAL. INS. CODE § 281 (West 1955); PATTERSON § 22.

technical property and contract "rights"[57] to determine enforceability of an insurance contract. The *Royal* decision allows judges to consider the "realities . . . of [each] situation."[58] Thus, if the insured has *actually* suffered a pecuniary loss, his insurance contract will be enforceable. On the other hand, if a loss has occurred but the insured, even though he had legal title in the damaged or destroyed property, has himself suffered no loss, he will not be allowed to recover. This concept provides a practical approach to the application of the insurable interest doctrine. Moreover, the test established by the court in *Royal* with regard to naked legal title could be applied generally to the doctrine of insurable interest. Under *Royal*, merely showing that one is a stockholder, remainderman, or some other "interested" party would no longer be sufficient to prove that he has an insurable interest. Instead, the insured would be required to show that occurrence of the event insured against caused him to suffer a *real, pecuniary* loss. Application of the *Royal* test provides the courts with a method of determining insurable interest which has meaning to the parties concerned, since both the insured and the insurer surely intended that pecuniary recovery under the policy should be based on the insured's actual pecuniary loss. The *Royal* doctrine provides a mechanism to accomplish this end.

57. See notes 12-13 *supra* and accompanying text.
58. 430 F.2d at 761.