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**UNIVERSITY OF LONDON**

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**FACULTY OF LAWS**

**INSURABLE INTEREST IN PROPERTY**  
**INSURANCE: A COMPARATIVE STUDY**  
**AMONGST ENGLISH, CANADIAN AND**  
**SAUDI ARABIAN LAWS**

**Essam Saad Al-Ghamdi**

**A Thesis submitted for the Degree of Doctoral of Philosophy**

**July 2006**

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## **Abstract**

The thesis is split into two parts. The first part examines the principle of insurable interest in property insurance as a test which distinguishes insurance contracts from wagering. Throughout the study, the principle of insurable interest will be explored and analyzed under English and Canadian Laws as models of the common law, on the one hand, and Saudi Law which is based upon Islamic Law, i.e. *Sharia*, on the other.

The second part deals with the Saudi conception of insurance contracts. Insurance contracts have been rejected by *Sharia* on the ground that they contain elements of *Riba*, (usury); *Gharar*, (uncertainty) and *Maysir* (gambling). Muslim scholars believe that where one of those elements is found in an insurance contract, it will be vitiated by virtue of *Sharia* principles. The principal object of this study is not only to make a critical study of the common law approach to insurable interest but to suggest a model of insurance that complies with the general principles of *Sharia*.

The thesis consists of eight chapters. The first chapter provides a brief outline of the requirement of insurable interest under the common law models and Saudi law. It will outline the objectives, significance, methodology, scope and the structure of the thesis. The second chapter will be devoted to a historical examination of the contract of insurance together with the requirement of insurable interest. The third chapter will consider the nature of the requirement of insurable interest and the principle of indemnity. The fourth chapter will discuss the consequences of lack of insurable interest.

The fifth chapter outlines the conception of contract in Saudi law and outlines the importance and the influence of Islamic law upon Saudi law. It also explores the elements of *Riba*, usury; *Maysir*, gambling and *Gharar*, uncertainty.

The sixth chapter will discuss the distinction between what Muslim scholars call 'commercial insurance', the original form of insurance that is understood by the common law and which is forbidden under *Sharia*, and 'co-operative insurance,' which, it will be argued is acceptable to *Sharia*. The seventh chapter will propose an alternative form of insurance that accommodates *Sharia*, i.e. 'solidary insurance.' The final chapter, eight, will evaluate the outcomes and will compare and contrast the contract of insurance in its original form, co-operative insurance and the suggested form of insurance, so-called 'solidary insurance.'

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***In the Name of Allah, the Most  
Compassionate, the Most Merciful***

**This Thesis is dedicated to the Nation of Prophet  
Mohammad (may peace be upon him)**

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# **Chapter One: Introduction**

## **1.1. Introduction**

Insurable interest is one of the most significant principles of insurance law and it is a fundamental requirement to the validity of an insurance contract. That is to say, an insured must possess some relationship to the subject-matter insured in order to claim indemnity from an insurer. Nevertheless, the nature of such relationship differs from one jurisdiction to another.

Many jurisdictions, including England, seek to strike down gaming and wagering from insurance contracts.<sup>1</sup> That was decided by English courts during the 18<sup>th</sup> century and it has been adopted up to the present.<sup>2</sup> Accordingly, Parliament passed Life Assurance Act 1774 to make illegal insuring a person's life without insurable interest at the time of concluding a contract of insurance.<sup>3</sup> In addition, Marine Insurance Act 1906 renders insurance policies without insurable interest void and Marine Insurance (Gambling Policies) Act 1909 prohibits gambling on loss by maritime peril.<sup>4</sup>

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<sup>1</sup> Section 1 of Marine Insurance Act 1906 provides that the contract of marine insurance is a contract of indemnity. Note, however, the effect of the Gambling Act 2005 on the requirement of insurable interest in chapter 4, *infra*. See, also, the operation of the principle of indemnity in chapter 3, *infra*.

<sup>2</sup> *Le Cras v Hughes* (1782) 3 Doug. 81, 99 ER. 549; *Da Costa v Jones*, (1778) 2 Cowp. 729, ER. 98.

<sup>3</sup> It is important to note that this study is focussing upon the requirement of insurable interest in property insurance and will exclude life assurance. See, section, 1.6, *infra*.

<sup>4</sup> See, section 2.3.2, *infra*.



Therefore, where a person wants to insure a property, he/she must have an insurable interest, otherwise, the insurance contract will be null and void. The requirement and meaning, however, of insurable interest have been introduced by Marine Insurance Act 1906<sup>5</sup> in section 5. Section 5(1)<sup>6</sup> provides that:

"Subject to the provisions of this Act, every person has an insurable interest who is interested in a marine adventure."

Section 5(2) goes on to state that:

"In particular a person is interested in a marine adventure where he stands in any legal or equitable relation to the adventure or to any insurable property at risk therein, in consequence of which he may benefit by the safety or due arrival of insurable property, or may be prejudiced by its loss, or by damage thereto, or by the detention thereof, or may incur liability in respect thereof."<sup>7</sup>

As a matter of fact, common law jurisdictions applied the requirement of insurable interest in order to safeguard insurance contracts from gambling and wagering. In English law, for example, there were several statutes that were passed by Parliament for the purpose of protecting the public policy from wagering as it was viewed as an

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<sup>5</sup> Hereafter, MIA 1906 [UK].

<sup>6</sup> This definition was drafted with accordance to Lord Eldon's view, the *legal interest test*, in *Lucena v Craufurd*, (1806), 2 B. & P. (NR.) 269, 127 ER, 630. It is important to note that the requirement of insurable interest applies to the other types of insurances.

<sup>7</sup> The Marine insurance Act 1745 enforced the requirement of insurable interest on insurance contracts as well as the Life Assurance Act 1774. None of them, however, defined the concept of "*insurable interest*" which the insured is obliged to possess at the time of the risk insured against. Furthermore, it seems that the definition of insurable interest in the Marine Insurance Act 1906 was the first statutory definition has ever appeared. See Nicolas Legh-Jones, J. Birds & D. Owen, *MacGillivray on Insurance Law*, (10<sup>th</sup> ed. 2003, 1-48, p.24. However, the definition has been criticized as being a restrictive view of insurable interest and not being exhaustive. Therefore, it was abandoned by the Supreme Court of Canada. See, C. Brown & J. Menezes, *Insurance Law in Canada*, 2<sup>nd</sup> ed. 1991, p. 69; R. Colinviaux, *Arnould's Law of Marine Insurance and Average*, 16<sup>th</sup> ed. 1981, para. 332, p.218.

inherently evil practice. As for insurance, the legislation was directed towards prohibiting wagering agreements by requiring an insurable interest and, also, to defeat the occurrence of "moral hazard" in insurance market.<sup>8</sup> That is where an insured is tempted to bring the loss to his/her property in order to benefit from the insurance money.<sup>9</sup>

In respect of Canadian Law, the judgment of *Kosmopoulos*,<sup>10</sup> imposed its significance upon the general view of Canadian Courts with respect to insurable interest. It rejected the English view as confirmed by the House of Lords in *Macaura v. Northern Assurance Company Ltd*,<sup>11</sup> that an insured must have any legal or equitable relation to the adventure or to any insurable property in order to be able to bring a successful claim against his insurer. Thus, the thesis will survey this judgment and evaluate its effect in the common law.

As far as Saudi Arabian Law is concerned, Commercial Court Law 1931<sup>12</sup> has also imposed the requirement of insurable interest in the field of marine insurance. Article 327 mentions the things which are insurable or what could be a subject-matter of insurance. It states that:

"Items which are insurable are..., (7) anything of value which may encounter marine perils."<sup>13</sup>

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<sup>8</sup> J. Lowry & P. Rawlings, *Insurance Law: Cases and Materials*, (Oxford: Hart, 2004), p. 262.

<sup>9</sup> See chapter two, *infra*, for more details.

<sup>10</sup> *Constitution Insurance Co. of Cannada v Kosmopoulos*, 1987, 34 D.L.R. (4<sup>th</sup>) 208.

<sup>11</sup> [1925] A. C. 619.

<sup>12</sup> Hereafter, CCL 1931 [SA]. It is noteworthy that, this is, currently, the only statute which regulates property insurance in Saudi Arabia.

<sup>13</sup> The things which article 327 mentioned as subject-matter of insurance, apart from the above mentioned, included ships and their machinery, equipment and provisions, hulls under construction and all other types of cargos, money borrowed under the marine procedure.

Moreover, the Implementation Regulations of the Cooperative Insurance Companies Control Law 2003<sup>14</sup> has imposed the requirement of insurable interest to be taken into consideration by insurance companies when issuing insurance policies. Article fifty-five of the Regulations states that:

"The basis of the information provided in the policy shall be the application submitted by the policyholder. When completing the insurance application, the following must be taken into consideration: 1- Insurable interest..."

However, insurance has been regulated by CCL 1931 in the field of marine insurance. The CCL 1931 has been criticised for being outdated and it does not serve its purpose at the present time. Therefore, the Saudi regulator is willing to pass a new statute in order to regulate insurance generally, i.e. non-marine.

Therefore, it is hoped that, this comparative study will present useful recommendations to develop and reform the regulation of insurance law in Saudi Arabia, especially, in relation to the doctrine of insurable interest by comparing the models of the common law, i.e. English and Canadian laws.

Furthermore, Islamic law, *Sharia*, is the sole source of the Saudi regulations on the basis that article (1) of the Saudi Basic Law 1992<sup>15</sup> provides:

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<sup>14</sup> By Royal Decree M/32, 01 Aug. 2003.

<sup>15</sup> Royal Order No. (A/91). 27/8/1412 H., 1/3/1992.

"The Kingdom of Saudi Arabia is a sovereign Arab Islamic state with Islam as its religion; God's Book and the Sunnah of His Prophet, God's prayers and peace be upon him, are its constitution, ..."

Article (7) provides:

"Government in Saudi Arabia derives power from the Holy Koran and the Prophet's tradition."

However, the CCL 1931 [SA] has non-religious origins. In fact, the CCL 1931 [SA] is a mere translation of the Ottoman Commercial Code 1850, and the latter was a translation of Part 2 of the French Code de Commerce of 1807.<sup>16</sup>

This thesis will explore the definition, the nature and the influence of the doctrine of insurable interest as a criterion which distinguishes an insurance contract from gambling and wagering under English and Canadian Laws, as models of the common law and Saudi Law. It will, also, explore the definition of cooperative insurance and find out how far it differs from commercial insurance, i.e., insurance contract in its original form. Furthermore, the thesis will discuss and examine the reasoning behind not accepting commercial insurance, in its original form, under Islamic Law, *Sharia*, as the basis of Saudi Law. This will encompass a discussion of *Riba*, usury or unlawful advantage by way of excess or deferment; *Maysir*, gambling; *Gharar*,

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<sup>16</sup> Ba-Naser, Khaled, *Utmost Good Faith in Marine Insurance Contracts*, (PhD Thesis), University of Southampton, 1999, p 3.

uncertainty, risk, speculation<sup>17</sup> and unjustifiable gain of people's money. *Quran* provides that,

**([29] O you who believe! Eat not up your property among yourselves in unjustly except it be a trade amongst you by mutual consent...).**<sup>18</sup>

The thesis is in eight parts and will discuss and examine the following questions:

- I) *What constitutes insurable interest under the common law and Saudi Law?*
- II) *Has the requirement of insurable interest rescued insurance contracts from gaming, gambling and wagering and how could the Gambling Act 2005 influence the requirement of insurable interest?*
- III) *Whether English Courts are willing to reject the defence of lack of insurable interest which could be arisen by insurers?*
- IV) *How far could cooperative insurance provide security to commercial activities in Saudi Arabia in order to improve the Saudi economy?*
- V) *Does cooperative insurance constitute a sufficient substitute for commercial insurance in the guise of commerce?*

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<sup>17</sup> The translation of *Riba and Gharar* is cited from N. A. Saleh, *Unlawful gain and legitimate profit in Islamic law*, 2<sup>nd</sup> ed., 1992, pp. 11, 62.

<sup>18</sup> M. Al-Hilali & M. Khan, *Translation of the meaning of THE NOBLE QURAN*, (1417 A.H), (1996-1997), Surat *An-Nisa*, verse 29.

VI) *Whether the form of insurance can be reformed to conform to Islamic Law?*

VII) *To what extent the requirement of insurable interest is complied with under the two legal systems, namely, common law and Saudi legal systems?*

VIII) *Finally, whether there is a substitute insurance form complies with Sharia that could be used in commercial activities?*



## 1.2. The Objectives of the Thesis:

The objectives of the thesis are as followed:

- 1- To examine the origins of the contract of insurance, generally, and the requirement of insurable interest, in particular, and how it operates under the selected legal systems, namely, common law and *Sharia*. It examines how the requirement of insurable interest provides the desired protection for interests of the parties under insurance and reinsurance contracts.
- 2- To examine how the requirement of insurable interest works under Saudi Law.
- 3- To discuss and analyse the Islamic view about insurance contracts and illustrate the views of the modern Muslim scholars.
- 4- To critically examine and discuss the modern view of Islamic religious scholars concerning, so-called, "*cooperative insurance*." Also, to find out how this form operates and whether it is commercially practical?
- 5- To discuss how the Saudi economy could benefit from this form of insurance?
- 6- To suggest a form of insurance contract that complies with the principles of Islamic law, *Sharia* to be, hopefully, considered when the Saudi regulation, in respect of insurance, is reformed.

7- To identify strengths and defects of the interpretation and the fulfillment of the application of insurable interest and, also, to recognize and try to provide workable solution for any problems that may appear.

8- To conclude by formulating a model of insurance that can be accommodated by orthodox Islamic Law.

### 1.3. The Significance of the Thesis

The significance of this thesis does not appear in its nature as being a comparative evaluation and analysis of the doctrine of insurable interest under each law of the selected legal systems. Nor, does it seek to justify the rejection of life insurance and commercial insurance by Islamic Law as being "*Haram*", but rather to benefit from the developed selected laws in order to develop the CCL 1931 [SA.] in respect of marine insurance and to formulate a model of insurance which complies with the Islamic principles.

Therefore, the thesis will introduce a hypothesis, as a substitute formulation of the insurance contract in its original form, and will try to examine it, evaluate it and justify it in a separate chapter. But this will be preceded by exploring how the doctrine of insurable interest, as a criterion which distinguishes insurance from gambling and wagering, currently operates since its emergence in the 18<sup>th</sup> century in the UK up to the present time.

The hypothesis of this thesis is intended to be a form of solidarity between members of a certain group to cooperate with and guarantee each other where one of them suffers a pecuniary loss that may threaten his/her economic status in the sphere of the Islamic rules and that is based on an order in *Quran* which sets out,

**([2] ... Help you one another in *Al-Birr* and *At-Taqwa* (virtue, righteousness and piety); but do not help one another in sin and transgression. And fear Allah. Verily, *Allah* is Severe in punishment).<sup>19</sup>**

Furthermore, it will establish a formulation of insurance that based on the principles of the Islamic law, and it is the following:

A group of people share a common or similar interest such as owning ships, importing/exporting goods, car drivers or any other society, join a club, union or any association through a contractual relationship, where a joined person pays a sum of money or premium, annually or in any other mode of payment, to the association for the purpose of being indemnified for a particular loss(es) by the latter at the time of the occurrence of the loss(es) and the indemnified member will be obliged to pay back what exceeds his/her total payment by either increasing the subsequent premiums or by monthly payment subject to the status of the member, the duration of the contract and other conditions set out in the contract. The member of such association aims to **avoid any liability or pecuniary loss immediately after the proof of the liability upon the member's shoulders**. In other words, the member aims to shift the loss to all other members' shoulders.

In order to crystallise the idea, the following scenario, hopefully, clarifies it:

Suppose, A is a car driver and he joins B, a club<sup>20</sup>. A pays £400 a year and he has not made a claim for last five years. In the sixth year, A had a car accident and he

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<sup>19</sup> Surat *Al-Maibah*, VI, verse 2.

suffered (£1000) of damage to be paid to a third party. According to the contractual relationship, B indemnified A for his loss and paid the third party £1000 in full. Now, A has paid six premiums, which totals £2400. However, due to the indemnity, B owes A £1400.

Six months after the first claim, A suffered another loss and had to pay £3400 to another third party. Under such circumstances, B indemnified A for the second loss. Therefore, A owes B £2000. In this case, A has to pay back £2000 to B either by increasing the subsequent premiums, that A pays £600 a year, or more, instead of £400, or the premium remains £400, but A pays £100 every month, subject to his/her income, the duration of his/her membership and the conditions of the contract.

If A decides to leave the club or the association, he has the right to get his money back if B, by the time of his decision, still owes A sum of money. Likewise, if the latter dies, his heirs or legatees have right to get the sum of money remains with the club or association for the testator or legator. The club or the association, on the other hand, has right of lien.

In respect of commercial transactions such as carriage of goods by sea or air, since the capital sums of such transactions are usually large, the position needs special arrangements and that could be arranged by specialised people in this field.

As far as the establishment of such association is concerned, there are different ways to achieve it, either by being considered by a government, by members of a

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<sup>20</sup> B is not an individual character. It is, nevertheless, a representative of the members.

particular field such as traders or by a company which practices insurances. In contrast to the other ways, the company can charge an annual fee on a member who wishes to join its membership as an administration fee. That fee will constitute a non-refundable premium. In other words, the company will play the same role as the said club or association or even the government does. Thus, if one member pays £400 premium, which is refundable, per annum and £50 annual fee to the company the fee will not be refundable as it is an equitable right of the company.<sup>21</sup> The total payments of the premiums, however, will be still refundable if the member does not want to renew his membership so long as he has fulfilled his duty to pay the applied annual fee to the company and he is not required to pay any sum of money that exceeds his total amount of the paid premiums where he has been indemnified for his loss(es) to the company, but the paid fees will not be refundable.

So, if the total number of the members is 10,000, the company will earn £500,000 every year and as many members will join its membership as much it will earn and that will allow a strong competition to take a place between wide range of companies which practice insurance or indemnity and will encourage each company to present as much improved services as it could to customers.

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<sup>21</sup> The company could provide facilities for those fees such as providing an insured a car while his car is being fixed or provide an accommodation for an insured who suffers fire loss to his house for some time or providing legal consultancy services. In other words, the company will provide special services, apart from selling its membership and its administration. In addition, the contract between the company and one member could be described as a contract of *lucrative bailment* under *Sharia*. Therefore, the company will be the bailee and the member will be the bailor. The relationship between the members with each other could be regarded as guarantee. Also, where a member is indemnified more than the total of his payment of premiums, the exceeded amount could be considered as loan. Therefore, this form of insurance is a combination of lucrative bailment, guarantee and loan contracts. So, all those contracts are absolutely lawful under *Sharia*. More discussion about the nature of this legal relationship will be analyzed in Chapter Seven.

Therefore, the target of this relationship is to be insurer and insured at the same time without taking any illegal advantage of other members and not, therefore, violating the Islamic rules.

## 1.4. The Methodology of the Thesis:

It will examine the doctrine of insurable interest and its development through the case law and the relative legislation under each legal system separately. Common law, i.e. English and Canadian laws, firstly, and, secondly, Saudi law. It has been thought that this exercise will be useful to fully understand the origins and the role of the insurance contract generally, and the principle of insurable interest, in particular, before examining insurance under Islamic Law. Under each law, the requirement will be evaluated discussed and examined amongst relevant Codes, Regulations and Cases. The thesis will, also, evaluate the opinions of some contemporary Islamic scholars in Saudi Arabia in relation to the legality of insurance under *Sharia*. In addition, previous studies and legal opinions and theories<sup>22</sup> regarding insurable interest will be discussed analyzed and, where it is appropriate, criticized. The topics, moreover, of the thesis will be divided into several chapters and will be discussed individually.

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<sup>22</sup> Such as books, articles and reports, etc.



## 1.5. The Scope of the Thesis:

For English Law,<sup>23</sup> the history of the doctrine of insurable interest is derived from decisions of the Courts during several centuries up to the present together with the relative statutes, i.e. Life Assurance Act 1774 [UK],<sup>24</sup> and Marine Insurance Act 1906 [UK]. Therefore, focusing on English Law will provide insight by giving an extensive and detailed presentation about the emergence of the doctrine of insurable interest. Further, the thesis will examine the influence of Canadian Law, i.e., *Kosmopoulos*,<sup>25</sup> in the common law.

In respect of Saudi Law, the Saudi legal system is based on the Islamic Law of *Sunni Hanbali* school and since the main target of this thesis is trying to present recommendations, by a comparative study, to the Saudi regulator to develop insurance regulations and suggest a form of insurance that complies with *Sharia*, this study will tackle the Islamic view from the *Sunni Hanbali* point of view, with references to other *Sunni* schools, namely, *Hanafi*, *Shafiy* and *Maliki* schools, and that for two main reasons. Firstly, to concentrate on how the application of insurable interest operates under the Saudi jurisdiction and try to work out how to develop the CCL 1931 [SA] by studying the other developed jurisdictions with regard to the doctrine of insurable interest, which are included in this study, in order to achieve as best development as possible. Secondly, the time of this study will not be sufficient to view, analyze and discuss in details the views of other Islamic law schools in respect of *Riba*, *Gharar*, and other concepts which make insurance contracts unacceptable under *Sharia*. In

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<sup>23</sup> Taking into consideration, Life insurance Act 1774, Gaming Act 1845, Marine Insurance Act 1906 and Marine Insurance (Gambling Policies) Act 1909.

<sup>24</sup> Hereafter, LAA 1774 [UK].

<sup>25</sup> *Constitution Insurance Co. of Cannada v Kosmopoulos*, 1987, 34 D.L.R. (4<sup>th</sup>) 208.

addition, life insurance will be excluded from this study because there is no regulation, at the present time, in Saudi Arabia regulates this type of insurance and it is not adopted or practiced by the Saudi jurisdiction.

## 1.6. The Structure of the Thesis:

The thesis is split into two parts and divided into eight chapters as the following:

Part One will be on the doctrine of insurable interest under the common law models and the Saudi law. Therefore, this part will contain chapters: Two, Three and Four.

Part Two will be on the Saudi conception of the contract of insurance and how Muslim scholars understand insurance contracts. Thus, this part will contain chapters: Five, Six and Seven. Accordingly, the structure of the thesis will be as the following:

Chapter One gives an introduction and goes on to illustrate the objectives, the significance, the scope and the structure of the thesis. It, also, gives a brief explanation of how *Sharia* operates as a constitutional law and a general idea about the opinions of Islamic scholars about insurance contracts. This is because it has been thought that including this chapter will present to the reader the position in Saudi Arabia about insurance contracts to understand and try to justify the reason behind suggesting a new form of insurance which is thought it will be a suitable form that complies with *Sharia*.

Chapter Two is devoted to considering the historical background of origins of the contract of insurance, generally, and the application of insurable interest in the field of property insurance under common law and to give a critical and detailed analysis of

the development of the requirement of Insurable Interest since its establishment up to the present time.

Chapter Three will discuss the definition and the nature of insurable interest and the principle of indemnity under the common law models and Saudi Law and how the requirement of insurable interest operates under each law.

Chapter Four will examine and evaluate the requirement of insurable interest as a defence and discuss the consequences of the lack of insurable interest and the effect of the Gambling Act 2005.

Chapter Five will outline understanding the law of contract in Saudi Arabian law and will explore how Islamic law, *Sharia*, influences Saudi regulations. Furthermore, it will explore three elements that turn a contract to be void or unlawful. Those elements are, namely, *Riba*, usury; *Maysir*, gambling and *Gharar*, uncertainty.

Chapter Six will be divided to explore cooperative insurance, analyze it and evaluate it. This is because it has been thought, that it is very necessary and essential for the achievement of this study to devote a separate chapter to fully understand this form of insurance and compare it with commercial insurance to work out whether it is a useful substitute of the latter form of insurance. This discussion will take a place after fully understanding the operation of commercial insurance and will give a clear view where the comparison with the cooperative insurance operates. Besides, it will explore how the forbidden elements that are *Riba*, *Maysir* and *Gharar* manifest in the contract of insurance, which are the reasons of not accepting the insurance contract in

its original form under *Sharia*, although the CCL 1931 [SA] regulates insurance in the field of Marine Insurance. It will also explore how the Saudi jurisdiction treats the contract of insurance.

Chapter Seven will evaluate and analyze the hypothesis of the thesis.<sup>26</sup> It has been thought that tackling the suggested form of insurance that complies with *Sharia* at this stage will give a clearer understanding how this model operates, especially after analyzing and understanding the contract of insurance, in general, and the concept of insurable interest, in particular, under the selected laws, on the one hand, and understanding how cooperative insurance operates, on the other hand. It will, thereafter, try to justify the suggested form of insurance as an ideal solution, under Islamic law.

Finally, Chapter Eight will evaluate the outcomes, identify possible defects and work out a framework for future reforms, where it is possible, under the said laws. In addition, it will compare and contrast the contract of insurance in its original form, cooperative insurance contract and the suggested form of insurance, i.e. solidary insurance.

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<sup>26</sup> See section 1.3, *supra*.

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## **PART ONE: THE DOCTRINE OF** **INSURABLE INTEREST**

## **Chapter Two: The Historical Development of the Doctrine of Insurable Interest**

### **2.1. Introduction**

Generally speaking, insurable interest is a fundamental principle underlying insurance law. It distinguishes a contract of insurance from wagering. It is, also, a legal requirement in order to enable an insured to claim on a policy of insurance when the risk insured against has occurred.<sup>1</sup> Therefore, it is significant, at the beginning, to outline the origins of the contract of insurance to work out how insurance contracts started to be used in commerce and how European ancients treated these species of contracts. In addition, to explore other forms of contracts that were used as a security and find out how similar they were to insurance contracts. Also, to find out whether there was any difficulty to practice insurance and, then, outline the origins of insurable interest and analyse its effect upon parties' duties which are arisen from insurance contracts they conclude.

Accordingly, section 2.2 will outline the origins and the historical development of the contract of insurance and explore some other forms of contracts that were used as

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<sup>1</sup> That is because of the nature of insurance contracts as being contracts of indemnity. More discussion about *the principle of Indemnity* will be analyzed in Chapter Three of this work at a later stage. See *Le Cras v Hughes* (1782) 3 Dougl 81, 99 ER 549, at 550; R. E. Keeton & A. I. Widiss, *Insurance Law*, Student Edition, 1988, at p. 134; Merkin, *Insurance Contract Law*, Vol.I, 2002, para. A-0389. It is significant, nevertheless, to emphasise that not all insurance policies are contract of indemnity. See, J. Lowry and P. Rawlings, *Insurance Law: Doctrines and Principles*, (1999), pp.14 & 15.

a security. Section 2.3 will discuss the origins of the doctrine of insurable interest.

Section 2.4 contains concluding comment.



## 2.2. The Origins of the Contract of Insurance

The emergence of insurance contract goes back to the beginning of the 13<sup>th</sup> century in Italy.<sup>2</sup> It was said, that insurance was invented by the *Jews* when they were banished from France by *Philip Augustus* in the year 1182 and they found Italy a suitable and safe refuge. They resorted to this expedient of insurance to secure their properties and themselves from losses because of the likelihood of banishment.<sup>3</sup> The merchants of north Italy perceived the success of insurance, "struck with its utility, were prompt to adopt and extend its use."<sup>4</sup> Although it was said that this narrative had a little chance of likelihood,<sup>5</sup> Duer had the wisdom, in his introduction, of accepting it on the ground that, in his words, "the sagacity of the Jews, in matter of finance is well known, and they were placed in circumstances of difficulty and distress that were well calculated to sharpen their invention. That they would resort to some expedient for averting or diminishing the losses to which they were exposed, we may certainly believe, and the expedients of insurance and bills of exchange which they are said to have invented, at the same time, admirable suited to accomplish their object."<sup>6</sup>

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<sup>2</sup> Duer, *Marine Insurance*, (1845), Vol. I, p. 29. The author presented factual evidence. "The Italian," he said, "alone explains its meaning and propriety. The word "*Polizza*," in Italian, signifies any note or memorandum in writing, creating, or evidence of a legal obligation; and hence the name is applied, with the same propriety, to a bill of exchange, a promissory note, and even to a receipt for money as to the written agreement of insurance. It seems a safe conclusion that insurance originated in the country, the language of which, has given to the agreement of the parties its distinctive appellation."

<sup>3</sup> The Jews were also banished by Dagobert and Philip the Long. See, Marshall, *A Treatise on the Law of Insurance*, (1805), p. 4; F. Hildyard, J. A. Park, *A System of the Law of Marine Insurance* (1842), (1987), Vol. I, lxviii.

<sup>4</sup> Duer, *supra*, n. 2, p. 30.

<sup>5</sup> Marshall, *supra*, n.3, p. 4. The author stated that, "... according to *Cleirac*, bills of exchange and policies of insurance are of *Jewish* birth and invention, and have nearly the same name, *Polizza di cambio*, *Polizza di sicurezza*. He adds that the *Italians* and *Lombards*, who were spectators of this *Jewish* intrigue, and the instruments employed in conducting it, preserved the forms of these instruments, which they afterwards well knew how to avail themselves of, in conveying out of *Italy* the effects of the *Guelphs*, when driven from thence by the *Gibbelines*." However, Marshall, did not support that narrative.

<sup>6</sup> Duer, *supra*, n. 2, pp. 30, 31.

In the thirteenth century, a group of Italian merchants were known as *Lombards*,<sup>7</sup> which had a colony in England thereafter, adopted insurance and considerably improved it and it was agreed that the *Lombards* were at least the first who introduced the contract of insurance to the world and brought it to perfection.<sup>8</sup> In fact, the earliest form of the contract of insurance was the contract of marine insurance.<sup>9</sup>

However, Macpherson observed that insurance was invented even earlier than the 13<sup>th</sup> century. He claimed that *Claudius*, the Roman emperor, was the first who invented insurance upon ships in the middle of the first century, about the year 51, when he intended to encourage merchants to import corn to his country. In his words, "The importation of corn being the branch of trade, which engaged the most general attention among the Romans, Claudius, during a time of scarcity, did every thing in his power to persuade the merchants to import it even in the winter, when it was customary lay up the ship. He took", he said, "upon him self all losses and accidents which might arise from the inclemency of the season, and he also made the importers sure of a certain rate of profit."<sup>10</sup>

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<sup>7</sup> In fact, the *Lombards* played an important role in the Europe. According to Marshall, during the 12<sup>th</sup> and 13<sup>th</sup> centuries, the commerce of Europe was almost entirely in the hands of *Lombards*, who were Italians, and their companies or factories settled themselves in almost every State in Europe. From thence, they became the only considerable merchants and bankers, "*and in those times rivalled even the Jews themselves in the art of usury*", *supra*, n. 3, p. 10.

<sup>8</sup> Park, *supra*, n. 3, lxviii. Park adheres to the idea that the *Lombards* were the inventors of insurance.

<sup>9</sup> Holdsworth, *A History of English Law*, (1925), Vol. 8, p. 274. The author observed, "...that as a separate and independent contract it dates from the early years of the fourteenth century ; and that it was evolved, like many other of our modern mercantile institutions, in the commercial cities of Italy." It seems that the author depended heavily, in the part of his work on the Origins of the Contract of Marine Insurance, on Mr Bensa's researches, particularly, *Histoire du Contrat d'Assurance au Moyen Age* (French tr.).

<sup>10</sup> David Macpherson, *Annals of Commerce*, 1805, Vol. I, at p. 151. See also the footnote in that page. Although Macpherson thinks that this event is the only foundation of insurance, I disagree, however, with him in this point. It seems that the support was provided by the emperor was a mere encouragement from a government, represented by *Claudius*, to its merchants during an extraordinary occasion to rescue the economy of its country from national losses. In addition, this scenario does not seem to be an agreement between two parties where one party undertakes, in consideration of a premium, to indemnify the other for a loss or losses that caused by a certain event or events . Therefore, I think insurance was not yet invented by that period of time. Nevertheless, it can be considered as a *governmental insurance* which is not a commercial transaction.

Park, nevertheless, in the introduction of his work, indicated that insurances were unknown to the ancient world. He observed that, "...it will appear, that insurances were in those days wholly unknown; or, if they were known, that the smallest proofs of the existence of such a custom have not come down to the present times."<sup>11</sup> Furthermore, Park traced the origin of insurances and he observed that no proof that the laws of *Rhodes*,<sup>12</sup> *Romans*,<sup>13</sup> *Amalfi*,<sup>14</sup> *Oleron*<sup>15</sup> and *Wisbuy*<sup>16</sup> had the smallest idea of the contract of insurance.

Holdsworth, presented, in his history of English Law,<sup>17</sup> some contracts which modelled on insurances. For instance, there were stipulations to be incorporated in contracts of carriage among both Greeks and Romans which were designed to shift

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<sup>11</sup> Park, *supra*. n. 3, xlvi.

<sup>12</sup> *Ibid*, pp. xlv, xlix. *Rhodian Law* is "the earliest known system or code of maritime law, supposedly dating from 900 B.C. Furthermore, Rhodian law was purportedly developed by people of the island Rhodes, located in the Aegean Sea and now belonging to Greece. The ancient inhabitants of Rhodes are said to have controlled the seas because of their commercial prosperity and naval superiority. Despite the uncertainties about its history, Rhodian law has often been cited as a source of admiralty and maritime law." B. A. Garner, *Black's Law Dictionary*, 7<sup>th</sup> ed., (1999), 1322.

<sup>13</sup> *Ibid*. lxiii. *Rowman law* is "the legal system of the ancient Rowmans, forming the basis of the modern civil law." Garner, *ibid*, 1329. Duer argued that "It is not then a necessary conclusion from the silence of the Roman law, that marine insurance was unknown.", *supra*, n. 2, at p. 23.

<sup>14</sup> *Ibid*, lxix, lxx, also termed *Amalphitan Code* which is "A code of maritime law compiled late in the 11<sup>th</sup> century at the port of Amalfi near Naples. The Code was regarded as a primary source of maritime law throughout the Mediterranean to the end of the 16<sup>th</sup> century." Garner, *ibid*, 79.

<sup>15</sup> *Ibid*, lxxiii. Park argued that "Anderson in his history of commerce has expressly stated that the laws of Oleron treat of insurances." However, he conjectured that, Anderson "does not adduce any authority in support of his opinion." He went on to make his comment about Anderson's statement that, "I have read them repeatedly with the direct view of discovering whether insurances were of so ancient a date: but I have not found a single word which could induce me to subscribe to such an assertion.", The laws of *Oleron* are "The oldest collection of modern maritime laws, thought to be a code existing at *Oleron* (an island off the coast of France) during the 12<sup>th</sup> century. It was introduced into England, with certain additions, in the reign of Richard I (1189-99). Garner, *ibid*, 894.

<sup>16</sup> Marshall, *supra*. n. 3, 8. Park, however, observed that the laws of *Wisbuy*, in article 66, "expressly mentioned insurances, and provided, that if the merchant obliged the master to insure the ship, the merchant shall be obliged to insure the master's life against the hazards of the sea." Laws of *Wisbuy* is "A code of maritime customs and decisions adopted on the island of Gothland (in the Baltic Sea), where Wisby was the principal port. The code was influential throughout northern Europe." Garner, *ibid*, 895. For more discussion on the laws of *Wisbuy*, see, Duer, *supra*. 2, p.40.

<sup>17</sup> *Supra*, n. 9.

the risks of, or damage to, the goods carried on either the carrier or the consignee.<sup>18</sup>

The maritime loan, also, played the role of security. That, the lender pays a sum of money to the borrower, usually a maritime carrier, to continue his voyage with security. However, should the goods be lost by a peril of the Sea, the lender will not be repaid, but in the case where the goods arrives safely or are damaged by the carrier's negligence, the lender will be repaid with a higher interest paid by the borrower and that interest represents a premium.<sup>19</sup>

Furthermore, it seems that insurance was not legally acceptable<sup>20</sup> and it used to be disguised under other contract forms such as a sale, an exchange or a maritime loan to avoid any question about the insurance legitimacy "on the ground that it infringed the laws against usury"<sup>21</sup>, with incorporation of stipulations regarding risks that could befall lenders. For instance, in the 13<sup>th</sup> century there were some contracts, such as sale or loan contracts, concluded with intention of being insurances. Thus, the contract of "*commenda*"<sup>22</sup> and "*mutuum*"<sup>23</sup>, for example, contained a kind of insurance. That in the contract of *commenda*, as Holdsworth explained, "...under which A advances money or other property to B to trade with, there is usually a stipulation as to the party

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<sup>18</sup> *Ibid*, 274.

<sup>19</sup> *Ibid*, 275. See also, B. A. Garner, *Black's Law Dictionary*, 7<sup>th</sup> ed., (1999), pp. 12, 947.

<sup>20</sup> Holdsworth, *ibid*, p. 106.

<sup>21</sup> *Ibid*, 274. For more discussion on the history of usury laws, see, Holdsworth, *ibid*, p. 100. He mentioned that usury was a crime and usurers used to be heavily punished, that "...usury was both a sin and crime. In the usurer's lifetime he was dealt with by the ecclesiastical courts as a sinner; but, if he died unrepentant, the king asserted a claim to his goods". In 1341 a statute passed enacted that, "The king and his heirs should have the cognisance of the usurers dead; and that the Ordinaries of Holy Church have the cognisance of the usurers in life, as to them appertaineth, to make compulsion by the censures of Holy Church for the sin, and to make restitution of the usuries taken against the laws of Holy Church.", *ibid*, 102. It seems that insurance was treated in this manner and, perhaps, that was the reason behind disguising insurance under other, legal, contracts.

<sup>22</sup> "A business association in which one person has responsibility for managing all business property" Garner, *supra*, n 12, at 262.

<sup>23</sup> "A transaction (sometimes referred to as a bailment) in which goods are delivered, but instead of being returned, are replaced by other goods of the same kind. At the common law such a transaction is regarded as a sale or exchange, and not as a bailment, because the particular goods are not returned." Garner, *supra*, n 12, at 1041.

on whom the risk of accidental loss is to fall."<sup>24</sup> In respect of the contract of *mutuum*, the lender pays over the money advanced with a deduction, bearing in mind that the borrower will not repay if the money was lost by the accident; it was considered that such a deduction was a true premium of insurance. Correspondingly, contracts of sale or exchange were frequently used as a loan at sufficient interest to compensate the lender for the use of his money and the provision that nothing was payable if the money was lost accidentally.<sup>25</sup> In this manner, a contract of sale was, as Holdsworth exemplified, in the following form: "Instead of B buying goods with money lent by A, A buys the goods himself and sells them to B, and the price which B agrees to pay will be (a) payable at a future date; (b) contingent upon the safe arrival at the place of payment, either of the original goods or the goods into which they have been converted; and (c) sufficient to meet the sum paid by A with maritime interest."<sup>26</sup> Likewise in the case of exchange, "B received coins from A on the terms of paying different coins (which would be of a different value) at another time or place; and according as the coins were at the risk of the borrower or lender, the value of the coins to be returned would differ. The difference between the rates of exchange, according as the money was repayable in any event, or only on the prosperous termination of the voyage, represents again a premium of insurance."<sup>27</sup>

More importantly, in order to crystallize the foundation and the development of the form of insurance, Holdsworth argued that in the 14<sup>th</sup> century, insurance was modelled on the maritime loan, which was developed into the contract of bottomry,

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<sup>24</sup> *Supra*, n 9, 275.

<sup>25</sup> *Ibid*, 276.

<sup>26</sup> *Ibid*. According to Holdsworth, in a later stage of that period, insurance was modelled on a sale that the property insured was considered to be sold to the insurer, the shipowner, subject to a *resolutive condition*, in the event of its safe arrival. Therefore, the goods were in the insurer's risk during the voyage, so he could sue for their recovery during that period. See, p. 277

<sup>27</sup> *Ibid*.

that "In the maritime loan the debtor, who has borrowed the money declares that he has received the sum advanced, and promises to restore an equivalent sum on the safe arrival of the ship or goods: in the insurance the insurer plays the part of the debtor, states that he has received the amount for which the ship or goods are insured, and promises to repay it in the event of the ship or goods not arriving safely." He carried on saying that, "It was only natural that the earliest insurers should be shipowners, they could charge a smaller premium because they could more easily guarantee a safe arrival." Therefore, he concluded that, "...it was inevitable that those who drew up the earliest contracts of insurance should be the same persons who as those who were in the habit of drawing up contracts of loan on bottomry. Hence" he said, "it was from the latter contract that some of the most important of the technical terms applicable to insurance at the present day (such, for instance, as "policy" and "premium") were originally taken."<sup>28</sup>

Thus, Holdsworth deduced two principles of insurance law flowed from this conception. The first principle was the principle of insurable interest, that "the insured must be the owner, or at least have some interest in the property insured." He said, "A man cannot transfer to another what he does not own." Therefore, he inferred that, "from the first the contract was a true contract of indemnity and not a mere wager on the safe arrival of ship or merchandise." The second principle was that, "if the ship or goods did not arrive safely, and the resolute condition failed to operate, the insurers were entitled to so much of the property insured as could be recovered."<sup>29</sup>

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<sup>28</sup> *Ibid*, 277.

<sup>29</sup> *Ibid*, 278. Resolute condition is, in *civil law*, a condition that upon fulfilment terminates an already enforceable obligation and entitles the parties to be resorted to their original position. B. A. Garner, *Black's Law Dictionary*, 7<sup>th</sup> ed., (1999), p. 290.

However, insurance business grew and flourished during the 14<sup>th</sup> century. Genoa, moreover, seemed to be the centre of that business which started to be popular day after day so quickly and "it came to be regarded as a distinct species of the large genus innominate contract."<sup>30</sup> Consequently, the contract of insurance separated from the contract of loan on bottomry and the contract of sale, ceased to be disguised under any of them and its legality became fully recognized. As Holdsworth pictured that time, he observed that "Shipowners,..., ceased to act as insurers; and the magnitude of the sums assured led to the practice of several persons joining in the contract, by writing their names under the police, with the proportion of the sum assured for which they were prepared to answer."<sup>31</sup>

Hence, the above said leads to the outlook of Marshall that, "The law of insurance is considered as a branch of marine law...It is also a branch of the law of merchants, being found in the practice of merchants, which is nearly the same in all the countries where insurance is in use...", thus, "The law of merchants not being founded in the particular institutions, of local customs of any particular country, but consisting of certain principles which general convenience has established to regulate the dealings of merchants with each other in all countries, may be considered as a branch of public law."<sup>32</sup>

It is noteworthy that, the first recorded insurance policy was drafted in Genoa, Italy, on 13<sup>th</sup> of October 1347.<sup>33</sup> And the earliest statute about insurance, according to

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<sup>30</sup> *Ibid.*

<sup>31</sup> *Ibid.*

<sup>32</sup> Marshall, *A Treatise on the Law of Insurance*, (1805), pp. 18, 19.

<sup>33</sup> *Ibid.*, 276; Siddeeg Al-Mesrati, *Mabda At-Taweedh Fe At-Tameen Al-Bahri*, (Arabic), *Principle of Indemnity in Marine Insurance*, 1986, p. 245; Another recorded insurance policy was claimed to be the

Macpherson was the statutes of Barcelona in 1433<sup>34</sup> which was finally codified in 1484.<sup>35</sup> Macpherson observed that on November 21<sup>st</sup>, "The citizens of Barcelona claim the honour of having made ordinance for regulating the important business of maritime insurance before any other community in Europe."<sup>36</sup> The statute prohibited insuring any vessel for more than three quarters of her real ascertained value; it prohibited insuring foreigner merchandize in Barcelona, unless it belongs to a subject of *the king of Aragon* and if the merchandize is freighted onboard a foreigner vessel it should not be insured for more than half of its real value and no merchandize whatever, except corn and wine, should be insured for more than three quarters of its real value. It made, moreover, unlawful and prohibited the words "*value more or less*" or similar to be inserted in policies; a vessel should be considered as certain lost if it was not heard of for six months; it identified the amount of commissions of insurance brokers and it regulated insurance brokerage business.<sup>37</sup>

In relation to fire insurance, its emergence goes back to the 16<sup>th</sup> and 17<sup>th</sup> centuries. Holdsworth noted that a system of fire insurance was in operation in 1591 and this kind of insurance was proposed to be established in England in 1635 and 1638, but it did not take a place until the occurrence of a great fire in London in 1666.<sup>38</sup>

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first policy was drafted in Palermo, Italy, on 13<sup>th</sup> March 1350, *all risks* policy. See, Andreas Haberbeck & Mark Galloway, *Saudi Shipping Law*, 1990, p. 212.

<sup>34</sup> Holdsworth, nonetheless, claims that the earliest legislation was the statute of Barcelona 1435. See, *ibid.* p282; Marshall, *A Treatise on the Law of Insurance*, (1805), p. 20; Duer, *Marine Insurance*, (1845), vol. I, p. 34, he claimed that the statute was enacted in 1436.

<sup>35</sup> The statue consisted of four statutes of 1435, 1458, 1461 and finally 1484.

<sup>36</sup> David Macpherson, *Annals of Commerce*, 1805, Vol. I, at p. 648. It seems that England and European countries benefited from this statute when they formed their statutes in order to regulate insurance contracts.

<sup>37</sup> *Ibid.*

<sup>38</sup> Holdsworth, *supra*, n. 9, p. 294. By that time, several fire insurance companies were established. In addition, other kind of insurances such as insurances against risks to persons and life insurance were known during that period. Life insurance was introduced in England by Italian merchants in the middle of the 16<sup>th</sup> century. For detailed discussion on the history of Life Insurance, see, Geoffrey Clark, *Betting on lives: The cultural of life insurance in England, 1695-1775*, (1999).



As far as the regulation of insurance in England is concerned, due to the growth of foreign trade in the 16<sup>th</sup> century and, therefore, the increase of the importance of insurance, the Council began to consider regulating the business of insurance and several actions were taken in order to achieve such a purpose.<sup>39</sup> However, no statute was passed during that period to formally regulate insurance. Yet, in the beginning of 17<sup>th</sup> century, according to Clark, the insurance business was not still known by many local merchants in England. He observed that, "Insurance in the early seventeenth century was still an arcane business transacted mainly by overseas merchants and large-scale moneylenders, and the range of insured contingencies remained within a tight commercial orbit."<sup>40</sup>

It is interesting to note, at this stage that Lord Mansfield's influence, during the 18<sup>th</sup> century, shaped much of insurance law generally. He established principles relating to, *inter alia*, utmost good faith, warranties and insurable interest.<sup>41</sup>

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<sup>39</sup> In 1574, "...an order was sent ...to the Lord Mayor of London to collect and certify the orders made and the rules applied by the merchants in matters of insurance." Also in the same year, "a grant was made to Richard Candler, giving to him and his deputies the sole right of making and registering insurances and policies and other instruments belonging to merchants." In the following year, The London Mayor was directed to fix prices making and registering insurance policies. In addition, he was directed to summon some expert civilians and merchants and to collect the information they provide and reduce it to writing. Holdsworth, *supra*, n 9, p. 285.

<sup>40</sup> Geoffrey Clark, *Betting on lives: The cultural of life insurance in England, 1695-1775*, (1999), p. 1. Prior to the 18<sup>th</sup> century, the idea of insurance was unfamiliar to the general English public. See p. 4.

<sup>41</sup> See, James Oldham, *The Mansfield Manuscripts and the Growth of English Law in the Eighteenth Century*, Vol. I, (Chapel Hill; London: University of North Carolina Press, 1992), p. 450. The author observed that, "Lord Mansfield established the principle that an insurance contract is an agreement requiring the utmost fidelity between parties. Fraud, concealment of a material fact that would alter the risk, breach of implied or express warranties, or deviation from the route implied by the terms of the contract would invalidate the contract. Furthermore, by consistently characterizing the contract as one of indemnification, Lord Mansfield applied the principle that the risk insured against must be commensurate with the risk actually run. This was related to the broader principle that the insured must have an "insurable interest" in the thing or person insured. Necessarily, one cannot be indemnified, held harmless, if one cannot be harmed. The requirement of an insurable interest became invalidating test. Life and fire insurance were developed by analogy to the principles of marine insurance; cases in which the insured lacked an insurable interest were deemed wagering and fell under statutory proscription."

## 2.3. The History of the Doctrine of Insurable Interest

Insurance was, as it has already been mentioned, introduced in England by Lombards.<sup>42</sup> English courts started to deal with insurance contracts in the sixteenth century by the court of Admiralty. The first insurance policy that was dealt with by an English court is to be found in *Broke v Maynard* (1547).<sup>43</sup> Holdsworth observed that the latter case, "...shows that at this date the practice of insurance was well known in England; and that this was the fact was specifically stated in the case of *Ridolphye v. Nunze* (1562)."<sup>44</sup>

As the matter of fact, Marshall claimed that insurance grew along with the maritime commerce.<sup>45</sup> Yet, almost all disputes in relation to insurance contracts used to be dealt with by arbitration,<sup>46</sup> until the first Act of Parliament was passed in (1601), for the purpose of creating a special tribunal for the determination of insurance cases.<sup>47</sup>

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<sup>42</sup> See, Alex L. Parks, *The Law and Practice of Marine Insurance and Average*, 1988, Vol. I, pp. 4, 5. The author claims that the Hansa merchants introduced marine insurance into England. He claims that: "As the Lombards extended their interests northward, they came into contact with the Hansa merchants of northern Europe who by then were organized into the Hanseatic League, probably one of the most powerful cartels which ever existed."

<sup>43</sup> Holdsworth, *supra*, n. 9, p 283. Where an action was brought by the insured on a policy written in Italian, and subscribed by two insurers. The insurers had paid the insured part of the sum and they had received no part of goods which had been salvaged and there had been a deviation. The action, therefore, was defended.

<sup>44</sup> *Ibid.*

<sup>45</sup> Marshall, *A Treatise on the Law of Insurance*, (1805), p. 8.

<sup>46</sup> Joseph A. Joyce, *A Treatise on Marine, Fire, Life, Accident and Other Insurances*, Vol. I, 1897, p. 6.

<sup>47</sup> Duer, *Marine Insurance*, (1845), Vol. I, p. 33; F. Hildyard, J. A. Park, *A System of the Law of Marine Insurance* (1842), (1987), Vol. I, lxxxvi. See also, Holdsworth, *A History of English Law*, 1925, Vol. 8, p. 282; Alex L. Parks, *The Law and Practice of Marine Insurance and Average*, 1988, Vol. I, p. 10.

### 2.3.1. *The Doctrine of Insurable Interest Prior to Legislation*

The nature of insurance contract, in its original status, is that an insured pays an insurer a sum of the money to hold him self harmless from any loss caused by a peril of the sea while his ship is performing her voyage. In other words, "a particular voyage should be free from perils."<sup>48</sup> As time passed, especially in the reign of *Charles II*,<sup>49</sup> new forms of policies of insurance, by expressed agreements, started to spread and were discharging a merchant from having an interest in the subject matter insured. In addition, the insurer was promising to pay the insured at the occurrence of the risk regardless the presence of any interest in the insured thing. That kind of policy incorporated such terms as "interest or no interest" or "without further proof of interest than the policy" or "without benefit of salvage to the underwriter" or Policy Proof of Interest, (p.p.i). In the time of *Queen Anne*,<sup>50</sup> policies of that kind were valid and legal.<sup>51</sup> By that time, according to *Clark*, "Much insurance...was indeed underwriting on purely speculative contingencies such as the outcome of siege, the timing of birth, and especially the longevity of individuals."<sup>52</sup> As a matter of fact, English courts were accepting wagering agreements in the guise of marine insurance as long as they did not give rise to questions regarding being against the public interest,<sup>53</sup> but parties had to have a mutual intention of wagering when they conclude an insurance policy or include a term like "interest or no interest". Otherwise, the courts would interpret the policy as a contract of indemnity which the insurer would

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<sup>48</sup> F. Hildyard, Park, *A System of The Law of Marine Insurance*, Vol. II, 8<sup>th</sup> ed., 1987. p.551.

<sup>49</sup> That was during the second half of the 17<sup>th</sup> century.

<sup>50</sup> In the beginning of the 18<sup>th</sup> century.

<sup>51</sup> Colinvaux, *Arnould's Law of Marine Insurance and Average*, Vol. I, 1981, para.331.

<sup>52</sup> Geoffrey Clark, *Betting on lives: The cultural of life insurance in England, 1695-1775*, (1999), p. 3.

<sup>53</sup> See the argument of Lord Mansfield in *Da Costa v Jones*, (1778) 2 Cowp. 729, 735, ER. 98, 1331; *Good v Elliott* (1790) 3 T.R. 693, ER. 100, 808; *Allen v Hearn* (1785) 1 T. R. 56, ER. 99, 969; *Jones v Randall* (1774) 1 Cowp. 37, 39, ER. 98, 954.

indemnify the insured for a real loss, therefore, the latter has to show his interest in subject matter of insurance in order to be insured.

However, although wagering contracts were enforceable, the courts started to reject that kind of insurance policies. For instance, in *Goddart v Garrett*,<sup>54</sup> the defendant had lent money on a bottomry bond, the sum was £300. Although he insured the ship for £450, he had no insurable interest in the ship; the plaintiff's bill was to be delivered up, by reason the defendant was not concerned in point of interest, as to the ship or cargo.

The defendant was obliged to declare his interest in the thing he had insured in order to bring a successful claim. "Per Curiam. Take it that the law is settled, that if a man has no interest, and insures, the insurance is void, although it be expressed in the policy interested or not interested."<sup>55</sup> The court went on to explain that,

"...the reason the law goes upon, is that these insurances are made for the encouragement of trade, and not that persons unconcerned in trade, nor interested in the ship, should profit by it; and where one would have benefit of insurance, he must renounce all interest in the ship. And the reason why the law allows that a man having some interest in the ship or cargo, may insure more, of five times as much, is that merchant cannot tell how little, his factor may have in readiness to lade on board his ship."<sup>56</sup>

Therefore, it was held that,

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<sup>54</sup> *Goddart v Garrett*, (1692) 2 Vern. 269, Trin. Term., ER. 23, 774.

<sup>55</sup> *Ibid.*

<sup>56</sup> *Ibid.*

"... the policy of insurance to be delivered up to be cancelled."<sup>57</sup>

Likewise, and in the same manner of *Goddart v Garrett*, in *Le Pypre v Farr*,<sup>58</sup> the defendant had insured goods at the value of £600; under the policy, he was not obliged to prove any interest. The Lord Chancellor, ordered the defendant to discover what goods he put on board; for although the defendant offered to renounce all interest to the insurer; yet referred it to the Master to examine the value of the goods saved ....., and to deduct it out of the value or sum of £600 at which the goods were valued by the agreement.<sup>59</sup>

Thus, because of that the number of issuing that kind of policies was in increasing and that was considered as a harmful issue to the public policy, the Legislature had taken care of protecting the branch of trade and the public interest.<sup>60</sup> Therefore, that was a sufficient reason to regulate Marine insurance generally.

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<sup>57</sup> *Ibid.* It has to be noted that, the validity of an insurance contract that made without an insurable interest in the Court of Chancery, which invalidated insurance policies without an insurable interest, differs from the position in the law courts which had taken the opposite view, i.e. validate an insurance contract without an insurable interest. See, Holdsworth, *supra*, n. 9, p. 292; James Oldham, *The Mansfield Manuscripts and the Growth of English Law in the Eighteenth Century*, Vol. I, (Chapel Hill; London: University of North Carolina Press, 1992), p. 469.

<sup>58</sup> *Le Pypre v Farr*, (1716) 2 Vern. 716, ER. 23, 1070; *Assievector v Cambridge*, 10 Mod., 77, ER. 88, 634. See also, *Sadler's Co. v Badcock*, (1743) 2 Atk. 554, ER. 26, 733, where the court rejected the insured's claim, on a fire policy, on the ground that no insurable interest had been shown at the time of the risk.

<sup>59</sup> F. Hildyard, Park, *A System of The Law of Marine Insurance*, n.3, *supra*, p.554; N. Legh-Jons, J. Birds & Others, *MacGillivray on Insurance Law*, (10<sup>th</sup> ed., 2003), para.1-19.

<sup>60</sup> See, R. S. Pinzur, "Insurable Interest: A Search for Consistency", *Ins. C. J.*, 1979, 109, 110; R. Merkin, "Gambling by Insurance- A Study of The Life Assurance Act 1774", *Anglo-American LR* [1980], p. 331, 334-5.

### 2.3.2. Insurable Interest under Legislation and Practice

During the 18<sup>th</sup> century, a number of statutes were passed by Parliament to regulate insurance contracts in order to protect the public interest. Therefore, first is the Marine Insurance Act 1745.<sup>61</sup> The preamble of the Act set out the reasons of the enforcement of it, with some ambiguity.<sup>62</sup> It provided that:

"Whereas it hath been found by experience, that the making assurance interest or no interest, or without proof of interest than the policy, hath been productive of many pernicious practices, whereby great numbers of ships, with their cargoes, have been fraudulently lost and destroyed .... and by introducing a mischievous kind of gaming or wagering, under the pretence of assuring the risk on shipping and fair trade, the institution and laudable design of making assurances hath been perverted; and that, which was intended for the encouragement of trade and navigation, has, in many instances become hurtful of, and destructive to the same."

The Act was passed for the purpose of controlling the issuance of insurance policies without interest, "or which provided that the policy itself was to be conclusive proof of interest ("ppi" policies) or made "interest or no interest)."<sup>63</sup> The Act prohibited

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<sup>61</sup> 19 Geo. 2, c. 37. See, Nicholas Legh-Jones Q.C., John Birds and David Owen, *MacGillivray on Insurance Law*, (10<sup>th</sup> ed., 2003), parag. 1-21.

<sup>62</sup> See, J. Lowry & P. Rawlings, "Re-thinking Insurable interest", Sarah Worthington, *Commercial Law and Commercial Practice*, (2003), 335, at p.336.

<sup>63</sup> Robert Merkin, *Colinvaux & Merkin's Insurance Contract Law*, Vol. I, 2002, parag. A-0387. Note that, the mere appearance of "interest or no interest, or without further proof of interest than the policy, or by way of gaming or wagering, or without benefit of salvage to the assurer, or free of average" on a policy makes it 'null and void' even if the insured has an insurable interest. See, J. Lowry & P. Rawlings, "Re-thinking Insurable interest", Sarah Worthington, *Commercial Law and Commercial Practice*, (2003), 335, at p.337.

issuing insurance policies by way of wagering, i.e., without interest in of the subject matter insured. It provided:

"..., that no assurance or assurances shall be made by any person or persons, bodies corporate politic, on any ship or ships belonging to his Majesty, or any of his subjects or on any goods, merchandises, or effects, laden or to be laden on board of any such ship or ships interest or no interest, or without further proof of interest than the policy, or by way of gaming, or wagering, or without benefit of salvage to the assurer; and that every such insurance shall be null and void to all intents and purposes."<sup>64</sup>

The second statute is Life Assurance Act 1774<sup>65</sup> which prohibited making insurances without an insurable interest. Merkin observed that "The paramount purpose of the 1774 Act was to stamp out gambling hidden by a notional insurance"<sup>66</sup>. It was stated in the preamble that:

"...no insurance shall be made ... on the life or lives of any person or persons, or on any other event or events whatsoever, wherein the person or persons for

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<sup>64</sup> Section (1). It is to be noted that, s 4 of the MIA 1906 [UK], is a mere copy of s 10 of the 1745 Act in respect of (Avoidance of wagering and gaming contracts). The 1745 Act is repealed by s. 92 MIA 1906.

<sup>65</sup> 14 Geo. 3, c. 48. It is also called the Gambling Act 1774. The Act is still in force at the present time. It is very important to note that, since the scope of this thesis tackles Insurable Interest in Property Insurance, it excludes types of Insurances other than *Indemnity Insurance*. It will not, nonetheless, exclude the other relevant issues arise from the 1774 Act. See R. Merkin, "Gambling by Insurance- A Study of The Life Assurance Act 1774", *Anglo-American LR* [1980], p. 331; W. R. Vance & B. M. Anderson, *Handbook on Law of Insurance*, (3<sup>rd</sup> ed., 1951), Sec. 15; Geoffrey Clark, *Betting on lives: The cultural of life insurance in England, 1695-1775*, (1999).

<sup>66</sup> R. Merkin, "Gambling by Insurance- A Study of The Life Assurance Act 1774", *Anglo-American LR* [1980], p. 331; Geoffrey Clark, *Betting on lives: The cultural of life insurance in England, 1695-1775*, (1999), p. 9.

whose use, benefit, or on whose account such policy or policies shall be made, shall have no interest...".<sup>67</sup>

It is of significance to note that, the LAA 1774 does not apply to real property insurance. That has been confirmed by the Court of Appeal in *Mark Rowlands Ltd. v Berni Inns Ltd*,<sup>68</sup> where the issue was that whether the tenant of the insured building, who had paid the premium, had an insurable interest in it, although his name was not inserted in the policy. The insurer's argument was that the tenant was not insured because he was not named in the policy pursuant to s. 2 of the LAA 1774 which provides that,

"it shall not be lawful to make any policy or policies on the life or lives of any person or persons, or other event or events, without inserting in such policy or policies the person or persons name or names interested therein, or for whose use, benefit, or on whose account such policy is so made or underwrote."

The Court, however, rejected the claim on the ground that the LAA 1774 does not apply to indemnity insurances. In his words, Kerr LJ expressed his view about the application of LAA 1774 on indemnity insurances that,

"Although obviously directed primarily to life insurance, the words "or other event or events" admittedly widen its scope. A literal application of the language of section 2 would create havoc in much of our modern insurance law,.... In my view... this ancient statute was not intended to apply, and does

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<sup>67</sup> *Ibid.*

<sup>68</sup> [1986] Q.B. 211. This judgment was approved, in relation to this issue, in *Siu Yin Kwan v Eastern Insurance Co. Ltd.* [1994] 2 A.C. 199.



not apply, to indemnity insurance, but only to insurances which provide for the payment of a specified sum upon the happening of an insured event."<sup>69</sup>

Furthermore, for the purpose of abolishing wagering contracts in the guise of insurance policies, the Marine Insurance Act 1788<sup>70</sup> was passed to prohibit issuing insurance policies without indicating the insured's name. It provided:

"...it shall not be lawful for any person or persons to make of effect, or cause to be made or effected, any policy or policies of assurance upon any ship or ships, vessel or vessels, or upon any goods, merchandises, effects or other property whatsoever, without first inserting or causing to be inserted in such policy or policies of assurance the name or names of the usual stile and firm of dealing of one or more of persons inserted in such assurance; or without instead thereof first inserting or causing to be inserted in such policy or policies of assurance the name or names or the usual stile and firm or dealing of the consignor or consignors, consignee or consignees, of the goods, merchandises, effects or property so to be insured; or the name or names, or the usual stile and firm of dealing of the person or persons residing in Great Britain, who shall receive the order for the effect such policy or policies of assurance, or of the person or persons who shall give the order or direction to

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<sup>69</sup> *Ibid*, at p. 227. For more discussion, see John Birds and Norma Hird, *Birds' Modern Insurance Law*, 6<sup>th</sup> ed., (2004), pp. 49-52; John Lowry & Philip Rawlings, *Insurance Law: Doctrines and Principles*, (2<sup>nd</sup> ed., 2005), p. 150; Robert Merkin, *Colinvaux & Merkin's Insurance Contract Law*, Vol. I, (2002), parag. A-0502; N. Legh-Jons, J. Birds & Others, *MacGillivray on Insurance Law*, 10<sup>th</sup> ed., (2003), parag. 1-162; Andrew McGee, *The Modern Law of Insurance*, (2001), parag. 4.15, p. 43; Malcolm Clarke, *The Law of Insurance Contracts*, (4<sup>th</sup> ed., 2002), parag. 4-4A.

<sup>70</sup> 28 Geo. 3, c. 56. This Act repealed another mischievous Act had been passed in 1785 "for regulating insurances, on ships and on goods, merchandises or effects" and for ending up the practice of issuing policies in blank. See, Robert Merkin, *Colinvaux & Merkin's Insurance Contract Law*, Vol. I, 2002, parag. A-0387. Nevertheless, this Act is repealed by s.92 MIA 1906 in the relation of Marine Insurance. However, the 1788 Act still technically applies to land policies on goods. See, John Lowry & Philip Rawlings, *Insurance Law: Cases and Materials*, 2004, p. 265.

the agent or agents immediately employed to negotiate or effect such policy or policies of assurance."<sup>71</sup>

The requirement of insurable interest, however, was more crystallised by decisions of courts. In *Le Cras v Hughes*,<sup>72</sup> the decision was given by Lord Mansfield. The Court considered the question, *inter alia*, of, "whether the assureds had an insurable interest in the subject-matter insured." It has been said that Lord Mansfield's judgment "established the foundation upon which almost all contemporary analysis of insurable interests rests."<sup>73</sup> The facts of this case were that, a Spanish ship, "*St. Domingo*", was captured by a British squadron at the harbour of *St. Fernando de Omoa*. A policy of insurance was obtained on the ship and its cargo. Subsequently, the ship and its cargo were lost by perils of the seas while was performing its voyage to a British port. The assureds, who were the officers and crews of the squadron, sought to recover under the policy, nevertheless, they had their claim rejected by the insurer on the ground that they were lack of insurable interest to comply with the requirement under the Marine Insurance Act 1745. Before the Court, in answering the question whether the assureds had insurable interest in the ship and its cargo, Lord Mansfield said that, it depended "...first on the Prize Act and the proclamation and, second, on the possession and on the expectation warranted by almost universal practice."<sup>74</sup> Lord Mansfield concluded

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<sup>71</sup> Section 29. This section gives the same effect of s 23 of the MIA 1906. The significance of this Act is to identify the person who is interested in the subject-matter of insurance.

<sup>72</sup> (1782) 3 Doug. 81, 99 ER. 549. See also, *Lowry v Bourdieu*, (1780) 2 Doug. 468. ER 99, 299, where the claimants who had lent money to a captain of a ship on the security of his bond, insured the ship and its cargo. Lord Mansfield rejected the claim on the ground that the policy was a wager, therefore, it was void. He held that "it was a hedge. But they had no interest; for, if the ship had been lost and the underwriters had paid, still the plaintiffs would have been entitled to recover the amount of the bond". He also observed that: "There are two sort of policies of insurance; mercantile and gaming policies. The first sort are contracts of indemnity, and of indemnity only... The second sort may be the same in form, but in them there is no contract of indemnity, because there is no interest upon which a loss can accrue. They are mere games of hazard; like the cast of a die", at p. 470.

<sup>73</sup> Keeton & Widiss, *n 1, supra*, s. 3.2(c) at p. 144.

<sup>74</sup> See, (1782) 3 Doug. at p. 85, ER 99, 549, at 551.

that the Prize Act and the proclamation of the Crown was "the strongest ground"<sup>75</sup> and was sufficient to constitute an insurable interest.

Thus, the assureds did not own the subject-matter of insurance. Their rights, however, were based upon what they had been granted by law, i.e. the Prize Act and the royal proclamation and that was a mere expectation.<sup>76</sup>

However, although the law enforced the requirement of insurable interest in order to satisfy the court that the contract of insurance was not wagering, it did not identify the meaning of insurable interest. Thus, the law needed a precise definition for insurable interest and that was, in fact, formulated in *Lucena v Craufurd*,<sup>77</sup> which is a fundamental precedent in the common law in respect of crystallizing the concept of insurable interest.<sup>78</sup>

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<sup>75</sup> *Ibid.*

<sup>76</sup> *Ibid.*, in answering the question, *whether the expectation is a sufficient interest*, Lords Mansfield had no doubt that, *yes*. Also, he believed that the contingency of the ship's coming home was a risk for the captor entitles him to possess a sufficient interest in order to insure the ship.

<sup>77</sup> (1806), 2 B. & P. (NR.) 269, 127 ER, 630.

<sup>78</sup> Lord Mansfield in *Le Cras* case stated that

"...since the Statute of Geo.2, insurance is a contract of indemnity. An interest is necessary, but no particular kind of interest is required." (1782) 3 Doug, at 86, 99 ER, 549, at 552.

It seems that the definition of insurable interest was left to the Courts' interpretation. See, *Boehm v Bell* (1799) 8 TR 154, ER. 101, 1318, where the court took the view of Lord Mansfield in *Le Cras* and held that the crew who had captured a ship had had an insurable interest in it as a prize. Lord Kenyon, held that:

"This ship was captured by the captains of the ships ...who were acting in the service of their country, and on whose conduct there is not the smallest imputation; they had the possession of the property insured, and from that possession, certain rights and duties resulted." He carried on saying that: "If it were a legal capture, the captors were entitled; if the capture were improper made, they were liable to be called to an account in the Court of Admiralty, where they might be amerced in damages and costs. They had therefore a right to insure themselves, against the decision that might have loaded them with damages and costs."

Grose J. discussed the general requirement of insurable interest, that:

"the whole difficulty has arisen from confound an absolute indefeasible interest with an insurable interest. It is not pretended that the assured had the absolute property in the subject of insurance; neither need they have such property to make the policy legal; it is sufficient if they had an insurable interest.", p. 161, ER 101, 1322; J. Lowry & P. Rawlings, "Re-thinking Insurable interest", Sarah Worthington, *Commercial Law and Commercial Practice*, (2003), 335, at p.338.

### 2.3.2.1. *Lucena v Craufurd*

In *Lucena v Craufurd*<sup>79</sup>, the action was on an insurance policy on Dutch ships and their cargos that were lost by a peril of the sea while performing their voyage to England.

A statute<sup>80</sup> authorized commissioners for the care, sale and management of, *inter alia*, Dutch ships and cargos and goods on board them where they are brought to a British port. James Craufurd and others were appointed as the Commissioners. They obtained an insurance policy on the said ships and cargos, nonetheless, they were lost during the voyage to England. The insurers, who were the plaintiffs, sought to escape liability and rejected the defendants' claim on the grounds, that at the time of the loss occurrence the Commissioners, the assureds, were lack of an insurable interest. The Court of King's Bench<sup>81</sup> found for the defendant, that Commissioners had insurable interest in the Dutch ships and their cargos at the time of the loss.

In contrast, the House of Lords revised the judgment of the Court of King's Bench and Exchequer-chamber. In fact, The House of Lords upheld the insurers' defence that the Commissioners' duty, according to the statute, should have been in effect after the arrival of the ships into a British port but not before then.

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<sup>79</sup> (1806), 2 B. & P. (NR.) 269, 127 ER, 630.

<sup>80</sup> 35 Geo. 3, c. 80.

<sup>81</sup> (1802) 3 B. & P. 75.

More importantly, the judgment has framed the definition of insurable interest by the wording of Lawrence J. and Lord Eldon, which are respectively known as the expectancy test, or factual expectation test and the legal interest test.<sup>82</sup>

Giving his judgment, Lawrence J. argued that:

"...It is first to be considered what that interest is, the protection of which is the proper object of a policy of assurance. And this is to be collected from considering what is the nature of such contract."<sup>83</sup>

He went on to define the contract of insurance, that:

"...insurance is a contract by which the one party in consideration of a price paid to him adequate to the risk, becomes security to the other that he shall not suffer loss, damage, or prejudice by the happening of the perils specified to certain things which may be exposed to them."<sup>84</sup>

Then, he emphasised on the requirement of insurable interest, that:

"...a man must somehow or other be interested in the preservation of the subject matter exposed to perils, follows from the nature of this contract, when not used as a mode of wager, but as applicable to the purposes for which it was originally introduced; but to confine it to the protection of the interest which

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<sup>82</sup> More discussion about the definition and the nature of insurable interest will be analysed in Chapter Three, *infra*.

<sup>83</sup> (1806), 2 B. & P. (NR.) 269, 127 ER, 630, p. 300.

<sup>84</sup> *Ibid*, 301.

arises out of property, is adding a restriction to the contract which does not arise out of its nature...A man is interested in a thing to whom advantage may arise or prejudice happen from the circumstances which may attend it..."<sup>85</sup>

Furthermore, Lawrence J. defined the insurable interest as the following:

"To be interest in the preservation of a thing, is to be so circumstanced with respect to it as to have benefit from its existence, prejudice from its destruction. The property of a thing and the interest deviseable from it may be very different: of the first the price is generally the measure, but by interest in a thing every benefit and advantage arising out of or depending on such thing, may be considered as being as comprehended."<sup>86</sup>

Lord Eldon, however, presented the leading speech. In his view, the insurable interest is that,

"...a right in the property, or derivable out of some contract about the property, which in either case may be lost upon some contingency affecting the possession or enjoyment of the party."<sup>87</sup>

In fact, Lord Eldon criticized the view of Lord Mansfield in *Le Cras*, that a mere expectation of a grant by the Crown constitutes a sufficient interest. In his words:

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<sup>85</sup> Ibid. p. 302.

<sup>86</sup> Ibid, p. 301-2.

<sup>87</sup> Ibid, p. 321.

"... that expectation, though found upon the highest probability, was not interest, and it was equally not interest, whatever might have been the chances in favour of the expectation."<sup>88</sup>

He justified his view by observing that:

"...If a moral certainty be a ground of insurable interest, there are hundreds, perhaps thousands, who would be entitled to insure. First, the dock company, then the dock master, then the warehouse keeper, then the porter, then every other person who to a moral certainty would have anything to do with the property, and of course get something by it."<sup>89</sup>

### ***2.3.2.2. Prohibition of Wagering in Insurance***

A further Act was passed by Parliament is the Gaming Act 1845.<sup>90</sup> It is relevant to insurance because it made all contracts which are made by way of gaming or wagering null and void by s.18.<sup>91</sup> Therefore, a contract of insurance without an insurable interest is, simply, considered a wager contract and it is, therefore, void. Section 18 of the Act provides that:

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<sup>88</sup> Ibid. 323.

<sup>89</sup> Ibid, p. 324. For a critical discussion on this issue, see, John Lowry, "The Quickening of Insurable Interest in Property Insurance: A Return to Strict Orthodoxy in English Courts", [2002] *ILLJ* 225.

<sup>90</sup> (8 & 9 Vict. c. 109). The Act is still enforced at the present time.

<sup>91</sup> Note, however, the effect of the Gambling Act 2005. Further discussion on this will take a place in chapter 4, *infra*.

"All contracts or agreements, whether by parole or in writing, by way of gaming or wagering, shall be null and void; and no suit shall be brought or maintained in any court of law and or equity for recovering any sum of money or valuable thing alleged to be won upon any wager..."

As a consequence of long period of practice of endeavouring to strike down wagering in the guise of insurance policies and regulating marine insurance, particularly, and non-marine insurance, generally, Parliament passed the Marine Insurance Act 1906,<sup>92</sup> which repealed the previous Acts 1745 *in toto* and 1788.<sup>93</sup> The latter Act, however, was repealed in the relation of marine insurance.

Section 4(1) of Marine Insurance Act 1906 made void every contract of insurance by way of gaming or wagering. It states that:

"Every contract of marine insurance by way of gaming or wagering is void."

Accordingly, the "ppi" policies are void, but are not prohibited.

Section 4(2) addresses the shape of a contract which is deemed to be gaming or wagering:

"(a) Where the assured has not an insurable interest as defined by this Act, and the contract is entered into with no expectation of acquiring such an interest; or

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<sup>92</sup> (6 Edw. 7, c. 41).

<sup>93</sup> Nevertheless, there are sections in MIA 1745 were copied in MIA 1906. See, Nicholas Legh-Jones Q.C., John Birds and David Owen, *MacGillivray on Insurance Law*, (10<sup>th</sup> ed.), 2003, parag. 1-25.



(b) Where the policy is made 'interest or no interest,' or 'without further proof of interest than the policy itself.' or 'without benefit of salvage to the insurer,' or subject to any other like term:

Provided that, where there is no possibility of salvage, a policy may be effected without benefit of salvage to the insurer."

The MIA 1906 [UK], moreover, took the view of Lord Eldon in defining insurable interest. Section 5(2) provides:

"In particular a person is interested in a marine adventure where he stands in any legal or equitable relation to the adventure or to any insurable property at risk therein, in consequence of which he may benefit by the safety or due arrival of insurable property, or may be prejudiced by its loss, or by damage thereto, or by the detention thereof, or may incur liability in respect thereof."

In addition to the latter Act, Marine Insurance (Gambling Policies) Act 1909 prohibited gambling on loss by maritime perils. Section 1 states that:

"If-

- (a) any person effects a contract of marine insurance without having any bona fide interest, direct or indirect, either in the safe arrival of the ship in relation on which the contract is made or in the safety or preservation of the subject matter insured, or a bona fide expectation of acquiring such an interest; or
- (b) any person in the employment of the owner of a ship, not being a part owner of the ship, effects a contract of marine insurance in relation to the

ship, and the contract is made 'interest or no interest', or 'without further proof of interest than the policy itself', or 'without benefit of salvage to the insurer', or subject to any other like term,

the contract shall be deemed to be a contract by way of gambling on loss by maritime perils, and the person effecting it shall be guilty of an offence, and shall be liable, on summary conviction, to imprisonment,..., for a term not exceeding six months or a fine not exceeding,..., and in either case to forfeit to the Crown any money he may receive under the contract."

## 2.4. General Comments

It seems, from what has been mentioned, that insurance contract has been affected by three factors they are, namely, religious, political and social factors. In the first place, during the middle ages insurance was in a doubtful place of being lawful. That is to say, may be, it was infringing the law of usury and due to the wide and powerful authority of the Church,<sup>94</sup> its decision was very important to practice a transaction away from breaking the law. That appears in the existence of the ecclesiastical court which has the authority to punish any person accused to be a sinner. Therefore, insurance was considered, perhaps, to be a kind of those expedients which contain usury. It was seen that insurance was disguised under different forms of contracts such as a maritime loan, a sale or an exchange and those contracts contained high interests.<sup>95</sup> Holdsworth traced the development of commerce in Europe, generally, and in England, particularly, and he explained the picture in that period as that, "The money was borrowed,..., not for productive but for consumptive expenditure. There was therefore some justification, both for Aristotle's view that all interest was unlawful because money did not breed money, and for the literal acceptance of the Scriptural prohibitions of usury."<sup>96</sup> Thus, on this ground, he deduced that, "If we remember these facts, we shall not be surprised that the church and the canon law condemned all lending of money as a sin; that the civil law and the laws of the states of Western Europe endorsed and sanctioned this condemnation; that all transaction were carefully sifted to see whether they were tainted with its presence; and that the

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<sup>94</sup> Holdsworth, *supra*. n. 9, p. 107.

<sup>95</sup> *Ibid*, p. 106.

<sup>96</sup> *Ibid*, p. 101. This explains the reason behind passing two statutes in 1487. The first statute, made void all bargains grounded in usury, subject to a penalty of £100, in addition to any punishment which might be inflicted by the ecclesiastical court. The second inflicted penalties on brokers who made these usuries contracts. At pp. 102- 103.

prohibition of usury thus became,..., the keystone of the political economy of the Middle Age."<sup>97</sup>

In the second place, due to the growth of trade in the 15<sup>th</sup> and 16<sup>th</sup> centuries, economic conditions were changing. The general rule of prohibition of usury was in effect, but it was found out that, making a productive use of borrowed money and a payment for the use of borrowed money might be advantageous both to the parties of the contract and to the state. Therefore, a large number of rules were in effect "which were designed to distinguish between those payments for the use of money which were usurious and illegal, from those which were permissible."<sup>98</sup> Those rules were based upon the distinction between a mere payment for the use of money, and a payment made to compensate the lender for some loss caused by non-payment (*damnum emergens*),<sup>99</sup> or for failure to realize some expected gain as a result of not having the money available (*lucrum cessans*).<sup>100</sup> However, the loss must have been proved and the loan must have been gratuitous.<sup>101</sup> Holdsworth pointed out that, "Technically, the payment was made, not for the loan, but for non-payment of a gratuitous loan at the date promised. Gradually, however," he continued, "in the case of traders, the loss came to be presumed; and, with the shortening of the period of the gratuitous loan, the making of it gratuitously for a short period came to be a mere formality."<sup>102</sup> Thus, the risk run by the lender entitled him to be paid for the use of his money.

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<sup>97</sup> *Ibid.*

<sup>98</sup> *Ibid.*

<sup>99</sup> [Latin "damage arising"]. *Roman law*. An actual realized loss (such as the decline in the value of property) as opposed to an expected future loss (such as loss of profit), Garner, *supra*, n 12, at p. 398.

<sup>100</sup> [Latin "ceasing gain"]. *Roman law*. Interest or damages awarded for an expected future loss (such as anticipated loss of profit) as opposed to an actual realizable loss, Garner, *supra*, n 12, at p. 960.

<sup>101</sup> Holdsworth, *supra*, n. 9, p. 103.

<sup>102</sup> *Ibid.*

It seems that, the English economic policy took that manner. Accordingly, as Holdsworth observed, "The London ordinance of 1391 makes it quite clear that such lending for gain, if accompanied by risk, was not punishable as usury." Therefore, this principle applied to loans on bottomry and the contract of *commenda* that "The lender risked the loss of his money if the ship did not arrive safely and for this risk he was entitled to be paid. Insurance", he said, "also could be similarly justified."<sup>103</sup> Consequently, "In all these cases payment was made, not for the loan of money, but for the loss or risk of loss run by the lender. It was only if the lender contracted to receive payment for his money in any event that he fell under the ban of the law."<sup>104</sup>

In this manner, Clark pointed out that, in "...England never arrived at wholesale bans on the insurance trade, in part because – given its unprecedented wartime expenditures after 1688 – a more attractive strategy lay in keeping as much of the insurance business as possible legal in order to broaden the tax base. So", he said, "from 1694 small stamp duties were periodically imposed on insurance policies, and under Anne duties placed upon insurance policies even helped fund the national lotteries, themselves devised to help finance the war."<sup>105</sup>

In the third place, it could be noticed that, merchants had found insurance very essential in commercial life that could provide the confidence to trade abroad. Therefore, insurance has been recognized as a need in society that could not be disregarded and as a crucial instrument which provides a guaranteed security and a

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<sup>103</sup> *Ibid*, p. 104.

<sup>104</sup> *Ibid*.

<sup>105</sup> Geoffrey Clark, *Betting on lives: The cultural of life insurance in England, 1695-1775*, (1999), p. 21.

protection against misfortune. Thus, people started to widely use insurance and take advantage of its utilities, especially in the field of life insurance.<sup>106</sup> Consequently, insurance industry became one of the essential aspects of materiality.

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<sup>106</sup> *Ibid*, p. 5.

# **Chapter Three: The Definition and The Nature of Insurable Interest**

## **3.1. Introduction**

This chapter explores the definition of insurable interest and surveys its nature. Although the definition of insurable interest has been mentioned at the first chapter of this work,<sup>1</sup> it has been thought that the definition needs to be, for the purpose of this study, elaborated upon. This is important due to the fact that the principle of insurable interest has been a fundamental requirement that distinguishes insurance from wagering under common law.<sup>2</sup>

Professor Ivamy said that, the interest that is insurable, "must, however, be a real interest, since the mere expectation of acquiring an interest, however probable, does

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<sup>1</sup> See, *supra*, p. 1. Article 5 of the MIA 1906 provides:

"(1) Subject to the provisions of this Act, every person has an insurable interest who is interested in a marine adventure.

(2) In particular a person is interested in a marine adventure where he stands in any legal or equitable relation to the adventure or to any insurable property at risk therein, in consequence of which he may benefit by the safety or due arrival of insurable property, or may be prejudiced by its loss, or by damage thereto, or by the detention thereof, or may incur liability in respect thereof."

<sup>2</sup> A wagering contract has been defined by Hawkins J in *Carlill v. The Carbolic Smoke Ball Company* [1892] 2 QB 484, at pp. 490-91, as,

"one by which two persons, professing to hold opposite views touching the issue of a future uncertain event, mutually agree that, dependent upon the determination of that event, one shall win from the other, and that other shall pay or hand over to him, a sum of money or other stake; neither of the contracting parties having any other interest in that contract than the sum or stake he will so win or lose, there being no other real consideration for the making of such contract by either of the parties. It is essential to a wagering contract that each party may under it either win or lose, whether he will win or lose being dependent on the issue of the event, and, therefore, remaining uncertain until that issue is known. If either of the parties may win but cannot lose, or may lose but cannot win, it is not a wagering contract." See, also, *Ellesmere v Wallace* [1929] 2 Ch 1, at pp. 24, 36, 48-49; *Newbury International Ltd v Reliance National Insurance Co Ltd and Tyser Special Risks Ltd* [1994] 1 Lloyd's Rep 83.

not give the right to insure the property out of which the expectation arises."<sup>3</sup> It is interesting to find out how accurate this passage is, especially after the repeal of section 18 of the Gaming Act 1845<sup>4</sup> by the Gambling Act 2005.<sup>5</sup> The effect of the Gambling Act 2005 regarding the requirement of insurable interest and the consequence of the lack of insurable interest will be considered in chapter four of the thesis. In addition, it has been mentioned earlier that the majority of contemporary Muslim scholars are of the opinion that insurance does not comply with *Sharia* because it contains, *inter alia*, gambling, or wagering.<sup>6</sup> Therefore, it is the purpose of this chapter to explore the principle of insurable interest as a criterion that differentiates insurance from wagering. Accordingly, section 3.2 below will explore the definition of insurable interest and analyze its nature within two tests. They are, namely, the legal interest test and the factual expectation interest test; these will be dealt with in section 3.2.1. This will necessarily lead to an examination of the principle of indemnity and its relation to the doctrine of insurable interest which will be surveyed in section 3.2.2. In addition, section 3.3 will explore the definition of insurance and insurable interest under Saudi law, i.e. Commercial Court Law 1931 and Cooperative Insurance Companies Control Law 2003 and its Implementing Regulations. Finally, section 3.4 contains concluding comments.

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<sup>3</sup> E. R. Hardy Ivamy, *General Principles of Insurance Law*, (London, Butterworths, 6<sup>th</sup> ed., 1993), p. 22.

<sup>4</sup> Section 18 provides that,

"All contracts or agreements, whether by parole or in writing, by way of gaming or wagering, shall be null and void; and no suit shall be brought or maintained in any court of law and or equity for recovering any sum of money or valuable thing alleged to be won upon any wager..." This section has been repealed by section 334 of the Gambling Act 2005 which provides that,

"(1) The following shall cease to have effect-...

(c) section 18 of the Gaming Act 1845 (c. 109) (voiding of gaming contracts)..."

<sup>5</sup> J. Lowry & P. Rawlings, *Insurance Law: Doctrines and Principles*, 2<sup>nd</sup> ed., (2005), p. 150. See, Robert Merkin, "Insurable Interest: The repeal of the prohibition on gambling", *Insurance Law Monthly* [2005], 4.

<sup>6</sup> See, *supra*, section 1.3.1. at p. 9.



### 3.2. Definition of Insurable Interest under *common law*

The concept of insurable interest consists of two words, 'insurable' and 'interest'. Therefore, it will be more appropriate and sensible to define each word in turn and then explore insurable interest as one concept.

**Insurable:** *adjective*, means, able to be insured.<sup>7</sup> In other words, it is the ability to conclude a contract of insurance about the subject matter of insurance; or shift a risk from an insured to an insurer. In fact, none of the UK legislation has defined the contract of insurance.<sup>8</sup> The Courts, however, have made attempts to define or describe the contract of insurance.<sup>9</sup> For instance, Lawrence J. in *Lucena v Craufurd*,<sup>10</sup> defined insurance as,

"...a contract by which one party in consideration of a price paid ...  
adequate to the risk, becomes security to the other that he shall not suffer loss,

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<sup>7</sup> B. A. Garner, *Black's Law Dictionary*, (St. Paul, Minn. West Group, 7<sup>th</sup> ed., 1999), p. 802.

<sup>8</sup> Malcolm A. Clarke, *The Law of Insurance Contracts*, (London, Lloyd's of London Press, 4<sup>th</sup> ed., 2002), p. 1; Andrew McGee, *The Modern Law of Insurance*, (London : Butterworths 2001), parag. 1.3; Nicholas Legh-Jones, *MacGillivray on Insurance*, (London, Sweet & Maxwell, 10<sup>th</sup> ed., 2003), parag. 1-1; J. Lowry & P. Rawlings, *Insurance Law: Doctrines and Principles*, (Oxford, Hart, 2<sup>nd</sup> ed., 2005), p. 2. J. Lowry and P. Rawlings observed, at p. 3, that, "Legislation provides some guidance for the purpose of regulation. The Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 (as amended) does not define 'contract of insurance', but does set out a list of indicative activities that required authorisation by the Financial Services Authority (FSA). Furthermore, the FSA has recognised that in view of both the general prohibition against unauthorised persons engaging in insurance business and the importance attached to clear and accountable regulation, there is a need for clear guidelines as to how it will exercise its discretion. The FSA has, therefore, issued its own criteria based on the judgment of Channell J in *Prudential Insurance Company v. Commissioners of Inland Revenue* [1904] 2 KB 658, (see below), which concerned the application of stamp duty to insurance policies." The reason why the contract of insurance has not been defined by legislation in the UK is to be found in *Department of Trade and Industry v. St. Christopher Motorists' Association Ltd*, [1974] Lloyd's Rep. 17, 18. See below.

<sup>9</sup> R. W. Hodgkin, "Problems in defining insurance contracts", *LMCLQ* [1980], 15; J. Lowry & P. Rawlings, *Insurance Law: Doctrines and Principles*, 1999, p. 3. It is true that there are numerous attempts to form a definition for insurance in both cases and textbooks. See, R. L. Purves, "The Expanding (or Shrinking) Scope of "Insurance" in FSA Regulation", [2001] *J. B. L.*, 623; E. R. Hardy Ivamy, *Dictionary of Insurance Law*, (London, Butterworths, 1981), at p. 33.

<sup>10</sup> (1806), 2 Bos. & Pul. (N. R.) 269, 127, ER 630.

damage, or prejudice by the happening of the perils specified to certain things which may be exposed to them. If this be the general nature of the contract of insurance, it follows that it is applicable to protect men against uncertain events which may in any wise be of disadvantage to them..."<sup>11</sup>

In answering the question 'what is insurance', Templeman J., in *Department of Trade and Industry v. St. Christopher Motorists' Association Ltd*,<sup>12</sup> argued that,

"... one looks first of all to the statutes to see if they define insurance, and for reasons which are understandable the result is a blank."<sup>13</sup>

It seems that the reasons behind not having a particular definition of insurance are due to the fact that,

"There are various types of insurance business on which the Acts concentrate, and no difficulty has ever arisen in practice, and therefore there has been no all-embracing definition, and the probability is that it is undesirable that there should be, because definitions tend sometimes to obscure and occasionally to exclude that which ought to be included."<sup>14</sup>

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<sup>11</sup> Ibid, at 301, 127 ER, at 642.

<sup>12</sup> *Department of Trade and Industry v. St. Christopher Motorists' Association Ltd*, [1974] Lloyd's Rep. 17.

<sup>13</sup> Ibid, 18.

<sup>14</sup> Ibid. Similarly, it has been stated that, "It rarely occurs, in cases determinable on common law principles, that any question to the exact meaning of insurance is really material, for, other than the doctrine of *uberrima fides*, the law of insurance has few significant principles of its own.", Merkin, *Colinvaux's Law of Insurance*, (London, Sweet & Maxwell, 7<sup>th</sup> ed., 1997), p. 1; John Birds & Norma J. Hird, *Bird's Modern Insurance Law*, (London, Sweet & Maxwell, 6<sup>th</sup> ed., 2004), p. 12 to p. 19.

In the same manner, Megarry V.-C. was of the opinion that a contract of insurance is "a concept which it is better to describe than to attempt to define..."<sup>15</sup>

Thus, the attitude of courts towards insurance contracts is to look at the contract as a whole and to consider the features which might be expected to be found in an insurance contract.<sup>16</sup> In *Prudential Insurance Company v. Commissioners of Inland Revenue*,<sup>17</sup> Channell J. sought a description for insurance by considering its features and he observed that:

"Where you insure a ship or a house you cannot insure that the ship shall not be lost or the house burnt, but what you do insure is that a sum of money shall be paid upon the happening of a certain event. That I think is the first requirement in a contract of insurance. It must be a contract whereby for some consideration, usually but not necessarily for periodical payments called premiums, you secure to yourself some benefit, usually but not necessarily the payment of a sum of money, upon the happening of some event. Then the next thing that is necessary is that the event should be one which involves some amount of uncertainty. There must be either uncertainty whether the event will ever happen or not, or if the event is one which must happen at some time there must be uncertainty as to the time at which it will happen. The remaining essential is that which was referred to by the Attorney-General when he said the insurance must be against something."<sup>18</sup>

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<sup>15</sup> *Medical Defence Union Ltd. v. Department of Trade* [1980] Ch. 82 at 95.

<sup>16</sup> J. Lowry & P. Rawlings, *Insurance Law: Doctrines and Principles*, (Oxford, Hart, 1999), p. 4.

<sup>17</sup> *Prudential Insurance Company v. Commissioners of Inland Revenue* [1904] 2 KB 658.

<sup>18</sup> *Ibid*, at 663. According to J. Lowry and P. Rawlings, this description has enjoyed general approval in the English courts. The authors also added one more characteristic of insurance that had not been mentioned by Channell J, that the parties must be under a duty of utmost good faith. See, John Lowry & Philip Rawlings, *Insurance Law: Cases and Materials*, (Oxford, Hart, 2004), p. 18; see *Joseph v. Law Integrity Insurance Co. Ltd.* [1912] 2 Ch 581; *Flood v Irish Provident Assurance Co Ltd* [1912] 2 Ch 597; *Gould v Curtis* [1913] 3 KB 84; *Fuji Finance Inc v Aetna Life Insurance Co Ltd* [1997] Ch 173.

He, then, threw light on a crucial element that must be attached to a contract of insurance, i.e. interest, which constitutes a distinction between such contract and wagering, in his words,

"A contract which would otherwise be a mere wager may become an insurance by reason of the assured having an interest in the subject-matter-- that is to say, the uncertain event which is necessary to make the contract amount to an insurance must be an event which is *prima facie* adverse to the interest of the assured. The insurance is to provide for the payment of a sum of money to meet a loss or detriment which will or may be suffered upon the happening of the event."<sup>19</sup>

More recently, there has been an attempt to define insurance in broad terms. Sir Peter Webster defined insurance as,

"an agreement by the insurer to confer on the insured a contractual right which, *prima facie*, comes into existence immediately when loss is suffered by the happening of an event insured against, to be put by the insurer into the same position in which the insured would have been had the event not occurred, but in no better position."<sup>20</sup>

As far as Canadian law is concerned, insurance is defined as,

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<sup>19</sup> *Ibid.* See, R. W. Hodgkin, "Problems in defining insurance contracts", *LMCLQ* [1980], 15. The author concluded that, "In none of...pieces of legislation was a contract of insurance defined and each judgment, expressly depending as it must on the facts before the court, fails to give a comprehensive definition. Such failure is intentional.", at p. 20. See also, Malcolm A. Clarke, *The Law of Insurance Contracts*, (London, Lloyd's of London Press 4<sup>th</sup> ed., 2002), pp. 1 & 8.

<sup>20</sup> *Callaghan and Another v. Dominion Insurance Co. Ltd. and Others* [1997] 2 Lloyd's Rep. 541, at 544. See, Robert Merkin, *Colinvaux & Merkin's Insurance Contract Law*, Vol. I, (Looseleaf), (London, Sweet and Maxwell, 2002), para. A-0031.

"the undertaking by one person to indemnify another person against loss or liability for loss in respect of a certain risk or peril to which the object of insurance may be exposed, or to pay a sum of money or other thing of value upon the happening of a certain event."<sup>21</sup>

In addition, in *Saskatchewan Crop Insurance Corp. v. Greba*,<sup>22</sup> Hrabinsky J presented a definition of insurance, in his words,

"A contract of insurance is a contract whereby the insurer promises in return for payment of a premium by the insured to pay the insured a sum of money upon the occurrence of one or more specified events, the occurrence of which is uncertain. To obtain insurance the insured must have an insurable interest in the property insured."<sup>23</sup>

It must be stressed that there are two essential elements of insurance. Firstly, risk shifting, or transferring of risk, and, secondly, risk distributing, or spreading of risk.<sup>24</sup>

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<sup>21</sup> Insurance Act, RSO Ont. 1980, c. 218, section 1, para. 30; see also, Insurance Act, RSA 1980, c. 1-5 (Alberta), section 1 (k1). This is an example of Canadian uniform legislation on defining insurance. Clarke also presented a definition of insurance in the US legislation, for example, section 22 of the California Insurance Code (2000) which defined insurance as, a "contract whereby one undertakes to indemnify another against loss, damage or liability arising from a contingent or unknown event." Clarke commented that, the above definitions do not much differ from the way of English courts in defining insurance, which is preferred to be called "description of insurance". Thus, he observed that, "...these 'definitions' have proved to be too bland to be useful without further elaboration. For example, if an insurance promise is an undertaking to indemnify against loss or damage (California) or to indemnify another person against loss (Canada), how is that distinguished from other kinds of commercial contracts, in which the primary obligation is quite different but a secondary obligation, that one party undertakes to indemnify the other in the event of non-performance of the primary obligation, looms large. The need to make such a distinction is no less pressing because some courts in England have described the insurer's obligation to pay indemnity as an obligation to pay damages for having failed to prevent the insured loss." See, Malcolm A. Clarke, *The Law of Insurance Contracts*, (London, LLP, 4<sup>th</sup> ed., 2002), p. 5; John Lowry & Philip Rawlings, *Insurance Law: Cases and Materials*, (Oxford, Hart, 2004), pp. 16 & 17.

<sup>22</sup> *Saskatchewan Crop Insurance Corp. v. Greba* (1997) 154 Sask. R. 289.

<sup>23</sup> *Ibid*, parag. 143, at p. 312.

<sup>24</sup> See, Peter Cane, *Atiya's Accidents, Compensation and the Law*, (London, Butterworths, 6<sup>th</sup> ed., 1999), p. 353-56. The author surveys the notion of compensation, shifting of losses and the tort system and he observes that, "The effect of the tort system is not, in general, merely to shift a loss from one person to another; the loss is normally distributed over a large number of people, and over some period

That is to say, by the contract of insurance, the risk is shifted from the insured to the insurer and risk is spread between numbers of people, i.e. policyholders or insureds. Williams is of the opinion that in order to understand the reason that shifting of risk and risk distribution are significant features of insurance, it is important to consider the benefit that insurance provides for an insured, on the one hand, and for society, on the other hand. From the insured party's point of view, he/she will benefit from insurance, as a device for transferring to another party, i.e. the insurer, the risk which in the event of its occurrence will result a financial loss, in two ways. Firstly, in the event of the actual loss due to the occurrence of the risk insured against, the insured will be at least closer to his economic position as it was before the risk has occurred. Secondly, even if the insured suffers no loss he enjoys the benefit of security.<sup>25</sup>

From the standpoint of society, Williams observed that, "insurance...reduces uncertainty for society as a whole though risk "distribution." The insurer", he said, "accomplishes this by combining fairly homogenous risks in a common "pool", in numbers large enough that the actual losses of the entire group can be expected to fall within statistical norms. It then collects from each insured a premium set at a level sufficient to ensure that the amounts paid in by the "winners", those who do not incur a loss, can be expected to cover the losses of the "losers." He carried on to say that, "Rather than simply bearing the insured's risk, the insurer distributes that risk among the pool of policyholders, each of whom has now replaced a potentially large,

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of time." He adds that, "...there are many ways in which losses can be distributed which are namely, the law of tort, interwoven as it is with liability insurance, first party insurance and social security that is financed as it is by a mixture of insurance and taxation." Further, the author observes that those ways were not the only ways to distribute losses and gave some examples for that, compensation for road accident could be financed by flat-rate contributions that solely paid by motorists instead of by variable insurance premiums; or could be financed by special tax on petrol, so motorists who used the roads more would pay more. Thus, he is of the opinion that, "Because there are so many ways of distribution losses, it cannot be said that loss distribution as such is a rational and desirable goal of the law. Any loss distribution system must be judged according to the way it distributes particular losses.", at p. 355.

<sup>25</sup> S. Williams, "Crafting a Rule of Decision", *Col. L. Rep.* (1998) 98, p. 1996, at p.2014.

uncertain financial loss with a small, certain cost, i.e. the premium."<sup>26</sup> Furthermore, since collecting premiums from each insured creates capital, Williams thinks it could be invested elsewhere. He said, "...by permitting individuals to distribute their risk of loss due to fortuitous events among others, insurance encourages new investments by entrepreneurs, thereby promoting the accumulation of a new capital."<sup>27</sup> In this regard, Clarke observed that, "By calculation and collection of appropriate premiums from each member of the pool, the insurer sees that each shifting of risk, together with associated individual benefits, is effectively and securely achieved."<sup>28</sup>

**Interest:** Advantage or profit, especially of a financial nature; or, a legal share in something; all or part of a legal or equitable claim to or right in a property.<sup>29</sup>

As noted above, generally speaking, insurable interest has been shaped into two forms, namely, the legal interest test and the factual expectation test in *Lucena v Craufurd*.<sup>30</sup> Further, Harnett and Thornton described insurable interest as, "that kind of relationship to an occurrence, or, ..., that kind of interest in the property insured, which a claimant must show in order to have a legally enforceable claim to recovery."<sup>31</sup> They observed that the requirement of insurable interest has been underlain by three policies; they are namely, the policy against wagering, the policy

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<sup>26</sup> *Ibid.*

<sup>27</sup> *Ibid.* at pp. 2014-15.

<sup>28</sup> Malcolm A. Clarke, *The Law of Insurance Contracts*, (London, LLP, 4<sup>th</sup> ed., 2002), p. 6. See *Hampton v Toxteth Co-operation Provident Sy Ltd* [1915] 1 Ch 721 a non-property insurance case (life), tackled shifting of risk as being an essential feature of insurance. See also, the judgment of Lord Writ in *Wooding v Monmouthshire* [1939] 4 All ER 570, at pp 595-96.

<sup>29</sup> B. A. Garner, *Black's Law Dictionary*, (St. Paul, Minn., West Group, 7<sup>th</sup> ed., 1999), p. 816. Insurable interest has been defined as, "A term to describe the legal or equitable relation in which the insured stands to the subject-matter insured in consequence of which he may benefit by its safety and be prejudiced by its loss." See, E. R. Hardy Ivamy, *Dictionary of Insurance Law*, (London, Butterworths, 1981), at p. 65.

<sup>30</sup> (1806), 2 B. & P. (NR.) 269, 127 ER, 630. For facts, see, *supra*, p. 37. See below 3.2.1.

<sup>31</sup> Bertram Harnett and John Thornton, "Insurable Interest in Property: A Socio-Economic Reevaluation of a Legal Concept", *Col. L. R.* (1948) 48, p. 1162, at 1164.

against rewarding and thereby tempting the destruction of property and the policy of confining insurance contracts to indemnity.<sup>32</sup> In addition, Merkin observes that "permitting a person to insure a subject matter which he has no interest in preserving, and in which he has no interest other than the policy itself, gives rise of two dangers. First, there is possibility that the assured is doing no more than wagering with the insurer on continued safety of the insured subject matter... A second," he continues, "and probably more fundamental, objection to insurance without interest is that an assured who stands to benefit from the early destruction of what has been insured will be tempted to take steps to bring about such early destruction."<sup>33</sup>

According to the above views, it seems that reaching to a clear definition for insurance contract has been a difficult matter. Therefore, it can be agreed with Templeman J.<sup>34</sup> that the contract of insurance should not be defined in particular words "because definitions tend sometimes to obscure and occasionally to exclude that which ought to be included."<sup>35</sup> Further, concluding a precise definition for insurable interest is, also, of difficulty. Accordingly, Waller LJ observed that

"...it is difficult to define insurable interest in words which will apply in all situations. The context and the terms of a policy with which the court is concerned will be all-important. The words used to define insurable interest in, for example, a property context, should not be slavishly followed in different contexts, and words used in a life insurance context where one identified life is

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<sup>32</sup> Ibid, at 1165.

<sup>33</sup> Robert Merkin, *Colinvaux's Merkin's Insurance Contract Law*, Vol. I, (2002). parag. A-0385.

<sup>34</sup> *Department of Trade and Industry v. St. Christopher Motorists' Association Ltd*, [1974] Lloyd's Rep. 17.

<sup>35</sup> Ibid, at p. 18.



the subject of the insurance may not be totally apposite where the subject is many lives and many events."<sup>36</sup>

Word LJ, however, did not accept that the concept of insurable interest was elusive. He observed that,

"I reluctantly conclude that such differences as exist between life insurance, on the one hand, and marine/non-marine insurance, on the other hand, do not justify different concepts of insurable interest applying to those groups. If statute and binding House of Lords authority compel for the latter category the need for a legal or beneficial interest in the subject matter of the insurance and eschew the adequacy of an expectation of harm or benefit, then I consider it wrong to allow a looser concept to prevail for the former. I cannot accept that any interest in anything is a sufficient insurable interest."<sup>37</sup>

Therefore, it is appropriate, at this stage, to explore the scope of the nature of insurable interest within two identified tests, i.e. *the legal interest test* and *the factual expectation test*.<sup>38</sup>

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<sup>36</sup> *Feasey v Sun Life Assurance Company of Canada* [2003] EWCA Civ 885, [2003] 2 All ER (Comm) 587, parag. [71].

<sup>37</sup> *Ibid*, parag. [191].

<sup>38</sup> John Lowry and Philip Rawlings, "Re-thinking Insurable Interest", Sarah Worthington, *Commercial Law and Commercial Practice*, (2003), p. 335.

### 3.2.1. Legal interest test v. factual expectation test

The conventional description of insurable interest under the legal interest test is that an insured must have a proprietary interest, i.e. legal, equitable or contractual interest, in the subject matter of insurance.<sup>39</sup>

It has been said that, Lord Eldon took a restrictive view in defining insurable interest to avoid illusory insurance,<sup>40</sup> and to control the number of those persons who could insure.<sup>41</sup> Lord Eldon thought that,

"If moral certainty be a ground of insurable interest, there are hundreds, perhaps thousands, who would be entitled to insure. First the dock company, then the dock-master, then the warehouse-keeper, then the porter, then every other person who to a moral certainty would have ally thing to do with the property, and of course get something by it."<sup>42</sup>

Accordingly, an enforceable right whether is legal or equitable right in a property or a right is derivable out of a contract about the property must be possessed by an insured at the time of the occurrence of the risk insured against, "which in either case may be lost upon some contingency affecting the possession or enjoyment of the

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<sup>39</sup> See, John Birds, "Insurable Interest", in N. Palmer & E. McKendrick, *Interests in Goods*, (1998), p. 91; John Lowry & Philip Rawlings, *Insurance Law: Cases and Materials*, (2004), parag. 6.2.

<sup>40</sup> *Constitution Insurance Co of Canada v Kosmopoulos* (1987) 34 D.L.R. (4th) 208, at p. 217; John Lowry and Philip Rawlings, *Insurance Law: Doctrines and Principles*, (1999), p. 51.

<sup>41</sup> R. A. Hasson, "Reform of the Law Regulating to Insurable Interest in Property – Some Thoughts on *Chadwick v Gibraltar General Insurance*" (1983-84) 8 *Can Bus LJ* 114, 115.

<sup>42</sup> *Lucena v Craufurd*, (1806) 2 B. & P. (NR.) 269, at 324.

party.",<sup>43</sup> to say the insured is interested in the property and, therefore, he could be insured.

According to Lowry and Rawlings, "the legal interest test has attracted substantial criticism by both judges and commentators in major common law jurisdiction."<sup>44</sup>

This view, i.e. the criticism, has been starkly illustrated by the House of Lords in *Macaura v. Northern Assurance Company Ltd.*<sup>45</sup>

### 3.2.1.1. *Macaura*<sup>46</sup>

Macaura was a sole shareholder in a company which owned timber and he affected a policy insurance to insure the company's asset, i.e., the timber against fire by his own name. Subsequently, the greater part of the timber was destroyed by fire only two weeks after affecting the insurance and the insured claimed on the policy to recover the loss from his insurer. The latter, however, rejected the claim on the ground that the insured did not, actually, have an insurable interest in the timber, notwithstanding that he was an unsecured creditor and the sole shareholder. A company has been held to be

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<sup>43</sup> *Ibid*, at 321; *Routh v Thompson* (1809) 11 East 428, particularly, 433.

<sup>44</sup> John Lowry & Philip Rawlings, *Insurance Law: Cases and Materials*, (2004), p. 276. See for example, *Moran, Galloway & Co. v Uzielli* [1905] 2 K.B. 555, that Walton J. observed that, "The definition of insurable interest has been continuously expanding, and dicta in some of the older cases, which would tend to narrow it, must be accepted with caution.", at 563; Robert Merkin, *Colinvaux's Merkin's Insurance Contract Law*, Vol. I, 2002. parag. A-0397.

<sup>45</sup> [1925] A. C. 619; See also, a Canadian case that adopted *Macaura* principle, *Zimmerman v St Paul Fire & Marine Insurance Co* (1967) 63 DLR (2<sup>nd</sup>) 282, in particular, 285; Malcolm A. Clarke, *The Law of Insurance Contracts*, 4<sup>th</sup> ed., (2002), p. 162; John Lowry and Philip Rawlings, *Insurance Law: Doctrines and Principles*, (1999), pp. 51, 52.

<sup>46</sup> [1925] A. C. 619.

an entity distinct and separate from its shareholders.<sup>47</sup> Indeed, the House of Lords dealt with two cases of insurable interest in two characters; they are, namely, an insurable interest of a creditor in a debtor's property and an insurable interest of a shareholder in a company's assets.

In the first case, Lord Buckmaster adopted the view that a creditor is incapable to insure his debtor's property,<sup>48</sup> that,

"As a creditor his position appears to me quite incapable of supporting the claim. If his contention were right it would follow that any person would be at liberty to insure the furniture of his debtor, and no such claim has ever been recognized by the Courts."<sup>49</sup>

This finding is convincing because if the creditor is allowed to insure his debtor's property, the creditor will either be tempted to destroy the insured property to gain the insurance money, or gain the insurance money where the property is lost due to the occurrence of an insured risk which infringes the principle of indemnity.

As far as the second case is concerned, Lord Buckmaster was of the opinion that, a shareholder is entitled to insure only up to the extent of his share but not the company's assets.<sup>50</sup>

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<sup>47</sup> *Salomon v Salomon* [1897] AC 22.

<sup>48</sup> *Moran, Galloway & Co. v. Uzielli* [1905] 2 KB 555.

<sup>49</sup> [1925] A. C. 619, p. 626.

<sup>50</sup> *Ibid*, pp. 626, 627. His Lordship held that,

"Turning now to his position as shareholder, this must be independent of the extent of his share interest. If he were entitled to insure holding all the shares in the company, each shareholder would be equally entitled, if the shares were all in separate hands. Now," he continued, "no shareholder has any right to any item of property owned by the company, for he has no legal or equitable interest therein. He is entitled to a share in the profits while the company continues to carry on business and a share in the distribution of the surplus assets when the company is wound up. If he were at liberty to effect an insurance against loss by fire of any item of the company's property, the extent of his insurable interest

Lord Buckmaster adopted the legal interest test and he, again, avoided Lawrence J view, i.e. the factual expectation test, he said,

"I find ... a difficulty in understanding how a moral certainty can be so defined as to render it an essential part of a definite legal proposition. In the present case, though it might be regarded as a moral certainty that the appellant would suffer loss if the timber which constituted the sole asset of the company were destroyed by fire, this moral certainty becomes dissipated and lost if the asset be regarded as only one in an innumerable number of items in a company's assets and the shareholding interest be spread over a large number of individual shareholders."<sup>51</sup>

Not only did Lord Buckmaster deny an insurable interest of a creditor or a shareholder in a debtor's property or a company's assets, but also he denied the insurable interest of the insured as a bailee in the timber. He concluded that,

"Neither a simple creditor nor a shareholder in a company has any insurable interest in a particular asset which the company holds. Nor can his claim to insure be supported on the ground that he was a bailee of the timber, for in fact he owed no duty whatever to the company in respect of the safe custody of the goods; he had merely permitted their remaining upon his land."<sup>52</sup>

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could only be measured by determining the extent to which his share in the ultimate distribution would be diminished by the loss of the asset - a calculation almost impossible to make. There is no means by which such an interest can be definitely measured and no standard which can be fixed of the loss against which the contract of insurance could be regarded as an indemnity."

<sup>51</sup> *Ibid.*

<sup>52</sup> *Ibid.*, 628.

In the same manner, Lord Sumner was of the opinion that, Mr Macaura had no insurable interest in the company's asset because he did not own it or had legal or equitable relationship to it.<sup>53</sup>

It should be emphasized that, while *Macaur*, as a House of Lords decision, remains a good law in English courts in relation to insurable interest, it has been dropped in other common law jurisdictions.<sup>54</sup> Thus, the legal interest test has been criticized by many legal authors as "less relevant in the context of modern commercial practice."<sup>55</sup>

Basically, Lord Eldon's approach represented the orthodox throughout most Anglo-Commonwealth jurisdictions until 1987 when the legal interest test was rejected by the Canadian Supreme Court, particularly in *Constitution Insurance Co of Canada v Kosmopoulos*.<sup>56</sup> The significance of *Kosmopoulos* is that the case followed the factual expectation test which is led by Lawrence J.<sup>57</sup>

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<sup>53</sup> *Ibid*, 630. His Lordship observed that,

"It is clear that the appellant had no insurable interest in the timber described. It was not his. It belonged to the Irish Canadian Sawmills, Ltd., of Skibbereen, co. Cork. He had no lien or security over it and, though it lay on his land by his permission, he had no responsibility to its owner for its safety, nor was it there under any contract that enabled him to hold it for his debt. He owned almost all the shares in the company, and the company owed him a good deal of money, but, neither as creditor nor as shareholder, could he insure the company's assets. The debt was not exposed to fire, nor were the shares, and the fact that he was virtually the company's only creditor, while the timber was its only asset, seems to me to make no difference. He stood in no "legal or equitable relation to" the timber at all. He had no "concern in" the subject insured. His relation was to the company, not to its goods, and after the fire he was directly prejudiced by the paucity of the company's assets, not by the fire. No authority has been produced for the proposition that the appellant had any insurable interest in the timber in any capacity, and the books are full of decisions and dicta that he had none." The House of Lords also ruled that Mcaura's interest could not even based on bailment as he had not been liable for the timber.

<sup>54</sup> The requirement on insurable interest in the sphere of the legal interest test is no longer acceptable in Australia by Insurance Contracts Act 1984, Part III; in Canada by *Kosmopoulos* (1987) 34 D.L.R. (4th) 208; [1987] 1 S.C.R. 2, see below; in the USA by *Hays v Milford Mutual Fire Ins. Co*, 48 NE 754 (Sup Ct, Mass, 1898). See, Malcolm Clarke, *Policies and Perceptions of Insurance Law in the Twenty-First Century*, (Oxford, 2005), p. 32.

<sup>55</sup> John Lowry and Philip Rawlings, "Re-thinking Insurable Interest", Sarah Worthington, *Commercial Law and Commercial Practice*, (2003), p. 335, 361. For more discussion on this, see below.

<sup>56</sup> (1987) 34 D.L.R. (4th) 208; [1987] 1 S.C.R. 2. See, John Lowry & Philip Rawlings, *Insurance Law: Cases and Materials*, (2004), p. 284.

<sup>57</sup> *Lucena v Craufurd*, (1806) 2 B. & P. (NR.) 269, at 302.

### 3.2.1.2. *Kosmopoulos*<sup>58</sup>

Kosmopoulos entered into a commercial lease for premises in the City of Toronto. Subsequently, he ran a business of manufacturing and selling leather goods. As a result of the advice of Kosmopoulos' solicitor, he incorporated *Kosmopoulos Leather Goods Limited* "the company" in order to protect his personal assets. The insured was the sole shareholder and director of the company. Nevertheless, although the business was technically carried on through the limited company, the insured always thought that he owned the store and its assets. In fact, nearly all the documentation required in the business, including bank accounts, sales tax permits and hydro and telephone accounts, made no Kosmopoulos' own name.

Furthermore, Kosmopoulos' solicitor tried to obtain the approval of the landlord to an assignment of the lease of the premises from Kosmopoulos to the company. However, this approval was never obtained. The lessee, during the policy duration, was not the company, but Kosmopoulos.

Accordingly, Kosmopoulos took out an insurance policy to insure the company's assets but in his own name. Then, a fire broke out in the adjoining premises and caused fire, water and smoke damage to the assets of the company and to the rented premises. Consequently, the insured claimed on the policy but the insurer rejected the claim on the ground that the insured was lack of insurable interest in the company's assets.

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<sup>58</sup> (1987) 34 D.L.R. (4th) 208; [1987] 1 S.C.R. 2.

Wilson J in the Supreme Court of Canada dealt with the issue which was "whether a sole shareholder of a corporation has an insurable interest in the assets of that corporation."

Indeed, Wilson J did not accept the rule in *Macaura*<sup>59</sup> case that a sole shareholder has no insurable interest in the assets of the company. Nor she supported Lord Eldon's view or the legal interest test. Instead, she criticized Lord Eldon's view in favour of Lawrence J's view or the factual expectation test,<sup>60</sup> that,

"Lawrence J.'s view of insurable interest..., in my view, provides a readily ascertainable standard. Lord Eldon's concern that a broader definition of insurable interest would lead to too much insurance may also be illusory. Insureds will still have to disclose all material circumstances ... and declare the nature of their interests ... to the insurer in order to enable it to judge the risk to be taken. If the insurer cannot estimate the likelihood of the loss occurring (because, for example, the information is in the hands of third parties) then it does not have to write the policy. It can also protect itself by limiting its liability or it can charge larger premiums."<sup>61</sup>

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<sup>59</sup> [1925] A.C. 619.

<sup>60</sup> In order to support her criticism, moreover, Wilson J cited, at p. 218, from Brown and Menezes, *Insurance Law in Canada*, (1982), at p. 84, that,

"After *Macaura*, it is no longer possible to claim merely that one would be adversely affected by the loss; the insured must assert that he owned an interest in the objects destroyed. This provides the illusion of great certainty. Property law is among the most technical and certain segments of the law. This certainty is totally illusory because the new formulation makes no concessions either to the reasons for which insurable interest is a component of insurance law or for commonplace business transactions. ... Assuming that an insurable interest in "things" must mean property, among the simple questions raised are matters such as how does one own a direct interest in property which is not in existence at the time of the contract? Can next season's crops or fluctuating inventory be insured? Are warehousing and other bailee policies subject to the law as set out in *Macaura* so as to limit the right to insure to the bailee's liability to the bailor?"

<sup>61</sup> *Ibid*, pp. 217, 218.



Furthermore, Wilson J was of the opinion that, adopting the factual expectation test would provide better security and beneficial insurance to a society and that Lord Eldon's approach would, she thought, be abandoned in favour of the broader concept of insurable interest, i.e. Lawrence J's approach. In her words,

"A broadening of the concept of insurable interest would, it seems to me, allow for the creation of more socially beneficial insurance policies than is the case at present with no increase in risk to the insurer. I therefore find both of Lord Eldon's reasons for adopting a restrictive approach to insurable interest unpersuasive.

It seemed for a time as if Lord Eldon's view was going to be abandoned and that of Lawrence J. upheld."<sup>62</sup>

Furthermore, Wilson J turned, then, to critically deal with *Macaura* case in more details, that,

"Quite apart from the fact that Lord Buckmaster's rationale for a restrictive concept of insurable interest seems somewhat less than convincing, the *Macaura* case is in itself a rather odd case. The case originally went to arbitration on the question of fraud. The arbitrator held that there was no fraud but that the insured had no insurable interest. *Professor Robert Keeton*, Basic Text on Insurance Law (1971), has noted that "it is difficult to reject the inference that, though not proved [the charges of fraud] influenced the court to

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<sup>62</sup> *Ibid*, pp. 218, 219. Wilson J reviewed some authorities in favour of Lawrence J's view, that "In *Patterson v. Harris* (1861), 1 B. & S. 336, 121 E.R. 740, and in *Wilson v. Jones* (1867), L.R. 2 Ex. 139, courts allowed two shareholders of a company established for the purpose of laying down a trans-Atlantic submarine cable to recover on an insurance policy once the cable had been destroyed even although neither had a legally enforceable right in the cable. In *Blascheck v. Bussell* (1916), 33 T.L.R. 51 (Eng. K.B.), there was no challenge to the insurable interest of the plaintiff who had insured the health of an actor he had engaged for a performance. That interest was a purely pecuniary, non-legal one concerned with the consequences of the actor's non-performance on account of injury."

reach a theory of insurable interest that is nothing short of pernicious" (p. 117)... In my view, this inference, if legitimate, further weakens the authority of *Macaura* as a precedent.

Another curious thing about *Macaura* is that it has not been strictly applied in later cases. An attempt has been made to offset the arbitrariness and harshness of the *Macaura* principle by the use of a presumption of sorts."<sup>63</sup>

More significantly, she evaluated the three policies that have been outlined as underlying the requirement of an insurable interest, by Harnett and Thornton; which are, namely, (1) the policy against wagering under the guise of insurance; (2) the policy favouring limitation of indemnity; and (3) the policy to prevent temptation to destroy the insured property,<sup>64</sup> under *Macaura* principle.

In the first place, Wilson J highlighted the statutory requirement of insurable interest and emphasized the possibility of practicing wagering in the guise of insurance and that the restrictive definition of insurable interest was not an ideal mechanism to combat such an illness. She said that,

"I think it is probably easy to overestimate the risk of insurance contracts being used in today's world to create a wagering transaction. There seem to be many more convenient devices available to the serious wagerer.

If wagering should be a major concern in the context of insurance contracts, the current definition of insurable interest is not an ideal mechanism to combat

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<sup>63</sup> *Ibid*, p. 220.

<sup>64</sup> Bertram Harnett and John Thornton, "Insurable Interest in Property: A Socio-Economic Reevaluation of a Legal Concept", *Col. L. R.* (1948) 48, p. 1162, at 1178-83; John Birds, "A Shareholder's Insurable Interest in his Company's Property", *J. B. L.* (1987) 309, at 310-11. It seems that, Wilson J had relied heavily on Harnett and Thornton's article in dealing with this issue as well as C. Brown & J. Menezes, *Insurance Law in Canada*, (1982).

this ill. The insurer alone can raise the defence of lack of insurable interest; no public watchdog can raise it. The insurer is free not to invoke the defence in a particular case or it can invoke it for reasons completely extraneous to and perhaps inconsistent with those underlying the definition." She continued that, "*The Macaura* principle, in my view, is an imperfect tool to further the public policy against wagering. By focusing merely on the type of interest held by an insured the current definition gives rise to the possibility that an insured with the "correct" type of interest, but no pecuniary interest, will be able to receive a pure enrichment unrelated to any pecuniary loss whatsoever. Such an insured is, in effect, receiving a "gambling windfall". But this same approach excludes insureds with a pecuniary interest, but not the type of interest required by *Macaura*. Such insureds purchase insurance policies to indemnify themselves against a real possibility of pecuniary loss, not to gain the possibility of an enrichment from the occurrence of an event that is of no concern to them."<sup>65</sup>

In the second place, it has been said that, "Insurances on property are prima facie to be construed as contracts of indemnity.",<sup>66</sup> Therefore, Wilson J was of the view that the extension of the insurable interest definition, under the legal interest test in *Macaura* case, was not consistent with the principle of indemnity. In her words,

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<sup>65</sup>(1987) 34 D.L.R. (4th) 208, pp. 222, 223. She, thereafter, cited from Harnett and Thornton at p. 1181,<sup>65</sup> that:

"While some form of valuable relationship to the occurrence is necessary to avoid the wagering aspect, the policy against wagering is satisfied by any valuable relationship which equals the pecuniary value of the insurance, regardless of the legal nature of that relationship.

I agree with their conclusion and find, therefore, that the restrictive definition of insurable interest set out in *Macaura* is not required for the implementation of the policy against wagering."

<sup>66</sup> *Lonsdale & Thompson Ltd. v. Black Arrow Group Plc* [1993] 2 Lloyd's Rep. 428, at 432 per J Sumption QC; s 1 MIA 1906; Malcolm A. Clarke, *The Law of Insurance Contracts*, 4<sup>th</sup> ed., (2002), para. 4-2B; John Lowry and Philip Rawlings, *Insurance Law: Doctrines and Principles*, (1999), p. 14. Note that, the principle of Indemnity will be dealt with, at a later stage of this Chapter, in more details.

"The public policy restricting the insured to full indemnity for his loss is not consistent with the restrictive definition of insurable interest set out in *Macaura*. Indeed, an extension of that definition may better implement the principles of indemnity. At present, insureds such as Mr. Kosmopoulos who have suffered genuine pecuniary loss cannot obtain indemnification because of the restrictive definition. The *Macaura* case itself shows how the indemnity principle is poorly implemented by the current definition of insurable interest. Had Macaura named the corporation as the insured, or had he taken a lien on the timber to secure the debt, he would have been held to have had an adequate interest. But without these formal steps Macaura's interest satisfied the principle of indemnity."<sup>67</sup>

In the third place Wilson J assessed the restrictive definition of insurable interest where the insured does not have insurable interest in the insured property and the possibility of the temptation of destroying the subject matter of insurance in the case that or, what is called, *the moral hazard*. She observed that,

"It has also been said that if the insured has no interest at all in the subject-matter of the insurance, he is likely to destroy the subject-matter in order to obtain the insurance moneys. Thus, the requirement of an insurable interest is said to be designed to minimize the incentive to destroy the insured property. But it is clear that the restrictive definition of insurable interest does not necessarily have this result. Frequently an insured with a legal or equitable interest in the subject-matter of the insurance has intimate access to it and is in a position to destroy it without detection. If Lawrence J.'s definition of

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<sup>67</sup> (1987) 34 D.L.R. (4th) 208, p. 223.

insurable interest in *Lucena v. Craufurd* were adopted, this moral hazard would not be increased. Indeed, the moral hazard may well be decreased because the subject-matter of the insurance is not usually in the possession or control of those included within Lawrence J.'s definition of insurable interest, i.e., those with a pecuniary interest only. It seems to me, therefore, that the objective of minimizing the insured's incentive to destroy the insured property cannot be seriously advanced in support of the *Macaura* principle.

It is no doubt true that if in fact the proceeds of insurance could be paid to a sole shareholder free of the corporation's creditors, the sole shareholder would have a greater incentive to destroy the business assets than if the proceeds were paid into the insolvent corporation subject to the claims of its creditors."<sup>68</sup>

Therefore, her conclusion was that,

"... it seems to me that the policies underlying the requirement of an insurable interest do not support the restrictive definition: if anything, they support a broader definition than that set out in *Macaura*."<sup>69</sup> She, then continued to say that, "... there is little to commend the restrictive definition of insurable interest. As Brett M.R. has noted over a century ago in *Stock v. Inglis*... it is merely "a technical objection ... which has no real merit ... as between the assured and the insurer". The reasons advanced in its favour are not persuasive and the policies alleged to underlie it do not appear to require

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<sup>68</sup> *Ibid*, p. 224. Wilson J emphasized that American courts had dispensed with the narrow insurable interest definition. John Birds observed that, "Wilson J... pointed out how many American courts have dispensed with a narrow insurable interest requirement with no evidence of insoluble problems of calculation, difficulties in ascertaining insurable interests, wagering, over-insurance or willful destruction of property. In addition, commentators generally favoured a wide test."; in, John Birds, "A Shareholder's Insurable Interest in his Company's Property.", *J. B. L.* (1987) 309, at 311.

<sup>69</sup> *Ibid*, p. 226.

it. They would be just as well served by the factual expectancy test. I think *Macaura* should no longer be followed. Instead, if an insured can demonstrate, in Lawrence J.'s words, "some relation to, or concern in the subject of the insurance, which relation or concern by the happening of the perils insured against may be so affected as to produce a damage, detriment, or prejudice to the person insuring", that insured should be held to have a sufficient interest. To "have a moral certainty of advantage or benefit, but for those risks or dangers", or "to be so circumstanced with respect to [the subject-matter of the insurance] as to have benefit from its existence, prejudice from its destruction" is to have an insurable interest in it."<sup>70</sup>

Lowry and Rawlings point out that, "Wilson J's analysis reflects a shift in emphasis from Lord Eldon's concern, which led him to define insurable interest narrowly, to a view that recognizes the economic and social benefit of insurance and, therefore, a broader conception of insurable interest. In the modern commercial world", they said, "property insurance is generally sought to secure indemnification, and, as Wilson J points out, it is more socially beneficial to encourage widespread insurance than to restrict it. That seems, therefore, no convincing reason in this context for interfering with freedom of contract and, in particular, for not requiring insurers to meet liabilities under contracts which they have freely entered into and for which they have received premiums."<sup>71</sup>

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<sup>70</sup> *Ibid*, p. 227; See, further, John Lowry and Philip Rawlings, "Re-thinking Insurable Interest", Sarah Worthington, *Commercial Law and Commercial Practice*, (2003), p. 335, at 347-350.

<sup>71</sup> *Ibid*, at 350.

As the matter of fact, *Macaura*, as a House of Lords decision, still represents the orthodox approach of English courts. That is because there are few cases that have been arisen before English court which concerned insurable interest as an issue.<sup>72</sup>

Birds, in his comment on the requirement of insurable interest in *Kosmopoulos*, observed that, "Such a lengthy consideration of insurable interest, and in particular of the policy issues underlying the requirement, cannot be found in any reported modern English case, principally no doubt because the issue has not arisen for consideration since *Macaura*. This hardly be because a relevant factual situation has not presented itself."<sup>73</sup> He remarked the reasons why the issue of insurable interest has not been litigated and he presented two reasons behind that. He said: "The first is that there are some ways around the strictness of the *Macaura* rule. A shareholder can insure his shares against loss of value owing to the failure of an adventure upon which the company has embarked. An unsecured creditor may insure against his debtor's insolvency. Such an insurance against pecuniary loss is widespread, although it is based upon an existing proprietary or contractual right, namely ownership or the shares or of the chose in action that is the debt in the respect of the two cases cited, i.e. [*Macaura* and *Kosmopoulos*]...The second reason", he added, "is that the courts have been prepared to recognize, where an insurer might be able to successfully plead lack of insurable interest as a defence, that the insured can show that the requirement has been properly waived. The essential requirement is that the true construction of

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<sup>72</sup> *Ibid*, at 354.

<sup>73</sup> See, John Birds, "Insurable Interest", in N. Palmer & E. McKendrick, *Interests in Goods*, (1998), p. 91, at 94. In this context, in a Scottish case, *Cowan v Jeffrey Associates* 1999 SLT 757, the issue arose before the court was whether the director and sole shareholder of a company possessed an interest. Lord Hamilton, sitting in the Outer House, followed the *Macaura* principle and he ruled that to a change of the kind of insurable interest, as the one mentioned in *Kosmopoulos*, needed to be affected either by the legislature or the House of Lords, at p. 761; in the same manner, see, *Mitchell v Scottish Eagle Insurance Co Ltd* 1997 SLT 793. See also, Lowry & Rawlings, *ibid*.

the insurance policy provides for the insurer to pay notwithstanding that the insured has no insurable interest."<sup>74</sup>

Clarke, moreover, declares that, for an insured to have an insurable interest in the subject-matter of insurance, he is required to satisfy, under English law, two requirements; firstly, a relation to the subject-matter of insurance giving rise to an economic interest; secondly, a proprietary interest in it, or a legal or equitable relation to the subject-matter insured. However, Canadian law requires only the first requirement, i.e. a relation to the property insured that provides an economic interest.<sup>75</sup> Additionally, he explains, in this context, that, "The property must be such that the insured may reasonably expect to benefit by the safety or due arrival of the property or to be prejudiced by its loss, damage or detention ... If, however, the subject-matter is not in fact at risk in this sense, or will not be when the cover purports to commence, there is no economic interest and thus no insurable interest."<sup>76</sup>

It is an essence to note that, the ownership constitutes an absolute insurable interest in the property owned. That is to say, a car owner or a landlord, for instance, has an absolute insurable interest in the car or the house so long as the insured could prove, at the time of the occurrence of the event insured against, that the ownership has been actually in effect and, consequently, a pecuniary or economic loss took place thereby.

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<sup>74</sup> *Ibid.*

<sup>75</sup> Malcolm A. Clarke, *The Law of Insurance Contracts*, 4<sup>th</sup> ed., (2002), parag. 4-3. According to the author, the Canadian case applies in both Australia and the UCA. Further, the expression of *economic interest*, comes from the United States. See, for example, the New York Insurance Law, section 158; used by the Australian Law Reform Commission, Report No. 20. *Insurance Contracts*, parag. 120.

<sup>76</sup> *Ibid*, parag. 4-3A. See, Bertram Harnett and John Thornton, "Insurable Interest in Property: A Socio-Economic Reevaluation of a Legal Concept", *Col. L. R.* (1948) 48, p. 1162, at 1171. The authors observed that, "The factual expectation is the simplest expressed, yet most all-inclusive of insurable interest concept; it is the expectation of economic advantage if the insured property continues to exist, or, stated negatively, the expectation of economic disadvantage accruing upon damage to the insured property."



According to Harnett and Thornton, "Absolute ownership is the solid predictable foundation of this unsteady insurable interest structure that has been constructed with the mortar of property concepts."<sup>77</sup>

However, insurable interest in property is not confined to absolute legal ownership.<sup>78</sup> Instead, where an insured possess a right which is recognized by law on the property insured, such right constitutes an insurable interest. Accordingly, in *Lloyd v Fleming*,<sup>79</sup> for example, an assignee of an insurance policy had an insurable interest in the subject-matter of insurance because the assignment transferred all rights accrued under the policy and, therefore, the assignee was entitled to sue upon it in his own name, even though the assignment was done after the occurrence of the loss.

Blackburn J. concluded that,

"A policy of marine insurance is a contract of indemnity against all losses accruing to the subject-matter of the policy from certain perils during the adventure. This subject-matter *need not be strictly a property*, in either the ship, goods, or freight; for, as has been long said, if a man is so situated with respect to them that he will receive benefit from their arriving safely at the end of the adventure, or sustain loss in consequence of their not arriving safely, he has an insurable interest."<sup>80</sup>

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<sup>77</sup> Bertram Harnett and John Thornton, *ibid*, at 1166.

<sup>78</sup> *Ibid*; Nicholas Legh-Jones, *MacGillivray on Insurance*, 10<sup>th</sup> ed., (2003), parag. 1-120; R. A. Hasson, "The Supreme Court in Flames: Fire Insurance Decisions After *Kosmopoulos*" [1995] *Osgoode Hall LJ* 679, at 681.

<sup>79</sup> (1872) LR 7 QB 299.

<sup>80</sup> *Ibid*, p. 302.

Furthermore, the tenant who is likely to benefit from an insurance policy taken by his landlord has an insurable interest, even though his interest in the property insured may be limited.<sup>81</sup> Thus, in *Mark Rowlands Ltd v Berni Inns Ltd*,<sup>82</sup> a fire insurance policy was taken out by the plaintiff landlord on a building. The landlord let the basement and part of the ground floor of the building to the defendant tenant. Due to the defendant's negligence, a serious fire broke out at the premises and effectively destroyed the whole building. The fire originated in the ceiling void of the basement part of the premises in which a quantity of flammable material had been stored or deposited. However, although the plaintiff was fully indemnified by his insurers, the latter sought by virtue of their right of subrogation to recover the damages from the defendant tenant on the grounds that the fire had been caused by the defendant's negligence. Kerr LJ held that,

"Provided that a person with a limited interest has an insurable interest in the subject-matter of the insurance ... there is no principle of law which precludes him from asserting that an insurance effected by another person was intended to enure for his benefit to the extent of his interest in the subject-matter..."<sup>83</sup>

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<sup>81</sup> Malcolm A. Clarke, *The Law of Insurance Contracts*, 4<sup>th</sup> ed., (2002), p. 133; Bertram Harnett and John Thornton, "Insurable Interest in Property: A Socio-Economic Reevaluation of a Legal Concept", *Col. L. R.* (1948) 48, p. 1162, at 1167.

<sup>82</sup> [1985] 2 Lloyd's Rep. 437.

<sup>83</sup> *Ibid*, 442. Clarke observed that, "If the tenants could enforce the insurance directly, or indirectly by compelling the landlords to enforce it, their position would be like that of an insured who must have an insurable interest. Where, however, they have a contractual right to have the landlords insure the property (and damages if they do not), and a contractual right to have insurance money used to reinstate the property (and to damages if it is not), they are at one step removed from the position of an insured; nonetheless, it appears from the proviso in this statement in the Court of Appeal that they must satisfy the requirement of interest. Be that as it may, it is clear that persons such as tenants of property do have an insurable interest." Malcolm A. Clarke, *The Law of Insurance Contracts*, 4<sup>th</sup> ed., (2002), p. 28.

It must be stressed that, there are various cases where persons who are entitled to insure properties that they do not own,<sup>84</sup> so long as the destruction of the properties makes those persons suffer losses or results liabilities. Thus, a bailee, such as a carrier or a warehouseman, is entitled to insure the goods bailed with him. In *Tomlinson v Hepburn*,<sup>85</sup> the insured carrier insured a consignment of tobacco with the defendant underwriter. The consignment was stolen before it was unloaded, but without the fault or the negligence of the carrier. The insurer rejected the claim of the insured under the policy on the ground that, *inter alia*, the insurance was a contract of indemnity and, therefore, the policy covered only the carrier's liability for negligence, not the owners' proprietary interest, and the carrier had no insurable interest in the goods as opposed to his own charges. As a matter of fact, the House of Lords found for the insured carrier as a bailee. In his words, Lord Reid concluded that,

"A bailee can if he chooses merely insure to cover his own loss or personal liability, to the owner of the goods either at common law or under contract and if he does that of course he can recover no more under the policy than

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<sup>84</sup> For more details on this, see, Nicholas Legh-Jones, *MacGillivray on Insurance*, 10<sup>th</sup> ed., (2003), Sect. 6, p. 55-92; Malcolm A. Clarke, *The Law of Insurance Contracts*, 4<sup>th</sup> ed., (2002), Sect. 4-5, p. 148-167; Robert Merkin, *Colinvaux's and Merkin's Insurance Contract Law*, Vol. I, (2002). parag. A-0484 to parag. A-0487 and parag. A-0508 to parag. A-0539; John Lowry and Philip Rawlings, *Insurance Law: Doctrines and Principles*, (1999), parag. 4.4., at pp. 57-60; Andrew McGee, *The Modern Law of Insurance*, (2001), parag. 4.29 to 4.33.

<sup>85</sup> [1966] AC 451. [HL]. See also, *Waters v Monarch* (1856) 5 E1 & B1 870; *Ramco (U.K.) Ltd. v. International Insurance Company of Hannover Ltd* [2004] 2 Lloyd's Rep. 595; [2004] Lloyd's Rep IR 606, where Waller LJ commented on *Waters*, in parag. [32], that,

"The principles established by *Waters* were highly convenient principles, but constituted an exception to the equally ancient common law principle that normally a claimant cannot sue for loss which he has not himself suffered; this was particularly striking where the cause of action was contractual (as a claim on an insurance policy always will be) since it appears inconsistent with the doctrine of privity of contract to enable a goods-owner to recover his loss when he is not a party to the contract. There is thus something of an anomaly in allowing a bailee to recover for a loss he has not suffered... The anomaly is much less striking now that the Contracts (Rights of Third Parties) Act, 1999 is on the statute book. But enabling a party to a contract to recover for a loss he has not suffered or enabling a goods-owner to recover pursuant to a contract to which he is not a party is still the exception rather than the rule; the "exception" established in *Waters* should not itself be extended beyond its proper limits without good reason and no such reason exists in the present case."

*Hill v Scott* [1895] 2 QB 713; *Transcontinental Underwriting Agency SRL v Grand Union Ins. Co Ltd* [1987] 2 Lloyd's Rep. 409; *Maurice v Goldsbrough Mort & Co* [1939] AC 452; Malcolm A. Clarke, *The Law of Insurance Contracts*, 4<sup>th</sup> ed., (2002), p. 157; Nicholas Legh-Jones, *MacGillivray on Insurance*, 10<sup>th</sup> ed., (2003), parag. 1-137.

sufficient to make good his own personal loss or liability. But equally he can if he chooses insure up to his full insurable interest - up to the full value of the goods entrusted to him and if he does that he can recover the value of the goods though he has suffered no personal loss at all. But in that case the law will require him to account to the owner of the goods who has suffered the loss or, ..., he will be trustee for the owners."<sup>86</sup>

Lord Pearce, from his point of view, justified this conclusion, that,

"...commercial convenience makes it reasonable for him to insure the whole property in the goods and to recover the whole of the moneys, holding the balance in trust for those whose loss it represents. In such a case he is not gaming and there is no reason why he should not so act."<sup>87</sup>

As a result of what has been mentioned, Lowry and Rawlings perceive that, "...the judiciary has displayed tentative signs of a willingness to sidestep the force of *Macaura*."<sup>88</sup> Thus, in *Sharp v Sphere Drake Insurance, The Moonacre*,<sup>89</sup> the assured, for tax purposes, bought a yacht, Moonacre, in a company's name and he took out an insurance policy in his own name. A fire broke out on board the yacht and, therefore, it sank and was constructive total loss. The insured claimed on the policy but the insurer, rejected the claim on the ground that, *inter alia*, the policy was in Sharp's name and not in the company's name which had been, in fact, the registered owner. Subsequently, the insurer contended that, the insured had no legal or equitable relation

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<sup>86</sup> *Ibid*, p. 467. See, also, *Ramco (U.K.) Ltd. v. International Insurance Company of Hannover Ltd* [2004] 2 Lloyd's Rep. 595; [2004] Lloyd's Rep IR 606.

<sup>87</sup> *Ibid*, p. 477.

<sup>88</sup> John Lowry and Philip Rawlings, "Re-thinking Insurable Interest", Sarah Worthington, *Commercial Law and Commercial Practice*, (2003), p. 335, at 354. Also, Robert Merkin, *Colinvaux's and Merkin's Insurance Contract Law*, Vol. I, (2002). parag. A-0397.

<sup>89</sup> [1992] 2 Lloyd's Rep. 501.

to the yacht and, therefore, he lacked insurable interest. Before the court, Colman Q.C., sitting as a Deputy Judge of the High Court, distinguished this case from *Macaura*, and he held that:

"The legal relation in which he, [the insured], stood to the vessel was that for as long as the powers of attorney remained he was entitled to use it for his own purposes and to exercise over it such control as he saw fit. His powers were such that he could even abandon it to the insurers in the event of a constructive total loss; a relation to the goods sometimes considered decisive on the issue of title to sue ... Mr. Sharp's relation to the vessel was therefore materially different from that of Mr. Macaura to the timber. The latter had neither beneficial rights over or in respect of the timber nor obligations in respect of it. Although he might or indeed probably would be unable to recover his debt from the company if the timber were destroyed and although the asset value of the company in which he was the sole shareholder would thereby be reduced, the detriment that he would thus sustain would not be in consequence of any relation in which he stood to the timber but by reason of the relation in which he stood to the company which owned the timber. In my judgment Mr. Sharp by reason of the powers of attorney stood in a legal relationship to the vessel in consequence of which he would benefit from the preservation of the vessel and, if the vessel were lost or damaged, he would suffer loss of a valuable benefit. I therefore hold that he had an insurable interest in the vessel."<sup>90</sup>

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<sup>90</sup> *Ibid*, p. 512.

### 3.2.1.3. Co-insurance Policies on Construction Contracts

It seems in several cases that, English Courts are following the factual expectation test. That appears in construction contracts insurance cases where the head contractor is required by the contract to insure the project for his benefit as well as the sub-contractors'. Then, the essential issue that will, herein, be arisen is that whether the sub-contractor has an insurable interest in a policy which is taken out by the head contractor.<sup>91</sup> Thus, the courts distinguish between joint, composite and pervasive interests.<sup>92</sup>

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<sup>91</sup> John Lowry and Philip Rawlings, "Re-thinking Insurable Interest", Sarah Worthington, *Commercial Law and Commercial Practice*, (2003), p. 335. See also, Birds, John, "Interest - Orthodox and Unorthodox Approaches" [2006] *J.B.L.* 224-231.

<sup>92</sup> *Ibid*; *General Accident Fire & Life Ass. Corp. v Midland Bank Ltd.* [1940] 2 K.B. 388; *Central Bank of India v Guardian Ass. Co. Ltd* (1936) 54 Ll.L.Rep. 247, in particular, p. 260; *Samuel v Dumas* [1924] AC 431; Sir M. J. Mustill and J. C. Gilman, *Arnould's Law of Marine Insurance and Average*, 16<sup>th</sup> ed., (1981), Vol. I, parag. 341. Joint and composite insurances, therein, are described as that, "...when two or more interests are insured under the same policy will be construed as a composite insurance, insuring each person interested severally in respect of his own interest. There can only be a joint insurance in the strict sense when the assureds have a joint interest in the insured property, as where they are joint owners. If the policy is joint, each assured must be joint in any proceedings, and defences arising from the conduct of any of them are available against them all. Payment to one joint assured operates as a good discharge under the policy."; Also, Nicholas Legh-Jones, *MacGillivray on Insurance*, 9<sup>th</sup> ed., (1997), parag. 1-187. "There cannot be a joint insurance policy unless the interest of the several persons who are interested in the property insured is a joint interest. Where, therefore, the interests of different people in the same insured property are diverse interests, a policy purporting to insure all the persons interested must be construed as a composite policy insuring each one severally of his own interest. Where, in such policy, payment in case of loss is expressed to be payable to the insured, any payment, although made by a cheque drawn in favour of all the insured jointly, must be regarded as in essence a payment in discharge of the several loss or losses in respect of which the indemnity has been operative, and those of the insured who are entitled to be indemnified are entitled to insist on payment of that money over to them from the other or others who, having suffered no loss in respect of his or their interest, are not entitled to receive it otherwise than as mere payees on behalf of those who have suffered a loss. Where such a joint payment was made in respect of the loss suffered by one only of the three persons insured by a composite policy, each in respect of his own several interest in the property covered by the policy and after such payment it was discovered that the claim made by the person in respect of whose interest and alleged loss the payment was made was a fraudulent claim, it was held that the insurers could not recover the money from the other payees named on the cheque who in fact had never received the money but had merely indorsed the cheque over to the fraudulent claimant who alone had received it."; more recently, see, *State of the Netherlands v Youell and Hayward* [1997] 2 Lloyd's Rep 440 in particular, p. 448, where Rix J illustrated pervasive interest, that: "A pervasive interest in this sense partakes of certain characteristics of both a separate interest and a joint interest for the very good reason that in such a case the claimant is entitled to claim not only for himself but also for the benefit of his co-assureds in the full amount of the loss."

In *Petrofina (U.K.) Ltd. v. Magnaload Ltd.*,<sup>93</sup> the sub-contractors on a construction site had, besides the owner and the head contractors, an insurable interest in the entire works even though they were working on a part of the site and they were lacked property interest in the work. In fact, their interest was based upon that, should any part of the works be damaged or destroyed, each sub-contractor could, in the event of negligence, suffer loss. Therefore, the sub-contractors' insurable interest appears in the continued existence of the work. Drawing the analogy of the insurable interest possessed by a bailee in goods, Lloyd J. held that,

"... frequently mentioned in connection with a bailee's right to insure the full value of the goods. From a commercial point of view it was always regarded as highly convenient."<sup>94</sup>

In support of his proposition, he, subsequently, referred to Lord Pearce's judgment in *Tomlinson v. Hepburn* that,

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<sup>93</sup> [1983] 2 Lloyd's Rep 91; Noted by John Birds [1983] *JBL* 479; Ahmed Tolu Olubajo, "Pervasive Insurable Interest: A Reappraisal" *Const. L.J.* (2004), 20(2), 45-57; Nicholas Legh-Jones, *MacGillivray on Insurance*, 10<sup>th</sup> ed., (2003), parag. 1-155; Malcolm A. Clarke, *The Law of Insurance Contracts*, 4<sup>th</sup> ed., (2002), p. 158; John Birds, "Insurable Interest", in N. Palmer & E. McKendrick, *Interests in Goods*, (1998), p. 91, at 102. See, further, *Stone Vickers Ltd v Appledore Ferguson Shipbuilders Ltd* [1991] 2 Lloyd's Rep 288, a marine insurance case where the sub-contractors were suppliers of component parts to a ship that was under construction and off-shore oil production facility. The Court dealt with the issue that, "whether the supplier of a part to be installed into the vessel or contract works under construction might be materially adversely affected by loss of or damage to the vessel or other works by reason of the incidence of any of the perils insured against by the policy in question." The Court, then, ruled that, "there is no reason in principle why such a sub-contractor should not also have sufficient interest in the whole contract works to be included as co-assured under the protection of the head contractor's policy.", at p. 301. See also, a perfect comment on *Stone Vickers* case in *MacGillivray on Insurance*, 10<sup>th</sup> ed., (2003), parag. 1-156, at p. 74, where was stated that, "...the fact that a sub-contractor might suffer financial disadvantage if the contract works were to suffer loss or damage is not itself a ground of insurable interest. It appears that the sub-contractors in question were unable to demonstrate that they possessed a legal or equitable interest in relation to the contract works. Nor could they show that the works were at their risk. The possibility of being held liable only for damage caused by their own employees would support an insurance against the risk of legal liability to the owners of the works but not an insurance of the works themselves. If the risk of becoming liable to the owner of property for negligently damaging it was a ground of insurable interest in property, cases in which the existence of an interest was denied should have been decided otherwise," as in *Macaura* case, "and it confuses the distinction between insurances on property, on the one hand, and product liability insurances on the other."

<sup>94</sup> *Ibid*, at 96.

" Lord Pearce in *Tomlinson v. Hepburn* ([1966] 1 Lloyd's Rep 309; [1966] AC 451), at pp. 322 and 481 said:

A bailee or mortgagee, therefore (or others in analagous positions) has by virtue of his position and his interest in the property a right to insure for the whole of its value, holding in trust for the owner or mortgagor the amount attributable to their interest. To hold otherwise would be commercially inconvenient and would have no justification in common sense."<sup>95</sup>

Thus, he was of the opinion that building and engineering contracts would involve different sub-contractors, therefore, it would have been more convenient for all parties including the insurer to allow the head contractor to take out a single policy covering all the whole risk of the contractor and sub-contractors in relation to the entire contract works. Having not done that, each sub-contractor would have to take out his own policy which "would mean, at the very least, extra paperwork; at worst it could lead to overlapping claims and cross claims in the event of an accident." He went on to say that, "the cost of insuring his liability might in the case of a small sub-contractor, be uneconomic."<sup>96</sup>

The fundamental point being made by Lloyd J. was, therefore, that the sub-contractors interest was based upon a pervasive interest in the entire property.<sup>97</sup>

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<sup>95</sup> *Ibid.*

<sup>96</sup> *Ibid.*

<sup>97</sup> *Ibid*, at 97; since there had not been any English decision directly had dealt with this issue, Lloyd J based his view upon a Canadian case *Commonwealth Construction Co Ltd v Imperial Oil Ltd* (1976) 69 DLR (3d) 558, where de Grandpre J stated that, "On any construction site, and especially when the building being erected is a complex chemical plant, there is ever present the possibility of damage by one tradesman to the property of another and to the construction as a whole. Should this possibility become reality, the question of negligence in the absence of complete property coverage would have to be debated in Court. By recognizing in all



Similarly, the same approach was followed in *National Oilwell Ltd v Davy Offshore (UK) Ltd*,<sup>98</sup> where Colman J. considered the issue which was that, whether the suppliers of a subsea wellhead completion system to be used as part a floating oil production facility was insured under the policy of the contractor's All Risks policy as co-insureds. He held that,

"There is, in my judgment, in particular no reason in principle why such a supplier should not, and every commercial reason why he should, be able to insure against loss of or damage to property involved in the common project not owned by him and not in his possession. The argument that because he has no possessory or proprietary interest in the property he can have no insurable interest in it and that his potential liability in respect of loss of or damage to it is insufficient to found such an insurable interest is in my judgment misconceived."<sup>99</sup>

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tradesmen an insurable interest based on that very real possibility, which itself has its source in the contractual arrangements opening the doors of the job site to the tradesmen, the Courts would apply to the construction field the principle expressed so long ago in the area of bailment. Thus all the parties whose joint efforts have one common goal, e.g., the completion of the construction, would be spared the necessity of fighting between themselves should an accident occur involving the possible responsibility of one of them.", at pp 562, 563; see, also, Ahmed Tolu Olubajo, "Pervasive Insurable Interest: A Reappraisal" *Const. L.J.* (2004), 20(2), 45-57, where the author comments, at p. 47, that, "... the policy objective underlying the court's finding that co-insureds under a construction policy possess a pervasive insurable interest in the contract works is to prevent parties involved in a common goal from suing one another in the event of damage to the joint effort. Presumably, the reason for this is to ensure that the communal goal of the parties in this case, the construction of the plant, is not disrupted. There is obvious commercial sense in preventing such parties from suing one another in the event that one of them causes damage to the works. The true basis of the doctrine is therefore commercial convenience." See, John Lowry and Philip Rawlings, "Re-thinking Insurable Interest", Sarah Worthington, *Commercial Law and Commercial Practice*, (2003), p. 335, at 356.

<sup>98</sup> [1993] 2 Lloyd's Rep 582; see also, *Hopewell Project Management Ltd. v. Ewbank Preece Ltd.* [1998] 1 Lloyd's Rep 448, particularly, at p. 456.

<sup>99</sup> *Ibid*, p. 611.

He observed that, potential liability that derived from a contract which is concluded between the insured head contractor and the owner of a property constitutes a sufficient insurable interest. In his words,

"The suggestion that there cannot as a matter of law be an insurable interest based merely on potential liability arising from the existence of a contract between the assured and the owner of property or from the assured's proximate physical relationship to the property in question, is in my judgment, to confine far too narrowly the requirements of insurable interest. There is nothing in the authorities which prevents such a relationship to the property from giving rise to an insurable interest in the property for the purposes of an insurance on property."<sup>100</sup>

In this context, Merkin commented that, "The basis of insurable interest in such a case, i.e. *National Oilwell*, is that if the works are destroyed or damaged, the sub-contractor's own contract will be brought to an end..."<sup>101</sup> Hence, it is the view of the author that, "an insurable interest exist if: the assured has legal or equitable title to the subject matter; or if the assured is in possession of the subject matter; or if the assured is not in possession of the subject matter but may be either responsible for, or suffer loss in the event of, any damage to the subject matter."<sup>102</sup>

Furthermore, in *Glengate-KG Properties Ltd. v. Norwich Union Fire Insurance Society Ltd.*,<sup>103</sup> The plaintiffs, Glengate, purchased a building with consideration of refurbishment. Accordingly, Glengate took out two policies of insurance; the first

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<sup>100</sup> *Ibid.*

<sup>101</sup> Robert Merkin, *Colinvaux's Merkin's Insurance Contract Law*, Vol. I, (2002). parag. A-0397, p. 10365.

<sup>102</sup> *Ibid.*

<sup>103</sup> [1996] 1 Lloyd's Rep 614.

policy was a material damage policy and it provided insurance cover in respect of any of the property described in the schedule accidentally lost, destroyed or damaged but excluded damage to, *inter alia*, "plans, designs unless specifically mentioned as insured by this Section". The second policy was a consequential loss policy and it contained a proviso which stated that "at the time of the happening of the Damage there shall be in force. . .an insurance covering the interest of the Insured in the property at the Premises against such Damage . . ."

A fire broke out in the building which damaged the building and destroyed a large number of architects' plans and drawings. Unfortunately, no copies existed of many of these plans and the architects had to reproduce them at considerable expense. In addition, the drawings and plans were not insured. The plaintiffs, Glengate, alleged that the fire was to delay completion of the work by 22 weeks and that most of this was attributable to the time needed to replace the plans that had been destroyed. Subsequently, the plaintiffs sought to recover against the insurer the cost of reproducing the plans and revenue lost by reason of the delay in completion of the development under the policy that provided against business interruption.

Therefore, the Court of Appeal considered the meaning of 'the interest of the insured' in a policy that covering the owner of a building against consequential loss caused by a fire or other insured peril. Also, it looked into the question that whether the insured, Glengate, had an insurable interest in drawings owned by the architects at the time of the loss. Although the Court held that the drawings and the plans were not owned by the assured, the latter was entitled to insure them. Neill LJ held that,

"I have come to the clear conclusion that in the context the reference to 'interest' in the proviso was a reference to an interest in the narrower sense. Glengate had no such interest in the architects' drawings, even though they might have a licence to use the designs and might one day have acquired the property in the drawings. At the time of the fire the drawings were the property of the architects and in my judgment it was the architects' responsibility to replace them if destroyed."<sup>104</sup>

Auld LJ, moreover, based Glengate's insurable interest in the drawings and the plans on Lawrence J's factual expectation test.<sup>105</sup> He observed that,

"...where the insurance cover in issue is against some loss consequential on damage to property, there is no reason why there should be so close a legal relationship between the insured and the object damaged. The insurable interest is in the event insured against rather than in the object the damage to which causes that event."<sup>106</sup>

He, further, views his opinion that the assured could not insure the drawings under the material damage policy on the ground that,

"...the insurable interest in question under the proviso was that in respect of damage to property under the material damage policy, that is, 'the property of the insured or for which. . .they are responsible', not that in respect of loss of rent resulting from such damage under the consequential loss policy. That is why the proviso requires that – there shall be in force, under Section 1 or otherwise an insurance covering the interest of the insured in the property. .

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<sup>104</sup> *Ibid*, p. 622.

<sup>105</sup> *Ibid*, p. 623.

<sup>106</sup> *Ibid*, p. 624.

.against such damage." He went on to say that, "the proviso only required Glengate to insure against material damage its own property or that in respect of which the cost of repair or replacement would fall on it. I do not consider that Glengate's possible licence to use the design represented by the drawings or its expectation of ownership of the drawings on completion of the project or its contingent liability under cl. 4.37 of the RIBA Conditions of Engagements to pay the architects' for the work of preparing replacement drawings gave it a sufficient proprietary or contractual interest in the drawings themselves to make them an insurable interest under the material damage policy."<sup>107</sup>

Sir Iain Glidewell, nevertheless, disagreed with Neill LJ's description that an interest was as a 'personal property interest', which is a narrow definition of insurable interest, on the basis that such a description would entitle only an owner or bailee of the drawings to insure them and that was not applied to Glengate and, therefore, the latter did not have an insurable interest in the drawings. Instead, Sir Iain Glidewell could find an insurable interest in the drawing on the basis of Lawrence's 'factual expectation' test and, therefore, held that,

"... the phrase 'the interest of the insured in the property' in its context in a policy of insurance covers whatever interest the insured has, including an insurable interest which is not a personal property interest." Therefore, he ruled that, "On the facts of the present case, Glengate clearly had an interest in the continued existence of the architects' drawings. In my judgment they therefore had an insurable interest in those drawings. I see no unfairness or

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<sup>107</sup> *Ibid*, pp. 624-5. *Olubajo* commented that, "... in *Glengate*, Auld L.J. was of the view that the wide test was an extension of the narrow rule, which made "commercial sense" but should be closely defined. This at the very least suggests that he considered commercial motivations to lie behind the wider test of insurable interest in property.", Ahmed Tolu Olubajo, "Pervasive Insurable Interest: A Reappraisal" *Const. L.J.* (2004), 20(2), 45, at p. 50.

illogicality resulting from my conclusion. Since Glengate had an insurable interest, they could themselves have insured the architects' drawings under the material damage policy. Alternatively (and more probably) they could have required the architects themselves to take out such insurance, which would have satisfied the proviso. In the absence of any such insurance, however, it is my judgment that the proviso applied and was not satisfied."<sup>108</sup>

As regard to the above mentioned, Lowry and Rawlings observed that, "While not the primary issue in these cases, the definition of insurable interest was, nevertheless, decisive in determining the rights on obligations of the parties. This line of authority can, therefore, be seen as amounting to some recognition of the broader conception of interest as adopted in Canada and elsewhere. However," they said, "a limit was placed upon this trend by the Court of Appeal in *Deepak Fertilisers And Petrochemicals Corporation v. Davy McKee (London) Ltd and ICI Chemicals & Polymers Ltd*."<sup>109</sup>

In *Deepak* case, the Court of Appeal ruled that a sub-contractor's insurable interest in the property ceased immediately after the construction was actually completed, notwithstanding his potential liability thereafter.

The facts of the case were that, a construction of methanol plant in India was belonging to Deepak. The plant was built between January 1988 and September 1991

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<sup>108</sup> *Ibid*, p. 626; John Lowry and Philip Rawlings, "Re-thinking Insurable Interest", Sarah Worthington, *Commercial Law and Commercial Practice*, (2003), p. 335, at 357; Ahmed Tolu Olubajo, *ibid*, at pp. 49, 50.

<sup>109</sup> [1999] 1 Lloyd's Rep. 387, hereafter, *Deepak*; John Lowry and Philip Rawlings, "Re-thinking Insurable Interest", Sarah Worthington, *Commercial Law and Commercial Practice*, (2003), p. 335, at 358. See comments on *Deepak* case in, John Lowry, "The Temporal Limits of Contractors' Insurable Interest" [2001-02] *King's College Law Journal* 236-239; Nicholas Legh-Jones, *MacGillivray on Insurance*, 10<sup>th</sup> ed., (2003), parag. 1-157, 1-158.

and, then, was commissioned in October 1991. Davy, co-defendants, provided technical information to Deepak in connection with the construction and commissioning the plant. ICI, although not privy to the contract between Deepak and Davy, agreed to comment on Davy's designs and provide information and advice under the terms of a licence agreement between ICI and Davy which permitted the latter to use the ICI's intellectual property. Four months after the performance of the plant, Deepak issued a letter of acceptance to Davy in February 1992 which stated that although the plant had been demonstrated acceptable quality, retention of £50,000 would be in effect in relation to certain malfunctions which affected its performance. Subsequently, the plant exploded. Nevertheless, although there were no casualties, the plant was damaged and needed to be rebuilt. Deepak sued both Davy and ICI for negligence, negligent misrepresentation and breach of collateral warranty in connection with the design and construction of the plant. ICI claimed an indemnity from Davy. The latter, however, argued that its liability was precluded under the contract, pursuant to the material terms of the agreement between Deepak and Davy which stated that,

Art 10.10.2 DEEPAK shall indemnify and hold DAVY and its employees harmless from and against any and all liability for death, illness or injury to any employee of Deepak's or for loss or damage to the property of Deepak. . .and shall cause DAVY to be named as co-insured in all policies of insurance effected in respect of the Plant all rights of subrogation against DAVY being waived.

Art 10.10.3 For the purpose of this Article Davy shall include the licenser ICI and their employees and Deepak shall include all associated organizations, its contractors and their personnel.

Accordingly, Davy argued that they were entitled to be regarded as a co-insured under Deepak's all risks insurance policy, which also covered fire and explosion risks. Consequently, Davy argued that the insurance arrangements disentitled Deepak from bringing its claim. The issue, therefore, was whether Davy, as sub-contractor, had had an insurable interest in the plant at the time of the loss in October 1992.

Rix J, at first instance,<sup>110</sup> held that Davy had an insurable interest in the plant in October 1992 on the ground of their potential liability, should they have caused damage to the plant.<sup>111</sup>

Nevertheless, the Court of Appeal rejected Rix J's findings. Stuart-Smith LJ dealt with the question that, "whether Davy would have had an insurable interest in the plant itself". His answer was that, "Davy may well have had an insurable interest in the plant whilst it was under construction and commissioning."<sup>112</sup> He went on to say that,

"In our judgment Davy undoubtedly had an insurable interest in the plant under construction and on which they were working because they might lose the opportunity to do the work and to be remunerated for it if the property or structure were damaged or destroyed by any of the "all risks", such as fire or flood."

Thus, after the works were completed,

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<sup>110</sup> [1998] 2 Lloyd's Rep. 139.

<sup>111</sup> *Ibid*, at pp. 158, 159.

<sup>112</sup> *Supra*, n 87, at p. 399.



"Davy would only suffer disadvantage if the damage to or destruction of the property or structure was the result of their breach of contract or duty of care."<sup>113</sup>

He further declared that,

"In order to protect the contractor and sub-contractors against the risk of disadvantage by reason of damage or destruction of the property or structure resulting from their breach of contract or duty they would, in accordance with normal practice, take out liability insurance or, in the case of architects, professional indemnity insurance...what they cannot do is persist in maintaining an insurance of the property or structure itself."<sup>114</sup>

Consequently, should the plant is damaged due to the fault of Davy and after it was commissioned, such damage would not be covered by the insurance policy. Therefore, Davy could be sued by the insurer.<sup>115</sup> In contrast, Hamilton, QC, considered *Deepak* and he preferred that the sub-contractors' pervasive interest should have continued so long as damage to property could have involved the sub-contractors in legal liability.<sup>116</sup>

Lowry, moreover, commented on *Deepak* that, "Although the Court of Appeal did not go so far as to disavow the reasoning in the *Petrofina*, *Stone Vickers* and *National Oilwell* line of cases, it is patently clear that the prevailing judicial approach to all

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<sup>113</sup> *Ibid.*

<sup>114</sup> *Ibid.*

<sup>115</sup> John Lowry and Philip Rawlings, "Re-thinking Insurable Interest", Sarah Worthington, *Commercial Law and Commercial Practice*, (2003), p. 335, at 358-9.

<sup>116</sup> Adrian Hamilton, QC, "Commentary II on 'Re-thinking Insurable Interest'", Sarah Worthington, *Commercial Law and Commercial Practice*, (2003), p. 369, at p. 371.

risks policies on plant and works is that they are not to be viewed as being tantamount to liability insurance. The interest of a contractor is limited to the risk of loss of income in the event of the work terminating as a result of negligently caused damage. Once construction work is completed a contractor is no longer subject to such risk although, of course, he may continue to be exposed to a liability action. For this contingency a separate liability policy should be effected."<sup>117</sup>

Furthermore, in *Feasey v Sun Life Assurance Co of Canada*,<sup>118</sup> Waller LJ declared that, in his comment on *Deepak*, the insurable interest of a sub-contractor could have been based on his pecuniary loss due to the plant's destruction by the risk insured against because he would have lost his remuneration thereafter. He said,

"...so far as the all-risks policy during the currency of the contract period was concerned, an insurable interest even on property seems to go beyond a 'legal or equitable' interest in the property. A sub-contractor's insurable interest on the judgments in *the Deepak* case flows from the pecuniary loss that he will suffer from the loss of the opportunity to do work if the plant was destroyed by fire."<sup>119</sup>

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<sup>117</sup> John Lowry, "The Temporal Limits of Contractors' Insurable Interest" [2001-02] *King's College Law Journal* 236-239, at 239.

<sup>118</sup> [2003] EWCA Civ 885. The case concerned a life assurance policy.

<sup>119</sup> *Ibid*, parag. [94]. It is noteworthy to mention the cases that Waller LJ listed which had concerned issues of insurable interests of sub-contractors in works or plants, he said, " In the judgment reference is made to *Petrofina (UK) Ltd v Magnaload Ltd* [1983] 3 All ER 35, [1984] QB 127, *Stone Vickers Ltd v Appledore Ferguson Shipbuilders Ltd* [1991] 2 Lloyd's Rep 288 and *National Oilwell (UK) Ltd v Davy Offshore Ltd* [1993] 2 Lloyd's Rep 582. No disapproval is expressed of those decisions; it is simply said ([1999] 1 All ER (Comm) 69 at 85 (para 64)) that '[i]n each case the insurable interest subsisted during construction and commissioning'. Those decisions were themselves at first instance being respectively of Lloyd J, Mr Anthony Colman QC sitting as a deputy judge of the High Court and Colman J as he then became. The *Petrofina* case, was however, also approved in the Court of Appeal (save in one immaterial respect) in *Mark Rowlands Ltd v Berni Inns Ltd* [1985] 3 All ER 473, [1986] QB 211. They have been followed in *Hopewell Project Management Ltd v Ewbank Preece Ltd* [1998] 1 Lloyd's Rep 448, a decision of Mr Recorder Jackson QC (as he then was). The *Petrofina* case, the *Stone Vickers* case, and the *National Oilwell* case were also extensively analysed and approved so far as material in the judgment of Brooke LJ in *Co-operative Retail Services Ltd v Taylor Young Partnership Ltd* [2000] 2 All ER (Comm) 865. That

Subsequently, Waller LJ concluded that,

"The principles which I would suggest one gets from the authorities are as follows. (1) It is from the terms of the policy that the subject of the insurance must be ascertained. (2) It is from all the surrounding circumstances that the nature of an insured's insurable interest must be discovered. (3) There is no hard and fast rule that because the nature of an insurable interest relates to a liability to compensate for loss, that insurable interest could only be covered by a liability policy rather than a policy insuring property or life or indeed properties or lives. (4) The question whether a policy embraces the insurable interest intended to be recovered is a question of construction. The subject or terms of the policy may be so specific as to force a court to hold that the policy has failed to cover the insurable interest, but a court will be reluctant so to hold. (5) It is not a requirement of property insurance that the insured must have a 'legal or equitable' interest in the property as those terms might normally be understood. It is sufficient for a sub-contractor to have a contract that relates to the property and a potential liability for damage to the property to have an insurable interest in the property. It is sufficient under s 5 of the Marine Insurance Act 1906 for a person interested in a marine adventure to

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judgment was itself approved when the case went to the House of Lords ([2002] UKHL 17, [2002] 1 All ER (Comm) 918, [2002] 1 WLR 1419). These decisions hold that persons in the position of sub-contractors have an insurable interest in the work or plant as a whole; the definition of that interest relied on in those authorities comes originally from a judgment in the Canadian Supreme Court, *Commonwealth Construction Co Ltd v Imperial Oil Ltd* (1976) 69 DLR (3d) 558 at 563 which in terms recognised the insurable interest of sub-contractors -- 'having its source in the very real possibility ("may") of liability, considering the close interrelationship of the labour performed by the various trades under their respective agreements.'

They held further that sub-contractors can recover from insurers the full value of the works holding (where appropriate) the balance beyond their interest in trust for the owner. They further held most relevantly that sub-contractors can defeat a subrogated claim based on the sub-contractor's liability in negligence to the owner because the insurers were pursuing a claim in relation to the loss covered by the policy." See, also, the House of Lords' decision in *Simpson v Thompson* (1877) L.R. 3 App Cas 279.

stand in a 'legal or equitable relation to the adventure'. That is intended to be a broad concept..."<sup>120</sup>

Significantly, Sir Jonathon Mance outlined the rules that governing insurable interest which, according to him, are,

"(a) technical, because of the various different statutory regimes, (b) doubtfully necessary in many cases, because of the principle that an insured can only recover an indemnity and (c) contrary also in spirit in other cases to the principle which allows value policies covering sums considerably in excess of the actual loss."<sup>121</sup>

### ***3.2.2. The Principle of Indemnity***

#### ***3.2.2.1. Introduction***

An insured can only recover his loss and his loss only under a contract of insurance. In order to recover his loss under his insurance policy and seek indemnity from his insurer, the insured must prove two facts; firstly, the insured must prove that the risk insured against has actually occurred and, secondly, as a result of such occurrence, he suffered a pecuniary loss. It has been said that, "There is an obvious symbiosis between the indemnity principle and the insurable interest requirement.

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<sup>120</sup> *Ibid*, parag. 97.

<sup>121</sup> Sir Jonathan Mance, "Commentary I on 'Re-thinking Insurable Interest'", Sarah Worthington, *Commercial Law and Commercial Practice*, (2003), p. 365.

Indemnity, which underpins insurance law generally, limits the liability of an insurer to the actual loss suffered by the insured..., less any excess that the insured has agreed to bear. If the insured is paid a sum greater than that which represents the loss so that he or she profits the indemnity principle is violated."<sup>122</sup> Therefore, it is necessary, at this point, to explore the principle of indemnity.

### 3.2.2.2. *The Nature of the Principle of Indemnity*

The nature of the contract of insurance, in particular property insurance,<sup>123</sup> is that, it is a contract of indemnity.<sup>124</sup> Section (1) of Marine Insurance Act 1906 states that,

"A contract of marine insurance is a contract whereby the insurer undertakes to indemnify the assured, in manner and to the extent thereby agreed, against marine losses, that is to say, the losses incident to marine adventure."<sup>125</sup>

The meaning of indemnity, under a fire insurance policy, was outlined by the Court of Appeal via Brett LJ in *Castellain v Preston*,<sup>126</sup> he said that,

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<sup>122</sup> John Lowry & Philip Rawlings, *Insurance Law: Cases and Materials*, (2004), parag. 13.1, p. 641.

<sup>123</sup> According to Ivamy, in property insurance "the specified event operates on the property of the assured. It comprises marine insurance, fire insurance, burglary insurance, fidelity insurance, solvency insurance, and insurance against loss of property by other accidental causes, e.g. plate glass insurance, livestock insurance, loss of licence insurance, and insurance against war risks." See, E. R. Hardy Ivamy, *General Principles of Insurance Law*, 6<sup>th</sup> ed., (1993), at p. 8.

<sup>124</sup> *Le Cras v Hughes* (1782) 3 Dougl 79, per Lord Mansfield; *Castellain v Preston* (1883) 11 QBD 380 at 386 per Brett LJ; *Allgemeine Versicherungs Gesellschaft Helvetia v German Property Administrator* [1931] 1 KB 672; *Finlay v. The Mexican Investment Corporation* [1897] 1 Q.B. 517; *Re Miller, Gibb & Co. Ltd.* [1957] 1 Lloyd's Rep. 258.

<sup>125</sup> Same meaning was stated in Life Assurance Act 1774 that,

**"3. How much may be recovered where the insured hath interest in lives**

*...in all cases where the insured hath interest in such life or lives, event or events, no greater sum shall be recovered or received from insurer or insurers than the amount of value of the interest of the insured in such life or lives, or other event or events."*

"... I feel obliged to revert to what is the foundation of every rule with regard to insurance law, which is this: Every contract of marine or fire insurance is a contract of indemnity, and of indemnity only, the meaning of which is that the assured in case of a loss is to receive a full indemnity, but is never to receive more. Every rule of insurance law is adopted in order to carry out this fundamental rule, and if ever any proposition is brought forward, the effect of which is opposed to this fundamental rule, it will be found to be wrong."<sup>127</sup>

The significance of the principle of indemnity, nevertheless, appears at the time of measuring the loss that an insured suffers from by the risk insured against.<sup>128</sup> Thus, the 'sum insured', which is usually stated in a policy of insurance, differs from the actual cost of loss of the insured. Consequently, it is not necessary that the assured should recover the full amount of the sum insured once the risk insured against has actually occurred. Therefore, where the sum insured, for instance, under a fire insurance policy is £50,000,000 and the actual cost of loss is £10,000, the insured cannot recover more than the actual cost of loss, i.e. £10,000.<sup>129</sup> Accordingly, 'indemnity' means that, "the insured is to be put back to the position he or she would have been in had the loss not occurred, less any excess which the insured has agreed

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<sup>126</sup> [1881-1885] All ER Rep 493. See further, *Reynolds v Phoenix Assurance Co Ltd* [1978] 2 Lloyd's Rep 440 *per Forbes J*; *Leppard v Excess Insurance Co Ltd* [1979] 1 WLR 512.

<sup>127</sup> *Ibid*, 495 *per Megaw LJ*.

<sup>128</sup> According to Lewis, the loss needs to be identified and quantified. See, Charles Lewis, "A Fundamental Principle of Insurance Law" [1979] *LMCLQ* 275.

<sup>129</sup> That, of course, differs from valued policies where the sum recoverable is fixed by the contract (as the case in marine insurance policies). Also, it differs from the position in contingency insurance as in life and accident policies where the terms of the of the policy fix the sum that should be recovered where the risk insured against has occurred. See, John Lowry and Philip Rawlings, *Insurance Law: Doctrines and Principles*, (1999), pp. 179, 180. For more discussion on valued policies, see *Goole and Hull Steam Towing Co Ltd v Ocean Marine Insurance Co Ltd* [1928] 1 KB 589, at 594, *per MacKinnon J*; Nicholas Legh-Jones, *MacGillivray on Insurance*, 10<sup>th</sup> ed., (2003), parag. 1-15 at p. 8; Susan Hodges, *Law of Marine Insurance*, (1996), Ch. 5, at p. 71; Howard Bennett, *The Law of Marine Insurance*, (1996), parag. 18.1. at p. 344. John Lowry and Philip Rawlings, *Insurance Law: Doctrines and Principles*, (1999), pp 15, 181.

to bear."<sup>130</sup> Thus, the principle of indemnity, in fact, limits the insurer's liability towards his insured to the latter's actual loss that proved.<sup>131</sup>

Furthermore, the loss must be pecuniary and derived from the possession of insurable interest that is required by law. Accordingly, "where insurable interest is determined by reference to economic interest in the insured property, insurable interest becomes subsumed within the indemnity principle. If the insured property in economically useless insurable interest may be extinguished."<sup>132</sup>

Campbell observes that, there are three meanings of the insurer primary obligation, i.e. a promise "to indemnify". They are, namely:

- 1- A promise to prevent loss from occurring.
- 2- A promise that loss will not occur.
- 3- A promise to compensate the insured in the event that the loss does occur.

Thus, he argued that, the third meaning, i.e. indemnity is a compensation for loss, is most likely to accord with the parties' intention in property insurances and with precedent and consistent with the insurer's ability to perform the contract in common

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<sup>130</sup> John Lowry and Philip Rawlings, *Insurance Law: Doctrines and Principles*, (1999), p. 179.

<sup>131</sup> John Lowry & Philip Rawlings, *Insurance Law: Cases and Materials*, (2004), parag. 13.1, p. 641; *Halsbury's Law of England*, Vol. 25 (Reissue), 4<sup>th</sup> ed., (2003), p. 10.

<sup>132</sup> See summary of an American case, *Chicago Title & Trust Co v United States Fidelity & Guaranty Co* 376 F Supp 767 (1973) *per* Will J, in John Lowry & Philip Rawlings, *ibid*, p. 642, where the insured claimed on his policy to seek indemnification from his insurer for destruction of the insured building that was empty, secured and boarded. It had been gutted by a previous fire and had not been used in any way. Will J ruled that, "...it would be ludicrous to allow the plaintiff [the insured] to recover a substantial amount of money representing the replacement cost less depreciation of a building that was for all practical purposes non-existent. It would be grossly inequitable for plaintiff's beneficiary to recover \$43,000 for a building which less than one month prior to its destruction she had purchased for \$4,000 in what appears to have been an arm's length transaction and in which building she had made absolutely no additional investment or improvement."

policy obligations.<sup>133</sup> He criticized the manner of the recent English cases as focusing on the first meaning of indemnity, i.e. a promise to prevent loss from occurring.<sup>134</sup> Instead, he thought, the third meaning is the one that should have been considered.

Thus, the House of Lords in *Firma C-Trade S.A. v Newcastle Protection and Indemnity Association (The Fanti)*,<sup>135</sup> Lord Goff did, in fact, emphasize that the indemnity meant a promise to prevent loss from occurring. In his words,

"...I accept that, at common law, a contract of indemnity gives rise to an action for unliquidated damages, arising from the failure of the indemnifier to prevent the indemnified person from suffering damage, for example, by having to pay a third party. I also accept that, at common law, the cause of action does not (unless the contract provides otherwise) arise until the indemnified person can show actual loss: see *Collinge v. Heywood* (1839) 9 Ad. & E. 633. This is, as I understand it, because a promise of indemnity is simply a promise to hold the indemnified person harmless against a specified loss or expense. On this basis, no debt can arise before the loss is suffered or the expense incurred; however, once the loss is suffered or the expense incurred, the indemnifier is in breach of contract for having failed to hold the indemnified person harmless against the relevant loss or expense."<sup>136</sup>

Campbell mentioned that, there are two obligations fall on an insurer's shoulders towards his insured in property insurance. They are, namely, primary obligation and secondary obligation. In primary obligation, the insurer, on the occurrence of loss or

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<sup>133</sup> Neil Campbell, "The nature of an insurer's obligation" [2000] *LMCLQ* 42, at p. 48.

<sup>134</sup> He argued that, under liability insurance policies, a promise to prevent loss from occurring, most accurately reflects both the parties' intentions and precedent. See, *ibid*.

<sup>135</sup> [1991] 2 A.C. 1.

<sup>136</sup> *Ibid*, at pp 35-36.



damage to the property insured, is obligated "to indemnify the insured by providing compensation for such loss or damage. Compensation might be provided by paying money to the insured, or by reinstating damaged property."<sup>137</sup>

As far as the insurer's secondary obligation is concerned, Campbell argued that, "Failure by the insurer to perform its primary obligation is a breach of contract. On breach the insurer will come under a secondary obligation to pay compensatory damages to the insured, and the insurer will acquire a secondary right to payment of the same."<sup>138</sup> However, the insured, under common law, cannot recover any consequential losses that caused by the breach of the insurer of fulfilling his primary obligation, i.e. promise to prevent loss from occurring.<sup>139</sup> According to Campbell, "...the common law has, until recently, been reluctant to award damages for losses consequent upon the failure to pay, or late payment of, money."<sup>140</sup>

Therefore, in *Sprung v Royal Insurance (UK) Ltd*,<sup>141</sup> the claimant insured was owning a small business of collection, processing and redistribution of animal waste products and took out theft insurance policy and an insurance policy to cover "sudden and unforeseen damage...which necessitates immediate repair or replacement of the Plant before it can resume normal working." In April 1986, while the business in

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<sup>137</sup> Neil Campbell, "The nature of an insurer's obligation", *LMCLQ* 42, at p. 44.

<sup>138</sup> *Ibid*, at p. 46. Campbell divided the losses for which the insured might seek damages in such case into two types. They are, "First, the insured will suffer a direct loss of the benefit that the insurer promised but failed to provide. In most cases this loss is quantified by determining the sum of money that the insurer was primarily obliged to pay to the insured. Secondly, the insured might suffer consequential losses as a result of not receiving the benefit promised by the insurer. For example, the insured might be unable to afford to repair damaged plant without insurance monies, and lose profit as result."

<sup>139</sup> *President of India v. Lips Maritime Corporation* [1988] A.C. 395, in particular, p. 425, *per* Lord Brandon of Oakbrook, he said:

"...there is no such thing as a cause of action in damages for late payment of damages."

<sup>140</sup> Neil Campbell, "The nature of an insurer's obligation" *LMCLQ* 42, at p. 46.

<sup>141</sup> [1999] Lloyd's Rep. I.R. 111.

financial pressure, vandals broke into the insured premises and destroyed certain items of machinery. When the insured claimed on the policy, the insurer unjustifiably rejected the claim on the ground that vandalism was not covered by the policy. After four years, the insurer admitted liability and paid the insured the value of the items of machinery that had been destroyed, (£30,000), plus interest. The insured claimed that the delay of payment from the part of the insurer had caused his business to collapse and claimed (£75,000) damages. Evans LJ, ruled that such damages were not recoverable. Beldam LJ took that same view and he said:

"By long-standing decisions it is settled that the liability of insurers under a policy arises when the loss occurs and the liability is to pay money for that loss. That the insurers have the option themselves to reinstate or to pay for the reinstatement of the property damaged under the terms of the policy does not alter the essential nature of their liability, which is to pay the sum of money as damages. Thus the failure to pay is a failure to pay damages and, by decisions binding on this court, an assured has no cause of action for damages for non-payment of damages."<sup>142</sup>

Birds, in his comment on *Sprung* case, observes that, "It has to be recognised that as a matter of strict law, unless and until the House of Lords reviews the question of insurance indemnities being damages, the decision in *Sprung* seems unimpeachable. It is thus very difficult to see how the common law could properly compensate the insured in that sort of position. But it does seem clear that there should be such a remedy where an insurer repudiates or refuses to admit liability without reasonable

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<sup>142</sup> *Ibid*, at 119. This judgment was, in fact, followed the decision of Hirst J in *Ventouris v Mountain (The Italia Express)(No. 2)* [1992] 2 Lloyd's Rep. 281.

grounds, and the Court of Appeal thought so also. The only solution, perhaps, is to make this another area of insurance law where statutory reform is needed."<sup>143</sup>

In the light of what has been mentioned, it could be said that the principle of indemnity prevents an insured from misusing insurance and making profits out of it. It limits insurers' liabilities towards their insureds and allows them to pay the insureds what they have actually lost within the extent of their insurable interests.

Harnett and Thornton illustrated the mechanism of the principle of indemnity. They stated that, "The general statement that insurance is traditionally a contract of indemnity is significant in determining the measure of an insured's recovery, for the attempt is always to evaluate the insurable interest and the impairment of it through the occurrence of the insured event. Having then ascertained loss in terms of economic impairment, that impairment becomes the measure of recovery. Colloquially phrased, the amount of allowable recovery is theoretically the extent to which the insured is "out of pocket", or alternately put, an insured can recover only to the extent of his interest"<sup>144</sup>

Thus, and recovery exceeds the insured's interest is, simply, wagering. In this regard, they observed that, "To the extent that a possible insurance recovery is in excess of the insured's interest, it is a wager, and limiting indemnity to the extent of the interest is simply the way in which an insurance contract is removed from the wager category. The traditionally distinct purpose of," they said, "insurable interest as

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<sup>143</sup> John Birds, "No Damages Remedy when Insurers Unjustifiably Repudiate Liability" [1997] *J. B. L.* 368, at 371. See also, Marion Egan, "Insurer's Duty to Pay" [1998] *Int. J. L. R.* 6 (5), 166.

<sup>144</sup> Bertram Harnett and John Thornton, "Insurable Interest in Property: A Socio-Economic Reevaluation of a Legal Concept", *Col. L. R.* (1948) 48, p. 1162, at 1176.

a limitation on indemnity is, then, merely the wagering policy accoutered in different verbal cloth"<sup>145</sup>

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<sup>145</sup> *Ibid*, p. 1183.

### 3.3. Definition of Insurable Interest under *Saudi Law*

Unlike the UK legislation, marine insurance contract was defined by article (324) of Commercial Court Law 1931. It provides that,

"An insurance policy is a marine contract containing an undertaking to pay the full amount of insurance in consideration of a premium received by the insurer against losses and damages that may be caused by a marine disaster to items which he wants to safeguard against any marine carriage risk."<sup>146</sup>

El-Sayed, translates the definition of the contract of insurance in article (324) of the CCL 1931 [SA] as,

"A marine contract containing an undertaking by the insured to pay an agreed insurance premium to the insurer in return for insurance indemnity against perils and loss that may be incident to a marine disaster on items that could meet a risk on a sea voyage."<sup>147</sup>

It seems that, El-Sayed is quite satisfied with the latter definition that it is a comprehensive one. He is of the opinion that, "...this definition is a comprehensive statement expressing the risk that is the object of insurance and, on the strength of this definition," he says, "a risk that is the object of insurance is a maritime risk in its legal sense, apart from the risks that may occur during a voyage."<sup>148</sup> That, of course, differs

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<sup>146</sup> This is a translation from Arabic to English by, Nicola H. Karam, *Business Laws of Saudi Arabia*, Vol. I, (1994), p. 13-66.

<sup>147</sup> Hussein M. El-Sayed, *Maritime Regulations in the Kingdom of Saudi Arabia*, (1987), p. 173. The author commented that, "...this definition is a comprehensive statement expressing the risk that is the object of insurance and, on the strength of this definition, a risk that is the object of insurance is a maritime risk in its legal sense, apart from the risks that may occur during a voyage."

<sup>148</sup> *Ibid.*

from the manner of English courts which describe the contract of insurance rather than define it.<sup>149</sup>

Furthermore, in the light of both translations of article (324) of the CCL 1931 [SA], the Saudi maritime law presents an ill definition for the contract of marine insurance that needs an urgent reformation. In fact, the statement of El-Sayed that the definition is comprehensive, cannot be supported because it did not consider the features of insurance. The weakness of the definition can be noticed where it is compared with, for example, the description of the contract of insurance in *Prudential Insurance Company v. Commissioners of Inland Revenue*,<sup>150</sup> that,

"Where you insure a ship or a house you cannot insure that the ship shall not be lost or the house burnt, but what you do insure is that a sum of money shall be paid upon the happening of a certain event. That I think is the first requirement in a contract of insurance. It must be a contract whereby for some consideration, usually but not necessarily for periodical payments called premiums, you secure to yourself some benefit, usually but not necessarily the payment of a sum of money, upon the happening of some event. Then the next thing that is necessary is that the event should be one which involves some amount of uncertainty. There must be either uncertainty whether the event will ever happen or not, or if the event is one which must happen at some time there must be uncertainty as to the time at which it will happen. The remaining

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<sup>149</sup> *Medical Defence Union Ltd. v. Department of Trade* [1980] Ch. 82 at 95. See generally, section 3.2 above.

<sup>150</sup> [1904] 2 KB 658.

essential is that which was referred to by the Attorney-General when he said the insurance must be against something."<sup>151</sup>

It can be noted that the latter description of insurance takes into consideration, for instance, that, payments of premiums are periodical. Indemnity is not necessarily to be payment of sum of money; that it could be, for example, replacement of the subject-matter of insurance; the occurrence of the event and its time insured against must be uncertain. In contrast, the definition of insurance under article (324) of the CCL 1931 [SA] omitted such features. In other words, the article lacks comprehensiveness.

Furthermore, article 1(12) of the Implementing Regulations of the Cooperative Insurance Companies Control Law 2003, interpreted and outlined the nature of insurance. It states that,

"Insurance: Mechanism of contractually shifting burdens of pure risks by pooling them."<sup>152</sup>

In addition, article 1(17) identifies "Insurance Policy" as,

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<sup>151</sup> *Ibid*, at 663, *per* Channell J. See, also, *Callaghan and Another v. Dominion Insurance Co. Ltd. and Others* [1997] 2 Lloyd's Rep. 541, at 544, *per* Sir Peter Webster. The most important and remarkable feature of an insurance contract is the application of fulfilling the duty of utmost good faith or the doctrine of *uberrimae fidei*. See examples for English insurance literature, J. Lowry & P. Rawlings, *Insurance Law: Doctrines and Principles*, 2<sup>nd</sup> ed., (2005), chapter 4, pp. 77-123; John Lowry & Philip Rawlings, *Insurance Law: Cases and Materials*, (2004), chapter 4, pp. 129-229; John Lowry and Phillip Rawlings on 'Insurers, Claims and the Boundaries of Good Faith' [2005] *MLR* 82; H. Bennett, 'Mapping the Doctrine of Utmost Good Faith in Insurance Law' [1999] *LMCLQ*, 165; Malcolm A. Clarke, *The Law of Insurance Contracts*, 4<sup>th</sup> ed., (2002); Robert Merkin, *Colinvaux's and Merkin's Insurance Contract Law*, Vol. I, (2002); Nicholas Legh-Jones, *MacGillivray on Insurance*, 10<sup>th</sup> ed., (2003), chapter 17; Andrew McGee, *The Modern Law of Insurance*, (2001), chapter 5; J. Birds and N. Hird, *Bird's Modern Insurance Law*, 6<sup>th</sup> ed., (2004); Robert Merkin, *Colinvaux's and Merkin's Insurance Contract Law*, 7<sup>th</sup> ed., (1997), chapter 5; Birds and Hird, "Misrepresentation and non-disclosure in insurance law- identical twins or separate issues" [1996] *MLR* 285.

<sup>152</sup> English version. See article 1 (7) of the Implementation Regulations, Arabic version.

"Legal document/contract issued to the insured by the insurer setting out the terms of the contract to indemnify the insured for loss and damages covered by the policy against a premium paid by the insured."

As a matter of fact, English courts are more conscious about describing insurance rather than defining it as the matter in Saudi jurisdiction. That is to say, where the latter has specifically identified insurance, English courts describe it rather than define it. The reason, according to Templeman J, is that,

"definitions tend sometimes to obscure and occasionally to exclude that which ought to be included."<sup>153</sup>

As far as the principle of insurable interest is concerned, the only definition of insurable interest was provided by article 55 of the Implementing Regulations of the Cooperative Insurance Companies Control Law 2003. The English version of the Implementing Regulations requires the insurable interest to be considered at the time when the contract is concluded, but it does not define insurable interest. It states that,

"The basis of the information provided in the policy shall be the application submitted by the policyholder. When completing the insurance application, the following must be taken into consideration: (1) Insurable interest..."

However, the Arabic version of the Implementing Regulations defines insurable interest as the possibility of incurring loss or liability to the assured by the insured risk. Article 55 of the Implementing Regulations does not clarify whether the insurer is obligated to consider the assured's insurable interest before accepting the risk, or it

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<sup>153</sup> *Department of Trade and Industry v. St. Christopher Motorists' Association Ltd* [1974] 1 WLR 99 at 101.



is the duty of the assured to show his interest before concluding the contract. In practice, however, the insurable interest must be shown by the assured at the time of the loss.

In respect of the CCL 1931 [SA], although insurable interest was not clearly defined therein by particular rules, it set out items that could be insured and those which could be not. Article 327 provides the insurable items that,

"(1) vessels which sail individually or in convoys, whether loaded or empty and whether fitted out or not; (2) machinery and equipment of vessels; (3) hulls and superstructures; (4) provisions; (5) money borrowed under the marine procedure; (6) kind and nature of cargo; (7) anything having value which may be the subject of marine hazards."<sup>154</sup>

It can be noticed that, paragraph (7) of article 327 of CCL 1931 includes the other paragraphs of the article. Thus, the vessel and its contents, i.e. hull and machinery, equipments and provisions, etc., its cargo and a maritime loan constitute economic interests. It has to be borne in mind that, the maritime loan which is considered under this article to be insured is that form the part of the lender, whereas the borrower cannot insure the maritime loan he gets against marine risks, as it will be seen below. According to Haberbeck and Galloway, since intangibles can be insured under article 327 of the CCL 1931, such as money lent against ship or cargo, "there is no reason why a mortgagee may not insure his interest in a ship." They add that, "An insurer may reinsure his liability in respect of any given maritime adventure."<sup>155</sup> They, further, observe that, "The wide definition of insurable subject-matter under article

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<sup>154</sup> This is a translation from Arabic to English by, Nicola H. Karam, *Business Laws of Saudi Arabia*, Vol. I, (1994), p. 13-67.

<sup>155</sup> Anderson Haberbeck and Mark Galloway, *Saudi Shipping Law*, (1990), at p. 224.

327 (7) makes it clear that the insurance of other intangibles, such as, for example, third party liabilities or charterer's interests, is also valid under the Commercial Court Law, provided that their value can be quantified if a claim arises."<sup>156</sup>

In contrast, article 341 of the CCL 1931 lists the uninsurable items, or things that are not subject to insurance. The article provides that:

"The freight of and profit resulting from the goods on board the vessel, as well as the crew's wages, and marine borrowings and benefits are not insurable; if insurance is carried, it shall be null and void."

Haberbeck and Galloway comment on this article and due to the fact that freight is not insurable, they perceive that, "it is...arguable that insurance in respect of charter hire is permissible. However, given that no distinction between freight and hire is made in the Commercial Court Law's section on carriage of goods, we are of the opinion that the use of term freight in this context extends to hire, too."<sup>157</sup> They conclude, therefore, that, "Article 341 does not confine the exclusion to insurance by the shipowner. Thus, cargo insurance for the *c. & f.* value of cargo is not valid."<sup>158</sup> However, in practice the authors do not think that any Saudi insurer would refuse "to pay the freight proportion of a claim on this ground."<sup>159</sup>

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<sup>156</sup> *Ibid.*

<sup>157</sup> *Ibid.*, at p. 225. Therefore, hire is uninsurable.

<sup>158</sup> *Ibid.* *c & f* is abbreviation used usually in international trade and it is "a term in a quoted sales price indicating that the quoted price includes the cost of the goods and freight charges to the named destination, but not insurance or other special charges. During shipment, the risk of loss is on the buyer." B. A. Garner, *Black's Law Dictionary*, (7<sup>th</sup> ed., 1999), p. 350.

<sup>159</sup> *Ibid.* It is significant here to understand the meaning of the word freight under English law and find out about its scope in insurance law. "The word freight in insurance law has a more extensive signification than the general law of shipping, and is used comprehensively to denote the benefit derived by the shipowner from the employment of his ship."

Freight, strictly speaking, as between the shipowner and freighter, is the price to be paid by the latter to the former for the carriage of goods in the ship, and is only payable on the arrival of the goods at their port of destination; but in policies of insurance it also denotes that which is less properly called freight,

In addition, the expected profits from the sale of the goods are excluded from being insurable. El-Sayed is of the opinion that the reason for such exclusion, although it is not clear, is that "the expected profit could be obtained after arrival."<sup>160</sup> Haberbeck and Galloway, moreover, take the same view and illustrate this exclusion that, "cargoes may only be insured for their arrival value at the destination. Any margin taking into account anticipated profits cannot be insured." They carry on explaining that, "In Saudi practice, it is common for values to be calculated as *c. & f.* + 10%. Provided that the 10% has some basis in actual costs, such as customs dues, port charges, and transport on arrival..."<sup>161</sup>

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*viz.* the price agreed to be paid by the charterer to the shipowner for the hire of the ship, or a part of it, under a charterparty or other contract of affreightment, and also the benefit which the shipowner expected to derive from the carriage of his own goods in his own ship, in the shape of their increased value to him at the port of delivery. As Lord Tenterden observes with respect to the meaning of the term "freight," it is the same thing to the shipowner whether he receives the benefit of the use of his ship by a money payment from one person who chartered the whole ship; or from various persons who put specific quantities of goods on board; or from persons who pay him the value of his own goods at the port of delivery, increased by their carriage in his own ship. (*Flint v Flemyng* (1830) 1 B. & Ad. 45 at p. 48.).

Rule 16 in Schedule I to the Marine Insurance Act 1906 states that in ordinary policy "The term 'freight' includes the profit derivable by a shipowner from the employment of his ship to carry his own goods or moveables, as well as freight payable by a third party, but does not include passage money." Both freight in the strict sense of the word and price paid for the hire of the ship under a charterpart are no doubt covered by the words "freight payable by a third party."", Raoul Colinvaux, *Arnould's Law of Marine Insurance and Average*, 16<sup>th</sup> ed., (1981), Vol. I, parag. 311.

<sup>160</sup> Hussein M. El-Sayed, *Maritime Regulations in the Kingdom of Saudi Arabia*, (1987), p. 177.

<sup>161</sup> The authors are of the view that a Saudi insurer, "may not refuse to pay a claim calculated including such percentage." Anderson Haberbeck and Mark Galloway, *Saudi Shipping Law*, (1990), at p. 225. Insurance on profits under English law is lawful. The leading view was expressed by Lawrence J. in his judgment in *Barclay v Cousins* (1802) 2 East 544, ER 102, p. 478, that, "As insurance is a contract of indemnity, it cannot be said to be extended beyond what the design of such species of contract will embrace, if it be applied to protect men from those losses and disadvantages which but for the perils insured against the assured would not suffer; and in every maritime adventure the adventurer is liable to be deprived, not only of the things immediately subjected to the perils insured against, but also of the advantages to be derived from the arrival of those things at their destined port. If they do not arrive, his loss in such case is not merely that of his goods or other things exposed to the peril of navigation, but of the benefits which, were his money employed in an undertaking not subject to the perils, he might obtain without more risk than the capital itself would be liable to; and if when the capital is subject to the risks of maritime commerce it be allowable for the merchant to protect that by insuring it, why may he not protect those advantages he is in danger of losing by their being subjected to the same risks? It is surely not an improper encouragement of trade to provide that merchants, in case of adverse fortune, should not only not lose the principal adventure, but that that principal should not, in consequence of such bad fortune, be totally unproductive; and that men of small fortunes should be encouraged to engage in commerce by their having the means of preserving their capitals entire...", pp. 546, 547.

Furthermore, article 341 prohibits taking out an insurance policy to insure crew's wages. Haberbeck and Galloway observed that, "If this prohibition is directed at the ship's owner only, it can be rationalized on two grounds: Under Saudi law crew members are not entitled to wages if the adventure is frustrated.<sup>162</sup> Accordingly, it is arguable that the owner has no insurable interest in respect of wages which he pays in such circumstance, since he does so as a volunteer. Secondly, the crew's ordinary wages are a contractual liability and not a risk. However, Article 341 also prevents crew members from taking out insurance in respect of their potential loss of earnings."<sup>163</sup>

The article, moreover, prohibits insuring money borrowed for a marine loan from the part of the borrower. The reason is that under Saudi law, the lender cannot recover the marine loan if the vessel is lost or destroyed by a marine peril.<sup>164</sup> El-Sayed argues that, "...if insurance on the amount borrowed were to be allowed, this would lead to

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<sup>162</sup> Article 112 of the Saudi Labor and Workmen Law, Royal Decree No. M/21 1969/1389 A.H.

<sup>163</sup> Anderson Haberbeck and Mark Galloway, *Saudi Shipping Law*, (1990), at p. 225. Therefore, this article leaves crew members on board Saudi ships unsecured, especially, if it is known that, "seafarers are excluded from the cover provided under the Social Security Regulations of 1969." Thus, the authors advise those who work as seamen on board Saudi ships that, "they should take out insurance for loss of earning with foreign insurer." See also, Hussein M. El-Sayed, *Maritime Regulations in the Kingdom of Saudi Arabia*, (1987), p. 177. In English law, the matter was the same. "Seamen have been debarred by the laws of most, if not all, maritime states from insuring their wages. The reason being the belief that such an insurance might tempt them in time of danger not to exert themselves to the utmost for the preservation of the ship. By law of England it was an implied condition of the seaman's contract with the shipowner that his wages dependent on the earning of freight by the ship. This rule was generally expressed by saying that freight is the mother of wages. Therefore, when a ship was lost in the course of the voyage, the seaman was usually a loser to the extent of the wages already earned by him, and also (except when he obtained another ship) in respect of the wages which he would have earned during the remainder of the voyage. Yet, on grounds of policy, ..., the insurance of his wages, or of any commodities which he was to receive at the end of the voyage in lieu of wages, was not permitted. The law relating to the earning of wages was altered by the Merchant Shipping Act 1854. Wages are no longer dependent on freight being earned, and seamen are now entitled, in the event of the ship being lost, to be paid their wages until the time of the loss... But the loss of the ship may still involve a loss of the wages which the seamen would have earned during the remainder of the voyage, or of the period of time for which they were engaged.", Raoul Colinvaux, *Arnould's Law of Marine Insurance and Average*, 16<sup>th</sup> ed., (1981), Vol. I, parag. 323. Marine Insurance Act 1906, at the present time, allows seamen to insure their wages. Section 11 of the Act states that, "The master or any member of the crew of a ship has an insurable interest in respect of his wages."

<sup>164</sup> Article 316, Commercial Court Law 1931.

the borrower combining the amount of the loan which he would be exempted from paying and the insurance compensation."<sup>165</sup>

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<sup>165</sup> Hussein M. El-Sayed, *Maritime Regulations in the Kingdom of Saudi Arabia*, (1987), p. 177. In this regard, Haberbeck and Galloway comment that, "This prohibition does not prevent the insurance of ships or cargoes against which loans are secured, but relates solely to the debts secured thereon. Whilst the lender can insure against the loss of property against which a loan is secured, an assured who insure both his property and a loan secured thereon would profit from its destruction." Anderson Haberbeck and Mark Galloway, *Saudi Shipping Law*, (1990), at p. 225.

### 3.4. General Comments

This chapter reviews the description of the contract of insurance and analyzed the doctrine of insurable interest under common law. Therefore, it can be said that, the contract of insurance includes the following features:

- (1) A contract of insurance must contain a promise from an insurer to his insured to indemnify him once a certain event happens.
- (2) The insured must make, usually but not necessarily, periodical payments called premiums.
- (3) The payments of premiums are made by the insured to secure some benefit, usually but not necessarily, a payment of a sum of money insured. The benefit must be of economic value and it does not have to be a sum of money. In *Department of Trade and Industry v. St. Christopher Motorists' Association Ltd*,<sup>166</sup> the benefit was provided to the SCMA members was providing a driver and, if it is necessary, a car and driver for some period of time in the case that one of the members could not drive for some reasons.
- (4) The contract of insurance is an aleatory contract.<sup>167</sup> The event insured against must be either uncertainty whether the event will ever happen or not, or if the

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<sup>166</sup>*Department of Trade and Industry v. St. Christopher Motorists' Association Ltd* [1974] Lloyd's Rep. 17.

<sup>167</sup> It has been said that a contract of insurance is "a contract upon speculation", in *Re Barrett; ex parte Young v N M Superannuation Pty Ltd* 106 ALR 549, (1992) (Fed Court of Australia), per von Doussa J. See, Robert S. Pinzur, "Insurable Interest: A Search for Consistency" [1979] *Insurance Counsel Journal* 109. The author perceived that an insurance contract and a wager share some similar characteristics. He said, "Both are contracts upon a condition and entail some risk. Both are aleatory contracts, whereby the obligor becomes obligated only upon the occurrence of the specified event. Furthermore, the purchaser in both contracts pays a relatively small amount of money in exchange for the possibility of recovering something of much greater value or, in the alternative, nothing at all. Which he will receive depends upon chance-whether his wager is won or whether an insured loss occurs.", at p. 110. However Pinzur argued that, "the payor does get something more than "nothing at all". In a wager, the bettor gets the thrill and excitement of the gamble. In insurance, the insured is

event is one which must happen at some time there must be uncertainty as to the time at which it will happen.<sup>168</sup>

- (5) The contract of insurance is a device shifting or transferring risk from the insured to the insurer. Insurance, also, allows risk to be spread upon numbers of insureds by way of risk distribution. This feature has been considered under Saudi law. Article 1 (12) of the Implementing Regulations of the Cooperative Insurance Companies Control Law 2003 states that,

"Insurance: Mechanism of contractually shifting burdens of pure risks by pooling them."<sup>169</sup>

- (6) The contract of insurance imposes upon the parties to fulfill the duty of utmost good faith. Should one of the parties become in breach of such duty, the aggrieved party reserves the right to avoid the contract. Section 17 of the Marine Insurance Act 1906 states that,

"A contract of marine insurance is a contract based upon the utmost good faith, and, if the utmost good faith be not observed by either party, the contract may be avoided by the other party."

Likewise, article 342 of the CCL [SA] applies the duty of disclosure and representation. It states that,

"If the insured keeps silent about or gives different particulars than those he should mention in the insurance policy, or if the particulars do not conform to those shown in the bill of lading, and if the insurer discovers the true nature thereof, regardless whether the risk is not as grave as that which appears to

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purchasing some security and freedom from worry. Nevertheless, these subjective factors do not involve any economic value." Footnote 3, p. 110. More discussion on the comparison between wagering and insurance will take a place in chapter 4.

<sup>168</sup> *Prudential Insurance Company v. Commissioners of Inland Revenue* [1904] 2 KB 658, at p. 663.

<sup>169</sup> English version. See article 1 (7) of the Implementation Regulations, Arabic version. See also, article 55 (2).

result from such silence or statement, or the risk, other than that the presumed results, and to a risk nullifying the policy or making the policy according to other terms, the insurance policy made out shall in respect of the insurer be deemed to be null and void; such silence, or false statement or difference shall cause the insurance policy to lapse, even though no event occurs to cause the loss and perishing of the insured items."<sup>170</sup>

As far as the definition of the contract of insurance under Saudi law is concerned, it can be said that the definition lacked comprehensiveness. Therefore, it can be said that the common law manner in describing insurance rather than defining it, is more comprehensive than presenting a fixed definition which could be rigid and might exclude some other forms of insurance that should be included.<sup>171</sup>

In respect of the requirement of insurable interest, the repeal of s18 of Gaming Act 1845 by s334 Gambling Act 2005 has made insurable interest not a pre-requisite for a contract of insurance any longer. The question that arises, however, is that whether the requirement of insurable interest will no longer be considered as a criterion that differentiates insurance from wagering should the Gambling Act 2005 become in effect?

As from the part of the insurer, he might not be able to depend on the lack of insurable interest in order to support his defence to escape liability towards his insured to indemnify him where the insured proves his loss due to the occurrence of

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<sup>170</sup> For detailed discussion on the duty of utmost good faith under Saudi law, see, Khaled Ba-Naser, *Utmost Good Faith in Marine Insurance Contracts: A Comparative Study*, (PhD Thesis), University of Southampton, (1999).

<sup>171</sup> *Department of Trade and Industry v. St. Christopher Motorists' Association Ltd*, [1974] Lloyd's Rep. 17, at p. 18.



the risk insured against. Yet, the principle of indemnity in insurance might be the only available criterion which distinguishes insurance from wagering. Therefore, having said that the insured cannot recover his loss unless he proves that the risk insured against has actually occurred and the loss he suffered from was actually caused by that risk, it is necessary that the insured has some interest in the property insured which made him/her take out an insurance policy to preserve his/her interest therein. Consequently, the principle of insurable interest is, in fact, included in the principle of indemnity.

In regard to Saudi law, there is no one particular provision deals with the definition of insurable interest apart from article 327 of the CCL 1931 [SA] which lists the items that are insurable and article 341 of the CCL 1931 which lists the uninsurable items. As for article 341 of the CCL 1931, it is doubted to be in use at the present time.<sup>172</sup> That is, perhaps, attributable to the fact that, the provisions of the Commercial Court Law 1931 were drafted as early as the beginning of 19<sup>th</sup> century. Furthermore, although several parts of this law has been repealed by other provisions, chapter 11 of the CCL 1931 which concerns the contract of marine insurance has remained untouched and has not been repealed or developed yet. Therefore, it can be said that several rules in chapter 11 of the CCL 1931 are almost abandoned. In addition, insurance disputes which relate to property or liability insurance policies and that are dealt with by arbitration do not refer to the CCL 1931, unless a dispute relates to marine insurance policies.

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<sup>172</sup> Although article 341 prohibits insuring profits, the National Corporate for Cooperative Insurance, (NCCI), a Saudi Arabian insurance company, has announced about its offer to insure loss of profits due to the cessation of commercial activities as a result of the occurrence of a risk insured against. See, *Al-Riyadh Newspaper*, Tuesday 12 April 2005, No. 13441.

# **Chapter Four: The Consequence of Lack of Insurable Interest and The Effect of Gambling Act 2005**

## **4.1. Introduction**

It has been said that, the principle of insurable interest gives a property insurance contract its identity as indemnity.<sup>1</sup> It, also, distinguishes the contract of insurance from wagering and gambling.<sup>2</sup> Therefore, it may be thought desirable to explore the position where an insured does not possess an interest in the subject-matter insured at the time of the occurrence of an insured peril or risk. Thus, this chapter surveys the consequence of lack of insurable interest in property insurance and that will take place in section 4.2. The time of the requirement of insurable interest and when it must be shown is discussed in section 4.2.1. Section 4.2.2 analyses the use of lack of insurable interest as defence. That will lead, therefore, to explore the consequence of lack of insurable interest on the return of premiums in section 4.2.3. Furthermore, this chapter discusses the concepts of contractual interest and statutory interest in section 4.2.4; then it finds out whether the requirement of insurable interest could be waived in section 4.2.5.

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<sup>1</sup> See section 1.1, *supra*.

<sup>2</sup> The nature of the contract of insurance is that, it is an aleatory contract. The word aleatory means, "depending on the throw of a die or on chance", see, *Concise Oxford Dictionary* (10 ed), 2001. See, Nicholas Legh-Jones Q.C., John Birds and David Owen, *MacGillivray on Insurance Law*, (10<sup>th</sup> ed.), 2003, parag. 1-10. Professor Merkin observes that "Contracts of insurance, like wagering contracts, are aleatory contract "depending upon uncertain event or contingency as to both profit and loss"; for financial or other consideration the insurer agrees to pay or otherwise benefit the insured on the happening of a specified event or contingency which is outside the control of the insurer." Robert Merkin, *Colinvaux & Merkin's Insurance Contract Law*, Vol. I, (2002), parag. A-0001.

In addition, the impact of s.18 of Gaming Act 1845 is explored in section 4.3. It, also, examines the effect of Gambling Act 2005 on the requirement of insurable interest in section 4.4. Moreover, this chapter finds out the position of lack of insurable interest under Saudi jurisdiction in section 4.5. Section 4.6 is for general comments.

## 4.2. The Consequence of Lack of Insurable Interest

Broadly speaking, the absence of an insurable interest in indemnity insurance at the time of the loss insured against renders the insurance policy worthless and provides a defence to the insurer.<sup>3</sup> There is no statutory requirement that insurable interest must to be possessed by the insured in goods other than in the sphere of marine insurance. By virtue of section 4 of MIA 1906, a marine policy, to be valid and enforceable, must be attached by insurable interest. By contrast, a marine policy which is not supported by insurable interest will be null and void and, therefore, unenforceable.<sup>4</sup> Section 4 (1) of MIA 1906 states that:

"Every contract of marine insurance by way of gaming or wagering is void."

Section 4 (2) of the Act describes a marine policy which is considered to be by gaming or wagering. It provides that:

"A contract of marine insurance is deemed to be a gaming or wagering contract-

- (a) Where the assured has no insurable interest as defined by this Act, and the contract is entered into with no expectation of acquiring such an interest; or
- (b) Where the policy is made "interest or no interest", or "without further proof of interest than the policy itself", or "without benefit of salvage to the insurer", or subject to any other like term:

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<sup>3</sup> Lord Justice Mance, Iain Goldrein and Robert Merkin, *Insurance Disputes*, (2<sup>nd</sup> ed.), 2003, parag. 1.26.

<sup>4</sup> See, *John Edwards & Co Ltd v Motor Union Insurance Co* [1922] 2 KB 249.

Provided that, where there is no possibility of salvage, a policy may be effected without benefit of salvage to the insurer."

Section 1 of Marine Insurance (Gambling Policies) Act 1909 imposes criminal liability. It enacts that,

"If-

- (a) any person effects a contract of marine insurance without having any bona fide interest, direct or indirect, either in the safe arrival of the ship in relation on which the contract is made or in the safety or preservation of the subject matter insured, or a bona fide expectation of acquiring such an interest; or
- (b) any person in the employment of the owner of a ship, not being a part owner of the ship, effects a contract of marine insurance in relation to the ship, and the contract is made 'interest or no interest', or 'without further proof of interest than the policy itself', or 'without benefit of salvage to the insurer', or subject to any other like term,

the contract shall be deemed to be a contract by way of gambling on loss by maritime perils, and the person effecting it shall be guilty of an offence, and shall be liable, on summary conviction, to imprisonment, with or without hard labour, for a term not exceeding six months or a fine not exceeding level 3 on the standard scale,<sup>5</sup> and in either case to forfeit to the Crown any money he may receive under the contract."<sup>6</sup>

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<sup>5</sup> Marine Insurance (Gambling Policies) Act 1909 s.1 (1) (amended by virtue of the Criminal Justice Act 1948 s.1 (2); and the Criminal Justice Act 1982 ss.38, 46). 'Standard scale' means the standard scale of maximum fines for summary offences as set out in the Criminal Justice Act 1982 s. 37 (as amended). See, *Halsbury's Laws of England*, Vol. 25, 4<sup>th</sup> ed., (2003 Reissue), parag. 387; see also,

Accordingly, where a policy is made in "ppi" form or intended to be in a way of wagering or gambling, the policy is void.<sup>7</sup>

#### ***4.2.1 The Time of Existence of Insurable Interest***

The time that an insured is required to possess an insurable interest in order to validate his claim against the insurer in indemnity insurance is the time of the occurrence of the loss.<sup>8</sup> However, the only one exception to this rule is where the subject-matter is insured 'lost or not lost'.<sup>9</sup> Thus, section 6 of MIA 1906 provides that,

"(1) The assured must be interested in the subject-matter insured at the time of the loss though he need not be interested when the insurance is effected: Provided that where the subject-matter is insured 'lost or not lost,' the assured may recover although he may not have acquired his interest until after the loss, unless at the time of effecting the contract of insurance the assured was aware of the loss, and the insurer was not.

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parag. 22, note 9, "At the time at which this volume states the law, the standard scale is as follows: level 3, £1000."

<sup>6</sup> (9 Edw. 7, c. 12). See, Robert Merkin, *Colinvaux & Merkin's Insurance Contract Law*, Vol. I, (2002), parag. A-0393/1, note 1, at p. 10362; James Davey "The reform of gambling and the future of insurance law" *Legal Studies* (2004) Vol. 24 No. 4, 507, at 509 and note 15.

<sup>7</sup> Robert Merkin, *Colinvaux & Merkin's Insurance Contract Law*, Vol. I, (2002), parag. A-0482. Bearing in mind, however, the effect of Gambling Act 2005, *infra*.

<sup>8</sup> *Sparkes v Marshall* (1836) 2 Bing NC 761; *Howard v Lancashire Insurance Co* (1885) 11 SCR 92.

<sup>9</sup> Nicholas Legh-Jones Q.C., John Birds and David Owen, *MacGillivray on Insurance Law*, (10<sup>th</sup> ed.), 2003, parag. 1-39.

(2) Where the assured has no interest at the time of the loss, he cannot acquire interest by any act or election after he is aware of the loss."<sup>10</sup>

The effect of s.6 was considered in *Cepheus Shipping Corporation v. Guardian Royal Exchange Assurance Plc. (The "Capricorn")*,<sup>11</sup> where Mance J observed that:

"Under s. 6 of the Marine Insurance Act, the plaintiffs' insurable interest in the subject-matter insured (here freight or other income from trading) must have existed at the time of the loss though no such interest need exist when the insurance is effected."<sup>12</sup>

#### ***4.2.2. Lack of Insurable Interest as a Defence***

Lack of insurable interest constitutes a "technical" defence for an insurer against his insured and, therefore, the issue of lack of insurable interest should be raised by the insurer as a defence. In other words, "the onus is upon the insurer to either put the insured to proof of his insurable interest or deny it."<sup>13</sup> Such a defence, however, is not favoured by English courts. For example, Mance J has observed:

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<sup>10</sup> The matter is different in respect of life assurance. Insurable interest is required therein at the time of effecting the policy. See, *Dalby v India and London Life Assurance Co* (1807) 9 East 72; Robert Merkin, "Gambling by insurance – a study of the Life Assurance Act 1774" (1980) 9 *Anglo-American LR* 331; John Birds' & Norma Hird, *Birds' Modern Insurance Law*, (6<sup>th</sup> ed.), 2004, at p. 36; Nicholas Legh-Jones Q.C., John Birds and David Owen, *MacGillivray on Insurance Law*, (10<sup>th</sup> ed.), 2003, parag. 1-32; John Lowry & Philip Rawlings, *Insurance Law: Doctrine and Principles*, (2<sup>nd</sup> ed.), 2005, p. 152.

<sup>11</sup> [1995] 1 Lloyd's Rep 622.

<sup>12</sup> *Ibid*, at p. 641.

<sup>13</sup> Lord Justice Mance, Iain Goldrein and Robert Merkin, *Insurance Disputes*, (2<sup>nd</sup> ed.), 2003, parag. 1.27.

"If underwriters make a contract in deliberate terms which covers their assured in respect of a specific situation, a Court is likely to hesitate before accepting a defence of lack of insurable interest."<sup>14</sup>

Hence, the insured is not obliged, in principle, to state his interest in the contract of insurance.<sup>15</sup> In *Macaura v. Northern Assurance Company Ltd* case,<sup>16</sup> the insurer did successfully reject the insured's, who was the sole share holder in his company, claim on the basis of the lack of insurable interest in the company's asset.<sup>17</sup> Bird and Hird noted that, the insurers, in *Macaura*, did not reject the insured's claim on the ground of lack of insurable interest as they recognised that the policy was valid, but because they did not accept that the insured did have, at the time of loss, the interest necessary required in such a contract of indemnity.<sup>18</sup>

However, while an insurer in England is able to support his claim against his insured for the lack of insurable interest in a case similar to *Macaura*, the issue is

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<sup>14</sup> *The Capricorn* [1995] 1 Lloyd's Rep 622, at p. 641.

<sup>15</sup> *Mackenzie v. Whitworth* (1874-75) LR Ex. 142, 148. See, *Stock v Inglis* (1883-84) LR 12 QBD 564, where Lord Brett MR held, at p. 571, that,

"In my opinion it is the duty of a Court always to lean in favour of an insurable interest, if possible, for it seems to me that after underwriters have received the premium, the objection that there was no insurable interest is often, as nearly as possible, a technical objection, and one which has no real merit, certainly not as between the assured and the insurer. Of course we must not assume facts which do not exist, nor stretch the law beyond its proper limits, but we ought, I think, to consider the question with a mind, if the facts and the law will allow it, to find in favour of an insurable interest."

See, also, Malcolm Clarke, *The Law of Insurance Contracts*, (4<sup>th</sup> ed.), 2002, sec. 4-1D. Professor Clarke observes that, "...but that is a defence that he [the insurer] is slow to raise, because it is bad for the image of the industry to take what is widely perceived as a technical defence, and courts are ill disposed to companies that take premiums and then cry "no contracts"."; Nicholas Legh-Jones Q.C., John Birds and David Owen, *MacGillivray on Insurance Law*, *ibid*, parag. 1-13.

<sup>16</sup> [1925] A. C. 619.

<sup>17</sup> See the facts in section 3.2.1.1, *supra*.

<sup>18</sup> John Birds & Norma Hird, *Bird's Modern Insurance Law*, (6<sup>th</sup> ed.). 2004, at p. 59. Thus, this case shows the difference between the contractual requirement of interest and the statutory requirement of interest as they both will be illustrated below.



differently viewed in Supreme Court's decision in *Constitution Insurance Co of Canada v Kosmopoulos*.<sup>19</sup>

Unlike *Macaura*, the sole share holder in a company, Mr. Kosmopoulos, had insurable interest in the company's asset and, therefore, the insurer could not escape liability to indemnify the insured for the asset's destruction by claiming that the insured did not have insurable interest in the company's asset. Furthermore, in the case that the insurer does not plead lack of insurable interest and stays silent "there is effectively a presumption in favour of there being an interest."<sup>20</sup>

Lowry and Rawlings argue that, modern insurers can insert questions in the proposal forms regarding the relationship between the proposer and the property that is intended to be insured which make them make their decisions whether or not to accept the risk.<sup>21</sup> Thus, "the duty of disclosure, which places the insurer in an advantageous position when compared with parties in non-insurance contracts, makes it difficult to justify a situation in which the insurer can freely enter into the contract on the basis of full disclosure and still deny liability because of a lack of insurable interest."<sup>22</sup> Therefore, Lowry and Rawlings are of the opinion that it is wrong to allow the requirement of insurable interest "to be used as a technical defence in circumstances which bear no relation to its original policy objectives."<sup>23</sup>

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<sup>19</sup>(1987) 34 D.L.R. (4th) 208; [1987] 1 S.C.R. 2. See the facts in section 3.2.1.2, *supra*.

<sup>20</sup> Lord Justice Mance, Iain Goldrein and Robert Merkin, *Insurance Disputes*, (2<sup>nd</sup> ed.), 2003, parag. 1.27.

<sup>21</sup> John Lowry and Philip Rawlings, "Re-thinking Insurable Interest", in Sarah Worthington, *Commercial Law and Commercial Practice*, (2004), 335, at p. 362.

<sup>22</sup> *Ibid.*

<sup>23</sup> *Ibid.*, at p. 364.

It seems that, the defence of lack of insurable interest depends on the scope or description of insurable interest in a jurisdiction.<sup>24</sup>

#### ***4.2.3 The Effect of Lack of Insurable Interest upon Return of Premium***

Where a policy is void due to lack of insurable interest or where the policy has been avoided by the insurer, the only possible remedy from the part of the insured is the return of premium. Section 84 (1) of MIA 1906 enacts that:

"Where the consideration for the payment of the premium totally fails, and there has been no fraud or illegality on the part of the assured or his agents, the premium is thereupon returnable to the assured."

Furthermore, section 84 (3) (a) provides that:

"Where the policy is void, or is avoided by the insurer as from the commencement of the risk, the premium is returnable, provided that there has been no fraud or illegality on the part of the assured; but if the risk is not apportionable, and has once attached, the premium is not returnable."

Section 84 (3) (c) goes on to states that:

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<sup>24</sup> See the two descriptions of insurable interest, i.e. Eldon's legal interest and Lawrence's factual expectation, which are adopted in common law system in *Lucena v Craufurd* (1806), 2 Bos. & Pul. (N. R.) 269, 127, ER 630. *per* Lord Eldon and Lawrence J.

"Where the assured has no insurable interest throughout the currency of the risk, the premium is returnable, provided that his rule does not apply to a policy effected by way of gaming or wagering."

In the light of section 84 of MIA 1906 and its sub-sections, Merkin sets out three situations where insurable interest is lacked of.

1) Where an insured does not possess insurable interest at the time of concluding the contract, but he is expecting to obtain an interest during the currency of his insurance policy. Here, it does not mean that the policy was made by way of gaming or wagering should the insured could not obtain the interest, it means, nevertheless, that the consideration for the payment of the premium has totally failed. In other words, the policy is invalid due to the non-existence of a considerable insurable interest.<sup>25</sup> As a result of that, the insured is entitled to recover the premium that he has paid from his insurer pursuant to ss.84 (1) and 84 (3) (c) of MIA 1906.<sup>26</sup> The same rule applies where the insured possesses an insurable interest at the time of taking out the policy on his goods, for example, but loses it during the currency of the policy because he sells the goods. Here, the consideration would not have totally failed and, therefore, the insurer should return the premium to the insured.<sup>27</sup>

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<sup>25</sup> Lord Justice Mance, Iain Goldrein and Robert Merkin, *Insurance Disputes*, (2<sup>nd</sup> ed.), 2003, para. 1.29.

<sup>26</sup> Robert Merkin, *Colinvaux & Merkin's Insurance Contract Law*, Vol. I, (2002), para. A-0482 and A-0507.

<sup>27</sup> See, Lord Justice Mance, Iain Goldrein and Robert Merkin, *Insurance Disputes*, (2<sup>nd</sup> ed.), 2003, para. 1.29, where it is noted, in footnote (2) at p. 14, that, "unless the contract is divisible (in the sense that the contract reveals that premium is assessed monthly or can be attributed to the period of cover which has failed), a claim in restitution cannot be maintained."

Thus, in *Newbury International Ltd. v. Reliance National Insurance Co.*,<sup>28</sup> the plaintiffs were the assureds under two policies. The insurer undertook to indemnify the assureds in respect of their contractual liability in the event Russell Ingall, a well known racing driver, achieves a top three series position after the 12th race in the 1992/1993 New Zealand International Formula Ford Series. In the first policy the sum insured was £425,000. In the second policy the sum insured was £66,000. Russell Ingall came in first in every single race in the 12 race series, but he was not declared the winner in the last race because he was disqualified. The assureds claimed under the policies, but the insurer rejected the claim. It was argued that the assureds suffered no loss; that the liability of the assureds was contingent on the receipt of the moneys from the insurer and since they had not received any moneys under the policies they were under no liability to make payment to anyone else. The issue was whether or not these policies represented true policies of insurance or whether they were in reality simply wagering contracts without any insurable interest. Hobhouse J. declared that the assureds lacked insurable interest, but they were entitled to retain the premiums. In his words, Hobhouse J. observed that,

"...on the face of it Newbury International themselves have suffered no loss as a result of being unable to recover under the policies save that the premiums have been wasted but as previously stated, in the light of my decision of the dispute as between Newbury International and Reliance, Newbury International will receive back those premiums which are presently being held in an interest bearing escrow account."<sup>29</sup>

2) Where an insured takes out an insurance policy without possessing insurable

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<sup>28</sup> [1994] 1 Lloyd's Rep 83.

<sup>29</sup> *Ibid*, at p. 92.

interest nor is he having any expectation of acquiring insurable interest, the policy is deemed to be made by way of gaming or wagering as it is described by s.4 (2) (a). Therefore, by virtue of s.84 (3) (c) the insured is deprived of recovering the premium.<sup>30</sup>

3) Where an insured has actually an insurable interest or an expectation of acquiring an insurable interest; therefore the policy, according to s.4 (a) MIA 1906, is valid, but because the policy has been made in "ppi" form, the policy is void pursuant to s.4 (b) MIA 1906. Consequently, the insured has no right of restitution of his premium under s. 84 (3) (c) MIA 1906.<sup>31</sup> In *Re London County Commercial Reinsurance Office*,<sup>32</sup> Lawrence J. dealt with a case evolved a marine policy in "ppi" form and he explained the reason of inserting a term "ppi" in an insurance policy. According to him, that does not mean that the insured does not possess an insurable interest according to s.4 (a). In his words,

"... the term p.p.i. in a policy does not necessarily indicate that the assured has no insurable interest or does not expect to acquire an insurable interest. That term is inserted because the insurable interest is such that a loss in respect of it, though real, would be difficult to prove or assess. By the addition of such a

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<sup>30</sup> Robert Merkin, *Colinvaux & Merkin's Insurance Contract Law*, Vol. I, (2002), parag. A-0482. See, also, Nicholas Legh-Jones Q.C., John Birds and David Owen, *MacGillivray on Insurance Law*, (10<sup>th</sup> ed.), 2003, parag. 8-27, where is stated that it was held in *Brophy v N. American Life Ass. Co.* (1902) 32 S.C.R. 261, a Canadian case that, "where a company had insured in the belief that the assured had an insurable interest, and subsequently during the currency of the risk discovered that he had no such interest, it might apply to the court for cancellation of the contract, and was not bound to return the premium where the policy amounted to an illegal wagering contract."

<sup>31</sup> Robert Merkin, *ibid.*

<sup>32</sup> [1922] 2 Ch. 67, (1922) 10 Ll. L. Rep. 370.

term to the contract the underwriters agree to release the assured, in the event of a claim, from the difficulty and expense of proving his interest."<sup>33</sup>

Lawrence J. clearly declared that where a policy was made by way of gaming or wagering, such policy would not be illegal, but only void.<sup>34</sup> Accordingly, he ruled that,

"The policies as issued were in substance and in fact p.p.i. policies and the effect of attaching the p.p.i. clause was in my judgment to render the policies void by virtue of the provisions of s. 4 of the Act of 1906. In my judgment therefore, unless the assured can succeed in their claim for rectification, all the policies to which the p.p.i. clause was attached at the time of issue are void."<sup>35</sup>

However, Lawrence did allow the insured to recover his premiums.<sup>36</sup> In this regard, Merkin observes that, "It is certainly difficult not to have sympathy with this approach, as the assured who has a legitimate insurable interest but who cannot claim

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<sup>33</sup> *Ibid*, at p. 71. In other occasion he said that,

"In my opinion the fact that the policies contain the p.p.i. clause does not of itself prove that the assured has no insurable interest in the subject matter of the insurance, or that the policies are gaming or wagering policies, as that clause may have been inserted on account of some difficulty in proving interest." At p. 79.

Note that, insurance policies that were made by way of gaming and wagering were illegal under MIA 1745. See, Raoul Colinvaux, *Arnould's Law of Marine Insurance and Average*, Vol. I, (16<sup>th</sup> ed.), (1981), parag. 389, p. 263. It seems that inserting "ppi" terms in insurance policies was a usual practice in marine insurance. P.O. Lawrence J. observed that, "It has become usual to add a p.p.i. clause (when required) by means of a slip bearing the following form of words: "This slip is no part of the policy and is not to be attached thereto, but is to be considered as binding in honour on the underwriters: the assured however having permission to remove it from the policy should they so desire."

<sup>34</sup> *Ibid*, at p. 73.

<sup>35</sup> *Ibid*, pp. 82-83. It is of significance to note the issue that was arisen by P.O. Lawrence in respect of that, "whether the claimants are entitled to have these policies rectified by striking out the p.p.i. clause." In such circumstances, a Court would reject any possibility of rectification. P.O. Lawrence was of the opinion that,

"... the claim for rectification cannot possibly succeed as there is no evidence whatever of a common or even of a unilateral mistake. The reason why the company attached the p.p.i. clause to these policies is because the closing instructions expressly stipulated that the policy should be a p.p.i."

<sup>36</sup> *Ibid*, at p. 85.

under the policy because of its form has probably been punished enough. A further consideration is that the reason for the policy being in "ppi" form is at least as much to do with the insurer's drafting practices as with the assured's desires, and it seems inappropriate that the insurer – or its liquidator- should have a windfall of the premiums in those circumstances."<sup>37</sup>

#### ***4.2.4. Contractual and Statutory Requirements of Interest***

It has been said that there are two kinds of interest which are, namely, contractual interest, (or insurable interest that required by the character of the contract of insurance itself) and statutory requirement of interest.<sup>38</sup> In the case of lack of contractual interest, an insurer would have a defence against his insured where the latter has no insurable interest at the time of the loss at all or the interest is not sufficient to meet the standard of insurable interest that is required by law. Therefore, the policy would not be enforceable by the insured.<sup>39</sup> Nonetheless, if the insurer chooses not to deny the insured's insurable interest, the insured would be able to enforce the policy.<sup>40</sup> In respect of statutory requirement of insurable interest:

"Whether the terms of the contract demand an insurable interest or not, an interest of some kind and to some extent is required directly or indirectly by

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<sup>37</sup> Robert Merkin, *Colinvaux & Merkin's Insurance Contract Law*, Vol. I, (2002), parag. A-0482.

<sup>38</sup> Nicholas Legh-Jones, John Birds and David Owen, *MacGillivray on Insurance Law*, (10<sup>th</sup> ed.), 2003, parag. 1-11, 1-13 & 1-17.

<sup>39</sup> *Macaura v Northern Assurance Co.* [1925] A.C. 619, 632.

<sup>40</sup> Nicholas Legh-Jones, John Birds and David Owen, *MacGillivray on Insurance Law*, (10<sup>th</sup> ed.), 2003, parag. 1-13.

statute in every contract of insurance, and the contract will be void, and in some cases illegal if the requisite interest is absent."<sup>41</sup>

According to Birds and Hird, the LAA 1774 is not likely to be regarded as applicable to any indemnity insurance.<sup>42</sup> Thus, the only relevant statutory requirement is the prohibition on gaming or wagering and the requirement of insurable interest that is implied into the contract of insurance as a consequence of the nature of the principle of indemnity which requires an insured to show his loss at the time of the occurrence of the risk.<sup>43</sup> It has to be borne in mind, of course, that the requirement of insurable interest in s.4 of MIA 1906 provides a certain kind of interest, i.e. legal or equitable interest, which constitutes a statutory requirement of interest for marine policies. This provision has aided judges in non-marine cases, more particularly in relation to indemnity insurance generally. Therefore, it has been held that,

"Anybody who sues on a policy can only sue in respect of his own interest unless by special provisions, the law allowing it, the policy is made for the sake of another, or unless some statute says the policy shall ensure for the benefit of somebody else."<sup>44</sup>

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<sup>41</sup> *Ibid*, parag. 1-17. See, *Chitty on Contracts*, Vol. II, (28<sup>th</sup> ed.), 1999, s. 41-010.

<sup>42</sup> *Mark Rowlands Ltd v Berni Inns Ltd* [1986] QB 211, at p. 227 *per* Kerr J. It is interesting to note that, before the LAA 1774, it had been held in *Sadler's Co v Badcock* (1743) 2 Atk 554, that insurable interest in buildings had been required at the time of the policy. However, in *Re King, Robinson v Gray* [1963] Ch 459, Lord Denning MR, at p. 485, noted that it was dismissed that the LAA 1774 did apply to buildings insurance. See, John Lowry & Philip Rawlings, *Insurance Law: Doctrine and Principles*, (2<sup>nd</sup> ed.), 2005, p. 151.

<sup>43</sup> John Birds & Norma Hird, *Bird's Modern Insurance Law*, (6<sup>th</sup> ed.). 2004, at pp. 58-59.

<sup>44</sup> *Cosford Union v Poor Law and Local Government Officers' Mutual Guarantee Association Ltd* (1910) 103 LT 463, at 465, *per* Phillimore J., cited in E. R. Hardy Ivamy, *Dictionary of Insurance Law*, (London, Butterworths, 1981), at p. 66.



#### 4.2.5. *Waiver of Proof of Insurable Interest*

An important issue is whether the requirement of proof of insurable interest can be waived. According to Lowry and Rawlings, the question of whether an insurer can waive insurable interest has been left open by English decisions.<sup>45</sup> Nonetheless, in relation to the contractual interest, the insurer is able to waive proof of interest by not denying the insured's interest where the latter claims on his policy, so long as the interest arises out of the nature of the insurance and not statutory.<sup>46</sup> Thus, in *Williams v Baltic Insurance Association of London*,<sup>47</sup> Mr Eric Bransby Williams, the owner of a motor car, took out a policy of insurance by which the insurers agreed to indemnify him against damage to, or loss of, his motor car, and (by cl. 2) "against all sums for which the insured (or any licensed personal friend or relative of the insured while driving the car with the insured's general knowledge and consent) shall become legally liable in compensation for .... accidental bodily injury caused to any person." During the currency of the policy and while the insured's sister, Miss Bransby Williams, a licensed driver, was driving the car with his general knowledge and consent of the insured, an accident happened which caused personal injuries to third parties. The injured parties recovered damages against her. The insured, therefore, claimed that the insurers were liable under the policy to indemnify his sister and to pay to her or to him as trustee for her the amount of those damages. The insurer, however, rejected the claim on the ground that the insured incurred no liability by the accident, and consequently he cannot recover. Nor had Miss Bransby Williams any

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<sup>45</sup> John Lowry & Philip Rawlings, *Insurance Law: Cases and Materials*, 2004, p. 312.

<sup>46</sup> Nicholas Legh-Jones, John Birds and David Owen, *MacGillivray on Insurance Law*, (10<sup>th</sup> ed.), 2003, parag. 1-16.

<sup>47</sup> [1924] 2 KB 282.

interest in the event. She had no interest in the car itself apart from the bare possibility that she might be allowed sometimes to drive it. That was a mere chance, which gave her no interest; certainly not at the essential date - namely, when the policy was effected.<sup>48</sup> Nevertheless, Roche J rejected the insurer's argument and observed that:

"On the question of interest Mr. Claughton Scott [counsel for the insured] said that Mr. Bransby Williams was interested in Miss Bransby Williams's immunity from claims, and that she was herself interested in her protection against claims; further that she was interested as the driver of the motor car in respect of the motor car itself. I do not decide these points, but I think there is a great deal in them. With regard to the last point it will be noted that in the Marine Insurance Act, 1906, a person is interested in a marine adventure who (*inter alia*) may incur liability in respect thereof."<sup>49</sup>

Thus he held that,

"The general argument that Mr. Bransby Williams cannot recover for Miss Bransby Williams because the latter cannot recover for herself, is based upon this, that the insured is Mr. Bransby Williams. That, I think, is begging the

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<sup>48</sup> The insurer relied on Life Assurance Act 1774, that s.1 of the Act makes null and void insurances on the life of any person or on any event, wherein the assured has no interest. Sect. 2 states that: ".... It shall not be lawful to make any policy or policies on the life or lives of any person or persons, or other event or events, without inserting in such policy or policies the person or persons name or names interested therein, or for whose use, benefit, or on whose account such policy is so made or underwrote." Sec.3 provides that no greater sum shall be recovered from insurers than the amount or value of the interest of the insured. Sect. 4: "Provided always that nothing herein contained shall extend, or be construed to extend, to insurances bona fide made by any person or persons, on ships, goods, or merchandises; but every such insurance shall be as valid and effectual in the law as if this Act had not been made." Roche J, however, rejected the insurer's argument in this regard on the ground that the 1774 Act did not apply in that case and it was sufficient to prove the loss at the time of the commencement of the risk because the insurance was on a car which is considered as goods, thus, it was excepted by s.4 of LAA 1774. At pp. 289-90.

<sup>49</sup> *Ibid*, p. 290.

question. Mr. Bransby Williams is the insured in the sense that he is the person who effected the insurance, but it is an insurance for himself and the other persons mentioned in cl. 2, and, accordingly, the company's contract is to indemnify all such persons in the event of those things happening against which the insurance is effected."<sup>50</sup>

In the light of the facts of the above case, cl. 2 constituted a waiver by the insurer of proof of interest by the insured. Likewise, in *Prudential Staff Union v. Hall*,<sup>51</sup> the union effected a policy of insurance with Lloyd's underwriters covering the loss by any of its members by certain perils, including burglary and house-breaking, of any moneys held by them as agents or collectors of the company. The policy described the union as "the assured" and the underwriters contracted to pay the union in case of a loss occurring within the policy. The underwriters had previously paid the union in respect of claims made on behalf of members and had represented that it was proper for the union to present such claims. The assured claimed indemnity for loss by burglary of moneys held by two of its members for the company, the defendant underwriters pleaded that the union had no insurable interest and, therefore, they could not sue. That the action should have been brought by the members who claimed to have suffered the loss. Although the Court admitted that the union lacked insurable interest, Morris J held that,

"In my judgment, the alleged loss is one in relation to which the union are entitled to sue, because the defendant contracted to pay to the union. No doubt the union would regard themselves as trustees for the particular members of

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<sup>50</sup> *Ibid.*

<sup>51</sup> [1947] KB 685. See also, *Waters v Monarch Life and Fire Assurance Co* (1856) 5 El & Bl 870; *Thomas v National Farmers' Union Mutual Insurance Society* [1961] 1 WLR 386.

any amount recovered, so that those members could pay such amount in settlement of any claims made on them by their employers for moneys received or held on their behalf..."<sup>52</sup>

Lowry and Rawlings comment case that, "By enlisting the trust device Morris J was able to circumvent any element of wagering thus avoiding any violation of public policy considerations."<sup>53</sup>

So far as the statutory requirement of interest is concerned, the parties of an insurance contract are not allowed to waive the illegality or nullity by inserting a clause in the policy or otherwise.<sup>54</sup> A court will not enforce an insurance policy that is made without an insurable interest even if the insurer does not, in fact, arise this point, at the litigation, as a defence against the insured.<sup>55</sup> Thus, in *Gedge v Royal Exchange Assurance Corporation*,<sup>56</sup> for instance, the plaintiff insured took out an insurance policy to be indemnified against loss with regard to non-arrival by a ship at a certain date in a certain port. The Court found that the policy was a "ppi" policy and was, therefore, illegal under s.1 of Marine Insurance Act 1745.<sup>57</sup> Although the insurer did not plead the invalidity of the policy, Kennedy J. ruled that,

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<sup>52</sup> *Ibid*, p. 691.

<sup>53</sup> John Lowry & Philip Rawlings, *Insurance Law: Cases and Materials*, 2004, p. 312. See, further, John Birds & Norma Hird, *Birds' Modern Insurance Law*, (6<sup>th</sup> ed.), 2004, pp. 58-60.

<sup>54</sup> Nicholas Legh-Jones, John Birds and David Owen, *MacGillivray on Insurance Law*, (10<sup>th</sup> ed.), 2003, parag. 1-17.

<sup>55</sup> Lord Justice Mance, Iain Goldrein and Robert Merkin, *Insurance Disputes*, (2<sup>nd</sup> ed.), 2003, parag. 1.27; *Chitty on Contracts*, Vol. II, (28<sup>th</sup> ed.), 1999, s. 41-010.

<sup>56</sup> [1900] QB 214.

<sup>57</sup> Section 1 of MIA 1745 stated that,

"No assurance or assurances shall be made by any person or persons, bodies corporate or politick, on any ship or ships belonging to His Majesty, or any of his subjects, or on any goods, merchandises, or effects, laden or to be laden on board of any such ship or ships, interest or no interest, or without further proof of interest than the policy, or by way of gaming or wagering, or without benefit of salvage to the assurer; and every such assurance shall be null and void to all intents and purposes."

"Their counsel [the plaintiffs'] argued that the illegality was not pleaded by the defendants [insurer]; in my opinion that makes no difference... No Court ought to enforce an illegal contract or allow itself to be made the instrument of enforcing obligations alleged to arise out of a contract or transaction which is illegal, if the illegality is duly brought to the notice of the Court, and if the person invoking the aid of the Court is himself implicated in the illegality. It matters not whether the defendant has pleaded the illegality or whether he has not. If the evidence adduced by the plaintiff proves the illegality, the Court ought not to assist him."<sup>58</sup>

Furthermore, s.18 of Gaming Act 1845 renders void every contract of insurance made without interest or, at least, a reasonable expectation of acquiring an interest "in the occurrence of the future risk or event other than the amount which will be won or lost under the contract."<sup>59</sup>

However, it has been expected that Gambling Act 2005 will enter into force from 1 September 2007, which means that s.18 of Gaming Act 1845 will be repealed. Therefore, it is necessary, at this stage, to consider, firstly, the effect of s.18 of Gaming Act 1845 and, then, the effect of Gambling Act 2005 on the requirement of insurable interest in property insurance.

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<sup>58</sup> [1900] QB 214, at p. 220. See also, *Griffiths v Fleming* [1909] 1 KB 805, 820; *Cheshire & Co. v Vaughan & Co.* [1920] 3 KB 240, 251, 255-256; *Newbury International v Reliance National Insurance Co* [1994] 1 Lloyd's Rep. 83, 85.

<sup>59</sup> Lord Justice Mance, Iain Goldrein and Robert Merkin, *Insurance Disputes*, (2<sup>nd</sup> ed.), 2003, parag. 1.8.

### 4.3. The Effect of Gaming Act 1845, s. 18

It has been said that effecting an insurance policy without an insurable interest was legal in England until middle of the 18<sup>th</sup> century.<sup>60</sup> However, s.4(1) of Marine Insurance Act 1906 makes effecting insurance policies "by way of gaming or wagering" void and s.4(2) describes the cases where an insurance policy is deemed to be made by way of gaming or wagering.<sup>61</sup> Additionally, Life Assurance Act 1774 renders insurance policies without insurable interest not only void, but also illegal.<sup>62</sup> Parliament, moreover, has passed Gaming Act 1845 to make all wager contracts void by section 18 of Gaming Act 1845, which provides that,

"All contracts or agreements, whether by parole or in writing, by way of gaming or wagering, shall be null and void; and no suit shall be brought or maintained in any court of law and or equity for recovering any sum of money or valuable thing alleged to be won upon any wager..."

The Act does not define a wagering contract,<sup>63</sup> but the contract has been defined by Hawkins J in *Carlill v. The Carbolic Smoke Ball Company*,<sup>64</sup> that,

"one by which two persons, professing to hold opposite views touching the issue of a future uncertain event, mutually agree that, dependent upon the

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<sup>60</sup> In particular, until the application of Marine Insurance Act 1745. See section 2.3.1, *supra*. In fact wagers, at that time, were legal and enforceable. See, John Birds' & Norma Hird, *Birds' Modern Insurance Law*, (6<sup>th</sup> ed.), 2004, at p. 34.

<sup>61</sup> See section 4.2, *supra*.

<sup>62</sup> Section 1 of LAA 1774.

<sup>63</sup> See *Chitty on Contracts*, Vol. II, (29<sup>th</sup> ed.), 2004, ch. 40.

<sup>64</sup> [1892] 2 QB 484.

determination of that event, one shall win from the other, and that other shall pay or hand over to him, a sum of money or other stake; neither of the contracting parties having any other interest in that contract than the sum or stake he will so win or lose, there being no other real consideration for the making of such contract by either of the parties. It is essential to a wagering contract that each party may under it either win or lose, whether he will win or lose being dependent on the issue of the event, and, therefore, remaining uncertain until that issue is known. If either of the parties may win but cannot lose, or may lose but cannot win, it is not a wagering contract."<sup>65</sup>

Merkin discusses the meaning of "by way of gaming or wagering." A wagering contract needs the attention of both parties to wager which means it would be difficult to find, outside insurance, many situations where one party is wagering and the other is not. He argues that, "If mutuality is a requirement, it is apparent that the Gaming Act, s.18 will have little, if any, impact, as insurers are not gamblers within the generally accepted meaning of the word."<sup>66</sup> He concludes that s.4(2)(b) of MIA 1906 has no relevance outside the marine context,<sup>67</sup> where it is obvious that an insurer intends to wager.<sup>68</sup>

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<sup>65</sup> *Ibid*, at pp. 490-91.

<sup>66</sup> Robert Merkin, *Colinvaux & Merkin's Insurance Contract Law*, Vol. I, (2002), parag. A-0392.

<sup>67</sup> The section provides that,

"A contract of marine insurance is deemed to be a gaming or wagering contract- ...

(b) Where the policy is made "interest or no interest", or "without further proof of interest than the policy itself", or "without benefit of salvage to the insurer", or subject to any other like term:

Provided that, where there is no possibility of salvage, a policy may be effected without benefit of salvage to the insurer."

<sup>68</sup> Robert Merkin, *Colinvaux & Merkin's Insurance Contract Law*, Vol. I, (2002), parag. A-0392.

Professor Merkin adds that, "MIA 1906, s.4(2)(b) operates to avoid a "ppi" or equivalent policy whether or not the assured has an interest, whereas it is unlikely that the Gaming Act 1845, s.18 would apply to a case in which the assured himself has an interest and is not wagering."

According to Merkin, an insurance policy could be by way of gaming or wagering where the assured alone intends to gamble. Nevertheless, it is not sufficient to amount to a wager where the assured does not possess an insurable interest as he might have acquiring an interest in future, but where he does not have expectation of acquiring an interest, the Gaming Act 1845, s.18 would apply to the insurance contract.<sup>69</sup>

Despite the fact that Gaming Act 1845, s.18 has its impact upon insurance contracts, it is necessary to examine the effect of Gambling Act 2005 which renders wagering contracts enforceable.

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<sup>69</sup> *Ibid.* See, also, *Chitty on Contracts*, (28<sup>th</sup> ed., 1999), ss. 41-012, 40-018, 40-027.



## 4.4. The Effect of Gambling Act 2005

It has been mentioned that all contracts that are made by way of gaming or wagering have been null and void in England by section 18 of Gaming Act 1845.<sup>70</sup> However, section 18 of Gaming Act 1845 has been repealed by section 334(1)(c) of Gambling Act 2005 which provides that,

(1) The following shall cease to have effect-

(c) section 18 of the Gaming Act 1845 (c. 109) (voiding of gaming contracts).

Furthermore, section 335 of Gambling Act 2005 renders gaming, or gambling, contracts enforceable. It states that,

"(1) The fact that a contract relates to gambling shall not prevent its enforcement.

(2) Subsection (1) is without prejudice to any rule of law preventing the enforcement of a contract on the grounds of unlawfulness (other than a rule relating specifically to gambling)."

It can be said that, s.335 (2) constitutes a saving for "any rule of law preventing the enforcement of a contract on the grounds of unlawfulness" unless the unlawfulness is based upon a rule relating specifically to gambling. As consequences of Gambling Act 2005, Merkin notes that, "(a) gambling contracts are valid; (b) any rule of law that

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<sup>70</sup> See section 2.3.2, *supra*. See, also, Robert Merkin, *Colinvaux & Merkin's Insurance Contract Law*, Vol. I, parag. A-0392. Professor Merkin argues that, "It has yet to be decided whether the assured's expectation of acquiring an interest must be reasonable although, given that the test of wagering is subjective, it would seem that the assured's honest belief that he might acquire an interest is enough to save the policy from the taint of wagering."

does not relate specifically to gambling and that renders the contract unlawful remains operative; and (c), by way of exception to (b), any rule of law that relates specifically to gambling and that renders the contract unlawful ceases to have effect."<sup>71</sup>

Therefore, as for the requirement of insurable interest in life insurance the rule is saved and remains applicable. Pursuant to the LAA 1774, an insured must possess insurable interest at the date of effecting the policy and failing to do so is unlawful.<sup>72</sup> However, in *Feasey v Sun Life Assurance Co of Canada*,<sup>73</sup> Waller L.J. observed that "the gambling was not the antithesis of insurable interest."<sup>74</sup> According to Merkin, "A contract struck down by the 1774 Act is not, therefore, a gambling contract, but simply one that is not supported by insurable interest. It might be thought on this basis", he said, "that the Gambling Act 2005, s.335 (1) has no effect on the statutory insurable interest requirement for life assurance. Even if that is wrong, then the LAA 1774 is preserved by s.335(2) because it sets out a rule of law that provides for unlawfulness and it is not a statute that relates specifically to gambling."<sup>75</sup> Thus, this rule applies to any insurance policy that falls within the scope of LAA 1774.

As far as marine insurance policies are concerned, it has been mentioned that s.4(1) of MIA 1906 renders a policy that is made "by way of gaming or wagering" void and s.4(2) illustrates positions where an insurance policy is deemed to be made "by way of

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<sup>71</sup> Robert Merkin, *ibid*, parag. A-0393; R. Merkin, "Insurable Interest: The repeal of the prohibition on gambling", (Dec. 2005) *Insurance Law Monthly* 4, at p. 5.

<sup>72</sup> *Dalby v India & London Life Assurance Co* (1854) 15 CB 365; Robert Merkin, *ibid*, parag. A-0393. For more discussion on this, see, Robert Merkin 'Gambling by insurance- a study of the Life Assurance Act 1774' (1980) 9 *Anglo- American LR* 331.

<sup>73</sup> [2003] EWCA (Civ) 885, [2003] Lloyd's Rep IR 637.

<sup>74</sup> Robert Merkin, *Colinvaux & Merkin's Insurance Contract Law*, Vol. I, (2002), parag. A-0393

<sup>75</sup> *Ibid*

gaming or wagering." Further, the position in respect of insurance policies on goods is the same that applies in marine insurance policies.

An important issue is whether s.1 of Marine Insurance (Gambling Policies) Act 1909 has any effect on saving the requirement of insurable interest from being abolished?

Section 1 of Marine Insurance (Gambling Policies) Act 1909 states that,

"(1) If-

- (a) any person effects a contract of marine insurance without having any bona fide interest, direct or indirect, either in the safe arrival of the ship in relation on which the contract is made or in the safety or preservation of the subject matter insured, or a bona fide expectation of acquiring such an interest; or
- (b) any person in the employment of the owner of a ship, not being a part owner of the ship, effects a contract of marine insurance in relation to the ship, and the contract is made 'interest or no interest', or 'without further proof of interest than the policy itself', or 'without benefit of salvage to the insurer', or subject to any other like term,

the contract shall be deemed to be a contract by way of gambling on loss by maritime perils, and the person effecting it shall be guilty of an offence, and shall be liable, on summary conviction, to imprisonment, with or without hard labour, for a term not

exceeding six months or a fine not exceeding level 3 on the standard scale,<sup>76</sup> and in either case to forfeit to the Crown any money he may receive under the contract."<sup>77</sup>

Thus, the 1909 Act criminalises taking out a marine insurance policy "by way of gaming or wagering." Having said that, the requirement of insurable interest in s.4 of MIA 1906 should be saved by s.335(2) of Gambling Act 2005 which states that,

"...without prejudice to any rule of law preventing the enforcement of a contract on the grounds of unlawfulness..."

In other words, the position here should be similar to that relating to life assurance policies under LAA 1774 which renders void and illegal the taking out of insurance policies within the scope of the 1774 Act without insurable interest. However, Merkin argues that s.4 of MIA 1906 does not render insurance policies without interest unlawful; it simply renders them void. He is of the opinion that, "s.335(2) does not apply to any rule of law which relates specifically to gambling, but this is precisely what s.4 does." Therefore, he thinks that, "It might be thought, therefore, that s.335 of the Gambling Act 2005 deprives s.4 of the 1906 Act of any effect."<sup>78</sup>

In so far as the application of 1909 Act is concerned, there is no authority that could be found on applying s.1 of Marine Insurance (Gambling Policies) Act 1909 on an insured who had gambled on an insurance policy. Davey observes that, "...the

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<sup>76</sup> Marine Insurance (Gambling Policies) Act 1909 s.1 (1) (amended by virtue of the Criminal Justice Act 1948 s.1 (2); and the Criminal Justice Act 1982 ss.38, 46). 'Standard scale' means the standard scale of maximum fines for summary offences as set out in the Criminal Justice Act 1982 s. 37 (as amended). See, *Halsbury's Laws of England*, Vol. 25, 4<sup>th</sup> ed., (2003 Reissue), parag. 387; see also, parag. 22, note 9, "At the time at which this volume states the law, the standard scale is as follows: level 3, £1000."

<sup>77</sup> (9 Edw. 7, c. 12).

<sup>78</sup> Robert Merkin, "Insurable Interest: The repeal of the prohibition on gambling", (Dec. 2005) *Insurance Law Monthly* 4, at p. 5.

effecting of marine gambling policies is criminalised by the Marine Insurance (Gambling Policies) Act 1909." He notes, however, that, he "can find no reported prosecutions under this Act. Such prosecutions require the consent of the Attorney-General, and his office has confirmed that it has no record of this consent being granted."<sup>79</sup>

Merkin observes that "It is the case that the Marine Insurance (Gambling Act) 1909 does create criminal offences in virtually all cases where the policy is made without interest under the MIA 1906, s.4. However, the 1909 Act does not of itself render policies without interest "unlawful" in the civil sense: the reason that they are unenforceable is not because they are criminal under the 1909 Act, but because they are void under the 1906 Act."<sup>80</sup>

In fact, there is no authority whatsoever repeals the Marine Insurance (Gambling Policies) Act 1909 which means that, the rule that gambling on insurance policies is illegal is still in effect notwithstanding the repeal of s.18 of Gaming Act 1845. If this analysis is not agreed with, the principle of indemnity is always there to safeguard insurance policies from being gambled upon.<sup>81</sup>

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<sup>79</sup> James Davey "The reform of gambling and the future of insurance law" *Legal Studies* (2004) Vol. 24 No. 4, 507, at 509 and note 15. In *Moran v Lloyd's* [1983] 1 Lloyd's Rep. 51, Lloyd J. said, at p. 54, that, " After the passing of the Marine Insurance (Gambling Policies) Act, 1909, it would, of course, have become necessary for a person charged with an offence under that Act by reason of having effected such a policy to prove his interest. Otherwise he would have been liable to a maximum penalty of six months imprisonment." Davey notes that, the allegation in *Moran* case " would have fallen within the 1909 Act had they concerned marine and not aviation insurance."

<sup>80</sup> Robert Merkin, *Colinvaux & Merkin's Insurance Contract Law*, Vol. I, (2002), parag. A-0393/1, note 1, at p. 10362.

<sup>81</sup> Robert Merkin, "Insurable Interest: The repeal of the prohibition on gambling", (Dec. 2005) *Insurance Law Monthly* 4, at p. 5. Professor Merkin observes that, "The indemnity principle is untouched by the 2005 Act and it remains the case that the assured must prove his loss when the peril occurs. There is little point, therefore, in the assured taking out a policy without interest given that he can never recover under it, assuming, of course, that there is no move to write policies on a ppi basis, a practice which was permitted by the common law in the marine context before 1745, when it was outlawed but only as regards marine policies."

One more thing need to be said here is that, the principle of insurable interest is, actually, included in the principle of indemnity. That is to say, you cannot be indemnified for a loss of a property unless you are interested in it. Thus, it is the duty of law to form a clear definition of insurable interest and identify the time of its presence.

Under Islamic law, for instance, there is nothing preventing a son from looking after his dead father's friend financially according to the father's will because, in fact, that is an obligation on the son under *Sharia*.<sup>82</sup> If, for example, the wealthy son buys a house for his father's poor friend and registers it in the latter's name, the son, on the face of things, is not interested in the house; thus, under English law, he cannot insure the house in his name even if he pays the premium to an insurer. It is obvious, under legal interest test,<sup>83</sup> that the son has no insurable interest in the house. Insurable interest under legal interest test is described by Lord Eldon as,

"a right in the property, or derivable out of some contract about the property, which in either case may be lost upon some contingency affecting the possession or enjoyment of the party."<sup>84</sup>

However, it is arguable that the son is interested in the house under the factual expectation test which is presented by Lawrence J:

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<sup>82</sup> Under Islamic law of succession, a person is allowed to grant a non-successor person up to one third of his wealth. It is assumed in this hypothesis, there was an agreement between the father and the son that instead of granting one third of the father's wealth to his poor friend, the son undertakes to look after the friend financially during the friend's life.

<sup>83</sup> *Lucena v Craufurd* (1806), 2 B. & P. (NR.) 269, 127 ER, 630, *per* Lord Eldon.

<sup>84</sup> *Ibid*, at 321.

"To be interest in the preservation of a thing, is to be so circumstanced with respect to it as to have benefit from its existence, prejudice from its destruction. The property of a thing and the interest deviseable from it may be very different: of the first the price is generally the measure, but by interest in a thing every benefit and advantage arising out of or depending on such thing, may be considered as being as comprehended."<sup>85</sup>

Therefore, applying the notion of factual expectation test on this hypothesis, if the son could prove that he is so circumstanced with respect to the house as to have benefit from its existence, prejudice from its destruction, why could not he insure the house in his name, especially if he could prove his responsibility on looking after his father's friend according to the father's registered will and the fact that the son disclosed the position to the insurer at the stage of negotiation?

Furthermore, the principle of indemnity obliges the injured insured to show his loss when the risk insured against has actually occurred. Therefore, the insured will satisfy such a requirement where he shows his loss. In commercial activities, such a conclusion would be convenient due to its flexibility. Thus, the main role of the contract of insurance is to shift the risk from the insured to the insurer and that what the insured pays the premium for. Accordingly, in the above hypothesis, the friend is looked after by the son according to the father's will, consequently, the friend will not be able to reinstate the house where it is burnt down by an insured risk, i.e. fire and, therefore, the man will be homeless. If that is happened, the son is obligated either to

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<sup>85</sup> *Ibid*, at 301-2.

reinstate the house or provide another accommodation to the friend, which means that, the son has an economic interest in the friend's house. Therefore, since the son pays the premium to the insurer to shift such a risk to the latter, the insurer cannot deny, when the risk insured against has occurred, the insured son's claim on the ground of lack of insurable interest. It could be argued, therefore, that the requirement of insurable interest, herein, could be described as a contractual requirement which could be waived by the insurer. In addition, should the insurer claims, at the litigation, that he could reject the insured's claim for wanting of proof of interest, a Court could reject it on the ground that the insured has disclosed all the essential facts which allowed the insurer to reject the claim at the time of the negotiation stage.



#### 4.5. Lack of Insurable Interest under Saudi Law

The matter is not clear under Saudi law due to the fact that insurance cases are not acceptable by Saudi Courts on the basis that insurance does not comply with the *Sharia* general rules.<sup>86</sup> However, insurance disputes have been dealt with by Ministry of Commerce and Arbitration. Unfortunately, none of insurance cases that have been dealt with by these offices have been published. Furthermore, neither the Commercial Court Law 1931 nor the Co-operative Insurance Companies Control Law 2003 and its Implementing Regulations provide clear solutions in cases where insurable interest is lacking.

Therefore, it is assumed that lack of insurable interest would render an insurance contract void pursuant to the general practice of insurance disputes which will depend solely on views of various arbitrators or members who are appointed to resolve insurance disputes in the Saudi Ministry of Commerce who base their decisions on rules of foreign jurisdictions such as the UK.

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<sup>86</sup> See, generally, chapter six, *infra*.

## 4.6. General Comments

The principle of insurable interest is a fundamental element in the contract of insurance and it cannot be abolished for any reason because it lies at the center of insurance. The principle of indemnity does not trigger in the contract unless there is an insurable interest possessed by an insured. Therefore, it is submitted that the principle of insurable interest is likely to be of little significance due to the principle of indemnity. Lowry and Rawlings are of the view that, "the principle of indemnity, which prohibits recovery to those who cannot establish proof of loss, is in itself sufficient to render the requirement [of insurable interest] redundant."<sup>87</sup>

Professor Clarke presents other more traditional reasons for the requirement of insurable interest.<sup>88</sup> One reason is to stop people using insurance for gambling or wagering. In his opinion, using insurance for wagering is a thing of the past, but today there are "many more convenient devices available to the serious wagerer."<sup>89</sup> Another reason is that; "people with insurable interest are less likely to succumb to temptation to bring about the loss insured against."<sup>90</sup> He is of the view that a person who has a large debt might be tempted to insure other people's property and then burn it when he needs insurance money, but the same temptation will not be where the insured insures his own property. He justifies his view for some motives. Firstly, sentiment or the inconvenience of being deprived of the property will secure that a temptation of such

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<sup>87</sup> John Lowry and Philip Rawlings, "Re-thinking Insurable Interest", in Sarah Worthington, *Commercial Law and Commercial Practice*, (2004), 335, at p. 364.

<sup>88</sup> Malcolm Clarke, *The Law of Insurance Contracts*, (4<sup>th</sup> ed.), 2002, parag. 4-2.

<sup>89</sup> Malcolm Clarke, *Policies and Perceptions of Insurance Law in The Twenty-First Century*, (Oxford, 2005), at p. 36, cited from *Constitution Ins. Co. v Kosmopoulos* [1987] 1 SCR 2, 22, per Wilson J.

<sup>90</sup> *Ibid.*

kind is resisted.<sup>91</sup> Secondly, insurance on a property gives rise of 'moral hazard' which can be overrated where the countervailing factors of sentiment and inconvenience are ignored and the fact that insurers take long time to pay insurance money.<sup>92</sup> Apart from that, according to him, fraudulent claims can be discovered by skilled investigators and unlikely to succeed.<sup>93</sup>

It can be said that, insurers have many weapons which they use against their insureds to escape liability of making good their losses. Therefore, it seems that lack of insurable interest is the weakest weapon of insurers against their insureds. Clarke observes that, "in practice [insureds] will find it difficult to insure property of any value and in which they have no interest at all other than crime without falling foul of the rules about misrepresentation or non-disclosure. If they do insure it," he says, "and then burn it, they will find it impossible to obtain the insurance money without committing fraud."<sup>94</sup> Thus, even if a fraudulent claim is successful, insurers are too slow to pay and, then, the enjoyment of the insurance money "is spoiled by unwelcome attention of the policy."<sup>95</sup>

Consequently, Clarke is of the opinion that the requirement of insurable interest either in its strict sense, as the case under English law, or in its broad concept does not appear to serve its purpose. He thinks that people should be allowed to insure what ever they like.<sup>96</sup>

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<sup>91</sup> *Ibid*, at p. 37.

<sup>92</sup> *Ibid*. Professor Clarke criticizes the manner of modern insurers in Britain in paying their insureds insurance monies and he gives an example for that, "in late 2003 a leading insurer confessed at a conference that its offices took between 500 and 1,200 days to settle claims under £2,500."

<sup>93</sup> *Ibid*.

<sup>94</sup> *Ibid*.

<sup>95</sup> *Ibid*, at p. 38.

<sup>96</sup> *Ibid*.

The opinion of Professor Clarke that people should be at liberty to insure other people's property is, in my opinion, correct. The reason is that, so long as an insured could prove his loss at the time of the claim by any legal evidence, there is no reason why his insurer rejects the claim as long as the principle of indemnity is, in fact, satisfied. The main role of insurance, as it has been mentioned, is to shift the risk from the insured to the insurer whose duty is promise to compensate the insured in the event that the loss does occur.<sup>97</sup> If the insured proves his loss successfully about a property, it means he is economically interested in such property.

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<sup>97</sup> See section 3.2.2.2, *supra*.

## **PART TWO: INSURANCE UNDER** **ISLAMIC JURISPRUDENCE AND** **SAUDI REGULATIONS**

# **Chapter Five: Law of Contract** **under Saudi Legal System**

## **5.1. Introduction**

This chapter outlines the concept of contract under the Saudi legal system and underlines how Saudi law deals with the law of contract to find out how Saudi jurisdiction deals with insurance contracts generally. That will necessarily lead to explore three elements that make a contract or a transaction unlawful. Those are, namely, *Riba*, usury, *Gharar*, uncertainty and *Maysir*, gambling. However, it has to be noted that, chapter six will be devoted to discuss the position of the contract of insurance in the eyes of Islamic jurisprudence together with the position under the Saudi legal system. Furthermore, chapter six will examine whether the elements of *Riba*, *Gharar* and *Maysir* do, in fact, exist in the contract of insurance? If they do, to what extent?

Therefore, section 5.2 outlines the principles that the Saudi legal system is based upon. Section 5.3 summarises the influence of Islamic law upon Saudi law. Definition of contract in Islamic jurisprudence and how Saudi jurisdiction deals with it will be discussed in section 5.4. The latter section will also include discussions on the motives of invalidating a contract in *Sharia*. In particular, it will explore the elements

of *Riba*, usury, *Gharar*, uncertainty and *Maysir*, gambling. Concluding comments take place in section 5.5.

## 5.2. Saudi Legal System

Broadly speaking, Islamic Law, *Sharia*, is the sole source of the Saudi regulations. That is clearly indicated in the Saudi Basic Law 1992<sup>1</sup> which provides:

Article (1):

"The Kingdom of Saudi Arabia is a sovereign Arab Islamic state with Islam as its religion; God's Book and the *Sunnah* of His Prophet, God's prayers and peace be upon him, are its constitution, ..."

Article (7) provides:

"Government in Saudi Arabia derives power from the Holy Koran and the Prophet's tradition."

Article (48) states:

"The courts will apply the rules of the Islamic *Sharia* in the cases that are brought before them, in accordance with what is indicated in the Book (*Quran*) and the *Sunnah*, and statutes decreed by the Ruler which do not contradict the Book or the *Sunnah*."

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<sup>1</sup> Royal Order No. (A/91). 27/8/1412 H., 1/3/1992.



Having mentioned that Islamic Law is the basis and the sole source of Saudi Law, it is crucial, at this stage, to give a brief explanation about Islamic Law, *Sharia*, in order to understand how Saudi Law operates.

### 5.3. The Essential Framework of Islamic Law

Briefly, by way of background, it could be noted that, Islamic Law<sup>2</sup> consists of orders and prohibitions arising from the *Quran and Sunnah*. *Quran*<sup>3</sup> is the Islamic holy book and it includes rules and principles regulating, for instance, relationships between God "*Allah*" and a person, *Allah's servant*,<sup>4</sup> people with each other, and societies in general, relationships between people and their Governments and Muslims and non-Muslims, etc. *Sunnah* is the *Prophet Mohammad's*, peace be upon him, tradition, i.e. *Prophet Mohammad's*, peace be upon him, statements, actions and decisions. It explains, supplements and interprets the general principles of *Quran*. For instance, Muslims are obliged to pray and to pay *Zakat*<sup>5</sup> by the *Quran* as it provides:

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<sup>2</sup> In Arabic language it is called "*Sharia*" which is translated in English as Law. For more discussion on Islamic Law, see, for example, K. Faruki, *Islamic Jurisprudence*, (1962), p. 5; J. Nasir, *The Islamic Law of Personal Status*, 2<sup>nd</sup> ed., 19.

<sup>3</sup> It is spelt also "*Koran*", and defined as: "the sacred writings of Islam revealed by God to the prophet Muhammad during his life at Makkah and Medina. The Koran is the sacred book of the Muslims (sometimes called Mohammedans by non-Muslims, a term considered offensive by some Muslims). It is the most important foundation on which Islam rests and it is held in the highest veneration by all Islamic sects. When being read it must be kept on a stand elevated above the floor. No one may read it or touch it without first making a legal ablution. It is written in the Arabic language, and its style is considered a model. The substance of the Koran is held to be uncreated and eternal. Mohammed was merely the person to whom the work was revealed. At first the Koran was not written, but entirely committed to memory. But when a great many of the best Koran reciters had been killed in battle, Omar suggested to Abu-Bekr (the successor of Mohammed) that it should be written down. Abu-Bekr accordingly commanded Zeid, an amanuensis of the prophet, to commit it to writing. This was the authorized text until 23 years after the death of the prophet. A number of variant readings had, however, crept into use. By order of the calif Osman in the year 30 of the Hejira, Zeid and three assistants made a careful revision which was adopted as the standard, and all the other copies were ordered to be burned. The Koran consists of 114 suras or divisions. These are not numbered, but each one has a separate name. They are not arranged in historical order. These suras purport to be the addresses delivered by Mohammed during his career at Mecca and Medina. As a general rule the shorter suras, which contain the theology of Islam, belong to the Makkan period; while the longer ones, relating to social duties and relationships, to Medina. The Koran is largely drawn from Jewish and Christian sources, the former prevailing. Moses and Jesus are reckoned among the prophets. The biblical narratives are interwoven with rabbinical legends. The customs of the Jews are made to conform to those of the Arabians. Islamic theology consists in the study of the Koran and its commentaries. A very fine collection of Korans, including one in Cufic (the old Arabic character), is to be found in the Khedival Library at Cairo, Egypt." See, Online Dictionary website on, <http://onlinedictionary.datasegment.com/word/Quran>.

<sup>4</sup> That is worshipping of Allah by all manners such as praying, fasting *Ramadhan*, the holy month, and Paying *Zakat*, a specified sum of money in a particular time paid for a specified group of people.

<sup>5</sup> *Ibid*.

**([110] And perform As-Salat (prayer) and give Zakat and whatever of good (deeds that Allah loves) you send forth for yourselves before you, you shall find it with Allah. Certainly, Allah is All-Seer of what you do.)<sup>6</sup>**

But that are not described. *Sunnah*, however, describes the performance of praying, its conditions, its times, etc., and how and when should a Muslim pay *Zakat*.

Therefore, *Quran* and *Sunnah* are primary sources of Islamic Law which set out the general principles of Islamic Law, "*Sharia*". Furthermore, religious scholars are playing a significant role in interpreting and explaining those principles. An opinion of a scholar about an issue in respect of its legitimacy is called "*Fatwa*". The latter, analyses a new issue and identifies its principles, then, it compares them with the general principals of "*Sharia*". The scholar, thereafter, will be able to endeavour and make his opinion about the issue whether it is lawful, which is so called "*Halal*" or forbidden, which is so called "*Haram*" and that action is called "*Ijtihad*"<sup>7</sup>. There are two main doctrines in Islamic Law and they are, namely, *Sunni* and *Shi'ey*.<sup>8</sup>

Under *Sunni* doctrine there are different schools of law, namely, *Maliki*, *Hanafi*, *Shafiy* and *Hanbali*. In fact, an opinion about a case varies from one school to another and sometimes a view of a scholar on an issue differs from another in the same school of law, this difference is called "*Ikhtilaff*", bearing in mind that the difference is not about the principles, but about their interpretation and details. Furthermore, where scholars unanimously agree about a legitimacy of an issue in one period, it is called

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<sup>6</sup> Surat *Al-Bagarah*, I, verse 110.

<sup>7</sup> See, J. Nasir, *The Islamic Law of Personal Status*, 2<sup>nd</sup> ed., (1990), p. 3.

<sup>8</sup> The clearest example of a jurisdiction which adopts the *Sunni* doctrine is in Saudi Arabia, Egypt and Pakistan. However, Iran adopts the *Shi'ey* doctrine.

"*Ijmaa*" which constitutes law and will bind Muslims.<sup>9</sup> Additionally, Islamic scholars operate, usually, "*Qe'yas*", analogy, in order to compare and examine principles of a new issue with the general principles of *Sharia* to make a judgement whether the new issue is lawful under *Sharia* or not. Thus, *Ijmaa* and *Qe'yas* constitute secondary sources of Islamic law.

In fact, most Islamic countries adopt the *Sunni* doctrine. Nevertheless, these countries follow different schools of law. For example, *Maliki* school is followed by Kuwait and Algeria, *Hanafi* school is followed by Egypt and Sudan, *Shafiy* school is followed by Yemen. Saudi Arabia, however, follows the *Hanbali* school.

Judges, nevertheless, refer to *fatwas* about a case to explain its issues, especially, if the issue is new, such as insurance, and sometimes a judge finds several *fatwas* about a certain question and, of course, he has to make his judgment about it. Under such circumstances, he usually evaluates the *fatwas*, according to the school of law he belongs to, and justifies his decision once he makes his judgment.

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<sup>9</sup> J. Nasir, *The Islamic Law of Personal Status*, 2<sup>nd</sup> ed., (1990), at p. 22.

## 5.4. The Concept of Contract in Saudi Law

Generally, there is no a precise regulation in Saudi law deals particularly with the law of contract. However, understanding the concept of contract is derived from the general understanding of contract by the orthodox Islamic jurisprudence. In fact, "The *Sharia* textbooks do not set out general principle of contract law, but instead detail the rules relating to a number of specific contracts, such as sale, hire, and loan agreements."<sup>10</sup> Bearing in mind that, Islamic *Sharia* does not strictly nominate certain contracts to be lawful, but it obligates parties to avoid unlawful gaining of profits by complying with its general rules and avoiding particular forbidden elements.

Islamic *Sharia*, therefore, permits Muslims to conclude what ever contracts they desire according to their interests as long as those contracts do not contain any element that infringes *Sharia* principles. In addition, parties, under *Sharia* principles, are obligated to fulfill their duties that are arisen from their contracts. That is attributable to the general obligation in the *Quran*. Allah, glory to Him, said,

**(O you who believe! Fulfil (your) obligations)<sup>11</sup>**

Thus, in order to make lawful transactions, such transactions must be freed from illegal elements such as, for instance, *riba*, usury, *gharar*, uncertainty and *maysir*, gambling. The general principle in *Sharia* is that a person must not eat unlawfully other people's money. Allah, glory to Him, said,

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<sup>10</sup> Anderson Haberbeck and Mark Galloway, *Saudi Shipping Law*, (Surrey: Fairplay Publications, 1990), at pp. 9, 10.

<sup>11</sup>

**(O you who believe! eat not up your property among yourselves in vanities: but let there be amongst you traffic and trade by mutual goodwill: nor kill (or destroy) yourselves: for verily Allah hath been to you Most Merciful!).<sup>12</sup>**

As far as the definition of contract is concerned, Muslim jurists describe a bilateral agreement, such as a sale contract, and a unilateral act, such as a will, as *Aqd* (pl. *Uqud*), which means contract.<sup>13</sup> As a matter of fact, most of Muslim jurists define contract as "the obligation of an offer given by one party to the acceptance given by the other party, in a way where its legal effect is expressed on the thing contracted upon."<sup>14</sup> Or, contract is "a binding or a connection between the offer and the acceptance which fulfills certain criteria so that it has a legal effect."<sup>15</sup>

Baharum drew a comparison between English and Islamic laws regarding the concept of contract and he deduced that, "in comparison with English law, the Islamic concept of contract is wider. Under English law," he said, "a contract will not be valid unless it is concluded with at least two essential elements present: agreement of the

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<sup>12</sup> An-Nessa, 4, verse 29. See, M. Al-Hilali & M. Khan, *Translation of the meaning of THE NOBLE QURAN*, (1417 A.H, 1996-1997), at p. 310.

<sup>13</sup> Fadi Moghaizel, *Insurance in the Light of Islamic Legal Principles*, (PhD Thesis, School of Oriental and African Studies, University of London, 1990), pp. 119-120. The author observed that, "Unlike Western system of law, the *Sharia* does not contain a general law of contract. Each contract is studied separately in the classical texts without the elaboration of a general theory applicable to all contracts. It is modern authors who have deduced from the rules which are common to various Islamic contracts a numbers of general principles in an attempt to build a comprehensive Islamic theory of contracts and obligations."

<sup>14</sup> Salih A. Al-Kuhaimi, *Contract Law and Judicial Law in Saudi Arabia*, (PhD Thesis, School of Oriental and African Studies, University of London, 1982), p. 162.

<sup>15</sup> *Ibid*, at p. 163.

parties, and consideration. In Islamic law, by contrast, a contract may exist without the agreement of the other."<sup>16</sup>

As for regulating contracts in Saudi Arabia, Saudi authorities cannot, in principle, codify or enforce rules that are described as being against the general *Sharia* principles. Therefore, Saudi government, for example, could not enforce Saudi people on buying motor insurance at the time that Saudi eminent Muslim scholars were of the opinion that insurance was repugnant to *Sharia*.<sup>17</sup> However, when the scholars decided that cooperative insurance does comply with the general rules of *Sharia*, the Saudi government enforced third party insurance and health insurance and presented them as cooperative insurances.<sup>18</sup> Nevertheless, there is no evidence that cooperative insurance is, in fact, practiced. Instead, conventional or commercial insurance is the type of insurances that is actually adopted.

Therefore the government passed the Cooperative Insurance Companies Control Law 2003 and its implementation regulations as well as the National Cooperative Health Insurance Law 1999<sup>19</sup> and its implementation regulations,<sup>20</sup> which regulate the Saudi insurance market.

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<sup>16</sup> Mohammad Ali Haji Baharum, *Misrepresentation: A Study of English and Islamic Contract Law*, (PhD Thesis, University of Essex, 1986), p. 32.

<sup>17</sup> Decision No. (10/5), 4/4/1397 A.H., 25/3/1977, Researches of the Board of Great Ulama in Saudi Arabia, *At-Tameen (Insurance)*, Vol. 4, (2001), 35, at p. 307. For further details on the status of insurance under Islamic jurisprudence and Saudi law, see chapter six, *infra*.

<sup>18</sup> The enforcement of third party insurance (or driving license insurance) took a place on 15 Ramadan 1423 H., 19 December 2002. Note that, both of motor and health insurances have been presented as cooperative insurances.

<sup>19</sup> Royal Decree No. (M/10) 1/5/1420 H., 11/9/1999.

<sup>20</sup> Ministerial resolution No. D/23/460 on 27/03/1423 H., 08/07/2002.

#### **5.4.1. Invalidity of Contract**

A contract will be invalid in Saudi law where it is rejected by the general rules of Islamic *Sharia*. Thus, where the subject-matter of the contract is forbidden under *Sharia*, the contract is void under Saudi law. Accordingly, the sale of pork or alcohol is void under Saudi law because they are both forbidden under *Sharia*. Consequently, the Saudi courts refuse to deal with a contract that its subject-matter is, in fact, forbidden under Islamic law.

Furthermore, where a contract contains *Riba*, usury, a serious degree of *Gharar*, uncertainty or *Maysir*, gambling, such a contract will be void. Therefore, it is of significance, at this stage, to explore these three elements.

#### **5.4.2. Riba**

The element of *Riba* has been forbidden by the primary source of *Sharia*, i.e. *Quran* and *Sunnah*. Therefore, it is interesting to tackle the authority that forbids *Riba* and, then, explore the notion of *Riba*.



#### **5.4.2.1. Prohibition of Riba**

Generally speaking, *riba* is forbidden in *Quran* and *Sunnah*.

Firstly, *Allah*, glory to Him, forbids *riba* in *Quran* in several occasions:

1- *Allah*, glory to Him, said in *Surrat Ar-Rum* (No. 30, V. 39):

**(And that which you give in gift (to others), in order that it may increase (your wealth by expecting to get a better one in return) from other people's property, has no increase with Allah; but that which you give in Zakat seeking Allah's countenance, then those they shall have manifold increase).<sup>21</sup>**

2- *Allah*, glory to Him, said in *Surrat Al- Baqarah* (No. 2, V. 275, 276, 278 and 279):

**([275] Those who eat *Riba* (usury) will not stand (one the Day of Resurrection) except like the standing of a person beaten by *Shaitan* (Satan) leading him to insanity. That is because they say: "Trading is only like *Riba* (usury)," whereas Allah has permitted trading and forbidden *Riba* (usury). So whosoever receives an admonition from his Lord and stops eating *Riba* (usury) shall not be punished for the past; his case is for Allah (to judge); but whoever returns [to *Riba* (usury)], such are the dwellers of the Fire they will abide therein.**

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<sup>21</sup> M. Al-Hilali & M. Khan, *Translation of the meaning of THE NOBLE QURAN*, (1417 A.H), (1996-1997), p. 545.

**[276] Allah will destroy *Riba* (usury) and will give increase for *Sadaqat* (deeds of charity, alms, etc.) And Allah likes not the disbelievers, sinners.**

**[278] O you who believe! Be afraid of Allah and give up what remains (due to you) from *Riba* (usury) (from now onward), if you are (really) believers.**

**[279] And if you do not do it, then take a notice of war from Allah and His Messenger but if you repent, you shall have your capital sums. Deal not unjustly (by asking more than your capital sums), and you shall not be dealt with unjustly (by receiving less than your capital sums.)<sup>22</sup>**

3- *Allah*, glory to Him, said in *Surrat Al-Imran* (No. 3, V. 130)

**(O you who believe! Eat not *Riba* (usury) doubled and multiplied, but fear Allah that you may be successful.)<sup>23</sup>**

4- *Allah*, glory to Him, said in *Surrat An-Nisa* (No. 4, V. 161)

**([160] For the wrong-doing of the Jews, We made unlawful for them certain good foods which had been lawful for them and for their hindering many from Allah's Way; [161] And their taking of *Riba* (usury) thought they were forbidden from taking it and their devouring of men's substance wrongfully (bribery). And We have prepared for the disbelievers among them a painful torment.)<sup>24</sup>**

Secondly, *Riba* has been forbidden in *Sunnah* by Prophet Mohammad, may peace be upon him. The following *Hadiths* are some of what was narrated about him.

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<sup>22</sup> *Ibid*, pp. 62, 63.

<sup>23</sup> *Ibid*, p. 92.

<sup>24</sup> *Ibid*, p. 137.

1- Narrated Abu Saeed Al-Khudri: Once Bilal (one of the Prophet's companions) brought *Barni* (a kind of) dates to the Prophet, peace be upon him, and the Prophet asked him, "From where have you brought these?" Bilal replied, "I had some inferior kind of dates and exchanged two *Sa* (measure) of it for one *Sa* of *Barni* dates, in order to give it to the Prophet to eat." Thereupon the Prophet said, "Beware! Beware! This is definitely *Riba* (usury)! This is definitely *Riba*! Do not do so, but if you want to buy (a superior kind of dates) sell the inferior kind of dates for money and then, buy the superior kind of dates with that money."<sup>25</sup>

2- Narrated Abu Hurairah: The prophet, peace be upon him, said, "Avoid the seven great destructive sins." The people enquired, "O Allah's Messenger! What are they?" He said, "(1) To join others in worship along with Allah, (2) to practice sorcery, (3) to kill a person which Allah has forbidden except for a just cause (according to Islamic law), (4) to eat up *Riba* (usury), (5) to eat up an orphan's wealth, (6) to show one's back to the enemy and fleeing from the battlefield at the time of fighting, (7) and to accuse chaste woman, who never even think of anything touching their chastity and are true believers."<sup>26</sup>

3- Narrated Abu Saeed Al-Khudri: The prophet, peace be upon him, said, "Gold for gold, silver for silver, barley for barley, dates for dates, salt for salt, like for like, may be exchanged in such manner that they are equal measure for measure payment being

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<sup>25</sup> *Ibid*, footnote (2b), p. 63, (*Sahih Al-Bukhari*, Vol.3, Hadith No. 506).

<sup>26</sup> *Ibid*, footnote (1b), p. 92. (*Sahih Al-Bukhari*, Vol.4, Hadith No. 28).

made from hand to hand. If any one gives more or asks for more he has dealt in Riba. The receiver and the giver are equally guilty."<sup>27</sup>

Thirdly, Saudi law prohibits usury. For example, article (2) of the Saudi Arabian Monetary Agency Law states that,

"The Saudi Arabian Monetary Agency shall not pay nor receive interest, but it shall only charge certain fees on services rendered to the public and to the Government, in order to cover the Agency's expenditures. Such fees shall be charged in accordance with a regulation passed by the Board of Directors and approved by the Minister of Finance.

The Agency shall not have a capital and shall, therefore, repay to the Government its entire capital."<sup>28</sup>

#### **5.4.2.2. Definition of Riba**

*Riba* is usually translated in English as "usury" or "interest". Saleh, however, observes that, *riba* in its Islamic context has broader sense.<sup>29</sup> He defines it as,

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<sup>27</sup> Mohammad ibn Issa Al-Titmithi, *Sunan Al-Tirmithi*, Vol. 3, (Maktabat Mustafa Al-Halabi, Cairo-Egypt), (1956), p. 541; in Sherif Madi M. Madi, *The Concept of Unlawful Gain and Legitimate Profit in Islamic Law*, (PhD Thesis, School of Oriental and African Studies, University of London), (1989), at p. 96.

<sup>28</sup> Royal Decree No. 23, 23/5/1977 H., 15/12/1957. See, also, Article (6) of Commercial Instruments Law, Royal Decree No. M/37, 11/10/1383, 25/2/1964. The article renders any stipulation on an interest in a commercial instrument null and void. It provides that: "A provision in the bill of exchange for payment of interest shall be null and void."

"unlawful gain derived from the quantitative inequality of the counter-values in any transaction purporting to effect the exchange of two or more species..., which belong to the same genus...and are governed by the same efficient cause... Deferred completion of the exchange of such species, or even of species which belong to different genera but are governed by the same ...efficient cause is also *riba*, whether or not the deferment is accompanied by an increase in any one of the exchanged counter-values."<sup>30</sup>

Accordingly, there are two categories of *riba*, namely, *rida Al-Fadhil* that is manifested in the unlawful excess of one of the counter-values, and *riba An-Nase'ah* that is manifested in delaying completion of the exchange of the counter-values with or without a profit or an increase.<sup>31</sup> *Riba* is also described as, "any unjustified increase of capital, whether in loans or sales, for which no equal compensation or return is given."<sup>32</sup>

#### 5.4.3. *Gharar*

The element of *Gharar* has been a significant issue in Islamic jurisprudence which affects the validity of onerous contracts. *Sharia* principles aim to achieve fare

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<sup>29</sup> See also, Sami Tamer, *The Islamic Financial System*, Economics and Management, Series V, (2005), p. 33. Tamer translates *Riba* as "unlawful gain"; at footnote 49, p. 33; Sherif Madi M. Madi, *The Concept of Unlawful Gain and Legitimate Profit in Islamic Law*, (PhD Thesis, School of Oriental and African Studies, University of London), (1989), at p. 85.

<sup>30</sup> Nabil A. Saleh, *Unlawful Gain and Legitimate Profit in Islamic Law*, 2<sup>nd</sup> ed., (1992), p. 16.

<sup>31</sup> *Ibid.* The basic form of *riba* is *riba Al-Jahilleyah* or the pre-Islamic *riba* which appears in that where a lender asks his debtor at the due time of the payment of the debt whether he would pay or delay the payment with a particular increase of the debt. See, Nabil A. Saleh, *ibid*, at p. 17; Sherif Madi M. Madi, *The Concept of Unlawful Gain and Legitimate Profit in Islamic Law*, (PhD Thesis, School of Oriental and African Studies, University of London), (1989), at p.88; Aly Khorshid, *Islamic Insurance*, (2004), p. 38. The author explains both kinds of *riba* as that *riba Al-Fadhil* occurs when goods of similar kinds are exchanged with a disparity between them. *Rib An-Nai'ah* appears when there is a delay in performance.

<sup>32</sup> Sherif Madi M. Madi, *ibid*, at p. 85.

equivalence between parties in a transaction in order to avoid any dispute, as much as possible, that might be arisen by one of the parties. Therefore, it is important, at this stage, to go through *Sharia* authority in relation to forbidding Gharar in contracts and, then, explore Gharar as a concept.

#### **5.4.3.1. Prohibition of Gharar**

##### **1- *Quran***

Unlike the element of Riba, Gharar is not nominated in Quran, but the general prohibition of the element of Gharar could be derived from the following verse,

*Allah*, glory to Him, said,

**(O you who believe! eat not up your property among yourselves in vanities: but let there be amongst you traffic and trade by mutual good-will: nor kill (or destroy) yourselves: for verily Allah hath been to you Most Merciful!).<sup>33</sup>**

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<sup>33</sup> An-Nessa, 4, verse 29. See, M. Al-Hilali & M. Khan, *Translation of the meaning of THE NOBLE QURAN*, (1417 A.H), (1996-1997), at p. 310.

## 2- *Sunnah*

There are many *Hadiths* that have forbidden Gharar and some transactions that contain the element of Gharar.<sup>34</sup> For example,

A- "Abu Huraira (Allah be pleased with him) reported that Allah's Messenger (may peace be upon him) forbade (two types of transactions) *Mulamasa* and *Munabadha*."<sup>35</sup>

B- "Abu Huraira (Allah be pleased with him) reported that Allah's Messenger (may peace be upon him) forbade a transaction determined by throwing stones, and the type which involves some uncertainty."<sup>36</sup>

C- "Ibn Abbas (Allah be pleased with them) reported Allah's Messenger (may peace upon him) as saying: He who buys food-grain should not sell it until he has taken possession of it."<sup>37</sup>

D- "Jabir Ibn Abdullah (Allah be pleased with them) is reported to have said that Allah messenger (may peace be upon him) forbade the sale of a heap of dates the weight of which is unknown in accordance with the known weight dates."<sup>38</sup>

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<sup>34</sup> See, Imam Ahmad Ibn Ali Al-Asqalani, *Fatih Al-Bari Sharh Sahih Al-Bukhari*, Vol. 4, (Dar As-Salam, Riyadh-Saudi Arabia), (2000), pp. 450-55; Imam Shihab Ad-Deen Al-Qistalani, *Irshad As-Sari Sharh Sahih Al-Bukhari*, Vol. 5, (Dar Al-Kutub Al-A'alamiyah, Beirut-Lebanon), (1996), pp. 108-112.

<sup>35</sup> Imam Muslim, *Sahih Muslim*, Vol. III, No. (3608), (Ashraf Printing Press, Pakistan, 1987), p. 797; see footnote 1970 & 1971, "*Mulamasa* means that a man touch another's garment of cloth or anything else without turning it over. *Munabadha* means that man throws his cloth to another, and the other throws his cloth to the first, thus confirming their contract without inspection or mutual agreement."

<sup>36</sup> *Ibid*, No. (3614), at p. 798. Transactions by throwing stones were during pre-Islamic period where one of the parties either the seller or the buyer throw a stone to items and any item that is touched by the stone would be taken by the buyer and, therefore, the transaction would be binding.

<sup>37</sup> *Ibid*, No. (3640), at p. 801.

E- "Ibn Umar (Allah be pleased with them) reported that Allah's Messenger (may peace be upon him) forbade the sale of fruits until they were clearly in good condition; he forbade it both to the seller and to the buyer."<sup>39</sup>

#### 5.4.3.2. Definition of Gharar

Gharar is a difficult concept to be identified due to the fact that the concept includes more than one meaning; it includes risk, peril, uncertainty, speculation, want of knowledge and unknown outcome or results.<sup>40</sup> Furthermore, each Sharia school of law has a different interpretation about the scope of the concept of Gharar, but there is no disagreement between them about the prohibition of Gharar in onerous contracts in a certain degree.

The Hanbali school of legal scholarship describes Gharar as the unknown outcome<sup>41</sup> or a subject-matter that is not being able to be handed over whether it exists or it does not,<sup>42</sup> it is the subject-matter that is unknown whether it will happen or not, or where

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<sup>38</sup> *Ibid*, No. (3654), p. 803.

<sup>39</sup> *Ibid*, No. (3665), p. 805

<sup>40</sup> Nabil A. Saleh, *Unlawful Gain and Legitimate Profit in Islamic Law*, 2<sup>nd</sup> ed., (1992), p. 63; Sami Tamer, *The Islamic Financial System*, Economics and Management, Series V, (2005), p. 115; Aly Khorshid, *Islamic Insurance*, (2004), p. 39; Sherif Madi M. Madi, *The Concept of Unlawful Gain and Legitimate Profit in Islamic Law*, (PhD Thesis, School of Oriental and African Studies, University of London, 1989), at p. 159; Al-Dhareer observes that it has been difficult to find a word in other legal systems provides the same meaning of Gharar under Sharia. See, As-Seddeeg M. Al-Dhereer, *Al-Gharar wa Atharaho fe Al-Uqood fe Al-Fiqh Al-Islami*, (Arabic), Uncertainty and its Effect Contracts in Islamic Jurisprudence, (1967), p. 47.

<sup>41</sup> Imam Ahmad Ibn Abdul Halim Ibn Taymiyyah, *Majmu'a Al-Fatawa*, Vol. 29, (Dar Al-Kutub Al-A'alamiyah, Beirut-Lebanon), (2000), p. 13.

<sup>42</sup> As-Seddeeg M. Al-Dhereer, *supra*, pp. 31, 32. The Hanafi school of law describes Gharar as the suspicion about the existence of the subject-matter; *ibid*, p. 28. The Maliki school of law describe Gharar as the unknown existence of a thing that its character is unknown; *ibid*, p. 29. The Shafiy school



its measure or quantity is unknown.<sup>43</sup> Muslim jurists have presented numerous examples in some sale contracts that contain the element of Gharar. For example, it is Gharar where a vendor sells fish in the sea or a free bird in the air or a fetus of an animal in its mother womb and, therefore, such transactions are illegal and any contract is concluded thereupon is void.<sup>44</sup> Thus, Khorshid observes that, "Gharar... resides in the uncertainty affecting the occurrence of the contract or of the obligations under it. This is to be seen as separate from *juhalah*-<sup>45</sup> ignorance or uncertainty as to the outcome of the contract. The concept of *juhalah*, means that the commodity or the price to be paid is unknown, whereas in the case of Gharar the contract and the obligations of the parties under it are certain to take place but one of the elements of the contract is not defined."<sup>46</sup>

However, some jurists do not distinguish between Gharar and *jahalah*. Instead, they treat Gharar and *jahalah* as one thing.<sup>47</sup> Al-Dhereer argues that the concept of Gharar is wider than the concept of *jahalah*, unknown subject-matter, that every unknown commodity is Gharar, but not every Gharar is unknown. In other words, Gharar could exist without being unknown, as, for example, selling a stray animal; here the animal could exist and be well defined, but the vendor cannot hand it over to the purchaser.<sup>48</sup>

It can be said that, according to Al-Dhareer, Gharar is where the existence of the

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of law describes it as the risk or the unknown result; *ibid*, p. 30. See, Aly Khorshid, *Islamic Insurance*, (2004), p. 39; Hussain Hamid Hassan, *Hukom Ash-Sharia Al-Islamiyah fi Uqood At-Tameen*, (Arabic), The Judgment of Islamic Sharia in Insurance Contracts, undated, pp. 449-454.

<sup>43</sup> Imam Shams Ad-Deen Mohammad Ibn Qayyim Al-Jawziyah, *Zad Al-Ma'ad*, Vol. 5, (Dar Al-Kutub Al-A'lamiyah, Beirut-Lebanon), (1998), p. 436. See, also, Mohammad Ibn Idris Ash-Shafei, *Al-Umm*, Vol. 6, (Dar Qutaybah), (1996), pp. 214-15.

<sup>44</sup> Sherif Madi M. Madi, *The Concept of Unlawful Gain and Legitimate Profit in Islamic Law*, (PhD Thesis, School of Oriental and African Studies, University of London), (1989), at p. 164.

<sup>45</sup> It is spelt as *Jahalah*.

<sup>46</sup> Aly Khorshid, *Islamic Insurance*, (2004), p. 39.

<sup>47</sup> Sulaiman Al-Thunayan, *At-Tameen wa Ahkamuh*, (Arabic), Insurance and its Rules, (Dar Ibn Hazim, Beirut-Lebanon), (2003), footnote (1), p. 230; As-Seddeeg M. Al-Dhereer, *Al-Gharar wa Atharaho fe Al-Uqood fe Al-Fiqh Al-Islami*, (Arabic), Uncertainty and its Effect Contracts in Islamic Jurisprudence, (1967), p. 39.

<sup>48</sup> *Ibid*, p. 39.

subject-matter is unknown even if it is well defined, whereas the element of *jahalah* is where the subject-matter does exist but its features are unknown, as, for example, where a person buys a house for a certain price but without knowing its features and whether it is suitable to be a dwelling-house.

The Hanbali jurists Ibn Taymiyyah and Ibn Al-Qayyim, considered Gharar as gambling;<sup>49</sup> that where a vendor sells a stray animal, the transaction is on risk and, therefore, the purchaser would pay much less than its real price. Accordingly, should the subject-matter of the contract, i.e. the stray animal is found, the purchaser wins the difference between the paid price and the real price of the animal. On the other hand, where the animal is not found, the vendor wins, surely, the reduced price for nothing and the purchaser loses what he has paid the vendor. Thus, in the latter transaction one party unlawfully eats the other party's money which causes enmity and hatred.

#### **5.4.4. *Maysir***

The element of *Maysir*, gambling, has been forbidden by *Quran* and *Sunnah*. The principle element in gambling is that it contains an excessive degree of *gharar*, uncertainty, and risk. That, to win a stake, both parties depend solely on luck and none of them knows whether will win or lose. However, one of the parties will win whereas the other party will lose, usually but not necessarily, sum of money.

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<sup>49</sup> Imam Ahmad Ibn Abdul Halim Ibn Taymiyyah, *Majmu'a Al-Fatawa*, Vol. 29, Dar Al-Kutub Al-A'alamiyah, Beirut-Lebanon), (2000), p. 13; Imam Shams Ad-Deen Mohammad Ibn Qayyim Al-Jawziyah, *Zad Al-Ma'ad*, Vol. 5, (Dar Al-Kutub Al-A'alamiyah, Beirut-Lebanon), (1998), p. 439.

#### **5.4.4.1. Prohibition of Maysir**

##### **1- Quran**

Allah, glory to Him, said in *Surrat Al-Ma'idah* (No. 5, vv. 90, 91),

**([90] O you who believe! Intoxicants (all kinds of alcoholic drinks), and gambling, and *Al-Ansab*,<sup>50</sup> and *Al-Azlam* (arrows for seeking luck or decision) are an abomination of *Shaitan*, (Satan) handiwork. So avoid (strictly all) that (abomination) in order that you may be successful.**

**[91] *Shaitan* (Satan) wants only to excite enmity and hatred between you with intoxicants (alcoholic drinks) and gambling, and hinder you from the remembrance of Allah and from As-Salat (the prayer). So, will you not then abstain?).<sup>51</sup>**

Ibn Kathir, a Muslim *Quran* commentator, interpreted these verses that, "Allah forbids His believing servants from consuming *Khamr* (Intoxicants) and *Maysir* (Gambling) which is gambling. Ibn Abi Hatim recorded that `Ali bin Abi Talib, the Leader of the Faithful, said that chess is a type of gambling. Ibn Abi Hatim recorded that `Ata', Mujahid and Tawus, or, two of them, said that every type of gambling, including children's playing with (a certain type of) nuts, is *Maysir*. Ibn `Umar said

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<sup>50</sup> Al-Ansab were altar stones, in whose vicinity sacrifices were offered (during the time of Jahiliyyah).

<sup>51</sup> M. Al-Hilali & M. Khan, *Translation of the meaning of THE NOBLE QURAN*, (1417 A.H), (1996-1997).

that *Al-Maysir* means gambling, and this is the same statement that Ad-Dahhak reported from Ibn `Abbas, who added, "They used to gamble during the time of *Jahiliyyah*, until Islam came. Allah then forbade them from this evil behavior."<sup>52</sup>

Allah, glory to Him, also said,

**(They ask you (O Muhammad, may peace be upon him) concerning alcoholic drink and gambling. Say: "In them is a great sin, and (some) benefits for men, but the sin of them is greater than their benefit." ...).**<sup>53</sup>

## **2- Sunnah**

Narrated Abu Hurairah: Allah's Messenger, may peace be upon him, said:

"Whoever takes an oath in which he (forgetfully), mentions *Lat* and *Uzza* (i.e. two idols of Arab pagans) should say: "*La illah illallah*" (none has the right to be worshipped but Allah), and whoever says to his companion, 'Come along let us gamble,' must give alms (as an expiation)."<sup>54</sup>

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<sup>52</sup> See, <http://www.theholybook.org/en/a.46197.html>.

<sup>53</sup> Al-Baqarah, 2, verse 219, M. Al-Hilali & M. Khan, *Translation of the meaning of THE NOBLE QURAN*, (1417 A.H, 1996-1997), p. 46.

<sup>54</sup> Sahih Al-Bukhari, Vol. 6, No. 383, ibid, FN. 4.

#### 5.4.4.2. Definition of Maysir

Muslim jurists use terms *Maysir* or *Quimar* to refer to gambling.<sup>55</sup> *Qimar* is where someone wins a property or money from someone else depending on a chance or a contingent event. Al-Sanhuri defined gambling as a contract where a gambler undertakes to pay money or anything else that is agreed upon to another in the case that he loses the gambling.<sup>56</sup> *Rehan*, wagering, is a kind of *Maysir*, that where one wagerer undertakes to pay to another, usually but not necessarily, a sum of money should an uncertain event occurs. Thus, Al-Sanhuri describes *Rehan*, wagering is a contract between two wagerers, that if the event occurs, one of the wagerers loses whereas the other wins. In contrast, where the event does not occur, the wagerer wins while the other wagerer loses.<sup>57</sup>

Muslim scholars describe gambling as a danger that threatens Muslim societies. According to Madi, the reason behind prohibiting gambling in Islamic *Sharia* is that, "it can harm society, especially the needy, and because it may provide income without work. There is always a winner and a loser in gambling. For the loser there may be a stressful feeling of regret and frustration. Hence, the total prohibition of games of chance and lotteries and all services relating to evil work in Muslim society."<sup>58</sup>

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<sup>55</sup> For general definition of gambling, see, Researches of the Board of Great Ulama in Saudi Arabia, *At-Tameen (Insurance)*, Vol. 4, (2001), 35, at p. 116. Sulaiman Al-Thunayan, *At-Tameen wa Ahkamuh*, (Arabic), Insurance and its Rules, (Dar Ibn Hazim, Beirut-Lebanon), (2003), p. 223.

<sup>56</sup> Mustafa Mohammad Al-Faqi, Abdul Rrazag Al-Sanhuri, *Al-Waseet fi Sharh Al-Qanoon Al-Madani*, (in Arabic), Al-Waseet in Explanation of the Civil Law, part 7, Vol. 2, 2<sup>nd</sup> ed., (Dar An-Nahdhah Al-Arabiyyah Cairo-Egypt), (1990), p. 1257.

<sup>57</sup> *Ibid.*

<sup>58</sup> Sherif Madi Muhammad Madi, *The Concept of Unlawful Gain and Legitimate Profit in Islamic Law*, (PhD Thesis, School of Oriental and African Studies, University of London, 1989), at p. 183.

Shaikh Yusuf Al-Qaradawi remarked that, "Gambling has its own compulsions, the loser plays again in the hope of winning the next game in order to regain his earlier losses while the winner plays to enjoy the pleasure of winning impelled by greed for more... This habit consumes gamblers' time and energy, making them non-productive idlers and parasites in society, who take, but do not give, who consume, but do not produce. Moreover, due to his absorption in gambling, the gambler neglects his obligations towards his community. It often happens that a gambling addict sells his honor, religion and even his country for the sake of the gambling table, since his devotion to the table dulls his sense of values and kills all other devotions."<sup>59</sup>

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<sup>59</sup> Yusuf Al-Qaradawi, *Al-Halal wa Al-Haram fi Al-Islam*, (Arabic), The Lawful and the Prohibited in Islam, (Shorouk Interenational, UK, 1985), p. 305, cited in, Sherif Madi, *ibid*, pp. 183-184.

## 5.5. General Comments

This chapter is an introduction for understanding the law of contract under Islamic law together with Saudi law in order to understand the reason behind the rejection of the conventional insurance contract by the majority of contemporary Muslim scholars.

Therefore, in the light of the above discussions, it is the purpose of this study to examine the contract of insurance under Islamic jurisprudence to highlight the position of the contract of insurance under Saudi law. In addition, it is the aim of this study to find out whether the contract of insurance contains the elements of *Riba*, *Gharar* and *Maysir* and it should be, therefore, rejected in both *Sharia* and Saudi law. Thus, it will be appropriate to discuss these issues within the next chapter.

## **Chapter Six: The Contract of Insurance** **under Islamic Law (*Sharia*)**

### **6.1. Introduction**

This chapter will explore the legitimacy of insurance contracts under *Sharia*. It seeks to answer a significant question: why do the majority of Islamic scholars claim that insurance is repugnant to *Sharia*? This chapter will, therefore, survey the main motives for not accepting commercial insurance, the original form of insurance or the conventional insurance, i.e. *Riba*, usury, *Gharar*, uncertainty and *Maysir*, gambling. Nevertheless, it must be noted that the notions of *Riba*, *Gharar* and *Maysir* have been dealt with by Islamic jurisprudence in great detail. This chapter will deal with these three notions inasmuch as they relate to the contract of insurance.

It will, also, explore a suggested form of insurance, as a substitute for conventional insurance, i.e. cooperative insurance, that has been suggested by some contemporary Muslim jurists and has enjoyed a general approval by the Board of Great Ulama in Saudi Arabia.<sup>1</sup> However, it is important to survey the issue of "subject matter of the contract of insurance" to discover how the element of *Gharar* goes to the root of the contract of insurance and influence its validity.

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<sup>1</sup> The Board of Great Ulama contains great Islamic jurists in Saudi Arabia which has its power and influence upon Saudi policy, society and commercial activities by viewing its *fatwas*. The members of the board are appointed by the Saudi government.



Thus, section 6.2, below, will discuss the issue of the subject-matter of the contract of insurance. Section 6.3 will explore the doctrine of cooperative insurance. Whether it is a workable form of insurance is tested in section 6.3.1. In addition, the legality of the conventional insurance and the motives for rejecting this form of insurance by the majority of Muslim scholars is surveyed in section 6.3.2. The argument surrounding the legality of the contract of insurance is discussed in section 6.3.3. Section 6.4 will explore the position of insurance contracts under Saudi jurisdiction and how insurance disputes have been resolved. Finally, section 6.5 contains concluding comments.

## 6.2. The Subject-matter of The Contract of Insurance

It must be stressed that the issue is whether it is possible to identify the object of the contract of insurance. In other words, it must be discovered what an insured is paying a premium for. Broadly speaking, the insured is paying the premium to be insured or to be indemnified by his insurer or to protect himself against certain risks. Thus, it is of significance to find out what exactly is the insured buying from the insurer? It must be distinguished, however, from the issue of "the subject matter insured."

Braham Atallah observes that, there has been a disagreement between legal jurists about identifying the subject-matter of the contract of insurance.<sup>2</sup> Some legal jurists claim that the subject-matter of the contract is the object that is exposed to an insured risk, in other words, it is the subject-matter insured. Accordingly, the subject-matter of the contract in life insurance would be the person who insures his life; in fire insurance on a house the subject-matter would be the house; as for liability insurance the subject-matter is the liability of the insured.<sup>3</sup> Some others are of the opinion that the subject-matter of the contract of insurance is the risk insured against. According to As-Sanhuri, for instance, there are three elements in the contract of insurance; there are, namely, the risk, the premium and the insurance money. He claimed that, the premium is the subject-matter of the insured's duty; the insurance money is the subject-matter of the insurer. The risk, however, is the principle subject-matter of the contract of insurance because it is the subject-matter of the duty of the insured and the

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<sup>2</sup> Braham Mohammad Atallah, *At-Tameen*, (Arabic), Insurance, (Al-Thaqafiyah Al-Jami'iyah, Alexandria- Egypt), (1984), p. 83.

<sup>3</sup> *Ibid*, p. 84.

insurer. He argued that, the insured's duty is to pay the premiums to insure him self from the risk insured against, and the insurer's duty is to pay the insurance money to the insured to insure the latter from the risk. Therefore, the insured risk is the motive for the payments of the premiums and the insurance money.<sup>4</sup> However, some other legal jurists are of the opinion that the principle of insurable interest is the subject-matter of the contract of insurance. Sarkhoh, for example, observes that the subject-matter of the contract of insurance is every legal economic interest which encourages an insured to go into a contract of insurance to insure such interest against a contingent risk.<sup>5</sup>

In respect of common law, in *Feasey* case,<sup>6</sup> Weller LJ discussed the notion of "the subject-matter of insurance"; he reviewed some authorities and came up with a conclusion that the subject-matter could be grouped into four groups, that:

"Group (1) are those cases where the court has defined the subject matter as an item of property; where the insurance is to recover the value of that property;

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<sup>4</sup> Mustafa Mohammad Al-Faqi, Abdul Rrazag Al-Sanhuri, *Al-Waseet fi Sharh Al-Qanoon Al-Madani*, (in Arabic), Al-Waseet in Illustration of the Civil Law, part 7, Vol. 2, 2<sup>nd</sup> ed., (Dar An-Nahthah Al-Arabiyyah Cairo-Egypt), (1990), pp. 1540-41. This view has been approved by number of Arab legal jurists which, as it seems, depends of the French view. See, for example, Mohammad Ali Arafah, *Sharh Al-Qanoon Al-Madani Al-Jadeed fi At-Tameen wa Al-Uqood As-Saghirah*, (Arabic) Explanation of The New Civil Law in Insurance and Small Contracts, 2<sup>nd</sup> ed., (University of Fuad the First Press, Cairo, Egypt) 2<sup>nd</sup> ed., (1950), p. 26; Jalal M. Ibrahim, *At-Atameen*, (Arabic), Insurance, (University of Kuwait Press, Kuwait), (1989), p. 126; Khamis Khudr, *Al-Uqood Al-Madaniyah Al-Kabirah*, (Arabic), The Large Civilian Contracts, (Dar An-Nahdhah Al-Arabiyyah), (1979), p. 414; Ahmad Sharaf Ad-Deen, *Ahkam At-Tameen*, (Arabic), Insurance Rules, (University of Kuwait Press, Kuwait), (1983), p. 170. The author argues that there is more the one object in insurance as subject-matter of the contract such as indemnity. However, the risk is the principle subject-matter of the contract of insurance.

<sup>5</sup> Yaqub Sarkhoh, *At-Tameen Al-Bahri fi Al-Qanoon Al-Kuwaiti*, (Arabic), Marine Insurance in Kuwaiti Law, (University of Kuwait Press, Kuwait), (1993), p. 104. See, also, Mohammad H. Lutfi, *Al-Ahkam Al-'Ammah Le-Aqd At-Tameen*, (Arabic), General Rules of Insurance Contract, 3<sup>rd</sup> ed., (2001), p. 142; Braham Mohammad Atallah, *At-Tameen*, (Arabic), Insurance, (Al-Thaqafiyah Al-Jami'eyah, Alexandria- Egypt), (1984), p. 85.

<sup>6</sup> *Feasey v Sun Life Assurance Company of Canada* [2003] EWCA Civ 885, [2003] 2 All ER (Comm) 587.

and where thus there must be an interest in the property-real or equitable-for the insured to suffer loss which he can recover under the policy."<sup>7</sup>

The second group was that where the subject-matter was identified to be a particular life of a particular person.<sup>8</sup> The third group was that,

"where even though the subject matter may appear to be a particular item of property, properly construed the policy extends beyond the item and embraces such insurable interest as the insured has."<sup>9</sup>

Furthermore, Weller LJ observed that,

"Group 4 are policies in which the court has recognised interests which are not even strictly pecuniary. In relation to life policies there are policies on own life; policies on husband's life and policies on the life of the wife,... But even in the case of property something less than a legal or equitable or even simply a pecuniary interest has been thought to be sufficient."<sup>10</sup>

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<sup>7</sup> *Ibid*, para. [81]. He declared that within this group, "*Lucena v Craufurd* (1806) 2 Bos & PNR 269, 127 ER 630... The subject was certain identified ships; the perils insured against were the loss of the ships; the Commissioners had no interest legal or equitable in the ships but a mere expectation. That expectation could not be insured, therefore the subject did not embrace the insurable interest. Also within this group is *Anderson v Morice* (1875) LR 10 CP 609; affirmed (1876) 1 App Cas 713. Rice was the subject matter of the policy; if uninsured the plaintiff would have suffered no loss from any destruction of the rice since they were never at the plaintiff's risk; the loss of profits might have been insured but were not. Therefore the plaintiff could not recover. In *Macaura v Northern Assurance Co Ltd* [1925] AC 619, [1925] All ER Rep 51 the subject matter of the insurance was identified timber owned by a company; a shareholder in the company had no interest in the timber whatever in that even without insurance the shareholder would suffer no pecuniary loss from destruction of the timber as such. Any loss suffered would have been as shareholder and his profits as shareholder were not the subject of the insurance. It was, however, recognised in *Macaura's* case that it would have been possible to so describe the subject of the insurance as to embrace the insurable interest in profits, and approval was given to *Wilson v Jones* (1867) LR 2 Exch 139..."

<sup>8</sup> *Ibid*, para. [82].

<sup>9</sup> *Ibid*, para. [87]. According to him, *Wilson v Jones* (1867) LR 2 Exch 139 exemplifies this group.

<sup>10</sup> *Ibid*, para. [90]. Weller LJ referred to *Sharp v Sphere Drake Insurance plc, The Moonacre* [1992] 2 Lloyd's Rep 501, where the court recognized the boat as the subject of the insurance; *Glengate-KG Properties Ltd v Norwich Union Fire Insurance Society Ltd* [1996] 2 All ER 487, where Neill LJ supported *The Moonacre* judgment as being 'valuable judgment' and Auld LJ was less sure that the ruling was right; *Deepak Fertilisers & Petrochemicals Ltd v Davy McKee (London) Ltd* [1999] 1 All

As noted above, identifying the subject-matter of the contract is elusive. Having said that the subject-matter of the contract of insurance could be the risk insured against or the subject-matter insured or the principle of insurable interest, it is difficult to be accepted. In fact, the risk insured against is a future possible event and the consequence of its occurrence triggers the insurer's fulfillment of its duty of indemnity. This is the reason for concluding an insurance contract. Article (344) of Saudi Commercial Court Law 1931 states that events which are described as "maritime perils", that,

"All losses and damages sustained by the insured items shall be borne by the insurer, whether it be a result of a tempest, sinking, wreck, leakage or cracking, or as a result of the necessary change of course in the voyage, or the replacement of the vessel, or the jettisoning of goods through fire, seizure, usurping, or arrest of the vessel by a court order or as a result of the declaration of war or acts of retaliation and hostilities and any other peril and marine siege."<sup>11</sup>

As for English law, section (3) of the Marine Insurance Act 1906 defines "maritime peril" as:

""Maritime perils" means the perils consequent on, or incidental to, the navigation of the sea, that is to say, perils of the seas, fire, war, perils, pirates, rovers, thieves, captures, seizures, restraints, and detainment's of princes and peoples, jettisons, barratry, and any other perils, either of the like kind or which may be designated by the policy."

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ER (Comm) 69 and some other cases. Consequently, he concluded that, *inter alia*, "it is from the terms of the policy that the subject of the insurance must be ascertained." Parag. [97].

<sup>11</sup> Nicola H. Karam, *Business Laws of Saudi Arabia*, Vol. I, (1994), p. 13-71.

In property Insurance, the subject-matter insured can be described as the thing or the object that is considered to be the source of the insured's loss or liability where it is damaged or destroyed by the insured risk or peril. Article (327) of the CCL 1931 states objects that are described as subject-matters insured, that,

"(1) vessels which sail individually or in convoys, whether loaded or empty and whether fitted out or not; (2) machinery and equipment of vessels; (3) hulls and superstructures; (4) provisions; (5) money borrowed under the marine procedure; (6) kind and nature of cargo; (7) anything having value which may be the subject of marine hazards."<sup>12</sup>

Regarding English law, section (3) of the Marine Insurance Act 1906 describes the subject-matter of a marine policy as:

"(1) Subject to the provisions of this Act, every lawful marine adventure may be the subject of a contract of marine insurance.

(2) In particular there is a marine adventure where –

(a) Any ship goods or other moveables are exposed to maritime perils.

Such property is in this Act referred to as "insurable property";

(b) The earning or acquisition of any freight, passage money, commission, profit, or other pecuniary benefit, or the security for any advances, loan, or disbursements, is endangered by the exposure of insurable property to maritime perils;

(c) Any liability to a third party may be incurred by the owner of, or other person interested in or responsible for, insurable property, by reason of maritime perils."<sup>13</sup>

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<sup>12</sup> *Ibid*, p. 13-67.

<sup>13</sup> For more discussion on this, see, for example, Susan Hodges, *Law of Marine Insurance*, (1997), p. 23; John Lowry and Philip Rawlings, *Insurance Law: Doctrine and Principles*, 2<sup>nd</sup> ed., (2005), pp. 364 & 374.

In relation to the principle of insurable interest, it is a requirement that must be complied with by the insured only in order to validate his insurance policy. Therefore, it seems that the principle of insurable interest is not suitable to be the subject-matter of the contract of insurance.<sup>14</sup>

Thus, in order to identify the subject-matter of the contract of insurance, the way of concluding an insurance contract must be illustrated. Where a person intends to insure his house, for example, against fire and theft, he contacts an insurer either directly or indirectly, i.e. via an insurance broker or agent, to propose to the insurer his wish to insure his property. At the stage of negotiation, both parties, the insurer and the proposer, agree that the insurer promises to indemnify the proposer where he suffers a loss due to the occurrence of the insured risk in the subject-matter insured, i.e. the house, in return that the proposer pays a premium(s) to the insurer. The insurer's promise is contained in a document called "the insurance policy" and which requires the payment of the premium by the proposer at the stage of concluding the contract. After concluding the contract, the proposer becomes, from legal point of view, an insured where he is bound to pay the premium, whether in full or via installments. On the other hand, the insurer is bound to hand over the insured an insurance policy. Technically, the insured buys the document, i.e. the policy, from the insurer that represents the promise of indemnity from the part of the insurer. Therefore, the transaction between the two parties, the insurer and the insured, could be described as a sale of a conditional promise. That is to say that, the promise of the insurer is to

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<sup>14</sup> See chapter 3, *supra*, for detailed discussion on the principle of insurable interest.

indemnify the insured or to hold him harmless against the insured risk(s).<sup>15</sup> The condition is, obviously, that the loss that is suffered by the insured must be caused by an insured peril or risk. Consequently, it can be said that the subject-matter of the contract of insurance is the insurer's promise of indemnifying the insured. Thus, having identified the subject-matter of the contract of insurance, it will be possible to know whether the element of *Gharar* does exist in an insurance contract and if it does what its degree is.

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<sup>15</sup> *Firma C-Trade SA v Newcastle P & I Association (The Fanti)* [1991] AC 1, at p. 35. For more discussion on the nature of the duty of the insurer under English law, see chapter 3, *supra*, parag. 3.2.2.2. See, also, Neil Campbell "The Nature of an Insurer's Obligation" [2000] *LMCLQ* 42, at p. 48; John Lowry and Philip Rawlings "Insurers, Claims and Boundaries of Good Faith" (2005) 68(1) *MLR* 82, at p. 90.



### 6.3. Cooperative Insurance v Commercial Insurance

The emergence of the insurance contract goes back to the twelfth and thirteenth century in Italy in the guise of marine insurance in connection with the improvement of commerce.<sup>16</sup> The insurance contract, nevertheless, was unknown by the orthodox Islamic schools of law. Consequently, Muslim scholars have viewed the insurance contract with suspicion.

The first leading recorded *fatwa* in respect of insurance was found in the early 19<sup>th</sup> century by a Syrian scholar from the *Hanafi* school *Ibn Abdin* (1784-1836). He decided that insurance contracts, when was asked about marine insurance contracts, are not valid under *Sharia* for two reasons. Firstly, because a contract of insurance is not similar to any of recognised contracts by classic Muslim jurists and the commitment under such contract is not binding from the part of the insurer.<sup>17</sup> The

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<sup>16</sup> C. McArthur, *The Contract of Marine Insurance*, 2<sup>nd</sup> ed., 1890, xx. Therefore, insurance was invented in the west and it was said that it had been invented by Jews when they were expelled from France by its King by that time. Nevertheless it has not been proved that was the origin of insurance. McArthur mentioned that, "The French jurist Cleirac asserts, on the authority of Villani, a Florentine historian of the thirteenth century, that insurance was invented by the Jews, who had been expelled from France and found a refuge in Italy, and who resorted to this expedient as a means of securing themselves against the losses to which the removal of their property and effects was liable. It is said that the merchants of the north of Italy, who were cognizant of this device, being impressed with its utility, imported it into their dealings. While there appears no good reason for rejecting this statement, it cannot be regarded as a certain account of the first beginning of insurance, which is attaches to the origin of most of other inventions..." *Ibid*, footnote (d).

<sup>17</sup> Mohammad Ameen, Ibn Abdin, *Rad El muhtar Ala Eldur El mukhtar Sharh Tanweer Al-Absar*, (in Arabic), Vol. 4, 3<sup>rd</sup> ed., (Mustafa Al-Babi Al-Halabi, Cairo-Egypt), (1984), 184; Yaqob Sarkhoh, *At-Tameen Albahri fi Alqannon Al-Kuwaiti*, (in Arabic), Marine Insurance in Kuwaiti Law, 1993, p. 24; Andreas Haberbeck & Mark Galloway, *Saudi Shipping Law*, 1990, p. 213. Additionally, there were other jurists adopt *Ibn Abdin's* view that insurance contract is illegal under *Sharia* because it is not similar to any contract that is recognized by Islamic jurisprudence. See, the jurist Mohammad Bekeet Al-Mute'iy, Article by , Isawi, "Aqd At-Tameen min wejhat nathar Ashareia al-Islamiah wa Al-Qanoon", (Article in Arabic), Insurance contract from the aspect of Islamic Sharia and Law, in *Majallat Al-Ulom Al-Qanooneyah wa Al-Eqtisadeyah*, July 1962, pp. 167, 187, 188.

*fatwa* of the jurist Ibn Abdin has been considered by wide range of Islamic scholars.<sup>18</sup>

Haberbeck and Galloway observed that, jurist Ibn Abdin "Without giving clear reasons, decided that contracts of insurance are not valid under Islamic law. In his view the mere non-existence of insurance contracts in the framework of contracts recognized by the classic Sharia texts made this type of transaction suspect."<sup>19</sup>

In fact, Ibn Abdin drew an analogy between an insurance contract and some other contracts that had been known by the orthodox Muslim jurists, such as lucrative bailment, by comparing and contrasting rights and duties under each contract. His conclusion was that insurance does not impose a legal duty upon an insurer to guarantee the property of an insured when it is damaged by the risk insured against.<sup>20</sup> Ibn Abdin, moreover, distinguished between two cases. On the one hand, where a contract of insurance is concluded in an Islamic country, the contract would be illegal on the ground that Islamic law would have been applied, therefore, a Muslim cannot benefit from the insurance money because insurance clashes with the general principles *Sharia*. On the other hand, where the contract is concluded in a non-Islamic country, the contract would be legal because a Muslim insured in such contract would earn the insurance money by the agreement of the other party, the insurer, because *Sharia* would not apply therein.<sup>21</sup>

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<sup>18</sup> However, it is not necessarily that all legal researchers and Islamic jurists agree with this *fatwa*. See, for example, Mohammad Beltaji, *Ugood Attameen min wejhat Al-Fiqh Al-Islami*, (in Arabic), Insurance Contracts from the viewpoint of Islamic Jurisprudence, 2<sup>nd</sup> ed., (2000), pp. 21-25; As-Sayed Abdalmuttalib Abdoh, *Mabady At-Tameen*, (in Arabic), Insurance Principles, 4<sup>th</sup> ed., (1986), at p. 122.; Hussain bin Mansur, *At-Tameen fee Asharia Al-Islameyah*, (in Arabic), Insurance in Islamic Sharia, (1992), p. 31; Abdulhadi A. M. Al-Hakeem, *Aqd At-Tameen: Hageegataho wa Mashroeyatoh*, (in Arabic), Insurance Contract: its Truth and Legitimacy, (2003), p. 292.

<sup>19</sup> Andreas Haberbeck & Mark Galloway, *Saudi Shipping Law*, 1990, p. 213.

<sup>20</sup> See, Researches of the Board of Great Ulama in Saudi Arabia, *At-Tameen (Insurance)*, Vol. 4, (2001), 35, at p. 81.

<sup>21</sup> Mohammad Ameen, Ibn Abdin, *Rad El muhtar Ala Eldur El mukhtar Sharh Tanweer Al-Absar*, (in Arabic), Vol. 4, 3<sup>rd</sup> ed., (Mustafa Al-Babi Al-Halabi and his sons Co.), (1984), p. 185.

In this manner, Shaikh Mohammad Bekheet Al-Mutai'ey, observed that indemnity applies under *Sharia* in three cases. These are, namely, guarantee, transgression and destruction. Thus, the contract of insurance is not a contract of guarantee, nor is the insurer in transgression position to the insured property, nor is the insurer destroying the insured property. Accordingly, since the duty of an insurer is to indemnify his insured under a contract of insurance cannot be found under the said cases, such duty, therefore, is not binding.<sup>22</sup> He was of the opinion that insurance contains adventure that sometimes occurs, sometimes does not. Therefore, insurance, in this meaning, is gambling.<sup>23</sup>

Recently, there have been several meetings in several conferences and symposia that have been arranged by Muslim jurists researching into the lawfulness of insurance. The very first Islamic juristic conference was held in Damascus, Syria in 1961. The members who met in that conference examined both cooperative and commercial insurances. However, the members did not reach a unanimous conclusion. According to Al-Hakeem, there were two viewpoints; on the one hand, a group of the members was of the opinion that all forms of insurance are not valid under *Sharia*. On the other hand, insurance is, actually, valid and lawful under *Sharia*.<sup>24</sup> The first viewpoint was argued by Shaikh Mohammad Abo Zahrah; the second viewpoint was argued by Mustafa Al-Zarga.<sup>25</sup>

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<sup>22</sup> Issa Abdoh, *At-Tameen bayn Al-Halal wa Al-Haram*, (in Arabic), Insurance between Lawfulness and Prohibition, (1978), pp. 227-229. Abdoh mentioned other jurist took this manner, i.e. insurance is forbidden under Sharia, Shaikh Abdu Rrahman Qura'a, Dr Yusuf Al-Qaradhawi, Dr Jalal Assayad and some others, at pp. 227-249.

<sup>23</sup> *Ibid*; Researches of the Board of Great Ulama in Saudi Arabia, *At-Tameen (Insurance)*, Vol. 4, (2001), 35, at pp. 86-88.

<sup>24</sup> Abdul Hadi A. M. Al-Hakeem, *Aqd At-Tameen: Hageegataho wa Mashroeyatoh*, (in Arabic), Insurance Contract: its Truth and Legitimacy, (2003), p. 288.

<sup>25</sup> Both arguments are cited in Issa Abdoh, *At-Tameen bayn Al-Halal wa Al-Haram*, (in Arabic), Insurance between Lawfulness and Prohibition, (1978). Mustafa Az-Zarga's argument at p.119. Shaikh Mohammad Abo Zahrah's argument at p.136.

The second meeting was The Second Conference for Islamic Researches Assembly that took place in *Al-Azhar*<sup>26</sup> in Cairo, Egypt in 1965. The members decided that, cooperative insurance, which is performed by cooperative associations, is lawful because it is cooperation.<sup>27</sup> Furthermore, in The Third Conference for Islamic Researches Assembly that was held in Al-Azhar in 1966, the jurists decided that social insurance, which is provided by governments, cooperative insurance and health insurance are legal under *Sharia*. However, private insurance, which was meant to be commercial insurance, should have been explored and examined in depth.<sup>28</sup> In 1972, a symposium was held in Libya and it was recommended that cooperative insurance should be substituted by commercial insurance.

Furthermore, in September 1978 the jurists met again in the Assembly of Islamic Jurisprudence in Makkah, Saudi Arabia.<sup>29</sup> The members adopted the decision that had been made in March 1977 by the Council of the Board of Great Ulama in Saudi Arabia. The members declared that it had been unanimously decided that commercial insurance, including life insurance, had been forbidden under Islamic Law<sup>30</sup> for the principle following reasons:

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<sup>26</sup> Al-Azhar is an Islamic institution in Egypt that contains the Egyptian Islamic jurists. It has the same role of the Board of Great Ulama in Saudi Arabia. Al-Azhar and the Board of Great Ulama are both enjoying a great respect in the Islamic world.

<sup>27</sup> Issa Abdoh, *At-Tameen bayn Al-Halal wa Al-Haram*, (in Arabic), Insurance between Lawfulness and Prohibition, (1978), p. 249; Mohammad Al-Fanjari, *Al-Islam wa At-Tameen*, (Arabic), Islam and Insurance, 2<sup>nd</sup> ed., (Okath Co.), (1984), p. 61; Sadi Abo Jaib, *At-Tameen bayn Al-Hather wa Al-Ibahah*, (Arabic), Insurance between Prohibition and Permission, (1983), footnote (1), p. 6.

<sup>28</sup> Mohammad A. Khafaji, "Netham Al-Faedah fe Al-Muamalat Al-Iqtisadeyah wa Rae'y Al-Islam Feeha", (an Arabic article), "The System of Interest in Economic Transactions and The Opinion of Islam about it" (April 1983) 29 *Majallat Al-Bonok Al-Islamiyah*, Islamic Banks Report, 50, at 52.

<sup>29</sup> Abdulhadi A. M. Al-Hakeem, *Aqd At-Tameen: Hageegataho wa Mashroeyatoh*, (in Arabic), Insurance Contract: its Truth and Legitimacy, (2003), p. 289.

<sup>30</sup> Decision No. (10/5), 4/4/1397 A.H., 25/3/1977, Researches of the Board of Great Ulama in Saudi Arabia, *At-Tameen (Insurance)*, Vol. 4, (2001), 35, at p. 307.

1- Insurance contract is a *mu'awadhah* contract,<sup>31</sup> which can be translated in English as onerous contract, contingent and an aleatory contract. It contains excessive *Gharar*, uncertainty, by which the insured cannot, nor the insurer, at the time of concluding the contract, know the amount which he should pay and that he will get from the insurer in the case of the occurrence of the event insured against. The insured might pay one or two premiums and the risk occurs. The insurer, thereafter, is bound to indemnify the insured for his loss that is usually more than the total of what the latter has paid. On the other hand, the insured might pay all the agreed premiums without taking anything. Allah's Messenger, (peace and blessings be upon him), forbade *Gharar*.<sup>32</sup>

2- Insurance contract is a type of gambling due to the risk it contains in a financial contractual relationship; that, where the risk insured against occurs, the insured unlawfully earns the insurance money either without an equivalent right, as the situation under a life insurance policy, or more than the actual loss. On the other hand, the insurer unlawfully earns the premiums, which have been already paid by the insured in the case of non-occurrence of the event insured against. The uncertainty, therefore, is so excessive and that is forbidden under *Sharia*. Allah, glory to Him, said in *Quran* that:

**(O you who believe! intoxicants and gambling, (dedication of) stones, and (divination by) arrows, are an abomination of Satan's handiwork: eschew such (abomination), that ye may prosper [91] Satan's plan is (but) to excite enmity and hatred between you, with intoxicants and gambling,**

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<sup>31</sup> Arabic word that is translated as commutative contract in Mohammad Qal'aji & Hamid Qunaibi, *Mu'jam Lughat al-Fuqaha*, (Dictionary of Islamic legal terminology), (Dar An-Nafaes, Beirut-Lebanon), (1996), p. 408.

<sup>32</sup> Researches of the Board of Great Ulama in Saudi Arabia, *At-Tameen (Insurance)*, Vol. 4, (2001), 35, at p. 308.

**and hinder you from the remembrance of Allah, and from prayer: will ye not then abstain?).<sup>33</sup>**

3- Insurance contract contains *Riba*, usury. That, when an insured gets, in the case of indemnity, more than what he paid an insurer by way of premiums, the insured gets unlawfully more than what he already paid and that is *Riba Al-Fadhil*. If that happened after period of time, it becomes *Riba An-Nase'ah*. Thus, both kinds of *Riba*, namely, *Al-Fadhil* and *An-Nase'ah* are forbidden under *Sharia* by *Quran* and *Sunnah*. Allah, glory to Him said, in *Quran*:

**(O you who believe! devour not Usury, doubled and multiplied; but fear Allah; that ye may (really) prosper).<sup>34</sup>**

4- Insurance contracts contain unlawful gaining of the others' money, that the insurer unlawfully gains the insured's money in the case of non-occurrence of the insured risk. In contrast, the insured may gain more than what he actually suffered and that is repugnant to *Sharia*. Allah, glory to Him, said in *Quran* that:

**(O you who believe! eat not up your property among yourselves in vanities: but let there be amongst you traffic and trade by mutual goodwill: nor kill (or destroy) yourselves: for verily Allah hath been to you Most Merciful!).<sup>35</sup>**

Furthermore, the Board of Great Ulama in Saudi Arabia has, recently, researched insurance and concluded that, there are tree doctrines set out by Islamic scholars and

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<sup>33</sup> Al-Ma'idah, 5, verses 90, 91. See, M. Al-Hilali & M. Khan, *Translation of the meaning of THE NOBLE QURAN*, (1417 A.H), (1996-1997), at p. 309.

<sup>34</sup> Al-Imran, 3, verse 130. See, *Ibid*. p. 92.

<sup>35</sup> An-Nessa, 4, verse 29. See, *Ibid*, at p. 310.

legal jurists about the legitimacy of insurance under *Sharia*. The first doctrine observes that there are two types of insurance; they are, namely, cooperative insurance, which complies with *Sharia* and, secondly, commercial insurance, which is the conventional insurance and that is unacceptable under *Sharia*. The second doctrine claims that insurance, whether it is cooperative or commercial, is repugnant to *Sharia*. The third one is of the opinion that insurance are, actually, valid and legitimate under *Sharia* whether it is cooperative or commercial insurance.<sup>36</sup> Therefore, it is essential, at this juncture, to explore and evaluate these doctrines.

### ***6.3.1. Cooperative Insurance***

It has to be borne in mind that the practice of cooperative insurance does not exist in Saudi insurance market. The following illustration of this form of insurance has been presented by various Muslim scholars and legal jurists and it will be noted that they present suggestions that could be adopted. It will, also, be noted that the scholars and the jurists have been trying to clear the contract of insurance from those elements that turns it to be illegal. Thus, the form of cooperative insurance is theoretical more than practical.

Indeed, with regard to insurance on properties, the scholars divide insurance contracts into two categories, namely, commercial insurance and cooperative

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<sup>36</sup> Researches of the Board of Great Ulama in Saudi Arabia, *At-Tameen (Insurance)*, Vol. 4, (2001), 35, p. 81.

insurance. Commercial insurance is the conventional insurance or the original form of insurance and that includes life insurance and all other insurances.<sup>37</sup> Cooperative insurance is a type of insurance based upon donation and cooperation between a group of people who have mutual interests to spread a loss which a member of the group might suffer between all other members by way of contribution. Nonetheless, under this form of insurance, the premium paid by an insured should be paid with the intention of donation and the payer should not be waiting for a benefit from what he has paid. In addition, they suggest that an insurance company should have two roles; firstly, to practice insurance and pay indemnities from the assureds' premiums, or what is called contributions; secondly to invest the excess of the total of the premiums in legal commercial transactions and the profits should be paid back to the assureds according to their contributions.<sup>38</sup> In respect of being in deficit, the scholars suggest that, all members should cover such deficit according to each member's participation.<sup>39</sup>

Bin Hmaid is of the opinion that cooperative insurance could contain different insurance policies except life assurance. Further, he calls this form of insurance "Islamic insurance" and he says that the insurance is operated and managed by an Islamic insurance company which invests the total amount of the contributions on the members' behalf in return of a certain share from profits that are derived from such investment as it is a speculator, or in return of a certain amount of money, or fee, as an agent, but without infringing *Sharia* principles.<sup>40</sup>

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<sup>37</sup> For further details, see chapter three above.

<sup>38</sup> Saleh A. Bin Hmaid, *At-Taameen At-Taawni Al-Islami*, (Arabic), Islamic Cooperation Insurance, [http://islamtoday.net/islam/articles/show\\_articles\\_content.cfm?id=71&catid=74&artid=1679](http://islamtoday.net/islam/articles/show_articles_content.cfm?id=71&catid=74&artid=1679). Shaikh Bin Hmaid is the chairman of Mjlis Ash-Shura, or Consultation Counsel, in Saudi Arabia.

<sup>39</sup> Bin Hmaid, *ibid*.

<sup>40</sup> *Ibid*.



Shaikh Mawlawi defines cooperative insurance as, a participation of a group of people in establishing a fund that they finance by paying premiums by each one of them. Every one of the group take a particular part of the fund where he suffers a loss from a particular event. He says that the difference between cooperative insurance and commercial insurance is that in cooperative insurance the sum of money that is collected from the members of the group remains in the possession of the group, whereas in commercial insurance the sum of money that is collected goes for the shareholders of the insurance company. Therefore, cooperative insurance is mere organised solidarity.<sup>41</sup> In addition, cooperative insurance, he says, does not aim to make profits for the people who adopt it, but to remove suffering a loss from any of the insureds. Shaikh Mawlawi also observes that, *Zakat*<sup>42</sup> is a kind of solidarity system, but it is based upon taking money from a rich person to be given to a poor person, whilst cooperative insurance is not restricted to this principle. However, this kind of insurance is similar to another solidarity system which is *Al-Aaqilah*<sup>43</sup> system

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<sup>41</sup> Shaikh Faisal Mawlawi, *Netham At-Tameen wa Mawqiff Ashariah menho*, (Arabic), Insurance System and its Position in Sharia, (Dar Ar-Rashid Al-Islamiah- Beirut-Lebanon), (1988), p. 136. See also some other definitions of cooperative insurance that are similar to this definition in: Mustafa M. Az-Zarga, *Netham At-Tameen*, (Arabic), Insurance System, (Al-Resalah Est., Beirut-Lebanon), (1984), pp. 42, 43 & 123; Sadi Abo Jaib, *At-Tameen bayn Al-Hather wa Al-Ibahah*, (Arabic), Insurance between Prohibition and Permission, (1983), p. 18; Hussain bin Mansur, *At-Tameen fe Asharia Al-Islameyah*, (in Arabic), Insurance in Islamic Sharia, (1992), p. 53; Abd An-Nassir T. Al-Attar, *Hukom At-Tameen fe Al-Shariah Al-Islamiyah*, (Arabic), The Judgment of Insurance in Islamic Sharia, (Al-Nahthah Al-Misreyah Book Shop, Egypt), (1983), p. 7; Mabrok Al-Najar, *Aqid At-Tameen*, (Arabic), The Contract of Insurance, (Dar An-Nahdhah Al-Arabiyyah, Egypt), (1994), p. 94; Ghareeb Al-Jammal, *At-Tameen At-Tijari wa Al-Badeel Al-Islami*, (Arabic), Commercial Insurance and The Islamic Substitute, (Dar Al-Ietisam, Cairo-Egypt), (1979), p. 252; As-Sayed A. Abdoh, *At-Tameen Al-Islami*, Islamic Insurance, (Dar Al-kitab Al-Jamre'ey, Cairo-Egypt), (1988), p. 107; Ahmad Sharaf Ad-Deen, *Uqood At-Tameen wa Uqood Dhaman Al-Istethmar*, (Arabic), Insurance Contracts and Security Investment Contracts, (Hassam Press, Cairo-Egypt), (1986), pp. 242-245; Ahmad S. Melhim, *At-Tameen At-Ta'awni Al-Islami*, (Arabic), Islamic Cooperative Insurance, (National Library, Jordan), (2000), p. 61; As-Seddeeg M. Al-Dhereer, *Al-Gharar wa Atharaho fe Al-Uqood fe Al-Fiqh Al-Islami*, (Arabic), Uncertainty and its Effect Contracts in Islamic Jurisprudence, (1967), p. 640.

<sup>42</sup> A specified sum of money in a particular time paid for a specified group of people. It is taken from rich people to be given, *inter alia*, poor people. See, p. 7, *supra*.

<sup>43</sup> An Islamic system that invites members in one family to unite to pay a sum of money to the victim's family as an indemnity where one of them kills a human without malice aforethought. See, Mohammad

where members of a family of a killer in manslaughter case gather together to pay *Diyah*<sup>44</sup> to the victim's family. He, moreover, states that, since the system of *Muslims Treasure House*, which its role is to provide social security to Muslims in a state, may not exist at the present time, cooperative insurance could be a smaller Muslims Treasure House for a group of Muslims that could protect some of their interest. Therefore, some motorists could agree together to provide cooperative insurance to each other. Likewise, some traders could do the same to protect their interests in the same manner. Thus, this system does not infringe Islamic principles and could cover any additional expenses of solidarity that are not covered by *Zakat*.<sup>45</sup>

Al-Fanjari elucidates the mechanism of cooperative insurance. According to him, the value of contributions that are paid by members of a cooperative society might vary each year. The value would depend on the total amount of indemnities during a year. A member might not pay until a risk insured against has actually occurred and, then, the member could pay according to his proportion. Or, he might pay a part of his contribution and pay the rest at the end of the year; or he might get a refund depending on the calculation of the total amount of indemnities that year.<sup>46</sup> Additionally, cooperative insurance is called mutual insurance because the insureds are the insurers at the same time, that there is no an intermediary or a shareholder that could profit from shares between the members.<sup>47</sup>

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Biltaji, *Uqood At-Tameen*, (Arabic), Insurance Contracts, (Maktabat Al-Balad Al-Ameen, Cairo-Egypt), (2000), p. 126.

<sup>44</sup> An Islamic device which is an indemnity that consists of, usually but not necessarily, sum of money that is given to the victim's family by the killer, where he kills the victim without malice aforethought. See, Mohammad Qal'aji & Hamid Qunaibi, *Mu'jam Lughat al-Fuqaha*, (Dictionary of Islamic legal terminology), (Dar An-Nafaes, Beirut-Lebanon), (1996), p. 188.

<sup>45</sup> Shaikh Faisal Mawlawi, *Netham At-Tameen wa Mawqiff Ashariah menho*, (Arabic), Insurance System and its Position in Sharia, (Dar Ar-Rashid Al-Islamiah- Beirut, Lebanon), (1988), p. 136-7.

<sup>46</sup> Mohammad Al-Fanjari, *Al-Islam wa At-Tameen*, (Arabic), Islam and Insurance, 2<sup>nd</sup> ed., (Okath Co.), (1984), p. 36.

<sup>47</sup> *Ibid.*

Sharaf Ad-Deen remarks on the concept of cooperative insurance that, when members of a cooperative society pay contributions or premiums, they pay them as donations and they agree to indemnify each other should one of them suffer a loss. In addition, since each one of the members combine both characters of insureds and insurers and since indemnity is binding upon each member as well as they all pay premiums, the contract of cooperative insurance is away from being a commutative or onerous contract. In fact, this contract could be categorised as a donative contract. That the members go into the contract and pay the premiums as donations for cooperation; therefore, the element of Gharar, uncertainty, does not affect the legality of the contract and the legitimacy of taking the insurance money. Furthermore, he argues that, where the insurance money exceeds the total amount of the paid premiums, Riba, usury, does not appear in such a case because usury appears only in commutative or onerous contracts, but not in donation.<sup>48</sup>

Admittedly, Sharaf Ad-Deen recognises that there are difficulties that the system of cooperative insurance could encounter in order to be practised widely. Further, the system is not profitable and contributions or premiums are variable according to the number of the occurrence of risks insured against. However, he suggests solutions for such difficulties. The cooperative society, which represents the members, could invest the premiums in legitimate ways, then, by this way, profits could be made. Indemnities and any administration fees could be paid therefrom plus saving a sum of money for emergencies or pay any extra sum that remains back to the members

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<sup>48</sup> Ahmad Sharaf Ad-Deen, *Uqood At-Tameen wa Uqood Dhaman Al-Istethmar*, (Arabic), Insurance Contracts and Security Investment Contracts, (Hassam Press, Cairo-Egypt), (1986), p.245.

without spending any expenses from the capital.<sup>49</sup> His view, moreover, is that the investment of the premiums is not considered as an insurance activity; therefore, such activity does not alter the nature of the whole transaction from being donation to a commutative or onerous transaction.<sup>50</sup>

Zaki Ad-Deen Shaban observes that the cooperative insurance is more favourable than the commercial, or conventional, insurance for economy because the latter scheme allows insurance companies to control people's money and their wealth and makes them in the possession of insurance companies. That will, therefore, expand the control of insurance companies on the economic life. Shaban considers the commercial insurance, in this sense, as a source of danger upon a national economy.<sup>51</sup> He said that cooperative insurance fulfils the reason for insurance without causing any danger or harm because it is not influenced by the temptation of making profits. In addition, cooperative insurance is based on the principle that people's money is for them and under their control and it is available for everyone especially for those who have limited income due to the fact that the rate of cooperative insurance premium is low comparing it with the rate of commercial insurance premiums and that makes it more beneficial.<sup>52</sup>

Hussain Hassan considers this type of insurance, i.e. cooperative insurance, as mutual insurance. It can be said that, he emphasises that, there has been no disagreement between Muslim scholars and legal jurists on the fact that where

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<sup>49</sup> *Ibid.*

<sup>50</sup> *Ibid.* See also another argument in this manner in Zaki Ad-Deen Shaban, "At-Tameen min Wejhat Nathar Al-Shariyah Al-Islamiyah", (Article in Arabic), Insurance from Islamic Sharia Point of View, in *Majallat Al-Huquq wa Al-Sharia*, (Kuwait), Second Year, Vol. 2, (June 1978), 7, at p. 14.

<sup>51</sup> Zaki Ad-Deen Shaban, *ibid*, at p. 15.

<sup>52</sup> *Ibid.*

insurance is tackled as cooperation between some persons to indemnify each other by paying contributions by way of donation, insurance is desired under *Sharia*, therefore, it is legitimate.<sup>53</sup>

Shaikh Abdullah Al-Mini, in his research on the contract of insurance, is of the opinion that procedures of cooperative insurance and its elements are the same that could be found in commercial insurance;<sup>54</sup> they are, namely, insurer, insured, subject-matter of insurance, premium and insurance money where it is applicable. He criticises the opinion that there is a distinction between the two schemes of insurance. He reasons that the surplus that is derived from the total amount of the members' contributions, in the cooperative insurance, would be paid back to the members according to each member's contribution because they cooperate together to indemnify each other and they would cover any deficit. In contrast, the surplus in the commercial insurance would be a profit for the insurance company and in the case of being in deficit the company would be obliged to cover it from either its capital, or its capital stock.<sup>55</sup> Therefore, he argues that there is no distinction between cooperative insurance and commercial insurance.<sup>56</sup>

Mohammad Biltaji clearly suggests that cooperative insurance should be based upon the following grounds. Firstly, that all forms of Islamic cooperative insurance have to be founded on general Islamic principles such as solidarity, mercy and cooperation,

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<sup>53</sup> Hussain Hamid Hassan, *Hukom Ash-Sharia Al-Islamiyah fe Uqood At-Tameen*, (Arabic), The Judgment of Islamic Sharia in Insurance Contracts, undated, p. 441.

<sup>54</sup> Shaikh Abdullah Bin Sulaiman Al-Mene'e'a (Member of the Board of Great Ulama in Saudi Arabia), "At-Tameen bayn Al-Halal wa Al-Haram", (Arabic), Insurance between Lawfulness and Unlawfulness, (a research was presented to King Faisal Centre for Research and Islamic Studies), (2002), p. 12. See also this research on the web site, [http://islamtoday.net/articles/show\\_articles\\_content.cfm?id=71&catid=74&artid=1683](http://islamtoday.net/articles/show_articles_content.cfm?id=71&catid=74&artid=1683).

<sup>55</sup> *Ibid*, p. 13.

<sup>56</sup> *Ibid*, pp. 17-24.

like, for instance, the case in *Al-Aaqilah* system, *Al-Muwalat* and *An-Nehid*.<sup>57</sup> Furthermore, cooperative insurance must be cooperative or mutual because each member is bound by same duties and enjoys same rights that applicable to the other members. Secondly, a cooperative insurance system must not be (commercial), i.e. the intention of the parties must not be making profits, but solidarity. Nevertheless, the total amount of the members' contributions could be augmented and increased by way of *Mudharaba*,<sup>58</sup> but the profits must be added to the capital, i.e. the total amount of the premiums or contributions, in order to indemnify those members who suffer economic losses.<sup>59</sup>

Ghareeb Al-Jammal set out three features of cooperative insurance. Firstly, each member of a mutual, cooperative, insurance society gather both characters of the insured and the insurer because each member enjoys the benefit of security or insurance and each member, by contrast, bears indemnifying the other. Thus, the total amount of the paid contributions would be the pluses of the shared account; on the other hand, the total amount of the indemnities of losses would be the minuses for such account. Thus, where there is surplus in the account it would not be considered

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<sup>57</sup> An Islamic system where each member of a group of people pay out contributions that could be food, money, gold by way of charity to support each other and that their contributions do not have to be equal to each other. It is, also, where a group of people on a journey contribute to share the expenses of their journey. Mohammad Biltaji, *Uqood At-Tameen*, (Arabic), Insurance Contracts, (Maktabat Al-Balad Al-Ameen, Cairo-Egypt), (2000), p. 189.

<sup>58</sup> A contract whereby one party advances a sum of money to another party, as an agent, for investment that contains sharing of profits and losses. It is, also, sleeping partnership. See, Mohammad Qal'aji & Hamid Qunaibi, *Mu'jam Lughat al-Fuqaha*, (Dictionary of Islamic legal terminology), (Dar An-Nafaes, Beirut-Lebanon), (1996), p. 405. *Mudharaba*, as a contract, is practiced today by Islamic banks and it has been suggested to be practiced by cooperative insurers in order to increase the capital of the cooperative members in order to meet their claims and indemnities. See, Fadi Moghaizel, *Insurance in the Light of Islamic Legal Principles*, (PhD Thesis), SOAS- University of London, (1990), at pp. 162-172.

<sup>59</sup> Mohammad Biltaji, *Uqood At-Tameen*, (Arabic), Insurance Contracts, (Maktabat Al-Balad Al-Ameen, Cairo-Egypt), (2000), at p. 196.

as a profit by its all means; instead, it would be an increase of the contributions that is a legal right to the members that could be paid back to them.<sup>60</sup>

Secondly, solidarity between the members which means they cover each other against their risks. Although the principle of indemnity applies herein, that a member should not get more than his actual loss, Al-Jammal was of the opinion that there is possibility to agree on the contrary, i.e. a member can recover more than his loss on the ground that such agreement is not against the public system, or public interest.<sup>61</sup>

Thirdly, the rate of the contribution, the premium, varies depending upon the number of the occurrences of the risks insured against and the indemnities that have been paid. That is to say, where the total amount of the paid contributions is, in fact, insufficient to meet the due indemnities, the members are responsible for covering that deficit. In addition, the members can agree on a particular limit for their responsibility of indemnity. On the contrary, where there is surplus, the members have the right to claim back such surplus according to each member's contribution.<sup>62</sup>

Accordingly, Al-Jammal concludes that cooperative insurance societies could not be considered as companies because they do not aim to share profits, but to share losses. These societies differ from insurance companies in that insurance companies fix premiums according to statistics and they bear the risks where the indemnities of losses are more than the paid premiums.<sup>63</sup> Furthermore, commercial insurance companies do, sometimes, use some cooperative insurance functions, that sometimes

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<sup>60</sup> Ghareeb Al-Jammal, *At-Tameen At-Tijari wa Al-Badeel Al-Islami*, (Arabic), Commercial Insurance and The Islamic Substitute, (Dar Al-Ietisam, Cairo-Egypt), (1979), p. 253.

<sup>61</sup> *Ibid.*, p. 254.

<sup>62</sup> *Ibid.*, p. 255.

<sup>63</sup> *Ibid.*

an insurance company stipulates that an insured is entitled to share some profits that are earned by the company whereby the insured's premium will be decreased, unless the insured chooses to add the earned profit to the insurance money.<sup>64</sup> Al-Jammal, moreover, observes that, since insurance contracts contain Gharar, uncertainty, insurance must be controlled by cooperative societies to be practiced in the sphere of donation in order to be lawful under Sharia.<sup>65</sup>

Sulaiman Bin Thunayan, distinguishes between two forms of mutual insurance; they are, namely, direct mutual insurance and developed mutual insurance.<sup>66</sup> The first form, i.e. direct mutual insurance, is the one that is based upon cooperation between members of a group of people in one family or tribe or members in one occupation to insure each other against some losses.<sup>67</sup> The members gather together to finance a fund in this regard and where there is deficit, the members pay voluntarily to cover it without being forced by a contract. The second form, i.e. the developed mutual insurance, is, nowadays, different from the direct mutual insurance. The developed mutual insurance is dealt with by a modern and specialised administration, which is similar to the administrations that deal with insurance companies, whereas the direct mutual insurance's administration is practiced voluntarily. Participating in the developed mutual insurance has become through contractual agreement with every insured individually, while participating in direct mutual insurance was through solidarity that was based upon relationships between the members.<sup>68</sup> Generally

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<sup>64</sup> *Ibid*, p. 256. The author mentioned that, this procedure is used in life insurances, but there is no reason prevents that to be adopted in other insurances.

<sup>65</sup> *Ibid*, at p. 259.

<sup>66</sup> Sulaiman Al-Thunayan, *At-Tameen wa Ahkamuh*, (Arabic), Insurance and its Rules, (Dar Ibn Hazim, Beirut-Lebanon), (2003), p. 273.

<sup>67</sup> *Ibid*.

<sup>68</sup> *Ibid*, pp. 276, 277.



speaking, the developed mutual insurance has become similar to the commercial insurance; therefore, it contains Riba, Gharar and gambling.<sup>69</sup>

Ali Al-Gurrahdaghi argues that, Islamic insurance should be based on the following principles:

First, insurance contracts must comply with Islamic Sharia rules. That is to say, a new contract, such as insurance, must be free from any element that makes the contract illegal. A well recognised Islamic principle in Sharia is that all contracts and stipulations under Sharia are legal unless they contain what turns them to be illegal.<sup>70</sup>

Second, insurance contracts must be based on donation because Gharar that affects commutative or onerous contracts and makes them illegal does not affect charities or donations.<sup>71</sup> In a commutative or onerous contract each party gives something for getting something else from the other party. Therefore, the subject matter of the contract has to be well identified for not causing any conflict between the parties. However, in charities and donations the ignorance of the given object would not cause any conflict.<sup>72</sup>

Thus, where a person promises another to present a watch, for example, to him by way of charity, it does not matter what kind of watch it is and that would not give a

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<sup>69</sup> *Ibid*, p. 284.

<sup>70</sup> Ali Mohe'y Ad-Deen Al-Gurrahdaghi, "At-Tameen ala Al-Hayat wa Ad-Dhawabid Ash-Sharreyah Le-Uqood At-Tameen ala Al-Hayat", in *Bohooth fe Fiqh Al-Muamalat Al-Maleyah Al-Muaseerah*, (Dar Al-Bashayer Al-Islamiyah, Beirut-Lebanon), (2001), 261, at 315. It seems that the author supports the opinion that cooperative insurance is the form that complies with Sharia, whereas commercial insurance infringes Sharia principles.

<sup>71</sup> *Ibid*, p. 318.

<sup>72</sup> As-Seddeeg M. Al-Dhereer, *Al-Gharar wa Atharaho fe Al-Uqood fe Al-Fiqh Al-Islami*, (Arabic), Uncertainty and its Effect Contracts in Islamic Jurisprudence, (1967), pp. 522; Fatawa Ibn Taymiyyah, Vol. 3, pp. 342, 343.

donee the right of taking legal action against his donator. By contrast, where a vendor sells a watch for £1000 without identifying its mark or its features, the contract would be void due to the ignorance of the subject matter and the element of Gharar, but where the purchaser identifies the watch and the vendor presents a cheaper watch to the purchaser, the latter would possess a legal right to take legal action against the vendor for claiming his watch or a satisfactory compensation.

Third, distribution of the surplus among the members,<sup>73</sup> that Al-Gurrahdaghi suggests, the amounts of money that are deposited in the insurance company could be invested in legal ways and profits could be made therefrom. Therefore, such profits plus the amount of the premiums that remains after the payment of indemnities of the members' losses must be paid back to the insureds and the sharers.<sup>74</sup>

Fourth, participation in administration and losses, that Al-Gurrahdaghi sets out some cooperative insurance features,<sup>75</sup> such as that there are mutual interests between the members which require them to insure each other; the members share solidarity to cover each other; the premiums, or contributions, vary each year according to the cost of indemnities that are paid from the paid premiums.<sup>76</sup>

In the light of the above arguments, the element of donation in cooperative insurance is a fundamental and that excludes this form of insurance from commerce generally. That is to say, since the word "donation or charity" does not exist in commercial dictionary, there is no need to say that cooperative insurance is needed in

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<sup>73</sup> *Ibid*, p. 322.

<sup>74</sup> *Ibid*, pp. 322, 323.

<sup>75</sup> *Ibid*, pp. 323, 324.

<sup>76</sup> *Ibid*.

Islamic social life due to the fact that the Islamic Sharia and jurisprudence are rich of schemes that secure people. For instance, the system of *Zakat* imposes supporting eight categories of people on rich Muslims or those who are living in a good standard of life. Allah said, in *Quran*,

**(*As-Sadagat* (here it means *Zakat*) are only for the *Fuqara* (poor), and *Al-Masakin* (the needy) and those employed to collect (the funds), and to attach the hearts of those who have been inclined (towards Islam), and to free the captives, and for those in debt, and for Allah's Cause (i.e. for *Mujahidun* – those fighting in a holy battle), and for the wayfarer (a traveller who is cut off from everything); a duty imposed by Allah. And Allah is All-Knower, All-Wise).<sup>77</sup>**

In addition to that, it has been said there are numerous of cooperative systems under *Sharia* that impose and encourage Muslims to support each other such as *Sadagat*, charities, *Al-A'aqilah* system, *Al-Muwalat* and *An-Nehid* systems and other systems that cannot be tackled in details at this stage.

### **6.3.2. Illegality of Insurance under Sharia**

The majority of contemporary Muslim scholars and legal jurists support the need of insurance as a cooperative system and they observe that insurance contracts are legal under Islamic Law provided they are free of prohibited elements. It has been argued

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<sup>77</sup> Al-Taubah, verse 60, M. Al-Hilali & M. Khan, *Translation of the meaning of THE NOBLE QURAN*, (1417 A.H), (1996-1997), at p. 254.

that, conventional insurance is a commercial insurance and it is based upon fundamental prohibition elements such as *Riba* and *Gharar* and *Maysir*.<sup>78</sup>

Therefore, having said that *Riba*, *Gharar* and *Maysir* are three of the main reasons behind not accepting the commercial insurance, including life insurance, contracts, it is significant for the purpose of the thesis to give a sufficient explanation about how do these elements manifest in insurance at this stage.

### 6.3.2.1. *Riba*

*Riba* is manifested in insurance by that where the risk insured against has been actually occurred, the position would not be out of the following conditions: either the insured gets more than the amount of the premium that he has paid the insurer; or the insured gets less than the paid premium from the insurer; or he gets the same amount of the paid premium(s); therefore, *riba* occurs in all conditions. In the first and second condition *riba Al-Fadhil* occurs because the insured paid the premium before the insurer pays him the insurance money and they exchange one thing of same kind, i.e. money, in different time. In the third condition, *riba An-Nase'ah* appears in exchanging a thing of same kind in different time.<sup>79</sup>

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<sup>78</sup> In other words, they support cooperative insurance. See; Ahmad Sharaf Ad-Deen, *Ahkam At-Tameen fi Al-Qanoon wa Alqadha*, (in Arabic), Rules of Insurance in Regulation and Judiciary, 1983, p. 60; Yaqob Sarkhoh, *At-Tameen Albahri fi Alqanoon Al-Kuwaiti*, (in Arabic), Marine Insurance in Kuwaiti Law, 1993, 23, p. 27.

<sup>79</sup> Researches of the Board of Great Ulama in Saudi Arabia, *At-Tameen (Insurance)*, Vol. 4, (2001), 35, at p. 131; Sulaiman Al-Thunayan, *At-Tameen wa Ahkamuh*, (Arabic), Insurance and its Rules, (Dar Ibn Hazim, Beirut-Lebanon), (2003), p. 217; Hamad Al-Hammad, *Uqood At-Tameen*, (Arabic), Insurance Contracts, (1989), p. 13; Mabrok Al-Najar, *Aqid At-Tameen*, (Arabic), The Contract of Insurance, (Dar

Mohammad Biltaji is of the opinion that the contract of insurance is a kind of currency exchanging contract which has been surveyed by the orthodox Islamic scholars that where a person sells a currency to another.<sup>80</sup> Therefore, the transaction is exchanging currencies and that, under Sharia, must be at the same time, otherwise, it would be *riba An-Nase'ah* where the completion of the transactions is delayed.

Therefore, Shawkat Olayan observed that, the calculation of interest, which is *riba*, is a fundamental element in the insurance system that cannot be avoided.<sup>81</sup>

According to the above arguments, it seems that some jurists treat the contract of insurance as some well known contracts such as money exchanging contracts where *riba An-Nase'a* might occur in the case of delaying completion of the transaction. The analogy that has been drawn by some jurists between the contract of insurance and the money exchanging contract might be true where the analogy is drawn with, what is called, contingency insurance policies, such as life policies where the sum recovered

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An-Nahdhah Al-Arabiyyah, Egypt), (1994), p. 244; Mohammad Biltaji, *Uqood At-Tameen*, (Arabic), Insurance Contracts, (Maktabat Al-Balad Al-Ameen, Cairo-Egypt), (2000), p. 98. In this regard, a question was arisen to IslamOnline.net about the legitimacy of insurance transactions. The answer was provided by Sheikh Muhammad Salih Al-Munajjid, a Saudi scholar and he declared that, "All types of commercial insurance no doubt entail *Riba* (interest) because you pay a specific sum of money and take a larger or smaller amount should a risk occur. Accordingly, this coverage contains *Riba An-Nasi'ah* (interest on lent money) and *Riba Al-Fadl* (exchanging a superior thing of the same kind of goods with more of inferior quality of the same kind of goods), for as we know, the insurers take premiums from those under this coverage and promise to give them smaller or larger amounts should a risk occur to the insured. No doubt, this is the very same *Riba* which is prohibited according to many Qur'anic verses." [http://www.islamonline.net/servlet/Satellite?pagename=IslamOnline-English-Ask\\_Scholar/FatwaE/FatwaE&cid=1119503544750](http://www.islamonline.net/servlet/Satellite?pagename=IslamOnline-English-Ask_Scholar/FatwaE/FatwaE&cid=1119503544750), 06 March 2005.

<sup>80</sup> *Ibid.* See, also, Hussain Hamid Hassan, *Hukom Ash-Sharia Al-Islamiyah fi Uqood At-Tameen*, (Arabic), The Judgment of Islamic Sharia in Insurance Contracts, undated, p. 474. Hussain Hassan is of the opinion that the contract of insurance contains the element of *riba* because it is an agreement between one party, the assured, to pay a sum of money either at once or by instalments to another party, the insurer, to undertake to pay the assured or his/her successors or his/her beneficiary a sum of money when the risk insured against has occurred. Thus, Hassan treats the contract of insurance as a contract of exchanging money or currency.

<sup>81</sup> Shawkat Olayan, *At-Tameen fi Ash-Sharia wa Al-Qanoon*, (Arabic), Insurance in Sharia and Law, 2<sup>nd</sup> ed., (Dar Ar-Rasheed, Riyadh-Saudi Arabia), (1981), p. 217.

is fixed by the policy,<sup>82</sup> but the matter might be different in indemnity insurance policies, for example property insurance. That is to say, in property insurance it is not necessary that the insurer must pay the insured a sum of money where he suffers a loss due to the occurrence of the risk insured against as an indemnity. Instead, the indemnity could be by reinstatement, i.e. that where the insurer pays for the repair or replacement of the insured property instead of paying money to the insured.<sup>83</sup> In third party car insurance, for instance, the insurer usually, as the case in England, pays the garage directly where the third party victim's car is repaired.

It is doubted, therefore, the issue of *riba* is questionable therein, but that does not mean there is no other question that could be arisen regarding the legitimacy of insurance. It must be noted, however, that, if premium is considered as loan, as what some Muslim jurists think, the element of *riba* triggers where the insured is paid insurance money by his insurer or where even the insurer pays the garage directly where the third party victim's car is repaired in the case of third party insurance. The reason is that, under Islamic *Sharia* every loan produces an economic benefit is *riba*.

Indeed, the issues of *Maysir* and *Gharar* could be arisen in any form of insurance; if that is true, the contract of insurance will be rejected under *Sharia*. Therefore, it is necessary, at this stage, to explore how *Maysir* and *Gharar* manifest in the contract of insurance.

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<sup>82</sup> John Lowry and Philip Rawlings, *Insurance Law: Doctrines and Principles*, 2<sup>nd</sup> ed., (2005), p. 263, the matter is similar in valued policies in the case of marine insurance. See, also, the case in Valued Policies in Marine insurance. See, for example, section (27) of the Marine Insurance Act 1906 [UK]; Susan Hodges, *Law of Marine Insurance*, (1997), p. 71.

<sup>83</sup> John Lowry and Philip Rawlings, *ibid*, at p. 282. See, *Brown v Royal Insurance Co* (1859) 1 E1 & E1 853; *Carlyle v Elite Insurance Co* (1984) 56 BCLR 331.

#### **6.3.2.2. *Maysir***<sup>84</sup>

The contract of insurance contains the element of gambling where the assured pay the premium with a hope that he benefits from the insurance money should the risk insured against occurs. Otherwise, the insurer wins the premium where the contract of insurance expires without any claim from the part of the assured to be indemnified from a loss that is caused by the risk insured against. According to Al-Thunayan, the contract of insurance contains two fundamental principles, namely, risk and contingency. Gambling, therefore, is based upon the same principles, i.e. risk and contingency.<sup>85</sup>

#### **6.3.2.3. *Gharar***

As a matter of fact, the element of *Gharar* does not influence the validity of all contracts, but there is a certain degree of *Gharar* that must exist in a certain type of contracts. Al-Dhareer, nevertheless, sets out four conditions that must take place in a contract that contains *Gharar* in order to say such contract is invalid. There are, namely, the contract must be an onerous contract; *Gharar* in such contract must be excessive; *Gharar* must relate to the subject-matter of the contract; finally, there must

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<sup>84</sup> It is of importance to note that, the core of *Maysir*, gambling is the element of *Gharar*, uncertainty, which will be dealt with in detail below. The element of *Gharar* appears in gambling in that a gambler does not know at the time of playing whether he/she will win or lose. Note, also, the same rule applies to wagering.

<sup>85</sup> Sulaiman Al-Thunayan, *At-Tameen wa Ahkamuh*, (Arabic), Insurance and its Rules, (Dar Ibn Hazim, Beirut-Lebanon, 2003), p. 227.

not be a necessity for the contract.<sup>86</sup> Therefore, it is necessary to go through these conditions in more details.

Firstly, Gharar must exist in an onerous contract. That is to say, where the parties in a contract exchange economic benefits, as the case in a sale contract, lease or hire contract or other onerous contract, the parties must be clear about what they agree on. The general prohibition of Gharar was declared by Prophet Mohammad, peace be upon him, in many kind of sale transactions, as for instance, he prohibited selling fruits before they are ripe.<sup>87</sup> In this manner, Fadi Moghaizel observes that, "...Gharar is applicable to contracts involving an actual exchange of countervalues which are subject to the requirement of equivalence and not to a transaction containing a binding promise of financial assistance in consideration of a contribution to a fund affected for this purpose. That is why the sale of unripe fruits has been forbidden by the Prophet, peace be upon him. If they do not reach maturity for whatever reason, the projected

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<sup>86</sup> As-Seddeeg M. Al-Dhereer, *Al-Gharar wa Atharaho fe Al-Uqood fe Al-Fiqh Al-Islami*, (Arabic), Uncertainty and its Effect Contracts in Islamic Jurisprudence, (1967), p. 584.

<sup>87</sup> *Ibid*, at p. 585. See, Imam Abdullah Ibn Qudamah, *Al-Mughni*, Vol. 6, 4<sup>th</sup> ed., (Dar A'alam Al-Kutub, Riyadh-Saudi Arabia), (1999), p. 148; Nabil A. Saleh, *Unlawful Gain and Legitimate Profit in Islamic Law*, 2<sup>nd</sup> ed., (1992), p. 75. Saleh translated a list of ten cases which constitute forbidden Gharar transactions under Sharia that had been provided by a Muslim Maliki jurist Ibn Jauzi, that, "(a) Difficulty in putting the buyer in possession of the subject-matter; such as the sale of stray animal or the young still unborn when the mother is not part of the sale.

(b) Want of knowledge (*jahl*) with regard to the price or the subject-matter, such as the vendor saying to the potential buyer: "I sell you what is in my sleeve."

(c) Want of knowledge with regard to the characteristics of the price or of the subject-matter, such as the vendor saying to the potential buyer: "I sell you a piece of cloth which is in my home"; or the sale of an article without the buyer inspecting or the seller describing it.

(d) Want of knowledge with regard to the quantum of the piece or the quantity of the subject-matter, such as an offer to sell "at today's price" or "at the market price."

(e) Want of knowledge with regard to the date of future performance, such as an offer to sell when a stated person enters the room or when a stated person dies.

(f) Two sales in one transaction, such as selling one article at two different prices, one for cash and one for credit, or selling two different articles at one price, one price, one for immediate remittance and one for a deferred one.

(g) The sale of what is not expected to revive, such as the sale of a sick animal.

(h) *Bay' al-hasah*, which is a type of sale whose outcome is determined by the throwing of a stone.

(i) *Bay' munabadha*, which is a sale performed by the vendor throwing a cloth at the buyer and achieving the sale transaction without giving the buyer the opportunity for properly examining the object of the sale.

(j) *Bay' mulamasa*, where the bargain is struck by touching the object of the sale without examining it."; at pp. 64, 65.



equivalence would then be upset and the result would be an unjustified increase of capital to the benefit of the seller."<sup>88</sup>

Therefore, the element of Gharar does not influence the validity of donative contracts, such as gratuitous contract, because the grantee of the parties does not pay for what he gets and, therefore, Gharar in the latter contract does not cause a dispute between the parties. Having said that, the grantee does not unlawfully eat the grantor's money; therefore, the contract is valid.<sup>89</sup> As for the contract of insurance, it is an onerous contract that both parties have to fulfil their duties towards each other. The insured is obligated to pay out the premium and, on the other hand, the insurer undertakes to indemnify the insured should he/she suffer a loss due to the occurrence of insured risks.

Secondly, Gharar must be excessive in an onerous contract. The consequence of this degree is that one party will eat, or gain, the other party's money unlawfully. Accordingly, where a vendor sells a subject-matter that cannot hand over to the purchaser or where the vendor sells a stray animal, Gharar will invalidate the contract. Nevertheless, Gharar is slight or immaterial and, therefore, will not influence the validity of the contract where it is reasonable and does not cause any dispute between the parties. For example, where a person buys a house without seeing its foundation or where a tenant rent a house for a month and it is not certain whether the month will be twenty nine days or thirty days.<sup>90</sup> In fact, the notion of excessive Gharar enjoys

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<sup>88</sup> Fadi Moghaizel, *Insurance in The Light of Islamic Legal Principles*, (PhD Thesis, SOAS, University of London), (1990), p. 195.

<sup>89</sup> As-Seddeeg M. Al-Dhereer, *Al-Gharar wa Atharaho fe Al-Uqood fe Al-Fiqh Al-Islami*, (Arabic), *Uncertainty and its Effect Contracts in Islamic Jurisprudence*, (1967), p. 586.

<sup>90</sup> *Ibid*, p. 587. This example is provided by orthodox Muslim jurists using the Islamic calendar which depends on the moon.

flexibility in Islamic jurisprudence which is supported by Al-Dhareer because, according to him, the judgment whether the element of Gharar is excessive or not would depend on each case's facts and the nature of each transaction. It is admitted that the judgment on a transaction that whether it contains an excessive Gharar that invalidates it, is an elusive issue which depends on an endeavour of a scholar. Thus, Al-Dhareer supports the view that the criterion of an excessive Gharar is that where a contract is described by it as, for instance, selling fish in the sea or bird in the air.<sup>91</sup>

Applying this condition to the contract of insurance, Gharar is excessive in that none of the parties knows, at the time of concluding the contract, whether the risk insured against will actually occur and how much the insurer will indemnify the insured.

Thirdly, Gharar must relate to the subject-matter of the contract. It has been said that, where a vendor sells unripe fruits, the sale would be illegal due to the element of Gharar.<sup>92</sup> However, should the vendor sell a tree with its unripe fruits, the sale is legal because Gharar is in a thing that is subsidiary to the subject-matter of the contract, i.e. the tree.<sup>93</sup>

As far as the contract of insurance is concerned, an insured seeks insuring his interest against certain risks in order to protect his economic status from being prejudiced as a result of the occurrence of the insured risk(s). On the other hand, an

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<sup>91</sup> *Ibid*, p. 592. See, also, Nabil A. Saleh, *Unlawful Gain and Legitimate Profit in Islamic Law*, 2<sup>nd</sup> ed., (1992), p. 75.

<sup>92</sup> Imam Abdullah Ibn Qudamah, *Al-Mughni*, Vol. 6, 4<sup>th</sup> ed., (Dar A'alam Al-Kutub, Riyadh-Saudi Arabia), (1999), p. 148.

<sup>93</sup> As-Seddeeg M. Al-Dhareer, *Al-Gharar wa Atharaho fe Al-Uqood fe Al-Fiqh Al-Islami*, (Arabic), Uncertainty and its Effect Contracts in Islamic Jurisprudence, (1967), p. 594.

insurer provides the insured a promise to indemnify him/her should the risk insured against has actually occurred and caused him/her a loss. Thus, it has been mentioned that, where an insured buys an insurance policy from an insurer; the policy represents a promise from the part of the insurer that he is obligated to indemnify the insured should the latter suffers a loss under certain circumstances.

Accordingly, it can be said that the subject-matter of the contract is the insurer's promise of indemnity which is probable and dependant upon several factors; for example, the happening of the risk insured against, the loss suffered must be attributable to the insured risk, the risk must occur during the time of the insurance policy and the insured must possess an insurable interest in the subject-matter of insurance at the time of the loss.<sup>94</sup> There are, of course, other factors that are related to the insured's fulfilment of the duty of utmost good faith, the policy's warranties, etc. Furthermore, it has been admitted, under English law, that a contract of insurance is a contract upon speculation;<sup>95</sup> therefore, the contract of insurance is an aleatory contract. Consequently, the element of Gharar is related to the subject-matter of the contract that makes the contract of insurance invalid under Sharia.

Fourthly, there must not be a necessity for the contract that contains Gharar.<sup>96</sup> Al-Dhareer observes that, when people are in desire need of a contract, without which

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<sup>94</sup> For more discussion of deferent views about the definition of insurable interest under English law, see section 3.2, *supra*.

<sup>95</sup> *Carter v Boehm* (1766) 3 Burr 1905.

<sup>96</sup> It has to be borne in mind that, Dr Al-Dhareer used the word (*hajah*) which means need instead of (*dharurah*) which means necessity. However, he explained that traditional Muslim jurists had been using the word (*hajah*), need, in the same meaning of (*dharurah*), necessity. Therefore, he used, in his research, (*hajah*) in the same meaning of (*dharurah*). The difference between the two concepts is that (*dharurah*), necessity is a higher degree than (*hajah*), need. Furthermore, where there is a public need for all people in a place, such need is treated as necessity. Therefore, there are some nominated contracts in Sharia that have been legal although they contain the element of Gharar such as the sale of (*salam*) which means sale with advance payment for future delivery. This kind of sale is, in principle,

they are faced with difficulties, such contract would be legal regardless the degree of Gharar it contains. He, also, observes that elimination of difficulties from people is from the general principles of Sharia. However, it has to be borne in mind that, such contract must be legal in principle.

Furthermore, Hussain Hassan argues that, where an onerous contract contains Gharar in four situations the contract would be null and void. They are, namely, Gharar in the existence of the subject-matter, Gharar in the gaining, Gharar in the value or the price and Gharar in the time of gaining one of the counter-values.<sup>97</sup>

In the first place, Hassan argues that there is no disagreement between Muslim jurists that an onerous contract which has no object or subject-matter or which is uncertain to be existent, is void. According to him, where the subject-matter of a sale contract is a stray camel that is doubted to be existed, such contract is void because gaining the subject-matter, i.e. the camel, is subject to a risk of its existence. So, in the case of non-existence of the subject-matter, the purchaser would have paid his money

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illegal. However, due to the need for people to practice this kind of contracts, it has become a public need and, therefore, it has become legal. For more detailed discussion on this see, Nabil A. Saleh, *Unlawful Gain and Legitimate Profit in Islamic Law*, 2<sup>nd</sup> ed., (1992), p. 89. The author explains the sale of *salam* and its mechanism that, "the vendor has no title over the sale object but undertakes to make it available to the purchaser. The subject-matter of *bay' salam*, sale of *salam*, is a promise given against payment and not an object *in rem*; a personal obligation and not an object in kind. Under strict Sharia rules this kind of sale would be unlawful, for the vendor deals with an article which is not in his possession. Nevertheless, *bay' salam* was admitted by Sharia on the ground of a tradition attributed to the Prophet, peace be upon him, himself and on the ground of consensus (*ijma*) and because it responds to public need. *Bay' salam*, being an exception to a general rule, namely that the sale objected should be available to the contracting parties at the time the sale is concluded, is bound by special rules intended to minimize the danger of *gharar* and, rather theoretically, the danger of *riba*. In this connection the subject-matter and the price in a *bay' salam* cannot both be currencies, for the deferred exchange of currencies with or without an excess is unlawful according to nearly all schools of law."; at p. 89. See, As-Seddeeg M. Al-Dhereer, *Al-Gharar wa Atharaho fe Al-Uqood fe Al-Fiqh Al-Islami*, (Arabic), Uncertainty and its Effect Contracts in Islamic Jurisprudence, (1967), pp. 600-604. However, Dr Hussain Hamid Hassan used (*dharurah*) where he discussed the element of Gharar in the contract of insurance. See, Hussain Hamid Hassan, *Hukom Ash-Sharia Al-Islamiyah fi Uqood At-Tameen*, (Arabic), The Judgment of Islamic Sharia in Insurance Contracts, undated, p. 468. Accordingly, this thesis will use the concept of (*dharurah*) in this context.

<sup>97</sup> Hussain Hamid Hassan, *ibid*, pp. 456-462.

for nothing which is speculation. Therefore, he observes that, the latter case applies to the contract of insurance because the insurance money, which is a debt upon an insurance company, is uncertain to exist because it depends on the occurrence of the insured risk.<sup>98</sup>

In the second place, Hassan contends that, Muslim scholars are unanimous in that where a party in an onerous contract does not know at the time of concluding the contract whether or not he will receive one of the counter-values or the thing that makes him to conclude the contract, such contract will be void because the transaction is on risk.<sup>99</sup> That explains the reason behind forbidding foetuses in their mothers' wombs. As for the contract of insurance, Hassan argues that this condition applies to insurance because an insured does not know at the time of concluding the contract whether he will gain the insurance money, which he has paid the premiums for, because gaining the insurance money depends on a contingent event.<sup>100</sup>

In the third place, according to Hassan, where the price of an onerous contract is unknown, the contract will be void. This is unanimous among Muslim scholars.<sup>101</sup> Thus, where a person sells his house to another without identifying the price or a landlord lets his premises to a tenant without identifying the rate of the rent, the contract will be null and void. As far as the contract of insurance is concerned, in indemnity insurance, the insurance money is unknown at the time of concluding the contract because it depends on the loss that is caused by the insured risk from the part

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<sup>98</sup> *Ibid*, pp. 456, 457.

<sup>99</sup> *Ibid*, p. 457.

<sup>100</sup> *Ibid*.

<sup>101</sup> *Ibid*, pp. 458-460

of the insured. On the other hand, the insurance company does not know about the cost of the indemnity at the time of concluding the contract.<sup>102</sup>

In the fourth place, the ignorance of gaining one of the counter-values by either party renders an onerous contract null and void. Thus, Hassan argues that, in some forms of life insurance an insurance company is uncertain about the time of the payment of the insurance money to the beneficiary.<sup>103</sup> Therefore, this degree of ignorance constitutes an excessive Gharar which invalidates the contract.

### ***6.3.3. Legitimacy of Insurance under Sharia***

It can be said that, there are a minority of contemporary Muslim scholars and legal jurists who are of the view that insurance contracts in all forms are legal under *Sharia*.

*Al-Sanhuri*, as an example for this doctrine, claimed that insurance is lawful under *Sharia* because it is a system based upon cooperation between insureds to spread losses between them. On the other hand, an insurer is an intermediary, who coordinates the relationship between the insureds on a proper technical basis in order

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<sup>102</sup> *Ibid*, p. 460.

<sup>103</sup> *Ibid*, p. 462. See, also, Sulaiman Al-Thunayan, *At-Tameen wa Ahkamuh*, (Arabic), Insurance and its Rules, (Dar Ibn Hazim, Beirut-Lebanon), (2003), p. 237.

to indemnify the few insureds who suffer losses.<sup>104</sup> Surprisingly, *Al-Sanhuri* argued that insurance contracts, including life insurance, are valid under *Sharia*. That, "...there is another aspect in the contract of insurance other than the relationship between the insurer and the insured and the contract of insurance cannot be fully understood without considering that aspect. An insurance company", he said, "does not conclude an insurance contract with one insured, nor with few insureds. However, should the company conclude the contract in that way, it would be gambling or wagering, therefore, the contract would be unlawful." He carried on mentioning that, "Where the insurance company agrees, for example, to indemnify the insured in the case that his house is burnt down, in fire insurance, by paying him the amount of the value of his house and if it does not suffer loss by fire, the premium, which was paid by the insured, is an equitable right of the company. That is wagering. Yet, the company enters into insurance contracts with large number of insureds and receives premiums from each of them. The total of the premiums is paid to indemnify few of those insureds who suffered loss and the premium is calculated on technical principles that are derived from statistics."<sup>105</sup> Therefore, he believed that an insurance contract is lawful under *Sharia* because it is not gaming, but it is mere cooperation between insured to cover each other against any possible loss. He observed that,

"Indeed, from an economic technical aspect, contract of insurance is not gaming, not from the part of the insurer because he collects premiums from

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<sup>104</sup> See Mustafa Mohammad Al-Faqi, Abdul Rrazag Al-Sanhuri, *Al-Waseet fi Sharh Al-Qanoon Al-Madani*, (in Arabic), *Al-Waseet in Explanation of the Civil Law*, part 7, Vol. 2, 2<sup>nd</sup> ed., (Dar An-Nahdhah Al-Arabiyah Cairo-Egypt), (1990), foot note 1, p. 1382. It is significant to mention that, Dr Al-Sanhuri was the one who drafted the Egyptian Civil Law 1948. Therefore, his view is of importance because it represents a doctrine which is followed by wide range of Arab, especially Egyptian, legal jurists. See also, Hussam Al-Ahwani, *Almabadi Al-Aammah Lel-Tameen*, (in Arabic), General principles of Insurance, (1975), p. 33; Mustafa Az-Zarga, *Agid At-Tameen wa Mawgiff Asharia Al-Islamiah menho*, (Arabic), Insurance Contract and its position under Islamic Sharia, (Damascus University), (1962), pp. 25, 37; Ali Al-Khafif, a research presented to the second conference of the Islamic Research Academy of Al-Azhar, 1965, p. 33.

<sup>105</sup> Al-Sanhuri, *ibid*, at p. 1379.

the insureds and spends them to indemnify those insureds who suffer losses, but he does not expose himself to the contingency of loss or profit more than other person in any lawful business. Nor, from the part of the insured who does not benefit from insurance by gaming depending on fortune or chance. However, the insured benefits from insurance by cooperating with other insureds where losses are spread between them. Also, the insured secures himself from misfortune and risks by this cooperation. Thus, this cooperation should not be called gaming."<sup>106</sup>

Some other jurists have drawn an analogy between the contract of insurance and some other contract that have been well known for general Islamic scholars. Ahmad Taha As-Sanusi, for instance, analogised the contract of liability insurance with the contract of *Al-Muwalat*,<sup>107</sup> whereby someone of unknown descent agrees with someone else who is known descent that the latter undertakes to indemnify him for any legal fine where he accidentally causes death or grievous bodily harm, but without malice aforethought, such as manslaughter, in return for that the other person succeeds him should he die without successors. As-Sanusi was of the view that the contract of liability insurance and the contract of *Al-Muwalat* share some similarities, that in insurance there is a contractual duty whereby the insurer undertakes to indemnify the insured in the case he suffers a loss that is arisen from his liability to a

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<sup>106</sup> Mustafa Mohammad Al-Faqi, Abdul Rrazag Al-Sanhuri, *Al-Waseet fi Sharh Alkanoon Almadani*, (in Arabic), *Al-Waseet in Illustration of the Civil Law*, part 7, Vol. 2, 2<sup>nd</sup> ed., (Dar An-Nahthah Al-Arabiyyah Cairo-Egypt), (1990), foot note 1 (d), p. 1380, at p. 1383.

<sup>107</sup> See, Mohammad Qal'aji & Hamid Qunaibi, *Mu'jam Lughat al-Fuqaha*, (Dictionary of Islamic legal terminology), (Dar An-Nafaes, Beirut-Lebanon), (1996), p. 438.

*Al-Muwalat* contract is a cause of succession in Hanafi school of law in the Islamic jurisprudence. See, Mustafa Az-Zarga, *Agid At-Tameen wa Mawgiff Asharia Al-Islamiah menho*, (Arabic), Insurance Contract and its position under Islamic Sharia, (Damascus University), (1962), p. 22.



third party in return for payment of a premium. In Al-Muwalat,<sup>108</sup> there is a contractual duty between one party, *Mauwla Al-Muwalat*, and the other party where the latter undertakes to indemnify the first party in the case that he is obligated to pay a victim *Diyah* or *Arsh*<sup>109</sup> in return for the right of succession where the first party, *i.e.* *Mauwla Al-Muwalat*, has no successors.<sup>110</sup>

It can be said that, the nature of the contract of insurance totally differs from the nature of Al-Muwalat contract. According to Shawkat Olayan, there is a moral element in Al-Muwalat that is not found in insurance. That, in Al-Muwalat the reason of concluding the contract is moral and the parties agree on brotherhood to support and back each other and the financial support is a consequence of the contract. On the other hand, the relationship between the parties, in insurance, is based upon economic interests. The contract of insurance is a commutative contract, whereas the contract of Al-Muwalat is based upon creating a kinship between the parties.<sup>111</sup>

Furthermore, Shaikh Ali Al-Khafif analysed the contract of insurance and he was of the opinion that insurance was legal under *Sharia*. Although he admitted that the contract of insurance was an aleatory contract and contained some amount of *ghara*,

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<sup>108</sup> See, Mohammad Biltaji, *Uqood At-Tameen*, (Arabic), Insurance Contracts, (Maktabat Al-Balad Al-Ameen, Cairo-Egypt), (2000), p. 112.

<sup>109</sup> An Islamic devise, which is an economic penalty that is paid by a wrongdoer to his victim as an indemnity for wounds and fractures. See, Mohammad Qal'aji & Hamid Qunaibi, *Mu'jam Lughat al-Fuqaha*, (Dictionary of Islamic legal terminology), (Dar An-Nafaes, Beirut-Lebanon), (1996), p. 188.

<sup>110</sup> Mustafa Az-Zarga agreed with this analogy. See, Mustafa M. Az-Zarga, *Netham At-Tameen*, (Arabic), Insurance System, (Al-Resalah Est., Beirut-Lebanon), (1984), p. 57. In contrast, see the argument of Shaikh Mohammad Abo Zahrah who strongly disagreed with Az-Zarga on this analogy as well as the analogy between insurance and Al-Aqilah system; see Mustafa Az-Zarga, *ibid*, at pp. 73 & 74.

<sup>111</sup> Shawkat Olayan, *At-Tameen fe Ash-Sharia wa Al-Qanoon*, (Arabic), Insurance in Sharia and Law, 2<sup>nd</sup> ed., (Dar Ar-Rasheed, Riyadh-Saudi Arabia), (1981), pp. 159-160.

uncertainty, he thought that such uncertainty did not cause conflicts between parties and that what had been making insurance widespread between people.<sup>112</sup>

Mustafa Az-Zarga surveyed insurance not only as a contract, but as a system.<sup>113</sup> His view was that insurance in general, whether cooperative, or what is called mutual, or commercial, was based upon solidarity that could be achieved by three elements. These are, namely, cooperation between insureds, set-off between risks and the use of statistics.<sup>114</sup> According to him, in mutual insurance the cooperation is direct because making profits is not intended in this form. In commercial insurance, however, is profitable and the cooperation appears in indirect manner by way of set off between indemnities that are paid by an insurance company to its insureds who suffer losses that insured against and the premiums that are collected from the insureds. Therefore, it seems that the indemnity is actually operated by the insureds that where they pay their premiums to the insurance company. Nevertheless, the amount that exceeds after indemnifying all prejudiced insureds is considered a profit for the company and, thus, it is not refundable to the insureds. Thus, this case differs from the case in mutual, or cooperative, insurance that the insured can get back that surplus. Therefore, the

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<sup>112</sup> Issa Abdoh, *At-Tameen bayn Al-Halal wa Al-Haram*, (in Arabic), Insurance between Lawfulness and Prohibition, (1978), pp. 203-206. The author presented opinions of several legal jurists and scholars who thought that insurance was legal under Sharia on the ground that insurance is cooperation between insureds to indemnify each other. See, Shaikh Abdu Al-Wahhab Khilaf who said that the contract of life assurance was legal in Sharia because it was a speculation where the assureds present a capital to the speculator, the insurer, who exploit the capital and share the profits with the assureds, at p. 207; see also, Mohammad Al-Bahi who was of the opinion that the contract of insurance was not a sale contract, but solidarity contract between insureds to encounter with risks, at p. 209; Shaikh Abd Al-Munsif Mahmood, he was of the opinion that insurance was similar to guarantee, at 213; Mohammad Yusif Mosa, he thought that insurance was beneficial and it was kind of cooperation and about life insurance it was legal in Sharia so long as it did not contain riba, usury, that if the assured lived up to the age that specified in the contract, he should not take back more what he had actually paid to the insurance company. However, if he died before that age, his successors could earn the insurance money, at p. 214.

<sup>113</sup> Mustafa M. Az-Zarga, *Netham At-Tameen*, (Arabic), Insurance System, (Al-Resalah Est., Beirut-Lebanon, 1984). The author said that the role of insurance was just like the role of a lightning rod. The lightning rod provides a protection by transferring thunder to a route to avoid its harm. Likewise, the contract of insurance provides protection to avoid the harm of risks insured against; at p. 47.

<sup>114</sup> *Ibid*, at p. 42.

solidarity and cooperative principles in the system of insurance differentiates it from gambling.<sup>115</sup> He observed that the notion of cooperation could operate by spreading risk upon a large number of insureds and this way makes a loss disappear by reinsurance.<sup>116</sup> Az-Zarga argued that insurance was not gambling nor wagering that the contract of insurance is commutative and it is beneficial to both parties that it is profitable for the insurer and it provides security and indemnity for the insured, whereas in both gambling and wagering the parties depend, when they play, on luck and fortune.<sup>117</sup>

Furthermore, Az-Zarg never agreed with the argument that insurance contained Gharar, uncertainty. In his view, a contract of Gharar is based upon an adventure or a bet which is the case in wagering and gambling and its consequence is not beneficial to both parties. Instead, the consequence will be that one party loses and the other wins depending on the adventure or the bet.<sup>118</sup> In his opinion, the contract of insurance should not be considered as a contingent contract, that the contingency occurs from the part of the insurer that whether he would indemnify the insured where the risk insured against has actually occurred or not. The statistic principle in the insurance system would exclude contingency from the insurance contracts that the insurer goes into as a whole. As from the perspective of the insured, the contingency does not exist due to the fact that the insured does, in fact, get what he really expects from the insurance contract, i.e. security, no matter whether the risk insured against has occurred or not. Because where the risk does not occur, the insured would be unworried and secured that his property and his interests would have been sound. On

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<sup>115</sup> *Ibid*, at p. 43.

<sup>116</sup> *Ibid*.

<sup>117</sup> *Ibid*, at pp. 45 & 46.

<sup>118</sup> *Ibid*, p. 48.

the contrary, where the risk insured against has occurred, the insured would be indemnified and that, therefore, what the insured pays the premium for.<sup>119</sup>

Moreover, he argued that, the element of contingency, or uncertainty, is acceptable in contracts of guarantee by Islamic scholars not matter what its degree is, that the contract of guarantee would have been accepted where the guaranteed matter had been unknown to the guarantor whether about its existence or its amount. Thus, it would be legal where a guarantor undertakes to indemnify a creditor should his debtor die or travel abroad within a certain period of time.<sup>120</sup> According to Az-Zarga, the argument that insurance is not a property that could be bought, or in other words is an intangible item, should be rejected, that there is nothing in Sharia prevents a person to pay so much money for securing him self, his family and their properties and future by concluding contracts for that purpose. Therefore, hiring a watchman or custodian to protect or take care of a property against any aggression by other person would only provide a sense of security for the property owner and continuation of the safety of the property. This consequence is not tangible and, therefore, it differs from other consequences of other contracts such as carriage of things or making some product by a manufacturer. Instead, the consequence of the watchman's or the custodian's job is to provide security. Likewise, an insured, in a contract of insurance, spends a part of his money in order to get some security or insurance from losses that could result from some risks.<sup>121</sup>

Recently, Shaikh Abd Al-Muhsin Al-Ubaikan has been asked about the legitimacy of insurance on driving or third party insurance. His answer is that motor insurance is

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<sup>119</sup> *Ibid*, p. 50.

<sup>120</sup> *Ibid*.

<sup>121</sup> *Ibid*, p. 51.

a commercial insurance; in fact there is no distinction between commercial insurance and cooperative insurance and insurance is legitimate. He says, those people who say that insurance is unlawfully eating people's money pursuant to what Allah said that,

**(O you who believe! eat not up your property among yourselves in vanities: but let there be amongst you traffic and trade by mutual goodwill: nor kill (or destroy) yourselves: for verily Allah hath been to you Most Merciful!).<sup>122</sup>**

Unlawfully eating peoples' money could be by deceit, stealing, usury, but that does not appear in insurance. He observes that, where someone hires a guard man to guard his house from thieves and pays him for many years without any occurrence of the thieves, do we say the guard man unlawfully ate the house owner's money? No, an insured pays a premium for being unworried not for profiting. He rejects the view that insurance is *riba*, usury, and gambling. There is risk in gambling that a gambler pays 1000 S.R.<sup>123</sup> with a hope that he could earn 100,000 S.R., so he could win or lose. In insurance, however, there is no risk because the premium is paid as remuneration to the insurer who obviates a disaster from the insured. In other words, the premium, as remuneration, is paid for shifting the risk from the insured to the insurer. He, then, analogises insurance with *Al-Aaqilah* and that the insureds are cooperating with each other to obviate disasters from each other. As far as *ghara*, uncertainty, is concerned, Shaikh Al-Ubaikan does not see any uncertainty in the contract of insurance. That, the insured pays the premium with a full knowledge it will not be returned and it is for obviating the disaster. Further, he argues that if it is said that the commercial insurance is repugnant to Sharia because it is *riba*, usury, *gharar*, uncertainty and

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<sup>122</sup> An-Nessa, 4, verse 29. See, *Ibid*, at p. 310.

<sup>123</sup> An abbreviation for Saudi Riyal, Saudi currency.

gambling, the cooperative insurance is the same and it is, therefore, repugnant to Sharia because the members pay contributions to indemnify each other where one of them suffers loss, but it is said the member pays the contribution as donator. In fact, there is no donation here because the member pays the contribution in return for being indemnified when he suffers loss.<sup>124</sup>

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<sup>124</sup> Abd Al-Muhsin Al-Ubaikan, *At-Tameen*, (Arabic), Insurance, a recorded seminar on cassette, undated.

## 6.4. Insurance Contracts under Saudi Jurisdiction

Broadly speaking, Saudi courts reject any case which has to any forbidden element such as *riba*, usury. That is why the courts continuously refuse to deal with any case that relates, for example, to banks because there is a general belief that all banks in Saudi Arabia are usurious. Likewise, the Saudi courts have been refusing to deal with insurance cases for religious reasons.<sup>125</sup> Nonetheless, should a court find itself forced to deal with a case that its subject relates to insurance, the court will deal with it as the issue of insurance is never existed in the case and, instead, it will construe, where it is possible, insurance as a different issue. Accordingly, some Saudi courts have, recently, looked into some third party motor insurance cases, but they treat them as guarantee contracts instead. For example, there is a case that has been dealt with by the public court in city of Al-Madinah Al-Munawwarah,<sup>126</sup> where the defendant was the National Corporate for Cooperative Insurance that had been insuring a driver who negligently had a car accident which caused the death of the victim. Another court had found for the victim's family, the plaintiffs, and had obligated the defendant, the driver, to pay *Diyah* and damages.<sup>127</sup> However, due to the fact that the driver defendant was insolvent and, at the same time, insured, the plaintiffs alleged that the defendant's insurer should pay *Diyah* and damages as a guarantor. Although the insurer claimed, *inter alia*, that the court was not the competent court pursuant to Article (20) of the Cooperative Insurance Companies Control Law 2003, the court rejected the insurer argument and upheld the plaintiffs' allegation and held that the

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<sup>125</sup> See, Grievances Department case No. 1113/1/Q, 1423 A.H., 2002-3; case No. 1445/1/Q, 1425 A.H., 2005.

<sup>126</sup> Public Court- Al-Madinah Al-Munawwarah, case No. 154/1185/4, 5/7/1425 A.H., 21/8/2004.

<sup>127</sup> An Islamic device which is an indemnity that consists of, usually but not necessarily, sum of money that is given to the victim's family by the killer, where he kills the victim without malice aforethought. See, Mohammad Qal'aji & Hamid Qunaibi, *Mu'jam Lughat al-Fuqaha*, (Dictionary of Islamic legal terminology), (Dar An-Nafaes, Beirut-Lebanon), (1996), p. 188.

insurer should pay *Diyah* and damages for the insured because the insurer was the insured's guarantor.

Saudi judicial system is based on three types of courts. Public Courts, which enjoy the general authority and deal with civil, including family disputes, and criminal disputes;<sup>128</sup> Grievances Department, which deals with, *inter alia*, administrative and commercial disputes.<sup>129</sup> The Grievances Department is also called an administrative court,<sup>130</sup> and a number of commissions that deal with specified cases.<sup>131</sup> Thus, "Aside from the *Sharia* Courts, there are a number of judicial and quasi-judicial institutions with specialized jurisdictions. Some of these include the Chambers of Commerce and Industry, Committee on Commercial Paper, Supreme Commission on Labor Disputes, Commission on Impeachment of Ministers, and separate councils for civil servants, military personnel, and government employees. The judgments made in all of these bodies may be appealed to the Grievance Board."<sup>132</sup> Therefore, since Saudi courts have been rejecting resolving insurance cases, there is a need to establish a judicial committee for this regard.

In the light of the above, Saudi Government has passed the Cooperative Insurance Companies Control Law 2003 where it has been stated that insurance disputes shall be

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<sup>128</sup> Article (26) of Judiciary Law, Royal Decree No. M/64, 14/7/1395 A.H., 23/7/1975. The article states that,

"Courts shall have jurisdiction to decide with respect to all disputes and crimes, except those exempted by law. Rules for the jurisdiction of courts shall be set forth in the Shari'ah Procedure Law Courts and Law of Criminal Procedure. Specialized Courts may be formed by Royal Order on the recommendation of the Supreme Judicial Council."

<sup>129</sup> Article (8) of Grievances Department Law, Royal Decree No. M/51, 1402 A.H., 1982. Grievances Department became specialized in resolving commercial disputes by Royal Decree No. 241, 1987.

<sup>130</sup> It is translated also as (Grievance Board). For more discussion, see, Fahad Al-Dugaithir, *Raqabat Al-Qadha ala Qararat Al-Idarah*, (Arabic), Control of Judiciary on Administrative Decision, (Dar An-Nahdhah Al-Arabiah, Cairo-Egypt), undated. See, also, Alison Lerrick & Q. Javed Mian, *Saudi Business and Labor Law*, 2<sup>nd</sup> ed., (1987), pp. 198 & 231.

<sup>131</sup> See, Alison Lerrick & Q. Javed Mian, *ibid*, at p. 221.

<sup>132</sup> See, Programme on Governance in the Arab Region, United Nations Development Programme, at: <http://www.pogar.org/countries/judiciary.asp?cid=16>.



resolved by a committee of three members. It, also, states that parties in an insurance dispute can appeal before the Grievances Department. Article (20) of the Cooperative Insurance Companies Control Law 2003 states that,

"One committee or more shall be formed by an Edict of the Council of Ministers on a recommendation of the Minister of Finance. Such committee shall consist of three specialized members, one whom at least, must be a legal consultant. The committee shall undertake to resolve the disputes arising between insurance companies and their customers or between the companies and other companies when they subrogate the insured persons, and settle violations of regulatory and supervisory instructions issued to insurance and re-insurance companies and the violations of those engaged in self-employment occupations referred to under Article (18)... Representing the Public Prosecution before this committee, in respect of such violations, shall be the employees appointed by virtue of an order issued by the Minister of Finance. Resolutions adopted by such committee may be appealed before the Grievances Department."

It has to be noted, however, that the committee has not yet commenced proceeding. Insurance disputes, therefore, have been resolved either by an appointed committee in the Saudi Ministry of Commerce or Arbitration. Hence, this matter does not show clear manners in dealing with certain insurance issues under Saudi jurisdiction.<sup>133</sup> That is to say, it can be found that two different judgements on one issue depending on each arbitrator's point of view about the issue.

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<sup>133</sup> It has to be noted that, arbitral decisions and the decisions that are made by committee of resolution of insurance disputes in the Ministry of Commerce are not published and that makes the position rather harder to find out a particular manner in dealing with insurance legal issues.

## 6.5. General Comments

It seems that, the reason behind the variety of opinions between the Islamic scholars and the Muslim legal jurists about insurance contracts is the lack of a full understanding the legal aspects and technical features of insurance contracts.

Some of them tried to show that insurance contracts comply with *Sharia* by arguing that insurance should be tackled as a system between many insureds who undertook to cooperate with each other to spread losses upon themselves, but not as a contract between an insurer and an insured or few insureds, which will make the contract, in this form, a wagering or gambling contract. Therefore, under such circumstances, insurance contracts are lawful. That does not make legal sense because a contract of insurance is an agreement between two parties.

The other doctrine claimed that insurance is unlawful because it is not similar to any recognised contracts by the orthodox Islamic jurisprudence and the schools of law. In fact, Islamic law is not rigid to strictly nominate certain contracts to be lawful, that is incompatible with the general principle of *Sharia*. As the matter of fact, *Sharia* allows persons to go into agreements according to their interests so long as they comply with its general principles and as long as the do not unlawfully eat each other's money.

The third doctrine said that cooperative insurance, which is based upon donation or charity, is the only solution to reform insurance to comply with *Sharia*. Yet, this opinion takes the intention of donation or charity, at the time of concluding insurance contracts and, therefore, paying a premium, as a criterion which distinguishes

commercial insurance from co-operative insurance. Indeed, where a gratuitous contract contains *Gharar*, the contract is not void under *Sharia*, thus, the contract of cooperative insurance is a contract that is based upon charity or donation and, therefore, it is valid under *Sharia*. In point of fact, that cannot be an accurate criterion, especially, where the insured is a trader, for instance, wishes to insure his goods against fire and theft.

Those *fatwas*, in respect of cooperative insurance, did not consider or discuss the complication of the insurance market, especially, with regard to the contract of reinsurance. That could be noticed where the Muslim scholars suggested that all members of an insurance company should cover the deficit when it occurs. As a result, the members will play the role of insureds, insurers and reinsurers and that is hardly likely, if it is not impossible, to be adopted in practice. More importantly, the cooperative insurance does not seem to be a charity. That is to say, a member of an insurance company pays a premium to indemnify another, at the same time, he/she also expects to be indemnified where the risk insured against occurs. Therefore, the contract is an onerous contract and, thus, does not differ from the commercial insurance. Furthermore, a huge doubt about cooperative insurance whether it could be used in commercial activities.

Therefore, it is thought that, suggesting a formulation of insurance complies with *Sharia* within this study that could serve commerce in Saudi Arabia will introduce an appropriated practical form of insurance, taking into consideration, the nature of insurance contracts as contracts of indemnity. But, why does this matter?

The religion of Islam plays a major role in Muslims' lives. Thus, Saudi people in particular, are generally religious, so, they always ask scholars about any new activity or event they intend to do or go into whether it complies with *Sharia* and the people, usually, avoid any activity that infringes *Sharia*. Therefore, this explains why there are many Muslims reject interests from their banks in their accounts because that it is *usury* and it is "*Haram*" or forbidden under *Sharia*. A recent example is that, a Saudi insurance company, the National Corporate for Cooperative Insurance, or the NCCI, offered its shares to the market for subscription. The attendance of the people on the first day in banks, according to a manager of a branch, was very low and disappointing because of the *fatwas* that had made insurance forbidden and made people shy away from insurance.<sup>134</sup>

However, a scholar expressed his opinion<sup>135</sup> about the NCCI and he declared that he read the leaflet of the company which was brought to him by a representative of the company.<sup>136</sup> He came to a conclusion that, there was nothing to make the subscription in the NCCI forbidden and all arguments about the legitimacy of insurance are mere confusions. Thus, this opinion was considered as a *fatwa* and propaganda was made about it in order to attract the people to subscribe in the NCCI. Therefore, the propaganda rescued the NCCI and many people subscribed in the company during the last two days. Consequently, the Saudi Finance Minister announced that the total sum of shares for the subscription that was offered was 1.435 billion Saudi Riyals and was divided between 700,000 subscribers. The number of the subscribers, however, was 807.583 after the publication of the scholar's opinion and

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<sup>134</sup> Al-Riyadh Newspaper, Wednesday 22<sup>nd</sup> Dec. 2004, No. 13330.

<sup>135</sup> He was Shaikh Salih As-Saddlan. It seems that he agreed with a previous *fatwa* of Shaikh AbdulMuhsin Al-Ubaikan who thinks the commercial insurance is not forbidden.

<sup>136</sup> Al-Riyadh Newspaper, Riyadh, Sunday 2<sup>nd</sup> Jan. 2005, No. 13341.

that gave the NCCI an opportunity to earn 16.566 billion Riyals which constituted coverage of 11.5 times of the total amount of the shares which was expected.

# **Chapter Seven: Solidary Insurance**

## **7.1. Introduction**

This chapter explores the form of insurance that is suggested by this study. It is thought that it would be convenient if this model is to be nominated as "Solidary Insurance."<sup>1</sup> The reason is that since contemporary Muslim scholars have distinguished between commercial insurance, conventional insurance or the contract of insurance in its original form, on the one hand, and cooperative insurance that is based upon donation, which is presented to be a substituted form to commercial insurance, on the other hand, it is important to distinguish solidary insurance, which is based upon solidarity between members, from other forms or models to avoid any confusion. Thus, this chapter analyses the contract of solidary insurance.

Accordingly, section 7.2 describes and illustrates solidary insurance. Section 7.2.1 discusses the relationship between a member and the club. The relationship between a member and other members is examined in section 7.2.2. It also explores how solidary insurance fits in to the Saudi social security system. A comparison between conventional insurance, cooperative insurance and solidary insurance takes place in section 7.3. Further, section 7.3.1 examines the similarities and differences between

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<sup>1</sup> A clear explanation of the concept of "solidary" is presented by John Salmond, *Jurisprudence*, (Glanville L. Williams ed., 10<sup>th</sup> ed. 1947), at pp. 462-63 in, Bryan Garner, *Black's Law Dictionary*, (7<sup>th</sup> ed., 1999), p. 1399, that, "It is a single debt of £100 owing by each of them, in such fashion that each of them may be compelled to pay the whole of it, but that when it is once paid by either of them, both are discharged from it. Obligation of this description may be called solidary, ... A solidary obligation, therefore, may be defined as one in which two or more debtors owe the same thing to the same creditor."

the three forms of insurance. Section 7.3.2 explores the influence of insurance fraud upon insurance market and presents solidary insurance as a solution for such a problem. Finally, section 7.4 contains concluding comments.

## 7.2. Solidary Insurance

It is important, at this stage, to describe solidary insurance by the following hypothesis:

A group of people share a common or similar interest such as owning ships, importing/exporting goods, car drivers or any other society, join a club, union or any association through a contractual relationship, where a joined person pays a sum of money or premium, annually or in any other mode of payment, to the association for the purpose of being indemnified for a particular loss(es) by the latter at the time of the occurrence of the loss(es) and the indemnified member will be obliged to pay back what exceeds his/her total payment by either increasing the subsequent premiums or by monthly payment subject to the status of the member, the duration of the contract and other conditions set out in the contract. The member of such association aims to avoid any liability or pecuniary loss to a third party by shifting his liability upon all members' shoulders.

In order to crystallise the idea, the following scenario seeks to clarify it:

Suppose, (A) is a car driver and he joins (B), a club.<sup>2</sup> (A) pays £400 per annual and he has not made a claim for last five years. In the sixth year, (A) had a car accident and he suffered (£1000) of damage to be paid to a third party. According to the contractual relationship, (B) indemnified (A) for his loss and paid the third party

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<sup>2</sup> (B) is not an individual character. It is, nevertheless, a representative of the members.



£1000 in full. Now, (A) has paid six premiums, which totals £2400. However, due to the indemnity, (B) owes (A) £1400.

Six months after the first claim, (A) suffered another loss and had to pay £3400 to another third party. Under such circumstances, (B) indemnified (A) for the second loss. Therefore, (A) owes (B) £2000. In this case, (A) has to pay back £2000 to (B) either by increasing the subsequent premiums, that (A) pays £600 per annual, or more, instead of £400, or the premium remains £400, but (A) pays £100 every month, subject to his/her income, the duration of his/her membership and the conditions of the contract.

If (A) decides to leave (B), the club or the association, he has the right to get his money back if (B), by the time of his decision, still owes (A) sum of money. Likewise, if (A) dies, his heirs or legatees have the right to get the sum of money remains with (B), the club or association, for the testator or legator. (B), on the other hand, has right of lien.

It is suggested that solidary insurance could be provided and practiced by different ways, either by a government, by members of a particular field such as, for example, traders or by a company which practices insurances. It has been thought that providing this form of insurance by a company is the most convenient way due to the fact that companies are capable to present better services to people in various fields, generally, and in commercial activities, particularly. Accordingly, the company can apply an annual fee on a member who wishes to join its membership as an administration fee. That fee will constitute a non-refundable premium. In other words,

the company will play the same role as the said club or association or even the government does. Thus, if one member pays £400 premium, which is refundable, a year and £50 annual fee to the company the fee will not be refundable, because it is an equitable right of the company. The total payments of the premiums, however, will be still refundable if the member does not want to renew his membership with the company. Yet, the member is still required to pay the applied annual fee to the company and any amount of money that exceeds the total payments of his premiums that has been arisen from indemnifying the insured member for his losses. So, if the total number of the members is 10,000, the company will earn £500,000 every year.

Thus, it is thought that it would be of significance that the above hypothesis is illustrated in cases A, B and C in the following table:

### 7.2.1. Table of Solidary Insurance:

**A- An insured suffers no loss for 5 years. The premium amounts of £400; and the annual fee amounts of £50.**

Annual fee (non-refundable)	Premium (refundable) per annual	Total payments of the annual fee for 5 years	Total payments of premiums for 5 years	Total payments of annual fee + premiums for 5 years
£50	£400	£250	£2000	£2250

The insured can benefit only from the total payments of premiums which amount of £2000. The annual fees, which amount of £250 in this example, are equitable right of the insurance company. The insured is entitled to be paid back the amount of £2000 should he decide not to renew his membership for the sixth year.

**B- The insured suffers loss but does not exceed his total payments of premiums for 5 years.**

Total payments of premiums for 5 years	Cost of loss suffered by the insured	Amount of the premium in the insured's account after fixing the loss	Total payments of the annual fees for 5 years	Total payments of annual fees + premiums for 5 years and after fixing the loss
£2000	£1000	£1000	£250	£1250

The insured can only benefit from £1000, but cannot benefit from the amount of the annual fees which totals £250. Thus, the insured, in the case that he does not wish to renew his membership for the sixth year, is entitled to be paid back £1000.

**C- The insured member suffers loss exceeds the total amount of premiums for 5 years, but after paying the premium for the sixth year.**

Total payments of premiums for 6 years	Cost of loss suffered by the insured	Amount of the premiums in the insured's account after fixing the loss	Total payments of the annual fees for 6 years	Total payments of annual fees + the cost of loss, which both are due to be paid by the insured
£2400	£3400	- £1000	£300	£1300

Assuming the loss occurred in the sixth year, the insured, in this case, has to pay the annual fee of £50 + the debt of £1000, either by arranging a monthly payment or paying it at once. Where the insured does not wish to renew his membership, he is required to pay back the full amount of £1000, otherwise, he has to renew for the seventh year to cover his debt by monthly payment method. Therefore, he has to pay £50 as annual fee for the seventh year.

It seems that the above hypothesis consists of more than one relationship. Firstly, the relationship between a member and the club; and, secondly, the relationship between a member and other members.

### ***7.2.2 The Relationship between a Member and the Club***

The relationship between a proposer and the club, at the stage of negotiation, does not begin before both parties conclude a contract of insurance,<sup>3</sup> whereby the proposer becomes a member of the club. Therefore, the member owes the same duties that are owed by an insured in conventional insurance practice such as disclosing and representing all material facts and complying with the contract warranties.<sup>4</sup> Also, the member owes a duty to pay the annual fee and the agreed premium. On the other hand, the club undertakes to provide an insurance cover to the member and acts on his behalf towards other members and third parties where it is necessary.

In the light of such a relationship, where the club acts on behalf of the member towards the others, the club could be described as an agent of the member. The club must act prudentially to protect its members' interests by establishing rules for this regard. Thus, it is the duty of the club to take all necessary steps which secure repayments by the indemnified members whose indemnifications exceed their total amounts of paid premiums. In addition, the club should present any necessary advice for its member where the latter is involved in a claim against a third party.

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<sup>3</sup> See an illustration of concluding a contract of insurance in section 6.2.

<sup>4</sup> That is necessary for the protection of members' interests and the efficiency of insurance industry.

Furthermore, the club must provide separate accounts to each one of its members, therefore, the premiums that are paid by the members are considered as deposits. That is to say the club will be in the position of depository.<sup>5</sup>

According to the above analysis, since the club presents more than one service to its members, it is obvious that the annual fees that the club applies on its members are justifiable.

### ***7.2.3. The Relationship between a Member and the Other Members***

The purpose of insurance is to provide indemnities to insureds for losses that are caused by particular risks. Therefore, a member is his own insurer so long as the cost of loss does not exceed his total payments of premiums. However, where the loss exceeds the amounts of his paid premiums, the club will cover the shortage of the member's money. Consequently, the club, which represents its members, will provide a sum of money that will be considered as a loan.<sup>6</sup> That is to say, the indemnified member owes a duty to pay back what he is lent by the club. The repayment of the lent money needs mechanisms to be set up by the club and general authority to secure the efficiency of the insurance industry and the interests' of the members. Therefore, it

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<sup>5</sup> It is important to avoid any confusion between the club's position as depository and deposit insurance which means, "A federally sponsored indemnification program to protect depositors against the loss of their money, up to a specified maximum, if the bank or savings-and-loan association fails or defaults." Bryan Garner, *Black's Law Dictionary*, (7<sup>th</sup> ed., 1999), p. 804.

<sup>6</sup> It can be said, the members have an implied agreement to guarantee each other.

is presented by this research that the club could either increase the subsequent premiums or apply monthly payment to the indemnified member subject to his income, the duration of his membership and the conditions of the contract. Needless to say the club must limit its liability to protect its members' interests.

The question that arises is, what is the case where the loss of the wrong doer member is so huge that cannot be covered according to the member's circumstances as, for example, the total amount of the paid premiums is £2000 and the maximum provided cover by the club is up to £50,000, but the total loss to a third party is £200,000?

Here, the injured third party will only recover up to £52,000 and there will be still £148,000 not recovered because the member is in debt and used the maximum amount of indemnity. It has been said that *Sharia* is a one unit that cannot be divided into separate parts. Thus, Muslims are obligated to pay *Zakat* to certain groups of Muslim people; Allah, glory to Him, said,

**([60] *As-Sadaqat* (here it means *Zakat*) are only for the *Fuqara* (poor), and *Al-Masakin* (the needy) and those employed to collect (the funds), and to attract the hearts of those who have been inclined (towards Islam), and to free the captives, and those in debt, and for Allah's Cause (i.e. for *Mujahidun*- those fighting in a holy battle), and for the wayfarer (a traveller who is cut off from everything); a duty imposed by Allah. And Allah is All-Knower, All-Wise.)<sup>7</sup>**

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<sup>7</sup> Surat, At-Taubah, No. 9, verse 60.

The key word in the above verse is (in debt). Thus, the club can set up a list of members who are in debt to allow *Zakat* payers to pay for their debts as long as the cause of the debts is legal according to *Sharia*.<sup>8</sup> In Saudi Arabia, the mission of the Department of Zakat and Income Tax, DZIT, is, *inter alia*, "briefly to administer and collect zakat on commercial goods from Saudi individuals and companies and from individuals and companies of GCC states<sup>9</sup> subject to the same treatment like Saudis..."<sup>10</sup> Accordingly, the DZIT proceeds its mission pursuant to Zakat Regulation (by-law).<sup>11</sup> Article 1 of the Regulation identifies people who Zakat is to be collected from; it states that,

"All Saudi companies and persons: male, female, adults, minors, or legally incompetent, are subject to Zakat after completion of one year under the provisions of Islamic Jurisprudence starting from 1/1/1370 H. (corresponding to 13/10.1950)."

Articles 2, 3, 4 and 5 state the properties which are subject to Zakat and the manner of assessing it, that:

"2. Capital and its proceeds, receipts, profits and gains of zakatpayers are subject to zakat in accordance with relevant Islamic provisions.

3. Capital and its proceeds, receipts, profits and gains of zakatpayers from commerce, industrial activity, personal endeavors, financial properties and belongings, of whatever type and form, and inclusive of financial and

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<sup>8</sup> It has to be noted, however, that this method applies to the individuals in civil debts, but not to companies as civil debts differ from commercial debts. That is because commercial debts are usually solved by different procedures. See the position under Saudi commercial law in, Mohammad H. Al-Jabir, *Al-Qanoon At-Tijari As-Saudi*, (Arabic, Saudi Commercial Law), (4<sup>th</sup> ed., 1996), at pp. 46,47.

<sup>9</sup> GCC is abbreviation of Gulf Cooperation Council states which contains: Saudi Arabia, Kuwait, Bahrain, Oman, Qatar and United Arab of Emirates (UAE).

<sup>10</sup> <http://www.dzit.gov.sa/en/GeneralInfo/generalinfo1.shtml>.

<sup>11</sup> Issued per Ministerial Resolution number 393, in 6/8/1370 H, 13/5/1950, pursuant to Zakat Collection Law by Royal Decree No. 17/2/28/8634 of 29/6/1370 H, 7/4/1951.

commercial deals, dividends, in general any type of receipt that is zakatable according to Islamic Jurisprudence, are subject to Zakat.

4. Zakat is assessed on commercial goods, properties and financial belongings at estimated values at the end of the year in accordance with provisions of Islamic Jurisprudence

5. Current methods based on orders and instructions to assess zakat on sheep, cattle and plants will continue."

However, the DZIT is required to remit the collected Zakat to the Social Security Department.<sup>12</sup> Thus, Saudi government could impose an important role upon the DZIT in solidary insurance industry should such an industry is permitted to take place in Saudi society.

Accordingly, the injured third party could sue the club, as it is a representative of the wrong doer member, for £148,000. Thus, it is the duty of the club to contact the Social Security Department in order to cover the rest of the third party's loss, i.e. £148,000. There is no reason, however, prevents the club from paying over the injured third party £148,000 and, then, get the latter amount from the Saudi Social Security Department.

Furthermore, the debt can, also, be covered by *Sadaqah*, charity, as *Sharia* encourages Muslims to cooperate with and help each other in different manners, especially, financially. In *Quran*, Allah, glory to Him, said,

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<sup>12</sup> Article 2 of Decree No. 61/5/1 of 5/1/1383 H, 29/5/1963.



**(And if the debtor is having a hard time (has no money), then grant him time till it is easy for him to repay; but if you remit it by way of charity, that is better for you if you did but know. But if you remit it by way of charity, that is better for you if you did but know.)<sup>13</sup>**

Imam Ibn Kathir explained the above verse that,<sup>14</sup> "Allah commands creditors to be patient with debtors who are having a hard time financially. During the time of *Jahiliyyah* (the time prior to Islam), when the debt came to term, the creditor would say to the debtor, "Either pay now or interest will be added to the debt." Allah encouraged creditors to give debtors respite regarding their debts and promised all that is good, and a great reward from Him for this righteous deed, (But if you remit it by way of charity, that is better for you if you did but know) meaning, if you forfeit your debts and cancel them completely."

He provided some *Hadiths* in respect of encouraging a Muslim creditor to co-operate with a debtor who might be insolvent that,

"Imam Ahmad recorded that Sulayman bin Buraydah said that his father said, "I heard the Messenger of Allah say,

(Whoever gives time to a debtor facing hard times, will gain charity of equal proportions for each day he gives.)

I also heard the Prophet say,

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<sup>13</sup> *Al-Baqarah*, No. 2, verse,

<sup>14</sup> Imam Ibn Khathir is a well known *Quran* interpreter. He is Imad Ad-Din Isma'il bin Umar bin Kathir Al Qurashi Al Busrawi (d:774 AH).

(Whoever gives time to a debtor facing hard times, will earn charity multiplied two times for each day he gives.) I said, 'O Messenger of Allah! I heard you say, 'Whoever gives time to a debtor facing hard times, will gain charity of equal proportions for each day he gives.' I also heard you say, 'Whoever gives time to a debtor facing hard times, will earn charity multiplied by two times for each day he gives.' He said, (He will earn charity of equal proportions for each day (he gives time) before the term of the debt comes to an end, and when the term comes to an end, he will again acquire charity multiplied by two times for each day if he gives more time.)"<sup>15</sup>

Further, *Sharia* imposes a duty upon a Muslim governor or ruler to pay out unpaid debts for people who are under his regime and who cannot afford their debts especially for those who die before paying out their debts. That obligation upon the Muslim ruler has been clarified in *Sunnah* which provides that:

"Abu Huraira (Allah be pleased with him) reported that when the body of a dead person having burden of debt upon him was brought to Allah's

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<sup>15</sup> Imam Ibn Kathir, *Tafsir Ibn Kathir*, (Arabic), (Explanation of Ibn Kathir), on: <http://www.theholyybook.org/en/a.45837.html>. Imam Ibn Kathir, further, introduced some *Hadiths* regarding this matter, that, "Ahmad recorded that Muhammad bin Ka'b Al-Qurazi said that Abu Qatadah had a debt on a man, who used to hide from Abu Qatadah when he looked for him to pay what he owed him. One day, Abu Qatadah came looking for the debtor and a young boy came out, and he asked him about the debtor and found out that he was in the house eating. Abu Qatadah said in a loud voice, "O Fellow! Come out, for I was told that you are in the house." The man came out and Abu Qatadah asked him, "Why are you hiding from me" The man said, "I am having a hard time financially, and I do not have any money." Abu Qatadah said, "By Allah, are you truly facing a hard time" He said, "Yes." Abu Qatadah cried and said, "I heard the Messenger of Allah say,

(Whoever gives time to his debtor, or forgives the debt, will be in the shade of the Throne (of Allah) on the Day of Resurrection.)" Muslim also recorded this *Hadith* in his *Sahih*."

Messenger (may peace be upon him) he would ask whether he had left property enough to clear off his debt, and if the property left had been sufficient for that (purpose), he observed funeral prayer for him, otherwise he said (to his Companions): You observe prayer for your companion. But when Allah opened the gateways of victory for him, he said: I am nearer to the believers than themselves, so if anyone dies leaving a debt, its payment is my responsibility, and if anyone leaves a property, it goes to his heirs."<sup>16</sup>

Furthermore, it was narrated that:

"Abu Huraira (Allah be pleased with him) reported Allah's Apostle (may peace be upon him) having said this: By Him in Whose Hand is the life of Mohammad, there is no believer on the earth with whom I am not nearest among all people. He who amongst you (dies) and leaves a debt, I am there to pay it, and he who amongst you (dies) leaving behind children I am there to look after them. And who amongst you leaves behind property, that is for the inheritor whoever he is."<sup>17</sup>

According to the above two *Hadiths*, two comments need to be made. First, that when Prophet Mohammad (may peace be upon him) was giving his speech to his Companions at those situations, he was talking as a Messenger of Allah and as a ruler of the Islamic State. Thus, when he asked his Companions that, "You observe prayer for your Companion," it does not mean that he did not want to observe the funeral prayer for his deceased Companion, but it means that he wanted one of his

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<sup>16</sup> Imam Muslim, *Sahih Muslim*, Vol. III, "Kitab Al-Fara'id," No. 3944, p. 855, translated into English by Abdul Hamid Siddiqi, (Dar Al-Arabia Publishing, Printing and Distribution, Beirut-Lebanon).

<sup>17</sup> *Ibid*, No. 3946.

Companions by that time to come forward and relieve the deceased Companion from his burden.<sup>18</sup> It was commented, therefore, that, "The Holy Prophet (may peace be upon him) was fully aware of the love and the sense of mutual brotherhood amongst his Companions and was, therefore, confident that they would not let his dead Companion be deprived of great privilege of having his funeral prayer led by the Prophet (may peace be upon him) himself."<sup>19</sup> That was the case when the Islamic State was not solvent enough to perform that role. Accordingly, Prophet Mohammad (may peace be upon him) established an Islamic mutual insurance between Muslims that based upon brotherhood amongst them. It can be said that, comparing the latter method with the conventional life assurance, on the one hand, the deceased Muslim played the role of the insured and his family played the role of the beneficiaries,<sup>20</sup> on the other hand, the Muslim society played the role of the insurer.

Secondly, "when Allah opened the gateways of victory for him, he, Prophet Mohammad (may peace be upon him), said: I am nearer to the believers than

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<sup>18</sup> That is because Muslims believe, as a part of the religion of Islam, that every person will be responsible and asked for other people's rights, at judgment day after life including debts.

<sup>19</sup> Imam Muslim, *Sahih Muslim, supra*, footnote, 2053.

<sup>20</sup> Under Islamic law of succession, debts must be paid from a deceased man's inheritance before it goes to his heirs. Such a payment is obligatory. In *Quran*, Allah, glory to Him said, in *Surat An-Nisa* "[11] Allah (thus) directs you as regards your children's (inheritance): to the male, a portion equal to that of two females: if only daughters, two or more, their share is two-thirds of the inheritance; if only one, her share is a half. For parents, a sixth share of the inheritance to each, if the deceased left children; if no children, and the parents are the (only) heirs, the mother has a third; if the deceased left brothers (or sisters) the mother has a sixth. (The distribution in all cases is) **after the payment of legacies and debts**. Ye know not whether your parents or your children are nearest to you in benefit. These are settled portions ordained by Allah; and Allah is All-Knowing, All-Wise.

[12] In what your wives leave, your share is a half, if they leave no child; but if they leave a child, ye get a fourth; **after payment of legacies and debts**. In what ye leave, their share is a fourth, if ye leave no child; but if ye leave a child, they get an eighth; **after payment of legacies and debts**. If the man or woman whose inheritance is in question, has left neither ascendants nor descendants, but has left a brother or a sister, each one of the two gets a sixth; but if more than two, they share in a third; after payment of legacies and debts; so that no loss is caused (to anyone). Thus is it ordained by Allah; and Allah is All-Knowing, Most Forbearing."

The translation is cited from (al-islam.com), on: <http://quran.al-islam.com/Targama/DispTargam.asp?nType=2&nSora=4&nAya=11&nSeg=54&l=arb&t=eng>.

It is interesting to mention that, the above two verses, plus verse number [176] of *Surat An-Nisa*, are the bases of the Islamic law of succession. Note that, the payment of legacies and debts must be paid from an inheritance before it goes to the deceased man's heirs.

themselves, so if anyone dies leaving a debt, its payment is my responsibility..."

Here, the Islamic State became rich enough to perform its duty, i.e. social security or social insurance. Therefore, this *Hadith*, "shows not only the profound love of the Holy Prophet (may peace be upon him) for his Companions and his exemplary selflessness, but also his keen sense of responsibility. This also gives a clear indication of the responsibilities of an Islamic State in regard to the destitute people. It is the duty of the Islamic State to look to their economic needs and see that they do not suffer from hunger and privation, to clear of their debts if they are not solvent enough to pay them back and to properly look after the destitute families in case their earning members die. The Islamic State does not leave such helpless beings to the strokes of Fortune. The Islamic State has certain responsibilities in regard to them which it must undertake with full enthusiasm."<sup>21</sup>

As far as commercial transactions, such as carriage of goods by sea or air, are concerned, it is suggested that since the capital sums of such transactions are usually large, the position needs special arrangements and that could be arranged by specialised people in this field. However, there is nothing to prevent this form of insurance, i.e. solidary insurance, from being applied to such transactions.

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<sup>21</sup> *Ibid*, footnote, 2054.

### 7.3. Commercial v. Cooperative v. Solidary Insurances

It is of significance, at this stage, to make a comparison between commercial insurance, conventional insurance, that is rejected by the majority of Islamic scholars;<sup>22</sup> cooperative insurance,<sup>23</sup> which is presented by Muslim scholars as a substitute for conventional insurance; and solidary insurance,<sup>24</sup> which is presented by this study as an alternative form of insurance that could be applied for various activities, especially, commercial activities, but without infringing *Sharia* principles.

#### 7.3.1 Similarities and Differences

It is important to indicate that, there are two types of insurance that are applicable and regulated in Saudi Arabia, namely, motor (third party) insurance and health insurance. Both of those types are classified, theoretically, to be co-operative insurance. Hence, the conception of co-operative insurance, which is used in Saudi Arabia, is called *takaful* else where in some other Islamic societies. More importantly, all various insurance types that are practiced and/or regulated in Saudi Arabia are to be classified, practically, as conventional or commercial insurance.

In commercial insurance, or conventional insurance, insurance companies sell insurance to people through the contract of insurance whereby an insured is obligated

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<sup>22</sup> See, section 6.3.2, *supra*.

<sup>23</sup> See, section 6.3.1, *supra*.

<sup>24</sup> See, section 7.2, *supra*.

to pay a sum called premium and the insurance company is obligated to hand over the insured a document called insurance policy.<sup>25</sup> It has been argued that, an insurance company sells, in indemnity insurance, a conditional promise to indemnify its insured that is embodied in the insurance policy.<sup>26</sup> Consequently, there is uncertainty in the occurrence of the risk insured against and in the fulfilment of the insurer duty to indemnify the insured. Thus, the element of *Gharar*, uncertainty, is excessive which renders the contract void. In addition, it has been mentioned that where the insured pays the insurer sum of money and has it back, in the case of claiming indemnity, more than what he has paid the insurer, the element of *Riba*, usury, triggers which renders the contract not only void but also illegal.<sup>27</sup>

In respect of cooperative insurance, Muslim scholars suggest that insurance should be provided by an association which consists of members whose relationships with each other are based upon donation and cooperation. The members have mutual interests to spread a loss which a member of them might suffer between all other members by way of contribution.<sup>28</sup> Thus, every member has both characters of insured and insurer. Accordingly, it seems that the description of cooperative insurance that is presented by Muslim scholars does not differ too much from that is known as mutual insurance in marine insurance practice which is usually presented by protection and indemnity clubs or "P & I" clubs.<sup>29</sup> Mutual insurance is described by section 85(1) of MIA 1906 that,

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<sup>25</sup> See generally section 3.2, *supra*.

<sup>26</sup> For more details, see section 6.2, *supra*.

<sup>27</sup> See, section 6.3.2, *supra*.

<sup>28</sup> See section 6.3.1, *supra*.

<sup>29</sup> For more details on mutual insurance and P & I clubs, see, for example, Steven J. Hazelwood, *P & I Clubs: Law and Practice*, (LLP, 3<sup>rd</sup> ed., 2000).

"Where two or more persons mutually agree to insure each other against marine losses there is said to be a mutual insurance."

However, there are two differences that could be noted. First, contributions must be paid by members with intention of donation; and, second, the members have to cover any deficit that might occur in the end of financial year. Therefore, a form of insurance that is based on donation is doubted to be of use in commercial activities.

As far as solidary insurance is concerned, it can be said that it is a hybrid contract of commercial and cooperative insurances. That is to say, a member possesses both characters of insured and insurer; members finance one fund in order to benefit from it where one of them suffers a loss; the members do cooperate with each other as their relationships together are based upon solidarity; solidary insurance could be useful in commercial activities because it does not contain donation. More importantly, it is thought that solidary insurance could be a solution for moral hazards, where an insured destroys his own insured property to benefit from insurance money, and a very frequent and serious problem in insurance markets which is "insurance fraud."<sup>30</sup>

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<sup>30</sup> Fraud is a criminal offence and it is committed where a proposer obtains an insurance cover within the language of section 16(1) of the Theft Act 1968 which enacts that, "A person who by any deception dishonestly obtains for himself or another any pecuniary advantage..." Section 16(2) states, "...a pecuniary advantage within the meaning of this section is to be regarded as obtained for a person...where...(b) ...to take out any policy of insurance or annuity contract, or obtains an improvement of the terms on which he is allowed to do so..." See, *Manifest Shipping Co. Ltd. v. Uni-Polaris Insurance Co. Ltd.* [2001] 1 Lloyd's Rep. 389, at pp. 405-406. For more details on this, see, Malcolm Clarke, *The Law of Insurance Contracts*, (4<sup>th</sup> ed. Lloyd's of London Press), 2002, para. 23-14; John Lowry & Philip Rawlings, *Insurance Law: Doctrine and Principles*, (2<sup>nd</sup> ed. Hart Publishing), 2005, p. 255, where it is stated that, "A material statement in a claim is fraudulent if the insured either knew it to be false or else was reckless as to its true. Mere carelessness will not suffice." It is important to note that, an exaggerated claim is not fraud. In fact courts recognise it as "bargaining device used against insurers who frequently attempt to reduce the size of a claim"; in John Lowry & Philip Rawlings, *ibid.* See, Nicholas Legh-Jones Q.C., John Birds and David Owen, *MacGillivray on Insurance Law*, (Sweet and Maxwell, London, 10<sup>th</sup> ed.), 2003, para. 19-57. In *Ewer v National Employers' Mutual General Insurance Association* (1937) 57 Ll. L. Rep. 172, the claimant seek recovering for a second hand piece of furniture which was destroyed by fire to be replaced by a new one. The claimant advanced the price of the new item to be recovered by his insurer. Mackinnon



### 7.3.2 *Anti-Fraud*

Insurance industry in conventional insurance has been attacked by fraudsters. Cooperative insurance, assuming it exists in Saudi Arabia, is not safeguarded from such an attack. Therefore, it is important, at this stage, to examine the effect of fraud in the UK insurance market to understand how fraud could influence the efficiency of insurance industry in any other state.

Fraudulent claims in insurance market, at least in the UK, are high-rated. According to the Association of British Insurers, ABI, "Surveys have revealed that as many as 2 in 3 people would dishonestly claim money from their insurance company if they thought they could get away with it."<sup>31</sup> Thus, the ABI addressed the problem of insurance fraud and it seems a serious one. It is, may be, because buying insurance and dealing with its matters are done, at the present time, via, for example, telephone and internet. It was observed that, "The mood across all financial sectors is that the increasing amount of business done electronically and over the telephone has probably led to an increased vulnerability to dishonesty from 'faceless' customers. But unlike credit card fraud, for example, insurance fraud is rarely self-declaring.

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described the claimant as preposterous, but not fraudster. He held that no deception was perpetuate and he observed, at pp. 182-183, that,

"I do not think [the claimant] was doing that as in any way a fraudulent claim, but as a possible figure to start off with as a bargaining figure. We have been told that the defendant company wanted to see invoices. The invoices, of course, would show what the articles cost. As the [claimant] could not produce the invoices showing what the articles cost, I think he did the best he could in substitution for it....The [claimant] knew the claim would be discussed and probably drastically criticised by the assessors; he had been asked for invoices and he started the bargaining with them by putting down the cost price of these articles as if they were new." See also, *Orakpo v Barclays Insurance Services Ltd* [1995] L.R.L.R. 443, 451 *per* Hoffmann J. However, in *Central Bank of India v Guardian Assurance Co* (1936) 54 Ll. L. Rep 247, it was held fraudulent where a claim was over-valued for about one hundred times the true value of the loss.

<sup>31</sup> Association of British Insurers,  
[http://www.abi.org.uk/Display/default.asp?Menu\\_ID=1140&Menu\\_All=1,946,1140&Child\\_ID=458](http://www.abi.org.uk/Display/default.asp?Menu_ID=1140&Menu_All=1,946,1140&Child_ID=458).

This is particularly true of claims fraud where false losses might be claimed on the back of a genuine event such as a burglary. Untangling truth from lies is not an easy matter. Quantifying the problem with any accuracy is therefore difficult."<sup>32</sup>

Therefore, fraudulent claims, according to the ABI, have caused insurers, in the UK, suffer of over £1 billion per annum as a total amount of fraud on general personal lines business alone. However, although insurers have been endeavoring to defeat fraudulent claims, it is admitted that proving fraud in an insurance claim before a court is rather difficult, bearing in mind that the onus of proof is on the insurer which is a heavy burden.<sup>33</sup> Professor Clarke observes that, "The onus on the insurer is to some degree greater than that usual in civil cases. The degree depends *inter alia* on the gravity of the inevitable implications about the moral stature of the claimant."<sup>34</sup>

Furthermore, the Financial Ombudsman Service,<sup>35</sup> which its role is to settle financial disputes including insurance between customers and financial firms, outline some fraudulent claims. For example, an insured made a claim under her general household policy for 'escape of water' damage. As the damage was reasonably limited, the insurer asked her to send in repair estimates. In fact, the insured provided three estimates which were exaggerated. However, the insurer discovered that all three estimates, purporting to come from different contractors, were fraudulently produced by one contractor who had carried out extensive works for the insured in the

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<sup>32</sup> *Ibid.*

<sup>33</sup> For that reason, the ABI has initiated a data-sharing project which will deliver a bespoke counter-fraud system designed to meet insurers' needs. For more details see the ABI website, *ibid.*

<sup>34</sup> Malcolm Clarke, *The Law of Insurance Contracts*, (4<sup>th</sup> ed. Lloyd's of London Press, 2002), parag. 27-2A. See also, John Lowry & Philip Rawlings, *Insurance Law: Doctrine and Principles*, (2<sup>nd</sup> ed. Hart Publishing), 2005, p. 255. In *Hornal v. Neuberger Products Ltd.* [1957] 1 QB 247, Lord Denning, at p. 258, observed that, "The more serious the allegation the higher the degree of probability that is required."

<sup>35</sup> <http://www.financial-ombudsman.org.uk>. For more details on the FOS, see, Malcolm Clarke, *Policies and Perceptions of Insurance Law in the Twenty-First Century*, (Oxford, 2005), p. 239.

past. The insurer considered the insured to be guilty of fraud. Consequently, it cancelled her policy and refused to deal with the claim. The FOS was of the opinion that, if the fraud had not been discovered, the insurer would have paid more in compensation than was properly required of it, and more than the insured was legally entitled to, which means infringing the principle of indemnity.<sup>36</sup>

In the light of the above case, it is thought that the insured would not obtain fraudulent estimates if the insurance policy was a solidary insurance policy because that insured would not cost her self more than the actual loss she has, in fact, suffered from. The reason is that, in the case of indemnifying her for the loss, her total amount of premiums either would be decreased or she would have to repay what exceeded her paid premiums.

However, it is thought that solidary insurance is not completely protected from fraud as a dishonest insured member could commit fraud to recover his "fabricated" loss because he would not be able to afford such a loss and he would prefer to have old for new and pay its price monthly especially if he knows that his total payment of premiums would not cover the price of the new item. For instant, the FOS has come across a case where the insured was a self-employed plumber. In January, his home was burgled and he made a claim under his home insurance policy to his insurer. The insurer did indemnify him. In May, his van was broken into and a number of personal possessions were stolen, including the tools he used for his work. He made another claim to the insurer under the personal possessions section of his home contents policy. During the course of its enquiries, the insurer's loss adjusters insisted that the

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<sup>36</sup> Financial Ombudsman Service, *Ombudsman News*, Dec. 2004/Jan. 2005, Issue 42, pp 9-10. See online, [http://www.financial-ombudsman.org.uk/publications/ombudsman-news/42/42\\_ins\\_fraud.htm](http://www.financial-ombudsman.org.uk/publications/ombudsman-news/42/42_ins_fraud.htm).

insured must prove all his losses with original purchase receipts. Unfortunately, the insured was unable to find all the receipts, therefore, he asked a friend to fake one for him. When the insurer discovered the forged receipt, it 'avoided' the policy from the start. As a result of that, the insurer not only refused to pay for the items stolen from the van, it also tried to recover the money it had previously paid out to the insurer for his earlier burglary claim.<sup>37</sup>

Regardless what the consequence of such a claim was, the insured plumber, who is assumed here to be a solidary policyholder, could bring a false evidence to be indemnified for a fake loss. Therefore, it is important to operate the duty of utmost good faith in order to safeguard all members' interests.

The ABI, moreover, distinguishes between two types of fraud, namely, premeditated and opportunistic. Premeditated fraudsters are deliberate and professional criminals. They are those who take out insurance policies with the intention of committing fraud. What they concern about is "how lucrative the fraud might be and what are the chances of detection." They try to do their best to do what they have heard from a family member and a friend how to extract money from an insurance company.<sup>38</sup>

So far as opportunistic fraudsters are concerned, they are more likely to be honest customers and not fraudsters, but who might well inflate a claim that arises from a genuine event. "They might have suffered a burglary but the list of items stolen is partly a work of fiction. It is all too easy to add on some extra electrical items or an

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<sup>37</sup> *Ibid*, pp 8-9.

<sup>38</sup> ABI website,  
[http://www.abi.org.uk/Display/default.asp?Menu\\_ID=1140&Menu\\_All=1,946,1140&Child\\_ID=458](http://www.abi.org.uk/Display/default.asp?Menu_ID=1140&Menu_All=1,946,1140&Child_ID=458).

expensive leather jacket to the portable television and handful of cash that was actually stolen." Therefore, the ABI find the line between being a genuine policyholder and a dishonest claimant blurred.

It is thought that, premeditated fraudsters will not find solidary insurance a suitable industry to commit fraud and escape with it. Opportunistic fraudsters, however, will find solidary insurance rather difficult to inflate a claim because they cannot gain an economic advantage, as the case in conventional insurance, without bearing its consequences.

Therefore, perhaps that solidary insurance could decrease, if it could not vanish, fraudulent claims because an insured who might try to commit a fraud would think thousands times before doing so. The reason is that, where he is indemnified for a particular loss he is obligated, due to the nature of the contract, to pay back the amount of money that exceeds his total payment of premiums to the club, which means he cannot benefit from fraud.

## 7.4. General Comments

Solidary insurance is suggested as an alternative form of insurance which complies with general principles of *Sharia* and that could serve commercial activities. It can be said that solidary insurance is a solution for insurance fraud and it does not provide to wagerers a suitable environment to practice their habit in the guise of insurance. Furthermore, solidary insurance must be considered with other social security systems in Saudi Arabia, such as Social Security Department, in order to avoid any deficit that might occur.

In respect of whether solidary insurance could be adopted in a non-Islamic system or country, it is thought that a country, such as the UK, solidary insurance could be acceptable because the UK's insurance industry is a huge one. In addition, because insureds can benefit from their paid premiums in the case that they do not make claims, this form of insurance could attract wide range of people. However, solidary insurance needs to be regulated and well organized, which requires a role from the part of the government. Further, Muslims population in the UK is not small. According to Census 2001 statistics, in England, 3.1 per cent of the population, which is almost 1.6 million,<sup>39</sup> states their religion as Muslim (0.7 per cent in Wales).<sup>40</sup> Therefore, it is thought that solidary insurance will be welcomed by Muslims in the UK and may be by others.

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<sup>39</sup> See, the UK National Statistics, <http://www.statistics.gov.uk/focuson/religion/>.

<sup>40</sup> See, <http://www.statistics.gov.uk/census2001/profiles/commentaries/ethnicity.asp#top>.

## **Chapter Eight: Conclusions**

### **8.1. Introduction**

It is clear that the contract of insurance contains some elements that make it repugnant to *Sharia* principles. That is to say, an insurance contract contains the element of *Riba* whereby an insured pays a premium to an insurer and the latter pays it more by way of insurance money when the risk insured against occurs. The reason for this is that, Islamic scholars consider the paid premium as deposit and the insurer, who holds the insured's money as depositary. Furthermore, the thesis identified the subject matter of the contract of insurance by answering the question, "what does the insured pay the premium for?" The answer is that the insured gets a conditional promise from the insurer to be indemnified where he suffers loss due to the occurrence of the peril insured against. Such a promise is embodied in the contractual document called "the insurance policy." The promise, which is the duty of the insurer, is contingent and dependant upon many factors.<sup>1</sup> Subsequently, it could be said that the contract of insurance contains a serious degree of *Gharar*, i.e. uncertainty, which might lead to make the contract *Maysir*, gambling, and it is, therefore, void.

This chapter summarises the issues that have been discussed, analyzed and explored in this thesis.

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<sup>1</sup> See section 6.2.

## 8.2. The Influence of *Sharia* in Saudi Law<sup>2</sup>

It has been seen that *Sharia* is the sole source of Saudi law.<sup>3</sup> Therefore, any regulation or statute that infringes *Sharia* principles should have, in principle, no effect. This conclusion raises a question, namely, whether the Saudi regulations regarding insurance should be repealed?

The answer is difficult to be that the Saudi regulations regarding insurance should be repealed because the insurance industry is largely funded by insureds' premiums and different insurance markets via the contract of reinsurance. That is to say, an insurance market in a state can be domestic, but generally it is connected with global reinsurance markets, such as Lloyd's of London,<sup>4</sup> via reinsurance contracts. Furthermore, the insurance industry is a significant factor of improving a state's economy. Thus, in order to protect the public policy and the national economy, such an industry must not be left without regulation. What is recommended here is that insurance contracts in Saudi Arabia should be reformed to comply with *Sharia* principles. Subsequently, such reformation is a duty upon Muslim scholars together with Muslim legal jurists to come up with a form of insurance that serves needs of the society in various fields.

This study seeks to suggest "solidary insurance" as a possible form of the contract of insurance that could satisfy diverse purposes.

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<sup>2</sup> See, section 1.3, *supra*.

<sup>3</sup> See, Articles 1, 7 and 48 of Saudi Basic Law 1992. See, section 1.1, *supra*.

<sup>4</sup> For more details on Lloyd's market, see, for example, Malcolm Clarke, *Policies and Perceptions of Insurance Law in the Twenty-First Century*, (Oxford, 2005), p. 40; John Lowry & Philip Rawlings, *Insurance Law: Doctrines and Principles*, (Hart, 2<sup>nd</sup> ed., 2005), p. 40; John Lowry & Philip Rawlings, *Insurance Law: Cases and Materials*, (Hart, 2004), p. 61.



### 8.3. The Contract of Insurance

The insurance contract was invented in Europe in the 13<sup>th</sup> century in the field of marine and was introduced and spread by Lombards.<sup>5</sup> Insurance was introduced in Islamic states by traders as a result of their connections with European merchants and was not known by Muslim scholars until, perhaps, the beginning of the 19<sup>th</sup> century.<sup>6</sup>

The contract of insurance was not acceptable because it was considered to be infringing the law of usury according to the Church law which was dominating in Europe in the middle ages.<sup>7</sup> That is why the contract of insurance was disguised under other legal contracts by that time, such as maritime loans set with high interest rates.<sup>8</sup>

The contract of insurance has become of importance due to the growth of trade in the 15<sup>th</sup> and 16<sup>th</sup> centuries when economic conditions were changing in all over Europe. This, in turn, led to the need to regulate, at national level, insurance. Finally, it must be concluded, at this point, that the contract of insurance is better to describe rather than defined "because definitions tend sometimes to obscure and occasionally to exclude that which ought to be included."<sup>9</sup>

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<sup>5</sup> See, section 2.2, *supra*.

<sup>6</sup> That could be indicated by acknowledging that the first leading recorded *fatwa* in respect of insurance was found in the early 19<sup>th</sup> century by a Syrian scholar from the *Hanafi* school *Ibn Abdin* who lived between (1784-1836). See, section 5.2, *supra*.

<sup>7</sup> See, section 2.4, *supra*.

<sup>8</sup> See, sections, 2.2 and 2.4, *supra*.

<sup>9</sup> *Department of Trade and Industry v. St. Christopher Motorists' Association Ltd*, [1974] Lloyd's Rep. 17, at 18, *per* Templeman J. See, section 3.2, *supra*.

## 8.4. The Principle of Insurable Interest

The principle of insurable interest is a fundamental element in the contract of insurance. It is considered to be fundamental to the identity of insurance because it distinguishes an insurance contract from wagering and gambling. The principle of insurable interest was crystallised in the 18<sup>th</sup> century in England and, thereafter, has been adopted by common law courts. The requirement of insurable interest had to be adopted to stop gambling on lives and properties during that period. The following passage explains the idea of some people about insurance and how insurance was treated, that,

"Insuring of property in any city or town that is besieged, is a common branch of gambling insurance in time of war; but ingenious gamesters, ever studious to invent new, and variegate old games, have, out of this lawful game, (for insurance in general is no more than a game of chances), contrived a new amusement for gentlemen...which is for one person to give another forty pounds, and if café Gibraltar (for instance) is taken by a particular time, the person to whom the forty pounds are paid, is to repay £100; but if, on the contrary, the siege is raised before the time mentioned, he keeps the £40. In proportion as the danger the place is in of being taken increases, the premium of insurance advances; and when the place has been so situated, that repeated intelligence could be received of the progress of the siege, I have known the insurance to rise to £90 for one hundred...

Of shame insurances...made on places in time of war, foreign ministers residing with us have made considerable advantages. It was a well know fact, that a certain ambassador insured £30,000 on Minorca, in the war of 1755,

with advices at the same time in his pocket that it was taken. Our government did not get the intelligence till two days after this transaction. It was the third before it was made public; and thus the ambassador duped our people, who continued to accept premiums till the third day."<sup>10</sup>

Further, the principle of indemnity operates in the same manner that the principle of insurable interest does. That is to say, insureds' should be prevented from earning money or obtaining economic advantages throughout the contract of insurance. Both principles, i.e. insurable interest and indemnity, could be addressed where an insurer asks its insured, at the time of claiming under the policy for indemnity, the following questions:

A) What is your relationship to the property insured?

B) What is your loss that you have suffered?

Or, they could be addressed in the following requirements: prove your relationship to the insured property; prove your loss.

The first question or requirement is related to the principle of insurable interest. The second question or requirement is related to the principle of indemnity. Theoretically, the first question or requirement is not as important as the second one because proving the loss makes the insurer's duty of indemnity triggers. Therefore, it seems that insurable interest does not appear to serve its purpose.<sup>11</sup> It is recommended that the

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<sup>10</sup> Thomas Mortimer, *Every Man His Own Broker*, (London, WJ & J Richardson, 1801), cited in, John Lowry & Philip Rawlings, *Insurance Law: Cases and Materials*, (Oxford, Hart, 2004), pp. 261-62.

<sup>11</sup> Malcolm Clarke, *Policies and Perceptions of Insurance Law in The Twenty-First Century*, (Oxford, 2005), at p. 38. See, section 4.6, *supra*.

UK Parliament should follow the Australian model, i.e. avoid requiring insurable interest.<sup>12</sup>

One more thing needs to be mentioned, it seems that, although the requirement of insurable interest is applicable under Saudi regulations, it is not considered to be a criterion that distinguishes the contract of insurance from wagering and gambling. In fact, the majority of Muslim jurists consider conventional insurance as mere forbidden *Maysir*, gambling, notwithstanding that the requirement of insurable interest is, actually, complied with from the part of the insured.

Accordingly, it can be said that the recognition of gambling and/or wagering in the guise of insurance by common law lawyers do differ from that by Muslim jurists. Consequently, that explains the difficulty of juxtaposing the requirement of insurable interest to the concept of law under the Saudi Arabian legal system.

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<sup>12</sup> See, in particular, Australian Insurance Contracts Law 1984, s.16 which provides that, "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." Section 17 states that, "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."

## 8.5. Insurance Contract in Islamic Jurisprudence<sup>13</sup>

It has been seen that the contract of insurance has been rejected by the majority of Muslim scholars.<sup>14</sup> The reasoning, however, is varied. Some scholars made a comparison with other well known contracts and, then, concluded that insurance does not comply with *Sharia* because it is not similar to those Islamic contracts. Others did recognise the difference between the contract of insurance and other Islamic contracts and concluded, after examining insurance, that it includes some forbidden element, *inter alia*, *Riba*,<sup>15</sup> usury, *Maysir*,<sup>16</sup> gambling and *Gharar*,<sup>17</sup> uncertainty.

Other Muslim scholars, who are the minority, claim that insurance is, in fact, legal under *Sharia* because it is a kind of cooperation between insureds who are exposed to same or similar risks. They claim that an insurance company is a mere co-ordinator between insureds.<sup>18</sup> However, it has been argued that such an analysis does not comply with the nature of insurance business; that, the insurance company offers its product, i.e. insurance, in order to make profits because that company is, simply, a commercial body. Therefore, such an analysis cannot be supported or agreed with.

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<sup>13</sup> See, generally, chapter 6, *supra*.

<sup>14</sup> See, section 6.3.2, *supra*.

<sup>15</sup> See, section 6.3.2.1, *supra*.

<sup>16</sup> See, section 6.3.2.2, *supra*.

<sup>17</sup> See, section 6.3.2.3, *supra*.

<sup>18</sup> See, section 6.3.3, *supra*.

## 8.6. Co-operative Insurance<sup>19</sup>

Notwithstanding the above findings, Muslim scholars are aware of the importance of insurance in social life as well as its economic value. At the same time, the majority of contemporary Muslim scholars believe that conventional insurance clashes with *Sharia* principles. Therefore, they suggested a substituted form of insurance that does not infringes *Sharia* rules, namely, "co-operative insurance." The latter form is called, actually, mutual insurance, but the difference is that every member pays his/her premium or contribution as a donation that must be stated in the contract.<sup>20</sup>

It has been seen that, this form of insurance, i.e. co-operative insurance, is doubted to be of use in commercial activity because the element of donation is a fundamental one. As a matter of fact, *Sharia* jurisprudence does provide many social security systems that offer co-operation, unity and solidarity between members of Islamic societies.<sup>21</sup> Therefore, what it is needed is a form of insurance that complies with *Sharia* rules, but, at the same time, could be used in any activity, especially, in commerce.

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<sup>19</sup> It is important to note that, some societies call this form of insurance "*Takaful*." To learn more about that, see, <http://www.icmif.org/2k4takaful/site/welcome.asp>. Professor Malcolm Clarke remarks on *Takaful* in, *Policies and Perceptions of Insurance Law in the Twenty-First Century*, (Oxford, 2005), p. 45.

<sup>20</sup> See, section 6.3.1, *supra*.

<sup>21</sup> See, section 6.5, *supra*.

## 8.7. Solidary Insurance<sup>22</sup>

It is thought that the presentation of solidary insurance by this study is the issue that gives this thesis its value. That is to say, solidary insurance is, in fact, the basic issue of this research. Therefore, it is secured to say that this formulation of insurance, i.e. solidary insurance, has not been presented by any previous study.<sup>23</sup>

It is suggested that Solidary insurance could be a workable solution for Muslim societies as it provides security in both social and commercial lives.<sup>24</sup> It also provides a workable solution for insurance fraud.<sup>25</sup> Furthermore, it is thought that solidary insurance needs:

1- to be regulated by the government of the society which chooses to adopt it; 2- to be financed by different sources. It was suggested that in Saudi Arabia, solidary insurance could be supported by Zakat payers or by the Department of Zakat and Income Tax or the Social Security Department.<sup>26</sup>

Solidary insurance, moreover, could be, also, funded by investment. That is to say, a company or a club which provides this type of insurance could invest part of the total amount of the paid premiums by its member, but after getting permits from the members who do not mind their premiums to be invested because, at it has been

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<sup>22</sup> See, generally, chapter 6, *supra*.

<sup>23</sup> See the significance of the thesis, section 1.3, *supra*.

<sup>24</sup> See, section 6.2, *supra*.

<sup>25</sup> See, section 6.3.2, *supra*.

<sup>26</sup> See, section 6.2.2, *supra*.

mentioned earlier,<sup>27</sup> the club in this regard acts on behalf of its members. There is no reason why such premiums are not invested in the form of *Mudarabah*.<sup>28</sup>

It is recommended that solidary insurance should also be provided in the UK as it presents a suitable form of insurance for people who need it, but who do not wish to be enforced to do something against their belief. The HSBC bank, for example, recognised that there are many Muslims in the UK who need to get mortgages, but they avoid it due to the fact that the conventional mortgage contains the element of *Riba*, i.e. usury, which makes it, therefore, forbidden. Accordingly, the HSBC bank provides mortgage and banking services that comply with *Sharia* principles through the HSBC *Amanah Home Finance* and the HSBC *Amanah Bank Account*.<sup>29</sup> Similarly, solidary insurance should be provided by insurance market for the same purpose.

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<sup>27</sup> See, section 6.2.1, *supra*.

<sup>28</sup> A contract whereby one party advances a sum of money to another party, as an agent, for investment that contains sharing of profits and losses. See, Mohammad Qal'aji & Hamid Qunaibi, *Mu'jam Lughat al-Fuqaha*, (Dictionary of Islamic legal terminology), (Dar An-Nafaes, Beirut-Lebanon), (1996), p. 405. *Mudharaba*, as a contract, is practiced today by Islamic banks and it has been suggested to be practiced by cooperative insurers in order to increase the capital of the cooperative members in order to meet their claims and indemnities. See, Fadi Moghaizel, *Insurance in the Light of Islamic Legal Principles*, (PhD Thesis), SOAS- University of London, (1990), at pp. 162-172.

<sup>29</sup> For more details on this, see,  
<http://www.hsbc.co.uk/1/2/personal/current-accounts/more/amanah-finance>.



## **Glossary**

*Al-Aaqilah:* An Islamic system that invites members in one family to unite to pay a sum of money to the victim's family as an indemnity where one of them kills a human without malice aforethought.

*Al-Muwalat:* a contract whereby someone of unknown descent agrees with someone else who is known descent that the latter undertakes to indemnify him for any legal fine where he accidentally causes death or grievous bodily harm, but without malice aforethought, such as manslaughter, in return for that the other person succeeds him should he die without successors.

*An-Nehid:* An Islamic system where each member of a group of people pay out contributions that could be food, money, gold by way of charity to support each other and that their contributions do not have to be equal to each other. It is, also, where a group of people on a journey contribute to share the expenses of their journey.

*Arsh:* an Islamic devise, which is an economic penalty that is paid by a wrongdoer to his victim as an indemnity for wounds and fractures.

*Dharurah:* necessity.

*Diyah*: An Islamic device which is an indemnity that consists of, usually but not necessarily, sum of money that is given to the victim's family by the killer, where he kills the victim without malice aforethought.

*Fatwa*: a religious opinion of a Muslim scholar about an issue.

*Gharar*: uncertainty.

*Hajah*: need.

*Halal*: lawful, permissible, legitimate.

*Haram*: forbidden, illegitimate.

*Ijmaa*: unanimity of opinion between Muslim scholars on agreeing about a legitimacy of an issue in one period.

*Ijtihad*: a scholar's endeavour to make a decision about an issue whether it is lawful or forbidden.

*Ikhtilaff*: a difference of opinion between two, or more, Muslim scholars or two, or more, Islamic schools of law about a legitimate position of one issue.

*Jahalah*: ignorance.

*Mu'awadhah* contract: onerous contract.

*Mudharaba*: A contract whereby one party advances a sum of money to another party, as an agent, for investment that contains sharing of profits and losses. It is, also, sleeping partnership.

*Qe'yas*: analogy; a mechanism that Muslim scholars operate in order to compare and examine principles of a new issue with the general principles of *Sharia* to make a judgement whether the new issue is lawful under *Sharia* or not.

*Quran*: the Islamic holy book.

*Ramadhan*: the holy month that Muslims fast.

*Riba*: usury.

*Riba An-Nase'ah*: usury that is manifested in delaying completion of the exchange of the counter-values with or without a profit or an increase.

*Rida Al-Fadhil*: usury that is manifested in the unlawful excess of one of the counter-values.

*Sharia*: Islamic Law.

*Zakat*: a specified sum of money in a particular time paid for a specified group of people.

# **Appendices**

## **Appendix (A)**

### **Provisions Regarding Insurable Interest in Marine Insurance Act 1906**

#### **1. Marine Insurance Defined**

A contract of marine insurance is a contract whereby the insurer undertakes to indemnify the assured, in manner and to the extent thereby agreed, against marine losses, that is to say, the losses incident to marine adventure.

#### **2. Mixed Sea and Land Risks**

(1) A contract of marine insurance may, by its express terms, or by usage of trade, be extended so as to protect the assured against losses on inland waters or on any land risk which may be incidental to any sea voyage.

(2) Where a ship in course of building, or the launch of a ship, or any adventure analogous to a marine adventure, is covered by a policy in the form of a marine policy, the provisions of this Act, in so far as applicable, shall apply thereto, but, except as by this section provided, nothing in this Act shall alter or affect any rule of law applicable to any contract of insurance other than a contract of marine insurance as by this Act defined."

#### **3. Marine Adventure and Maritime Perils Defined**

(1) Subject to the provisions of this Act, every lawful marine adventure may be the subject of a contract of marine insurance.

(2) In particular there is a marine adventure where –

(a) Any ship goods or other moveables are exposed to maritime perils. Such property is in this Act referred to as "insurable property";

(b) The earning or acquisition of any freight, passage money, commission, profit, or other pecuniary benefit, or the security for any advances, loan, or disbursements, is endangered by the exposure of insurable property to maritime perils;

(c) Any liability to a third party may be incurred by the owner of, or other person interested in or responsible for, insurable property, by reason of maritime perils.

"Maritime perils" means the perils consequent on, or incidental to, the navigation of the sea, that is to say, perils of the seas, fire, war, perils, pirates, rovers, thieves, captures, seizures, restraints, and detainment's of princes and peoples, jettisons, barratry, and any other perils, either of the like kind or which may be designated by the policy.

#### **4. Avoidance of Wagering or Gaming Contracts**

(1) Every contract of marine insurance by way of gaming or wagering is void.

(2) A contract of marine insurance is deemed to be a gaming or wagering contract—

(a) Where the assured has not an insurable interest as defined by this Act, and the contract is entered into with no expectation of acquiring such an interest; or

(b) Where the policy is made 'interest or no interest,' or 'without further proof of interest than the policy itself,' or 'without benefit of salvage to the insurer,' or subject to any other like term:

Provided that, where there is no possibility of salvage, a policy may be effected without benefit of salvage to the insurer.

#### **5. Insurable Interest Defined**

(1) Subject to the provisions of this Act, every person has an insurable interest who is interested in a marine adventure.

(2) In particular a person is interested in a marine adventure where he stands in any legal or equitable relation to the adventure or to any insurable property at risk therein, in consequence of which he may benefit by the safety or due arrival of

insurable property, or may be prejudiced by its loss, or by damage thereto, or by the detention thereof, or may incur liability in respect thereof.

## **6. When Interest must Attach**

(1) The assured must be interested in the subject-matter insured at the time of the loss though he need not be interested when the insurance is effected:

Provided that where the subject-matter is insured 'lost or not lost,' the assured may recover although he may not have acquired his interest until after the loss, unless at the time of effecting the contract of insurance the assured was aware of the loss, and the insurer was not.

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

## **7. Defeasible or Contingent Interest**

(1) A defeasible interest is insurable, as also is a contingent interest.

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

## **8. Partial Interest**

A partial interest of any nature is insurable.

## **9. Re-insurance**

(1) The insurer under a contract of marine insurance has an insurable interest in his risk, and may re-insure in respect of it.

(2) Unless the policy otherwise provides, the original assured has no right or interest in respect of such re-insurance.



## **10. Bottomry**

The lender of money on bottomry or respondentia has an insurable interest in respect of the loan.

## **11. Master's and Seamen's Wages**

The master or any member of the crew of a ship has an insurable interest in respect of his wages.

## **12. Advance Freight**

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

## **13. Charges of Insurance**

The assured has an insurable interest in the charges of any insurance which he may effect.

## **14. Quantum of Interest**

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

(2) A mortgagee, consignee, or other person having an interest in the subject-matter insured may insure on behalf and for the benefit of other persons interested as well as for his own benefit.

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

## **15. Assignment of Interest**

Where the assured assigns or otherwise parts with his interest in the subject-matter insured, he does not thereby transfer to the assignee his rights under the contract of insurance, unless there be an express or implied agreement with the assignee to that effect. But the provisions of this section do not affect a transmission of interest by operation of law.

## **16. Measure of Insurable Value**

Subject to any express provision or valuation in the policy, the insurable value of the subject-matter insured must be ascertained as follows:

- (1) In insurance on ship, the insurable value is the value, at the commencement of the risk, of the ship, including her outfit, provisions and stores for the officers and crew, money advanced for seamen's wages, and other disbursements (if any) incurred to make the ship fit for the voyage or adventure contemplated by the policy, plus the charges of insurance upon the whole: The insurable value, in the case of a steamship, includes also the machinery, boilers, and coals and engine stores if owned by the assured, and, in the case of a ship engaged in a special trade, the ordinary fittings requisite for that trade:
- (2) In insurance on freight, whether paid in advance or otherwise, the insurable value is the gross amount of the freight at the risk of the assured, plus the charges of insurance:
- (3) In insurance on goods or merchandise, the insurable value is the prime cost of the property insured, plus the expenses of and incidental to shipping and the charges of insurance upon the whole:
- (4) In insurance on any other subject-matter, the insurable value is the amount at the risk of the assured when the policy attaches, plus the charges of insurance.

## **84. Return for Failure of Consideration**

- (1) Where the consideration for the payment of the premium totally fails, and there has been no fraud or illegality on the part of the assured or his agents, the premium is thereupon returnable to the assured.

(2) Where the consideration for the payment of the premium is apportionable and there is a total failure of any apportionable part of the consideration, a proportionate part of the premium is, under the like conditions, thereupon returnable to the assured.

(3) In particular –

(a) Where the policy is void, or is avoided by the insurer as from the commencement of the risk, the premium is returnable, provided that there has been no fraud or illegality on the part of the assured; but if the risk is not apportionable, and has once attached, the premium is not returnable;

(b) Where the subject-matter insured, or part thereof, has never been imperilled, the premium, or, as the case may be, a proportionate part thereof, is returnable;

Provided that where the subject-matter has been insured 'lost or not lost' and has arrived in safety at the time when the contract is concluded, the premium is returnable unless, at such time, the insurer knew of the safe arrival.

(c) Where the assured has no insurable interest throughout the currency of the risk, the premium is returnable, provided that this rule does not apply to a policy effected by way of gaming or wagering;

(d) Where the assured has a defeasible interest which is terminated during the currency of the risk, the premium is not returnable;

(e) Where the assured has over-insured under an unvalued policy, a proportionate part of the several premiums is returnable;

(f) Subject to the foregoing provisions, where the assured has overinsured by double insurance, a proportionate part of the several premiums is returnable;

Provided that, if the policies are effected at different times, and any earlier policy has at any time borne the entire risk, or if a claim has been paid on the policy in respect of the full sum insured thereby, no premium is returnable in respect of that policy, and when the double insurance is effected knowingly by the assured no premium is returnable.

## **85. Modification of Act in Case of Mutual Insurance**

- (1) Where two or more persons mutually agree to insure each other against marine losses there is said to be a mutual insurance.
- (2) The provisions of this Act relating to the premium do not apply to mutual insurance, but a guarantee, or such other arrangement as may be agreed upon, may be substituted for the premium.
- (3) The provisions of this Act, in so far as they may be modified by the agreement of the parties, may in the case of mutual insurance be modified by the terms of the policies issued by the association, or by the rules and regulations of the association.
- (4) Subject to the exceptions mentioned in this section, the provisions of this Act apply to a mutual insurance.

## **Appendix (B)**

### **Marine Insurance (Gambling Policies)** **Act 1909**

#### **S. 1 Prohibition of gambling on loss by maritime perils**

(1) If-

- (a) any person effects a contract of marine insurance without having any bona fide interest, direct or indirect, either in the safe arrival of the ship in relation on which the contract is made or in the safety or preservation of the subject matter insured, or a bona fide expectation of acquiring such an interest; or
- (b) any person in the employment of the owner of a ship, not being a part owner of the ship, effects a contract of marine insurance in relation to the ship, and the contract is made 'interest or no interest', or 'without further proof of interest than the policy itself', or 'without benefit of salvage to the insurer', or subject to any other like term,

the contract shall be deemed to be a contract by way of gambling on loss by maritime perils, and the person effecting it shall be guilty of an offence, and shall be liable, on summary conviction, to imprisonment, with or without hard labour, for a term not exceeding six months or a fine not exceeding level 3 on the standard scale, and in either case to forfeit to the Crown any money he may receive under the contract.

## **Appendix (C)**

### **Articles Regarding Insurable Interest in Commercial Court Law 1931**

#### **Art. 324**

An insurance policy is a marine contract containing an undertaking to pay the full amount of insurance in consideration of a premium received by the insurer against losses and damages that may be caused by a marine disaster to items which he wants to safeguard against any marine carriage risk.

#### **Art. 327**

Insurable items are:

(1) vessels which sail individually or in convoys, whether loaded or empty and whether fitted out or not; (2) machinery and equipment of vessels; (3) hulls and superstructures; (4) provisions; (5) money borrowed under the marine procedure; (6) kind and nature of cargo; (7) anything having value which may be the subject of marine hazards.

#### **Art. 341**

The freight of and profit resulting from the goods on board the vessel, as well as the crew's wages, and marine borrowings and benefits are not insurable; if insurance is carried, it shall be null and void.

## **Appendix (D)**

### **Articles Relating to Insurable Interest** **in Cooperative Insurance Companies** **Control Law 2003**

#### **Art. 20**

One committee or more shall be formed by an Edict of the Council of Ministers on a recommendation of the Minister of Finance. Such committee shall consist of three specialized members, one whom at least, must be a legal consultant. The committee shall undertake to resolve the disputes arising between insurance companies and their customers or between the companies and other companies when they subrogate the insured persons, and settle violations of regulatory and supervisory instructions issued to insurance and re-insurance companies and the violations of those engaged in self-employment occupations referred to under Article (18).... Representing the Public Prosecution before this committee, in respect of such violations, shall be the employees appointed by virtue of an order issued by the Minister of Finance. Resolutions adopted by such committee may be appealed before the Grievances Department.

## **Appendix (E)**

### **Articles Relating to Insurable Interest** **in the Implementing Regulations of the** **Cooperative Insurance Companies** **Control Law 2003**

#### **Art. 1(12)**

Insurance: Mechanism of contractually shifting burdens of pure risks by pooling them.

#### **Art. 1(17)**

Insurance Policy: Legal document/contract issued to the insured by the insurer setting out the terms of the contract to indemnify the insured for loss and damages covered by the policy against a premium paid by the insured.

#### **Art. 55**

The basis of the information provided in the policy shall be the application submitted by the policyholder. When completing the insurance application, the following must be taken into consideration:

- (1) Insurable interest.
- (2) Providing all material facts related to the insurance policy.



- (3) Indemnification of the policyholder based on the insurance policy shall be the purpose of the insurance and/or reinsurance policy.
- (4) Insurance provided must not violate any rules, regulations, and directives.

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