The insured interest and distinguishing it from the insured risk

Comment on the judgment by the Civil Division of the Supreme Court of 1 March 2023

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Introduction

In general contract theory, consent, consideration and the subject-matter are the three essential elements. In an insurance contract, the consideration is the insured risk, whereas the subject-matter is the insured interest. In both cases, if they are not present, the Insurance Contracts Act ("LCS" for the Spanish) declares the contract null and void.

Hence, with respect to the insured risk, Article 4 of the LCS states that "The insurance contract shall be null and void, save in those cases envisaged in Law, if the risk did not exist or the loss event had occurred when it is concluded." Along similar lines, Article 25 of the LCS determines in regard to the insured interest that "Without detriment to the provisions of Article 4, a contract for insurance against loss or damage is null and void if, at the time when it is concluded, there is no interest of the insured upon compensation of the loss or damage."

The economic interest which the person has in the loss event not occurring constitutes a legitimate purpose of coverage in a contract for an insurance policy against loss or damage, the rationale for which lies precisely in obtaining compensation for harm to the interest. The loss event is thus the materialisation of the risk and the harm to the insured interest.

Whereas the risk is the possibility of a chance event happening that prompts a want of assets, the insured interest is not strictly speaking the item insured, but rather the interest in it which the contracting party has. This is why we refer to an interest of the owner, usufructuary, mortgagee, etc[1].

Although both elements — risk and interest — may give rise to some confusion and appear intertwined, the fact is that they differ and perform separate roles in the insurance contract. The risk endows the contract with its random essential nature, whereas the insured interest represents the reason for the asset-related attribute which compensation involves. The non-existence or disappearance of the interest excludes the possibility of the loss or damage and acts as a block to the insurer's duty to compensate. If there is no interest, no loss or damage to it can occur. And if there is no loss event, then there is no detriment or injury to remedy or indemnify[2].

[1] This is how the risk and interest insured are defined in GARRIGUES J., *Contrato de Seguro Terrestre*, edition published by J. Garrigues, 2nd edition, 1982, pp. 9 and 18.

[2] See COLINA GAREA R, "Comentario al artículo 25", in BADILLO ARIAS, J.A. (coord.), *Ley de contrato de seguro: jurisprudencia comentada*, publ. Aranzadi, 4th edition, Cizur Menor, Navarre, 2022, page 634.

The judgment by the Civil Division of the Supreme Court of 1 March 2023

It cannot be claimed that a great deal of Spanish High Court case law exists on these two essential elements of the insurance contract, above all as regards what we should understand by "insured interest." It therefore seems useful to pass comment on this recent judgment which concerns precisely these two particular elements of the insurance contract, as well as the distinction between them.

Thus, it is that the Supreme Court builds its authoritative decisions in regard to these two elements upon what is a basic factual background.

Factual background

The events which produced this decision are as follows: a woman bought a home through a court auction and had it recorded on the Land Register in the name of a legal arrangement for property jointly owned by her and her husband.

On 20 May 2016 an application for an eviction order was filed against the occupant of the auctioned-off property and on 22 June 2016 the litigating parties together took out a multi-risk homeowner's insurance policy – without even entering the home or the insurer broaching the subject of a questionnaire form – for a sum assured of 54,000 euros for the structure and 7,000 euros for contents. Likewise, for cases of vandalism the full amount of the sums assured was agreed.

On 27 July 2016, the court delegation handed over the residence to the claimant. Upon taking possession of the premises, they witnessed the damage which was apparent inside it and noticed that the furniture had been removed. That very day the claimant filed a formal complaint with the Guardia Civil (Civil Guard) and the following day they reported the loss to the insurer who, having opened the vandalism case file turned down the claim, arguing that "the consequences reported were inconsistent with the actual facts."

Subject of the claim and the insurer's objection

Following the damage caused and the insurer's rejection, the insured filed a claim for the amount of 33,581.02 euros for damage to the structure and 7,670.19 euros for loss or damage to contents.

The insurer contested the claim for several reasons, chiefly on the grounds of there being no insured interest at the time when the policy was taken out (Article 25 of the "LCS", the Insurance Contracts Act), arguing that when the insurance contract was entered into the policy holder still did not have possession of the premises subject to litigation and had not entered its interior, meaning that they were not aware of its state. It thus understood that the contract was null and void under the terms stated in Article 25 of the LCS.

Moreover, in regard to the structure, it was alleged that "the date of the loss event" was not known "and therefore it cannot be determined whether the insurance contract was already in effect or not". Regarding the contents, the insurer contended that "there is a lack of active legitimation on the part of the claimant given that they have not been the owner of any of the items of furniture in the home before or after the insurance contract and it is not even known whether they were owned by the previous owner or even the occupant or in what amount or capacity."

Finally, having acknowledged that it had not made the policy-holder fill out any questionnaire given that the policy was taken out over the telephone, the insurer cited Articles 10 and 11 of the LCS, alleging that the insured was the owner of the home, the possession of which was still pending judicial handover, without informing the company of this.

Lower court judgments

In short, the judgment by the court of first instance was of the opinion that there was an insured interest as referred to in Article 25 of the LCS, since, when the policy was taken out, the claimant was the owner of the premises, even though they were unaware of what state it was in.

With respect to intentional misconduct or gross negligence on the part of the policy holder, as well as the possibility of the loss event having taken place before the policy was taken out, it took the view that these are facts which it behoves the insurer to prove, all the more so when there is no record of the company having made the claimant complete an appropriate questionnaire for the purposes of weighing up the circumstances which ought to have had a bearing on assessing the risk involved.

The judgment did not, however, admit the items under contents, since it was given to believe that in this particular case there was no insured interest on the grounds that the furniture did not belong to the claimant.

Even so, in ruling on the appeal filed by the insurer, the judgment by section six of the Seville Provincial Court overturned that of the first court, arguing that, just as the insurer maintained, there was a lack of an interest on the part of the policy holder, given that when the act of insuring took place the claimant had not entered the interior of the property which it was insuring (as the particulars of claim themselves recognise), meaning that they were not aware of what state the inside of the property was in, while there was no proof at all that the damage finally noted might have been caused after the insurance policy had been taken out.

Matters being thus, in the view of the Provincial Court at the time when the policy was being taken out the insurance did not involve any interest, and therefore pursuant to the provisions and subject-matter regulated under Article 25 of the Insurance Contracts Act to the extent that this relates to Article 4 thereof, the contract signed between the parties was rendered null and void and it cannot produce the consequences which the claimant seeks.

The appeal to the Supreme Court

The judgment by the court of first instance having been overturned and the allegations of the insured dismissed, the insured filed an appeal with the Supreme Court, repeating the line of argument which they had affirmed throughout the entire legal process. In essence, it held that there was an insurable interest (Article 25 of the LCS) given that the policy holder was the owner of the damaged property and took out the cover with the warning that it was to be used to rent out; in other words, normally in such circumstances possession of the premises does not fall to the owner but instead to anybody to whom the use thereof has been passed.

Regarding the company's allegation that paying out compensation was not in order because no accreditation was supplied of the exact date of the loss event, while citing Article 10 of the LCS, the court dismissed these grounds for objection based on the fact that the claimant was not required to complete a questionnaire at all and, that since the company did not bother to confirm the date upon which the loss event took place, the only remaining alternative was to find in favour of the claim.

To summarise, it concluded that "... in the case of an owner who has not been asked for proof of insurance either when the policy is taken out or when collecting the premium, it cannot be asserted that no interest exists when the loss event occurs if we bear in mind that they are the owner of a property and in taking out the insurance policy they clearly state that other people will be using the premises."

Authoritative decisions of the Supreme Court

The Supreme Court pronounces on certain matters which might be held to fall within its specialist area of doctrine and which appear to us useful to highlight in regard to this appeal filed with it, where, broadly speaking, it accepts the claimant's complaint.

The concept of insured interest

The court takes the view that in this case there does exist an insured interest on the part of the insured, who is the claimant in these proceedings, since they are the owner of the property which they had acquired via a court auction. The economic relationship which they have with the item is self-evident and the fact that they might seek to guard against impairment or harm that it might suffer on account of an act of vandalism represents an undeniable legitimate goal. Their interest is therefore hard to call into question right from the moment when they bought the home and it became part of their joint property arrangement.

It thus holds that "the interest becomes a special element in insurance contracts, and not only in insurance against loss or damage but also in insurance of persons. Were this not the case, then the insurance would be transformed into a straightforward bet. It is essential that the policy states the insured interest, so it is necessary for specification to be made of 'the item wherein insurance takes place' (Article 8.2 LCS)."

The High Court recognises that in Article 25 the LCS does not define what should be understood by insured interest and it therefore turns to case law. Here it brings in Judgment No. 997/2002 of 23 October which, citing the judgment of 16 May 2000, states that "in the orbit of insurance law the interest is constituted by the economic relationship that exists between an individual and an asset that represents the subject-matter covered by the policy." And on the other hand, Judgment 681/1994 of 9 July says that "in insurance against loss or damage the insured's interest in the case of justified compensation as a consequence of the insured risk amounts to a prerequisite for the contract to be valid."

The economic interest which the person has in the loss event not occurring constitutes a legitimate purpose of coverage in a contract for an insurance policy against loss or damage, the rationale for which lies precisely in obtaining compensation for harm to the interest. The loss event is thus the materialisation of the risk and the harm to the insured interest.

The court holds that the interest not only relates to the owner of the item but also to whoever has an interest under other forms of legal title, as Supreme court Judgment No. 260/2006 of 23 March establishes when it states that "... according to doctrine and case law, the insured interest in a contract against loss or damage can not only lie in the ownership the property insured, but also arise from some other economic association in connection with it, such as having title to a secured mortgage loan via the property alluded to, since in such a case the insured interest boils down to upholding the integrity of the mortgage security to satisfy the loan in the event of default."

Therefore, in the case which concerns us here, it is clear that the claimant has an interest in the structure, since they own the home. However, in regard to the contents, the claimant lacks an insurable interest given that the title which

supports their ownership derives from the judicial sale in foreclosure proceedings, wherein the existing furniture was not part of the auction and corresponding allocation to the husband of the claimant, as the court of first instance rightly determined.

The relationship between the insured interest and the insured risk

The court then holds that there is an intimate relationship between the interest and the risk, given that for the insurance to be effective the property regarding which there is an interest must be subject to a risk. As we said at the outset, we find ourselves confronted with two out of the three essential elements in an insurance contract (the third being consent).

Nevertheless, the fact that these elements are intertwined does not make them identical. As we have seen, they are subject to different regulation: risk comes under Article 4 of the LCS, whereas the interest is regulated by Article 25 of the LCS. In both cases, if they are not present, the contract is declared null and void.

Even so, risk is the possibility of a loss event occurring, and it is the core and sinew of the insurance contract, while the contract is entered into precisely as the antidote or antibody for it. In the court's opinion it is possible for there to be risk and no interest; for example, in the case of Court Division 1's judgment No. 10/2005 of 31 January 2005 the insured interest was held to be non-existent because tenant status regarding the premises had been lost when the fire broke out. It is clear that in that case the risk that was the subject of the coverage materialised but the policy holder was unable to claim compensation for the detriment as they had lost their economic interest in the item.

On the duty to state risk

Another of the controversial issues in these proceedings is the insurer's allegation that the insured did not declare the true insured risk on the terms of Article 10 of the LCS. Nevertheless, drawing on its abundance of case law concerning this Article, the court holds that, more than a duty to declare, this is a duty on the part of the policy holder to answer or reply to what the insurer asks them, since the insurer has a greater awareness of the importance of the facts for the purposes of accurately assessing the risk and therefore has to ask the contracting party for any information which it deems opportune.

This arrangement was clarified and buttressed (if possible) by amendment of the first paragraph of said Article 10 with the addition of a final subsection according to which "(the policy holder) shall be exonerated from this duty if the insurer fails to make them complete a questionnaire or when, even doing so, there are circumstances that could have a bearing on assessment of the risk and which are not included therein." Consequently, with regard to case law the policy holder's obligation to state all the circumstances of which they are aware that might influence the risk assessment before conclusion of the contract and according to the questionnaire which the insurer requires them to complete is fulfilled "by answering the questionnaire which the insurer presents to them, while the insurer assumes the risk in the event of not presenting it to them or doing so in a manner that is incomplete."

In the case before us here, the insurer had the chance to perform risk assessment by requiring the claimant to fill in a suitable questionnaire, which it chose not to do of its own free will. It thus has to assume the consequences of not having availed itself of the questionnaire. On top of this, there is no proof of when the damage to the home took place, or that the insured was aware of the damage when they took out the policy.