



## Insurable Interest and a Claimant's Status in Property Insurance Policies: Some Prerequisites to Recovery

By Rabih Hamawi

Claimants in first party property-damage cases may believe that being the named insured on the Declarations of a property insurance policy is, by itself, sufficient to guarantee them recovery for their insured losses: but they are wrong. In order for a claimant to recover under a property insurance policy, he or she must first have an insurable interest in the insured property at the time of the loss. This article will briefly discuss the concept of insurable interest in property insurance policies, and how the claimant's status may affect his or her rights to recovery.

### Introduction

The insurable-interest doctrine originated in the United Kingdom in the 18<sup>th</sup> century.<sup>1</sup> It was created to separate insurance contracts from wagering contracts, and the moral hazards associated with profiting from another's losses.<sup>2</sup>

### Existence of an Insurable Interest: Michigan Focuses on the Claimant's Pecuniary Gain or Loss

When examining the existence of an insurable interest, American jurisdictions are split between the factual-expectancy test, representing the majority view; and the legal-interest test, representing the minority view.

Michigan follows the majority view, the so-called "factual-expectancy" test, which focuses on the claimant's real-world expectations, rather than his or her title to the property.<sup>3</sup> Under the factual-expectancy test, the focus of the inquiry is the pecuniary loss the claimant has suffered as a result of the damage to or destruction of the insured property.<sup>4</sup> Michigan courts determine the existence of an insurable interest broadly, without regard to the claimant's title, lien, or possession of the property.<sup>5</sup> The loss of an expected financial gain of "other certain benefits growing out of or dependent upon [the insured property]" is sufficient to establish an insurable interest.<sup>6</sup> Recently, the Michigan Court of Appeals held that an insured's inability to obtain expected "profits" after destruction of the insured property constitutes an insurable interest.<sup>7</sup>

The existence of an insurable interest is a question of law for the court to decide because it deals with the interpretation and construction of an insurance contract.<sup>8</sup>

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### The Requirement of Establishing an Insurable Interest Affects All Claimants

Below are examples of claimants who may be affected by the requirement of insurable interest.

#### *Named insureds*

A named insured is any person or entity specifically identified in the policy's Declarations. An improperly identified named insured, one without an insurable interest, may not automatically bar the claimant's recovery, as recovery may still be available under a reformation or a third-party beneficiary theory.<sup>10</sup>

Historically, spouses who were not named insureds, but who had an insurable interest in the damaged property, were not permitted to recover under the policy for property owned by his or her spouse.<sup>11</sup> But after the Insurance Services Office changed its standard homeowners policy language,<sup>12</sup> policies now automatically include spouses as insureds under the policy provided they reside in the same household as the named insured.

#### *Mortgagees and loss payees*

Another type of a claimant with an insurable interest is a mortgagee or a loss payee when named in an insurance policy. A mortgagee's or a loss payee's insurable interest will be limited to its financial interest in the insured property. Another limiting right to recovery depends on the type of loss-payable clause protecting its interest.<sup>13</sup> In general, insurance policies contain two types of loss-payable clauses that protect lienholders: a standard mortgagee clause and an ordinary loss-payable clause.<sup>14</sup>

An ordinary loss-payable clause “directs the insurer to pay [the policy’s proceeds] to the lienholder, as its interest may appear, before the insured receives payment on the policy.”<sup>15</sup> It does not create a separate contract between the lienholder and the insurer, and an insured’s breach of the insurance contract conditions (nonpayment of premium or failure to secure the property after a loss) may prevent the lienholder’s recovery.<sup>16</sup>

A standard mortgagee clause, on the other hand, creates a separate and independent contract of insurance between the insurer and the lienholder. A standard mortgage clause shields the mortgagee from the defenses available to the insurer against the mortgagor.<sup>17</sup>

The failure to list a mortgagee as a lienholder on the insurance policy does not automatically bar the mortgagee’s recovery. Courts have held that proceeds payable to the mortgagor may be subject to an equitable lien in the unlisted mortgagee’s favor.<sup>18</sup>

A foreclosure may affect the insurable interest of both the mortgagor and the mortgagee. A mortgagor has an insurable interest in the mortgaged property until the expiration of the redemption period.<sup>19</sup> A mortgagee also maintains an insurable interest during the redemption period.<sup>20</sup>

But for a loss occurring before the sheriff’s sale, the mortgagee’s insurable interest will be lost if the mortgagee later purchases the property at the sheriff’s sale for an amount which extinguishes the mortgage debt.<sup>21</sup>

### Land-contract vendors and vendees

The vendor (seller) and vendee (buyer) in a land contract have separate insurable interests.<sup>22</sup> After the land contract is executed, the vendor retains legal title, while the vendee has equitable title.<sup>23</sup> Both vendors and vendees have an insurable interest in the property, and the land contract’s terms govern their respective rights to insurance proceeds.

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### Other potential claimants

Other parties who may have an insurable interest include a lessee who makes improvements to the leased property;<sup>24</sup> a building contractor, in a building under construction;<sup>25</sup> and a person or entity who has paid consideration for an option to purchase the insured property.<sup>26</sup>

If a partnership owns the insured property, each partner has an insurable interest in the partnership property to the

extent of his or her individual financial interest, and he or she may insure the property in his or her own individual name.<sup>27</sup>

### Conclusion

In summary, for a claimant to recover under a property insurance policy, he or she must have an insurable interest at the time of the loss. Michigan courts broadly define insurable interest and they focus on the financial loss that a claimant has suffered from the damage or destruction to the insured property, or the financial gain that the claimant would have received from its continued existence. ■

### About the Author

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### Endnotes

- 1 Harnett and Thornton, *Insurable Interest in Property: A socio-economic reevaluation of a legal concept*, 48 Colum L Rev 1162, 1164 (1948).
- 2 *Id.*
- 3 *Crossman v Am Ins Co of Newark, N J*, 198 Mich 304, 308–09; 164 NW 428 (1917).
- 4 *Id.*
- 5 *Id.*
- 6 *Id.*
- 7 *A B Petro Mart, Inc v Ali T Beydoun Ins Agency, Inc*, \_\_\_ Mich App \_\_\_, \_\_\_ NW2d \_\_\_ (2016) (Docket No 327481); slip op at 3.
- 8 *Morrison v Secura Ins*, 286 Mich App 569, 572; 781 NW2d 151 (2009).
- 9 *First State Sav Bank of Croswell v Nat’l Fire Ins Co of Hartford, Conn*, 244 Mich 668; 222 NW 116 (1928); *Root v Hamilton Mut Ins Co*, 116 Mich App 596; 323 NW2d 298 (1981); *Secor v Pioneer Foundry Co*, 20 Mich App 30; 173 NW2d 780 (1969).
- 10 MCL 600.1405.
- 11 *Agricultural Ins Co v Montague*, 38 Mich 548, 551; 31 Am Rep 326 (1878).
- 12 Insurance Services Office is an advisory organization providing statistical, actuarial, underwriting, and claims information and

- analytics; compliance and fraud identification tools; policy language; and information about specific locations for the property and casualty insurance industry.
- 13 *Foremost Ins Co v Allstate Ins Co*, 439 Mich 378, 383; 486 NW2d 600 (1992).
- 14 *Id.*
- 15 *Id.* at 384.
- 16 *Id.*
- 17 *Id.*
- 18 *Cottrell v Clark*, 126 Mich App 276, 281; 337 NW2d 58 (1983).
- 19 *Smith v Grange Mut Fire Ins Co of Mich*, 234 Mich 119; 208 NW2d 145 (1926).
- 20 *Perkins v Century Ins Co, Limited, of Edinburgh, Scotland*, 303 Mich 679, 682; 7 NW2d 106 (1942); *Consol Mortgage Corp v Am Sec Ins Co*, 69 Mich App 251; 244 NW2d 434 (1976).
- 21 *Smith v General Mortg Corp*, 402 Mich 125, 127; 261 NW2d 710 (1978).
- 22 *McCoy v Continental Ins Co*, 326 Mich 261; 40 NW2d 146 (1949); *Sriro v Dunn*, 265 Mich 112; 251 NW 370 (1933); *Root v Hamilton Mut Ins Co*, 116 Mich App 596; 323 NW2d 298 (1981).
- 23 *Barker v Klingler*, 302 Mich 282, 288; 4 NW2d 596 (1942).
- 24 *Cadillac Theatre Co v Fitzgerald*, 210 Mich 6; 177 NW 288 (1920).
- 25 *American & Foreign Ins Co v Allied Plumbing & Heating Co*, 36 Mich App 561; 194 NW2d 158 (1971).
- 26 *Crossman v Am Ins Co of Newark, N J*, 198 Mich 304, 308-09; 164 NW 428 (1917).
- 27 *Aromo v Fire Ass'n of Philadelphia*, 218 Mich 203; 187 NW 278 (1922).
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