

‘Insurable interest’ in South African Insurance law: time to lift the curse

‘After the 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 merit, certainly not as between the assured and the insurer.’

[Per Brett MR in *Stock v Inglis* (1884) 12 QB 564 at 571]

Introduction

The view expressed in the English case of *Stock v Inglis* may appear confusing to the layperson, who might consequently be heard to ask ‘What then prevents one from insuring thin air?’ – ‘Indeed, nothing at all, but you may have a hard time claiming for the loss!’ may be the answer of the South African insurance lawyer, who draws heavily upon English law for their understanding, and it is from this point that this paper shall proceed. Brett MR’s statement serves as an *hors d’oeuvre* to a retrospective on the development and content of the notion of ‘insurable interest’ in light of the requirements for a valid insurance contract (as opposed to any other contract of a more general nature). It is deceptively simple to note that the insurable interest is ‘...the object of the insurance contract, that is the interest for which the insurer undertakes liability’.¹ In order to give content to the concept, and attempt to describe its function (particularly with respect to modern non-indemnity insurance) courts have often resorted to policy-laden reasoning and a somewhat strained construction of the *stipulatio alteri* contract.²

It shall be submitted that when investigating the relevance of an insurable interest to the contract of insurance, it is necessary to make a fundamental distinction between the contract’s valid formation, its characterisation as an insurance contract (indicated by the presence of certain *essentialia*) and its enforceability. The categories of insurable interest that have been identified in our law will not be exhaustively considered, but rather the

¹ Hosten et al *Introduction to South African law and legal theory* (Natal: Butterworth, 1977) at 564. This expression of the concept was clearly stated in the English case of *Castellain v Preston* (1883) 11 QBD 380 (CA), as cited in Reinecke and van der Merwe *General Principles of Insurance Law* (Natal: Lexis Nexis-Butterworths, 2002) para 52.

² J R Midgley ‘Enforcing insurance contracts: insurable interest and stipulatio alteri’ (1986) 103 *SALJ* 18 at 19.

two broad types of insurance cover (indemnity and non-indemnity, or ‘capital’ insurance) will be discussed with a view to exposing the relevance of insurable interest to each. Various approaches to the utility of the notion that have been advocated by our courts and writers will be noted. In conclusion, it will be submitted that the requirement of an insurable interest in a contract of insurance is actually a purported one, but that this does not unduly diminish the relevance of the notion, since the characterisation and enforcement of that contract appears to rely upon it. In this final regard, reference will be made to recent South African case law and relevant legislation, as well as suggestions for reform.

A retrospective: the notion of ‘insurable interest’ in case law

The jurisprudence surrounding the notion of insurable interest is known as ‘interest theory’³, and has seen its origin and development in the type of insurance classed as indemnity insurance.⁴ A contract of indemnity is intended to provide cover for risks to physical non-human objects. Reinecke et al⁵ cite the origins of interest doctrine in English law to be the case of *Sadlers’ Co v Badcock*⁶, which held that if one was to characterise a contract as one of insurance, it was required that an insurable interest needed to exist both at the time of conclusion of the contract and at the time that the insurable event occurs. This has since evolved to merely require the interest to exist at the time that the damaging event occurs, and in this way allow for the insurance of interests which are subsequent to the contract’s conclusion.⁷ Under English law, the problem of wagers was seen as pressing, and the Gaming Act of 1845 was passed to prohibit wagers in general terms.⁸

Under Roman-Dutch law, it has been said that the old authorities favoured an approach to indemnity insurance whose goal was to assist the jurist in determining whether there had

³ S Mothupi ‘The problems and criticisms relating to interest theory in South African insurance law and other legal systems: some suggestions for reform’ in *Codicillus* XLIV No.2 (October 2003) 101.

⁴ Reinecke and Van der Merwe *General Principles of Insurance Law* (Natal: Butterworths,) at para 102.

⁵ *Ibid* at para 104.

⁶ (1743) 2 Atk 554.

⁷ *Op cit* (n3) at para 104.

⁸ Reinecke et al (n3) at para 157.

been a loss or not.⁹ There was no concept which could be said to describe the object of an insurance contract as an ‘insurable interest’ and consequently the only consideration was whether the agreement in question served to indemnify one of the parties against a loss, and then, as a matter of fact, whether that loss in patrimony had actually occurred.¹⁰ It has also been asserted that the only purpose of this enquiry was to determine the enforceability of the agreement, since if it was a wager, without a loss, then it was unenforceable¹¹ – this would appear the path of least resistance when dealing with this concept, a way of taking what some see as a superfluous construct ‘quietly into the night’, and will be dealt with later in this paper. It is important to note, as Hosten et al emphasise, that because we are dealing with general contracts principles foremost, the Roman-Dutch principles which underlie our jurisprudence in this area are seminal for any enquiry into the valid formation of the contract.¹²

To go any further back into legal history would lead us to the *lex mercatoria*¹³ and into the realms of academia, so let us instead proceed to twentieth century South Africa, where the courts began to attempt definition of the concept, having absorbed the full gamut of English influence in this area of specific contracts. The leading case remains the 1905 case of *Littlejohn v Norwich Union Fire Insurance Society*¹⁴ in the Transvaal, which gave content to the concept, and has not been overruled. The court held that

‘[i]f the insured can show that he stands to lose something of an appreciable commercial value by the destruction of the thing insured, then even though he has neither a *jus in re* nor a *jus ad rem* to the thing insured his interest will be an insurable one’.¹⁵

This liberal principle was upheld in subsequent provincial divisions, and has not been significantly updated. But it is clearly open to development due to its inclination towards legal uncertainty and its further interpretation at provincial level needs to be considered before proceeding to explore the concept’s purpose in a modern insurance contract.

⁹ Op cit (n3) at para 103.

¹⁰ Ibid.

¹¹ Op cit (n2) at 19.

¹² Op cit (n1) at 558.

¹³ Ibid.

¹⁴ 1905 TH 374.

¹⁵ Ibid at 380-1.

In *Phillips v General Accident Insurance Co (SA) Ltd*, De Villiers J considered the *Littlejohn* case, and held that the concept had been given ‘too much emphasis’ by certain academic writers and was only really useful in determining the enforceability of a particular contract.¹⁶ The judge held that the only relevance the concept had was to help the court decide whether the contract before it was an unenforceable wager or a genuine contract of indemnity, and in doing so he used the same expression as Brett MR in the *Stock* case when referring to the assertion that no insurable interest existed: ‘...such a defence is really a technical one’.¹⁷ The same judge decided a later case on similar lines, refusing to allow the concept to be determinative of an insurance contract’s validity, in favour of utilising it as a policy tool to discourage wagers.¹⁸ In *Phillips* he also stated that the ultimate enquiry into whether a valid contract of indemnity has arisen must focus on the intention of the parties, staying true to the strong thread of Roman-Dutch purism that runs through his judgment.¹⁹ The case came in for heavy criticism from the academics: Midgley commented on De Villiers J’s approach as ‘not being in accordance with our law’ due to his focus on the indemnity contract-wager issue, and the reference to a possible solution from *stipulatio alteri* doctrine as a means of insuring ‘moral interests’.²⁰ Reinecke and van der Merwe were critical from another perspective: they argued that the court had not gone far enough in undermining the perception that the insurable interest concept was relevant to the formation of a valid contract and supporting the understanding that the intention to create indemnity for one of the parties was ultimately determinative.²¹ Mothupi posits that the policy against enforcing wagers is controversial because not all wagers are prohibited.²²

In the case of *Refrigerated Trucking (Pty) Ltd v Zive NO (Aegis Insurance Co Ltd, third party)*, another single bench Transvaal decision, the court upheld the definition from

¹⁶ 1983 (4) SA 652 (W) 659 F-G.

¹⁷ *Ibid.*

¹⁸ *Steyn v AA Onderlinge Assuransie Assosiasie Bpk* 1985 (4) SA 7 (T) cited in Midgley *Op cit* (n2) at 18.

¹⁹ *Op cit* (n15) at 660A.

²⁰ *Op cit* (n10).

²¹ M Reinecke and S van der Merwe ‘Insurable interest and reasonable precautions: blessed be the meek (and gullible?)’ (1984) 101 *SALJ* 608 at 609.

²² *Op cit* (n3) at 103.

Littlejohn, and seemed to find that the strict interpretation of the concept of insurable interest was incorrect: an insurable interest is not as narrow as a 'loss or diminution of any right recognised by law or in any legal liability' but more in line with '...the economic interest of the insured.'²³ It is submitted that this is correct, since an 'interest' is less than a 'right' and therefore much wider in ambit. Nonetheless, this case did not add significantly to our understanding of the concept's content, nor did it deal expressly with the role of the concept vis-à-vis the contract's validity or enforceability. It also could be seen to have painted the concept into a corner with respect to non-indemnity insurance.

Immediately after *Refrigerated Trucking* came *Manderson T/A Hillcrest Electrical v Standard General Insurance Co Ltd*.²⁴ This time the case arose under a single bench in the Durban and Coast local division, and McCall J conducted a most useful précis of this area of insurance law, beginning the analysis on a telling note by saying that '[t]he problem of identifying, and defining, an insurable interest is a vexed one' and best suited to legislative reform!²⁵ The finding here was very narrow, and consumer-unfriendly, where the insured had taken out cover for a vehicle belonging to his sub-contractor as part of his own fleet. It was unfortunately stolen, and the court upheld the defence of 'no insurable interest' based on a narrow understanding of the insured's interest in the continued productive use of the vehicle. It is submitted that despite this harsh interpretation, the court was probably not incorrect in its view of the role of insurable interest, and this shall be taken up later in this work. Subsequently, the Short Term Insurance Act 53 of 1998 was passed, and its effect shall also be considered later in this work. The learned judge in *Manderson* considered the use of the concept to distinguish a wager from an enforceable contract to be in the realm of policy and ultimately unhelpful to the jurisprudence of interest theory.²⁶ What was seen to be crucial, in this respect, was the intention of the parties, and the judge accordingly approved the analysis that considers a wager to be where the risk of loss lies in the very making of the compact, while the insurance contract aims to indemnify the insured against loss of something

²³ 1996 (2) SA 361 (T) 371A-C, 372A.

²⁴ 1996 (3) SA 434 (D).

²⁵ Ibid at 439F-G.

²⁶ Ibid at 440B-C.

already possessed.²⁷ This view of the reasoning from the previous Transvaal cases seems helpful, and serves to refocus our attention on the inner workings of the concept itself. McCall J then continued to reason that ‘the concept of an insurable interest is inextricably interwoven with the question of loss.’²⁸ After canvassing the various academic texts in support of this reasoning, as well as briefly returning to *Littlejohn*’s case, it was concluded that Reinecke et al were correct in their analysis (which shall be explored shortly) that the real purpose of interest theory is to assist the parties in ascertaining a loss which could then be compensated.²⁹ McCall J held that the correct understanding of the loss described in *Littlejohn* ‘was a loss with a real value in trade or commerce’.³⁰

This case made a good attempt at deepening the well of knowledge with respect to insurable interest’s purpose in the contractual context. It seems that the judge assumed it only had relevance to the contract’s enforceability i.e. when a claim arises under an indemnity contract, and serves us little, if at all, in determining the contract’s validity. The latter must be monitored with reference to the parties’ intentions, which it is submitted is the correct basis for validity in South African law.

But the ongoing lack of juridical clarity came to the fore again in *Lynco Plant Hire & Sales Bk v Univem Versekringsmakelaars Bk*, in the Transvaal division.³¹ Here, Claassen AJ muddied the waters by approving *Littlejohn*’s definition of the concept, but then holding that ‘[w]at vasstaan is dat 'n versekerbare belang wel 'n vereiste is vir 'n geldige versekeringskontrak’!³² This statement goes directly to the view that an insurable interest is related to a contract’s validity, not its enforceability. It is submitted that the judge may have misconstrued previous decisions regarding the purpose of the concept, and possibly conflated unenforceability with illegality.

²⁷ Ibid at 440I-J.

²⁸ Ibid at 441A.

²⁹ Ibid at 442C-F.

³⁰ Ibid.

³¹ 2002 (5) SA 85 (T).

³² Ibid at 88F.

At appeal court level, very little has arisen regarding insurable interest. In the *Mostert* case, which was essentially a delictual matter, it was curtly stated that a city council ‘cannot insure unless it has an insurable interest’ – whether this goes to contractual validity or enforcement of a claim, nothing further was said.³³

The brief exposé undertaken thus far should be enough evidence of the lack of clarity surrounding the concept in case law. Further on, the relevant statute³⁴ will be considered, but it now serves to discuss how the concept has been applied specifically in indemnity and non-indemnity insurance contracts, before the question of whether it is a formative requirement, or one pertaining only to enforceability or simply part of the *essentialia* of an insurance contract is dealt with.

Indemnity Insurance

As a prelude, it must be made clear that the object of an insurance contract is distinguishable from the object at risk. Reinecke et al are unequivocal on this point and state that ‘[t]he object of risk is directly exposed to the peril insured against...[i]n case of indemnity insurance the object of the risk is a physical or non-human object, while in the case of capital insurance the object relates to a person.’³⁵ The shortcoming of this categorisation could be that it oversimplifies the diversity that exists within the indemnity category – liability insurance is, for example, a form of indemnity insurance that aims to protect the insured against the coming into being of a particular liability³⁶; it may thus be difficult to determine a physical object of the risk here. For this reason, Reinecke et al see fit to distinguish between property insurance and liability insurance as sub-categories of indemnity insurance.³⁷ The authors go on to say that it is more accurate to consider that the interest that is protected is the ‘interest in the non-occurrence of an event rather than as an interest in a particular object of risk.’³⁸

³³ *Mostert v Cape Town City Council* 2001 (1) SA 105 (SCA) 117E.

³⁴ Short Term Insurance Act 53 of 1998.

³⁵ Reinecke et al (n4) at para 53.

³⁶ Ibid at para 63.

³⁷ Ibid.

³⁸ Reinecke et al (n4) at para 57.

The crucial issue with property indemnity insurance revolves around the fact that such insurance serves to protect insured persons against loss of patrimony, and this includes negative patrimony (liabilities). This means that we could go a long way towards understanding the concept of insurable interest as being a means of explaining patrimonial loss within the specific context of the indemnity contract. Reinecke et al are proponents of this view, and there may be resonance in their approach, particularly with respect to the enforcement of a claim under an indemnity agreement.

In South Africa, if we accept that the nature of any contract depends on the intention of the parties, then surely the term which indicates that one party agrees to indemnify the other against a loss of a particular kind should be decisive? Reinecke and van der Merwe point this out in their case note on *Phillips*³⁹, but then go on to cite the age-old case of *Castellain v Preston*⁴⁰ as authority for the view that '[t]hroughout the long history of this doctrine its primary function has been to determine whether a specific insured has a claim in terms of a valid contract of insurance, and, if so, to what extent.'⁴¹ This would mean that the concept enjoys continued relevance in the loss-determination exercise. But how does it really differ from the ordinary private law of damages? The authors themselves admit that it seems indistinguishable from the '*id quod* interest' of someone who has suffered a negative alteration to their patrimony, based on a concrete analysis of the loss suffered, supported by sufficient proof.⁴² Midgley seems to concede that this approach may overcome a lot of the conceptual problems associated with using insurable interest solely as a policy-driven 'wager detector', which he argues is conceptually dangerous because it leaves a court with no basis for adjudicating claim values.⁴³

It is submitted that it does not follow that by using the concept once in one fashion, it cannot be used in the same case for another intimately related goal, so there may be no merit in Midgley's reasoning against using it to sniff out wagers.

³⁹ Reinecke and van der Merwe (n21) at 610.

⁴⁰ (1883) 11 QBD 380 CA.

⁴¹ Reinecke et al (n21) at 610.

⁴² Reinecke et al (n4) at para 55.

⁴³ J R Midgley 'Enforcing insurance contracts: insurable interest and stipulatio alteri' (1986) 103 *SALJ* 18 at 21.

What is really in issue then is why we need to retain the separate terminology when all we are doing is using the concept to measure the threshold for the indemnity to operate, something the law of damages already caters for in South Africa. The only reason may be because the concept of insurable interest has some special flavour, unique to insurance law. The problem becomes acute when faced with facts such as those in *Phillips*. What is really the objection to a husband insuring goods which are strictly under his wife's title? It is clear the judge engaged in some strained reasoning to prevent the insurer from wriggling off the hook. Did the husband really suffer a loss which could be equated to an insurable interest as per Reinecke et al's approach?

To resolve this, the law of *stipulatio alteri* contracts has been suggested as a possible avenue for exploration.⁴⁴ Here the third party could accept the contract concluded by the insurer and the insured, and thus take on the benefits of the cover, provided they comply with the terms, and so on. Mothupi (cautiously) sees this as a move in the right direction, as it appears to alleviate the problems in cases like *Refrigerated Trucking*, where a third party's liability is being covered.⁴⁵ But Midgley is very unforgiving of this line, and goes to great lengths to point out that the law surrounding *stipulatio alteri* contracts is by no means satisfactory⁴⁶ - are we just robbing Peter to pay Paul if we use this way out?

Finally, the question of whether insurable interest serves as an *essential* of the insurance contract must be considered. In this sense one is merely asking whether it is a characteristic which must be present in order to be able to denote the contract as one of insurance (and this question applies equally to non-indemnity contracts). It is submitted that the answer to this is a short one: if we accept Reinecke et al's view on the case law that insurable interest is only relevant as a specific loss determinant, then we are acknowledging that it is only required (if at all) at the time of occurrence of the risk event. If this is so, then it follows that it cannot possibly be an essential of insurance contracts, and that these rely on something else for their characterisation. It is further submitted that, as Mothupi correctly identifies, what is the true *essential* is the 'principle

⁴⁴ Reinecke et al (n21) at 613.

⁴⁵ Mothupi (n3) at 105.

⁴⁶ Midgley (n43) at 22-23.

of indemnity' that we have already discussed: the intention between the parties that one indemnify the other against the occurrence of loss-causing events in return for payment of premia.⁴⁷

It is thus becoming more obvious that the concept of insurable interest, certainly in the area of indemnity insurance, is dubious. Perhaps we should jettison it and return to fundamental principles: one party agrees to indemnify the other, premia exchange hands, a loss occurs and compensation is paid based on the ambit of the terms agreed to!

Non-Indemnity (Capital) Insurance

Here the situation is markedly different – because the object of risk is often a person's life, the possibility of morally repugnant situations of benefit is deemed to be stronger. English law is clear – the insurable interest in the case of life assurance must exist at the time of the contract's conclusion; it need not exist at the time of the risk event.⁴⁸ In SA, we have a dearth of case law on this point, and it is often stated that we therefore follow the English line, but this is very unclear, and the Roman-Dutch law is of no assistance in this respect.⁴⁹ It is not controversial to say that South African law recognises the types of interest protected by such contracts as being essentially non-patrimonial, and hingeing on 'emotional' and 'sentimental' losses, such as loneliness when a spouse dies, sadness at disability or disfigurement, inconvenience and so on.⁵⁰ This is tricky though, when we consider the the English rule – why should an interest in the relationship of comfort that one has within a marriage not be capable of being insured the day before the wedding occurs? In other words, if we were to adhere to the English law, we could not insure an expectancy of a non-patrimonial interest. Once again, Reinecke et al argue that the relevance of the concept to determining loss should continue, but that the principle of indemnity should apply to determining the nature of the contract.⁵¹

⁴⁷ *Mothupi* (n3) at 108-9.

⁴⁸ *Dalby v India and London Life Assurance Co* (1854) 15 CB 365 (Ex Ch) cited in Reinecke et al (n4) at para 84.

⁴⁹ Reinecke et al (n4) at para 85.

⁵⁰ *Ibid* at para 86.

⁵¹ *Ibid* at para 108.

The effect of the Short Term Insurance Act

Section 1(1) of the Short Term Insurance Act⁵² defines a short-term policy as ‘...a contract in terms of which a person, in return for a premium, undertakes to provide policy benefits if an event contemplated in the contract as a risk...occurs’.

This makes no reference to insurable interest, nor does the Act define ‘insurance’. This means that one would resort to the ordinary common law meaning and therefore see it to include any *essentialia* and requirements for validity that the common law does.⁵³ It can be said that the Act could be used as part of a broader argument that the concept has taken a beating in our law. But on its own, due to the wording, the Act is not conclusive in this respect.

Further legislation?

Mothupi puts forward the notion, after summarising the controversy surrounding the concept, that comprehensive legislative intervention to entrench Reinecke et al’s ‘principle of indemnity’ is required.⁵⁴ Considering that insurable interest appears to be the changeling child of initial legislative attempts to ensure that only a real loss was effectively indemnified, perhaps we must leave the misshapen creature in the stone circle at midnight and ask the fickle spirits of the lawmakers to make it go away. Or do we risk bringing further malice upon the insurance law household? Legislative reform is not always the panacea one hopes for, and the saying ‘never wish too fervently, for your wish may be granted’ comes to mind.

But should we choose to go this route and give the principle of indemnity a seat at the head of the table, perhaps we should then go even further: it is submitted that a lot of the intellectual ‘escape artistry’ seen in the judgments concerning insurable interest seems to have occurred because the courts could not face allowing the insurer *in casu* to escape making payments. The *Phillips* court stated ‘[i]f there is any doubt, the benefit should in my view be given to the insured, having regard to fact that normally the company has

⁵² Act 53 of 1998.

⁵³ Reinecke et al (n4) at para 531.

⁵⁴ Mothupi (n3) at 108-9.

throughout the period of insurance accepted the insurance premiums and that such a defence is really a technical one', with the 'defence' referred to being averment of the absence of insurable interest.⁵⁵ It is submitted that what is really said here is that the insurers acted in bad faith. Since *Brisley v Drotsky*⁵⁶, the term 'good faith' in the context of contractual actions is not to be mentioned as a naked argument, and the SCA has taken a hard line on this matter. This is where the legislature could step in and entrench this feature of insurance law as something which could be raised (even *mero motu*) to defeat such technical objections from insurers who have comfortably accepted premia for the duration of their agreements. Perhaps this alone may even put paid to the insurable interest debacle without having to do much else? The good faith feature is a tool for social justice in contracting and possibly enforcement of constitutional norms, so its benefit may even extend beyond insurance law litigation.

Conclusion

It has been shown that the concept of insurable interest came to us from English legislation, without any equivalent construction in Roman-Dutch law. It has served as a public policy tool for disallowing enforcement of wagers, and as a means for describing occurrence of a covered loss in the technical sense. It is not a requirement for valid formation of an insurance contract (although this may not be entirely clear with respect to capital insurance) but comes to the fore when a party seeks to enforce the obligation to indemnify as per an existing agreement. It does not even appear to be part of the *essentialia* of the insurance contract, as what seems fundamental is the principle of indemnity as determined by the intention of the parties and embodied in the terms. It gives rise to counter-intuitive technical defences, such as was seen in *Manderson*, and seems to allow such defences to succeed even in the clear absence of good faith by the insurer. With respect to non-indemnity contracts, we struggle with the traditional commercially-oriented definition from *Littlejohn*, which makes harmonising it with emotional and sentimental losses a fiction. It has spawned some dubious attempts to sustain it in the form of attenuated *stipulatio alteri* reasoning, and has generally fuelled

⁵⁵ *Phillips* (n16) at 659G.

⁵⁶ 2002 (4) SA 1 (SCA).

academic navel-gazing. So what is to be done with this beast? Complete amputation from the common law? This is unlikely to happen within the SCA, as the *Mostert* case shows. Legislative reform? Perhaps this is the most feasible euthanasia, but it is not without potential problems.

Perhaps there is a middle ground – the concept could be developed and nuanced to the extent that it forms a test for *id quod* interest which is unique to insurance law. In this sense, perhaps the courts could rather use it as an interpretive tool designed especially for use in analysing the loss suffered from a more liberal perspective, taking into account both good faith and the principle of indemnity. This would mean broadening the definitive statements about the concept and taking a quantum leap with respect to good faith and non-commercial losses. Sadly, this is probably asking too much from our courts, which develop the law in a casuistic manner, slowly, and with respect to good faith, not at all. Much as the common law is our greatest treasure, all that glitters is not gold, and it is reluctantly submitted that we must defer to the cold hard scratching of the drafter's pen and hope for the best...

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