Insurable Interest in Texas

INSURABLE INTEREST IN TEXAS

THE almost universal rule adopted by the courts is that a person having no insurable interest in the life of another may not procure a policy on the latter's life; if he does, the policy is void as to such beneficiary as a wagering contract and against public policy.[1] Texas courts have stated that the primary basis for the requirement of insurable interest is to prevent any incentive to bring about the premature death of the insured. In the case of *Cheeves v. Anders*[2] Associate Justice Brown summed up the attitude of the Texas courts as follows:

> In some states it is held that an element of wagering likewise enters into such contracts, which has led, as we believe, to inconsistencies in the decisions in some of the courts. Our court has placed the inhibition against such contracts upon the higher and sounder ground that the public, independent of the consent or concurrence of the parties, has an interest that no inducement shall be offered to one man to take the life of another.[3]

While Justice Brown seemingly rejected the wagering contract theory as the reason for the requirement of insurable interest, later cases have recognized it as co-existing with the public interest that no inducement be offered to one man to take the life of another.[4]

The best definition of what constitutes an insurable interest, in general terms, is found in *Texas Jurisprudence:*

> In the case of life insurance, an insurable interest exists only if there be a reasonable ground, founded upon the relations of the parties, either pecuniary or of blood or affinity, to expect some benefit or advantage from the continuance of the life of the assured.[5]

On the basis of relationship, independent of pecuniary expecta-

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[1] 29 AM. JUR., *Insurance*, § 353, p. 309.

[2] 87 TEX. 287, 28 S. W. 274 (1894).

[3] *Id.* at 291, 292, 28 S. W. at 275.

[4] Wilke v. Finn, 39 S. W. 2d 836 (Tex. Comm. App. 1931).

[5] 24 TEX. JUR., *Insurance*, § 70, p. 767.

iton, as constituting insurable interest, the Texas courts feel that such relationship must be in the second degree.[6] However, where the blood relationship fails to be of the second degree, the too-distant relative may still be held to have an insurable interest if he or she also has a reasonable expectation of pecuniary benefit in the continued existence of the insured.[7] The reasonable expectation of pecuniary benefit that a creditor has in the continued life of his debtor gives him an insurable interest in his debtor's life, but the interest is limited to the amount of the debt.[8] By statute a corporation, partnership, joint stock association, or a trust estate doing business for profit has an insurable interest in the life of any of its respective officers or stockholders; likewise, a partnership or a member thereof has an insurable interest in the life of any of the partners; and a charitable organization is deemed to have an insurable interest in any individual.[9]

It is not proposed here to give an extensive review of the law pertaining to insurable interest in Texas. But a situation will be examined in which Texas courts have adopted a peculiar rule differing from that entertained in the vast majority of jurisdictions. Proposed legislation which would modify this rule will be discussed.

It is established, of course, that an individual has an insurable interest in his own life. The element of wagering or any incentive to take the life of another cannot be said to be present in this instance. When a person takes out a policy of insurance on his own life, the majority of courts allow the policy to be sold or assigned, in spite of the fact that the assignee has no insurable interest in the insured's life. The assignee may collect the full amount of the proceeds of the policy. However, the assignment may not be a cover for a wagering policy.[10]

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[6] Wilton v. New York Life Ins. Co., 78 S. W. 403 (Tex. Civ. App. 1904).

[7] *Ibid.*; Smith v. Metropolitan Life Ins. Co., 123 S. W. 2d 956 (Tex. Civ. App. 1938).

[8] First Nat. Bank of Lockney v. Livesay, 37 S. W. 2d 765 (Tex. Civ. App. 1931), *aff'd*, 57 S. W. 2d 86 (Tex. Comm. App. 1933).

[9] Texas Laws 1951, c. 491; TEXAS INSURANCE CODE OF 1951, art. 3.49.

[10] Rylander v. Allen, 125 Ga. 206, 53 S. E. 1032 (1906).

Texas courts, on the other hand, do not allow the assignee of a policy to collect the proceeds, but limit the assignee's recovery to expenditures made by him plus interest. And if the assignee has made no expenditures, the assignment is void.[11]

While the Texas rule thus restricts the sale or assignment of life policies to persons having an insurable interest, such restriction seems unjustifiable in view of the case of *Fletcher v. Williams*.[12] There Fletcher effected a policy on his life payable to his father if alive at his death, or if not alive, then to his estate. The father predeceased the insured. Thereafter the insured executed an instrument wherein he directed the insurance company to pay the proceeds of the policy to Williams after his death. The court held the instrument to be a will and gave the proceeds of the policy to Williams even though he had no insurable interest. The court said that the proceeds of the policy became a part of the insured's estate immediately on his death and could, as in the case of other property, be disposed of by will. It would seem that what one can do indirectly by will he should be able to do directly by an assignment.

Under Article 10.12 of the *Texas Insurance Code of 1951* no longer is it necessary for one to have an insurable interest in the insured's life to be entitled to the proceeds of a fraternal benefit certificate. In the case of *Castillo v. Canales*[13] Woodmen of the World Life Insurance Society issued a fraternal benefit certificate to Miguel Villarreal, with Eloisa Sanchez the named beneficiary. The by-laws of the Society permitted anyone not prohibited by the laws of the State to be named beneficiary. Subsequently the insured changed the beneficiary to Eloisa Canales, she having no insurable interest in the insured's life. In allowing Eloisa Canales to recover the proceeds of the certificate the court said with reference to Article 10.12:

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[11] Manhattan Life Ins. Co. v. Cohen, 139 S. W. 51 (Tex. Civ. App. 1911) *er. ref.*

[12] 66 S. W. 860 (Tex. Civ. App. 1902) *er. ref.*

[13] 141 Tex. 479, 174 S. W. 2d 251 (1943).

> Prior to the adoption of the statute above referred to regulating fraternal benefit societies, it was the public policy or "law" of this State, with a few exceptions, that no one could be named as a beneficiary in a life insurance policy who did not have an insurable interest in the life of the insured. As previously stated, the Legislature had the right to change this public policy. By the statute above referred to that public policy was changed so that it then became the "law" of this State that a member of a fraternal benefit society, with the consent of the society, as evidenced by its laws could name as beneficiary in a life insurance policy whomsoever he pleased, and regardless of whether the named beneficiary had an insurable interest in the life of the insured.[14]

But why the distinction between fraternal policies and commercial policies? The only argument supporting the distinction is that the brotherly love aspect is present among members of a fraternal society and therefore any incentive to take the life of the insured would be negatived. But this argument is based on the relationship existing among members of the society; it certainly cannot be maintained that a designated beneficiary, a stranger to the society, would feel any more brotherly love toward one insured by a fraternal society than one insured by a commercial company. If the beneficiary is going to murder the insured for the proceeds of the policy, it is doubtful that he will give any consideration to the fact that the insured was covered by a fraternal society rather than a commercial company. Seemingly, any distinction as to the requirement of insurable interest with relation to the two types of policies is unwarranted. Whatever reasons motivated the legislature to pass Article 10.12 with respect to fraternal societies are just as valid with repect to commercial policies.

It should be further noted that the legislature has dissolved the basis of the decision of *Cheeves v. Anders* by eliminating the inducement to take the life of another. Article 21.23 of the *Texas Insurance Code of 1951* provides that the interest of a beneficiary in a life insurance policy shall be forfeited when the beneficiary willfully brings about the death of the insured.

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[14] *Id.* at 486, 174 S. W. 2d at 254.

Aside from the above considerations, the Texas rule preventing free assignability of life policies greatly reduces their value in the commercial world. The best example of the stifling effect of the requirement is found in the use of insurance policies as collateral security. In the majority of jurisdictions the value of life policies as collateral security would be equal to their face value, while in Texas the value is limited to the amount received by the insured from the security holder.

In the regular session of the Fifty-second Texas Legislature a bill[15] was introduced which would provide for certain changes in the present rule of insurable interest. Section 1 deals with the situation in which one takes out insurance on his own life. Thereunder, a person of legal age may apply for insurance on his own life and designate any person or legal entity he chooses as beneficiary. The insured may also assign or transfer any or all of his rights, interests or benefits to anyone, before[16] or after the policy is actually issued. The beneficiary or assignee, by the statute, will be held to have an insurable interest in the life of the insured. The effect of this section is to remove the existing limits on those who may be designated as beneficiary or assignee where the insured takes out the policy on his own life.

Section 2 deals with the situation in which one takes out insurance on the life of another. Here, each of the indicated persons or legal entities will have an insurable interest in another's life, provided, however, that the insured joins in the application for the insurance or in any change of beneficiary:

(a) An employer in the life of any employee.

(b) An employee in the life of his or her employer, which includes all individuals composing the employer.

(c) A stockholder of a closed corporation in the life of any other stockholder of such corporation.

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[15] S. 58, H. R. 173. The bill was passed by the House but never came up for vote in the Senate.

[16] The assignment or transfer must be after application is made, but may be before actual issuance of the policy.

It can be seen that the effect of this section is merely to enlarge the existing limits of those who may have an insurable interest in the life of another.

Even with this proposed legislation, however, Texas would still have the peculiar rule requiring an insurable interest both at the time of issuance and at the time of termination of the policy. The rule is based on the unsound premise that the primary purpose of insurable interest is to lessen the temptation to take life. Thus, *Cheeves v. Anders* would still be controlling, and, where a party has taken out life insurance on his partner's life and the partnership is dissolved before the death of the insured, the policy would be void as to the partner beneficiary, since he would not have an insurable interest at the termination of the policy.

The proposed bill would alleviate the harshness of the present doctrine as to beneficiaries and assignees on policies taken out by the insured on his own life. By giving any person chosen by the insured as beneficiary or assignee an insurable interest, Texas would reach the same result as that prevailing in most of the states, although by obviously indirect and inconsistent methods.

The passing of this legislation would be a step toward bringing Texas into accord with the more desirable majority view as to insurable interest. It would not entirely mitigate the existing Texas rule inasmuch as the insurable interest of the beneficiary might cease to exist, thereby barring him from recovery of the proceeds. With the enlargement of those who may have an insurable interest, however, the bill should be sufficient, together with Articles 10.12 and 21.23 of the Insurance Code, to persuade the judiciary that the intent of the Legislature is opposed to the present out-dated rule. The courts would then be in a position to overrule *Cheeves v. Anders* in favor of the sounder majority rule.

Robert A. (Dean) Carlton, Jr.
Morton J. Hanlon.

Addendum:

After this Comment was sent to press, *Roberts v. Southwestern Life Insurance Company*[17] appeared in the advance sheets. In this case a divorce settlement was entered into whereby it was agreed, among other provisions, that the wife would continue to have an insurable interest in the life of the husband after divorce, and that the husband would have the wife irrevocably made beneficiary in certain life insurance policies on his life. A judgment of divorce was rendered with the settlement incorporated therein. Some four years later the husband sought to change beneficiaries without the consent of the wife. The insurer brought suit for a declaratory judgment to establish the rights, status, and legal relationships of the parties under the policies. The case was adjudged in favor of the husband by the district court, holding that the wife did not have an insurable interest in his life after the divorce.

The court of civil appeals reversed the decision on the ground that the husband was estopped from asserting any right to change beneficiaries, and also on the ground that a declaratory judgment would not lie until the rights have become fixed, *i.e.*, not until the death of the insured.

By dicta Justice Young acknowledges that, under the present rule of insurable interest in Texas, the wife did not have an insurable interest in the life of the husband after the divorce and that the divorce judgment so stating was erroneous. However, this judgment was not void and, therefore, not subject to collateral attack in the present action. Justice Young registers displeasure with the present rule as laid down in *Cheeves v. Anders*. He points out that inasmuch as Article 10.12 of the *Texas Insurance Code of 1951* exempts fraternal societies from the rule, the burdening of all other insurance companies with the restriction results in unjust discrimination within the meaning of the Fourteenth Amendment of the Federal Constitution, and Article 1, Section 3 of the Constitution of Texas. It is further pointed out in the opinion just as this Com-

[17] 244 S. W. 2d 302 (Tex. Civ. App. 1951).