THE PRE-CONTRACT UTMOST GOOD FAITH IN THE
INSURANCE LAW

----A COMPARATIVE STUDY OF THE CHINESE LAW AND THE
COMMON LAW

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COMMON LAW

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Chapter 1. Introduction

The Chinese insurance industry revived in 1980 when the first insurance company, the People’s Insurance Company of China, came into being. After 24 years high-speed development, there have been 54 insurance companies by the end of October 2002. The annual premiums has increased 459 times from 1980’s RMB 0.46 billion to 2001’s RMB 210.94 billion with an average annual increasing rate of more than 30%. The achievements are significant. However, the law of insurance did not match the fast development of the insurance industry, and some problems have arisen due to the deficiencies and incomplete formulation of the law. One of these problems that is undermining the root of the insurance industry is the want of trust of the public in the

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1 It is called “revival”, because the insurance industry already existed in China since the late Qing dynasty when “the Western concept of insurance was introduced to China by foreign businessmen, [who] used the insurance policies which were commonly used in their own countries at that time.” (Clement Shum, “Insurance Companies in China” (1996) 8 Insurance Law Journal 37 at 37.) In 1805, the English merchants opened the Canton Insurance Society in Guangzhou, but the earliest Chinese insurance companies were established in 1885. After the founding of the People’s Republic of China, the insurance industry continued to develop until the end of 1958. During the period from 1949 to 1958, the State Council and its departments and commissions promulgated many regulations, such as the Ship Compulsory Insurance Regulation 1951, the Railway Vehicles Compulsory Insurance Regulation 1951, the Regulation of Compulsory Insurance of the Academic Injury to the Passengers of Ship, Railway and Airplane 1951, and the Regulations of Voluntary Insurance of Citizens’ Property 1957 (None of these regulations are enforced now), at the end of 1958, the national income of insurance reached RMB 1.6 billion. But from 1958 on, until 1979, nearly all of the insurance business was stopped due to the extremely “left” policy. The only survived insurance business during that period was international underwriting which was also extremely limited. Little wonder that few statute was published on the insurance during those 21 years. In 1979, economic reform took place and the insurance industry reappeared. See Clement Shum, ibid; Li Yuquan & He Shaojun, Zhong Guo Shang Fa (China Commercial Law) (Wuhan: Wuhan University Press, 1995) at 303-304; Si Yuzhuo, et al, Xin Bian Hai Shang Fa Xue (New Edited Maritime Law) (Dalian: Dalian Maritime University Press, 1999) at 465-466; Alberto Monti, “The Law of Insurance Contracts in the People’s Republic of China: A Comparative Analysis of Policyholders’ Rights”, online: the International Centre for Economic Research <http://www.icer.it/docs/wp2001/monti28-01.pdf> at 4-8.

2 Xu Xiao, “San Jia Wai Guo Bao Xian Gong Si Huo Zhun Jin Ru Zhong Guo Shi Chang (Three Foreign Insurance Companies have been Approved into China’s Market)”, Zhong Guo Bao Xian Bao (China Insurance News), November 5, 2002; Ding Tao, “San Jia Wai Guo Gong Si Zhun Ru, Zai Hua Wai Zi Bao Xian Gong Si Yi Da 34 Jia (Three Foreign Insurance Companies have been Approved; 34 Foreign Insurance Companies have been in China)”, Zhong Guo Zheng Quan Bao (China Securities News), November 4, 2002. As for why China’s insurance industry has developed so fast, see Alberto Monti, ibid.

3 RMB 100 is roughly S$ 21.

dishonest insurers who, from time to time, reject reasonable claims under the policies. One of the most disputed issues is the principle of utmost good faith. Several features of the Chinese legal system have contributed to the disputes on the principle of utmost good faith.

Firstly, there are quite a few ambiguities in the wording of the law. In China, the insurance contracts are governed by two main statutes. *The Maritime Code of the People’s Republic of China (1992)* applies to marine insurance contracts while *the Insurance Law of the People’s Republic of China (1995, revised in 2002)* applies to non-marine insurance contracts, with an exception that where *the Maritime Code* does not have specific rules on certain matters, *the Insurance Law* will apply to those matters. The marine insurance law of China was greatly influenced by *the Marine Insurance Act 1906 (U.K.)* and it in turn influenced the non-marine insurance law. The concepts borrowed from the common law, such as the materiality, have no parallel terms in the system of civil law, so they lack the backup from the civil law. In addition,

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5 The insured often complain that “the insurance is easy to apply, but the claim is hard to settle.” See e.g. Chen Qian & Peng Tingting, “Wo Guo Bao Xian Ye Xian Zhuang Tou Shi (Perspective on Our Country’s Insurance Industry)”, Qing Nian Shi Xun (Young’s News), March 1, 2001, online: the People’s Net <http://www.people.com.cn/digest/200103/02/jj030218.html>.


7 Hereafter *the Maritime Code*.

8 Hereafter *the Insurance Law*. In this thesis, unless otherwise mentioned, “the Insurance Law” means the version as revised in 2002.

9 The western concept of insurance was introduced to China by foreign businesspersons who used the insurance policies which were commonly used in their own countries at that time since the 19th century. See supra note 1. Britain, as the most influential marine insurance market at that time, has had her insurance theories and concepts spread to China through the practice of international business. In the latter half of the 19th century and the early 20th century, the British investment had a dominating, and before 1889 even monopolistic, control over the finance industry and the shipping industry in China. Immanuel C. Y. Hsu, *The Rise of Modern China*, 16th ed. (New York: Oxford, 2000) at 432-434.

10 The *Insurance Law* is promulgated later than *the Maritime Code* and, under the influence of the latter, has changed much compared with the *Property Insurance Contract Regulation 1981*, which is the precursor of the *Insurance Law*.

11 Even the duty of disclosure is alien to the Chinese law. Its requirement has surpassed the principle of good faith in the civil law which does not require voluntary disclosure of material information to the other party.

12 In China’s civil law system, the law governs general matters are called “the general law” while a special law governs more special matters. The special law has precedence over the general law but when an article of a special law is ambiguous or when a special law lacks some necessary content, the court usually resorts
both of the statutes are not very elaborate and need thorough interpretations to make their meanings clear. Thus the insured and the insurer often have their own understandings as to how the words should be interpreted. Sometimes, their understandings differ a lot. For example, as to what is the insurer’s liability for his failure to make general explanation, even the lawyers are not quite confident of the answer. Moreover, while the imperfect law requires more skilful interpretation, the quality of the judges in the People’s Court compounds the problem. Although the quality of the judges is not the issue that the thesis is going to resolve, it is hoped that the thesis can go some way towards clarification and development of the law.

The second problem is concerned with the pyramidal construction of Chinese legal system. The statutes passed by the Nation People’s Congress or its Standing Committee stand at the top of the pyramid and they are of high authority, but their number is much lower than that of the subordinate administrative regulations promulgated by the State Council, its departments and commissions, and the local governments. While the subordinate regulations are inferior to the to the general law, most commonly the General Principles of the Civil Law 1986. See also Alberto Monti, “The Law of Insurance Contracts in the People’s Republic of China: A Comparative Analysis of Policyholders’ Rights”, online: the International Centre for Economic Research <http://www.icer.it/docs/wp2001/monti28-01.pdf> at 14.

13 The insurer is under the duty to make general explanation as to the terms and clauses of the insurance contract according to article 17 of the Insurance Law. See page 163ff., below.

14 In China, a large number of judges do not have a bachelor degree in law. It has been reported that only about 10% has a bachelor degree (not necessarily in law) and many of judges only get three-to-six-months temporary legal training before they become judges. Those who are not trained in law come from the army, the police offices, and some other departments of the government. In order to resolve the unemployment problem of the soldiers deactivated from army, the nation has stuffed many deactivated soldiers into the court, among which some are even illiterate, disabled, or psychoneurotic! Fortunately, since the unification judicial examination was held in 2002, the door for those who are not qualified with a bachelor degree has been closed, but there is still a long way to go. See e.g. Jean-Pierre Cabestan, “Zhong Guo De Si Fa Gai Ge (China’s Reform on the Judicial System)”, online: The British Broadcasting Corporation <http://news.bbc.co.uk/hi/chinese/China_news/newsid_2149000/21492061.stm>; Tang Ji & Liu Jun, “Shou Wei She Hui Gong Zheng Zui Hou Fang Xian: Zhong Guo Fa Guan Su Zhi Ling Ren You (Guarding the Last Defending Line of Social Justice: The Quality of Chinese Judges Are Worrying)”, online: New China Net (Xinhua Net) <http://news.xinhuanet.com/newscenter/2003-09/25/content_1099095.htm>; He Weifang, “Fu Zhuan Jun Ren Jin Fa Yuan (Deactivated Soldiers Come into the Courts)”, Southern Weekends, January 2, 1998; Zhang Zhiming, “Dui Wo Guo Fa Guan Pei Xun De Liang Ge Jiao Du De Li Kang (Considerations from Two Approaches on the Training of Our Country’s Judges)”, online: China Legal Science Net <http://www.iolaw.org.cn/showarticle.asp?id=243>.
statutes in their validity, they can complement the gap when the principles in the statutes are too general, and they can to a certain degree extend or limit the application of the statutes.\textsuperscript{16} The Supreme People’s Court of China also promulgates interpretations of the statute to make the general rules practicable or to rectify the flaws. These judicial interpretations play an important role in Chinese legal system. So far as the law of insurance is concerned, one should not only know the rules of the \textit{Insurance Law} and the \textit{Maritime Code}, but also the interpretations by the Supreme People’s Court\textsuperscript{17} and the regulations made by the Insurance Regulatory Commission.\textsuperscript{18}

There are numerous regulations that would influence the insurance contract from many aspects.\textsuperscript{19}

\textsuperscript{16} For example, according to the \textit{Regulations Regarding Information Disclosure Regarding New Personal Insurance} promulgated by the Insurance Regulatory Commission (the CIRC), in making a new contract of “investment linked insurance”, the insured is required to disclose the achievements of investment account linked with that insurance within last ten years. If there were not such a regulation, the insurer would not be obliged to disclose it unless that data is part of the contract because the insurer has the duty to explain the terms of the contract according to article 17 of the \textit{Insurance Contract Law}. (This Regulation is available online: CIRC <http://www.circ.gov.cn/policy/list_detail.asp?auto_id=171>.) For another example, the Beijing Insurance Regulatory Commission made local regulations requiring the insurance companies to prompt the insured of certain matters before the contract has been concluded. See news report in \textit{Jing Hua Shi Bao (Beijing China News)} , March 13, 2004, section 18.

\textsuperscript{17} The Supreme People’s Court has not promulgated an all-around interpretation on the \textit{Insurance Law} or the \textit{Maritime Code}. However, it is working on a draft of judicial interpretation on the \textit{Insurance Law}. It is believed that this interpretation will be promulgated soon, but the exact time of promulgation has not been determined. The Supreme People’s Court has worked out a proposed draft for public review and is consulting opinions from all circles. See \textit{The Interpretation of the People’s Supreme Court’s on Several Questions of the Inquisition of Insurance Dispute Cases (Draft for Consultation)}, online: Law-Lib.com <http://www.law-lib.com/law/lfbj/lfbj_view.asp?id=10276>. Hereafter, the proposed

\textsuperscript{18} The People’s Bank of China was the department in charge of the insurance industry before the establishment of China’s Insurance Regulatory Commission in 1998. Since 1983, the People’s Bank of China has been the centre bank of China in charge of national currency, banking & finance industry and state treasury (before 1983, the People’s Bank of China also acted as a commercial bank). The position of the People’s Bank of China as the centre bank was confirmed by The People’s Bank of China Act 1995. Since 1949, the insurance industry was in the charge of the People’s Bank of China until 1998. After 1998, China’s Insurance Regulatory Commission took charge of supervision of the insurance industry. See “The People’s Bank of China”, online: the Information Network Centre of Macau <http://dawning.iist.unu.edu/China/ceec-e/zgjrjg/rmyh/indexxf1.html>. as for the administrative regulations promulgated by the CIRC, see \textit{supra} note 16.

\textsuperscript{19} For example, on May 21, 1997, the People’s Bank of China, the authority governing the insurance industry, in an official reply (the \textit{Reply on “the Inquiry Concerning the Interpretation on the Term of ‘All Risk’ in Marine Cargo Insurance”} (Yin Han [1997] No. 210)) to the People’s Insurance Company, interpreted the meaning of “all risk” in marine cargo insurance. Such documents are susceptible on their validity as authorities. For example, the judges said, in \textit{Shenzhen Hualian Food & Cooking Oil Co. v. Hua’an Property Insurance Company}, reported online: China Foreign-Related Commercial and Maritime Trial <http://www.ccmt.org.cn//hs/news/show.php?cld=939>, “[the Reply has given ‘all risk’ an interpretation much narrower than usually understood]… but the people outside China’s insurance industry will not know this; they usually get their understanding of insurance through, or only through, the terms of the insurance policy. Where the insurance company did not [interpret ‘all risk’], nor did the company attach
If the insured has known these regulations, he would at least reconsider whether to buy that type of insurance, but not all of the interpretations and the administrative regulations are easily accessible to the ordinary insurance consumers. Therefore, it may be appropriate to impose on the insurer a duty to disclose to the insured the subordinate regulations, the application of which would influence the insured’s decision on whether to buy the insurance.

Thirdly, in the *Insurance Law*, there are some peculiar rules full of Chinese characteristics, such as the duty of explanation (a kind of disclosure) of the insurer to the insured. Many of these peculiar rules are intended to protect the insured or to mitigate the harshness of the duty of disclosure as the English way of interpretation of utmost good faith has been criticized for a long time for its lack of flexibility and its bias towards the insurer. These ameliorating rules have laudable aims,

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20 Usually, the statutes are easily found in bookstores, but the judicial interpretations can only be found in certain professional periodicals which the ordinary people seldom hear. Furthermore, according to the Supreme People’s Court’s rule as per October 28, 1986, the People’s Court is not suggested to cite the judicial interpretations in the judgement although it actually decides according to it. A fortiori, some of the administrative regulations are not published at all. Some promulgations are even as informal as a reply to an insurance company on a particular matter. (See e.g. the *Reply on the Inquiry Concerning the Interpretation on the Term of ‘All Risk’ in Marine Cargo Insurance*” (Yin Han [1997] No. 210), *ibid.*

21 Discussed in more detail at page 178ff., below.


24 Criticisms are from many aspects and will be mentioned in respective later parts of this thesis. For example, the test of materiality imposes so hard a duty on the insured that an insured could not reasonably
but again being very general rules, their functional efficacy may be weakened. So the problem is how to interpret them so that they can function well in the whole legal system of the insurance contract law?

In addition, there are practical resistance to the enforcement of the law on duty of disclosure. The insured, especially those consumers, have never thought of there being such a duty of disclosure that would render the policy a piece of waste paper when they have paid premium for years. They often let the insurance agent, or employee, fill in the application form for them and even sign for them. On the other hand, the insurance companies, in order to compete with each other, push their personnel to explore the market with every effort. As a result, the marketing personnel, with their anxiety to conclude the contract to earn the commission, sometimes lure the insured to notice what the insurer would regard material. Avoidance of the contract is an inflexible and draconian remedy in cases of inadvertent and borderline breaches of the duty. The remedy for the insurer’s breach of the duty of disclosure is strictly limited to rescission of the contract which gives little help to the insured. The expert evidence is more accessible to the insurer. For these criticisms, see Nicholas Legh-Jones, gen. ed., *MacGillivray on Insurance Law*, 10th ed. (London: Sweet & Maxwell, 2003) at paras. 17-96, 17-100, 17-101; Hwee Ying Yeo, “Uberrima Fides - Reciprocity of Duty in Insurance Contracts” (1988) 2 R.I.B.L. 271 at 273; H. Y. Yeo, “Of Reciprocity and Remedies - Duty of Disclosure in Insurance Contracts” (1991) 11 LS 131; Yeo Hwee Ying, “Common Law Materiality – An Australian Alternative” [1990] J.B.L. 97; U.K., the Law Commission, *Insurance Law - Non-Disclosure and Breach of Warranty*, Law Com. No. 104, Cmd. 8064 (London: H.M.S.O., 1980) at paras. 3.17-3.22; U.K., the Law Reform Committee, *Conditions and Exceptions in Insurance Policies*, Law Reform Committee No. 5, Cmd. 62 (London: H.M.S.O., 1957) para. 4; R. A. Hasson, “The Doctrine of Uberrima Fides in Insurance Law - A Critical Evaluation” (1969), 32 M. L. R. 615.

25 For example, see the case reported online: China-Insuance.com <http://www.China-insurance.com/faguidaquan/content.asp?id=16290>. There is never an indisputable clause in any insurance contract in China. The undisputable clause will be discussed in more detail at page 137ff., below.

26 Here, the insurance agent means the agent hired by the insurance companies. In China, there are two kinds of insurance agent. One is independent agent, or contracting agent, such as a branch of the bank, which helps the insurance company to reach contract with their customers. The other is hired by the insurance companies. This kind of agent is quite akin to the company’s employee. The insurance broker is highly undeveloped. See the text accompanying infra note 294.

27 There are many disputes as to the validity of the contract signed by person authorized by the insured. However, this issue will not be discussed as it is not covered by the topic of utmost good faith. Interested people may refer to An Na & Tao Xudong, “Cong He Tong Fa Jiao Du Kan Dai Qian Ming Bao Dan De Fa Lv Xiao Li (The Legal Effect of Signing on Behalf of Others: from the View of the Contract Law)”, International Finance News, August 16, 2001, section 6, online: the People’s Net <http://www1.people.com.cn/BIG5/paper66/4010/475518.html>.

28 These marketing personnel usually do not have fixed salaries, or very low fixed salaries. Their income depends on, or mainly on, their selling of insurance. They sometimes fail to be distinguished from the insurance company’s agents.
sign the contract by exaggerating the benefit of the insurance,\(^{29}\) concealing the exemption clauses\(^{30}\) or even preventing the insured from performing the duty of disclosure.\(^{31}\) However, this is a universal problem rather than a particular Chinese one.

As a result, the principle of utmost good faith has become one of the most disputed issues of the insurance law. The statutes made by the Congress tend to protect the insured.\(^{32}\) However, since these statutes are too general to fully cover the complexity of the reality,\(^{33}\) the legal resources that are the most functionally effective are actually those subordinate regulations, which, on the contrary, tend to protect the insurer,\(^{34}\) because the insurance companies are the game player, the rule maker and the umpire all in one!\(^{35}\) Therefore, the law reformers should, on the one hand,

\(^{29}\) See Ren Guoping, “Tou Bao Ren Wei Bei Gao Zhi, Chu Xian Shui Fu Ze? (Who Is Liable Where The Insurance Applicant Was Not Informed?)” International Finance News (March 17, 2004) section 11, online: the People’s Net <http://www.people.com.cn/GB/paper66/11564/1042705.html>. In this article, a case is reported in which the insurance agent exaggerated that the compensation was 10,000 RMB but the agent did not show the insured all the terms of the insurance contract among which there was a term limited the insurance company’s compensation to 9,000 or actual loss which ever was lower.

\(^{30}\) Ibid.

\(^{31}\) Hu Bao, “Wei Ru Shi Gai Zhi Ze Ren Zai Shui? (Whose Liability is it where the Disclosure is not True?)”, International Finance News (March 24, 2004) section 10, online: the People’s Net <http://www.people.com.cn/GB/paper66/11619/1047347.html>. In this case, the insurance agent, eager to conclude the contract, told the insured that the insured’s illness did not need to be disclosed because the agent knew that the insurance company would not accept the application had the illness been disclosed. The insured had difficulties in proving that the agent had so instructed him.

\(^{32}\) The Explanations of the Draft of the Insurance Law of People’s Republic of China (1995), online: Jilee Insurance Company <http://www.jilee.com/professional/reference/insurancelaw/3-4-5.htm>. In its fifth paragraph, it was written that: “the drafting of the law has insisted three principles: … the second is to protect the insured’s legal right and interest… and to promote the stability of the enterprise’s business and the people’s life.”

\(^{33}\) It is described as a “skeleton awaiting flesh”. Ian Lancaster, “Insurance Law Commentary”, online: the Chubb Insurance Company <http://www.chubb.com/China/laws/inslaw-commentary.htm>.

\(^{34}\) For example, as to how the insurer should perform his duty of explanation, the People’s Bank of China has made a rule that if the insurer has completely and accurately printed the contractual terms on the back of the policy, the insurer is deemed to have performed the duty of explanation. This rule is stipulated in the Reply as to the Questions of the Meaning of the Clear Explanation in the Auto-Mobile Insurance Business Yin Fa Tiao [1997] No. 35 (promulgated on June 17, 1997). This explanation does not stand with the spirit of the insurance law, and it is almost impossible for the insured, especially the consumer insured which this rule is aimed at, to know this reply. Therefore, the People’s Courts are very reluctant to enforce it. See LongDa Trade v. PICC Dalian Economic & Technology Development Zone Branch (the People’s Middle Court of Dalian) reported in Ren Min Fa Yuan An Li Xuan Jing Bian Ben (Selected Cases of the People’s Court), vol. 1 (Beijing: Xin Hua Press, 2001) 663 at 667.

\(^{35}\) This can be inferred from the history of the People’s Insurance Company, China’s first and biggest insurance company. In 1949, the People’s Insurance Company was established by the People’s Bank of China. The first manager in general of the People’s Insurance Company was the associate president of the
refine the statutes and make them functional in light of the legislative intention to create a fair market environment for both the insurer and the insured, and, on the other hand, examine the validity and the appropriateness of the subordinate regulations in light of the legislative intention. It may also be appropriate to impose on the insurer a duty to disclose these subordinate regulations to the insured before the contract has been concluded. It is in this sense that the long-awaited judicial interpretation made by the Supreme People’s Court on the Insurance Law is highly expected to target this goal. In December 2003, the Supreme People’s Court published a proposed draft of this interpretation and has been consulting for comments or suggestions from all circles. One of the seven most disputable problems in this draft is the principle of utmost good faith.

The thesis is intended to clarify the ambiguities of the law on the pre-contract utmost good faith for the following reasons: (1) this area is one of the most disputable problems in the practice; (2) the continuing utmost good faith is of different nature to the pre-contract one and it is mainly

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People’s Bank of China. In December, 1958, when the domestic insurance business of the People’s Insurance Company was wholly banned (except in Shanghai and Harbin between 1958 and 1966) due to the extremely “left” policy, the external insurance business and the subsequent work of domestic insurance were left to the People’s Bank of China. When the economy reform took place in 1978, it was also under the leadership of the People’s Bank of China that the domestic insurance business of the People’s Insurance Company was recovered. In 1991, headed by the People’s Bank of China, the work team began drafting the Insurance Law. See also Hu Jihua, gen. ed., Zhong Hua Ren Min Gong He Guo Bao Xian Fa Shi Yi Ji Shi Yong Zhi Nan (The Paraphrase and Practical Guide of the Insurance Law of the People’s Republic of China) (Beijing: China Democracy and Legal System Press, 2002) at 59-61.


37 The Interpretation of the People’s Supreme Court’s on Several Questions of the Inquisition of Insurance Dispute Cases (Draft for Consultation), online: Law-Lib.com <http://www.law-lib.com/law/lfbj/lfbj_view.asp?id=10276>.


40 The pre-contract duty of utmost good faith in China is the operation of law, i.e., it is a statutory duty. See Sun Jilu, “Tou Bao Ren Gao Zhi Yi Wu Yan Jiu (Research on the Insurance Applicant’s Duty of Disclosure)”, (2003) 21:3 Tribune of Political Science and Law (Journal of China University of Political
governed by the principle of good faith which is stipulated in the Contract Law 1999 of China.\textsuperscript{41} The thesis will try to clarify the ambiguities of law as to the principle of utmost good faith in the following aspects: the definition of the principle and its relationship with the good faith in the general contract law,\textsuperscript{42} the scope of disclosure,\textsuperscript{43} the test of materiality and inducement,\textsuperscript{44} the remedies for the insured’s breach of the duty of disclosure,\textsuperscript{45} the scope of the insurer’s duty of utmost good faith, and the remedies for the insurer’s breach.\textsuperscript{46} The author also wishes that this thesis would amend the flaws in the judicial interpretation of the Insurance Law that is currently in draft and also contribute to the reform of China’s insurance law.

The English insurance law, especially the Marine Insurance Act 1906 (U.K.), has greatly influenced the legislation of China,\textsuperscript{47} which is commonly regarded as a civil law country.\textsuperscript{48} The English model of principle of utmost good faith has operated for hundreds of years and its success has witnessed the prosperity of London insurance market, so a comparative study between Chinese law and English law will give some beneficial insights into the reform of Chinese law on the

\textsuperscript{41} Discussed in more detail at page 38, below.
\textsuperscript{42} Discussed in more detail at page 36ff., below.
\textsuperscript{43} Discussed in more detail in Chapter 3, below.
\textsuperscript{44} Discussed in more detail in Chapter 4 & Chapter 5, below.
\textsuperscript{45} Discussed in more detail in Chapter 6, below.
\textsuperscript{46} Discussed in more detail at Chapter 7, below.
\textsuperscript{48} Alberto Monti, ibid, at 3.
principle of utmost good faith. Besides the English law, the Australian law, which is the revised model of the English law, will also be drawn upon.
Chapter 2. General Considerations of the Principle of Utmost Good Faith

I. The History of the Principle of Utmost Good Faith

1. The Origin of the Principle in Ancient Roman Law

In western countries, the principle of good faith which originated from ancient Roman law. It is called “bona fide” in Latin. “Fide” means “what has been done”. Cicero explained “fides” as “dictorum conventorumque constantia et veritas (truthfully abiding by our words and agreements).” “Bona” means “good”. Under this principle, the concealment of any material facts of which the other party was ignorant was prohibited in all kinds of contracts and the breach of this duty entitled the aggrieved party to rescind contract. In Roman law, the principle of good faith was also a discretionary doctrine that helped the judge to interpret and supplement the contracts.

2. The Development of the Principle in England

i. The Landmark of Carter v. Boehm

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49 Cicero: Marcis Tullius Cicero (BC106-BC43), the famous thinker in Ancient Rome.
53 (1766) 3 Burr 1905.
The principle of good faith originated in Roman law was revived by Italian merchants during the twelfth and fourth centuries.\textsuperscript{54} At this time, the English maritime industry and the related insurance business were dominated by the Lombard merchants, and the Court of Admiralty handling trade and shipping disputes applied civil law principles to suit the foreign traders.\textsuperscript{55} By the late sixteenth century, under the influence of the increasing commercial trade with Italian city-states, the principle of good faith, an alien concept of civil law, had gradually come into the English law and began to develop in certain contracts, such as insurance contract and contract of fiduciary relationship.\textsuperscript{56} The earliest and the most famous case on the principle of good faith in insurance is Lord Mansfield’s decision in \textit{Carter v. Boehm}.\textsuperscript{57} Many of what he said is still the law of U.K. nowadays.

ii. The Reasons for the Principle of Utmost Good Faith

The facts of \textit{Carter v. Boehm}\textsuperscript{58} were that after the capture of Fort Marlborough, the governor of the fort claimed under the policy but the insurer pleaded, as a defence against the claim, that the insured did not disclose material facts that the fort was not solid enough to withstand attack from enemy and that the French would attack this fort. Lord Mansfield said that:

\begin{quote}
"Insurance is a contract upon speculation. The special facts, upon which the contingent chance is to be found, lie more commonly in the knowledge of the insured only: the
\end{quote}


\textsuperscript{55} \textit{Ibid}.


\textsuperscript{57} (1766) 3 Burr 1905. It is asserted that the doctrine of good faith already existed in English common law before the case and what Lord Mansfield did was just recognition of the existence of the principle. See Semin Park, \textit{The Duty of Disclosure in Insurance Contract Law} (Brookfield, Vt.: Dartmouth Pub. Co., 1996) 19-20.

\textsuperscript{58} (1766) 3 Burr 1905.
underwriter trusts to his representation, and proceeds upon confidence that he does not keep back any circumstance in his knowledge, to mislead the underwriter into a belief that the circumstances does not exist. The keeping back of such a circumstance is a fraud and therefore the policy is void. Although the suppression should happen through mistake, without fraudulent intention; yet still the underwriter is deceived, and the policy is void; because the risqué run is really different from the risqué understood and intended to be run at the time of the agreement.”59

According to Lord Mansfield, the reason why such a duty should be imposed is the mutual trust and confidence between the parties, which composes the bases of insurance contracts. “Good faith forbids either party by concealing what he privately knows, to draw the other into a bargain, from his ignorance of that fact, and his believing the contrary.”60 From then on, the duty of disclosure became the essential part of the principle of utmost good faith. The historical background was that the insurer had little means to gain any information about the circumstances of the insured property or the insured person61 especially when the subject matter was outside of the insurer’s country. Nowadays, when modern communication and high technology have enabled the insurer to gain most of the relevant material circumstances, the principle of utmost good faith still exist because of the fact that it is much easier and less costly for the insured, who knows of the subject matter much better, to gain the knowledge of the material circumstances than for the insurer to discover them; and then the saved cost will in return benefit the insured with a lower premium. The principle of utmost good faith has become the requirement of economic efficiency.62

iii. Necessity of Fraud, Effect of Breach of the Duty and Nature of Reciprocity

59 Ibid, at 1905.
60 (1776) 3 Burr 1905 at 1909-1910.
As to whether the existence of fraud is essential to decide a breach of the duty of disclosure, it could be concluded from the above paragraph that Lord Mansfield emphasized on the mere fact of whether the insurer has been misled or not. In other words, whether there is fraud does not affect the result that the contract is avoidable at the option of the insurer. Although Lord Mansfield modified his view in the later case of Mayne v. Walter where he said “it must be a fraudulent concealment of circumstances that will vitiate a policy”, this view was not followed by later judges while the former view of Carter v. Boehm has persisted.

Lord Mansfield said that a breach of the duty of disclosure renders a contract void “in favour of the party misled by his ignorance of the thing concealed”. This means that the contract is avoidable at the option of the aggrieved party. Section 18(1) of the Marine Insurance Act 1906 (U.K.) stipulates that: “If the assured fails to make such disclosure, the insurer may avoid the contract.”

Lord Mansfield underlined that this duty equally applies to the insurer. He said:

“The policy would be equally void, against the underwriter, if he concealed; if he insured a ship on her voyage, which he privately knew to be arrived; and an action would lie to recover the premium... Good faith forbids either party by concealing what he privately knows. To draw the other into a bargain, from his ignorance of that fact, and his believing...”

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64 (1872) 3 Doug K.B. 79.
66 For example, see Lindenau v. Desborough (1828) 8 B. & C. 586; Elton v. Larkins (1832) 5 C. & P. 385; Bates v. Hewitt (1867) 2 Q. B. 595; Anderson v. Pacific Fire and Marine Ins. (1872) 7 C. P. 65.
67 (1766) 3 Burr 1905.
68 (1766) 3 Burr 1905 at 1910.
the contrary... this definition of concealment,...will generally hold to make it void, in
favour of the party misled by his ignorance of the thing concealed."

Nonetheless, the tendency of the courts and the customary practice in the insurance market on the
issue of reciprocity has been such that this duty has rarely been applied to an insurer.69 This is
partly because the insurer is unlikely to have something particularly in his knowledge that would
influence the insured on whether to have the insurance contract or on what terms to have the
contract. What counts as more weight is that the remedy for the breach of the utmost good faith
under the English law is avoidance of the contract and return of the premium70 which usually
would be of little benefit to the insured as “the insured is more concerned with ensuring that his
goods remain adequately covered than with recouping his premium contributions”.71

iv. The Application of the Principle in Other Contracts

Lord Mansfield said that the principle of good faith is “applicable to all contracts and dealings”72
and some other judges of his time also believed so.73 However, from about the 1870s onwards, the

131 at 131.
70 Joel v. Law Union & Crown Insurance Co [1908] 2 K.B.863; Locker & Woolf v. Western Australian
Insurance Co. [1936] 1 K.B. 408 at 415; Cornhill Insurance Co. v. Assenheim (1937) 58 Ll.L.Rep. 27 at 31;
at 144. See also Australian Law Reform Commission, Review of the Marine Insurance Act 1909, ALRC
was demonstrated in two cases: Banque Financière de la Cité S.A. v. Westgate Insurance Co. Ltd.; sub nom.
Hellenic Mutual War Risks Association (Bermuda) Ltd. (The Good Luck) [1991] 2 Lloyd’s Rep. 191 (H.L.);
first case is discussed in more detail at page 114ff., below. The second case is discussed in more detail in
infra note 661.
72 (1766) 3 Burr 1905 at 1910.
(1853) 10 Hare 493.
general requirement of good faith in all contracts faded out coinciding with the rise of the doctrine of "caveat emptor", and the principle of good faith remained only in certain kinds of contracts, such as the insurance contract.

v. Statutory Authorities

The principle of utmost good faith initiated by Lord Mansfield was later codified in the Marine Insurance Act 1906 (U.K.). Sections 17 to 20 set out the general principle that “A contract of marine insurance is a contract based upon the utmost good faith”, and specify its application in two central areas, i.e., misrepresentation and non-disclosure. The principles concerning utmost good faith codified in the Marine Insurance Act 1906 (U.K.) was said to have expressed the law applicable to both marine and non-marine insurance.

3. The Principle of Utmost Good Faith in China

i. The Economic Contract Law 1981 and the Property Insurance Contract Regulation 1983


75 The rise of "caveat emptor" was not attributed to one factor. "The goods were becoming too many, their uses too numerous, and their qualities too diverse to" make a measurement common to all. “As the bourgeois came to be powerful they could not remain quietly tolerant of a studies supervision of their activities. They were not to be ‘over-thwarted by preachers and others that cannot skill of their dealings.’” Moreover, Adam Smith’s argument that “each person, in aiming only at his own advantage, ‘is led by an invisible hand to promote an end which is no part of his intention’ won a growing approval.” Walton H. Hamilton, “The Ancient Maxim Caveat Emptor” (1931) 40 Yale Law Journal, 1133 at 1170-1171; Thomas Wilson, A Discourse on Usury, with an introduction, by R. H. Tawney (London: George Bell, 1925) at 64.

76 See Poh Chu Chai, Principles of Insurance Law, 5th ed. (Singapore: Butterworths, 2000) at 103.


78 The Economic Contract Law 1981 was abolished on October 1, 1999, by article 428 of the Contract Law 1999.

After the founding of the People’s Republic of China, the law on the matter of good faith, together with the insurance industry, was wiped out for a long time due to the communism ideology and its centrally planned economy. Economic reform took place in 1979, and China began to implement the “Socialist Market Economy” throughout the following decade. As a result, dramatic changes occurred in two aspects stimulating the growth of the insurance. The individuals, on one hand, began to be entitled to property rights, and the private property was protected by law, and later by the Constitution. On the other hand, “the Communist State began its slow but inexorable retreat and it ceased to take care of every aspect of the life of the Chinese People … the insurance contract is predestined to become the most important legal and economic tool available to those individuals who are not willing and/or able to bear the entirety of the risks associated with the implementation of the modern economic reforms.” With the fast development of the insurance industry, the need for a modern and sophisticated legal framework to regulate rights

80 The People’s Republic of China was founded in 1949 when the Chinese Communist Party overthrew “the Republic of China”. The law of the Republic of China still remains in force in Taiwan, which is claimed to be part of China. In 1929, the parliament of the Republic of China promulgated the *Insurance Law of the Republic of China*. The principle of utmost good faith (duty of disclosure) was incorporated in this insurance law. It was a fairly complete rule of the duty of disclosure, and it even had some virtues for the insurance law nowadays to learn from. For example, the *Insurance Law of the People’s Republic of China* nowadays has not yet set up the time limitation to the insurer’s right to terminate the contract on ground of the breach of utmost good faith and article 16(2) of the *Insurance Law of the Republic of China* is worthy of reference. However, all the laws made by the Republic of China became abolished as soon as the foundation of the People’s Republic of China in 1949 because the Communist Party believed that those laws were of Capitalism nature. Therefore, the legal system of the People’s Republic of China started afresh.
81 Supra note 1.
82 After Mao Zedong died in 1976, the national economics was at the edge of collapse. Deng Xiaoping and other Chinese leaders began to realise that they must immediately stop the class struggle and devote to the economic development. Two years after the death of Mao, in 1978, in the Third Plenary Session of the 11th Central Committee of the Communist Party of China, the policies of economic reform and opening to the outside were established and these policies have been pursued until today.
83 The *Constitution of the People’s Republic of China* was amended in 2004 to protect the private property rights.
85 See the text accompanying supra note 2 and note 4.
and duties of the parties of insurance contracts became clear and compelling. In 1981, the Economic Contract Law of China 1981 first established the duty of disclosure in the insurance contract in its article 46(2) although it was a very ambiguous rule. Soon after that, in 1983, article 46 was complemented and refined by the Property Insurance Contract Regulation 1983, article 7 of which became the precursor to the utmost good faith in the Insurance Law.

Although the Property Insurance Contract Regulation 1983 was still a rough rule and it no longer stands with the Insurance Law now, it had contained the major characters of the principle of utmost good faith in China’s non-marine insurance law. (1) The Property Insurance Contract Regulation 1983 established the duty of disclosure as a duty of law. (2) The Regulation created the insurer’s duty of utmost good faith, i.e. the duty to inform the insurance applicant of “the affairs as to the insurance contract”. This was a very broad term compared with the phrases in article 17 of the Insurance Law. It failed to give detailed guidance as to what the insurer should disclose and it also failed to provide the remedy for the breach of this duty, but this broad ambit of

87 Article 46(2) of the Economic Contract Law 1981 stipulated: “the insured’s responsibility: if the insured conceals the truth about the insured property, the insurer has the right to rescind the contract or is not liable in compensation.” [Translated in Statutes and Regulations of the People’s Republic of China, vol. 1, looseleaf (Hong Kong: University of East Asia Press and Institute of Chinese law, 1987-1990) Ch. 811213.1, at 8.] The Economic Contract Law 1981 was revised in 1993, and article 46 was changed to article 41, but the content of this article was unchanged.
89 Article 7 of the Property Insurance Contract Regulation 1983 stipulates that: “In making an insurance contract, the insurer shall inform the insurance applicant of the matters relating to the insurance contract; the applicant shall, in accordance with the insurer’s requirements, disclose the major risks which are necessary for the insurer to know in determining the premiums or whether to accept the insurance. “After the conclusion of the insurance contract, if the insurer finds that the applicant has failed to disclose such major risks as stated in the above section, the insurer has the right to terminate the contract or he shall bear no obligation for indemnification.”
These paragraphs are translated by the author, because article 7 of the translation text in Statutes and Regulations of the People’s Republic of China, ibid is not neatly phrased.
90 Article 7 of the Property Insurance Contract Regulation 1983, ibid.
91 The parallel phrases of article 17 of the Insurance Law reads “the insurer shall explain the contract terms to the applicant”.
the insurer’s duty of disclosure should have been reserved in *the Insurance Law* together with the detailed rules of articles 17 and 18.\(^\text{92}\) (3) The Regulation had adopted the proposition that the insured need only disclose those facts that the insurer requests. This proposition has been called “the inquiry-disclosure principle” in contrast with “the voluntary disclosure principle”, or “the active disclosure principle”,\(^\text{93}\) which is widely adopted in common law countries. However, it also contained a few ideas of common law, for instance, the rule that the insured is obliged to disclose only major risks which are necessary for the insurer to know has combined the idea of materiality. *The Property Insurance Contract Regulation 1983* was intended to apply to both marine and non-marine insurance contract,\(^\text{94}\) but after the promulgation of *the Maritime Code*, the marine and non-marine insurance began to operate in different legal systems.\(^\text{95}\)

ii. *The Maritime Code*

In 1992, *the Maritime Code* ratified by the Standing Committee of the National People’s Congress adopted the principle of utmost good faith as one of the internationally recognized principles. *The Maritime Code* codified almost every aspects of the maritime law including marine insurance in light of international practice.\(^\text{96}\) Although *the Maritime Code* does not use the expression of

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\(^{92}\) Discussed in more detail at page 178ff., below.


\(^{94}\) Article 22 of the Regulation: “Unless otherwise specified by law, this Regulation applies to the marine insurance contract.”

\(^{95}\) For the reasons of the separate operation of the two systems, see page 30ff., below.

\(^{96}\) For example, in *the Maritime Code*, the law of bill of lading was based on *the Hague-Visby Rules* with a few changes in light of *the United Nations Convention on the Carriage of Goods by Sea (the Hansberger Rules)*; the law of salvage was almost the reprint of *the International Convention on Salvage 1989*; many other conventions were also referred to, such as *the York Antwerp Rules 1974, the Athens Rules 1974*, etc. as far as the marine insurance was concerned, the Lloyd’s S. G. policy was referred to as the international insurance contract model and *the Marine Insurance Act 1906 (U.K.)* was referred to as the internationally recognised practice. Si Yuzhuo, *et al*, *Xin Bian Hai Shang Fa Xue (New Edited Maritime Law)* (Dalian: Dalian Maritime University Press, 1999) at 33-34, 464.
“utmost good faith”, articles 222 and 223 stipulate the duty of disclosure, which is the main content of the principle of utmost good faith.

Article 222 “Before the contract is concluded, the insured shall truthfully disclose to the insurer the material circumstances which the insured has knowledge of or ought to have knowledge of in the ordinary business practice and which have a bearing on the insurer in deciding the premium or whether be agrees to insure or not.

“The insured need not inform the insurer of the facts which the insurer has known of or the insurer ought to have knowledge of in the ordinary business practice if the insurer made no inquiry.”

Article 223 “Upon intentional failure of the insured to truthfully inform the insurer of the material circumstances set forth in paragraph 1 of article 222 of this Code, the insurer has the right to terminate the contract without refunding the premium. The insurer shall not be liable for any loss arising from the perils insured against before the contract is terminated.

“If, not due to the insured’s intentional act, the insured did not truthfully disclose to the insurer the material circumstances set out in paragraph 1 of article 222 of this Code, the insurer has the right to terminate the contract or to demand a corresponding increase in the premium. In case the contract is terminated by the insurer, the insurer shall be liable for the loss arising from the perils insured against which occurred prior to the termination of

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the contract, except where the material circumstances uninformed or wrongly informed of have an impact on the occurrence of such perils.°°

It is appropriate to briefly introduce the position of *the Maritime Code* in respect of utmost good faith, although the details will be discussed in more detail in the following chapters. According to *the Maritime Code*, the insured should make truthful disclosure of material circumstances. “Truthful” here means that the circumstances disclosed must be true and the insurer can neither conceal the truth nor make misrepresentation. The duty is to disclose what the insured knows or ought to know, but he does not need to disclose what the insurer knows or ought to know. If the insured intentionally, in the sense that he knows that his act would be a breach of his duty, breaches the duty of disclosure, the insurer may terminate the contract and forfeit the premium, and the insurer is not liable for any loss rising from the perils insured against, whether or not the loss occurs before or after the termination. If the insured unintentionally, the insurer may terminate the contract but he must refund the premium. The insurer is not liable for the loss occurring after the termination, but he is still liable to compensate for the loss occurring before the termination unless the non-disclosure has an impact on the occurrence of the loss. “An impact” means that the undisclosed circumstances must at least have some connection with the occurrence of the loss.

iii. *The Insurance Law*

*The Insurance Law* was regarded as the landmark in the development of the insurance law in China. It is a codification of internationally recognised insurance principles.°°° It was later amended in 2002 to comply with the commitments made by the Chinese government in entering the World

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Trade Organization. The main amendment was made on the governance of the insurance companies, including allowing the foreign investment into the insurance industry. The problems of the insurance contract were almost untouched and were left to be resolved by the judicial interpretation.\textsuperscript{100} However, a new article 5 was inserted to improve the good faith between the parties.\textsuperscript{101} Articles 17 and 18\textsuperscript{102} of the amended insurance law deal with the principle of utmost good faith.

\begin{quote}
Article 5 “When exercising rights or performing obligations, parties in insurance activities shall be consistent with the principle of honesty and good faith.”\textsuperscript{103}
\end{quote}

\begin{quote}
Article 17 “In concluding an insurance contract, the insurer shall explain the contract terms to the applicant, and the insurer may inquire about the relevant circumstances concerning the subject matter of the insurance or concerning the insured. The applicant shall make a truthful disclosure.

“The insurer shall have the right to terminate the insurance, if the applicant intentionally conceals the facts and does not perform his duty of truthful disclosure, or if the insured negligently fails to make disclosure thereby which is sufficient to affecting the insurer’s decision on whether or not to provide the insurance or whether to increase the premium rate.


\textsuperscript{101} In the Congress debates, the lack of good faith of the insurance companies became one of the focuses and as a result, article 5 was inserted. See Hu Jihua, gen. ed., \textit{Zhong Hua Ren Min Gong He Guo Bao Xian Fa Shi Yi Ji Shi Yong Zhi Nan (The Paraphrase and Practical Guide of the Insurance Law of the People’s Republic of China)} (Beijing: China Democracy and Legal System Press, 2002), ay 50-51.

\textsuperscript{102} Before the amendment was made in 2002, the articles dealing with the duty of disclosure were articles 16 and 17. They were renumbered to be 17 and 18, but the content was unchanged.

\textsuperscript{103} According to the Chinese original text, “honesty and good faith” is the same as “good faith”.
“If an applicant intentionally fails to perform his obligation of making a truthful disclosure, as regards the insured event which occurs prior to the rescission of the contract, the insurer shall bear no obligation for indemnification or payment of the insured amount, or for returning the premiums paid.

“If an applicant negligently fails to perform his obligation of making a truthful disclosure and this has a severe impact on the occurrence of an insured event, the insurer shall, in connection with the insured event which occurred prior to the rescission of the contract, bear no obligation for indemnification or payment of the insured amount but may return the premiums paid.

“By insured event is meant an event falling within the scope of cover under the insurance contract.”

Article 18 “If there are exclusion clauses provided by the insurer in the insurance contract, then the insurer shall make precise and clear explanations in respect thereof to the applicant when concluding the insurance contract, otherwise such clauses shall have not effect.”

It is appropriate to briefly introduce the position of the Insurance Law in respect of utmost good faith, although the details will be discussed in more detail in the following chapters. According to the Insurance Law, the insurer should explain the terms of the contract to the insured, and he should clearly explain the exemption clauses to the insured, failing which the exemption clauses

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104 “Insurance Law of the People’s Republic of China”, (2002) Issue 6, China Law 103 at 104. Paragraph 1 and 2 of article 17 has been modified by the author in accordance to the Chinese original language.
are not valid. The insured’s duty to disclose is based on the inquiry of the insurer and he should truthfully disclose what is asked. If the insured intentionally breaches the duty, the insurer may terminate the contract and he is not liable for any loss whether or not the loss occurs before or after the termination. If the insured negligently, in the sense that a reasonable person in his position would have disclosed it, breaches the duty the insurer may also terminate the contract as long as the non-disclosure is material. Where breach is negligent, the insurer is liable for the loss occurring before the termination unless the non-disclosure has a grave impact on the occurrence of the loss.

iv. The Difference between These Two Statutes

(a) Introduction

*The Insurance Law* and *the Maritime Code* are two main statutes currently in force governing insurance contracts and both contain the principle of utmost good faith. The rules of utmost good faith in the two statutes are quite different from each other in quite a few aspects.

First, there are some differences as to the breach of the duty of disclosure. *The Insurance Law* does not afford any remedy to the insurer where the insured breach the duty without negligence, while under *the Maritime Code* the insurer can terminate the contract for innocent non-disclosure.\textsuperscript{105} *The Maritime Code* provides that the insurer may claim for additional premium in lieu of terminating the contract, but there is no similar rule in *the Insurance Law*.\textsuperscript{106} The marine insurer will be discharged of his liability under the policy if the circumstance undisclosed has “an impact” on the

\textsuperscript{105} Discussed in more detail at page 129ff. and 134ff., below.

\textsuperscript{106} Discussed in more detail at page 148ff., below.
loss, but the insurer in non-marine insurance has to prove that the impact is grave before he is entitled to reject to compensate for the loss.\footnote{Discussed in more detail at page 131ff., below.}

(b) The Insurance Applicant v. the Insured

As to who is obliged to disclose to the insurer, the two statutes are different in the phrasing.\footnote{It has never been a problem in the common law where the position is simple and clear. The party who contracts with the insurer is the insured. Before the conclusion of the insurance contract, he is also called the insurance applicant. There is no difference whether the duty is imposed on the insured or on the insurance applicant because they are exactly the same principal.}

*The Insurance Law* insists that the insurance applicant is one of the parties to the contract and it is the applicant’s duty to make truthful disclosure.\footnote{See article 17 of the *Insurance Law*, at page 22, above.} The conceptions of “the insured” and “the insurance applicant” are also defined as different individuals. “The [insurance] applicant refers to the party who enters into an insurance contract with an insurer and [who] is obliged to pay the premiums under the insurance contract.”\footnote{Article 10(2) of the *Insurance Law*.} “The insured refers to a person whose property or life or body is protected by the insurance contract and who is entitled to claim for the insurance money. The applicant may also be the insured”\footnote{Article 22(2) of the *Insurance Law*.} but they are sometimes different individuals and in this situation the insured becomes the third party to the contract.\footnote{Hu Jihua gives some examples in which the insured are not the applicant. In property insurance, the owner may insure the subject matter for the interest of the mortgagee and consequently the mortgagee may become the insured; the manager or the charterer of the subject matter may insure for the owner’s interest and consequently the owner may become the insured. In life insurance, the father may apply for the insurance of the health of his son and make his son the insured. Hu Jihua, gen. ed., *Zhong Hua Ren Min Gong He Guo Bao Xian Fa Shi Yi Ji Shi Yong Zhi Nan (The Paraphrase and Practical Guide of the Insurance Law of the People’s Republic of China)* (Beijing: China Democracy and Legal System Press, 2002) at 110-111. Another example is “the Terms on the Credit Insurance of Consuming Loan of Automobiles” which is standard terms published for uniform use of all insurance companies. In the standard terms, the insurance applicant is the consumer who buys the automobile and the insured is the bank who loans to the consumer.} The difference between the insured and the applicant means that the insurer cannot terminate the contract for the insured’s non-disclosure or misrepresentation, nor can he terminate for the applicant’s non-disclosure of what the insured knows but the applicant does not know. Therefore, there are arguments that the law should
also impose a duty of disclosure on the insured, although he is the third party of the contract.\textsuperscript{113} However, if the insured were obliged to disclose, should the remedy available to the insurer be the termination of the contract? And would it be proper to impose such a duty on the third party while the breach would cause the contract to be terminated? In addition, because of the application of the inquiry-disclosure doctrine mentioned below, the insurer is able to ask the applicant to enquire from the insured if the applicant really does not know certain material circumstances, and if the insurer does not ask, the applicant is not obliged to disclose even if he knew it.\textsuperscript{114}

*The Maritime Code*, however, stipulates that “the insured” is obliged to make the disclosure,\textsuperscript{115} but the meaning of “the insured” in *the Maritime Code* is different to that of “the insured” in *the Insurance Law*. Although in *the Maritime Code* does not define what “the insured” means, “the insured” should be interpreted as the same concept as “the insurance applicant” in *the Insurance Law*, because in the context of *the Maritime Code*, the phrase “the insured” is always used as the counter part to the insurer\textsuperscript{116} in whole chapter of marine insurance while it never uses the phrase “the insurance applicant”. It is sometimes misleading that the same phrase “the insured” has different meanings in these two relevant statutes.\textsuperscript{117}


\textsuperscript{114} If the insurance applicant actually knows a circumstance but does not disclose because the insurer does not inquire, it does not necessarily constitute fraud because the applicant’s failure to disclose may be due to his unconsciousness of the materiality of that circumstances.

\textsuperscript{115} See article 222 and 223 of *the Maritime Code*, at page 20, above.

\textsuperscript{116} For example, article 216 of *the Maritime Code* defines the marine insurance contract as “a contract whereby the insurer undertakes, as agreed, to indemnify the loss to the subject matter insured and the liability of the insured caused by the perils covered by the insurance against the payment of an insurance premium by the insured.” in *the Maritime Code*, it is the main duty of the insured to pay the premium and in *the Insurance Law*, the applicant means the party who is obliged to pay the premium. Therefore, “the insured” in *the Maritime Code* actually has the same meaning as “the insurance applicant” in *the Insurance Law*.

\textsuperscript{117} For example, Shao Changcheng alleged that the definition of “the insured” made by *the Insurance Law* (that the insured is the person whose property is insured) should apply to the marine insurance contract and “the insured” in *the Maritime Code* has to be interpreted according to the definition made by *the Insurance Law* because article 153 of *the Insurance Law* provides that for matters not specified in *the Maritime Code*, the relevant provisions of *the Insurance Law* shall apply. Since *the Maritime Code* does not define who the
It is suggested that the two statutes unify the expressions as to the contractual party; it may be unified to the expression “the insured” as well so that the Chinese expression will be identical with international usage. Therefore, in this thesis, unless otherwise specified, “the insured” will be used in circumstances of both marine and non-marine insurance to mean the party with whom the insurer enters into the contract.

(c) Inquiry-Disclosure v. Voluntary Disclosure

_The Insurance Law_ followed its precursor _the Property Insurance Contract Regulation 1983_ in the principle of inquiry-disclosure.\(^\text{118}\) The doctrine of “inquiry-disclosure” means that the insured has no duty to disclose anything unless asked by the insurer even if the insured knows something which is material in fact but the insured does not know its materiality. However, if the insured actually knows the materiality of a circumstance which the insurer does not inquire, the concealment of the circumstance may constitute fraud in the general contract. In addition, the insured cannot give an answer without reasonable ground to believe its truth,\(^\text{119}\) but he can answer in the questionnaire with “I am not clear about it” if he really does not know it. If the insurer insists on the relevant answer, the insured can make further investigation.

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\(^{119}\) Otherwise the insured may breach the duty in negligence. For the meaning of negligence, see page 126, below. In China, the law does not differentiate a statement of an opinion from a statement of the fact. This problem is discussed in more detail at page 45ff., above.
It seems that the insurer should prove that he has asked about the relevant questions. The application form and the risk inquiry form designed by the insurer, should be regarded as the written form of the insurer’s inquiry.\textsuperscript{120}

On the contrary, as a result of learning from the common law,\textsuperscript{121} the Maritime Code adopts “the voluntary disclosure”.\textsuperscript{122} The marine insured should voluntarily disclose what he knows or ought to know even if the insurer does not inquire. The scope of the voluntary disclosure is defined in a similar way as the Marine Insurance Act 1906 (U.K.). Many of these conceptions may have come from the Marine Insurance Act 1906 (U.K.), such as the constructive knowledge and the materiality.

(d) Reasons for Adopting the Principle of “Inquiry-Disclosure”

The reasons for adopting such a principle in non-marine insurance could be found in the legislative documents. The insurance in China was a brand-new creature after economic reform, which took place in 1979,\textsuperscript{123} and the common people were quite unfamiliar with it and its rules. The duty of

\textsuperscript{120} Article 9(2) of The Interpretation of the People’s Supreme Court’s on Several Questions of the Inquisition of Insurance Dispute Cases (Draft for Consultation), online: Law-Lib.com <http://www.law-lib.com/law/lfbj/lfbj_view.asp?id=10276>.


\textsuperscript{123} Before economic reform, under the Unitarianism, the state was the big brother looking after every person. All factories, enterprises, schools, communities, and all kinds of organizations were all the organs of the state. These organs took care of every person on behalf of the state from every aspect, from birth to death, from house to illness, from accidents to the education of children. Insurance was thought as useless at that time. However, when economic reform took place, the market economic requires the enterprises to be independent, profit-earning and pure economic organizations. These “organs” began to give up the obligation of taking care of everything of their employees. And when the marketization was carried on irreversibly, the medical treatment became no longer free, and then the houses followed, and then was the education… In addition, inflation has prompted people’s to find more investment approaches other than just putting money in the banks and insurance became one of the attracting investment approaches. Moreover,
disclosure, which was outside the contract and which could avoid the contract, seemed so strange to them that they seldom realized the existence of such a duty until the insurance company rejected the claim on the ground of the breach of the duty. In addition, the insurance companies were not bothered with the facts that should be disclosed until the occurrence of the loss and, often, they even tried to induce the insured to keep silent on the material facts. When the Insurance Law was proposed to the National Congress 1995, the sponsor stated the circumstances of the insurance industry and the existing problems and made the protection of the insured as one of the guiding ideologies of the Insurance Law. He argued that, due to unfair competition between the insurance companies, the insured’s, especially the consumer insured’s, right and interest had been unlawfully encroached upon, so one of the main purposes of the Insurance Law was to reinforce protection for the insured and this ideology was unchallenged by the congress. Based on the reality that the insured was treated with injustice in regard to the duty of disclosure and the tendency to protect the insured, the Insurance Law adopted the principle of “inquiry-disclosure”. It seems that the adoption of the principle of inquiry-disclosure was influenced by the consumerism.


See supra note 31 at page 7.


Ibid, para. 5.

Ibid, para. 3 and para. 5.


It can be inferred from the context of the Law Commission’s Report, ibid, that when the law commission talked about the protection of the insured, it meant the consumer insured.
In 2002, when *the Insurance Law* was amended, the consumer protectionism was reinforced. The state council at first intended to make no amendment on the part of insurance contract. However, when the bill was discussed in the People’s Congress, about half length of the suggestions went against the dishonesty of the insurance companies, among which the insurer’s agent was forbidden from concealing material circumstances from the insured, hindering the insured from performing the duty of disclosure, and other improper conducts.

The adoption of the principle of inquiry-disclosure has created one of the main differences between the marine and non-marine insurance law.

(e) Whether the Two Doctrines should Be Combined into One?

There are arguments that the two statutes should integrate at least as to the rules of utmost good faith, but these arguments have divided into three kinds. The advocators of the first view argue that the voluntary disclosure principle of *the Maritime Code* has demanded such a high standard of obligation that it has overstepped China’s reality that the insured, even the merchant insured in marine insurance, has not gained the necessary knowledge to judge whether a particular circumstance is material to the risk. They conclude that since the insured in China is not as experienced as their counterparts in England, China’s marine insurance should not have copied the

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130 The purpose of the amendment had been to abide by China’s commitment as to her enter into the World Trade Organization, and to make the insurance market more competitive, so the suggested amendments were all on the supervision of the insurance industry. See *The Explanations of the Draft of the Insurance Law of People’s Republic of China (Draft)* (2002), in Hu Jihua, gen. ed., *Zhong Hua Ren Min Gong He Guo Bao Xian Fa Shi Yi Ji Shi Yong Zhi Nan (The Paraphrase and Practical Guide of the Insurance Law of the People’s Republic of China)* (Beijing: China Democracy and Legal System Press, 2002) 44.


rule of the voluntary disclosure from England.\textsuperscript{134} In their view, the rules of utmost good faith in the
Maritime Code should change to those of the Insurance Law.\textsuperscript{135}

The second view is diametrically opposed to the first one. The advocators of this view held that
the inquiry-disclosure doctrine is adverse to the actuarial evaluation of the risk and it has impeded
the development of the infant insurance industry.\textsuperscript{136} In their view, the doctrine of voluntary
disclosure should apply universally in marine and non-marine insurance. The last view that the
inquiry-disclosure principle should be complemented by the principle of voluntary disclosure is
actually quite akin to the second one.\textsuperscript{137}

The divergence of these arguments in themselves seems to justify the current mechanics that the
inquiry-disclosure applies to non-marine insurance while the voluntary disclosure applies to
marine insurance. Actually, there are good reasons for the different principles to apply in different
kinds of insurance. The consumer insured generally need more protection than the commercial
marine insured.\textsuperscript{138} On the other hand, the marine insured, compared with the insurer, is not as

\textsuperscript{134} Ibid.
\textsuperscript{135} Ibid.
\textsuperscript{136} Wang Haiming, “Lun Bao Xian Yao Zhun Xun Zu Da Cheng Xin Yuan Ze (The Insurance Must
Observe the Principle of Utmost Good Faith)”, [1999] 10 Zhong Guo Hai Shang Fa Nian Kan (Annual of
China Maritime Law) 282 at 290-291.
\textsuperscript{137} Zhao Qijin, “Lun Bao Xian Fa De Gao Zhi Yi Wu (On the Duty of Disclosure of the Insurance Law)”
(1996) Issue 3, Legal Science 56 at 57, where Zhao suggested that, in non-marine insurance, the insured
should voluntarily disclose it to the insurer if a circumstance is really material and the insured knows the
materiality to the insurer’s evaluation of the risks. (Under the current law, even though the insured knows
the materiality of the circumstances, he is not obliged to disclose under article 17 of the Insurance Law
unless he is asked by the insurer. However, such deed of the insured may constitute fraud in the civil law or
in the general contract law and fraud entitles the insurer more severe remedies.) This view may be
challenged by two problems. First, Zhao did not explain what “really material” means. It seems that the
words “really material” add nothing more than the meaning of “material”. Second, if the insured has
appreciated the materiality but still conceals the information, his conduct may have constituted fraud. The
insurer can avoid the contract on ground of fraud regulated by article 58 of the General Principles of the
Civil Law 1986. (As for definition of fraud, see also article 68 of the Opinions of the People’s Supreme
Court’s on Several Questions of the Enforcement of the General Principles of the Civil Law 1986
(provisional).)
\textsuperscript{138} It is true that non-marine insured may also be commercial insured, but the marine insured are generally
more experienced with underwriting matters as the insurance has long been an essential part of the marine
industry. In addition, unless China law had set up a new category of the consumer insurance and made
weak as suggested by the advocates of the inquiry-disclosure doctrine. Some big shipowners are often in a better bargaining position than the insurer. Even if there are many inexperienced small companies engaged in marine industry and maritime trade, the insurance brokerage will develop to help them and the insured will grow more and more experienced. So even if the voluntary disclosure principle had overstepped the reality, it will be suitable for the future, and perhaps in the near future.

Secondly, the subject matters of non-marine insurance are comparatively easy to be investigated by the insurer, while the marine industry is of such a nature that it is much more difficult for the marine insurer to find out every material circumstance by his own investigation, and, though it is not technically impossible, it will cause considerable economic loss to the carrier if he follows the insurer’s instructions to make an inspection on the vessel before the insurer will underwrite the risk.

Moreover, the marine insurance is more of an international character and it is important to harmonise with the international practice, the voluntary disclosure, for China’s insurance industry to grow internationally.

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separate regulations protecting the consumer insured, the consumer insured has to get protection from the general insurance law. See also page 28ff., below, where the author mentions why the consumer insured need more protection in China. See especially U.K., the Law Commission, *Insurance Law - Non-Disclosure and Breach of Warranty*, Law Com. No. 104, Cmd 8064 (London: H.M.S.O., 1980) at paras. 4.34-4.40, where the Law Commission thoroughly explained why they reject the dichotomy of consumer insurance and non-consumer insurance.

139 Actually, the insurance brokerage just began from 1999 but it has developed fast in recent years. See Xu Tao, “Bao Xian Zhong Jie Shi Chang Mian Lin Da Hao Fa Zhan Ji Yu (The Insurance Brokage Market Facing Excellent Developing Opportunity)”, online: XinHua Net <http://news.xinhuanet.com/fortune/2003-08/11/content_1020234.htm>.

140 Although the modern communication is quite advanced and the insurance companies have their agents all over the world, it is still difficult, say for an insurer living in China to investigate the situation of a ship sailing in the Persian Gulf. It is much easier and less costly to let the insured to disclose, say the situation of that ship.
Finally, some other countries, such as the U.S.A\textsuperscript{141} and the Australia,\textsuperscript{142} also have different rules regulating the disclosure in marine and non-marine insurance contract, and they operate well.

At first blush, the different application of law in marine and non-marine insurance seems to have made the law more complex, but this has enabled the law to have different rules to adapt to different areas where the balance point between the parties is different. As it is not difficult to differentiate between a marine insurance contract and a non-marine one,\textsuperscript{143} the current system is not as bewildering as imagined.\textsuperscript{144} In practice, not much dispute arises as to whether an insurance contract is marine or non-marine due to the procedure reasons.\textsuperscript{145}

As long as the divergence between the \textit{Insurance Law} and \textit{Maritime Law} 1992 in itself is not a problem, the only necessary modification to the principle of utmost good faith should be limited

\textsuperscript{141} In the U.S.A., the principle of utmost good faith has followed the British approach in marine insurance, while, in most states, the principle applied in the non-marine insurance is totally different. A significant difference is that “in most jurisdictions in the United States the insurer must show that the applicant intentionally concealed material information” before he is entitled to avoid the contract. Julie-Anne Tarr, \textit{Disclosure and Concealment in Consumer Insurance Contracts} (London: Cavendish, 2002) at 97. See also Thomas J. Schoenbaum, \textit{Key Divergences between English and American Law of Marine Insurance: a Comparative Study} (Centreville, Md.: Cornell Maritime Press, 1999) at 94-98.

\textsuperscript{142} In Australia, significant reform has been made to the duty of disclosure in the \textit{Insurance Contracts Act 1984 (Australia)} which applies to non-marine insurance contract, while the marine insurance contract is still governed by the \textit{Marine Insurance Act 1909 (Commonwealth)}, which reproduces the British counterpart. However, the \textit{Marine Insurance Act 1909 (Commonwealth)} is also in review and significant changes may be made to it. The Australian Law Reform Commission’s suggestions in \textit{Review of the Marine Insurance Act 1909}, ALRC Report No. 91 (Sydney: The Commission, 2001), if adopted, will make the law of marine and non-marine insurance basically consistent again. Even so, there will still be differences. Compare section 26B(3)(b)(ii) of the proposed revised \textit{Marine Insurance Act} and section 28(3) of the \textit{Insurance Contracts Act 1984}. See also Julie-Anne Tarr, \textit{Disclosure and Concealment in Consumer Insurance Contracts} (London: Cavendish, 2002) at 58.

\textsuperscript{143} See page 34, above.

\textsuperscript{144} \textit{Gibbs v. Mercantile Mutual Insurance (Aust)} [2003] HCA 39, 199 A.L.R. 497 has shown that question of whether an insurance contract is of marine or non-marine nature does not easily arise. In this case, the ship was operated at the estuary of the Swan River and this position was at the boundary of the sea and inland water, so it was rather a geography question than a legal problem.

\textsuperscript{145} In China, maritime cases are under a separate jurisdiction from other civil cases. It has to be decided whether a case is a marine one before the court can have the jurisdiction over it. It is a procedural question to be predetermined before the substantial disputes. Therefore, even if the principles as to the duty of disclosure were the same in marine and non-marine insurance, the court has to decide on whether the contract is marine or non-marine wherever the parties cannot agree on it. That is to say, the difference in the principles of duty of disclosure will not add to the dispute as to the nature of the contract. See also the text accompanying \textit{supra} note 150.
within the existing frameworks, i.e., the divergence between the Insurance Law and Maritime Law 1992. If the current problems of the principles in respectively marine and non-marine insurance law were resolved and all the ambiguity were clarified, the framework of the current law would be feasible by and large, and then, there would be no need to change it just to unify the rules.


Article 153 of the Insurance Law\textsuperscript{146} stipulates that the Maritime Code shall be applicable to marine insurance, while this Insurance Law 1995 shall apply to non-marine, but the Insurance Law shall also apply to marine insurance where the Maritime Code does not specify. For example, no articles in the Maritime Code have provided for the insurer’s duty of disclosure, but this doesn’t mean there is no such a duty imposed on the marine insurer. Instead, the insurer’s duty of disclosure, which is stipulated in article 17 and 18 of the Insurance Law, shall apply since the Maritime Code does not cover this area.

Since the law applying to the marine insurance contract differs from that to the non-marine insurance contract, it is important to distinguish between the marine and non-marine insurance contract.\textsuperscript{147} According to article 216 of the Maritime Code,\textsuperscript{148} whether an insurance contract is

\textsuperscript{146} Article 153 of the Insurance Law: “The Maritime Code of the People’s Republic of China shall be applicable to marine insurance. For matters where the Maritime Code does not specify, this Law shall apply.”

\textsuperscript{147} In the law of U.K., it is also very important to distinguish the marine insurance and non-marine insurance but so far as duty of disclosure is concerned, the difference is not great. In Australia, the distinction nonetheless became crucial since the Insurance Contract Act 1984 (Australia), which applies to non-marine insurance contract only, differs significantly from the Marine Insurance Act 1909 (Commonwealth). See Gibbs v. Mercantile Mutual Insurance (Aust) [2003] HCA 39, 199 A.L.R. 497; Kate Lewins, “Where Is the Boundary between Marine Insurance and General Insurance? Gibbs v. MMI Reaches the High Court” (2003) 15 Insurance Law Journal, 89.

\textsuperscript{148} Article 216 of the Maritime Code: “A contract of marine insurance is a contract whereby the insurer undertakes, as agreed, to indemnify the loss to the subject matter insured and the liability of the insured caused by perils covered by the insurance against the payment of an insurance premium by the insured.
marine or non-marine is judged by the perils covered by the contract. If the covered perils are marine perils, the contract is marine insurance contract. Article 216 defines marine perils as any maritime perils including perils occurring in inland rivers or on land which is related to a maritime adventure. Where a comprehensive insurance contract covers both marine and non-marine perils, Chinese law has no answer as to what kind of contract it is. One may consider all the relevant circumstances, say the purpose of the contract, the main risk or risks covered and the contractual terms, and decide whether the marine risk is appended to the non-marine risk or vice versa. In practice, if the case goes to the Maritime Court, then it must be a marine insurance contract; otherwise it is under the jurisdiction of the People’s Middle Court or the People’s Primary Court, as the case may be.

II. The Content of the Principle of Utmost Good Faith

1. The Meaning of Utmost Good Faith

i. The Meaning of Utmost Good Faith under the Common Law

The covered perils referred to in the preceding paragraph mean any maritime perils agreed upon between the insurer and the insured, including perils occurring in inland rivers or on land which is related to a maritime adventure.”


According to articles 18 and 19 of the Civil Procedure Law, and article 1.2 of the Opinions of the People’s Supreme Court’s on Several Questions in the Application of the Civil Procedure Law, maritime or admiralty cases are under the jurisdiction of the Maritime Court. So any dispute as to marine insurance contract is under the jurisdiction of the Maritime Court while disputes as to non-marine insurance contract are under the jurisdiction of the People’s Court. If the non-marine insurance dispute is momentous foreign related case or if it has momentous influence in the jurisdiction, it goes to the People’s Middle Court, otherwise it goes to the People’s Primary Court.
It has been said that “the word ‘utmost’ may add very little as it is the examination of ‘good faith’ that goes to the heart of the concept”. \(^{151}\) It has been observed that good faith means “different things to different peoples in different moods at different times and in difference places”, \(^{152}\) but an anthology of meanings has been provided as:

 “[Good faith means] fairness, fair conduct, reasonable standards of air dealing, decency, reasonableness, decent behaviour, a common ethical sense, a spirit of solidarity, community standards of fairness, decency and reasonableness.” \(^{153}\)

ii. The Meaning of Good Faith under the Chinese Law

(a) Two Principles with the Same Name

In the Chinese law, there are two principles both titled with the same name of “good faith”. One is the principle applied in general contract law and all kinds of civil activities, and the other is the principle in the insurance contract law which mainly embodied by the duty of disclosure. The latter is sometimes called “the principle of utmost good faith” while sometimes without the adjective “utmost”. \(^{154}\)


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In Chinese civil law, all civil activities, including contractual activities, must observe the principle of good faith. This principle has been called as “the monarchical principle” of the civil law, but it has very obscure meanings, and in different civil law countries its detailed...
application is quite different. Nonetheless, the substance of the principle of good faith in the civil law is that “where arise the new circumstances or new problems, which were not foreseen when the law was made, the court may exercise the discretionary power according to the principle of good faith and directly regulate the parties’ rights and obligations.” This principle is “no more than the equity law mastered by the civil law judges.”

(c) The Principle of Good Faith in the General Contract Law

The Contract Law 1999 also requires a duty of good faith to be observed in the negotiation, in the performance of the contract and even after the performance of the contract. Articles 6, 39, 164

faith” which emphasizes the subjective mind of the behaviour. In the field of debt relation, good faith means the reasonableness of one’s behaviour. It is called “the objective good faith” as the reasonableness is judged from the outside behaviour and the test is what a reasonable person will do in the particular circumstances. Xu Guodong, “Ke Guan Cheng Xin Yu Zhu Guan Cheng Xin De Dui Li Tong Yi Wen Ti (The Contradiction and Unity of Objective Good Faith and Subjective Good Faith)”, (2001) Issue 6, Zhong Guo She Hui Ke Xue (China Social Science) 97.

A reach on the principle of good faith analysing thirty typical sets of facts according to the laws of fourteen western European jurisdictions has shown that the differences among some of the civilian systems were as great as those between English law and the law of any of the civilian jurisdictions. See Reinhard Zimmermann, Roman Law, Contemporary Law, European Law: the Civilian Tradition Today (Oxford: Oxford University Press, 2001) at 170-171.


Li Gongguo, Min Fa Ben Lun (Cadre of the Civil Law) (Lanzhou: Press of the Lanzhou University, 1998) at 99, citing Rudolf Stammler.


Article 6 is the general requirement of the principle of good faith in contract law; it is the reiteration of that principle of the civil law in the special circumstances of the contract law. It stipulates that “The parties shall observe the principle of good faith in exercising their rights and fulfilling their obligations.”

Article 39 is also related to the good faith in insurance contract. It stipulates that “where a contract is concluded by way of standard terms, the party supplying the standard terms shall abide by the principle of fairness in prescribing the rights and obligations of the parties and shall, in a reasonable manner, call the other party’s attention to the provision(s) whereby such party’s liabilities are excluded or limited, and shall explain such provision(s) upon request by the other party.” However, this article is unimportant in practice because the Insurance Law is more favourable to the insured in that the insurer should explain the terms of the contract (not limited to the terms that excluded or limited the insurer’s liability, article 17 of the Insurance Law) and the insurer should clearly explain the exception clauses (article 18 of the Insurance Law). In addition, the terms of the insurance contract must be approved by the insurance supervision authority to ensure its fairness (article 107 of the Insurance Law).
2, 60, 92, and 125(1) are all relevant to the principle of good faith in the general contract law and they apply to all kinds of contracts, including the insurance contract, except where the insurance law provides otherwise. These rules basically embody the general meaning of the principle of good faith of the civil law but they are specified guides in the circumstance of the contract law. In especial, the Contract Law 1999 has created the pre-contract duty of good faith.

(d) The Principle of Utmost Good Faith of the Insurance Law

The good faith in the insurance law is of a higher standard than in the general contract law or in the general civil law, that is to say, the requirement of the insurance law is much higher and stricter than that of the contract law. First, in the marine insurance law, the parties are required to

165 Article 42: “In the making of a contract, the party that falls under any of the following circumstances, causing thus loss to the other party, shall be liable to compensate for the loss. (1) engaging in consultation with malicious intention in name of making a contract; (2) concealing intentionally key facts related to the making of the contract or providing false information; or (3) taking any other act contrary to the principle of good faith.”

166 Article 60: The parties shall fulfil their respective obligations as contracted. The parties shall observe the principle of good faith and fulfil the obligations of notification, assistance and confidentiality in accordance with the nature and aims of the contract and trade practices.

167 Article 92: After the termination of right and obligations under a contract, the parties shall perform the duties of notification, assistance and confidentiality in light of the principle of good faith and in accordance with trade practices.

168 Article 125(1) provides that the terms of the contract should be interpreted in accordance to good faith. It provides that “In event that the parties dispute about the understanding of a clause of the contract, the actual meaning of the clause shall be inferred and determined on the basis of the words and sentences used in the contract, related clauses of the contract, aim of the contract, trade practice and the principle of good faith.” All these articles in the preceding notes are translated by the Office of the Law Commission of the Standing Committee of the National People’s Congress, trans., Laws of the People’s Republic of China [1999] (Beijing: The Law Press, 1999).

169 There was no pre-contract duty of good faith, i.e., good faith in the negotiation of the contract, in the laws preceding the Contract Law 1999. Liang Huixing, one of the drafters of this statute, believed that the pre-contract good faith is first created in this statute. See Liang Huixing, “Guan Yu Zhong Guo Tong Yi He Tong Fa Cao An Di San Gao (On the Third Draft of the Unified Contract Law of China)”, (1997) Issue 2, Legal Science 47 at 26. But it is also alleged that the pre-contract good faith has been implied in the spirit of the preceding statutes. See Lu Tongming, “Di Yue Guo Shi Ren Li Lun Ji Qi Zai Shen Pan Shi Jian Zhong De Ying Yong (Theory of the Liability of the Negligence in the Contract Negotiation and Its Application in the Trial)”, (1999) Issue 1, Shandong Legal Science 46 at 47.

voluntarily disclose anything material to the other party, and, in the non-marine insurance, the parties are required to make true disclosure according to the insurer’s question, while in general contract, the parties are not obliged to make disclosure and there is no misrepresentation law in China.171 Second, the liability in the insurance law and marine insurance law available for the breach of the duty of utmost good faith is termination of the contract, while the breach of good faith in the contract law does not render the contract terminatable at the option of the party not in breach.172 Third, in the contract law, the breach must be causal connected with the loss before the aggrieved party can claim damage while, in the insurance contract law, the insurer can terminate the contract where the breach nonetheless does not contribute to the loss. Finally, the party who provides standard contract is under a heavier duty in the insurance law than in the contract law.173 Therefore, it is suggested to use the phrase of “utmost good faith” in the insurance law and the phrase of “good faith” in general contract law and the civil law.

When the Insurance Law was modified in 2002, the new-added article 5 clearly stated that “[w]hen exercising rights or performing obligations, parties in insurance activities shall be consistent with the principle of good faith.”174 It used the phrase of “good faith” instead of “utmost good faith”. Since the insurance contract requires a higher standard of good faith than the contract

171 The innocent party may rescind the contract for intentional misrepresentation because it constitutes a fraud. If there is no fraud, that party cannot rescind the contract. There is no rule in the Chinese law corresponding to of the misrepresentation law in the common law, although it is arguable that the rule of grave misunderstanding, the rule of significant injustice or the pre-contract duty of good faith may partly cover this issue. See also Sui Pengsheng, “Guan Yu He Tong Fa Zhong Zhong Da Wu Jie De Tan Tao (Discussion on the Grave Misunderstanding in the Contract Law)”, (1999) Issue 3, China Legal Science 104 at 106.
172 The remedy available to the party not in breach is damage according to article 42. Except for article 42, other articles related to good faith do not provide remedy for the breach of such duty, but the remedy possibly available is still damage because, according to article 8 and the spirit of the Contract Law 1999, the party of a contract cannot avoid, rescind or terminate the contract without the consent of the other party unless the law or the contract otherwise provides. Actually, it would be unjust to enable the party to terminate or rescind the contract for a minor breach of the collateral duty of good faith in the contract law.
173 See the text accompanying infra note 697.
174 It has been translated into “the principle of honesty and good faith” but the Chinese original wording does not suggest the insertion of “honesty”.
law, article 5 should be changed in light of section 17 of the Marine Insurance Act 1906 (U.K.) and clearly stipulate that “a contract of insurance is a contract based upon utmost good faith…”

2. Misrepresentations and Non-Disclosure

i. Misrepresentations and Non-Disclosure in the Common Law

The Marine Insurance Act 1906 (U.K.) states the rules of misrepresentations and non-disclosure in section 18 and 20 respectively and many classic textbooks on insurance law put the two in different chapters. Misrepresentation and non-disclosure are conceptually different. Misrepresentation is actionable not only in the insurance contract but in all kinds of contracts. Misrepresentation applies to the insurance contract in almost the same way as it applies to other contracts. However, one major difference between the rules of misrepresentation in the insurance contract and in general contracts is whether a representation of opinion should be made on reasonable grounds. The Misrepresentation Act 1967 (U.K.) may operate in the insurance context. As the result of the operation of section 2(2) of the act, the court has the discretion to award damages in lieu of rescission of the insurance contract. In Highlands Insurance Co. v. Continental Insurance Co., it was held that, obiter, the discretion would not be used in commercial contracts of insurance, but the possibility cannot be excluded in individual insurance

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177 This issue was recently brought out by Economides v. Commercial Union Assurance Co. plc [1998] Q.B. 587. See page 43.
contract. Actually, the insurance ombudsman has stated that he may use it in cases coming before him. On the contrary, non-disclosure is not actionable in contracts which are not *uberrima fides* except in very particular cases. Non-disclosure is much more tightly connected with the insurance contract and it is clear that the *Misrepresentation Act 1967 (U.K.)* does not apply to non-disclosure.

However, except the fact that in misrepresentation the court has the discretion to award damages in lieu of rescission while in non-disclosure the court has not, the distinction between misrepresentation and non-disclosure may not be material. In practice, an insurer, where possible, will plead both of non-disclosure and misrepresentation and “cases have frequently failed to distinguish between the two defences taken by an insurer.” Furthermore, the legal issues that arise in the context of misrepresentation or non-disclosure, such as the test of materiality, the test of a prudent insurer, the requirement of inducement, and the liability for misrepresentation or non-disclosure, are exactly the same.

ii. No Distinction between Misrepresentations and Non-Disclosure under the Chinese Law

In China, neither the *Insurance Law* nor the *Maritime Code* distinguishes the difference between representations and non-disclosure. Article 222 of the *Maritime Code* says “the insured shall *truthfully inform* the insurer...” and article 17 of the *Insurance Law* says “the applicant shall make

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181 For example, a car dealer sells a car which he knows to be dangerous without revealing that fact to the purchaser. Ewan McKendrick, *Contract Law*, 5th ed. (Basingstoke: Palgrave Macmillan, 2003) at 264. A summary of exceptional circumstances where a duty to disclose is imposed is available at Ewan McKendrick *ibid*, 274-275.
184 See also John Birds & Norma J. Hird, *ibid*, at 98.
an honest disclosure”. The expression of “truthfully inform” or “an honest disclosure” in their Chinese original expressions does not mean that the law only forbids fraudulent misrepresentation or concealment; instead, the Chinese original words should have been translated into “to make a statement which reflects the true facts”. This means the insured should not only make disclosure but also disclose the truth. He can neither keep the truth from the insurer nor make misrepresentations. There may be two reasons why the Chinese law does not distinguish misrepresentation from non-disclosure. The first reason is the similarity of misrepresentation and non-disclosure. As mentioned above, it is hard to discriminate between them. The other reason is that there is not such a complete rule of misrepresentation in the general contract law in the Chinese law and both misrepresentation and non-disclosure only appear in the insurance law, so it is much less necessary for China to distinguish the two rules.

iii. Facts and Opinions

(a) **Economides v. Commercial Union Assurance Co. plc**

A misrepresentation is a statement of the facts; a statement of opinion may be transformed into one of facts in the sense that it is a statement of fact that he actually held that opinion when he made the statement. Thus “the inaccuracy of the expressed opinion would, in and of itself, engender liability in misrepresentation.” Section 20(5) of the Marine Insurance Act 1906 (U.K.)

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185 It is one of the examples which show that the translated version of law is sometimes misleading. Even the official translation version may make mistakes.

186 See page on page 42, below.

187 However, the principle of grave misunderstanding, the rule of significant injustice or the pre-contract duty of good faith may partly cover the issue of misrepresentation. See Sui Pengsheng, “Guan Yu He Tong Fa Zhong Zhong Da Wu Jie De Tan Tao (Discussion on the Grave Misunderstanding in the Contract Law)”, (1999) Issue 3, China Legal Science 104 at 106. As for further discussed on the grave misunderstanding, see page 168ff., below.


clearly states that a “representation as to a matter of expectation or belief is true if it be made in good faith”. This section was interpreted by a recent case, *Economides v. Commercial Union Assurance Co. plc.*

The plaintiff insured in this case, a 21-year-old student from Cyprus, affected a household insurance with the defendant insurer in 1988. The plaintiff stated that the sum insured for contents was to be £12,000 and he represented that the valuables did not exceed one-third of that sum. He also declared that the statements given in the application form are to the best of his knowledge and belief, true and complete and that that proposal should form the basis of the contract. In 1990 the plaintiff’s parents came to live with him and had brought with them silverware and jewellery. On the advice of his father, the plaintiff increased his contents insurance to £16,000. In 1991, the flat was burgled and items worth £31,000 stolen. The valuables stolen greatly exceeded the one-third limit. The plaintiff claimed on his insurance. The insurer sought to avoid for misrepresentation and non-disclosure.

In this case, the representation as to the value of the jewellery is merely a statement of opinion rather than that of the facts, and it is clear that a statement of opinion is true if it is made in good faith. Consequently, the defendant insurer alleged that the plaintiff, in stating the value of the jewellery, should have reasonable grounds which the plaintiff did not have. The reasonable ground for one’s opinion is required in general contract law without which a representation will constitute a misrepresentation. However, Simon Brown L.J., who gave the leading judgment in the Court of Appeal, held that a representation of belief had to have some basis before it could be said to be valid.

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made in good faith, but it does not mean that an objective test had to be applied to the basis upon which the representation was made because section 20(5) the Marine Insurance Act 1906 (U.K.) required only honesty not reasonable grounds.\textsuperscript{194} In addition, Simon Brown L.J. concluded that the test for non-disclosure was the same as that for misrepresentation, namely that of honesty.\textsuperscript{195} Peter Gibson L.J., who reached the same conclusion but with a different approach, was of the view that good faith in section 20(5) the Marine Insurance Act 1906 (U.K.) should be judged subjectively.\textsuperscript{196}

(b) Facts and Opinions under the Chinese Law

The Chinese insurance law does not distinguish a representation of facts from that of opinions, but the Chinese scholars so far have paid little attention to this problem.\textsuperscript{197} The word “circumstances” in article 17 of the Insurance Law\textsuperscript{198} and articles 222 and 223\textsuperscript{199} of the Maritime Code is not defined by either of the statutes. In case reports, the insurer often rejects claims for the insured’s non-disclosure of material opinions.\textsuperscript{200} In these cases, the insured all had some grounds to support


\textsuperscript{195} Ibid.

\textsuperscript{196} Economides v. Commercial Union Assurance Co. plc [1998] Q.B. 587 at 606 per Peter Gibson L.J.

\textsuperscript{197} They usually take the circumstances as the synonym of facts. See e.g. Li Yuquan, Bao Xian Fa (Insurance Law), 2nd ed. (Beijing: The Law Press, 2003) at 58, but see Li Feng, “Lun Gao Zhi Yi Wu (On the Duty of Disclosure)”, (1998) Issue 3, Maritime Trial 8 at 10-11.

\textsuperscript{198} Article 17 of the Insurance Law: “In concluding an insurance contract, the insurer … may inquire about the relevant circumstances concerning the subject matter of the insurance or concerning the insured. The applicant shall make a disclosure which reflects the truth….”

\textsuperscript{199} Article 222 “Before the contract is concluded, the insured shall truthfully inform the insurer of the material circumstances…” Article 223, see page 20, above.

\textsuperscript{200} For example, in a group insurance (the parties’ names were not reported), the insured was a student aged six. He had suffered headache for nearly one year before the making of the insurance contract. As it was a simplified insurance, the insurer only asked the insured to provide the statement of his health in the questionnaire, which the insured gave no answer. Later it was found that the insured had cancer and the headache was the inchoate symptom of that cancer. The insurer rejected claim on ground of non-disclosure of the cancer. This case ended in conciliation and the insurer compensated 40% of the claim at last. Online: China Law Education <http://www.Chinalawedu.com/news/2003_12/5/1557487116.htm>. See also Wang B v. PICC, reported in Liu Zhixin, ed., Zhong Guo Dian Xing Shang Shi An Li Ping Xi (China Typical Commercial Cases and Comments) (Beijing: The Law Press, 1997) at 351-352. This case is discussed in more detail in infra note 340.
their belief that they were healthy, but the insurer rejected the claim nonetheless. The position of the court is unclear partly because the case ended in conciliation and partly because the report does not provide enough information on the attitude of the court. In deciding whether the word “circumstances” has the meaning of “opinions”, there would be a dilemma. If the meaning of “circumstances” had not included opinions, expectations, or belief of the insured, the insurer would not get such material information for his evaluation of the risk, but if the meaning of “circumstances” had included the “opinions”, the insured would be unreasonably under the onerous duty to ascertain the accuracy of his opinion as if it were a statement of a fact. Comparatively, the position of the common law is more balanced. The insured should disclose material opinions but a statement of opinion is true as far as it is made in good faith, or the representor has some grounds for it. It seems that the insurance law of China should also adopt this position.

III. Duration of the Duty of Disclosure

1. Continuing Duty of Utmost Good Faith

The duty of utmost good faith is not restricted to the pre-contract stage. In U.K., notable cases have embraced the position that utmost good faith should be observed throughout the contract.
while the details of the doctrine are far from settled. The situations in which the insured owes a post-contractual duty of utmost good faith may well be confined to some categories. These categories at least include that the insured should avoid making any fraudulent claim or any other fraudulent acts, and that the insured owes a duty of disclosure in any situation in which the insured is required to give information to the insurer under the terms of the policy (e.g., where there is an increase of risk). Besides the duty to avoid fraud, it seems that the other categories are all contractual duties. In Manifest Shipping Ltd. v. Uni-Polaris Insurance Co. (the “Star Sea”), Lord Hobhouse of Woodborough distinguished a lack of good faith which is material to the making of the contract itself from a lack of good faith during the performance of the contract, and said, “[t]he latter can derive from express or implied terms of the contract; it would be a contractual obligation arising from the contract and the remedies are the contractual remedies provided by the law of contract.” In Australia, the Insurance Contract Act 1984 (Australia) has been amended to accept the duty of good faith as an implied term of the contract “requiring each party to [the contract] to act towards the other party, in respect of any matter arising under or in relation to [the contract], with the utmost good faith”.


Even now, not all of the categories have been clearly decided and it would be too rash to say the post-contractual duty of good faith is only confined to these categories.


Section 13 of the Insurance Contract Act 1984 (Australia): A contract of insurance is a contract based on the utmost good faith and there is implied in such a contract a provision requiring each party to it to act towards the other party, in respect of any matter arising under or in relation to it, with the utmost good faith.
In U.K., several issues have been decided including that the continuing duty of utmost good faith is of the contractual nature,\textsuperscript{214} that duty continues until litigation starts,\textsuperscript{215} that avoidance is only appropriate in a post-contractual context in situations analogous to “situations where the insurer has a right to terminate for breach”.\textsuperscript{216} These issues have sparked considerable controversy.\textsuperscript{217} The trend to expend the pre-contract duty of utmost good faith into the post-contract stage has been cautioned against.\textsuperscript{218} It has been noted that the law would have been neater if it could “either unambiguously exclude the post-contractual doctrine from the ambit of section 17 or attribute to it a different juridical basis in order to avoid the glosses and contrivances in the judicial interpretation of this particular provision”.\textsuperscript{219} It is also criticized that it is unnecessary to resort to the principle of good faith in deciding cases of fraudulent claim.\textsuperscript{220}

\textsuperscript{214} Lord Hobhouse of Woodborough was of the view that the post-contract duty of good faith derives from express or implied terms of the contract, and Lord Scott also believed that “the content of the duty of good faith owed by an assured post-contract is not the same as the duty owed in the pre-contract stage.” The other Lords did not comment on this point. Manifest Shipping Co. Ltd. v. Uni-Polaris Insurance Co. Ltd. (The “Star Sea”) [2001] 1 Lloyd’s Rep. 389 at 400, per Hobhouse of Woodborough, at 411, per Lord Scott.

\textsuperscript{215} Lord Hobhouse of Woodborough, with whom the other Lords concurred, clearly hold that “[b]efore the litigation starts the parties’ relationship is purely contractual subject to the application of the general law...When a writ is issued the rights of the parties are crystallized...The disclosure of documents and facts are provided for with appropriate sanctions; the orders are discretionary within the parameters laid down by the procedural rules...therefore...once the parties are in litigation it is the procedural rules which govern the extent of the disclosure which should be given in the litigation, not s. 17 as such, though s. 17 may influence the Court in the exercise of its discretion.” Ibid, at 406-407. Lord Scott also found a great deal of force in the argument that the s. 17 duty does not apply to conduct in the prosecution of litigation, as to which the Rules of Court that govern litigation constitute the regulatory code.” Ibid, at 413.


\textsuperscript{220} “…making a fraudulent claim under the policy a breach of the duty of utmost good faith seems an unnecessary extension of the good faith concept. Because fraud already is wrongful, nothing is gained by adding breach of good faith; indeed, mixing the two doctrines in only a source of confusion.” Thomas J. Schoenbaum, Key Divergences between English and American Law of Marine Insurance: a Comparative Study (Centreville, Md.: Cornell Maritime Press, 1999) at 123.
In China, there are also many arguments that the principle of utmost good faith survives after the conclusion of the contract.\(^{221}\) Under the Chinese law, the parties to an insurance contract must also observe good faith in the performance of the contract, but this is requirement of the principle of good faith which is set up in the *Contract Law 1999*. Different from the law of U.K., the duty of good faith is a collateral duty imposed by law.\(^{222}\) Its contents and remedy have been discussed at page 38ff., above. Since the continuing duty of good faith applies to all kinds of contracts, it is more appropriate to discuss this problem in the context of general contract law instead of the insurance contract law since this problem arises in all kinds of contracts.\(^{223}\) Therefore, as a comparative study, this thesis is not going to discuss any further on the post contract duty of utmost good faith.

\(^{221}\) Wang Pengnan, *Hai Shang Bao Xian He Tong Fa Xiang Lun (On Marine Insurance Contract Law)*, 2\(^{nd}\) ed. (Dalian: Dalian Maritime University Press, 2003) at 41-42, marine insurance; Zhang Xianglan, *Hai Shang Bao Xian Fa (Marine Insurance Law)*, The Unified Textbooks for High Institutes of Politics and Legal Science (Beijing: China Politics and Legal Science University Press, 1996) at 28, marine insurance; Li Yuquan & He Shaojun, *Zhong Guo Shang Fa (China Commercial Law)* (Wuhan: Wuhan University Press, 1995) at 315, general insurance; Li Zhengming & Jia Linqing, *Hai Shang Bao Xian He Tong De Yuan Li Yu Shi Wu (The Theory and Practice of the Marine Insurance Contract)* (Beijing: China Politics and Legal Science University Press, 1994) at 30, marine insurance; Huang Huaming, *Zhong Guo Bao Xian Fa Li Shi Wu (The Theory and Practice of China Insurance Law)* (Beijing: The Economy Science Press, 1996) at 35, general insurance; Jin Zhaohua, “Lun Hai Shang Bao Xian De Cheng Shi Xin Yong Yuan Ze (On the Principle of Good Faith in Marine Insurance)”, (1999) May, Hai Shang Fa Xi Hui Tong Xun (CMLA News Letter) 11 at 13-15, marine insurance. These arguments usually take the view that the principle of utmost good faith includes, besides the pre-contract duty of disclosure, (1) the warranty (article 235 of *the Maritime Code*), (2) the duty of the insured to notify the insurer of the increasing of the risks after the conclusion of the contract of property insurance (article 37 of *the Insurance Law*), (3) the duty of the insured to positively prevent the occurrence of the risks (article 36 of *the Insurance Law*), (4) the duty of the insured to timely notify the insurer of the happening of the risks (article 22 of *the Insurance Law* and article 236 of *the Maritime Code*), (5) the insurer’s liability for his delay in payment of the insured amount (article 24 of *the Insurance Law*), and (6) penalty to fraud (article 28 of *the Insurance Law*). The author has found that the above (1)-(5) are all contractual obligations according to the wording of each article and (6) is the obligation arising from the breach of the contract. Nothing is gained by making them the subject of the principle of utmost good faith. In addition, these scholars believe that any contractual right must be exercised in good faith and any contractual duty must be performed in good faith, but this requirement derived from the general principle of good faith in the contract law and the civil law. Therefore, the author believes that it is more suitable to discuss the post contract principle of utmost good faith under the contract law or the general principle of good faith in the civil law.

\(^{222}\) See article 6 and 60 of *the Contract Law 1999* in *supra* note 162. See also Hu Kangsheng, ed., *Zhong Hua Ren Min Gong He Guo He Tong Fa Shi Yi (The Paraphrase of the Contract Law of the People’s Republic of China)* (Beijing: The Law Press, 1999) at 109; Huo Yang & Wang Quanxing, “Cong Min Fa De Fu Sui Yi Wu Dao Jing Ji Fa De Ji Ben Yi Wu (From the Collateral Duty to the Basic Duties of the Economic Law)”, online: CCCL <http://www.civillaw.com.cn/weizhang/default.asp?id=8748>.

\(^{223}\) There are arguments that the insurance law also has special rules of the post-contract principle of utmost good faith, but they are doubtful. See *supra* note 221.
2. The Duration of the Duty of Disclosure in the Common Law

i. General Principle on New Contract

As the purpose of the duty of disclosure is to help the insurer to assess the risk, the duty of disclosure continues throughout the negotiation of the contract and ceases at the time when the contract is completed.\textsuperscript{224} Therefore, any material fact which the proposed insured becomes aware of during the negotiations, or any fact which was immaterial but which later turns out to be material, must be disclosed to the insurer.\textsuperscript{225} In addition, any statement made at any stage of the negotiation which becomes inaccurate as a result of a change of circumstances must be amended or withdrawn by the insured prior to the conclusion of contract.\textsuperscript{226} After the contract is completed, there is no duty to disclose supervening material facts which come to the knowledge of the insured, or any facts which becomes material. Channell J. said in \textit{Re Yager and Guardian Assurance Co.} that “… the time up to which it must be disclosed is the time when the contract is concluded.”\textsuperscript{227}

ii. The Time of the Conclusion

It is obvious that the question as to which moment should be regarded as the time of the conclusion of a contract is extremely important. Section 21 of \textit{the Marine Insurance Act 1906 (U.K.)} stipulates that:


\textsuperscript{227} (1912) 108 L.T. 38 at 44.
“A contract of marine insurance is deemed to be concluded when the proposal of the assured is accepted by the insurer, whether the policy be then issued or not; and, for the purpose of showing when the proposal was accepted, reference may be made to the slip or covering note or other customary memorandum of the contract…”

The proposal is the offer by the insured and the acceptance of the proposal marks the time of the conclusion of the contract.

iii. Exceptions to the General Rule as to When a Contract Is Concluded

The date at which the duty of disclosure comes to an end can be changed by express provisions in the policy.228 In particular, in life insurance, it is a common practice that the contract includes a special clause that the commencement of the insurer’s liability is to be postponed until receipt of the first premium.229 Locker v. Law Union & Rock Insurance Co. Ltd230 shows a clear example of this. The insured’s duty of disclosure may also be extended by an express clause in a policy that the insurer’s liability does not commence until the policy is actually delivered to the insured.231 As a result, the duty exists longer.232 Additionally, it has been decided that the contract may modify the duty of disclosure stipulated by law with unambiguous words.233

iv. Renewal of a Contract

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A renewal of a contract is equal to a creation of a new contract.\textsuperscript{234} Consequently, the insured is under a duty to disclose to the insurer any material facts which have come to his knowledge before the contract is renewed. The life insurance, however, is not a renewable agreement but a long-term agreement which is usually continued by the payment of a periodical premium. In other words, the renewal of a life insurance is a sort of extension.\textsuperscript{235}

It often happens that the insured fails to realize his duty of disclosure on each renewal and seldom does the insurer remind the insured of the existence of such a duty. This difficulty has been eliminated by the Statements of Insurance Practice. \textit{The Statement of General Insurance Practice 1986},\textsuperscript{236} clause 3(a) stipulates:

\begin{quote}
“Renewal notices shall contain a warning about the duty of disclosure including the necessity to advise changes affecting the policy which have occurred since the policy inception or last renewal date, whichever was the later.”
\end{quote}

v. Alteration of a Contract

The insured’s duty of disclosure may be revived after completion of the contract when the contract is altered. If the alteration does not “substantially alter the nature of the bargain”,\textsuperscript{237} it is not a creation of a new contract. In such cases, the duty is limited to disclose any material fact relevant

\begin{footnotes}
\footnote{\textsuperscript{234} Malcolm A. Clarke, \textit{The Law of Insurance Contracts}, 4\textsuperscript{th} ed. (London: LLP, 2002) at 23-4C.}
\footnote{\textsuperscript{235} See John Birds & Norma J. Hird, \textit{Birds’ Modern Insurance Law}, 5\textsuperscript{th} ed. (London: Sweet & Maxwell, 2001) at 84.}
\footnote{\textsuperscript{236} In 1977, the Association of British Insurers, Lloyd’s and life assurance organizations adopted two Statements of Insurance Practice, one for general insurance and the other for life and long-term policies. The statements were revised in 1986 to reflect the Law Commission’s recommendations. See John Birds & Norma J. Hird, \textit{Birds’ Modern Insurance Law}, 5\textsuperscript{th} ed. (London: Sweet & Maxwell, 2001) at 124-126. \textit{The Statement of General Insurance Practice 1986} is available online: Association of British Insurers \textless http://www.abi.org.uk/Display/default.asp?Menu_ID=946&Menu_All=1,946,0&Child_ID=120\textgreater ;}
\footnote{\textsuperscript{237} Malcolm A. Clarke, \textit{The Law of Insurance Contracts}, 4\textsuperscript{th} ed. (London: LLP, 2002) at 23-4B.}
\end{footnotes}
to the change in the risk that comes to his knowledge before the alteration of the contract. Blackburn J. has observed in *Lishman v. Northern Maritime Insurance Co.* that:

“If the alteration were such as to make the contract more burdensome to the underwriters, and a fact known at that time to the assured were concealed which was material to the alteration, I should say the policy would be vitiated. But if the fact were quite immaterial to the alteration, and only material to the underwriter as being a fact which shewed that he had made a bad bargain originally, and such as might tempt him, if it were possible, to get out of it, I should say there would be no obligation to disclose it.”

3. **The Duration of the Duty of Disclosure in China**

i. **General Principle as to the Duration of the Duty**

There is no divergence between marine and non-marine insurance as to the question when the duty of disclosure comes to an end. The position is also basically the same as in the common law, but there are some ambiguities in the Chinese law. They are whether the insured will be warned of the duty of disclosure when renewing the policy, whether the insured should make disclosure when altering the contract, etc.

ii. **The Time of Conclusion**

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239 (1875) L.R. 10 C.P. 179.


241 See page 55ff., below.

242 See page 56ff., below.
Article 13 of the Insurance Law stipulates:

“When an insurance applicant proposes an insurance request, and an insurer agrees to accept the proposal, and after an agreement on contract clauses is reached, the insurance contract shall be deemed as concluded. The insurer shall promptly issue an insurance policy or other certificates of insurance to the applicant, and the insurance policy or other certificates of insurance shall contain and specify the contents of the contract agreed upon by both parties. Upon consent through negotiation, an applicant and an insurer may also conclude an insurance contract in writing in other forms other than those provided in the preceding paragraph.”

Article 221 of the Maritime Code stipulates:

“A contract of marine insurance comes into being after the insured puts forth a proposal for insurance and the insurer agrees to accept the proposal and the insurer and the insurer and the insured agree on the terms and conditions of the insurance. The insurer shall issue to the insured an insurance policy or other certificate of insurance in time, and the contents of the contract shall be contained therein.”

Therefore, the time of the conclusion of the contract is the same as under the common law. The proposal is an offer and the contract is reached when the insurer accepts the proposal. The wording of the Insurance Law that “an agreement on contract clauses is reached” and of the Maritime Code, that “agree on the terms and conditions of the insurance”, seems to show that the mutual agreement on the terms of the insurance contract is an additional requirement for the contract to be reached, but such a requirement, if it exists, is pleonastic because once the insurer has accepted the proposal, he is not allowed to say that he actually disagrees on the terms and conditions of the
contract. The time the insurer issues the policy or other certificates of insurance is not the time of
the conclusion of the contract, as both the Insurance Law and the Maritime Code consider the
issuance of the policy or other certificates as a duty that insurer should perform after the
conclusion of the contract.243

In case the insurer sends his acceptance of the proposal by post, however, unlike the common law,
the acceptance does not become valid until it reaches the insured.244 Post is not often used
nonetheless as a mean to send the acceptance in the modern society.

iii. Renewal of a Contract

It is the same in China that a renewal of a contract is equal to a creation of a new contract, so the
insured must disclose to the insurer any material facts that the insured knows before the renewal.
Life insurance is also a long-term contract and it is always extended instead of renewed.

The problem is that the insured will not be warned of the duty of disclosure in renewing the
contract. In practice, the insurer’s agent has a tendency to induce the insured not to disclose.245 The
solutions is to impose on the insurer a duty to warn the insured of the duty of disclosure upon
renewal of the contract, failing which deprives the insurer of the right to rely on the defence of
non-disclosure, as what The Statement of General Insurance Practice 1986 and the Statement of
Long-Term Insurance Practice 1986 have done. In non-marine insurance, there is no need to apply
this suggestion because the doctrine of “inquiry-disclosure” releases the non-marine insured from
disclosing anything the insurer does not inquire.246

243 See article 13 of the Insurance Law and article 221 of the Maritime Code.
244 See article 26 of the Contract Law 1999.
245 See supra notes 29, 31. See the reasons in infra note 739.
246 See the doctrine of “inquiry-disclosure” at page 55ff., above.
iv. Alteration of a Contract

In cases where the contract is altered, the law of China does not stipulate whether the insured should make disclosure to the insurer. However, in order to achieve the fairness in the dealing and secure the accuracy of the insurer’s estimate on the risks, the law should impose a duty of disclosure on the insured in marine insurance when the contract is altered for the insured’s benefit or under his request. The Chinese law has not adopted the English position that whether an alteration of the contract is tantamount to a new contract depends on whether the alteration has changed the nature of the risks. Since it is not clear whether or what kind of alteration of the contract is tantamount to a new contract under the Chinese law, there is an easier way to amend it which does not need to distinguish between an amendment of an existing contract and a creation of a new contract. As the rules of disclosure in making a new contract are different in marine and non-marine insurance, the suggestions are introduced separately below.

In the marine insurance, when making a new contract, there is a duty of “voluntary disclosure” which means that, notwithstanding the insurer does not enquiry, the insured should voluntarily disclose everything material that the insured’s knows or ought to know in his ordinary course of

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247 The alteration of the contract means the amendment or the supplement of the content of the original contract as agreed by both parties. See Hu Kangsheng, ed., Zhong Hua Ren Min Gong He Guo He Tong Fa Shi Yi (The Paraphrase of the Contract Law of the People’s Republic of China) (Beijing: The Law Press, 1999) at 128. The general contract law does not care whether the alteration constitutes a new contract since there is no difference between a new contract and a changed contract.

248 In U.K., where the change of an insurance contract is significant enough to alter the nature of the risk, it is equal to making a new contract and the duty to make full disclosure is needed. See text accompanying note 237 at 52. The Chinese law does not make a clear distinction between a modified contract and a new contract substituting the former one. Consideration is not required in order to alter a contract. Unless certain statute or administrative promulgation requires the contract being registered or getting approval from certain authority, the alteration is valid as far as mutual parties agree to such alteration. (Article 77 of the Contract Law 1999.) Therefore, the answer as to whether the insured should make disclosure cannot be deduced from the general contract law. This is one of the samples that Chinese insurance law lacks the support from the general law.
business. Then in cases of alteration of the contract, the scope of the disclosure is limited: the insured should disclose only those material circumstances relevant to the alteration of the contract. If the material fact is only relevant to the unchanged terms of the contract, the insured bears no duty to disclose it. That is to say, the more significant the alteration is, the wider range of disclosure must be made. This amendment of law will avoid the trouble to judge whether the alteration is significant enough to have changed the nature of the risks.

In non-marine insurance, as the Insurance Law adopts the “inquiry-disclosure” doctrine, which means that the law requires that insured only disclose those circumstances asked by the insurer, the insured should bear no duty to disclose anything unless the insurer inquires. In alteration of a contract, the position should be the same.

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249 Article 222 of the Maritime Code. For the meaning of voluntary disclosure, see page 27, above.
250 The reasons why the law should be such have been well explained by Blackburn, J. Above page 53.
251 For the inquiry-disclosure doctrine, see page 27ff., above.
252 Article 17 of the Insurance Law.
Chapter 3. The Insured’s Duty of Disclosure: Knowledge and Constructive Knowledge

I. The Position of the Common Law

1. Test of the Constructive Knowledge

The law never requires the insured to disclose what he is not able to know, but it is complicated as to whether the insured should disclose what he “ought to” know. In marine insurance, section 18(1) of the *Marine Insurance Act 1906 (U.K.)* provides that an insured is “deemed to know every circumstances which in the ordinary course of business, ought to be known by him”. Although it is said that the *Marine Insurance Act 1906 (U.K.)* has stated the rule applicable to both marine and non-marine insurance, the court of appeal has decided that the constructive knowledge, or the deemed knowledge, does not apply to private insurance.253 The interpretation of section 18(1) as to what is “in the ordinary course of business, ought to be known” is a disputed issue.254 The knowledge of the agent is also a complicated legal issue, but this will only be briefly mentioned below255 because a comparative study on the agent’s knowledge may not give too much help to the Chinese law since most of the insurance contracts in China are not arranged through the insured’s agent.256

254 This will be discussed at page 59, below.
255 See page 63, below.
256 See page 66, below.
The private insured \(^{257}\) is required to disclose what he actually knows. In *Economides v. Commercial Union Assurance Co. plc* \(^{258}\) all three members of the Court of Appeal stated that the private individuals who are not obtaining insurance in the course of a business does not bear the duty to disclose any form of deemed or constructive knowledge, \(^{259}\) and honesty is the only thing required of private insured. \(^{260}\) Therefore, the rule applied in private insurance is that

> “The duty is a duty to disclose, and you cannot disclose what you do not know. The obligation to disclose, therefore, necessarily depends upon the knowledge you possess.” \(^{261}\)

Although the constructive knowledge is not ascribed to the private insured, he, nonetheless, cannot wilfully shut his eyes to material circumstances which he has good reason to suspect exist. \(^{262}\) “If a man, suspicious of the truth, turns a blind eye to it, and refrains from inquiry - so that he should not know it for certain - then he is to be regarded as knowing the truth.” \(^{263}\)

Constructive knowledge is what the insured ought to know. Section 18(1) of the *Marine Insurance Act 1906 (U.K.)* requires the marine insured to disclose not only what he actually knows but also

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\(^{257}\) A private insured means a proposed insured who seeks insurance cover “for purpose unconnected with a business, such as an individual purchasing life or property cover”. See Nicholas Legh-Jones, gen. ed., *MacGillivray on Insurance Law*, 10th ed. (London: Sweet & Maxwell, 2003) at para. 17-12.


\(^{259}\) Ibid, at 601.

\(^{260}\) Ibid, where Simon Brown L.J. said, “In short, I have not the least doubt that the sole obligation on an assured in the position of this plaintiff is one of honesty.

\(^{261}\) *Jeol v. Law Union and Crown Insurance* [1908] 2 K.B. 863, per Fletcher Moulton L.J. at 884.


\(^{263}\) *The Eurysthenes* [1976] 2 Lloyd’s Rep. 171 at 179 per Lord Denning, M.R.
what he “in the ordinary course of business” ought to know. This, however, does not mean that the insured must conduct an investigation into his business,\footnote{Australia \& New Zealand Bank Ltd. v. Colonial \& Eagle Wharves Ltd.; Boag (third party) [1906] 2 Lloyd’s Rep. 241.} otherwise it will go against the merit of the principle of utmost good faith that it is less costly and more efficient for the insured to tell the insurer about the material circumstances.\footnote{Malcolm A. Clarke, The Law of Insurance Contracts, 4th ed. (London: LLP, 2002) at para. 23-8B.} If the insured does conduct such an investigation, he must disclose any material circumstances that he has found.\footnote{Australia \& New Zealand Bank Ltd. v. Colonial \& Eagle Wharves Ltd.; Boag (third party) [1906] 2 Lloyd’s Rep. 241 at 252; Malcolm A. Clarke, The Law of Insurance Contracts, 4th ed. (London: LLP, 2002) at para. 23-8B (However, Clarke is not satisfied with this position. He believes that the law should not “reword the diligence with the crown of heavier duties” and “discourage the voluntary investigation of risks which might better prevent loss”); Nicholas Legh-Jones, gen. ed., MacGillivray on Insurance Law, 10th ed. (London: Sweet \& Maxwell, 2003) at para. 17-13; Michael J. Mustill \& Jonathan C.B. Gilman, Arnould’s Law of Marine Insurance and Average, 16th ed., vol. 1 (London: Stevens \& Sons, 1981-1997) at para. 640.}

Although this point has been disputed,\footnote{Malcolm A. Clarke, The Law of Insurance Contracts, 4th ed. (London: LLP, 2002) at para. 23-8B.} in principle the rule of constructive knowledge expressed in section 18(1) applies to non-marine insurance,\footnote{Malcolm A. Clarke, The Law of Insurance Contracts, 4th ed. (London: LLP, 2002) at para. 23-8B, where Clarke believes that the constructive knowledge “in principle… also applies to non-marine insurance”. See also Nicholas Legh-Jones, gen. ed., MacGillivray on Insurance Law, 10th ed. (London: Sweet \& Maxwell, 2003) at para. 17-12, where the author takes the view that “the rule of deemed knowledge expressed in section 18(1) of the Marine Insurance Act 1906 applies to” insurance contract that is sough in the course of a business, namely the commercial insurance, no matter whether it is marine or non-marine, but it does not apply to consumer insurance. Contra John Birds \& Norma J. Hird, Birds’ Modern Insurance Law, 5th ed. (London: Sweet \& Maxwell, 2001) at 105, where the author thinks that this is an open question.} but the case of Economides \textit{v. Commercial Union Assurance plc}\footnote{[1998] Q.B. 587. See the details of this case at page 43ff., below.} seems to suggest that the constructive knowledge will not be applied at lease to the private insurance, which is effected by an individual not in the course of business.\footnote{Simon Brown L.J. decided that the only thing required of the private individual insured is honest, provided that he did not turn a blind eye to evidence of the material circumstances, and then the insured was under no obligation to make any sort of further inquiries. [1997] 3 All E.R. 636 at 648; John Birds \& Norma J. Hird, Birds’ Modern Insurance Law, 5th ed. (London: Sweet \& Maxwell, 2001) at 105; Nicholas Legh-Jones, gen. ed., MacGillivray on Insurance Law, 10th ed. (London: Sweet \& Maxwell, 2003) at para. 17-15; L.J. Mance, \textit{et al.}, ed., Insurance Disputes, 2nd ed. (London: LLP, 2003) at para. 4.52.}
Is the insured deemed to know what ought to be known in the ordinary course of the business of a prudent insured or what ought to be known in the ordinary course of his business? There are disputes as to whether the test of the constructive knowledge is the objective one or the subjective one.

Clarke takes the objective view that the insured ought to know what, in the ordinary course of business, a prudent insured ought to know. In *London General Insurance Co. Ltd. v. General Marine Underwriters Association*, the plaintiff insured was himself an insurer who had insured the cargo of a vessel that was on fire on the evening of 24 September. The fire was posted on the casualty board at Lloyd’s and the “casualty slop” was sent to the insured the next morning. Owing, however, to pressure of business in the plaintiffs’ office, nobody there took any notice of it when received. Thus, no one in fact knew of its contents when the plaintiffs’ department for reinsurance reached the reinsurance with the defendant reinsurer. The Court of Appeal held that the information contained in the slip was a material circumstance which, in the ordinary course of business, ought to have been known by the plaintiffs because the pressure of the particular insurer’s business was not an excuse though the pressure of the whole market might be.

Clarke explains why the law should be such:

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272 [1921] 1 K.B. 104.

273 Lord Sterndale said in *London General Insurance Co. v. General Marine Underwriters Association* [1921] 1 K.B. 104 at 110, that “if it were a question of their having done their best, so far as the pressure [of the Lloyd’s market] of business would allow, to make themselves acquainted with the casualty slips, and of their not being able to do so in time to stop the broker’s instructions, I think it might have been difficult to deal with such a case, but there is no such case before us. They never did anything at all.” It is clear from the words of Lord Sterndale and other judges (Warrington L.J. at 111 and Younger L.J. at 113) that the “pressure” refers to the pressure in the Lloyd’s market, instead of that in the plaintiff’s business. See Malcolm A. Clarke, *The Law of Insurance Contracts*, 4th ed. (London: LLP, 2002) at para. 23-8C, note 3.
“It would be odd, if the law applied an objective standard to inferences that the proposer
draws from what he knows, as well as an objective standard of materiality by reference to
the prudent insurer or, sometimes, the reasonable insured, yet allowed the proposer to
conduct his business in such a negligent way that facts never come to his attention in the
first place, so that the objective rules are never allowed to bite.”

The objective view that the insured should act like a prudent insured in obtaining relevant
knowledge for the purpose of proposing insurance is not widely accepted in U.K., although the
CMI report regards Clarke’s view as the existing English law. Recent cases have suggested
that the courts have interpreted the words “in ordinary course of business” more restrictively than
it was in London General Insurance Co. v. General Marine Underwriters’ Association Ltd. In
Australia & New Zealand Bank Ltd. v. Colonial & Eagle Wharves Ltd.; Boag (third party),
McNair J. decided that the insured was not required to do what a reasonable insured would have
done. “The assured is deemed to know only what he would be expected to know in the ordinary
course of his own business, making allowance for its imperfect organisation, prior to the
conclusion of the insured. Therefore, he is not deemed to be aware of matters which should be
known to him in the course of a well run business which he would have found out if he had re-
organised his schedule or business system at the time in question.” This subject view seems to
be favoured by the CMI report.

276 Australia & New Zealand Bank Ltd. v. Colonial & Eagle Wharves Ltd.; Boag (third party) [1960] 2
277 [1921] 1 K.B. 104.
279 Nicholas Legh-Jones, gen. ed., MacGillivray on Insurance Law, 10th ed. (London: Sweet & Maxwell,
The reasons why the subjective view is preferred are expressed by Arnould:

“The test of what ‘ought to be know’ by the insured is… a test of what ought to be known by the insured in carrying out his business in the manner in which he carries on that business; the underwriter takes the risk that the business may be run inefficiently unless the circumstances are such that the insured knows or suspects facts material to be disclosed. To hold otherwise would be tantamount to saying that underwriters only insure those who conduct their business prudently, whereas it is a commonplace that one of the purposes of insurance is to obtain cover against the consequences of negligence in the management of the assured’s affairs.”

2. The Knowledge of the Employee and the Agent

The agent of the insured should not only disclose to the insurer the material circumstances that he knows, or ought to know, but also what the insured is bound to know unless it comes to the insured’s knowledge too late to communicate to the agent. It was held that material facts ought to be forwarded to the agent with all reasonable diligence so as to reach the underwriter before the insurance is actually effected.

Whether the knowledge of an agent or an employee is imputed to the principal insured depends on the nature of the position of the agent or the employee and the authority given to him by the principal, and this kind of agent or servant is called the “agent to know”. “Some agents, so far represent the principal that in all respects their acts and intentions and their knowledge may truly

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be said to be the acts and intentions and knowledge of the principal. Other agents may have so limited and narrow an authority, both in fact and in the common understanding of their form of employment, that it would be quite inaccurate to say that such an agent’s knowledge or intentions are the knowledge or intentions of his principal.”

In other cases, the master of a ship and the general agent of a ship-owner for the transaction of his shipping business, the consigner and shipper of a cargo and the general representative of the assured at a foreign port have been held to be agents with whose knowledge the insured is affected. In circumstances where the insurance is effected through more than one brokers, it was held that the concealment of a material fact within the knowledge of any agent through whose agency, whether directly or indirectly, the insurance has been effected vitiates the policy. On the other hand, where the insurance is not effected through the broker, the concealment of any material circumstance by the broker will not vitiate the contract.

II. The Position in Chinese Marine Insurance Law

1. Test of the Constructive Knowledge

In China, article 222 of the Maritime Code also requires that the insured should disclose every material circumstance which he ought to know in the ordinary business practice, in addition to what he actually knows. Such a rule may help the insurer avoid the heavy burden of proving the actual knowledge of the insured, but whether a particular circumstance is within the presumed knowledge of the insured is still largely dependant on the discretion of the judge. The CMI report

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285 Gladstone v. King (1813) 1 M. & S. 35.
286 Fitzherbert v. Mather (1785) 1 T.R. 12.
stated that the Chinese law is taking an objective view, but this is probably caused by a mistake in the translation of the Maritime Code. Actually, the law does not specify whether the test of the constructive knowledge is the objective one or the subjective one. It is largely accepted among the scholars that the insured is not obliged to make special investigations so as to exhaust every material circumstance before the conclusion of the contract, but he must observe “reasonable inquiry” so as to find any available material circumstance, and it is further contended that the insured should exercise reasonable diligence in his management of the business so as to find the material circumstances. These arguments are in substance advocating the objective criterion.

So which test shall Chinese law adopt? It seems to me that the view of the objective test which is the position of London General Insurance Co. v. General Marine Underwriters’ Association Ltd. in the common law is the better choice for the marine insurance of China. First, if the test were the particular insured test, namely, the subjective one, how could the insurer prove that the particular insured, in the manner in which he carries on his business, ought to know the non-disclosed fact, since it is hardly possible for the insurer to find out how the particular insured

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290 See Trine-Lisewilhelmsen, “Duty of Disclosure, Duty of Good Faith, Alteration of Risk and Warranties: An analysis of the Replies to the CMI Questionnaire”, [2000] CMI Yearbook 332 at 354-355, where it is alleged that “[upon reading article 222 of the Maritime Code] the Chinese solution is subjective approach asking for what the assured ought to have known in his actual business practice.” This conclusion may attribute to the mistake made in the translation from Chinese to English. According to Si Yuzuo, A Seminar on the Unification of International Marine Insurance Law, made in Dalian Maritime University, in 1999, when the CMI was collecting materials on China marine insurance law, Dalian Maritime University provided a lot of research materials, among which there were an English translation of the Maritime Code. The version of the Maritime Code translated by Dalian Maritime University was accurate by and large; however, an error was made in article 222, which was translated as “...the insured shall truthfully disclose to the insurer the material circumstances which the insured has knowledge of or ought to have knowledge of in his ordinary business practice...” (The Maritime Code of the People’s Republic of China, 2nd ed. (Dalian: Dalian Maritime University Press, 1993) at 60.) According to the Chinese original text, there is no “his” before “ordinary business”. In another translation, there is no this “his” too. See Stephen FitzGerald, ed. China Laws for Foreign Business, vol. 3, looseleaf (North Ryde, N.S.W.: CCH Australia Ltd, 1985-1987) para. 15-642 at para. 15-642(224).


292 Wang Pengnan, ibid.

293 [1921] 1 K.B. 104.
carries on his business? Second, if the subjective test were adopted, the law would seem to be protecting those who carry on their business recklessly. Moreover, it would be ridiculous that an insured would be released from the liability for non-disclosure because his business was so improperly operated that material information never reached the relevant department in time.

In addition, the prudent insured test would drive the insured to manage his business with higher attention to the material circumstance related to the risk and consequently the risk will be reduced. On the other hand, if the particular insured test were applied, the insurer would be compelled to inquire in the proposal form and investigate how the insured conducts his business and this will increase the premiums accordingly. Moreover, the insurance brokage in China is very immature with only 1% of the premium income coming from those contracts reached through the broker. The tendency of the particular insured test to protect the careless people would hinder the insured to hire an experienced and prudent broker, and consequently hinder the development of the insurance brokage, the development of which is critical to a healthy insurance market.

2. The Knowledge of the Employee and the Agent

*The Maritime Code* does not mention the duty of agent. The relationship between the principal and the agent and the relationship toward a third part are set out in *the General Principles of the Civil Law 1986*. The general principle is that the principal should bear any consequence of the *acts* by the agent within his authority. It may follow that, when the insured makes an insurance contract

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295 Article 63 of *the General Principles of the Civil Law 1986*: “Citizens and legal persons may perform civil juristic acts through agents. An agent shall perform civil juristic acts in the principal’s name within the scope of the power of agency. *The principal shall bear civil liability for the agent’s acts of agency*. Civil juristic acts that should be performed by the principal himself, pursuant to legal provisions or the agreement between the two parties, shall not be entrusted to an agent.” [emphasis added] The Law Bureau of the State Council of the People’s Republic of China, trans., *Laws and Regulations of the People’s Republic of China Governing Foreign-Related Matters* (Beijing: the Law Press, 1991).
through an agent, whatever the agent knows or ought to know, is presumed to be the knowledge of the insured. However, this is not expressed by law in unambiguous words. Whether the word “acts”\(^{296}\) is inclusive of the meaning of knowledge will be disputed, so it is preferred that the Maritime Code could add an article imitating section 19 of the Marine Insurance Act 1906 (U.K.) so that any non-disclosure made by the agent through whom the insurance contract is made, for whatever reasons (except that the agent was defrauding the principal insured)\(^{297}\) and whether the principle knows, should result in the same consequence as if the non-disclosure were done by the insured himself.

Not all the employees have the same position as the agents under Chinese law. The law does not specify in which conditions the employees’ knowledge is imputed on the insured. Article 43 of the General Principle of Civil Law 1986 stipulates that “an enterprise as legal person shall bear civil liability for the operational activities of its legal representatives and other personnel”. Article 58 of the Judicial Interpretation of the General Principle of Civil Law further stipulates that “if the legal representatives and other personnel of an enterprise as legal person are engaged in any business activities in the name of the legal person and cause economic loss to others thereupon, the enterprise as legal person shall bear the civil liability.” These regulations are concerning the employees’ conduct, not their knowledge. The law would go too far if the employee’s knowledge were all imputed on the employer. China’s insurance law should use the English concept of the

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\(^{296}\) See note 295, bold words.

“agent to know” for reference on this point and only the knowledge of the agent to know should be
imputed to the insurer.298

III. Constructive Knowledge in China’s Non-Marine Insurance Law

The Insurance Law does not stipulate that the insured should disclose what he ought to know, but
the proposed judicial interpretation suggests that the constructive knowledge should also apply to
the non-marine insurance as well as the marine insurance.299

IV. What Need Not Be Disclosed?

1. Common Law Position

i. Introduction

In the landmark precedent Carter v. Boehm,300 Lord Mansfield said,

“The assured, need not mention what the underwriter knows, what way soever he came by
the knowledge; or what he ought to know; or takes upon himself the knowledge of; or
waives being informed of; or what lessens the risk agreed and understood to be run; or
general topics of speculation; or every cause which may occasion natural perils, as the
difficulty of the voyage, kind of seasons, probability of hurricanes, earthquakes, etc.; or
every cause which may occasion political perils, from the rupture of States, from war, and

298 For the “agent to know”, see page 63, below.
299 Article 9(1) of The Interpretation of the People’s Supreme Court’s on Several Questions of the
Inquisition of Insurance Dispute Cases (Draft for Consultation), online: Law-Lib.com <http://www.law-
300 (1766) 3 Burr 1905 at 1911.
the various operations of it, upon the probability of safety from the continuance and return of peace, or from the imbecility of the enemy.”

As far as marine insurance is concerned, the Marine Insurance Act 1906 (U.K.), section 18(3), provides

“In the absence of inquiry the following circumstances need not be disclosed, namely:
(a) Any circumstance which diminishes the risk;
(b) Any circumstance which is known or presumed to be known to the insurer. The insurer is presumed to know matters of common notoriety or knowledge, and matters which an insurer in the ordinary course of his business, as such, ought to know;
(c) Any circumstances as to which information is waived by the insurer;
(d) Any circumstance which it is superfluous to disclose by reason of any express or implied warranty.”

ii. Facts within the Actual or Presumed Knowledge of the Insurer

The insured need not disclose what the insurer knows in whatever way. In addition, at least in marine insurance, the insured is not bound to disclose facts within the ordinary professional knowledge of an underwriter and this “probably extends to other branches of insurance”. The

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presumed knowledge has been held to include the usages of trade, usual clauses of merchant contracts, the standing law of a state, the common sense and the other knowledge in the common course of the business of the insurer underwriting the same class of risks. The contents of Lloyd’s List or any other newspaper do not necessarily become the common sense, or public knowledge, and therefore there is no presumption of knowledge of the insurer merely on ground that the particular fact has been published in Lloyd’s List or any other newspaper.

iii. Waiver

(a) Introduction

In the present context, waiver means “the abandonment or relinquishment of a right or a defence which may occur as the result either of an election by the insurer or of the creation of an estoppel precluding him from relying upon his… rights against the assured”. If the insurer waives by express words, it is easy to judge; the problems often arise when the insured argues that the insurer has waived his right by his conduct, which is called implied waiver. Implied waiver is also

309 By the insertion of an express clause in the insurance contract, the parties can exclude the operation of the duty of disclosure, but this kind of clause cannot exclude the insured’s fraud. See HIH Casualty and General Insurance v. Chase Manhattan Bank [2003] 2 Lloyd’s Rep. 61 (H.L.); [2001] 2 Lloyd’s Rep. 483 (C.A.); [2001] 1 Lloyd’s Rep. 30 (Comm. Ct.).
an apparent flaw in the Chinese insurance law.\textsuperscript{310} So the following discussion will focus on the circumstances where the insurer waives by his conduct.

(b) Waiver of the Duty of Disclosure

Before the contract has been concluded, the insurer may waive the insured’s duty of disclosure totally or partially impliedly by his conduct.

For example, if the insurer does not seek for the information of a particular circumstance, the current proposition in U.K. is that the insurer has not necessarily waived the insured’s duty of disclosure by omitting to inquire,\textsuperscript{311} but this will be evidence that the insurer does not regard the matter as material.\textsuperscript{312} The position is that if the insurer has been given information that, although incomplete, constitutes a fair representation of the risk which would raise suspicions in the mind of a prudent insurer that there are other material circumstances, then the acceptance of the application without further inquiry constitutes a waiver by conduct.\textsuperscript{313} The self-regulation, the Statement of General Insurance Practice 1986,\textsuperscript{314} clause 1(d), takes the view that “those matters which insurers have found generally to be material will be the subject of clear questions in proposal forms”. In \textit{IOB report 1994},\textsuperscript{315} the Bureau was of the position that the scope of the insured’s duty of disclosure was determined by the questions put by the insurer as far as consumer insurance was concerned.

\textsuperscript{310} See page 78, above.
\textsuperscript{313} \textit{Supra} note 236.
If the insurer asks a question of limited scope in the manner that he implies that he has no interest in the rest matters outside the scope, he is deemed to have waived the disclosure of the rest matters.\textsuperscript{316} However, the implication of the question must be clear. For example, questions seeking trade references do not waive information about convictions.\textsuperscript{317} In addition, the implication must be reasonable, in the sense that a reasonable man reading it would think that the insurer is not seeking for further information.\textsuperscript{318}

In cases where the insurer asks questions but the insured does not answer, or the answer is incomplete, but the insurer nonetheless issues a policy without inquiry, the insurer will normally be taken as waiver of the disclosure in respect of the matters,\textsuperscript{319} unless the blank obviously implies a negative answer.\textsuperscript{320} In the latter circumstances, if the negative answer is wrong, the insurer can avoid the contract.\textsuperscript{321}

(c) Waiver of Further Information

\textsuperscript{316} This position is clearly stated by L.J. Asquith in \textit{Schoolman v. Hall} [1951] 1 Lloyd’s Rep. 139 at 143: “The question in a proposal form may be so framed as necessary to imply that the underwriter only wants information on certain subject-matters, or that within a particular subject-matter their desire for information is restricted within the narrow limited indicated by the terms of the question, and, in such a case, they may pro tanto dispense the proposer from what otherwise at common law would have been a duty to disclose everything material.”

\textsuperscript{317} \textit{Schoolman v. Hall}, ibid.


Lord Esher MR has said that it “is not necessary to disclose minutely every material fact; assuming that there is a material fact which he is bound to disclose, the rule is satisfied if he discloses sufficient to call the attention of the underwriter, in such a manner that they can see that if they require further information they ought to ask for it.”\textsuperscript{322} But if a presentation makes no reference to a material fact, it is not fair to say that the insurer has waived the disclosure.\textsuperscript{323}

iv. Warranty

The \textit{Marine Insurance Act 1906 (U.K.)}, section 18(3) (d) stipulates that the insured, in the absence of inquiry, need not disclose “any circumstance which it is superfluous to disclose by reason of any express or implied warranty”.\textsuperscript{324}

v. The “Spent” Convictions

According to the \textit{Rehabilitation of Offenders Act 1974 (U.K.)}, previous convictions are regarded as “spent” after a certain “rehabilitation periods”, varying from five to ten years depending on the type of sentence, and the insured is not liable for not disclosing such “spent” conviction even when the insurer inquires about his previous convictions. But if the conviction is a sentence of imprisonment for more than 30 months, such conviction is not caught by the Act.

2. The Position of China in Marine and Non-Marine Insurance


\textsuperscript{324} It seems that in the field of non-marine insurance contracts, the law applies the same in respect of this point. See Poh Chu Chai, \textit{Principles of Insurance Law}, 5\textsuperscript{th} ed. (Singapore: Butterworths, 2000) at 168.
i. Introduction

_The Maritime Code_ has given the general rule of what need not be disclosed, saying that “the insured need not inform the insurer of the facts which the insurer has known of or the insurer ought to have knowledge of in his ordinary business practice if the insurer made no inquiry.”

According to the _unius exclusio_ interpretation of this article, it seems that since the law only exempts the disclosure of the facts within the actual or presumed knowledge of insurer, any other facts which diminish risks, which have been waived by the insurer, which are the subject of a warranty or which are concerned with the previous convictions, must all be disclosed voluntarily.

In practice the insured can raise some of these defences. A clever judge may resort to some basic principles or abstract concepts in the civil law to support the insured in such cases. For example, where the insured fails to disclose a circumstance which diminish the risk, if the insurer claims that he has been induced by the non-disclosure, the inducement must result in a favourable contract to the insurer than it should have been had the disclosure been made.

If the insurer claims that the contract has not been more favourable to him, then there is no inducement and the insurer cannot terminate the contract too.

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325 Article 222(2).

326 _Unius exclusio_: It is a method of legal interpretation, meaning that an express mention of a word leads to the exclusion of those not mentioned. For example, if the law stipulates that contracts which go against the moral and good manners are invalid, it can be concluded that contracts which does not go against it are valid. See Liang Huixing, _Min Fa Jie Shi Xue (Theory of the Interpretation of the Civil Law)_ (Beijing: China Politics and Law University Press, 1995) at 213-297; Guan Ou, _Fa Xue Xu Lun (Exordium of Legal Science)_ (Taipei: Taiwan China Publishing House, 1966) at 66-67; Yuan Kunxiang, _Fa Xue Xu Lun (Exordium of Legal Science)_ (Taipei: Sanmin Publishing House, 1980) at 73-78; Zhang Zhiming, “Dang Dai Zhong Guo De Fa Lv Jie Shi Wen Ti Yan Jiu (Research on the Problem of the Legal Interpretation of Contemporary China)”, (1996) Issue 5, China Social Science 64 at 68.

327 If the insurer claims that the contract has not been more favourable to him, then there is no inducement and the insurer cannot terminate the contract too.
been made to the insurer. Since one of the basic principles in the civil law is “no damage, no remedy”, the insurer is not allowed to get remedy from what has benefited him.

As for the information which the insurer has expressly waived, it could be held that the waiver is evidence that the insurer regards it as unimportant or the insurer has not been induced by the non-disclosure. It is also possible to resort to the principle of good faith in the civil law which requires the party to a contract to exercise his right in a reasonable way, because an insurer who expressed that he did not want to know certain information and later accused the insured for not disclosing that information is not exercising his right in a reasonable way.

However, it is still suggested that the law clearly stipulate that those circumstances need not be disclosed in absence of the inquiry so that the law would not be so discretionary because not every judge will take these approaches illustrated above. In addition, however the judge interprets the law, there is no way that he could fairly decide that the insured need not disclose the spent convictions, so the law must be amended in this regard.

In non-marine insurance, as the result of adopting the principle of “inquiry-disclosure”, whatever is not asked by the insurer, not matter how material it is, need not be disclosed by the insured. On the other hand, not all questions asked by the insurer should be disclosed. The Insurance Law provides that the insurer can only make inquiry on conditions relating to the subject matter to be insured or the person to be insured. In addition, although without the law does not stipulate so in

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329 Discussed in more detail at page 79ff., below. For comparison of English cases on this issue, see infra note 338.

330 Actually many would not do so, considering the quality of the judges in China.

331 For the spent convictions under the common law, see page 73, above.
clear words, it is believed that the information expressed waived by the insurer need not be disclosed.332

ii. The Actual and Presumed Knowledge of the Insurer

The insured of marine insurance need not inform the insurer of the facts which the insurer has known of or the insurer ought to have knowledge of in his ordinary business practice if the insurer made no inquiry.333 There is no ambiguity in the meaning of the insurer’s actual knowledge, but, as the article leaves the word of “insurer” unadorned, the question rises: is the insurer deemed to know what a prudent insurer should know?

The test of judging the scope of the presumed knowledge of the insurer should be the objective one, namely, the test of a prudent insurer. This is because from the wording of article 222(2), it can be inferred that the legislative intent was to define the presumed knowledge of the insurer in the same manner as the presumed knowledge of the insured. If the word of “insured” in article 222 should be understood as a reasonable insured, there is no reason why the “insurer” should not be regarded as a reasonable, or prudent, insurer. Furthermore, to hold otherwise is equal to saying that the less the insurer takes care of his business, the heavier duty the insured would have.

In *Xi Gu Commercial Ins. v. People’s Insurance Company of China, Qingdao Branch*,334 a case decided by the Maritime Court of Qingdao, one of the essential matters was decided on what should be presumed to be known by the insurer. In this case, the insurer declined the claim on ground of non-disclosure of the material fact that the cargo was shipped on a barge tugged by

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332 See the text accompanying *supra* note 329.
333 Article 222(2) of *the Maritime Code*.
another ship, but the insured argued that the insurer should have known this because: (1) the circumstances of the shipment had been reported by a famous local newspaper and the local TV channel, so those circumstances were common public knowledge; (2) the documents that the insured had submitted to the insurer had included the information such as the weight, the size, and the name of the ship, and the undisclosed fact could be inferred from such information. Both the Maritime Court and the High People’s Court decided against the insured. Concerning the insured’s first argument, the judges held that the mere fact of the information having been reported by local media could not necessarily made that information a public knowledge, and the insured still had the duty to disclose it to the insurer. Concerning the second argument, the judges said, although there were some indications of the ship being a towage, such indications could not come to the mind of an ordinary people until he had understood the whole truth. Moreover, the law does not impose such a duty on the insurer to discover the truth by making enquiry on any information which would indicate the existence of further material circumstances as the insured’s duty should be performed voluntarily.

It could not be clearly discerned from this case whether the test of a prudent insurer or the particular insurer was adopted, but the judges did not inquire into how the insurer in this case carried on his business; instead, the judges based his conclusion on what an ordinary man, something like a reasonable man, would have thought. So the decision is close to the test of a prudent insurer. However, in a strict sense, there is still a small flaw in the judgement. The obiter dictum that the insurer has no duty to probe the details of the facts if the general information of the

335 The name of the ship was capable of the meaning of “a sailing towage” in Chinese. And according to the expert evidence submitted by the China Maritime Law Association, China’s official academic research association of maritime law, the fact of the ship being a towage should have been inferred by a prudent insurer from such a name of the vessel.

336 The High People’s Court is the direct higher court to the Maritime Court and the appeal from the maritime court goes to the high People’s Court. The High People’s Court located in the capital of each province, municipality directly under the central government, or national autonomous area. The Maritime Court locates in some port cities including Dalian, Tianjin, Qingdao, Shanghai, Wuhan, Ningbo, Xiamen, Guangzhou, Haikou, and Beihai, each Maritime Court has jurisdiction over certain ocean area. For details, see online: China Maritime Trail <http://www.ccmt.org.cn/hs/intro/indexall.php>.
facts has been disclosed cannot be fully accepted. The right point of view should be that if the insured has disclosed sufficiently enough information to draw the attention of a prudent insurer concerning the materiality of the details, but the particular insurer still chooses not to inquire about the details, or, due to his stupidity or carelessness, fails to appreciate the materiality of the details, the insured should be deemed as having fully performed his duty unless there is intentional concealment. Such a point of view coincides with the common law rule of waiver.

iii. Waiver

In both marine and non-marine insurance, there is no such a doctrine as waiver and there is even no parallel concept of waiver in the whole Chinese law. Where the insurer has expressed that he will waive his right if the insured breaches the duty of disclosure, or has expressly waived, either fully or partly, the performance of the duty of disclosure, the People’s Court should decide for the

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337 There is no doctrine of waiver or estoppel in the Chinese law. However, in the civil law, there are many rules that may have similar functions as waiver. Generally speaking, the solution to waiver under the Chinese law is a piecemeal one. For example, the extinction period, which means the period after which a certain right will be extinguished, serves part of function of waiver in the Chinese law. According to Article 55(1) of the Contract Law, where a party does not avoid the contract after one year of knowing his right to do so, the party will be barred from avoiding the contract. Article 55(2) of the same statute stipulates that the right to avoid a contract will be extinguished if the party with the right expressly gives up the right or gives up the right by his conduct. This provision is very similar to waiver, but it only applies to the right to avoid a contract. For another example, if someone promises to give up a right or some interest, then the promise must be obeyed because consideration is not needed to enable a promise actionable (in China, there is even no concept of consideration). Sometimes, the court will forbid a person to exercise his right which he has waived as the court considers the exercise of such a right would seriously conflict with the principle of good faith in the civil law, although the person’s right may be justified by a contract. See Li Yuquan, Bao Xian Fa (Insurance Law), 2nd ed. (Beijing: The Law Press, 2003) at 70; Mu Shengting & Xu Liang, “Guan Yu Bao Xian He Tong Fa Zhong De Ti Da Cheng Xin Yuan Ze Ren Ti (On the Problem of the Principle of Utmost Good Faith in the Insurance Contract Law)” (2003) 56:3 Wuhan University Journal (Social Science Edition) 287 at 290. It has also been argued that the doctrine of waiver is especially important to the insurance law. See Xu Shenliang & Li Xiao, “Bao Xian Fa Ye Yao Cao Ru Shi (The Insurance Law should also ‘Join the WTO’ as early as Possible)”, International Finance Newspaper, November 15, 2001, section 6, online: the National People’s Congress News <http://www.npcnews.com.cn/gb/paper12/1/class001200078/hwz211693.htm>.
insured on the ground that such a promise must be kept otherwise it would be a breach of the principle of good faith, one of the general principles in the contract law and civil law.\textsuperscript{338}

But in circumstances where the insurer, in the eyes of a lawyer of the common law, would be held to have impliedly waived the insured’s performance of the duty of disclosure by his conduct, the attitude of the courts in China is not very clear. In such cases, the court often resorts to giving a broad interpretation to certain general principles in the contract law or certain well-recognized theories of the civil law, such as the principle of good faith.\textsuperscript{339} Because these approaches are not very consistent and one person’s interpretation may differ from another’s, the decisions will be inconsistent accordingly. It is suggested that the best approach for China would be to borrow the concept of waiver from the common law for ensuring consistency in decisions.

Because of the lack of a clear doctrine of waiver in the Chinese law, practical difficulties often occurs when the insurer accepts the uncompleted proposal without any objection or further inquiry. In such circumstances, there are two opposite views.\textsuperscript{340} One assumes that it is the insurer’s duty to

\textsuperscript{338} For principle of good faith in the contract law and civil law, see page 36ff., above. For other approaches dealing with the expressed waiver, see text accompanying \textit{supra} note 329. For further discuss on the alternative approaches dealing with waiver under the Chinese law, see \textit{supra} note 337. Compare with the U.K. case, \textit{Drake Insurance plc v. Provident Insurance plc} [2003] EWCA Civ 1834. In this case, the judges clearly expressed their attitude against the insurer’s utilizing the principle of utmost good faith to avoid a contract in bad faith. “…the doctrine of good faith should be capable of limiting the insurer’s right to avoid in circumstances where that remedy…would operate unfairly.” (Per Rix L.J. at para. 87.) “If more than lip service is to be paid to the principle that an insurer shall show the utmost good faith, the principle in my judgment required that [simple] enquiry to be made before the ‘wholly one-sided’ remedy of avoidance was exercised.” (Per Pill L.J., dissenting, at para. 177.) See also, \textit{Carter v. Boehm} (1766) 3 Burr 1905 at 1918, for Lord Mansfield’s dictum that an insurer, by asserting a right to avoid for non-disclosure, would himself be guilty of want of good faith; \textit{Pan Atlantic Insurance Co v. Pine Top Insurance Co} [1995] 1 A.C. 501 at 505.

\textsuperscript{339} See text accompanying \textit{supra} note 329.

\textsuperscript{340} In \textit{Wang B v. PICC}, reported in Liu Zhixin, ed., \textit{Zhong Guo Dian Xing Shang Shi An Li Ping Xi (China Typical Commercial Cases and Comments)} (Beijing: The Law Press, 1997) at 351-352. The tribunal of the People’s Court had divided into two opinions. These two opinions are mentioned below. But the name of the judge who supports each opinion is unreported. The decision of this case at last was a concoction of the two opinions. In this case, the insured died from cancer. The beneficiary under the policy claimed. The insurance company denied liability on ground of non-disclosure. The People’s Court found that the insured did not disclose the fact that he already had cancer before the insurance contract was concluded, but the Court also found that the insured did not know that he had had cancer because his family had concealed this from him.
check the proposal; if he fails to do so, it is his negligence and the insurer should not be allowed to avoid the contract on ground of his own negligence.\textsuperscript{341} The other view considers the insured’s duty of disclosure to be a duty prior to the insurer’s duty to check the proposal. Since the insured has broken the duty first, why should the insurer be expected to amend the fault of the insured?\textsuperscript{342} The People’s Court sometimes goes the middle way between the two opposite view, and decides that the insurer should compensate part of the loss of the insured,\textsuperscript{343} but the decisions are not consistent and the Court ends the case in conciliation most of the time.\textsuperscript{344} Considering the current situation of China’s insurance industry, where the insurer often misleads the insured not to perform the duty of disclosure,\textsuperscript{345} it might be a better solution to adopt the view taken in \textit{Roberts v. Avon Insurance Co.}\textsuperscript{346} that

“Where a question in the proposal is left entirely unanswered, the issue of the policy, without further inquiry, has been held to be a waiver of information, and it would seem that the omission to answer a question cannot be regarded as a misstatement of fact, unless the obvious inference is that the applicant intended the blank to represent a negative answer.”

\textsuperscript{341} \textit{Ibid.}
\textsuperscript{342} \textit{Ibid.}
\textsuperscript{343} See “contributory negligence” at page 142-171, below.
\textsuperscript{344} See \textit{supra} note 712.
\textsuperscript{346} [1956] 2 Lloyd’s Rep. 240 at 249, citing E.J. Macgillivray & Dnis Browne, \textit{Macgillivray on Insurance Law}, 3\textsuperscript{rd} ed. (London: Sweet & Maxwell, 1947) at 503. See also the U.S.A. position that “by issuing the policy without requiring an answer to the question the company waived answer to the inquiry and elected to treat it as immaterial.” \textit{Bowles v. Mutual Benefit Health \\& Accident}, 99 F. 2d. 44 (4 Cir, 1938).
But this rule should be excluded when the insured conceals the truth intentionally.

Another example showing the difficulty arising from the want of the rule of waiver is the group insurance category: the insurer makes contract with the insured through an intermediary institution, such as a school or a ferry company. In such insurance, the insurer usually does not ask the circumstances of the particular insured and it is also difficult for the insured to communicate any material circumstance to the insurer. In non-marine group insurance, the insured can defend for his non-disclosure on ground of the doctrine of inquiry-disclosure. Nevertheless, in marine insurance, such as marine passenger life insurance, the insured will find himself in trouble because the Maritime Code provides that he should voluntarily disclose. In the author’s opinion, group insurance is a kind of consumer insurance in which the insurer has sacrificed the accuracy of the character of each individual insured in consideration of more efficient making of the contract and larger amount of market share. In this sense, the insurer could be regarded to have waived his right in regard to disclosure.

The proposed judicial interpretation has partly covered the issue of waiver. It stipulates that “after the contract has been concluded, if the applicant or the insured performs the duty of disclosure, and if the insurer has no objection, the insurer is not entitled to terminate the contract therewith.” The wording of this stipulation is a bit unclear, it seems that the true meaning is that after the contract has been concluded, if the insured makes complementary disclosure and if the

347 For the meaning of “inquiry-disclosure”, see 68, above.
348 It probably could be argued that, in group insurance, the insurer classifies the kind of the insured by identifying the intermediary organizations (the ferry operators, for example) and the marine peril are generally more associated with the intermediary organization than the individual insured. For example, in the passenger group insurance, whether the ferry operator is reliable is more important than the personality of the individual passenger. Therefore, the disclosure made by the individual insured are much less important and it generally cannot be said to have induced the insurer’s decision.
349 Article 9(3) of The Interpretation of the People’s Supreme Court’s on Several Questions of the Inquisition of Insurance Dispute Cases (Draft for Consultation), online: Law-Lib.com <http://www.law-lib.com/law/lfbj/lfbj_view.asp?id=10276>.
insurer has no objection at the time of complementary disclosure, the insurer cannot terminate the contract for this non-disclosure.

In addition, article 46 of this interpretation provides that where the insured has performed physical examination at the pointed hospital as requested by the insurer, if the insurer knows that the result of the physical examination of the insured is not consistent with the disclosure, or if the hospital fails to communicate the result of the physical examination to the insurer, the insurer cannot terminate the contract on ground of non-disclosure unless the matter undisclosed is not the subject of the examination.\(^{350}\)

iv. Warranty

*The Maritime Code* does not provide that it is unnecessary for the insured to disclose the matters of a warranty, but it actually does not matter too much because the insurer will either decline the claim for the breach of the warranty, which is much easier to be proved than the breach of the duty of disclosure, or the court will find the matter unimportant due to the existence of the warranty.

v. Previous Conviction

No law in China provides that any precious conviction can be concealed by the insured from the insurer. In fact, few have noticed the need to establish such a rule to protect those with a previous conviction so that it would be easier for them to be re-accepted by the society. However, it is not the task of the insurance law so I will not discuss the issue in detail.

\(^{350}\) See article 46 (physical examination and disclosure) of *The Interpretation of the People’s Supreme Court’s on Several Questions of the Inquisition of Insurance Dispute Cases (Draft for Consultation)*, ibid.
Chapter 4. The Insured’s Duty of Disclosure: Materiality

I. Common Law Materiality

1. Introduction to the Common Law Position

It is not all the facts the insured knows or ought to know that should be disclosed. The duty of disclosure only extends to those “material” circumstances. The requirement for materiality is set up in section 18(2) of the Marine Insurance Act 1906 (U.K.) as

“Every circumstance is material which would influence the judgement of a prudent insurer in fixing the premium or determining whether he will take the risk.”

Two issues are involved in the criterion of materiality, namely, to whom the non-disclosure or misrepresentation is material and what the “influence” means. The rule adopted in U.K. is called “a prudent insurer test”.\(^\text{351}\) This test, together with the interpretation of “influence”, which is called “the want to know test”,\(^\text{352}\) has been strongly criticized.\(^\text{353}\) The Australian law has adopted other tests of materiality, “a prudent insured test”.\(^\text{354}\) In China, it is unanimous agreed that the words stipulated in the Maritime Code mean “decisive influence”,\(^\text{355}\) but it is not clear whether the “insurer” means a prudent insurer or the particular insurer.\(^\text{356}\)

2. The Test of Materiality

\(^\text{351}\) “A prudent insurer test” means that a fact is material if it would influence the mind of a prudent insurer. Discussed in more detail at page 85ff., below.
\(^\text{352}\) Under the law of U.K., the non-disclosure has influenced a prudent insurer if the prudent insurer would want to know the relevant information. Discussed in more detail at page 89ff., below.
\(^\text{353}\) See supra note 24.
\(^\text{354}\) Discussed in more detail at page 99ff., below.
\(^\text{355}\) Discussed in more detail at page 94, below.
\(^\text{356}\) Discussed in more detail at page 94ff., below.
i. **Four Choices for the Test of Materiality**

No doubt, only the material circumstance should be disclosed, but in whose eye should the
circumstance be material? There could be four possible choices for the test of materiality,\(^{357}\) that is, the particular insured test, the particular insurer test, a prudent (or reasonable) insured test and a prudent insurer test. The first test, the particular insured test, which considers the actual opinion of the particular insured as the decisive yardstick for determining materiality, can be set aside for its obvious unfairness and bias to the insured.\(^{358}\) The second test, the particular insurer test, which means that a circumstance is material if the particular insurer regards it material, is also a subjective test. The particular insurer test would coincide with the requirement of actual inducement if the test for influence would be the decisive one.\(^{359}\) It should be applied combined with a prudent insurer test.\(^{360}\)

The third test, “a prudent insurer”, is the current law of the U.K.,\(^{361}\) and the fourth, “a prudent insured test”, is the most favourite test advocated in Australia by the legal reformers as a substitute for the current marine insurance law and it has been adopted in Australian general insurance law.\(^{362}\)

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\(^{358}\) *Lindenau v. Desborough* (1828) 8 B. & C. 586 at 592, where Bayley J. said that “The proper question is ‘whether any particular circumstance was in fact material?’ and not whether the party believed it to be so. The contrary doctrine would lead to frequent suppression of information, and it would often be extremely difficult to show that the party neglecting to give the information thought it material.” *Bates v. Hewitt* (1867) L.R. 2 Q.B. 595 at 608, where Mellor J. said that “… to enable a person proposing an insurance to speculate upon the maximum or minimum of information he is bound to communicate, would be introducing a most dangerous principle into the law of insurance.” Semin Park, *the Duty of Disclosure in Insurance Contract Law* (Brookfield, Vt.: Dartmouth Pub. Co., 1996) at 73-74. In *the Insurance Contract Act 1984 (Australia)*, the particular insured test is adopted combined with a reasonable insured test; see page 87, below.

\(^{359}\) See page 105ff., below.

\(^{360}\) See page 105, below.

\(^{361}\) See *infra* note 363.

\(^{362}\) Discussed in more detail at page 87, below.
ii. A Prudent Insurer Test

The current law of the U.K. takes the view that it is in the eyes of a prudent insurer, not the particular insurer, that the fact in question should be material. According to Lord Radcliffe, the prudent insurer is no more than the anthropomorphic conception of the standard of professional underwriting which the court found appropriate to uphold. The materiality is also connected to the class and character of the transaction contemplated, as the insurer of one kind of risk may be influenced by a particular circumstance that would not influence those underwriting other kinds of risk. It seems to be appropriate that some words such as “in that type of insurance” should be added after the term of “a prudent insurer” in s. 18(2) of the M.I.A. 1906.

It is the duty of the insurer to prove the materiality of a particular fact. The evidence from other independent experts who represent the prudent insurer as to the opinion on the question is admissible to prove materiality of a non-disclosure and is needed to help the judge discover the standards and practice of the notional prudent insurer. The expert evidence is not binding on the

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365 Scrutton L.J. showed an example, in Glicksman v. Lancashire and General Assurance Co. [1925] 2 K.B. 593 at 608, that in marine insurance the fact that another underwriter had rejected the risk was immaterial, whereas this was certainly material in non-marine insurance.


Consequently, the court will decide the question of materiality, considering all the relevant factors such as judges’ experience, common sense, whether the insurer asked the insured some relevant questions and the expert evidence. Consequently, the court will decide the question of materiality, considering all the relevant factors such as judges’ experience, common sense, whether the insurer asked the insured some relevant questions and the expert evidence.

iii. A Reasonable Insured Test

(a) The Reform in U.K.

A prudent insurer test has been criticized for a long time throughout common law countries. The most favoured substitutive test is “a reasonable insured test”, the basic idea of which is that the materiality of a fact is what a reasonable insured, that is, what a reasonable man in the position of an insured, would consider it material to the risk proposed to be covered. This test was discussed in full-scale by Fletcher Moulton L.J. in Joel v. Law Union and Crown Insurance Company and it was recommended by the Law Reform Committee (U.K.) in its Fifth Report. The committee concluded that “for the purpose of any contract of insurance no fact should be deemed as material unless it would have been considered material by a reasonable insured”. In 1980, the Law Commission considered that the present law of non-disclosure was unjust so that reform was needed. The Law Commission proposed a reasonable insured test in addition to a prudent insurer test.

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372 [1908] 2 K.B. 863 at 884.
374 Ibid at para. 14(1).
It was suggested that a prudent insurer test should still be the law, but its application should be limited according to a reasonable insured test. Under this suggestion, an insured is still obliged to disclose any circumstance that is material to a prudent insurer, but he is not obliged to do so if that circumstance will not be disclosed by a reasonable man in his position.376

Under the influence of these reports, reform took place in the Statement of General Insurance Practice 1986 and the Statement of Long-Term Insurance Practice 1986.377 These self-regulations provided that an insurer is not allowed to repudiate his liability on grounds of non-disclosure of material fact, which the insured could not reasonably be expected to disclose.378 However, these self-regulations are not law; they are only of value when those reputable underwriters choose to follow them.

(b) The Australian Reform

In Australia, a prudent insurer test, which had been the majority of the authorities, was abolished as a result of the new Insurance Contracts Act 1984 (Commonwealth). Section 21(1) of this act adopts a reasonable insured test in combination with a particular insured test, stating that:

“Subject to this Act, an insured has a duty to disclose to the insurer before the relevant contract of insurance is entered into, every matter that is known to the insured, being a matter that – (a) the insured knows to be a matter relevant to the decision of the insurer

376 Ibid.
377 See supra note 236.
378 Clause 2(b) of the Statement of General Insurance Practice 1986 and clause 3 (a) of the Statement of Long-Term Insurance Practice 1986.
whether to accept the risk and, if so, on what terms; or (b) a reasonable person in the circumstances could be expected to know to be a matter so relevant…”

The Marine Insurance Act 1909 (Commonwealth) is now under review, and the Australian Law Reform Commission also suggested that section 24(1) and 26(1) should be amended to provide that “an insured must disclose accurately all circumstances that it know, or a reasonable person in its position would know, to be material.”

iv. Reasons for Adopting a Reasonable Insured Test

The adoption of a reasonable insured test is spurred by the defaults of a prudent insurer test, which has been criticised mainly from the following aspects. First, the insured, even acting as a reasonable man with reasonable care, may fail in his duty of disclosure, because it is unrealistic and unfair to expect an insured to figure out what a prudent insurer would regard material.

Second, the particular insurer may not always act as carefully as the notional prudent insurer, and he may not care what a prudent insurer would care. Then why is the insured obliged to disclose

381 Anthony Diamond QC has observed: “Suppose that you or I, as reasonable prospective assureds, were to go in search of the prudent insurer. He is to be found, if anywhere at all, in the room at Lloyd’s. so let us suppose that you or I were to go to lime street… to interrogate the working underwriters, or least those of them that write marine business and are thus subject to the act of 1906. What would we find if we bean to ask a few questions? Surely we would find a few prudent underwriters. But also, in all probability, even in that ancient institution, we would find some who are not prudent at all. And even the great majority who are without question prudent underwriters, would tell us, if we persisted in our questioning, that there are occasions when they simply cannot afford to be prudent. For example, one might say that he cannot afford not to write a fixed lime on every risk presented by a certain broker; otherwise he would never see that broker again. Or another might tell us that he has on occasion to write ‘loss’ leaders’ knowing that the business will be unprofitable and in the hope of getting an entree into a particular line of business in the future.” A Diamond, “The Law of Marine Insurance: Has It a Future?” (1986) L.M.C.L.Q. 25 at 30-1. See also Australian Law Reform Commission, Review of the Marine Insurance Act 1909, ALRC Report No. 91
what the particular insurer does not need? Third, the insurer has “an unfair advantage in relation to the practice of expert evidence”, which is more easily tailored to the needs of the insurer’s defence. In comparison, a reasonable insured test is more reasonable in the regard and does not have these problems.

As suggested by the Law Reform Committee, the test of a reasonable insured will not bring any practical difficulty. The test is substantially a reasonable man test that has already been acquainted by the judges. In addition, if the test of a reasonable insured were accepted, the costly procedure of the expert evidence would be unnecessary and the unbalance in the capability of accessing to evidence would no longer exist.

Although there may be more than enough reasons for the U.K. to change her rigid position of the test of a prudent insurer, whether such a change is suitable to China will be discussed later.

3. **Degree of Influence**

i. **Decisive Test v. “Want to Know Test”**

According to the test of a prudent insurer, a fact is material if it would influence a prudent insurer’s decision on whether to take on the risk or what amount of premium he would

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See page 95ff., below.
There could be two explanations for the degree of influence in the test of materiality. One is called “the decisive influence”. The law of U.S.A. and Australia upholds this interpretation. It is held in most jurisdictions of U.S.A. that the word of “influence” means that had the prudent insurer possessed the undisclosed fact he would have accepted the risk with different terms, in particular with a different premium, from those that he had originally accepted. The Insurance Contract Act 1984 (Australia) also provides that the remedies do not apply “where the insurer would have entered into the contract, for the same premium and on the same terms and conditions, even if the insured had not failed to comply with the duty of disclosure or had not made the misrepresentation before the contract was entered into”. Similar sections have been suggested to substitute the relevant provisions of the Marine Insurance Act 1909 (Commonwealth).

The current law of the U.K. upholds another explanation that a fact is material as far as a prudent insurer would want to know it as a factor in assessing the risks; he is not necessary bound to have declined to assume the risk or increased the premium had he known the facts undisclosed or

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386 Poh Chu Chai, Principles of Insurance Law, 5th ed. (Singapore: Butterworths, 2000) at 123.
387 Clarke alleges that there could be four types of “influence”. Type A is information such that, if the insurer had known it, he would have refused to make the contract at all. Type B is information such that, if the insurer had known of it, he would have made a contract but only on different terms, especially as to premium. Type C is information which would have “affected” the insurer’s judgement in the sense, together with other information, it might have been sufficient to lead to different contract terms, but, considered alone in the particular case, it would have made no difference to the contract or its terms. Type D can be located between type B and C. see Malcolm A. Clarke, The Law of Insurance Contracts, 4th ed. (London: LLP, 2002) at para. 23-7A. Type A and B can both be called the decisive influence test, and type C and D can be regarded as indecisive (the want to know test).
389 Section 28(1) of the Insurance Contracts Act (Australian).
misrepresented. For the convenience of writing, Lord Mustill’s words are used to call the test “the want to know test”.

ii. From the C.T.I. Case to the Pan Atlantic Case

The two interpretations of “influence” were discussed in full scale in a series of recent cases. The first case is the C.T.I. case, where Kerr L.J., who delivered the main judgement, expressed his view of supporting the want to know test. Ten years later, in the Pan Atlantic case, the House of Lords got the chance to review the decision of the C.T.I. case. Lord Mustill, whose decision was the bare majority of three to two, said:

“…the duty of disclosure extended to all matters which would have been taken into account by the underwriter when assessing the risk (i.e. the speculation) which he was consenting to assume. This is in my opinion what the Act was intending to convey and what it actually says.”

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391 See the decisions of the C.T.I. case and the Pan Atlantic case below.
394 Kerr L.J. made a semantic analysis on two words of section 18 of the Marine Insurance Act 1906 (U.K.). He observed, in the C.T.I. case, at 492, “The word ‘judgement’ – to quote the Oxford English Dictionary to which we were referred - is used in the sense of ‘the formation of an opinion’. To prove the materiality of an undisclosed circumstance, the insurer must satisfy the Court on a balance of probability - by evidence or from the nature of the undisclosed circumstance itself - that the judgment, in this sense, of a prudent insurer would have been influenced if the circumstance in question had been disclosed. The word ‘influenced’ means that the disclosure is one which would have had an impact on the formation of his opinion and on his decision-making process in relation to the matters covered by s. 18 (2).”
396 Ibid at 445. Lord Goff of Chieveley concurred with Lord Mustill, saying that “it seems to me, as it does to Lord Mustill, that the words in s. 18(2) … denote no more than an effect on the mind of the insurer in weighing up the risk. The sub-section does not require that the circumstance in question should have a decisive influence on the judgment of the insurer; and I, for my part, can see no basis for reading this requirement into the sub-section.” Lord Slynn of Hadley agreed with Lord Mustill on that “the ‘decisive influence’ test is to be rejected and that a circumstance may be material for the purposes of an insurance contract (whether marine or non-marine) even though had it been fully and accurately disclosed it would not
In reaching his conclusion, besides an analysis on the meaning of section 18 of the Marine Insurance Act 1906 (U.K.), Lord Mustill also observed that the decisive influence test might cause practical difficulties.

“I am bound to say that in all but the most obvious cases the ‘decisive influence’ test faces them with an almost impossible task. How can they tell whether the proper disclosure would turn the scale? By contrast, if all that they have to consider is whether the materials are such that a prudent underwriter would take them into account, the test is perfectly workable.”

Moreover, according to Lord Mustill, considering together with the additional requirement of actual inducement which he regarded as the second question in his judgement, the want to know test may not cause the unfair situation where the insurer is able to get rid of a bad bargain on the technical defence of non-disclosure although he in fact had not care about the undisclosed circumstance at all. The effect of the additional requirement of inducement, however, largely depends on the application of the presumption of inducement.

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397 The legislature might here have said ‘decisively influence’... or all sorts of similar expressions, in which case Pan Atlantic’s argument would be right. But the legislature has not done this, and has instead left the word ‘influence’ unadorned... Furthermore... it should be observed that the expression used is ‘influence the judgement of the underwriter in... determining whether he will take the risk.’ to my mind, this expression clearly denotes an effect on the thought processed of the insurer in weighting up the risk, quite different from the words... such as ‘influence the insurer... to take the risk’. Pan Atlantic Ins. Co. v. Pine Top Ins. Co. [1994] 2 Lloyd’s Rep. 427 at 440, per Lord Mustill.

398 Ibid., at 441.

399 Ibid.

400 Because the House of Lords had set so low a standard of the test of materiality, it was easy for the insurer to prove the materiality. If the presumption of inducement from the proved materiality is easily applied, the burden would be shifted to the insured to prove that the particular insurer had not been induced, even though the insurer may have nothing to prove the inducement. See Semin Park, The Duty of Disclosure in Insurance Contract Law (Brookfield, Vt.: Dartmouth Pub. Co., 1996) at 156. As for presumption of actual inducement, see page 102ff., below.
iii. The Minority View in the Pan Atlantic Case

Both Lord Templeman and Lord Lloyd of Berwick supported the decisive test. In Lord Templeman’s opinion, “the judgment of a prudent insurer’ cannot be said to be ‘influenced’ by a circumstance which, if disclosed, would not have affected acceptance of the risk or the amount of the premium.”

Lord Lloyd of Berwick particularly reasoned why the decisive influence should be adopted.

According to Lord Lloyd of Berwick, the reason why the insurer may avoid the contract even where the insured innocently breaches the duty is said by Lord Mansfield that “the risqué run is really different from the risqué understood and intended to be run at the time of the agreement.”

“But if the prudent insurer would have accepted the risk at the same premium and on the same terms, it must be because, so far as he is concerned, the risk is the same risk.” Then how could the rejection of the decisive test be justified? “How in those circumstances could it be said that the actual insurer’s consent had been vitiated? And if not, on what other juristic basis could he claim the right to avoid the contract?”

Therefore, Lord Lloyd of Berwick described what the test should be as following:

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404 Ibid. Lord Lloyd of Berwick also relied on semantic analysis of the word “would”. He observed, “L.J. Kerr in a passage already quoted refers to things which the insurer might have done if he had been told of the undisclosed fact. In my judgment it is never enough to show that a prudent insurer might have declined the risk or charged an increased premium. It is necessary to show that he would have done.” See Ibid, 459.
“What… is meant by the words ‘would influence the judgment of a prudent insurer’? ... I would answer that it points to something more than what the prudent insurer would want to know, or take into account. At the very least it points to what the prudent insurer would perceive as increasing, or tending to increase the risk…The ordinary meaning of ‘influence’ is to affect or alter.”

The minority view of Lord Templeman and Lord Lloyd of Berwick supports that the Chinese law should adopt the decisive influence test in interpreting the relevant articles of law.

II. Materiality in China’s Marine Insurance

1. Test of Materiality

i. A Prudent Insurer v. the Individual Insurer

*The Maritime Code* also requires that the non-disclosure must be material before the insurer can cancel the policy. It may sound strange, but one has to regret that the verbal meaning of article 222 of *the Maritime Code* seems to have adopted the particular insurer test since article 222 leave the word “insurer” unadorned, saying that the insured shall disclose “the material circumstances… which have a bearing on the insurer in deciding the premium or whether he agrees to insure or not.” It is possible for the judges to read in the word “prudent” before the word “insurer” in

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405 Ibid, at 458.
406 Discussed in more detail at page 99ff., below.
408 The same problem exists in non-marine insurance in China, as article 17 of *the Insurance Law* also uses “the insurer” and no word of “prudent” or “reasonable” is added. See page 99ff., below.
article 222. Many scholars have supported this view.\textsuperscript{409} It goes without saying that, between the particular insurer test and a prudent insurer test, the \textit{Maritime Code} should choose the latter, which is the standing law of U.K.,\textsuperscript{410} but as to how the law should be changed on this point, one must also consider the requirement of actual inducement.\textsuperscript{411}

ii. Whether to Adopt a Reasonable Insured Test in the \textit{Maritime Code}?

Until now the voice of adopting the Australian model\textsuperscript{412} of test of a reasonable insured has not come up in China either in judicial or academic groups but it is still necessary to ask whether the \textit{Maritime Code} should transfer to a reasonable insured test. Though it may be urgent for the U.K. to abolish the test of a prudent insurer for the reasons listed above, those reasons cannot justify the necessity of China in changing the test.

The test of a prudent insurer is mainly criticized for its extreme harshness towards the insured in the U.K., while in China, if a prudent insurer test were to be adopted as suggested above, its application would not be too unfavourable to the insured as a result of other rules in the \textit{Maritime Code} which have moderated the strictness of the duty of disclosure. For example, the suggestion to adopt the decisive influence test will narrow the scope of the insured’s duty of disclosure,\textsuperscript{413} and


\textsuperscript{410} As for the law of U.K. on this issue, see page 85, above.

\textsuperscript{411} The author suggest to combining the concept of materiality and the inducement under Chinese law. See the author’s opinion on how to change the law on this point at page 105ff., below.

\textsuperscript{412} See page 87, above.

\textsuperscript{413} Discussed in more detail at page 99ff., below.
the causation requirement has further increased the difficulty for the insurer to completely get rid of his liability of indemnity.\textsuperscript{414}

The necessity for the U.K. to change the test of the prudent insurer is also partly influenced by the universal application of the test in non-marine insurance. It appears that the consumer insured need the protection from a reasonable insured test. On the contrary, the non-marine insured, including those consumers, are already protected by the inquiry-disclosure doctrine. The maritime merchant should be more aware of what is material to the insurer than those consumer insured during long time of exposure to the business and with the help of legal professionals.\textsuperscript{415}

In addition, the rule of expert evidence is also very different from that in the U.K.\textsuperscript{416} The unbalance in access to expert evidence between the insurer and the insured may not exist in China since “expert evidence” is not evidence at all.\textsuperscript{417} Moreover, the marine insured and the insurer may have a nip and tuck power in engaging experts.

iii. Expert Evidence

\textsuperscript{414} Discussed in more detail at page 129ff., below.
\textsuperscript{415} It gradually becomes a common practice, in most places of China, for the businessmen to consult the legal professionals, or hiring staff with legal training, in dealing with his business related to insurance, while it has not become a practice for ordinary people to do so.
\textsuperscript{416} Article 61 of the Evidence Rules of Civil Action by the Supreme People’s Court, Fa Shi [2001] No. 33, stipulates that: “The party may apply to the People’s Court for the explanations of certain special problem by one or two persons with special knowledge appearing in court. If the People’s Court permits the application, the relevant costs shall be borne by the applicant party. The judicial personnel and the parties may inquire of the persons with special knowledge who appear in court. With the permission of the People’s Court, the persons with special knowledge respectively applied by each party may do counterview on the relevant problems in the case. The person with special knowledge may inquire of the authenticator.” Discussed in more detail below.
\textsuperscript{417} In the Evidence Rules of Civil Action by the Supreme People’s Court, Fa Shi [2001] No. 33, the so called expert evidence is not regarded as evidence. In article 61 of the Evidence Rules, \textit{ibid}, such experts are called “persons with specialised knowledge” and their task is to “make explanations for specialised problems”. Since they are not evidence, the decision cannot rely on it; however, a well guided expert “explanation” will surely have an impact on the judge’s reasoning process.
The expert evidence, which was unknown a decade ago, has now become more and more popular in China in the judicial practice, although it is not admitted as evidence. The insurer more and more often resorts to the expert evidence to support the materiality of the facts in his defence of the non-disclosure. However, due to different litigation rules, most of the time, the expert is not summoned to the court for cross-examination and the evidence is only a written record of the opinion of the expert. Moreover, as the expert who gives evidence in support of the insurer is engaged by one of the parties, more often the insurer, the impartiality of the expert evidence is always in question. Therefore, the judges are in fact quite reluctant to accept the expert evidence as conclusive and prefer to rely on their own experience.

In a case appealed from the Maritime Court to the High People’s Court of Shandong Province, the appellant insured submitted the written opinion of the China Maritime Law Association on three questions. None of the opinions was considered by the High People’s Court and the decision was totally opposed to the opinions. Although this is a case in which the expert evidence is filed by the insured, it to some extent shows how the court in China treats the expert evidence.

2. Examples of Material Circumstances

It has been held that a ship for the purpose of disassembly, the cargo on deck, or the cargo that is on a barge tugged by another ship are circumstances material to the decision of the

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418 Ibid.
419 The evidence law is still being drafted. It is expected that the evidence law will change the situations and compulsorily requires cross-reference.
421 China Maritime Law Association, China’s official academic research association of maritime law.
insurer on the premium or whether to accept the risk. In another case, it was held that the mere misrepresentation of the series numbers of two contracts among a series of contracts was not material to evaluation of the risk.\footnote{In \textit{Chenco International Inc. v. China Pacific Insurance, Shanghai Branch},\footnote{[1997] Hu Hai Fa Shang Zi, No. 486, online: China Foreign-Related Commercial and Maritime Trial <http://www.ccmt.org.cn/hs/writ/judgementDetial.php?sId=433>.} the judge even gave a test for his judging of the materiality, saying that “it should be held that, although \textit{the Maritime Code} does not provide a clear definition for materiality, any circumstance showing the increase of the risk must be regarded as a material circumstance”\footnote{This is a similar approach to the Court of Appeal in \textit{Pan Atlantic Insurance Co. Ltd. and Another v. Pine Top Insurance Co.} [1993] 1 Lloyd’s Rep. 496 at 506, where Steyn, L.J. held that “the question is whether the prudent insurer would view the undisclosed material as probably tending to increase the risk.”}. However, one need always remember that China is not a case law country and future decisions are never bound by these given cases. These judgments at most provide some guidance for future reference.

It is suggested that the insurance application form should be more carefully designed. In China, the insurance companies’ usually use very simple application forms on which there is no guidance on what kind of circumstances will be regarded as material. It would greatly help the insured to accurately perform his duty of disclosure if the insurer could print the examples of the material circumstances on the blank back of application forms.\footnote{In making a list of the categories of the material circumstances, the English scholar’s summary may be a good reference. For example, Ivamy said, “in general, it can be said that the following classes of facts will usually be held to be material: (a) All facts suggesting that the subject matter of insurance, by reasons of its nature, condition, user, surroundings, or other circumstances, is exposed to more than ordinary danger from the peril insured against. (b) All facts suggesting that the proposed assured, in effecting the insurance, is actuated by some special motive, and not merely by ordinary prudence. (For example in marine insurance, a ship for disassembly use is of higher risk than normal.). (c) All facts suggesting showing that the liability of

3. **Degree of Influence**

Article 222 of the *Maritime Code* stipulates that the material circumstances mean the circumstances “which have a bearing on the insurer in deciding the premium or whether he agrees to sure or not”. “Have a bearing”, according to the maritime law scholars, means decisive influence.\(^{429}\) The courts are also inclined to accept the decisive influence test.\(^{430}\)

There is another problem in the test of influence in the *Maritime Code*: the material circumstances only mean the circumstances “which have a bearing on the insurer in deciding the premium or whether he agrees to sure or not”.\(^{431}\) The insurer should be also able to decline the claim when the undisclosed facts are such that had the insurer known he would still underwrite the policy with the same premium but with different terms because sometimes the changing of some other terms may be even more fundamental to the risk covered than the premium.

### III. Materiality in China’s Non-Marine Insurance

the insurers might be greater than would normally be. (d) All facts related to the “moral hazard”, such as the previous criminal record of the assured. (e) All facts that to the knowledge of the proposed assured are regarded by the insurers as material. In practice, the materiality of such facts is usually shown by the asking of a specific question. Hardy Ivamy, *General Principles of Insurance Law*, 6\(^{th}\) ed. (London: Butterworths, 1993) at 131-136. The previous refusals of similar type of insurance are material information that must be disclosed in non-marine insurance, but it is not so in marine insurance. See Poh Chu Chai, *Principles of Insurance Law*, 5\(^{th}\) ed. (Singapore: Butterworths, 2000) at 174-177.


\(^{430}\) See *Chenco International Inc. v. China Pacific Insurance, Shanghai Branch*, [1997] Hu Hai Fa Shang Zi, No. 486, online: China Foreign-Related Commercial and Maritime Trial <http://www.CCMT.org.cn/HS/writ/judgementDetial.php?slId=433>. The Court decided that “any circumstance showing the increase of the risk must be regarded as a material circumstance”. This is akin to the decisive influence test because the circumstances showing the increase of the risk would certainly make a prudent insurer change the terms of the contract more burdensome to the insured.

\(^{431}\) The common law also has this problem.
Materiality is unimportant where the insured has breached the duty of disclosure fraudulently, because the insurer can nevertheless avoid the contract where the fact undisclosed is immaterial.\textsuperscript{432} Materiality is only concerned with circumstances where the insured breaches the duty due to his negligence. Article 17(2) of the Insurance Law\textsuperscript{433} stipulates that if the insured has breached the duty of disclosure due to his negligence, the insurer is entitled to terminate the contract only when the non-disclosure “is sufficient to affect the insurer in deciding whether or not to agree to the insurance or to raise the insurance premium rate.” Like the words in article 222 of the Maritime Code, the word “insurer” here is again left unadorned so the verbal meaning of the test of materiality is the particular insurer test. It should be interpreted as a prudent insurer test.

According to article 17(2),\textsuperscript{434} the test of influence must be the decisive influence test when the insured has breached the duty of disclosure due to his negligence because “sufficient to affect” apparently means that the non-disclosure must affect the insurer to make a different decision at least as to what premium he would have charged.

Materiality in non-marine insurance is a less important question than in marine insurance due to the application of the inquiry-disclosure doctrine. Generally speaking, the questions asked by the insurer are usually relevant to material information and the insured should make truthful answers. Additionally, the questions listed in the non-marine insurance application forms are much more carefully designed than those in the marine ones.

\textsuperscript{432} Article 17(2) of the Insurance Law: “The insurer shall have the right to terminate the insurance, if the applicant intentionally conceals the facts and does not perform his duty of truthful disclosure, or if the insured negligently fails to make disclosure thereby which is sufficient to affect the insurer’s decision on whether or not to provide the insurance or whether to increase the premium rate.” While in marine insurance, even the insured intentionally breaches the duty of disclosure, the circumstances he conceals or misrepresents must be material before the insurer can terminate the contract.

\textsuperscript{433} Ibid.

\textsuperscript{434} Ibid.
Chapter 5. Additional Requirement of Actual Inducement

I. The Requirement of Actual Inducement in U.K.

1. The Pan Atlantic Case

In the Pan Atlantic case, it was eagerly anticipated that the House of Lords would have overruled the decision of the C.T.I. case and abolished the want to know test, but the House of Lords did not uphold it. They, however, introduced a requirement additional to materiality before the insurer could rescind policy, namely, the requirement of actual inducement. Consequently, in order to succeed in the defence of non-disclosure, the insurer has to prove that he was actually induced by the misrepresentation or the non-disclosure “using ‘induced’ in the sense in which it is used in the general law of contract”. Lord Mustill concluded that:

“If the misrepresentation or non-disclosure of a material fact did not in fact induce the making of the contract (in the sense in which that expression is used in the general law of misrepresentation) the underwriter is not entitled to rely on it as a ground for avoiding the contract.”

Under the general law, “if the false statement of fact actually influenced the [representee], the [representor is] liable, even though the [representee] may have been also influenced by other

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436 Thus, the law significantly shifts in favour of the insureds. See Poh Chu Chai, Principles of Insurance Law, 5th ed. (Singapore: Butterworths, 2000) at 120.
438 Ibid, at 453.
motives. In this sense, inducement must decisively influence the insurer’s mind although it not necessary to be the sole causation. According to Lord Mustill, this decisive meaning of inducement under the general law should be equally applied in the insurance law. This position has been supported by earlier cases.

2. The Effect of the Pan Atlantic Case

The decision of the want to know test in the C.T.I. case has made it too easy for the insurer to prove the materiality of something undisclosed. The additional requirement of actual inducement made in the Pan Atlantic case has in certain degree restored the decisive influence rule although without altering the position of the C.T.I. case. Lord Mustill considered materiality and actual inducement as two different questions. As a result, there is a double check for the insurer to avoid the contract: in order to avoid the contract the insurer has to prove that the information undisclosed not only has influenced the prudent insurer, although not necessarily changed his mind, but also decisively influenced the actual insurer.

The additional requirement of actual inducement has, to some extent, protected the insured from unduly taken advantage of by the insurer when the insurer misuses the right to avoid the contract with the technical defence of non-disclosure. The extent, to which the insured is to be protected, however, depends largely on the application of the presumption of inducement.

3. Presumption of Actual Inducement

Edgington v. Fitzmaurice (1884) 29 Ch.D. 459 at 485, per Fry L.J. See also e.g. JEB Fasteners v. Marks, Bloom & Co. [1983] 1 All E.R. 583.

Decorum Investments v. Atkin [2001] 2 Lloyd’s Rep. 378 at 382, where David Steel J., with reference to the Pan Atlantic case, said that: “if a fair presentation of the circumstances material to the risks has not been made and if the failure to do so has induced the actual insurer to enter into the particular contract when he would not otherwise have done so, at all or on the same terms, then the insurer is entitled to void the contract.”
Generally the onus is on the insurer to prove the actual inducement, but there is presumption that
the withheld facts being material may be sufficient for the court to apply the presumption of the
actual inducement, and thus, the onus shifts to the insured. This position was delivered by Lord
Mustill\textsuperscript{441} in apparently general words.\textsuperscript{442}

One year after the Pan Atlantic case,\textsuperscript{443} \textit{St. Paul Fire & Marine Insurance Co. v. McConnell
Dowell Constructors Ltd},\textsuperscript{444} a case appealed to the Court of Appeal, demonstrated how the
presumption of actual inducement was formulated and applied. In this case, three of the four
defendant underwriters had given evidence which sufficiently proved the actual inducement. The
forth, however, did not give evidence. He would not have been “entitled to avoid their contract
unless there is a presumption upon which they can rely to discharge the burden of proving
inducement which rests upon them”.\textsuperscript{445} By reference to \textit{Halsbury’s Laws of England},\textsuperscript{446} Evans L.J.
pointed out that:

“Inducement cannot be inferred in law from proved materiality, although there may be
cases where the materiality is so obvious as to justify an inference of fact that the

\textsuperscript{441} “As a matter of common sense however even where the underwriter is shown to have been careless in
other respects the assured will have an uphill task in persuading the court that the withholding or
misstatement of circumstances satisfying the test of materiality has made no difference… For present
purposes it is sufficient to say… that on the facts of this particular case the position as regards causation is
so clear that the appeal can be decided in favour of the indemnitors without the need for remittal to the trial
Mustill alone said this. Lord Goff concurred with other parts of Lord Mustill’s judgements but not
specifically with this. Lord Slynn did the same but in more general terms. See also Malcolm A. Clarke, \textit{The
\textsuperscript{442} L.J. Mance, \textit{et al.}, \textit{ed.}, \textit{Insurance Disputes}, 2\textsuperscript{nd} ed. (London: LLP, 2003) at para. 4.60.
\textsuperscript{445} \textit{Ibid} at 127.
\textsuperscript{446} 4\textsuperscript{th} ed., vol. 31 para. 1067.
representee was actually induced, but, even in such exceptional cases, the inference is only

*a prima facie* one and may be rebutted by counter evidence.”

Therefore, it can be concluded that, unless the materiality is so obvious that the actual insurer is very likely to be induced, the insurer cannot rely on the presumption of actual inducement.\(^{447}\)

Some more recent cases also confirmed this position.\(^{448}\) In *Assicurazioni Generali SpA v. Arab Insurance Group (BSC)*,\(^{449}\) Clarke L.J. further stated that

“In order to prove inducement the insurer or reinsurer must show that the non-disclosure or misrepresentation was an effective cause of his entering into the contract on the terms on which he did. He must therefore show at least that, but for the relevant non-disclosure or misrepresentation, he would not have entered into the contract on those terms. On the other hand, he does not have to show that it was the sole effective cause of his doing so.”\(^{450}\)

II. **Requirement of Inducement in China Law**

1. **Inducement in China’s Marine Insurance**

\(^{447}\) Indeed, it is noteworthy that the only situation to date in which the presumption of inducement has been successfully pleaded by an underwriter is that of a market subscription where the majority of the underwriters were able to give evidence of their state of mind but one was unable to do so. See “Warranties and the Full Reinsurance Clause”, Insurance Law Monthly, 16.1(1), January 2004.


\(^{450}\) *Ibid*, at 149. Sir Christopher Staughton agreed with Clarke L.J. on the point that “causation cannot in law exist when even the ‘but for’ test is not satisfied” See *ibid*, at 170. But Ward L.J. took the opposite view that “it is sufficient if the representation is a cause even if it is not the cause operating on the representee when he enters into the contract.” See *ibid*, at 175.
Actual Inducement Incorporated in the Materiality

In article 222 of the Maritime Code, it is stipulated that the test of materiality is the individual insurer test plus the decisive influence, so the test of materiality requires that the particular insurer has to show that he himself was decisively influenced by the non-disclosure, in the sense that but for the non-disclosure he, at least, would not have enter into the contract with the same terms. This has the same effect as the requirement of actual inducement. Therefore, the individual insurer test plus the decisive influence constitutes the requirement of actual inducement, and actual inducement is indeed what the materiality means in China’s marine insurance law.

The Double Check Interpretation

As criticised above, the problem in article 222 regarding the test of materiality is that the test is the particular insurer test. Some scholars have suggested reading in a word of “prudent” before the unadorned word of “insurer” in article 222. The problem is that if “the insurer” should be interpreted to mean a prudent insurer, then the requirement of actual inducement would be

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451 Article 222 of the Maritime Code: Before the contract is concluded, the insured shall truthfully inform the insurer of the material circumstances which the insured has knowledge of or ought to have knowledge of in his ordinary business practice and which have a bearing on the insurer in deciding the premium or whether be agrees to insure or not…

452 See page 94ff., above.

453 Although the law does not use the word “decisively influence”, it is the prevailing view that it should be so interpreted. See page 99ff., above.


455 See page 94, above.

eliminated. For this reason, if “the insurer” should be interpreted to mean a prudent insurer, a new subsection providing the requirement of inducement would simultaneously need to be added.

Alternatively, the unadorned word of “insurer” could be interpreted as having “double meanings”, i.e., “the insurer” in article 222 means that a circumstance is material if the particular insurer was induced to enter into the contract by the non-disclosure and a prudent insurer in his position would also be so induced. The author calls it the “double check interpretation”. Although the law of U.K. considers the materiality and the actual inducement as two separate issues, they can be combined into one rule, i.e., the double check interpretation. If the double check interpretation were adopted, the Maritime Code would not need a new subsection of actual inducement and the law would be neater. Moreover, there is procedure reason to adopt it. It is within the power of the People’s Supreme Court to interpret “the insurer” to have a “double check” meaning, while only the National People’s Congress or its Standing Committee has the power to add a new subsection of actual inducement into the Maritime Code. As the National People’s Congress and its Standing Committee have very short meeting period, it might be quite a long time before amendment of the Maritime Code could be listed in their working schedules. It is relatively convenient for the People’s Supreme Court to make a double check interpretation.

iii. Presumption of Inducement

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458 The National People’s Congress holds meeting once a year. The time of the meeting varied from 5 to 26 days and the average time is thirteen working days annually. Its Standing Committee has a bit more and longer meetings. It has meeting every two months and each meeting lasts for about 8 working days. The total working days of the Standing Committee are about 48 days. See Li Lin, “Li Fa Cheng Xu Fen Xi (Analysis on the Legislation Procedure)”, online: the Institute of China Law <http://www.iolaw.org.cn/showarticle.asp?id=527>. Because the National People’s Congress and its Standing Committee are the national highest authority it has lots of bills to pass every year, the short working time does not allow it to consider a “small” amendment in the Maritime Code.
Assuming that the Maritime Code adopts the double check test as suggested, we have to next consider the question how the presumption of actual inducement is to be applied. To begin with, it is only in a small number of certain circumstances where the general civil law stipulates presumption and the court is eligible to apply the presumption as stipulated. Most of the presumptions appear in the law of special tort. In the marine insurance, no law stipulates whether and how the presumption of actual inducement should be applied. Then the general law must apply. The onus to prove is imputed on the insurer due to the stipulation of article 5 of the Evidence Rules on Civil Action by the Supreme People’s Court.

Therefore, there is no presumption of actual inducement from proved materiality in the Chinese law. of course, the proved materiality, if obvious enough, could help persuade the court that the insurer is likely to have been actually induced. In addition, even without the presumption of actual inducement, the judge may also, in limited situations, deduce actual inducement from the nature of the misrepresentation, the grade of the importance of the fact undisclosed, the intention of the insured, his own experience, and other relevant circumstances.

2. Non-Marine Insurance

See e.g. articles 123 and 126 of the General Principles of the Civil Law 1986. In most cases of tort, the plaintiff has to prove the fault (intention or negligence) of the defendant who has done the tort, but in these two articles, the burden to prove whether the defendant has fault is reversed to the defendant. This is because the existence of the fault of the tort-doer has been presumed. In theory, the tort in the case of which the burden of proof is reversed is called “special tort”. (Article 123: “If any person causes damage to other people by engaging in operations that are greatly hazardous to the surroundings, such as operations conducted high aboveground, or those involving high pressure, high voltage, combustibles, explosives, highly toxic or radioactive substances or high-speed means of transport, he shall bear civil liability; however, if it can be proven that the damage was deliberately caused by the victim, he shall not bear civil liability.” Article 126: “If a building or any other installation or an object placed or hung on a structure collapses, detaches or drops down and causes damage to others, its owner or manager shall bear civil liability, unless he can prove himself not at fault.”)

Article 5 of the Evidence Rules on Civil Action by the Supreme People’s Court (Fa Shi [2001] No. 33): “In cases of contractual dispute… the party who alleges the modification, dissolution, termination or rescission of contracts should provide evidence of the existence of the facts that have caused the alteration of the contracts.”

Article 9 of the Evidence Rules on Civil Action by the Supreme People’s Court, Fa Shi, [2001] No. 33 stipulates that: “the party need no provide evidence for the following facts: …(3) facts that can be deduced from the law, known facts, or common sense… unless the party has sufficient counter evidence to overrule.”
Neither the materiality of the facts undisclosed nor actual inducement is required in establishing a successful defence of non-disclosure. This is the position stipulated by article 17 of the Insurance Law which does not mention any additional conditions other than the inquiry of the insurer. It is understandable that the Insurance Law does not require actual inducement since the inquiry of the insurer in most of the time is sufficient to speak for itself regarding the materiality and inducement of the non-disclosed facts. However, materiality is essential for the insurer to get remedy in negligent non-disclosure.\textsuperscript{462} As the word “insurer” in article 17(2) of the Insurance Law is also left unadorned like article 222 of the Maritime Code, the materiality in non-marine insurance should also be interpreted as “the double test” in the marine insurance to incorporate the requirement of actual inducement.

III. Summary of the Essentials in the Duty of Non-Disclosure

To summarise, in order to establish a defence that the insured has breach the duty of disclosure, the insurer has to satisfy the court of certain conditions.

In U.K., the essential conditions that constitute a successful defence of non-disclosure include: (1) that the insured knew, or ought to know in ordinary course of business, certain fact, before the conclusion of the insurance contract; (2) that the insured failed to disclose it or misrepresented it to the insurer; (3) that the fact was not a fact that need not to be disclosed; (4) that this fact was material, in the sense that a prudent insurer wants to know it in his deciding process of evaluating the perils; and (5) that the particular insurer was induced by the non-disclosure or misrepresentation.

\textsuperscript{462} See page 99, above.
Under China marine insurance law, the conditions are: (1) that the insured knew, or ought to know, certain fact, before the conclusion of the insurance contract; (2) that the insured failed to truthfully disclose it to the insurer; (3) that the fact was not a fact that need not to be disclosed; and (4) that the fact is material in the sense that it induced the particular insurer to enter into the contract. It is suggested that both the particular insurer and the notional prudent insurer must be induced before the particular insurer can rely on the non-disclosure.

In non-marine insurance in China, a breach of the duty of disclosure consists of: (1) that the insurer, before the insurance contract was concluded, inquired the insured about certain facts; (2) that the insured did not provide the true information or provided the incorrect information on the facts; (3) the insured had done so either deliberately or negligently; 463 and (4) that if the insured breached the duty negligently, non-disclosure must be decisively material in the same sense as it is in the marine insurance law.

These conditions seem not quite different especially between the English law and China’s marine insurance law, but there is hidden difference behind these conditions. In U.K., as far as these conditions are satisfied, the insured will be convinced to have breached the duty of disclosure and consequently the insurer will not be responsible for any loss or damage under the policy, while in China, in both marine and non-marine insurance law, the mere fact that the insured has breached the duty of disclosure only enable the insurer to terminate the policy. When a contract is terminated, the insurer is not automatically entitled to reject the claim rising before the termination. Whether the insurer can decline such claim depends on (1) the psychological state of the insured in which he has breach the duty of disclosure, and (2) the causal connection between the fact undisclosed and the occurrence of the risks. 464 The psychological state also determines whether the

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463 The definitions of deliberate and negligent will be discussed in next chapter.
464 Article 17 (3), 17(4) of the Insurance Law and article 223 of the Maritime Code.
premiums should be refund.\textsuperscript{465} The detailed discuss of the conditions on which the insurer may get different remedies is carried on in the next sub-chapter.

\textsuperscript{465} Article 17 (3), 17(4) of the \textit{Insurance Law} and article 223 of the \textit{Maritime Code}. 
Chapter 6. Remedy for the Breach of the Duty of Disclosure by the Insured

I. Remedy under the Law of U.K.

1. Rescission of the Contract

Rescission of the contract is the main, if not the sole remedy, for the breach of the duty of disclosure, and in most cases where the insurer seeks for remedy, rescission is an adequate and proper remedy. Many cases have decided that a failure on the part of the insured to observe the duty of disclosure renders the insurance contract avoidable at the option of the insurer. “The policy is equally liable to be avoided whether his failure is attributable to fraud, carelessness, inadvertence, indiﬀerence, mistake, error of judgement, or even to his failure to appreciate its materiality.” In breach of the duty of disclosure, the policy is not avoided automatically. The insurer may either elect to rescind the policy or conﬁrm it. The effect of rescission is “total retroactivity”, which means that rescission “terminates the contract, puts the parties in statu quo ante and restores things, as between them, to the position in which they stood

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470 Abbott v. Howard [1832] Hayes 381 (life insurance); cf Lee v. Jones (1864) 17 C.B.(N.S.) 482 (guarantee) per Shee J. at 495.
473 Elton v. Larkins (1832) 5 C. & P. 385 (marine insurance); Morrison v. Universal Marine Insurance Co. (1872) L.R. 8 Ex. 197, (marine insurance), where the broker had made inquiries and satisﬁed himself that the information did not relate to the ship in question, though, as a matter of fact, it did.
before the contract was entered into”. It follows that the insurer must return the premiums and he is not liable for claims arising before the moment of rescission; even if the insurer has paid the claim only after which he finds the breach of the duty of disclosure on the part of the insured, the insurer has the right to recover the compensation from the insured.

2. Limitation to the Rescission of the Contract

There are certain limitations to the rescission of the contract under the law of U.K. One of these limitations is the discretion of the court or the arbitrator to award damages in lieu of rescission under the Misrepresentation Act 1967, but it is only applicable to misrepresentation and usually the court is reluctant to do so. The others, according to Clarke, are affirmation, sometimes

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479 It was held in Highlands Insurance Co. v. Continental Insurance Co. [1987] 1 Lloyd’s Rep. 109 at 118 that the court would not consider applying damages in lieu of rescission under the Misrepresentation Act 1967 in commercial insurance. The reasons why the court was reluctant in awarding damage in lieu of rescission were given by Steyn J.

“The rules governing material misrepresentation fulfil an important ‘policing’ function in ensuring that the brokers make a fair representation to underwriters. If s. 2(2) were to be regarded as conferring a discretion to grant relief from avoidance on the grounds of material misrepresentation the efficacy of those rules will be eroded. This policy consideration must militate against granting relief under s. 2(2) from an avoidance on the grounds of material misrepresentation in the case of commercial contracts of insurance.”

The possibility of applying section 2(2) of the Misrepresentation Act 1967 in non-commercial insurance contract was not excluded by Steyn J., but the reluctance of the court to do so was apparent. As there is no similar rule in China’s general contract law, the comparison work will not focus on this, and for the reasons given by Steyn J., the author does not suggest that the Chinese law should have such a rule especially in insurance contract law.

called waiver of the right to rescind, lapse of time, and exclusion. Clarke also mentions other “would-be” limitations, but they are of little relevance with insurance contract: performance (Performance does not bar rescission of insurance contract obtained by fraudulent misrepresentation or non-disclosure, *Kettlewell v. Refuge Assurance Co* [1908] 1 K.B. 545; as for other cases, the Misrepresentation Act 1967 abolished this bar by its section 1. Clarke, *ibid* at para. 23-18D), restitution (Normally, restitution is a requirement in order to rescind a contract, but this requirement gives little difficulty in the law of insurance. Clarke, *ibid* at para. 23-18E.), third party rights (An assignee of the policy is not a third party. Clarke, *ibid* at para. 23-18F).

Lapse of time alone does not bar the right to rescind the insurance contract unless it constitutes affirmation. Affirmation means that if the party who has the right to rescind the contract, after knowing all the facts giving rise to the right of rescission, still elects to affirm the contract, then he will lost the right. Clarke also mentions other “would-be” limitations, but they are of little relevance with insurance contract: performance (Performance does not bar rescission of insurance contract obtained by fraudulent misrepresentation or non-disclosure, *Kettlewell v. Refuge Assurance Co* [1908] 1 K.B. 545; as for other cases, the Misrepresentation Act 1967 abolished this bar by its section 1. Clarke, *ibid* at para. 23-18D), restitution (Normally, restitution is a requirement in order to rescind a contract, but this requirement gives little difficulty in the law of insurance. Clarke, *ibid* at para. 23-18E.), third party rights (An assignee of the policy is not a third party. Clarke, *ibid* at para. 23-18F).


Tan Lee Meng, *Insurance Law in Singapore*, 2nd ed. (Singapore: Butterworths Asia, 1997) at 144; *Orako v. Barclays Insurance Service* [1995] L.R.L.R. 443. Clarke also mentions other “would-be” limitations, but they are of little relevance with insurance contract: performance (Performance does not bar rescission of insurance contract obtained by fraudulent misrepresentation or non-disclosure, *Kettlewell v. Refuge Assurance Co* [1908] 1 K.B. 545; as for other cases, the Misrepresentation Act 1967 abolished this bar by its section 1. Clarke, *ibid* at para. 23-18D), restitution (Normally, restitution is a requirement in order to rescind a contract, but this requirement gives little difficulty in the law of insurance. Clarke, *ibid* at para. 23-18E.), third party rights (An assignee of the policy is not a third party. Clarke, *ibid* at para. 23-18F).

what exact period the delay will be regarded as affirmation; it could be that so far as the delay is within a reasonable time, the right to rescind is not lost.

In life insurance, the insurer sometimes provides “indisputable policy” which the insurer will lose his right to avoid on ground of misrepresentation or disclosure after the policy has been in force for a particular time except there is fraud. The legal effect of the indisputable clause was accepted in *Anstey v. British Natural Premium Life Assurance Ltd.*

3. **Remedy in Damage**

i. **The Westgate Case: at the First Stage**

A claim for damages based on the duty of utmost good faith will not be supported by any court in England. The leading case on this point of law is *Banque Financière de la Cité S.A. v. Westgate Insurance Co. Ltd.*

This is a novel and interesting case in that the insured claimed damages for the insurer’s breach of duty of disclosure. In this case, a Mr. Ballestero persuaded syndicates of banks to enter a series of loan contracts with four companies controlled by him. The principle securities in support of each loan were a pledge of gemstones and a credit insurance policy, which contained a fraud exclusion clause. The banks were named either as the co-insured or the assignees. The borrowing companies defaulted on all the loans and the gemstone turned out to be negligible. When the insured banks claimed reimbursements under the policies against the insurers, the insurers denied liability on the ground that the loss was caused by Mr. Ballestero’s fraud and the

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488 [1909] 99 L.T. 765. As a contrast, under the Chinese law, it is not a contractual limitation but a statutory one that the life insurer will lose his right of rescission after 2 years of conclusion if the right of rescission is based on misrepresentation of the age of the insured. See article 54 of *the Insurance Law*. Discussed in more detail at page 137ff., below.

fraud exclusion clause was applicable. The banks then contended that their loss was caused by the insurers’ failure to disclose to them a deceit of the broker known to the insurers. In the first instance, Steyn J. decided that the duty of disclosure is reciprocal and the insured also has the right to be free of concealment; this right must be protect and when it has been infracted in such a way that damages are the only adequate remedy, damages must be awarded. His reasoning was almost a reprint of the principle “ubi jus ibi remedium”.490

ii. The Westgate Case: in the Court of Appeal

This judgement was quite exciting since the duty of disclosure had hitherto been operating against the insured, but the spark was stamped out in the appeal. The Court of Appeal, although agreeing that the duty of disclosure was reciprocal, held that:

“… [The appellant submitted] that the breach of a party to a contract uberrimae fidei of his obligation of disclosure is itself capable of giving rise to an action for damages in an appropriate case. This is a novel claim as yet entirely unsupported by any decision of the Courts of this country…”491

The Court of Appeal also denied other routes, including tort, implied terms of contract, etc., by which the insured banks pursued its claim for damages. Consequently, Slade L.J., who delivered the only judgment, concluded: “If the banks' right to full disclosure of material facts is founded neither on tort nor on contract nor on the existence of a fiduciary duty nor on statute, we find it

490 See Steyn J.’s reasoning in [1987] 1 Lloyd’s Rep. 69 at 96. “Ubi jus ibi remedium”: where there is a right, there is a remedy.
difficult to see how as a matter of legal analysis it can be said to found a claim for damages.”\textsuperscript{492}

The House of Lords agreed with the Court of Appeal.

iii. The Westgate Case: the Reasons of the Court of Appeal and the House of Lords

(a) The Power of the Court

The decision of the Court of Appeal was confirmed by the House of Lords on different ground that the damages suffered by the banks were not the consequence of the insurer’s non-disclosure.\textsuperscript{493} Lord Templeman, with whom the other members\textsuperscript{494} of the House of Lords agreed, thought that, although not necessary, but “it may be helpful to observe that [he] agree[s] with the Court of Appeal that a breach of the obligation [of disclosure] does not sound in damages”.\textsuperscript{495} According to him, “[t]he only remedy open to the insured is to rescind the policy and recover the premium,”\textsuperscript{496} and he totally agrees with “the cogent reasons advanced by Slade L.J.”\textsuperscript{497} Slade L.J. put forward four policy reasons for not awarding damages for breach of duty of disclosure:

First, the powers of the Court to grant relief in the case of non-disclosure stems from the jurisdiction originally exercised by the Court of Equity to prevent imposition, and the power of the Court to grant relief in the case of duress and undue influence stems from the same jurisdiction. Since duress and undue influence give rise to no claim for damages, there is no reason why non-disclosure should do so.\textsuperscript{498}

\textsuperscript{492} Ibid at 547.
\textsuperscript{493} [1990] 2 Lloyd’s Rep. 377 at 387, per Lord Templeman.
\textsuperscript{494} Lord Brandon, Lord Ackner and Lord Jauncey. Lord Bridge reserved his opinion on this question.
\textsuperscript{495} [1990] 2 Lloyd’s Rep. 377 at 387.
\textsuperscript{496} Ibid.
\textsuperscript{497} Ibid at 387-388.
Does this reason logically support what it seeks to prove? Is it necessary for non-disclosure to have the same remedy as duress and undue influence only because they have the same originality? In addition, “how can anyone sensibly justify an English insurance policy to a foreign would-be user by explaining that the obligation to make full disclosure is still solely based upon the special powers of some separate system of courts which has not exist for over a century?”

(b) The Decision of the C.T.I. Case

The second reason is the decision in the C.T.I. case which establishes that where an underwriter is seeking remedy of rescission, the actual effect of the non-disclosure on his mind is irrelevant. If the same approach applies reciprocally, it follows that “the Court will be concerned not so much with the effect of the non-disclosure on [the insured’s] mind as that of the mind of a prudent notional insured in his position”. This being so, “it could legitimately be asked how damage could be awarded if the non-disclosure had no effect on the insured”.

Steyn J., the trial judge who advocated remedy in damages, also recognized this difficulty, but this argument has no longer been a formidable obstacle preventing damages from being sought against the insurer since the Pan Atlantic case, in which it was held that the existence of actual inducement, the effect of non-disclosure on the actual insurer, is the condition precedent to the right of the insurer to avoid the policy. However, even regardless of the Pan Atlantic case, there is a simple answer to the difficulty raised by Slade L.J.: rescission of contract and damages are two parallel remedies, and each has its own criteria.

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502 Ibid.
The third reason lies in the fact that the *Marine Insurance Act 1906 (U.K.)* does not provide damages as a remedy for the breach of the duty of disclosure. Notwithstanding that Slade L.J. has mentioned Section 91(2) of the *Marine Insurance Act 1906 (U.K.)*, he still thinks the silence of the Act on this matter is a clear inference that the legislators has no intent to make remedy of damages available.\(^5\)

Section 91(2) of the *Marine Insurance Act 1906 (U.K.)* provides that “the rules of the common law including the law merchant, save in so far as they are inconsistent with the provisions of this Act, shall continue to apply”. This provision clearly shows that the Act’s failure to provide damages for the breach of the duty of disclosure should not be treated as if the Act were intended to prohibit such a form of remedy. It followed that judges are not bound to decide that damages are excluded as a remedy. A good example of this approach is demonstrated in the Pan Atlantic case.\(^6\)

Knowing that the *Marine Insurance Act 1906 (U.K.)* does not require non-disclosure to have actual inducement on the particular insurer’s mind, the House of Lords, nevertheless, decided there is such a requirement in the common law and such a requirement shall continue valid since it is not inconsistent with any provisions of the Act.\(^7\)

(d) The Possible Harshness

The last reason given by Slade L.J. was that:

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“A decision that the breach of such an obligation [i.e., the breach of good faith] in every case and by itself constituted a tort if it caused damages could give rise to great potential hardship to insurer and, even more, perhaps, to insured persons.” 508

He added that as the breach of the duty of utmost good faith does not concern itself with whether the breach is innocent or not, to create such an absolute liability “could expose either party to an insurance contract to a claim for substantial damages in the absence of any blameworthy conduct”. 509

However, Slade L.J.’s worry that the creation of a new tort of the breach of utmost good faith would cause great hardship would not be a problem if damages are limited to non-disclosure other than the innocent. Indeed, as Clarke has pointed out, 510 rescission and damage are distinct remedies and each should have its own criteria.

iv. Other Approaches besides Utmost Good Faith

Besides principle of utmost good faith, there could be other approaches to seek damages for the breach of duty of disclosure under the law of U.K., such as tort under the principle established by Hedley Byrne & Co. v. Heller & Partners Ltd, 511 fiduciary relationship, and fraud. Nonetheless, the Court of Appeal in the Westgate case accepted none of these approaches, so the general principle has been that no remedy in damage is awarded for the breach of the duty of disclosure,

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510 “Indeed, it is one thing to say to a man that, if he does not disclose the whole truth as he knows it, the other will be able to withdraw from the contract because he did not know enough to give informed consent, but another thing to say to the first man that he assumes responsibility for consequential loss suffered by the other and will be liable to pay damages for it.” Malcolm A. Clarke, The Law of Insurance Contracts, 4th ed. (London: LLP, 2002) at para. 23-15C.
no matter whether it is the insurer or the insured who breaches the duty.\textsuperscript{512} However, there might be two exceptions.

\textit{v. Tort}

Damages are recoverable when the misrepresentation is fraudulent. Where fraud takes the form of positive misrepresentation, damages are recoverable for the aggrieved party,\textsuperscript{513} while, subject to some exceptions, mere passive non-disclosure of truth, however deceptive, does not amount to deceit in law,\textsuperscript{514} less possibly to give rise to an action for damage. When fraud is involved, the legal basis on which the aggrieved party seeks for damages is not the principle of utmost good faith but the tort of deceit.\textsuperscript{515} Accordingly, the measurement for the damages is tortious.

\textit{vi. The Misrepresentation Act 1967}

As to non-fraudulent misrepresentation, damages might be available under the Misrepresentation Act 1967. Section 2(1)\textsuperscript{516} of the act allows the representee to claim damages for negligent misrepresentation as if that misrepresentation were made fraudulently. Negligent misrepresentation is defined as misrepresentation made without reasonable ground to believe that the facts represented were true. Hence, the tortious measurement applies in the damages awarded


\textsuperscript{515} \textit{Newbigging v. Adam} (1888) L.R. 13 App. Cas. 308, per Bowen L.J.

\textsuperscript{516} Section 2(1) of the Misrepresentation Act: Where a person has entered into a contract after a misrepresentation has been made to him by another party thereto and as a result thereof he has suffered loss, then, if the person making the misrepresentation would be liable to damages in respect thereof had the misrepresentation been made fraudulently, that person shall be so liable notwithstanding that the misrepresentation was not made fraudulently, unless he proves that he had reasonable ground to believe and did believe up to the time the contract was made that the facts represented were true.
against the so-defined negligent misrepresentation. Damages are also available under section 2(2).\footnote{517} Where the party entitled to rescind the contract claims to do so, the court or the arbitrator may exercise his discretion to award damages “in lieu of rescission, if of opinion that it would be equitable to do so, having regard to the nature of the misrepresentation and the loss that would be caused by it if the contract were upheld, as well as to the loss that rescission would cause to the other party.”\footnote{518} No matter whether or not the representee is entitled to damages under section 2(1), namely, whether or not the representation is a negligent one as defined in section 2(1), damages under section 2(2) are always subject to the discretion of the court or the arbitrator.\footnote{519} The measures of the damages under section 2(2), as is suggested,\footnote{520} are different from that under section 2(1) and are the measures employed in the breach of contract. In addition, it is noteworthy that the court is usually reluctant to apply section 2(2) to insurance contract.\footnote{521}

II. Remedy under the Chinese law

1. The Insurer’s Right to Terminate the Insurance Contract

The word of “termination” is used to describe the insurer’s right against the breach of duty of disclosure in the Insurance Law and the Maritime Code. Termination is different from rescission. According to the Contract Law 1999, rescission of the contract has retroactive effect: it

\footnote{517} Section 2(2) of the Misrepresentation Act: Where a person has entered into a contract after a misrepresentation has been made to him otherwise than fraudulently, and he would be entitled, by reason of the misrepresentation, to rescind the contract, then, if it is claimed, in any proceedings arising out of the contract, that the contract ought to be or has been rescinded the court or arbitrator may declare the contract subsisting and award damages in lieu of rescission, if of opinion that it would be equitable to do so, having regard to the nature of the misrepresentation and the loss that would be caused by it if the contract were upheld, as well as to the loss that rescission would cause to the other party.

\footnote{518} Section 2(2) of the Misrepresentation Act.

\footnote{519} Section 2(3) of the Misrepresentation Act.

\footnote{520} Malcolm A. Clarke, The Law of Insurance Contracts, 4th ed. (London: LLP, 2002) at 751, suggesting this, however, he also admits that “this point has not been finally settled.”

extinguishes the contract as if the contract had never existed,\textsuperscript{522} while termination of the contract has effect mainly prospectively and under certain conditions it has retrospective effect. The party may demand restoration to the original status in accordance with the situation of performance and the nature of the contract.\textsuperscript{523} As the Insurance Law and the Maritime Code are special laws\textsuperscript{524} compared with the Contract Law 1999, article 17 of the Insurance Law and article 223 of the Maritime Code shall apply in preference to article 97 of the Contract Law 1999.\textsuperscript{525} As to what the Insurance Law and the Maritime Code does not stipulate, such as limitation of time, the Contract Law 1999 applies.

The insurer cannot terminate the contract after the contract has come into being subject to certain exceptions provided by law or by the insurance contract.\textsuperscript{526} Breach of the duty of disclosure is one of these exceptional circumstances where the insurer can terminate the contract. As to the marine insurance, article 227 of the Maritime Code provides that, “unless otherwise agreed in the contract”,\textsuperscript{527} neither party may terminate the contract after the commencement of the insurance liability. This provision should not influence the insurer’s right of rescission against the insured’s

\textsuperscript{522} Article 58 of the Contract Law 1999: After a contract becomes invalid or is rescinded, any property obtained under the contract shall be returned. If it is impossible or unnecessary to return the property, compensation shall be made at an estimated price. The party at fault shall compensate the other party for the loss caused by the fault. If both parties have faults, they shall bear their respective responsibilities.

\textsuperscript{523} See article 97 of the Contract Law 1999: After the dissolution of a contract, for those clauses not yet performed, the performance shall cease. For those already performed, the party concerned may, accordance with the situation of performance and the nature of the contract, demand their restoration to the original status or take other remedies measures, and have the right to claim compensation.

In this article, the phrase “dissolution” means the same thing as “termination” for both of them are translated from one Chinese word “Jie Chu”.

\textsuperscript{524} Special law means that the law that governs special matter. Special law is relative with what it is compared. For example, the Insurance Law governs insurance law, so it is special law compared with the Contract Law 1999; the Maritime Code governs marine insurance law, so the Insurance Law is general law compare with the Maritime Code.

\textsuperscript{525} Article 97 of the Contract Law 1999 defines the legal effect of termination of a contract in general contract environments. See article 97 in supra note 523.

\textsuperscript{526} Article 16 of the Insurance Law: Unless this Law otherwise provides or the insurance contract otherwise stipulates, the insurer may not terminate the insurance contract after its conclusion.

\textsuperscript{527} Emphasis added.
breach of duty of disclosure.\textsuperscript{528} Similarly, article 35 of \textit{the Insurance Law}\textsuperscript{529} should not interfere with the insurer’s right of termination either.\textsuperscript{530}

Whether the insurer has the right to terminate the insurance contract as a remedy for the breach of the duty of disclosure by the insured, and what effect the termination has, largely depends on the state of mind in which the insured breaches the duty of disclosure.\textsuperscript{531} In Chinese law, the state of mind is categorized into intention, negligence, and innocence. The effect of termination of the insurance contract can only be understood after the meanings of intention and negligence are made clear.

2. \textbf{Definitions of Intention, Negligence, and Innocence}

i. \textbf{Methodology of Definition}

Amongst the three concepts, it is more important to define intention and negligence because innocence can easily be defined as the state of mind in which the doer is neither intentional nor negligent. Unfortunately, none of the statutes, vis. \textit{the Insurance Law}, \textit{the Maritime Code}, and \textit{the Contract Law 1999} nor \textit{the General Principles of the Civil Law 1986} has defined these important concepts.

\textsuperscript{528} There is a minor logic flaw in article 227 of \textit{the Maritime Code} in that it provides that neither party can terminate the contract “unless otherwise agreed in the contract”, [emphasis added] while article 223 of \textit{the Maritime Code} provides that, in circumstances of the breach of the duty of disclosure, the insurer has the right to terminate the contract but this is not a right of contract. Hence, it is obvious that article 227 of \textit{the Maritime Code} should have used the same wording as article 16 of \textit{the Insurance Law}, stipulating that “unless this Law otherwise provides or the [marine] insurance contract otherwise stipulates…”

\textsuperscript{529} Article 35: After the commencement of the insurance liability of insurance contracts of cargo transportation and voyage insurance contracts of transport means, the parties to such contracts may not terminate the contracts.

\textsuperscript{530} Although article 35 of \textit{the Insurance Law} does not provide any exception to the insurer’s right to terminate the contract, this article should be subject to other provisions of law and the terms of the contract. This point of view is accepted by Hu Jihua, gen. ed., \textit{Zhong Hua Ren Min Gong He Guo Bao Xian Fa Shi Yi Ji Shi Yong Zhi Nan (The Paraphrase and Practical Guide of the Insurance Law of the People’s Republic of China)} (Beijing: China Democracy and Legal System Press, 2002) at 136.

\textsuperscript{531} For how and to what extent, the right to terminate the contract is affected, see iii.
concepts though they are frequently used in these statutes. In order to define the meaning of intention and negligence, this thesis will use the following reference: the general meaning of the two concepts in non-legal context, the definitions of the two concepts in the criminal law, and the definitions given by some civil law scholars. It is noteworthy that fault in China legal context means the state of mind of either intention or negligence.

ii. Definition of Intention

According to *A Grand Dictionary of Chinese*, intention means “to have a mind to”, “to cherish certain intentions” or “to do something on purpose”. In particular, this dictionary has mentioned the meaning of this word in the criminal law, saying that:

“Intention is the state of mind of the doer where he clearly knows that his act will produce the consequence that will endanger the society, but he still pursues or is indifferent to the occurrence of those consequences; the mind of pursuance of the occurrence of the consequence is called the ‘direct intention’ and the mind of indifference to the occurrence of the consequence is called ‘indirect intention’. If A overthrows B’s car hoping B, his personal enemy, to die, this is direct intention; his indifference to the death of the other passengers in the car is indirect intention.”

Article 14(1) of *the Criminal Law 1997* provides similar definition as *Ci Hai*.

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532 *The Criminal Law of the People’s Republic of China 1997* is the only statute that has provided definitions for intention and negligent.
535 Ibid.
536 Article 14(1) “An intentional crime is a crime constituted as a result of clear knowledge that one’s own act will cause socially dangerous consequences, and of hope for or indifference to the occurrence of those consequences.” [Translated by the author.]
A comparison with the common law results in an interesting finding. The common law does not
distinguish direct or indirect intention. At first appearance it seems that an intention under the
common law only includes what is called “direct intention” in Chinese law, but the doctrine of
transferred malice has the same effect as the “indirect intention”.\footnote{537}

The civil law scholars define “intention” in the context of the civil law quite similarly as the
Criminal Law 1997. “Intention is the state of mind that the doer has foreseen that his act is capable
of causing certain consequence while he hopes or is indifferent to the occurrence of the
consequence.”\footnote{538} Applying the civil law definition of intention to the principle of utmost good
faith in the insurance law, the breach of the duty is intentional if, and only in so far as, the
insured,\footnote{539} actually knowing something material to the insurer in assessing the risks, fails to make
truthful disclosure with desire that the insurer would be concealed or misled, or he is indifferent\footnote{540}
to the consequence that the insurer would be concealed or misled.

So intention requires actual knowledge of the material circumstances. It cannot be said that the
breach is intentional if the insured does not know the fact even though an ordinary person in his
circumstances should know it, or if the insured fails to disclose something because he forgets

\footnote{537} Intention is generally explained as “[t]he willingness to bring about something planned or foreseen; the
state of being set to do something.” (\textit{Black’s Law Dictionary}, 17\textsuperscript{th} ed. at 814.) “An intention is the purpose
or design with which an act is done. It is the foreknowledge of the act, coupled with desire of it, such as they
fulfill themselves through the operation of the will. An act is intentional if, and only in so far as, it exists in
idea before it exists in fact, the idea realising itself in the fact because of the desire by which it is
accompanied.” Clanville L. Williams, \textit{Salmond on Jurisprudence}, 11\textsuperscript{th} ed. (London: Sweet & Maxwell, 1957)
at 410. As for the doctrine of transferred malice, see P. J. Fitzgerald, \textit{Salmond on Jurisprudence}, 12\textsuperscript{th} ed.
at B and wounding C held to be a malicious wounding of C).

\footnote{538} Wei Zhenying, \textit{Min Fa (Civil Law)} (Beijing: Beijing University Press & High Education Press, 2000) at
692. See also Wang Liming & Yang Lixin, \textit{Qin Quan Xing Wei Fa (Tort Law)} (Beijing: the Law Press, 1996)
at 71.

\footnote{539} It applies the same as the insurer because duty of disclosure is imposed on both parties.

\footnote{540} Most of the time, the insured breaches the duty of disclosure with desire that the insurer will be misled to
enter into the insurance contract which he would not enter into or would enter into at a higher premium. In
such circumstances, the intentional breach amount to cheat or fraud. It is also possible that the insured does
not expect the insurer to be mislead but he still conceals the facts for some other reasons, for example, that
he feels embarrassed to disclose something related to private life. In such circumstances, it is still
intentional breach of the duty, but it does not become a cheat or fraud; it is “indirect intentional” breach.
it,\textsuperscript{541} or if the insured of a marine insurance contract has remembered certain fact but due to his inexperience he fails to appreciate its materiality.\textsuperscript{542} In addition, intention is “a typically culpable state of mind”;\textsuperscript{543} if a person cannot control his mind, he is in no sense blameable. Therefore, if a person with no capacity for civil conduct\textsuperscript{544} makes misrepresentation or concealment, or if a person with limited capacity for civil conduct\textsuperscript{545} makes misrepresentation or concealment which exceeds his intellectual or mental state, the misrepresentation or the concealment is not intentional.

iii. Definition of Negligence

According to \textit{Ci Hai}, negligence means “fault” in daily context.\textsuperscript{546} It is a word capable of more than one meaning, but in the legal context it has special meaning:

\begin{itemize}
  \item In this kind of situations, the breach is negligent.
  \item This circumstance arises only in marine insurance because in non-marine insurance the “inquiry-disclosure” principle requires the insured to disclose everything the insurer has asked. There is no question of whether the insured can appreciate the materiality of the fact.
  \item Wei Zhénying, \textit{Min Fa (The Civil Law)} (Beijing: Beijing University Press & High Education Press, 2000) at 692.
  \item A person with no capacity for civil conduct means a minor under the age of 10 or a mentally ill person who is unable to account for his own conduct. See the relevant articles of the \textit{General Principles of the Civil Law 1986}. Article 11: “A citizen aged 18 or over shall be an adult. He shall have full capacity for civil conduct, may independently engage in civil activities and shall be called a person with full capacity for civil conduct. A citizen who has reached the age of 16 but not the age of 18 and whose main source of income is his own labour shall be regarded as a person with full capacity for civil conduct.” Article 12: “A minor aged 10 or over shall be a person with limited capacity for civil conduct and may engage in civil activities appropriate to his age and intellect; in other civil activities, he shall be represented by his agent \textit{ad litem} or participate with the consent of his agent \textit{ad litem}. A minor under the age of 10 shall be a person having no capacity for civil conduct and shall be represented in civil activities by his agent \textit{ad litem}.” Article 13: “A mentally ill person who is unable to account for his own conduct shall be a person having no capacity for civil conduct and shall be represented in civil activities by his agent \textit{ad litem}. A mentally ill person who is unable to fully account for his own conduct shall be a person with limited capacity for civil conduct and may engage in civil activities appropriate to his mental health; in other civil activities, he shall be represented by his agent \textit{ad litem} or participate with the consent of his agent \textit{ad litem}.”
  \item A person with limited capacity for civil conduct means a minor at or above the age of 10 and below the age of 18 subject to article 11(2) of the \textit{General Principles of the Civil Law 1986}, or a mentally ill person who cannot fully account for his own conduct. See the relevant articles \textit{ibid}.
  \item \textit{Ci Hai (A Grand Dictionary of Chinese)} (Shanghai: Shanghai Dictionary Press, 1999) at 1169.
\end{itemize}
“Negligence is the opposite to intention… in the criminal law, it is the state of mind of the doer that he should have foreseen that his act is capable of producing consequence that will endanger the society but he fails to foresee the consequence due to his inadvertence, or that he has foreseen the consequence but he readily assumes that it will not occur, so as to cause the detrimental consequence. An example of the former is that a driver has not foreseen the possibility of the car’s knocking down a pedestrian due to his carelessness and hence causes the traffic accident. An example of the latter is that a drive clearly knows that driving too fast may cause traffic accident but he readily relies on his driving skill of avoiding collision only to result in accident.”

Article 15(1) of the Criminal Law 1997 provides similar definition as Ci Hai.

In the civil law, most scholars have made the same definitions for “negligence”. “Negligence means that the doer should foresee and could foresee the illegal consequence his act may cause, but he fails to do so, or he has foreseen that consequence but he readily believes that it would not occur, so as to cause the illegal consequence.” What a person should have foreseen is judged by what an ordinary people with ordinary knowledge and reasonable care in his circumstances would have foreseen, but if he has special knowledge or he has special duty to take more care, then his act should be judged according to the higher standard. This definition has imitated that in the criminal law; the only difference is that the illegal consequence here has not come to the degree that constitutes a crime. According to this definition, negligence can be of two types: the

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547 Ibid.
548 "A negligent crime occurs when one should foresee that one’s act may cause socially dangerous consequences but fails to do so because of carelessness or, having foreseen the consequences, readily assumes he can prevent them, with the result that these consequences occur.” [Translated by the author.]
549 Liang Huixing, Zhong Guo Min Fa Jing Ji Fa Zhu Wen Ti (Some Problems of China Civil Law and Economic Law) (Beijing: The Law Press, 1991) at 119. Also see Wei Zhenying, Min Fa (The Civil Law) (Beijing: Beijing University Press & High Education Press, 2000) at 692. But see Wang Liming & Yang Lixin, Qin Quan Xing Wei Fa (Tort Law) (Beijing: the Law Press, 1996) at 71, where Wang Liming & Yang Lixin define that negligence means that “the doer should foresee or could foresee the illegal consequence his act may cause…”
carelessness, i.e., that the doer should foresee but fails to foresee, and the overconfidence, i.e.,
that the doer has foreseen but he readily believes that the consequence would not occur.\textsuperscript{550}
Sometimes, it needs complicated philosophical analysis to distinguish the negligence of
overconfidence and indirect intention which is beyond the task of this thesis.\textsuperscript{551}

So far as the principle of utmost good faith is concerned, the negligent breach of the duty of
disclosure is any breach due to the insured’s failure to exercise reasonable care, or special care if
he has duty to take more care\textsuperscript{552} to gain the material facts or to recall what has come to his mind,
or any breach due to the insured’s overconfidence that the fact were not material. The person with
no or limited capacity for civil conduct cannot be convicted of negligence either.

3. The Liability for Intentional Non-Disclosure

In both marine and non-marine insurance, the insured’s liability,\textsuperscript{553} or the insurer’s remedy, for
intentional non-disclosure is the same. First, the insurer will have the right to terminate the
contract, and after that he is no longer liable for any loss of or damages to the insured subject.\textsuperscript{554}

\textsuperscript{550} Zhao Bingzhi, gen. ed., \textit{Hai Xia Liang An Xing Fa Zong Lun Bi Jiao Yan Jiu (Comparative Study of the
Pandect of the Criminal Law of the Two Sides of the Taiwan Strait)}, vol. 1 (Beijing: the Press of the
People’s University of China, 1999) at 380-389.
\textsuperscript{551} For the complex analysis of the difference between the negligence of overconfidence and indirect
intention, see Niu Zhongzhi & Liu Junying, “Jian Jie Gu Yi Yu Guo Yu Zi Xin Guo Shi De Qu Bie Yu Ren Ren
Ding (The Difference and Cognizance of Indirect Intention and the Negligence of Overconfidence)”, (2002)
Guo Yu Zi Xin De Guo Shi: Li Lun Yu Shi Ji De Mao Dun (On Indirect Intention and the Negligence of
12; Chen Guozhu, “Gu Yi Fan Zui Yu Guo Shi Fan Zui Zhi Bi Jiao (The Comparison between the
\textsuperscript{552} For example he may have a warranty to do so.
\textsuperscript{553} The Chinese law usually defines what is called a remedy in the common law as the liability of the wrong
doer.
\textsuperscript{554} Article 17(2) of the \textit{Insurance Law} and article 223(1) of the \textit{Maritime Code}. See these articles at page 21
and 19 respectively.
Second, the insurer is not liable for any loss of or damages to the insured subject occurring before the termination.\footnote{See article 17(3) of the Insurance Law and article 223(1) of the Maritime Code. See these articles at page 21 and 19 respectively. It may seem redundant to distinguish the liabilities before and after the termination of the contract, but in non-intentional breach of the duty of disclosure, they are quite different.} Third, the insurer can retain the premiums.\footnote{Ibid.}

4. The Liability for Unintentional Non-Disclosure in Marine Insurance

If there is an unintentional non-disclosure, whether negligent or innocent, before the conclusion of a marine insurance contract, definitely the insurer can terminate the contract and reject any claim for loss or damages occurring after the termination.\footnote{Article 223(2) of the Maritime Code: “If, not due to the insured’s intentional act, the insured did not truthfully disclose to the insurer the material circumstances set out in paragraph 1 of article 222 of this Code, the insurer has the right to terminate the contract or to demand a corresponding increase in the premium. In case the contract is terminated by the insurer, the insurer shall be liable for the loss arising from the perils insured against which occurred prior to the termination of the contract, except where the material circumstances uninformed or wrongly informed of have an impact on the occurrence of such perils.”} As opposed to circumstances where the non-disclosure is intentional, the insurer is still liable for any loss of or damages to the insured subject occurring before the termination, unless the material circumstances undisclosed or wrongly disclosed have an impact on the occurrence of the perils.\footnote{Ibid.} The phrase here need explaining is “an impact on the occurrence of the perils.”

First, the impact must be related to the perils which cause the loss or the damages that the insured claims for. If the material circumstances have an impact on one peril while the damages are caused by another irrelevant peril, the insurer cannot reject the claim for the peril occurring before the termination of the contract.

Second, the impact is not equal to the materiality of the undisclosed fact. The undisclosed fact must be material before the question of impact could arise. The impact is the influence of the
undisclosed fact on the perils that have actually occurred, while the materiality means the influence on the mind of the actual or notional prudent insurer.

Finally, the impact does not mean that the undisclosed fact must be the proximate cause of the occurrence of the loss or damages. Not many articles have defined what impact means. It is suggested that the impact is not strict legal causation, and an impact is weaker than the effect of causal connection.\(^{559}\) In a few cases, the judges have briefly discussed the meaning of impact. In *Xi Gu Commercial Ins. v. the People’s Insurance Company of China, Qingdao Branch*,\(^ {560}\) the equipment was shipped on a barge towed by a tug but the insured had not disclosed these circumstances to the insurer due to the insured’s overconfidence that the insurer might have known the circumstances from local news. The equipment was damaged by gale on the sea. The court held that the circumstances undisclosed had an impact on the occurrence of the damages because the wind power had been above gale, under which circumstances the shipping of towage would not be seaworthy. In another case,\(^ {561}\) the fact that insured ship was bound for disassembly was held to have an impact on the occurrence of the ship’s breakdown and sinking. In both cases, the facts undisclosed are not the prime causes of the occurrence of the damages,\(^ {562}\) nor are they the proximate cause. In the second case, the court did not even take the trouble to analyse how the undisclosed fact impacted the occurrence of the breakdown; it merely required some relationship between the fact and the occurrence. Therefore, in general, for there to be an impact, the undisclosed fact can be an indirect cause, or a contributing cause. It could be said that there is an impact as far as the undisclosed fact may increase the possibility of the occurrence of the accident which actually occurs.


\(^{562}\) The prime cause in the first case is the gale and in the latter is the cyclone and billo.
5. The Liability for Negligent Non-Disclosure in Non-Marine Insurance

Although the question of materiality does not arise when talking about what the insured should disclose since the principle applied in non-marine insurance is the inquiry-disclosure, the fact undisclosed must be material if the insurer wants to terminate contract where the non-disclosure is negligent. That is equal to say, if the insurer wants to terminate the contract, he should either prove that the non-disclosure is intentional or that the non-disclosure is material. The double-check-test shall apply in determining the materiality.

Where the insurer has terminated a non-marine insurance contract for negligent non-disclosure, the insurer is not liable for any loss which occurred after the termination, but he is still liable for the loss occurring before the termination of the contract unless the non-disclosure has a grave impact on the occurrence of the risks. This position is basically the same as the Maritime Code. Rather than “an impact”, the Insurance Law has used “a grave impact”. So a proper interpretation may be that, in non-marine insurance, where the non-disclosure is negligent, if the insurer wants to be

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563 Article 17 of the Insurance Law stipulates that, “if the applicant... negligently fails to make disclosure thereby which is sufficient to affect the insurer making a decision...” The meaning of materiality is deduced from the influence of the non-disclosure on the insurer’s decision.

564 Article 10 of The Interpretation of the People’s Supreme Court’s on Several Questions of the Inquisition of Insurance Dispute Cases (Draft for Consultation) (available online: Law-Lib.com <http://www.law-lib.com/law/lfbj/lfbj_view.asp?id=10276>) suggests that “if the risk is not caused by the material fact undisclosed by the applicant... the insurer may not terminate the contract or reject the liability under the policy on ground of non-disclosure by the applicant.” But this provision is inconsistent with the statute which is of high authority than the judicial interpretation. According to article 17 of the Insurance Law, the insurer’s right to terminate the contract does not depend on the linkage between the occurrence of the risk and the undisclosed circumstances, so it is wrong to stipulate that the insurer may not terminate the contract where the non-disclosure has no grave impact; actually, the insurer is only prohibited to reject the claim in such circumstances. That may be why this article has cause great disputes. See the disputes in news report online: South Weekend <http://www.nanfangdaily.com.cn/jj/20031218/jr/200312170601.asp>.

565 The Insurance Law does not stipulate whether “the insurer” in article 17(2) means the prudent insurer or the actual insurer. For those reasons given above, this article should be interpreted as a double check interpretation, i.e., both the particular insurer and a prudent insurer in his position would be induced to enter into the contract. Discussed in more detail at page 105ff., above.

566 Article 223 of the Maritime Code.
released from the pre-termination liability, the circumstances undisclosed must be at least the main cause of the occurrence of the risks.\textsuperscript{567}

Article 10 of the proposed judicial interpretation suggests that the “grave impact” should mean that the fact undisclosed is the “main and decisive cause” of the occurrence of the risk.\textsuperscript{568} This interpretation seems reasonable. However, this article continues to stipulate that “if the risk is not caused by the material fact undisclosed by the applicant, the court may regard that that fact undisclosed has no ‘grave impact’ on the occurrence of the risk, and the insurer may not terminate the contract or reject the liability under the policy on ground of non-disclosure by the applicant.”\textsuperscript{569} This seems to have confused the difference in the conditions of the right of termination and those of the right to reject the claim. According to article 17(2) of the Insurance Law, the insurer is entitled to terminate the contract where the non-disclosure is either material or fraudulent. The right of termination is not dependent on causation, but causation must be fulfilled in order to reject the claim arising before the termination. Therefore, the proposed judicial interpretation should delete the italic words “terminate the contract”.\textsuperscript{570}

6. The Defects of the Nexus Approach

\textsuperscript{567} See Li Yuquan, \textit{Bao Xian Fa (Insurance Law)}, 2\textsuperscript{nd} ed. (Beijing: The Law Press, 2003) at 65, where Li Yuquan rebuts the argument that the “grave impact” means necessarian causation, so he insists that the main cause is enough to establish the grave impact. If a cause will unavoidably cause a certain consequence, then there is necessarian causation between the cause and the consequence.

\textsuperscript{568} See article 10 of the \textit{Interpretation of the People’s Supreme Court’s on Several Questions of the Inquisition of Insurance Dispute Cases (Draft for Consultation)}, online: Law-Lib.com <http://www.law-lib.com/law/lfbj/lfbj_view.asp?id=10276>.

\textsuperscript{569} \textit{Ibid.} Emphasis added. In addition to the problem mentioned below, there is a verbal problem. The second sentence seems redundant and causes misunderstanding. The first sentence has make clear the meaning of the grave impact that it is a main and decisive cause, while the second sentence says that “If the risk is not caused by the material fact” is misleading. One will be confused why the second sentence does not emphasize the “main and decisive” cause. Therefore, the second sentence, if not deleted, should be changed to “If the risk is not \textit{decisively} caused by the material fact undisclosed by the applicant, the court may regard that that fact undisclosed has no “grave impact” on the occurrence of the risk...”

\textsuperscript{570} If the insurer had to prove the causation before he can terminate the contract, he could terminate the contract only after the loss had occurred, because he can never prove the causation before a given loss has occurred. See generally Chen Ken, “Bao Xian Fa Si Fa Jie Shi Zheng Bian Shi Mo (The Disputes in the Judicial Interpretation of the Insurance Law)”, Economic News of 21\textsuperscript{st} Century, 17 Dec, 2003, online: Southern Daily <http://www.nanfangdaily.com.cn/jj/20031218/jr/200312170601.asp>.
The impact of undisclosed matters on the occurrence of the risk is also called the nexus approach.\footnote{U.K., the Law Commission, \textit{Insurance Law - Non-Disclosure and Breach of Warranty}, Law Com. No. 104, Cmnd 8064 (London: H.M.S.O., 1980) at paras. 4.89-4.97.} It has already been alleged that the nexus approach has its defects.\footnote{\textit{Ibid.} See also Australian Law Reform Commission, \textit{Insurance Contracts}, ALRC Report No. 20 (Canberra: Australian Govt. Pub. Service, 1982) at para. 191.} First, where the insurer would not have accepted the contract at all had he known the material fact, it would be unfair for him to take responsibility of the loss under the contract because the contract would not have existed at all.\footnote{U.K., The Law Commission, \textit{ibid}, at paras. 4.91, 4.94, 4.96; Australian Law Reform Commission, \textit{ibid}.} Second, some circumstances can never be said to contribute the occurrence of the risk,\footnote{\textit{Ibid.}} such as the circumstances related to “moral hazard”\footnote{U.K., The Law Commission, \textit{ibid}, at para. 4.93.} and those related to the recoverability of the loss, although these circumstances may be very important in assessing the risks. Consequently, the insured would be encouraged to conceal such circumstances in order to get lower premiums because the insurer will never be able to reject the claim on ground of non-disclosure of these circumstances under the nexus approach, and the insurer will be less able to accurately identify which risks are good and which are bad and to adjust premium rates accordingly.\footnote{\textit{Ibid}, at para. 4.95.}

There is much force in the arguments above, but this has not held up the adoption of this approach in many countries.\footnote{This approach has already been adopted in Japan (section 645 of the \textit{Commercial Code of Japan}) and Taiwan (article 64 of the \textit{Taiwan Insurance Law}). Both of them have the same provision as China. In Norway, the causal connection approach is employed; in Australia, this approach is suggested to be added into the \textit{Marine Insurance Act 1909 (Commonwealth)}. See \textit{infra} not 578.} However, the nexus test in both \textit{the Maritime Code} and \textit{the Insurance Law} should be amended accordingly. First, if the undisclosed circumstances are such that the insurer would not have accepted the risk had he known the truth, the insurer should not be liable for the
loss regardless of whether these circumstances have an impact on the risk.\textsuperscript{578} In absence of fraud, if the insurer would have accepted the risk but on different conditions, the insurer should be entitled to avoid liability unless the loss is not attributed to the circumstances that should have been disclosed.\textsuperscript{579} Second, the insurer should also be able to avoid the liability where the undisclosed matter has an impact on the recoverability of the claim, though it may not have an impact on the occurrence of the risk.\textsuperscript{580}

7. **Could There Be Innocent Non-Disclosure?**

Theoretically, an innocent non-disclosure means a non-disclosure committed by the insured due to reasons other than his intention or his negligence. Suppose that the insured has tried every shift available to inform the insurer of the change of an important circumstance, but due to an act of God, or an accident that nobody with reasonable care could anticipate, such a non-disclosure should be treated as innocent.

*The Insurance Law* does not stipulate whether the insured is liable for innocent non-disclosure perhaps because of its rareness. Since *the Insurance Law* has specified the liabilities for intentional and negligent non-disclosure while omitting that for innocent non-disclosure alone, the interpretation of *unius exclusio*\textsuperscript{581} of this article should be that the innocent non-disclosure does not give rise to any liability. In addition, according to *the General Principles of the Civil Law*

\textsuperscript{578} This is the position of Norwegian marine insurance law and the Australian Law Reform Commission also made this suggestion as to the reform of *the Marine Insurance Act 1909 (Commonwealth)*. See Australian Law Reform Commission, *Review of the Marine Insurance Act 1909*, ALRC Report No. 91 (Sydney: The Commission, 2001) at paras. 10.112, 10.114, 10.120.

\textsuperscript{579} *Ibid.*

\textsuperscript{580} For example, where there was a unique clause in the charter party excluding the charterer’s liability and the insured shipowner failed to disclose it to the insurer, the insurer would be barred from recover loss payable to the shipowner from the charterer. Then the insurer should be able to avoid the liability for the loss. See also Wang Jie, “Qian Tan Gao Zhi Yi Wu Fa Lv Tiao Kuan Zai Shi Wu Zhong De Wen Ti (Briefly Discuss on the Problems of the Duty of Disclosure Clause in the Practice)” (1999) May, Hai Shang Fa Xi Hui Tong Xun (CMLA News Letter) 76.

\textsuperscript{581} See *supra* note 326.
force majeure, or an act of God, exempts the person from the performance of any duty influenced thereof, so the insured should not be liable for innocent non-disclosure if it is caused by force majeure.

8. Limitation to the Right of Termination

In the common law, there is no fixed time limitation to the insurer’s right of rescission of the contract in the breach of utmost good faith. “The party defrauded may keep the question open so long as he does nothing to affirm the contract… [but] lapse of time without rescinding will furnish evidence that he has determined to affirm the contract, and when the lapse of time is great, it probably would in practice be treated as conclusive evidence that he has so determined.” This position would increase the uncertainty of the insured’s arrangement on his life or business because he does not know when exactly he can begin to rely on the insurer’s silence.

Both the Insurance Law and the Maritime Code fail to provide any limitation for the insurer’s right of termination of the contract against the insured’s non-disclosure with only a small exception. It is therefore possible for the relevant provision of the Contract Law 1999 to apply.

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582 Article 107 of the General Principles of the Civil Law 1986: “Civil liability shall not be borne for failure to perform a contract or damage to a third party (a third party should have been translated into other peoples) if it is caused by force majeure, except as otherwise provided by law.” Translation available in the Law Bureau of the State Council of the People’s Republic of China, trans., Laws and Regulations of the People’s Republic of China Governing Foreign-Related Matters (Beijing: the Law Press, 1991).


584 In article 53 of the Insurance Law, it is provided that “If the age of the insured declared by applicant is not true to fact, and the actual age fails to be in conformity with the age limit as agreed upon in the contract, the insurer may terminate the contract, and return the insurance premium to the applicant after deducting the handling fees, however, the contract which has been served for more than two years into since its conclusion shall be excluded.”
According to article 95 of the Contract Law 1999, the party’s right to terminate the contract may be extinguished by the lapse of time.\(^{585}\) According to this article, the right to terminate the contract will be extinguished after a reasonable period from the date when the party with right to terminate was urged by the other party to exercise the right unless otherwise provided by law or by the contract.\(^{586}\) That is to say, unless the insured urges the insurer to exercise the right of termination against the non-disclosure, the insurer’s right will always exist.

This result is unfavourable. In deed, article 95 of the Contract Law 1999 has been seriously criticised by the contract law scholars for the uncertainty it would cause to the validity of the contract.\(^{587}\) First, “a reasonable period” has long been criticised as a very vague definition in the Chinese law and has caused much dispute.\(^{588}\) Second, it is alleged that the extinction period was intended to prompt the obligee\(^ {589}\) to exercise his right timely so that the validity of the contract would be ascertained as soon as possible.\(^ {590}\) If the extinction period\(^ {591}\) starts to run only after the

\(^{585}\) Article 95 of the Contract Law 1999: “(1) If a time limit for exercising the right to dissolve the contract is provided for by laws or by agreement of the parties, and the party concerned does not exercise such right at the expiration of the time limit, such right shall vanish. (2) If no time limit for exercising the right to dissolve is provided for by laws or by agreement of the parties, but the party concerned does not exercise such right within a reasonable period of time after being urged by the other party, such right shall vanish.” There are two points requiring explaining. First, it is suggested that the word “vanish” had better be substituted by “extinguish”. (See Wu Qifei & Feng Xia, “He Tong Fa Ying Yi Ben Qiu Ci Lu (Flaws in the English Version of the Contract Law)”, (2001) December, Journal of Guangxi Administrative Cadre Institute of Politics and Law 118.) Second, “dissolve” in the Contract Law 1999 has the same meaning as “terminate” in both the Insurance Law and the Maritime Code because both of the two words are translated from the same Chinese words “Jie Chu”. That is to say, in the Chinese original text, “dissolve” and “terminate” are the same ostensibly and literally. Therefore, in thesis, these two words will be unified as “terminate”.

\(^{586}\) Article 95(2) of the Contract Law 1999, ibid.

\(^{587}\) See infra note 588, 590.

\(^{588}\) It has been strongly criticised for the uncertainty this word will cause. It is also suggested that the legislation should use this word as less as possible. See Liang Huixing, “Tong Yi He Tong Fa: Cheng Gong Yu Bu Zu (The United Contract Law: The Success and the Defeat)”, (1999) Issue 3, China Legal Science 25 at 28.

\(^{589}\) The obligee means the party who has the right to terminate the contract.


\(^{591}\) The extinction period is a civil law concept which means the period after which a certain right will be extinguished. See also supra note 337.
urgency of the opposite party,\textsuperscript{592} it would not coincide with the legislation intention. Finally, suppose in an extreme example, where the obligee continued to accept the performance of the opposite party without excising his right to terminate the contract for one year. Could the obligee terminate the contract thereafter because the opposite never urged him to exercise the right? It would be unreasonable if the obligee could do so.\textsuperscript{593} Therefore, the right to terminate the contract should be exercised within a fixed period from the time when the obligee knows the fact which gives rise to the right. As far as the insurance contract is concerned, this fixed period is usually set by law as one month in many civil law countries.\textsuperscript{594} China may follow their positions.\textsuperscript{595}

9. \textbf{The Indisputability Clause}

Sometimes, the life insurance policy will include an indisputability clause\textsuperscript{596} into the policy. This has been a custom in the many countries. However, until now, no policy in Chinese insurance market has included such an indisputability clause.\textsuperscript{597} The only exception is that the life insurance policy usually contains a clause of the misrepresentation of age which provides that, if the insured has misrepresented his age and if the insurer thereby has the right to terminate the policy, the right must be exercised within two years from the conclusion of the contract. However, had article 53 of

\begin{footnotesize}
\begin{itemize}
\item The opposite party means the party vis-à-vis the party who has the right to terminate the contract.
\item In the common law, the rule governing this kind of circumstances is waiver, but there is no rule of waiver. Although the court may decide that the obligee cannot exercise the right to terminate the contract as the exercise may breach the principle of good faith stipulated in the civil law. See \textit{supra} note 337 for waiver.
\item In German (article 20 of \textit{German Insurance Contract Law}), Japan (article 645 of \textit{Japanese Commercial Code}), Macau (article 974 of \textit{Macau Commercial Code}), and Taiwan (article 64 of \textit{Taiwan Insurance Law}), the insurer has to exercise the right to terminate, or rescind, according to the respective provisions, the contract within one month of knowing the non-disclosure or misrepresentation. In Italy, the period is three months according to article 1893 and 1898 of \textit{Italian Civil Code}. See Li Yuquan, \textit{Bao Xian Fa (Insurance Law)}, 2\textsuperscript{nd} ed. (Beijing: The Law Press, 2003) at 62-64.
\item However, whether the period should be one month (as is in German, Japan, and Taiwan) or three months (as is in Italy) may be further considered.
\item An indisputability clause makes the insurance contract indisputable after it has been in force for a particular time, normally two years. The effect of the clause is that the insurer cannot rely upon defences of non-disclosure, misrepresentation and certain breach of warranty to avoid the contract or deny the liability under the contract. See John Birds & Norma J. Hird, \textit{Birds’ Modern Insurance Law}, 5\textsuperscript{th} ed. (London: Sweet & Maxwell, 2001) at 95.
\end{itemize}
\end{footnotesize}
the Insurance Law\textsuperscript{598} not stipulated so, it is very doubtful whether the life policy will contain the clause of the misrepresentation of age. The lack of the indisputability clause will be a defect in the domestic insurers’ competing with the foreign insurers\textsuperscript{599} after the insurance market was fully opened under the agreements of the accession of China into the WTO.\textsuperscript{600} Moreover, there are sufficient reasons to ask why only the misrepresentation of age will be excused after two years while others will not. There is no sense that the misrepresentation of age is less material or less misleading than others. Therefore, the Insurance Law should make the indisputability clause as a compulsory clause in the life insurance. Fortunately, the proposed judicial interpretation\textsuperscript{601} will complement this defect.

10. The Way to Exercise the Right to Terminate the Insurance Contract

Pursuant to article 96 of the Contract Law 1999, the party who wants to terminate the contract must notify the other party and the termination does not take effect until the notification reaches the other party.\textsuperscript{602} Article 96 applies to the circumstances specified in articles 93\textsuperscript{603} and 94.\textsuperscript{604} Non-

\textsuperscript{598} See supra note 276.
\textsuperscript{599} Xu Shenliang & Li Xiao, “Bao Xian Fa Ye Yao Zao Ru Shi (The Insurance Law should also ‘Join the WTO’ as early as Possible)”, International Finance Newspaper, November 15, 2001, section 6, online: the NPC News <http://www.npcnews.com.cn/gb/paper12/1/class001200078/hwz211693.htm>.
\textsuperscript{600} Annex 9 of Protocol on the Accession of the People’s Republic of China governs the opening of the financial service market. Under this annex, China’s insurance market will open to foreign insurance companies and they will have a fair competition with the domestic ones. Online: the Ministry of Commerce of the People’s Republic of China <http://www.moftec.gov.cn/article/200207/20020700032358_1.xml>.
\textsuperscript{601} Article 40 (Application of the Indisputable Clause): After two years from the conclusion of the contract, if the insurer does not use the right of termination of the insurance contract stipulated in article 17(2) of the Insurance Law, the right is extinct, except where the contract has been ceased. See The Interpretation of the People’s Supreme Court’s on Several Questions of the Inquisition of Insurance Dispute Cases (Draft for Consultation), online: Law-Lib.com <http://www.law-lib.com/law/lfbj/lfbj_view.asp?id=10276>.
\textsuperscript{602} Article 96 of the Contract Law 1999: when a party advocates the dissolution of the contract in accordance with the provisions of paragraph 2 of articles 93 and 94 of this Law, the party shall notify the other party. The contract shall be dissolved when the notice reaches the other party. If the other party has objection it may apply to a People’s Court or an arbitration institution to determine the validity of the dissolution of the contract. Where provisions of the laws and administrative regulations require the dissolution of a contract to go through approval and registration procedures, such provisions shall govern.
\textsuperscript{603} Article 93: The parties may dissolve the contract upon consensus through consultation.
disclosure in insurance contract is not directly mentioned in article 93 or article 94, but it can be
categorized into the 5th circumstances specified in article 94, i.e., “any other circumstances as
provided for by law”. Therefore, article 96 of the Contract Law 1999 also applies in the breach of
the duty of disclosure. The termination of the insurance contract takes effect at the time the notice
is received by the insured. The way of notification is not specified by law, so it can be in written,
oral or via any other communication, but the insurer bears the risk that the notice may fail to reach
the insured since the notice of termination only takes effect after it is received. But if the judicial
interpretation of the Insurance Law is passed, it probably will stipulate that the notice of the
termination must be in written.

The insurer must be careful that, if he decides to terminate the contract, he should notify the
insured as soon as possible. The effect of termination of the contract does not automatically relieve
the insurer from the liability which occurred before the termination; the insurer still bears the
liability before the termination unless the non-disclosure is intentional or the undisclosed
circumstances have an impact (in marine insurance) or a severe impact (in non-marine insurance)
on the occurrence of the risk. In some cases, the intention or the impact may be difficult to

The parties may stipulate the conditions for dissolution of the contract by either party. When the conditions
for dissolution of the contract mature, the party with the right to dissolve may dissolve the contract.

604 Article 94: The parties may dissolve the contract under any of the following circumstances: the aim of the
contract cannot be attained because of force majeure; before the period of performance expires, either party
clearly indicates by word or by act that it will not discharge the principal debts; either party delays the
discharge of the principal debts and still fails to discharge them within a reasonable period of time after
being urged; either party delays the discharge of debt or is engaged in other illegal activities and thus makes
realization of the aim of the contract impossible; or any other circumstances as provided for by law.

605 Article 7 (The Duty of Notification on the Termination of the Contract) of the proposed interpretation:
“After the conclusion of the contract, if one party alleges termination of the contract according to the CIL or
according to this judicial interpretation, that party should notice the other party in written, and the contract is
terminated when the notification reaches the other party…” This judicial interpretation is still in draft, and
this draft is published for public consultancy. Since many of the insurance documents are required to be in
written form, it is also reasonable to have the notice of termination being so. See The Interpretation of the
People’s Supreme Court’s on Several Questions of the Inquisition of Insurance Dispute Cases (Draft for

606 Discussed in more detail at page 128, above.

607 Discussed in more detail at page 129, 131, above.
prove, so an experience insurer, after finding the breach of the duty of disclosure by the insured, should not wait until the risks occur.\footnote{608}

Article 96 of the Contract Law 1999 allows the party who opposes the termination of the contract to request a People’s Court or an arbitration institution to validate the contract. If the contract is validated thereby, the termination of the contract is invalid ab initio and the contract keeps valid retrospectively to the original time when the contract took effect. If the court or the arbitration institution does not validate the contract, the termination of the contract is valid and the contract ceases from the time of the notice of the termination.

11. **Damages under China Law**

i. **Damage after the Termination of the Contract**

Damages are not available under the Maritime Code or the Insurance Law since neither of them mentions damages as a remedy for non-disclosure, but the Contract Law 1999 has filled this gap. Under article 97 of this statute, the aggrieved party may claim damages after the termination of the contract subject to the situation of the performance and the nature of the contract.\footnote{609} The General Principles of the Civil Law 1986 also stipulates that “a party’s right to claim compensation for losses shall not be affected by the alteration or termination of a contract.”\footnote{610} Damages, termination

\footnote{608} This is different to the British position. In U.K., the remedy is avoidance ab initio, so it does not matter when the insurer avoid the contract as he can always reject the claim whether it arises before or after the avoidance. In China, only where the breach of the duty is intentional or the undisclosed matter has an impact on the risk does the termination have effect retrospectively. See page 128, 129, 131, above.\footnote{609} See article 97 of the Contract Law 1999 at supra note 523.\footnote{610} Article 115 of the General Principles of the Civil Law 1986. Translation version by the Law Bureau of the State Council of the People’s Republic of China, trans., Laws and Regulations of the People’s Republic of China Governing Foreign-Related Matters (Beijing: the Law Press, 1991). In Hongfeng Company v. Ping An Insurance Company, reported in, Li Ping, Bao Xian Fa Xin Shi Yu Li Jie (New Interpretation and the Cases of the Insurance Law) (Beijing: Tongxin Publishing House, 2001) 70, the People’s Court awarded damage to the insured but did not based on this article. See the details of this case at 170.
of the contract, restitution are parallel and compatible remedies, \(^{611}\) so the insurer’s right to termination the contract does not affect the right to claim damages and the insured may also claim damages from the insurer against the insurer’s breach of the duty of utmost good faith. \(^{612}\) Although, these articles have clarified that the remedy of damage is not precluded only because the insurer has the right to terminate the contract, they do not point out the exact ground for the insurance parties to claim damage.

ii. Negligence in the Negotiation of the Contract

The approach for the insurance parties to claim damage is the pre-contract duty of good faith in the general contract law, \(^{613}\) the breach of which is called the “negligence in negotiation of the contract”. \(^{614}\) The breach of the duty of disclosure is a type of the negligence in negotiation. \(^{615}\) The negligence in negotiation entitles the aggrieved party to claim damage if he can prove that the other party’s negligence, \(^{616}\) but the damage is restricted to the loss of “reliance interest” only, \(^{617}\) so

\(^{611}\) However, there are three circumstances where the party who has terminated the contract cannot claim for damage. First, if the contract is terminated by mutual agreement of the parties and the agreement has exempted the party’s liability in damage, the other party cannot claim damage after the agreement. Second, if the termination of the contract is caused by force majeure and either party could be blamed for the termination, then either party cannot claim damage from the other party. Finally, if one party’s termination of the contract has sufficiently protected his interest, he cannot claim for damage. See Wang Liming, *Wei Yue Ze Ren Lun (The Obligation of the Breach of the Contract)*, 2nd ed. (Beijing: China Politics and Law University Press, 2003) at 726-727.

\(^{612}\) The insurer’s duty of utmost good faith will be further discussed in the next chapter.

\(^{613}\) As for the pre-contract duty of good faith in the *Contract Law 1999*, see also page 38ff., above.

\(^{614}\) The pre-contract duty of good faith is the contingent duty of notification, assistance, disclosure, protection, care, secrecy, loyalty and so on which the proposed parties to the contract bear to each other according to good faith in the course of negotiation of the contract. The breach of such duty is also called the “negligence in negotiation of the contract”. See Wang Liming, *Wei Yue Ze Ren Lun (The Obligation of the Breach of the Contract)*, 2nd ed. (Beijing: China Politics and Law University Press, 2003) at 767-813; Feng Jianping, “Shi Yong Di Yue Guo Shi Ze Ren De Ruan Gan Wen Ti (Some Problems in Applying the Liability of the Fault in the Negotiation of the Contract)”, (2000) Issue 8, People’s Justice 18.


\(^{616}\) Although it is called the negligence in negotiation, an intentional misconduct in negotiation a fortiori entitles the aggrieved party to claim damage. Articles 42 and 43 of the *Contract Law 1999* have enumerated some circumstances of the breach of the pre-contract duty. They are all intentional breach of the duty. But it is believed there are other forms of breach of the pre-contract duty which may be negligent, so it is generally agreed that an actionable breach of pre-contract duty must be at least negligent. A judge of the Middle
either party of the insurance contract may claim damage for loss of reliance interest. Although this
lets the insured get more protection where the insurer breaches the duty of utmost good faith, it
also causes the dangerous potentiality that the insurer would claim a large amount of damage from
the insured. However, the People’s Court will surely consider whether the damage is
reasonable and by far no case has been reported where an insurer sues damages from the insured
for the insured’s non-disclosure.

The article which enables the aggrieved party to claim damage for the negligence in the
negotiation of the contract is article 42 of the Contract Law 1999.

Article 42 “In the making of a contract, the party that falls under any of the following
circumstances, causing thus loss to the other party, shall be liable to compensate for the
loss.

“(1) engaging in consultation with malicious intention in name of making a contract;


However, scholars believe that the damage available to the negligence in negotiation is to compensate for the reliance interest of the aggrieved party, instead of the interest that would be gained through the performance of the contract.

For example, the court will consider whether the termination of the contract has been reasonably sufficient to protect the insurer’s interest. See supra note 611. In addition, it seems that the insurer cannot claim damage for the compensation he has paid or is liable to pay to the insured on ground that the negligent non-disclosure does not have an impact on the risk; to hold otherwise would directly go against article 16 of the Insurance Law and article 223 of the Maritime Code.
“(2) concealing intentionally key facts related to the making of the contract or providing false information; or

“(3) taking any other act contrary to the principle of good faith.”

This article applies to all kinds of contracts. It clearly stipulates that the breach of the pre-contract good faith results in damage. However, whether the breach of the duty of disclosure in the insurance law belongs to “any other act contrary to the principle of good faith” largely depends on how the article is interpreted.

The phrase “any other act contrary to the principle of good faith” is very obscure. One interpretation is that any other act contrary to the principle of good faith only refers to those acts similar to the other two acts listed in section (1) and (2) which are both acts with ill intention, and hence “any other act” should only means acts with ill intention. The other view takes that ill intention is not indispensable to constitute the breach of the pre-contract duty of good faith and merely negligence is enough. The second is the prevailing view in China. If the second

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622 The words “the party … shall be liable to compensate for the loss” in Chinese means that that party should assume the liability in damage. For the meaning of intention and negligence, see page 124 and page 126, below. For the detailed discuss on the damage available to the breach of the duty of disclosure, see page 140ff., below (the insured’s breach) & page 170ff., below (the insurer’s breach).


interpretation is right, the duty of disclosure of the insurance law will be regarded as the
eembodiment of the principle of good faith of the general contract law in the special area of
insurance. That is to say, the breach of the duty of disclosure in itself constitutes the negligence in
the “negotiation of the contract” so that the remedy of damage can be applied. This is significantly
different to the position of the law of U.K.\textsuperscript{625} where the breach of the duty of utmost good faith
entitles the aggrieved party only the option to rescind the contract.\textsuperscript{626}

iii. Scope of Damage

It is generally believed that the damage is restricted to the loss of reliance interest, which includes
the loss of the opportunity to contract with a third party\textsuperscript{627} and all kinds of expenses directly
arising from the negotiation. For the latter type of damage, the insurer may directly deduct the
commission charge and other reasonable expenses in the making of the contract from the

\begin{quote}
Ren Li Lun Ji Qi Zai Shen Pan Shi Jian Zhong De Ying Yong (Theory of the Liability of the Negligence in
the Contract Negotiation and Its Application in the Trial”), (1999) Issue 1, Shandong Legal Science 46 at 47.\textsuperscript{625} In U.K., the law does not recognise that the parties should observe good faith in negotiation of a contract.
Lord Ackner observed, in \textit{Walford v. Miles} [1992] 2 A.C. 128 at 138, that the courts are ill-equipped to
determine whether a proper reason existed for the termination of negotiations and are therefore not prepared
to recognise the validity of an obligation to negotiate in good faith. “Such a firm rejection of the contract to
negotiate illustrates once again the freedom of contract reasoning and its continuing influence on
International, 2002) at 34-35. However, although the law of U.K. does not recognise good faith as an
autonomous legal doctrine, a wide range of doctrines are relied in U.K. which have a similar function as the

document of good faith in civil law countries. See Reinhard Zimmermann, \textit{Roman Law, Contemporary Law,
European Law: the Civilian Tradition Today} (Oxford: Oxford University Press, 2001) at 172-173.\textsuperscript{626}

\textsuperscript{625} See, for example, \textit{Banque Financière de la Cité S.A. v. Westgate Insurance Co. Ltd.; sub nom. Banque

\textsuperscript{626} The opportunity cost occurs where A had had the opportunity to contract with a third party, but A at last
chose to contract with B due to his reliance on B. most scholars in China support the view that the party in
breach of the pre-contract duty of good faith should compensate for the other party’s loss of opportunity, if
that opportunity really existed. See Wen Jingfang, “Xi Di Yue Guo Shi Ze Ren De Ren Ding Ji Ze Ren Xing
Shi (Analysis of the Recognition and the Liability of the Negligence in the Contract Negotiation)”, (1999)
Issue 3, Journal of Legal Science 27 at 28; Feng Jincai, “Di Yue Guo Shi Ze Ren De Si Fa Shi Yong (The
81 at 82; Hu Kangsheng, ed., \textit{Zhong Hua Ren Min Gong He Guo He Tong Fa Shi Yi (The Paraphrase of the
Contract Law of the People’s Republic of China)} (Beijing: The Law Press, 1999) at 73. But see Wang
Liming, \textit{Wei Yue Ze Ren Lun (The Obligation of the Breach of the Contract)}, 2\textsuperscript{nd} ed. (Beijing: China
\end{quote}
premiums that should be returned. Usually the expenses should not exceed the premiums otherwise they cannot be regarded as reasonable. A prudent insurer should consider all kinds of reasonable expenses before framing the premium rates so the premium should be higher than all the expenses otherwise there would be no profit.

iv. Conclusion of Damage and Suggestions

Therefore, unlike the law of U.K., the remedies available in China are not restricted to termination only. This significantly increases the choices of remedy in the Chinese insurance law and is a superior improvement on the English law position in the sense that damage is far more useful to the insured when the insurer breaches the duty. Therefore, there is no need to change the nature of the duty of utmost good faith to be an implied term of the contract so as to allow the insured to claim damages.

628 In cases of intentional non-disclosure, the insurer can retain the premiums so there is no question of deduction. Where the non-disclosure is innocent, innocence act will not entitle damages according to article 42 of the Contract Law 1999. The most disputable question is: will negligent non-disclosure entitle the insurer to deduct commission charge from the premiums that should be refunded? According to theory of pre-contract duty, the insurer is entitled to claim damages. Since the insurer owes premium refund to the insured and the insured owes damages for commission charge and other reasonable expenses to the insurer, the insurer may offset the debt according to article 99 of the Contract Law 1999. (Article 99: If the parties mutually owe matured liabilities, and if the varieties and quality of the targeted matters of the liabilities are the same, either party may offset its liabilities against those of the other party, except for liabilities that cannot be offset according to the provisions of laws or according to the nature of the contract.) If the insurer could not deduct from the premium refund, he must bring an act against the insured. This would increase the quantity of litigation.


630 Under the Insurance Contract Law 1984 (Australia), the duty of utmost good faith is an implied term of the contract. Section 13: “The duty of the utmost good faith: A contract of insurance is a contract based on the utmost good faith and there is implied in such a contract a provision requiring each party to it to act towards the other party, in respect of any matter arising under or in relation to it, with the utmost good faith.” The Marine Insurance Act 1909 (Commonwealth) still insists the traditional nature of utmost good faith that it is a statutory duty. Section 23: “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.” But it is doubtful how long would the Marine Insurance Act 1909 (Commonwealth) goes on insisting this position. The Australian Law Reform Commission (ALRC) has recommended making good faith an implied term of the contract. See Australian Law Reform Commission, Review of the Marine Insurance Act 1909, ALRC Report No. 91 (Sydney: The Commission, 2001) at 10.143-10.150.
However, it would be dangerous if the insurer is able to claim damage from the insured for even a minor negligence in his performance of disclosure, as few people would like to buy insurance if he is potentially faced with a large amount of claim of damage. Therefore, it is suggested that the insurance law of China should have a “no other remedies” provision like the Insurance Contract Act 1984 (Australia), stipulating that the insurer is not entitled to any remedy other than provided by the Insurance Law and the Maritime Code in relation to the duty of disclosure, whether or not that remedy is provided by the contract or by any other law. If such a provision is added, the insurer’s remedy would not include damage and the insured will be safe.

12. **Refund of Premiums**

After the termination of the insurance contract, the insurer may retain the premiums if the non-disclosure is intentional. The intentional non-disclosure is considered as a fraudulent behavior which would highly endanger the insurance business so it is necessary to forfeit the premiums as penalty. The position on intentional non-disclosure is the same in both marine and non-marine insurance, and it in harmony with the common law.

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631 Section 33 (No other remedies): The provisions of this Division are exclusive of any right that the insurer has otherwise than under this Act in respect of a failure by the insured to disclose a matter to the insurer before the contract was entered into and in respect of a misrepresentation or incorrect statement.

632 The standard insurance contracts in China have not had such a clause which enables the insurer to claim damage or avail to other remedies stricter than what has been provided by the insurance law, but this cannot be precluded in the future. To prevent the dishonest insurer from misusing autonomy of contract, it is necessary to have such a “no more remedy provision” in the insurance law.

633 It is also necessary to have a “no other remedy provision” to prevent the administrative regulations or the local regulations from enlarging the remedies that the insurer may utilise.

634 See article 17 of the Insurance Law and article 223 of the Maritime Code.

635 Section 84(3)(a) of the Marine Insurance Act 1906 (U.K.): 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.
As to negligent non-disclosure in non-marine insurance, article 17 of the Insurance Law stipulates that the insurer “may” refund the premiums. The phrase “may” seems to suggest that the insurer has the option to decide whether to refund or not. However, the phrase should not be so interpreted. The purpose of the remedy for non-disclosure is to release the insurer from the misevaluated risks rather than to punish the insured who has made slight error. In addition, if the premiums were not refundable whether or not the breach is intentional or negligent, article 17 would not have iterated it separately in paragraph 4 and 5. A case of non-marine insurance also supports this position, in which the judge stated that the insurer should refund the premiums if the insurer cannot prove that the misrepresentation is intentional. Most of time, the termination of the insurance contract only affects the part of the contract that has not been performed, so the insured should be regarded as covered before the termination. Therefore, the refund of premiums should be prorated to reflect the proportion of the period after the termination to the whole insured period.

The Maritime Code does not stipulate whether the premium is refundable for unintentional non-disclosure. Wang Pengnan, in the 1st edition of his textbook, suggested that the premium should be refunded to the insured because article 17 of the Insurance Law should apply on this issue since the

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636 Technology Import and Export Company of Hubei Province v. PICC Hubei Branch [2002] E Min Si Zong Zi, No. 11. This is the final judgment by the People’s High Court of Hubei Province. In this case, it was held that the policy was avoided because the insured lacked of insurable interest which was the main reason for the judgement, but there was also misrepresentation by the insured. The judge stated that “since the insurer could not prove that the misrepresentation was intentional, the premiums should be refunded to the insured.”

637 See Wang Guiguo & John MO, eds., The Chinese Law (Hague: Kluwer Law International, 1999) at 714. The proposed judicial interpretation of the Insurance Law also has similar rules. See article 6 of the Interpretation of the People’s Supreme Court’s on Several Questions of the Inquisition of Insurance Dispute Cases (Draft for Consultation), online: Law-Lib.com <http://www.law-lib.com/law/lfbj/lfbj_view.asp?id=10276>. Compared with the “none or full” return of premiums under section 84(3) (a) of the Marine Insurance Act 1906 (U.K.). This may contribute to the difference between the remedies of rescission and termination. Under the Marine Insurance Act 1906 (U.K.) once the contract is avoid, it is avoided ab initio, and the insurer is not liable for any loss. On the contrary, in the Chinese law, the insurer can only terminate the contract for negligent non-disclosure and he is still liable for the loss before the termination unless the loss is attributed to the non-disclosure. In certain sense, the insured has been covered before the termination, so it would be unfair if an insurer had to return the whole premium.
*Maritime Code* has not regulated on it.\(^{638}\) However, in the 2\(^{\text{nd}}\) edition, he changed the opinion, saying that *the Maritime Code* should have made it clear that the premium is not refundable and *the Maritime Code* should be so amended in the future.\(^{639}\) There seems to be no reason why Wang suggested making the premium not refundable in marine insurance and making the position different from that of non-marine insurance. The confiscation of the premium in intentional non-disclosure is to punish those who commit deceit. There should not be punitive remedy in unintentional non-disclosure.\(^{640}\)

13. **Increasing the Premiums Instead of Rescission**

i. **Introduction**

Increase of the premium is a remedy where the insurer may collect additional premium from the insured. The additional premium is calculated by what the insurer would have charged minus what the insurer actually charged. This is different to the principle of proportionality adopted in France.\(^{641}\) The approach of increasing premium also faces the difficulty that the principle of proportionality has faced, i.e., the difficulty in calculating what the premium would have been. However, the disputes as to what the premium would have been may not be as many under the

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\(^{639}\) Wang Pengnan, *Hai Shang Bao Xian He Tong Fa Xiang Lun (On Marine Insurance Contract Law)*, 2\(^{\text{nd}}\) ed. (Dalian: Dalian Maritime University Press, 2003) at 82. Wang did not give reasons why he had changed the opinion.


\(^{641}\) Under the remedy of proportionality, which is discussed in more detail at page 151, below, the insurer is entitled to reduce his liability to pay the proportion of the claim which the actual premium paid bears to the premium which would have been payable if the material facts had been disclosed. It may be more comprehensible to show the difference with formulations. Under the increase premium rule in the Chinese law:

- The additional premium = the would-be premium – the actual premium
- Under the proportionality rule in the French law:

  - The insurer’s liability = the claim * (the actual premium / the would-be premium)
approach of increasing premium as the principle of proportionality because, under the latter principle, a minor difference in the would-be premium will result in a great difference in the liability that the insurer should bear, while under the former approach, a minor difference will readily be compromised between the parties.

ii. Marine Insurance

The Maritime Code allows the marine insurer to claim for additional premiums instead of terminating the contract when the insurer has found the non-disclosure unintentionally committed by the insured. Where the peril insured against does not occur during the whole insured period, or where the insurer does not want to spoil the business relationship with the insured, the remedy of termination or rescission of the contract will not be too much value in his eyes. The right to claim for additional premiums becomes very useful in these circumstances. The amount of the additional premiums that the insurer can claim is the balance of the premiums which should have been paid had there been no non-disclosure minus the premiums actually paid. If the insured refuses to pay the additional premiums, the insurer can sue him and ask the court to enforce the claim. The remedy of additional premiums is not compatible with the other remedies. If the contract is terminated, any additional premiums are no longer available.

The Maritime Code does not stipulate whether the insurer can claim for additional premiums instead of terminating the contract where the non-disclosure is intentional, but it can be reasonably concluded from article 223(2) that the insurer has the right to claim for additional premiums. An international breach of the duty of disclosure is of much graveness than a negligent one, and the penalty to the former should therefore be more Spartan than that of the latter. Therefore, a penalty to the negligent breach definitely may apply to the intentional breach, though the

\[642\text{ Article 223(2) of the Maritime Code}\]
counterproposition is not necessarily true. If the option for additional premiums is a better remedy for the insurer in certain circumstances, the law should not deter the insurer to do so; the insurer himself is the best judge for his own interest after all.

iii. Non-Marine Insurance

Claim for additional premium is not available in non-marine insurance, but it is odd that the right to claim additional premium is not available in non-marine insurance contract while it is available in marine insurance contract. The calculation of the amount of the notionally “would-be” premium depends much on a system of fixed tariffs. In life insurance and certain areas of general insurance, it is relatively easier to establish such a system; on the other side, the marine insurance premium is often set on *ad hoc* basis.

iv. The Law of Australian on This Point

The remedy to claim additional premiums has been adopted in Australia. *The Insurance Contract Act 1984 (Australia)* provides that the insurer may reduce the liability under the insurance contract to the amount that would place the insurer in a position in which the insurer would have been if the breach of the duty of disclosure had not occurred.643 This Act applies to non-marine insurance contracts. As to marine insurance contracts, the Australian Law Reform Commission also made similar suggestions to the reform of *the Marine Insurance Act 1909 (Commonwealth)*.644 Under these provisions, the insurer can deduct the balance between the actual premium, deductible, or

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643 Section 28(3) of *the Insurance Contracts Act 1984*.
644 26B (3) (b), Schedule 1, *Marine Insurance Amendment Bill 2001*. See Australian Law Reform Commission, *Review of the Marine Insurance Act 1909*, ALRC Report No. 91 (Sydney: The Commission, 2001) at 366. The difference between the Marine Insurance Amendment Bill 2001 and the Insurance Contracts Act 1884 is that: the former specified the items that could be varied to reflect the position that the insurer would have been if the duty of disclosure had not been breached; these items are premium, deductible or excess.
excess, and the notionally “would-be” premium, deductible, or excess, as the case may be, from the compensation payable to the insured.

There are two differences between Australian law and The Chinese law, and each difference suggests a virtue of the respective law. The Australian law excels in that it does not limit the deduction within premium only. The Chinese law has overlooked the possibility that the insurer may have demanded other terms than the premium. On the other hand, the Australian law falls short of making the remedy only a “shield”, namely that the insurer can only deduct the balance from the compensation payable to the insured. The criticism has that “An incentive is created for insureds not to disclose or to misrepresent material facts. By omitting to disclose or by misrepresenting, they obtain a reduction in premium… Only in the unlikely event of a claim is the additional premium ‘paid’. The penalty for misrepresentation is trivial.”645 As a result, the honest insured will pay for the dishonest. The Chinese law allows the insurer to exercise the right positively, namely that the insurer can claim for additional premium even where no compensation has been alleged, therefore the insured who breaches the duty will pay for his own fault. The differences seem to suggest that the two countries’ law should learn from each other.

14. Misrepresentation of Age and the Principle of Proportionality

In China, the principle of proportionality applies only in the misrepresentation of age in life insurance. It is stipulated in article 54 of the Insurance Law,646 which shall prevail to the general

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646 Article 54: (1) If the age of the insured declared by applicant is not true to fact, and the actual age fails to be in conformity with the age limit as agreed upon in the contract, the insurer may terminate the contract, and return the insurance premium to the applicant after deducting the handling fees, however, the contract which has been served for more than two years into since its conclusion shall be excluded. (2) If the age of the insured declared by the applicant is not true to fact, which hereby causes the applicant paying an insurance premium less than the insurance premium payable, the insurer shall have the right to correct it and demand the applicant to make up the insurance premium, or pay the insurance benefit according to the
remedies available to the breach of the duty of disclosure. Article 54(1) provides that, for the misrepresentation of age, the insurer may terminate the contract only when the actual age does not accord with the age limit as agreed in the contract and he may only exercise this right within two years from the conclusion of the contract. Article 54(2) provides that where the insurer cannot terminate the contract due to the previous subsection, what he is entitled is an option that he can either claim for additional premium or he can adjust his liability to pay the proportion of the claim which the actual premium bears to the premium which would have been.

The law of U.K. does not have the principle of proportionality in the duty of disclosure. The principle of proportionality in France means that the insurer is obliged to pay the proportion of the claim which the actual premium paid bears to the premium which would have been payable if the material facts had been disclosed. The main defect of the principle of proportionality is the difficulty in proving the notional would-be premium, or what the insurer would have charged had he known the truth. Due to this defect, both the Law Commission of U.K. and the Australian

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percentage of the actually paid insurance premium to the insurance premium payable. (3) If the age of the insured declared by the applicant is not true to fact, which hereby causes the applicant paying an insurance premium more than the insurance premium payable, the insurer shall return the insurance premium collected in excess to the applicant.

Article 54(2) of the Insurance Law is special rule compared with the general remedies available to the breach of the duty of disclosure because it is specifies the remedy in the special cases of misrepresentation of age in life insurance contract.

Here the additional premium is calculated in the same way as mentioned at page 148, above.


It is relatively easier to calculate the would-be premium in the area where there is a system of fixed tariffs, such as in life insurance. The calculation would be much more difficult to make in areas where the risks are unusual ones or where the premiums are set on an ad hoc basis due to competitive pressures. It is the same difficult where the undisclosed fact was connected with a moral risk. In addition, where the insurer would not have accepted the risk at all, it is almost impossible to calculate what the premium would be. There is also the danger that insurer might abuse a system based on their own recalculation of the premium. See U.K., the Law Commission, Insurance Law – Non-Disclosure and Breach of Warranty, Law Com. No. 104, Cmnd 8064 (London: H.M.S.O., 1980) at para. 4.8; Australian Law Reform Commission, Insurance Contracts, ALRC Report No. 20 (Canberra: Australian Govt. Pub. Service, 1982) at paras. 189-190.
Law Reform Commission have rejected the principle of proportionality as a proposed law reform of their countries.

Although the principle of proportionality suffers from the defects mentioned above, the difficulty in calculating what the premium does not pose a major problem in the Chinese law, because the principle of proportionality here only applies to the misrepresentation of age in life insurance. In this area there is a system of fixed tariff, and the effect of the misrepresentation of age on the risk is easy to calculate. However, the principle of proportionality should not apply to intentional misrepresentation of age and the law should allow the insurer to terminate the contract for intentional misrepresentation.

15. Summary of the Insurer’s Remedies under the Chinese Law

Under the Chinese law, the insurer is entitled to terminate the contract when and only when the non-disclosure is either fraudulent or material. Termination of the contract has the following effects: first, the insurer is no longer liable for any loss occurring after the termination; second, he is not liable for the loss occurring before the termination if and as far as the undisclosed fact has an impact (in marine insurance) or a grave impact (in non-marine insurance) on the occurrence of the loss; finally, the premiums must be returned unless the non-disclosure is fraudulent. Termination takes effect upon notice in written. The right of termination should be confined to certain period. Damages are available for non-disclosure on ground of principles in the general contract law and the civil law, but it is suggested that the insurance law should restrict the insurer from availing to the right to claim damages. The insurer may also choose to increase the premium in lieu of terminating the contract in marine insurance. It is argued that the insurer should be entitled to the

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651 Similarly, the Insurance Contract Act 1984 (Australia) has adopted the principle of proportionality in life insurance. See section 29(4) of this act.
same right in non-marine insurance. In life insurance, the insurer cannot terminate the contract in very limited circumstances; instead, he can adjust his liability to pay the proportion of the claim which the actual premium bears to the premium which would have been. In general, there are various remedies for non-disclosure under the Chinese law and this has made the law more flexible.

Table: Part of the Insurer’s Right against Non-Disclosure under the Chinese Law

<table>
<thead>
<tr>
<th>The nature of the contract</th>
<th>Marine insurance</th>
<th>Non-marine insurance</th>
</tr>
</thead>
<tbody>
<tr>
<td>The state of mind</td>
<td>Intentional</td>
<td>Intentional</td>
</tr>
<tr>
<td>Unintentional (negligent or innocent)</td>
<td>Yes</td>
<td>Yes, unless there is an impact.</td>
</tr>
<tr>
<td>Whether the insurer has right to terminate the contract</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Whether the insurer is liable for loss occurring before the termination</td>
<td>No</td>
<td>Yes, unless there is an impact.</td>
</tr>
<tr>
<td>Whether the insurer can retain the premiums</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>Whether the insurer can claim for additional premium</td>
<td>Yes</td>
<td>Yes</td>
</tr>
</tbody>
</table>

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See page 131ff., above.
Chapter 7. The Insurer’s Duty of Utmost Good Faith

I. Insurer’s Duty of Disclosure under the Common Law


The principle of utmost good faith was innately a reciprocal duty imposed on both parties to the insurance contract. The insurer was under the same duty as the insured to disclose everything material to the insured in concluding the insurance contract.\(^{653}\) Lord Mansfield, in the leading case of *Carter v. Boehm*,\(^{654}\) observed that:

> “Good faith forbids *either* party by concealing what he privately knows, to draw the other into a bargain, from his ignorance of that fact, and his believing the contrary.”\(^{655}\) “The policy would be *equally* void, against the *underwriter*, if he concealed; as if he insured a ship on her voyage, which he privately knew to be arrived; and an action would lie to recover the premium.”\(^{656}\)

Section 17 of *the Marine Insurance Act 1906 (U.K.*) also confirms the reciprocity of the principle of utmost good faith:

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\(^{654}\) (1766) 3 Burr 1905.

\(^{655}\) *Ibid* at 1910.

\(^{656}\) *Ibid* at 1909, emphasis added.
“A contract of maritime 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.”

Once again, the reciprocity of the principle was iterated in the Westgate case the trial judge, the Court of Appeal and the House of Lords all approved that the duty of disclosure is reciprocal, but the court held that the remedy available to the insured is restricted to rescission of the contract only. In another case of Bank of Nova Scotia v. Hellenic Mutual War Risks Association (Bermuda) (The Good Luck), the court reiterated the reciprocity of the duty of disclosure, although it was not necessary to do so.

The history of the development of the principle of utmost good faith has clearly shown that the duty of disclosure is reciprocal. Nobody would have any doubt about the nature of reciprocity of the duty. However, the duty of disclosure by the insurer, apart from the above cases and a few other cases, has rarely emerged in English insurance case law. The duty of disclosure had almost unilaterally rested upon the insured. The tendency was also reflected in the Marine Insurance Act 1906 (U.K.), which defines the insured’s duty of disclosure in through via four sections, while it

657 Emphasis added.
659 The trial judge’s decision that the insured can claim damage for the insurer’s breach of the duty of disclosure is overruled by the Court of Appeal and the House of Lords.
661 The House of Lords held that the plaintiff assignee was entitled to the damages from the defendant insurance company but not on the ground of utmost good faith. ([1991] 2 Lloyd’s Rep. 191 at 203-205) The Court of Appeal held that the insurer owes a duty to disclose to the insured but not to the assignee. ([1989] 2 Lloyd’s Rep. 238 at 261-264)
only indicates the reciprocity of the duty via one section.\footnote{663} This tendency could be attributable to the fact that, when the rule was first applied to marine insurance cases, “underwriting was at its infancy, communication facilities were poor, and, in the nature of things, the one who was often in a better position to ascertain the special knowledge turned out invariably to be the insured rather than the insurer.”\footnote{664} Now the situations have changed much. An insurance company usually has its own data collecting framework which is so powerful that it often helps the insurer to gain some information unilateral known by the insurer. Therefore, it seems to be more important now to accentuate the insurer’s duty of disclosure for the sake of fair dealing and good faith.


Three questions must be answered inevitably in order to obtain a clear scope of the duty. (1) What should the insurer disclose? Namely, does the scope of disclosure extend to both actual and constructive knowledge? (2) What is the test for materiality? (3) What is the test for inducement? As a whole, these questions could be incorporated by one question, i.e., “Is the scope of the insurer’s duty of disclosure the same as that of the insured’s?”

The *Marine Insurance Act 1906 (U.K.)* offers little assistance in defining the scope of the insurer’s duty of disclosure. In *Carter v. Boehm*,\footnote{665} Lord Mansfield seemed to suggest a narrow view that the insurer’s duty is “restricted to the facts as to the risk which would induce the insured either not

\footnote{663} Namely, section 17 which stipulates that “if the utmost good faith be not observed by either party, the contract may be avoided by the other party.”
\footnote{665} (1766) 3 Burr 1905.
to insurer or to insure for a lower premium.” In the first instance of the Westgate case, Steyn J. adumbrated a rough working definition, which was intended to be refined through future cases:

“… In considering the ambit of the duty of the disclosure of the insurers, the starting point seems to me as follows: in a proper case it will cover matters particularly within the knowledge of the insurers, which the insurers know that the insured is ignorant of and unable to discover but which are material in the sense of being calculated to influence the decision of the insured to conclude the contract of insurance. In considering whether the duty of disclosure is activated in a given case a court ought, in my judgment, to test any provisional conclusion by asking the simple question: did good faith and fair dealing require a disclosure?”

Steyn J.’s definition of the scope of the insurer’s duty of disclosure is quite broad, but it is still unsatisfactory. First, it is not clear whether the insurer need to disclose what he is deemed to know or what he should know in the ordinary course of his business. Second, the additional requirement of “good faith” and “fair dealing” amount to gilding the lily and the variable meanings of “good faith” and “fair dealing” would cause a great deal of dispute. In addition, according to Steyn J’s test for materiality, a circumstance is material if it is “calculated” to influence the decision of the insured. “Calculated to influence” would mean that the influence needs not to be decisive in the sense that the insured at least would not have had the same contract had he known the truth. This seems to embrace the want-to-know test which is the current law on the insured’s duty of

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666 Semin Park, The Duty of Disclosure in Insurance Contract Law (Brookfield, Vt.: Dartmouth Pub. Co., 1996) at 193. Park got this conclusion from the example given by Lord Mansfield that a ship arrives safe. This is a fact that diminishes the risk insured against.


668 For comment on the additional requirement of “good faith” and “fair dealing”, whether these two phrases apply conjunctively or disjunctively, and what are the meanings of the phrases, see Hwee Ying Yeo, “Uberrima Fides – Reciprocity of Duty in Insurance Contracts” [1988] 2 R.I.B.L 271 at 284-285.
disclosure but which has been highly criticized to be bad law. The use of “calculated” would undesirably extend the duty of disclosure.

The Court of Appeal offered an alternative yardstick, -- the minimum scope of the insurer’s duty of disclosure, a test which the House of Lords endorsed:

The duty falling upon the insurer must at least extend to disclosing all facts known to him which are material either to the nature of the risk sought to be covered or the recoverability of a claim under the policy which a prudent insured would take into account in deciding whether or not to place the risk for which he seeks cover with that insurer.

The Court of Appeal wisely defined what is surely within the scope of the insurer’s disclosure while leaving the question open for future cases to complement the scope of the insurer’s duty of disclosure. It is also important that the Court has pointed out the core of the insurer’s duty of disclosure, i.e., the recoverability of a claim under the policy which is the most concerned information to the insured. In the Court’s definition, there are still two points unclear. The first is whether the insurer should disclose what he is deemed to know. The second is whether the scope of the material facts is limited to those related to the nature of the risk sought to be covered or the recoverability of a claim under the policy. However, these could be completed by future cases; after all, the Court just stipulated that the duty at least extend to those facts within the actual

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669 See the decisive test & “want to know test”, at page 89ff., above.


672 See also: H. Y. Yeo, “Of Reciprocity and Remedies - Duty of Disclosure in Insurance Contracts” (1991) 11 LS 131 at 136, where Yeo observed that “there exists ‘rather different reasons for which the insured and the insurer require the protection of full disclosure’… On one hand, the insurer is, in the main, concerned with matters that will directly affect the risk… On the other hand, the insured, once he has decided that it would be prudent to pass the risk on to an insurer, is naturally less concerned with the risk itself but is instead more interested in whether he can recover his losses in the event of any contingencies.”
knowledge of the insurer. On the whole, the Court’s definition is a mirror image of the duty imposed on the insured.673


The remedy for the insurer’s breach of the duty of disclosure is rescission of the contract and return of the premium.674 This position has been consistent675 since Lord Mansfield. It was unsuccessfully challenged only by Steyn J. in the Westgate case.676 The remedy of rescission is useful where the insured has been misled, due to ignorance of certain circumstances which the insurer should have disclosed, to buy an insurance which he does not need, but it would be of little help where the insured becomes unable to recover his loss.

For Lord Mansfield, the insurer’s duty of disclosure is aimed at protecting the insured from being misled into a needless insurance contract. This implication is illustrated by the example he gave: an underwriter has insured a ship on her voyage which the underwriter privately knows that the ship has arrived safe; if the underwriter conceals this matter from the insured, he is in breach of the duty of utmost good faith.677 It is observed that Lord Mansfield considered the insurer’s duty of disclosure restricted to the facts which would induce the insured either not to insure or to insure

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673 The degree of influence, according to the Court, is also the pure influence test. However, “taking into account” is better than “calculated to influence” (the phrase used by Steyn J).
675 For example, see Glasgow Assurance Corp. v. William Symondson & Co. (1911) 16 Com.Cas. 109 at 121, where Scrutton J. stated that the only remedy was avoidance. However, this dictum was clearly obiter, although it was relied upon by the Court of Appeal in the Westgate case in support of their decision. (John Birds & Norma J. Hird, Birds’ Modern Insurance Law, 5th ed. (London: Sweet & Maxwell, 2001) at 128, note 80.)
for a lower premium.\textsuperscript{678} Therefore, the insured’s right in such circumstances is the rescission of the insurance contract and recovery the premium. It is possible that, in Lord Mansfield view, since the insurer’s duty of utmost good faith would arise only in these kinds of circumstances, the sole remedy of rescission of the insurance contract is adequate for the insured to protect his right.

The question of remedy was recently fully discussed in the Westgate case. The House of Lords at last denied the remedy of damage. According to them, the only available remedy to both the insured and the insurer in the case of breach of the duty of utmost good faith is rescission of the contract at the option of the innocent party.\textsuperscript{679} However, the reasons why damage should not be awarded, which were given by the Court of Appeal and agreed with by the House of Lords, are not convincing.\textsuperscript{680} In fact, rescission is only efficient for the insurer; for the insured, it is far from enough in some circumstances. Where the insured becomes unable to recover his loss due to the non-disclosure of the insurer, what the insured need is damage. The following discussion on the reform of Chinese insurance law will suggest some more remedies for the insurer’s breach of the duty of utmost good faith.

II. The Insurer's Duty of Utmost Good Faith under China Law

1. The Background of China

The insurance contract is a standard contract unilaterally drafted by the insurer beforehand. Most of the insureds have not much muscle to change the terms of the contract; they can only accept or reject the contract as a whole and actually they have no choice but to accept the contract as far as


\textsuperscript{680} Discussed in more detail at page 114ff., above.
they want their lives or properties ensured. Moreover, the individual insured can seldom understand the whole contract which is full of legal and insurance glossaries. Therefore, most of the time, an insurance contract cannot be considered to be a contract freely entered into by the insured. It is especially so in China as in the most places of China there is only one insurance company available. In addition, it has been discussed by the Standing Committee of the National People’s Congress on the problem of agents of insurance companies misleading the insured to enter into insurance contract with some insurance companies even abetting the agents in misleading the insured. Therefore, it is very important to protect the insured from being misled, and this is the task of the law on the insurer’s duty of utmost good faith. The insurer’s disclosure would help the insured, especially those without much knowledge of insurance, to decide whether to buy the insurance.

2. Introduction of the Insurer’s Duty of Utmost Good Faith under China Law

681 For example, in Guardian Insurance Co v. Underwood Constructions Pty (1974) 48 A.L.J.R. 307 at 308, Mason J. described a policy as a “jumble of ill-assorted documents expressed in the distinctive style which insurance companies have made their own.” In Forsikringsaktieselskapet Vesta v. Butcher [1989] 1 Lloyd’s Rep. 331 (H.L.), Lord Bridge of Harwich commented on a Lloyd’s reinsurance policy in the following terms:”… the only people who can expect to profit from the ambiguities of the present form … are the lawyers.” See Julie-Anne Tarr, Disclosure and Concealment in Consumer Insurance Contracts (London: Cavendish, 2002) at 1, in note 2. Tarr also analyses in details on the unevaluability of the terms of the insurance contract from economics view. See Julie-Anne Tarr, ibid, at 13-20.

682 In most of the places, the People’s Insurance Company of China is the only available property insurer and the China Life Insurance Company is the only available life insurer. The statistics of 2001 showed that the former occupied 73.74% income of the national property insurance market and the latter occupied 57.05% income of the national life insurance market. See “2001 Nian Zhong Guo Bao Xian Shi Chang Bao Fei Shou Ru Tong Ji (Statistic of Premium Income of China Insurance Market in 2001)”, Zhong Guo Bao Xian (China Insurance), 2002, Issue 6, cited in Xu Feiqiong, “Zhong Guo Bao Xian Ye Fa Zhan De Hui Gu Yu Ping Gu (The Review and Evaluation of the Development of the Insurance Industry of China)”, Lun Tan Tong Xun (Forum Newsletter), December 10, 2002, online: China Reform Forum <http://www.crf.org.cn/newsletter/200212/003.htm>.

The insurer’s duty of utmost good faith in China is not a complete and integrated duty like it is under the common law where the insurer is required to disclose everything material to the decision of the insured. The insurer’s duty of utmost good faith under China law includes two aspects. (1) General explanation of the terms of the insurance contract. (2) Special explanation of the exemption clauses in the insurance contract. These two duties are stipulated in the Insurance Law and apply to both marine and non-marine insurance contract since the Maritime Code does not have rules on these issues. It is argued that these duties are duty of explanation; they are different from the duty of disclosure. However, since the interpretation of the clauses of the contract belongs to the circumstances which would influence the insured on whether to buy the insurance, the duty of explanation may be treated as a type of disclosure. Anyway, it is widely believed that the duty of explanation is a pre-contract duty of utmost good faith.

3. General Explanation of the Terms of the Insurance Contract

i. Introduction to the Duty of General Explanation

Article 17 of the Insurance Law states in general words that “Before an insurance contract is signed, the insurer shall disclose to the applicant the contents of clauses of the contract, and also may make inquiry on conditions relating to the subject-matter to be insured or the person to be insured.” From the wording of this article, it can be said that the insurer’s duty to explain the terms of the insurance contract is the reciprocal duty to the insured’s duty of disclosure. The explanation

684 See the proposed definition given by the Court of Appeal in the Westgate case, at page 159, above.
685 Article 17(1) of the Insurance Law.
686 Article 18 of the Insurance Law.
usually includes, but not is limited to, the nature of the risk covered, the liability of the insurer, the exemption clauses, the duty of the insured, the payment of the premium, and the recovery of loss and damages. The requirement of explanation means that the insurer must correctly explain the terms of the contract; he can neither keep silent nor wrongly explain them. The duty of explanation is a voluntary duty whether or not the insured has inquired.

As comparison, under the law of U.K., it is the broker’s duty to explain the content of the contract to the insured. The reason why China makes it the duty of the insurer instead of the broker is due to the fact that there are not many brokers in the industry and most of the contracts are not reached through brokers.

ii. The Degree of Explanation

To what extent the explanation should be is not specified by law. The insurance companies and some judges allege that “insurers will usually list the terms of the contract on the back of the policy and this has satisfied the requirement of article 17(1) of the Insurance Law.” That is to say, the insurer need to do nothing and the terms listed on the back of the policy explains by

689 The explanation of the exemption clauses will be further discussed infra.

690 See Nicholas Legh-Jones, gen. ed., MacGillivray on Insurance Law, 10th ed. (London: Sweet & Maxwell, 2003) at paras. 36-30, 36-31. But the broker of course does not have to thoroughly explain every term of the contract to his principal, but he must take reasonable steps to ensure that his principal understands the nature of the risk and the basis on which the insurance is written. Otherwise the broker will be answerable for his negligence. Warren v. Sutton [1976] 2 Lloyd’s Rep. 276; British Citizens’ Assurance Co. v. Woolland & Co. (1921) 8 L.I.L.R. 89; General Accident Fire & Life Assurance Corp. v. Minet (1942) 74 L.I.L.R. 1.

691 When the Insurance Law was passed in 1995, there are actually no brokers in China at all. See the text accompanying supra note 294. In contrast, in U.K., the insured is always represented and assisted by a broker. See Nicholas Legh-Jones, gen. ed., MacGillivray on Insurance Law, 10th ed. (London: Sweet & Maxwell, 2003) at para. 36-1.

692 Ibid.

themselves. According to them, the meaning of “to explain the terms” has no difference with that of “to show the terms”. Comparatively, a more reasonable interpretation of article 17(1) of the Insurance Law is found in the proposed draft of the judicial explanation on the Insurance Law.\footnote{Article 8 of The Interpretation of the People’s Supreme Court’s on Several Questions of the Inquisition of Insurance Dispute Cases (Draft for Consultation), online: Law-Lib.com <http://www.law-lib.com/law/lfbj/lfbj_view.asp?id=10276>.} Article 8 of the draft proposes that

The insurer should, according to article 17(1) of the Insurance Law, explain the terms of the insurance contract to the insurance applicant to the extent that an ordinary person would understand the explanation, \textit{but the insurer may explain to different extent according to the applicant’s experience on insurance application.}\footnote{Emphasis added.}

It is reasonable to stipulate that the explanation should be capable of being understood by an ordinary person, but the latter part of article 8 (the italic words) has blurred the standard imposed on explaining. Suppose that the extent to which insurer explains the terms of the contract may be varied according to the experience of the applicant, what is the use of the general standard of an ordinary person? In addition, does it mean that the insurer should first find out whether the insured is experienced or not before the insurer make any explanation? In the author’s view, just like a prudent insurer means a reasonable insurer “in that type of insurance”,\footnote{See page 85 above.} an ordinary person means an ordinary man in that type of insurance and this standard shall apply consistently to all circumstances except where the insured is apparently inexperienced; in that exceptional case, the insurer shall make further effort to make the insured understood.

\begin{itemize}
  \item[iii.] The Liability for Non-Performance of the Duty of General Explanation
\end{itemize}
(a) The *Contra Proferentem* Rule

The law does not make it clear what liability will arise from the insurer’s failure to perform the duty of general explanation. Does this mean that the insurer has no liability if he has breached the duty of general explanation? If no, then what kind or kinds of liability will arise from such breach? In the absence of any statutory authority, the question could only be answered by analysis of the legal theory of the civil law.

Every breach of a duty is accompanied by a liability, otherwise the duty is no longer compulsory and the duty is no long a duty. The purpose of the duty of the insurer to explain the terms of the insurance contract is to prevent the insurer from taking advantage of the insured’s inexperience and similarly so in respect of the duty of special explanation. If the insurer fails to perform the duty of explanation, the insured is deprived of the right-to-know. But a duty cannot exist if the breach of the duty would not cause any liability. To protect the insured’s right, there must be liability for the breach of the duty of general explanation.

The duty of explanation in the insurance contract is alien to the law applied to other standard contract\(^{697}\) and the most suitable remedy may also come from the provisions within *the Insurance Law*. Article 31 of provides that

\(^{697}\) If the standard contract is not insurance contract, the provider of the standard contract is only obliged to draw the other party’s attention to the exemptible and restrictive clauses and the duty of explanation is not voluntary. This rule is stipulated in article 39 of *the Contract Law 1999*. “If standard clause are used in making a contract, the party that provides the standard clauses shall determine the rights and obligations between the parties in accordance with the principle of fairness, and *shall call in a reasonable manner the other party’s attention to the exemptible and restrictive clauses regarding its liability*, and give explanations of such clauses at the *request of the other party*. ‘Standard clauses’ means the clauses that are formulated in anticipation by a party for the purpose of repeated usage and that are not a result of consultation with the other party in the making of the contract.” [emphasis added]
“When the insurer has disputes on the contents of an insurance contract with the applicant, the insured or the beneficiary, the People’s Court or arbitration organ shall make interpretation and explanation favourable to the insured and the beneficiary.”

Combined with article 31, article 17(1) should be interpreted to mean that, if the insurer fails to explain a term of the contract, and if that term has caused disputes between the parties, the court or arbitration organ should interpret the term favourably to the insured and the beneficiary. As far as the insurer breaches the duty of general explanation, this “contra proferentem rule” should apply regardless of the clause left unexplained, whether the unexplained clause is material or minor, whether the insured’s own negligence may have contributed to the loss. In *Shenzhen Hualian Food & Cooking Oil Co. v. Hua’an Property Insurance Company*, the insurer failed to explain the

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698 Article 41 of the *Contract Law 1999* provides that the terms of a standard contract should be interpreted first according to the ordinary meaning of the words. If there are more than one ordinary meanings, then the *contra proferentem* rule applies. So it would be wrong if article 31 of the *Insurance Law* were interpreted as that whenever there is a dispute over a term of the insurance contract, that term would be interpreted in favour of the insured regardless of the ordinary meaning of the term. Fortunately, the proposed judicial interpretation of the *Insurance Law* will clarify this ambiguity. Article 20 stipulates that “where the insurer has dispute with the applicant, the insured or the beneficiary on the terms of the contract, the People’s Court should interpret according to the common understanding, with reference to the relevant wording of the insurance contract, any relevant terms, the purpose of the contract, the trade practice and the principle of good faith, so as to ascertain the true meaning of the term, and the People’s Court may ascertain the meaning of the term according to the following rules: (1) where the written stipulation is different to the oral one, the former prevails; (2) where the stipulation on the insurance application and policy is different to that on other insurance documents, the former prevails; (3) where the special stipulation is different to the standard clause, the former prevails; and (4) where the content of the clause is different due to the inconsistence of the way of recording or due to the time of the recording, the postil prevails to the text, later postil prevails to the earlier postil, pasted postil prevails to postil in text, and what is written by hand prevails to what is printed. After common understanding interpretation, if there are still two or more than two understandings, the People’s Court should make interpretation according to article 31of the Insurance Law. However, if the insurance contract is drafted by the applicant, the interpretation should be favorable to the party who accepts that contract.” [Emphasis added.] See *The Interpretation of the People’s Supreme Court’s on Several Questions of the Inquisition of Insurance Dispute Cases (Draft for Consultation)*, online: Law-Lib.com <http://www.law-lib.com/law/lfbj/lfbj_view.asp?id=10276>.

699 *Shenzhen Hualian Food & Cooking Oil Co. v. Hua’an Property Insurance Company*, online: China Foreign-Related Commercial and Maritime Trial <http://www.ccmt.org.cn//hs/news/show.php?cId=939>. In this case, the insured and the insurer entered into an “all risk” contract which provided that “All Risks: Aside from the risks covered under the F.P.A. (Free Particular Average) and W.A. (With Average) conditions as above, this insurance also covers all risks of loss of or damage to the insured goods whether partial or total, arising from external causes in the course of transit.” Later, the cargo was damages by external cause, but what was exactly the cause could not be found out. The insured alleged that, since the contract was an all risk contract, the insurer did not have the duty to prove what exactly the cause of damage was. The insurer alleged that the “all risk” was in fact “named risks” because the wording of the contract
term “all risk” which the insurer alleged to have different meaning from the common understanding. The court applied “contra proferentem rule” and interpreted “all risk” in favour of the insured. As the result of such interpretation, the contract was held to have covered the loss that the insured claimed.

Therefore, the insurer has to explain the contract especially when the terms of the contract have unusual meanings. If he has explained, those terms should be interpreted according to his explanation, but if he has failed to explain, they will be interpreted contra proferentem.

(b) Avoidance of the Contract

However, if the remedy to the breach of the duty of general explanation is only the application of the “contra proferentem rule”, it may not prove adequate for the insured. For example, where the

should be interpreted as “all Risks = F.P.A. + W.A. + risks arising from external causes”, and the “risks arising from external causes” means 11 named risks according to the explanation of the People’s Bank of China, the administrative competent authority for the insurance industry in China. In response to a request for guidance on the coverage of the People’s Insurance Company of China (All Risks) Clauses, the Bank stated, inter alia, that:

“External causes only refer to theft, pilferage and non-delivery (TPND), fresh water and/or rain damage, shortage, mixture and contamination, leakage, clash and breakage, taint of odour, sweat and heating, hook damage, breakage of packing, rust.”

Therefore, the insurer argued that the risks covered by the policy were name risks and thereby the insured had the duty to prove that the cause of the damage fell within the named risks arising from that 11 external cause. The Maritime Court of Guangzhou held that, although the People’s Bank of China had interpreted the “external causes” as those 11 causes, the layman of insurance would not know it and they could only understand the contract through the terms on the back of the policy, but the insurance company did not clarify in the policy that the “all risks” were in fact named risks, and neither did it attached the interpretation of the People’s Bank of China to the policy, and neither did it explain the “all risks” clause during the acceptance of the risks, and this caused the conflicting understandings of the clause. In such circumstances, the disputed clause should be interpreted in favour of the insured or the beneficiary, namely the external causes are not restricted to those 11 risks, therefore it is the insurer’s duty to prove that the cause of the damage in this case does not fall within the scope of cover. In addition, the Court held that the interpretation of the People’s Bank of China is not binding because the Bank, as a regulatory authority of the insurance industry, does not has the right to explain the contract between the parties. The insurance company appealed. The People’s High Court of Guangdong Province fully agreed with the Maritime Court and dismissed the appeal. The decision of his case is contrary to some previous cases where the facts were similar. For those previous judgements on this point, see Zhang Xianwei, “Marine Insurance in China: Coverage of the PICC All Risks Clauses”, online: China Foreign-Related Commercial and Maritime Trial <http://www.ccmt.org.cn/english/explore/exploreDetial.php?sId=267>.
insured, who fails to understand the scope of the coverage which the insurer did not explain, has bought an insurance which he actually does not need, the proper remedies for him are avoidance of the contract and refund of the premium. Actually, the insured may also avoid the contract on ground of “grave misunderstanding” 700 which is explained in the following paragraph, but there are more difficulties in proving grave misunderstanding than just proving the insurer’s failure to explain. 701

According to article 54 of the Contract Law 1999, 702 the party may avoid the contract ab initio for grave misunderstanding. 703 This refers to the situations where the party has misunderstanding on the type, quality, or quantity of the subject matter, or the nature of the contract, and the misunderstanding has caused the effect that the contract has gone against the party’s true will and has caused considerable loss. 704 However, there are great disputes as to the detailed meaning of grave misunderstanding. 705 According to scholars’ interpretation, in order to prove the grave misunderstanding, the party must show that he has been induced to enter the contract by the misunderstanding. 706 The misunderstanding may either be mutual or unilateral misunderstanding. 707

700 Grave misunderstanding is similar to the common law concept mistake; it is just a different usage of phrase.
701 If the insured relies on the ground of grave misunderstanding to avoid the contract, the insured has to prove that the insurer’s failure to explain has caused grave misunderstanding on the part of the insured, in addition to proving the insurer’s failure to explain.
702 See also article 59 of the General Principles of the Civil Law 1986. It has similar provision as article 54 of the Contract Law 1999.
703 The party may also ask the People’s Court or an arbitration organ to reasonably alter the contract instead of avoiding the contract. See article 73 of the Opinions of the People’s Supreme Court’s on Several Questions of the Enforcement of the General Principles of the Civil Law 1986 (provisional).
704 Article 71 of the Opinions of the People’s Supreme Court’s on Several Questions of the Enforcement of the General Principles of the Civil Law 1986 (provisional). It is something like mistake under the common law.
706 Sui Pengsheng, Ibid, at 106.
707 Ibid.
Therefore, if the insurer’s non-performance of the duty of explanation has caused the insured to gravely misunderstand the nature of the coverage or any other material matter of or related to the contract, the insured may avoid the contract thereby. This position was supported by the People’s Court.\footnote{See \textit{Hongfeng Company v. Ping An Insurance Company}, reported in, Li Ping, \textit{Bao Xian Fa Xin Shi Yu Li Jie (New Interpretation and the Cases of the Insurance Law)} (Beijing: Tongxin Publishing House, 2001) 70. This case is discussed in more detail at page 170, above.}

(c) Damage to the Insured

In some very exceptional circumstances, damage may be the only proper remedy. First, the insured may claim damage on ground of negligence in negotiation just as the insurer may claim damage on this ground too.\footnote{The insurer’s right to claim damage is discussed at page 140ff., above, where the author suggested adding a “no more remedies rule” into \textit{the Insurance Law} so that the insurer may not claim damage. But under the current law, either party may claim damage for the loss of reliance interest.} Second, if the insured is able to avoid the contract on ground of grave misunderstanding, he can claim damage thereafter. This position has been repeatedly supported by the People’s Court.\footnote{See \textit{Hongfeng Company v. Ping An Insurance Company}, reported in, Li Ping, \textit{Bao Xian Fa Xin Shi Yu Li Jie (New Interpretation and the Cases of the Insurance Law)} (Beijing: Tongxin Publishing House, 2001) 70; \textit{Wang B v. PICC}, reported in Liu Zhixin, ed., \textit{Zhong Guo Dian Xing Shang Shi An Li Ping Xi (China Typical Commercial Cases and Comments)} (Beijing: The Law Press, 1997) at 351-352. The first case is discussed in more detail at page 170, above, and the second case is discussed in detail in supra note 340.}

In \textit{Hongfeng Company v. Ping An Insurance Company},\footnote{\textit{Hongfeng Company v. Ping An Insurance Company}, \textit{ibid.}} a car was insured with the replacement value being 300,000 Yuan. Later when the car was damaged in a road accident, the insured claimed 294,000 Yuan loss. The insurer alleged that the replacement value of that car was actually at least 600,000 Yuan and denied the claim on ground of misrepresentation. This case ended in judicial conciliation.\footnote{Judicial conciliation is often used in civil cases. Most of civil disputes end in judicial conciliations. The settlement agreement reached under judicial conciliation has the same enforceable effect as the verdicts. In the trial of civil cases, the People’s Court should make clear the facts and distinguish between right and}
General Principles of the Civil Law 1986, the People’s Court held that although the insured could not be compensated under the contract, the insurer was still liable for a large part of the loss because the insurer’s failure to explain the meaning of “replacement value” and failing to strictly check the application form were the main causes to the insured’s inability to secure coverage under the insurance. As a result, the insurer was adjudged to bear 85% of the loss. This conciliation was thought to be justice and reflective of what the law should be. The People’s Court, through repeated judgements, has also developed a scale to measure the percentage of each party’s contribution.

4. Special Explanation of the Exemption Clauses

wrong, and conduct conciliation between the parties on a voluntary basis. It is believed that the People’s Court must make clear the wrong and right of the parties in the conciliation unless both parties require not doing so. That is why the attitude of the People’s Court can be found in the conciliation documents, even if the case ended in conciliation. See article 85, 89 and 90 of the civil procedure law 1996; Ma Yuan, Min Shi Shen Pan De Li Lun Yu Shi Wu (The Theory and Practice of Civil Procedure) (Beijing: Publishing House of the People’s Court, 1992) at 292-293; Chen Jiadao, et al, “Min Shi Tiao Jie Qian Tan (Discuss on the Civil Conciliation)”, [1995] Issue S1, Heilongjiang Social Science 71. Conciliation is different from compromise. Compromise is voluntarily reached by the parties outside the court. The conciliation document has the same legal force as a verdict of the People’s Court, so it can be compulsorily executed by the Execution Tribunal of the People’s Court, while the settlement agreement reached through compromise cannot be executed by the Execution Tribunal of the People’s Court; it has to go through normal trial procedures before obtaining a verdict.

Article 59: “A party shall have the right to request a People’s Court or an arbitration agency to alter or rescind the following civil acts: (1) those performed by an actor who seriously misunderstood the contents of the acts; (2) those that are obviously unfair. Rescinded civil acts shall be null and void from the very beginning.”

Article 61(1): “After a civil act has been determined to be null and void or has been rescinded, the party who acquired property as a result of the act shall return it to the party who suffered a loss. The erring party shall compensate for the other party for the losses it suffered as a result of the act; if both sides are in error, they shall each bear their proper share of the responsibility.”

See Li Ping, Bao Xian Fa Xin Shi Yu Li Jie (New Interpretation and the Cases of the Insurance Law) (Beijing: Tongxin Publishing House, 2001) 70.

Ibid at 72-74.

The scale is not law; it is just a guide to predict what the People’s Court may decide. If A has intention or grave negligence, while B has only slight negligence, B’s contribution is below 10%. If A has intention or grave negligence, while B has ordinary negligence, B’s contribution is 10%-25%. If A has intention, while B has grave negligence, B’s contribution is 25%-50%. If both parties have intention or grave negligence to the same degree, each party’s contribution is 50%. See Wang Liming & Yang Lixin, Qin Quan Xing Wei Fa (Tort Law) (Beijing: the Law Press, 1996) at 215. Although this book is on the tort law, the contribution proportionality of negligence also applies to other civil liabilities where the liability is shared by the parties according to their proportion of negligence.
i. The Liability for Failure to Explain the Exemption Clauses

The liability for failure to explain the exemption clauses is clearly set out by article 18 of the 
*Insurance Law* that:

“Where an insurance contract contains clauses on liability exemption of the insurer, the 
insurer shall disclose them clearly to the applicant before the insurance contract is signed, 
and if the insurer fails to make it clear to the applicant, such clauses will not have binding 
force.”

The effect of an exception clause being not binding is that the coverage of the contract has been 
enlarged. For instance, where the insurer does not clearly explain to the insured a clause of 
property insurance contract which provides that the insurer is not liable for any loss caused by 
earthquake, the insurer later may not reject the claim on the ground that earthquake is an exempted 
risk. However, it does not mean, for example, a fire insurance contract will thereby cover the loss 
from earthquake unless the wording of the scope-of-cover clause is broad enough to include 
earthquake. Therefore, the contract has to be interpreted as a whole. Where an exemption clause is 
not clearly explained and thereby is not binding, the contract should not be interpreted as if there 
were a clause providing coverage of that exempted risk; instead, it should rather be interpreted as 
if that clause did not exist.

A breach of the duty of special explanation certainly constitutes a breach of the duty of general 
explanation,\(^7\) so the remedies applied to the breach of the duty of general explanation may also 
equally apply to that of special explanation at the request of the insured. However, it seems that

\(^7\) The duty of special explanation requires “clear explanation” of the exemption clause while the duty of 
general explanation requires explaining all the terms in the contract. The latter includes the former.
the insured cannot require the clause to be non-binding and at the same time to be constructed contra proferentem as the clause must be treated as binding if it is to be constructed favourably to the insured.

ii. The Scope of Exemption Clauses

The exemption clauses should not be restricted to those with a title of “exemption clause”, otherwise the insurer may disguise the exemption clauses in the name of other clauses by technically drafting the wording and avoid the duty of clear explanation therewith. So any clauses that extend the insured’s duty or limit the insurer’s liability may be regarded as exemption clauses. These would include three categories. The first is exemption clauses which exclude or restrict certain risks which are covered by the “scope of cover clauses”. The second kind of these clauses imposes on the insured the duties or obligations, the breach of which will enable the insurer to terminate or rescind the contract, or to avoid or reduce the liability of indemnity. The third kind limits the amount of indemnity, such as the franchise clause, the deductible clause, and the pro-rata clause.

The proposed judicial interpretation of the Insurance Law regretfully does not make clear the scope of exemption clauses, but it has this tendency. Article 13 stipulates that if the insurance contract includes the warranty clause, the insurer should make clear explanation during the making

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720 For example, a clause to exclude the fire set by the insured. See The Second Civil Tribunal of the People’s High Court of Fujian Province, ibid.

721 Ibid.

722 Ibid.

723 The full name is The Interpretation of the People’s Supreme Court’s on Several Questions of the Inquisition of Insurance Dispute Cases (Draft for Consultation), online: Law-Lib.com <http://www.law-lib.com/law/lfbj/lfbj_view.asp?id=10276>.
of the contract to the insured in accordance with article 18 of the *Insurance Law*; if the insurer fails to do so, the warranty clause is invalid. The judicial interpretation regards warranty clause the same as an exemption clause in the sense that the insurer has to clearly explain them. The warranty clause can be categorised into the second kinds of clauses mentioned above.

iii. The Way to Explain and the Onus to Prove

The insurer may explain the contract orally or in written form, but for the evidential purpose, a written explanation by the insurer is well advised, though it is the insured’s onus to prove that the insurer has not made the explanation. In the proposed judicial interpretation of the *Insurance Law*, it is suggested that it should be the insurer’s onus to prove that he has performed the duty of explanation. If it is passed in the future without change, the insurer is more likely to explain in written form.

Although the onus to prove still rests on the insured, in order to avoid disputes, the insurer usually prints on the insurance application form or the policy a note which states that the insured confirms that the insurer has made clear explanation on every term, including the exemption clauses, of the

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724 General speaking, if the law does not requires the form of a civil activity, the party is free to do it orally or in written form. For example, the Contract Law 1999 does not require the contract to be in written form, so an oral contract is valid. The *Insurance Law* does not stipulates whether the explanation must be in written form, so the insurer is free to explain the contract either orally or in written form. Article 11 of proposed judicial interpretation of the *Insurance Law* provides that both oral explanation and written explanation are valid. See the Interpretation of the People’s Supreme Court’s on Several Questions of the Inquisition of Insurance Dispute Cases (Draft for Consultation), online: Law-Lib.com <http://www.law-lib.com/law/lfbj/lfbj_view.asp?id=10276>.

725 Article 2(1) of Some Provisions of the Supreme People’s Court on Evidence in Civil Procedures: The parties concerned shall be responsible for producing evidences to prove the facts on which their own allegations are based or the facts on which the allegations of the other party are refuted.

726 Article 11 of the Interpretation of the People’s Supreme Court’s on Several Questions of the Inquisition of Insurance Dispute Cases (Draft for Consultation), online: Law-Lib.com <http://www.law-lib.com/law/lfbj/lfbj_view.asp?id=10276>.

727 The exact time is still unknown, but it is believed it will be soon,
contract and the insured has fully understood the explanation made by the insurer.\textsuperscript{728} The prevailing view in China is that the statement, if signed by the insured, is binding on the insured.\textsuperscript{729} However, this statement should not be treated as a term of the contract nor as the insured’s waiver of the insurer’s performance of the duty of explanation. The statement should have effect at most as evidence that the insurer has performed the duty of explanation, and the insured must be allowed to challenge it with contrary evidence.

Article 11 of the proposed judicial interpretation of the *Insurance Law*\textsuperscript{730} has thoroughly specified some issues about the insurer’s duty of special explanation.

Article 11 (the clear explanation of the exemption clauses): The “clear explanation” in article 18 of the *Insurance Law* means that the insurer, when making the insurance contract with the applicant, should make clear reminders on the policy or other insurance documents in such a way that is sufficient to call the applicant’s attention to the exemption clauses.

\textsuperscript{728} See e.g. “Gold Cow” Investment Guarantee Style Family Property Insurance Application Form of the People’s Insurance Company of China; Hull Insurance Policy of the People’s Insurance Company of China; Application for Hull Insurance of the People’s Insurance Company of China. The statement is often on the front of the form just above the signature of the insured, so it is in notable place. On the application form of Ping An Insurance (Group) Company of China, there is also a similar statement the wording of which varies according to the kind of coverage but always contains that “the insured has understood the exemption clauses.”

\textsuperscript{729} See The Second Civil Tribunal of the People’s High Court of Fujian Province, “Bao Xian He Tong Jiu Fen An Jian Ruo Gan Fa Lv Wen Ti Yan Jiu (Research on Some Legal Problem of Insurance Contract Dispute Cases)”, in Wang Liming et al., eds., *Pan Jie Yan Jiu (Judgement Research)*, vol. 9 (Beijing: The People’s Court Press, 2002) 61 at 68-69. The insurer often uses three means to perform the duty of explanation: (1) There is significant indication on the application form that prompts the insured to read the terms of the contract especially the exemption clauses. (It is not the practice in marine insurance however. Contrary example: Application for Hull Insurance of the People’s Insurance Company of China Dalian Branch.) (2) The terms of the contract are printed on the back of the application form and the exemption clauses have been boldfaced. (3) The statement that the insured confirms that the insurer has made clear explanation on every term, including the exemption clauses, of the contract and the insured has fully understood the explanation made by the insurer. It is then believed that after doing these, the insurer has performed the duty of explanation perfectly accordant to the requirement of the law.

\textsuperscript{730} *The Interpretation of the People’s Supreme Court’s on Several Questions of the Inquisition of Insurance Dispute Cases (Draft for Consultation)*, online: Law-Lib.com <http://www.law-lib.com/law/lfbj/lfbj_view.asp?id=10276>.
clauses, and the insurer should make oral or written explanation on the content of exemption clauses to the applicant.

The insurer bears the obligation to prove that he has performed the duty of clear explanation. The exemption clauses in the contract in themselves can not prove that the insurer has performed the duty of explanation.

When a branch of an insurance company makes an insurance contract with the insurance applicant, that branch can not be released from the performance of the duty of “clear explanation” stipulated in article 18 of the Insurance Law only because another branch of the insurer has had the same kind of insurance contract with that applicant.

The proposed interpretation will clarify many ambiguities in the current law and it will change some points of law more reasonably. First it clarifies that the insurer should not only remind but also explain the exemption clauses. Second, it shifts the onus to prove from the insurer to the insured, and it confirms that the exemption clauses in themselves can not prove the performance of the duty. This judicial interpretation fails to mention what is the evidence rule regarding the general explanation. The result of this failure is that the general law\footnote{See Article 2(1) of Some Provisions of the Supreme People’s Court on Evidence in Civil Procedures in supra note 725.} will apply and the insured will bear the onus to prove that the insurer has not performed the duty of general explanation and it will be very difficult for the insured to do so. In addition, there seems to be no reason to apply totally different evidence rules to the explanation of the exemption clauses from that of the other clauses. Therefore, it seems that this evidence rule (article 11) should not be restricted to explanation of exemption clauses only, and the insurer should be obliged to prove that he has explained the terms of the contract as specified in article 17(1) of the Insurance Law.
III. A Comparison and Suggestions for Reform of the Insurer’s Disclosure

1. The Scope of the Insurer’s Duty of Disclosure: Unitary or Piecemeal

The pre-contract duty of utmost good faith falling on the insurer under the law of U.K. is aligned by one definition, and the insurer is required to disclose everything material. In contrast, in Chinese law, the scope of the insurer’s duty of disclosure is not an integrated obligation; it is more like an aggregation composed of two plates: one plate is the duty of general explanation, and the other plate is the duty of special explanation. There is no general rule which will incorporate the two plates and draw a clear line between what should be disclosed and what need not. Moreover, there is no requirement that the insurer should disclose everything material to the insured.

The absence of a general rule results in the ambiguity whether the insurer will be liable for non-disclosure of other matters besides the two duties of explanation. If the insurer would be liable, e.g., for the non-disclosure of a material circumstance which would influence the insured’s

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733 Ibid.

734 It is alleged that there is a post-contract duty of good faith imposed on the insurer i.e., the insurer’s liability in delay of the payment of the compensation. According to article 24, “[t]he insurer shall, after receiving claims for indemnity or payment of insurance benefit from the insured or the beneficiary, timely come to a decision, as for those within the insurance liability, he shall execute the liability of indemnity or payment of the insurance benefit within 10 days after reaching an agreement over the indemnity or payment of the insurance benefit with the insured or the beneficiary. If the insurance contract has the stipulations on insured amount and the period for indemnity or payment, the insurer shall, as contracted, execute the liability of indemnity or payment of the insurance benefit. Apart from paying the insurance benefit, the insurer who fails timely to execute the liability as provided in the preceding paragraph shall indemnify the insured or the beneficiary for losses therefrom.” However, the author does not think that this should be regarded as a type of the duty of utmost good faith because wherever a party delays payment in whatever contract, that party will be liable for such delay; there is nothing particular in the Insurance Law on this issue. To make the liability of delay on the payment a duty of utmost good faith is meaningless.
decision on whether to have the contract with this insurer, one must face the question: where are
the legal bases for this position? The People’s Court does not have the power to create a law. On
the other hand, it would be unfair if the insurer were not required to disclose every material
circumstance while the insured is. The Court, in its quest to realize justice, might have to rely on
some basic principles of the civil law and make the judgements inconsistent from one to another.
Therefore, the Insurance Law should learn from the common law to have a general rule stipulating
the insurer’s duty of utmost good faith.

The proposed duty of disclosure imposed on the insurer shall apply to both marine and non-marine
insurance. The insured’s duty in non-marine insurance is governed by the principle of inquiry-
disclosure, nevertheless, this is because the inexperienced insured need more protection, so it
would be odd if the insurer’s duty is based on the principle of inquiry-disclosure in non-marine
insurance.

2. **A Proposed Definition of the Insurer’s Duty of Disclosure**

When formulating the rules of the insurer’s duty of disclosure, it is necessary and reasonable to
refer to the rules of the duty of the insured, but it is not desirable to copy without any change
because some areas of the duty of the insured also need changing. It is preferable to refer to the
“good law” of the rules of the insured’s duty of disclosure. Therefore, the constructive knowledge,
the test for materiality, degree of influence and inducement should be stipulated to reflect what the
law should be. By this way, the formulation of the insurer’s duty of disclosure would include the

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735 For example, the Court may give a broad interpretation to article 42 of *the Contract Law 1999* so that the
words “any other act contrary to the principle of good faith” would include the insurer’s non-disclosure of
the material circumstances. The Court may also conclude that the insurer’s non-disclosure is intentional if
the insurer knows that the circumstance would have influenced the insured’s decision.
rules of the insurer’s constructive knowledge, the reasonable insured test for the test of materiality, decisive influence and actual inducement:

1. Before the contract is concluded, the insurer should disclose to the insured, every material circumstance within his knowledge. If the insurer fails to do so, the insured may avoid the contract and claim for whole refund of the premium. (This is a general statement of the insurer’s duty, imitating the duty as per section 18(1) of the Marine Insurance Act 1906 (U.K.) mutatis mutandis. As for the remedy, please refer to page 183, below.)

2. The insurer is deemed to know everything he ought to know in the ordinary business practice. (The same as the insured’s constructive knowledge.)

3. The insurer is not required to disclose those circumstances that the insured actually knows or ought to know, unless inquired by the insured. (A mirror image of article 222(1) of the Maritime Code.)

4. A circumstance is material if the insured would not, and a reasonable man in his position would not, contract with that insurer, or would contract with that insurer but only under a different term, had he known that circumstance. (Here the first “insured” should be interpreted as the actual insured, and the second means the notional reasonable insured. The double check rule, which should also be adopted in the insured’s duty of disclosure, functions both as the test of materiality [a reasonable insured test] and the actual inducement. The decisive influence is employed, which is also suggested to be the rule of the insured’s duty of disclosure.)

3. The Reasoning of This Definition
A good definition of the disclosure duty falling on the insurer must incorporate all the important circumstances that the insured need to know when deciding to buy the insurance, while it must not impose on the insurer too much obligation to the extent that it will substantially increase the cost of insurance and ultimately increase the premium. Bearing this in mind, the author will examine whether the proposed definition is workable.

The Court of Appeal in the Westgate case has suggested two categories which are potentially material from the insured’s perspective: the circumstances related to the recoverability of the claim and the risk sought to cover. Under the first category, there would be circumstances related to: (1) the financial credibility of the insurer;\textsuperscript{736} (2) the payment record of the insurer;\textsuperscript{737} (3) the fact that some of agents, staffs or employees of the insurance company are not reliable; for instance, they may be anxious to conclude more contract to earn more commission,\textsuperscript{738} which is common in China;\textsuperscript{739} (4) any special or unusual interpretation of the term of the contract, or the interpretation of any term that is difficult to understand for a layman if the insured apparently inexperienced;\textsuperscript{740} (5) the existence of the duty of disclosure in marine insurance.\textsuperscript{741}

\textsuperscript{737} Ibid.
\textsuperscript{738} Ibid at 142.
\textsuperscript{739} In China’s insurance market, not only the market agents have their income associated with the sale amount, but almost all the staff in every department have their income so associated. Sometimes, even the non-marketing staff have sale quota to fulfil. This phenomenon is also associated with the highly undevelopment of insurance brokers which is the insured’s agent.
\textsuperscript{740} This has been regulated by articles 17(1) and 18 of the Insurance Law.
\textsuperscript{741} In China, the non-marine insurance is governed by the principle of inquiry-disclosure, so the insurer does not need to warn the insured of the existence of the duty of disclosure. It is alleged that the marine insured is more experienced than those individual insured so there is also no need to warn of the existence of the duty of voluntary disclosure. Considering that a simple warn will not cause much difficulty to the insurer, while it can avoid possible disputes arising from non-disclosure by the insured due to his inexperience in underwriting or obliviscence of the duty, it is just and fair to impose such a duty.
As to the second category, Lord Mansfield has hinted that the disclosure only includes those circumstances decreasing the risk. There is an interesting query as to whether the insurer should disclose any circumstance within his knowledge that increases the risk running on the property insured. The answer seems to be no. Not only has Lord Mansfield hinted so, but subsection 3(a) of section 18 of the Marine Insurance Act 1906 (U.K.) stipulates that in the absence of inquiry the insured need not disclose any circumstance which diminishes the risk. The reason behind subsection 3(a) is that the disclosure of circumstances which diminish the risk helps the insured, not the insurer, so the rule of the insured’s duty of disclosure, which is to protect the insurer, need not punish the non-disclosure of such circumstances. Similarly, assuming that the insurer privately knows that, e.g., war is imminent, he is quite unlikely to provide war risk for the proposed insured. Conversely, if the insurer would like to cover the increasing risk anyway, he will inform the insured of that circumstance with great pleasure. The insurer will not, in any cases, obtain any additional benefit from concealing that kind of circumstance.

These two categories of circumstances suggested by the Court of Appeal in the Westgate case are both incorporated in the proposed definition of the insurer’s duty of disclosure: the insured would not have any contract with the insurer if the insured knows that the insurer is not credible or not reliable, or if the insured knows that the risk is much lower than he has supposed. As for others circumstances that do not fall within the two categories, the insurer may still be obliged to disclose

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742 The example given by Lord Mansfield in Carte v. Boehm (1766) 3 Burr 1905.
744 Possibly, it may further be argued that even if this particular insurer would be unlikely to underwrite the additional risk, it does not mean all the other insurers in the market will not underwrite it, so the insured will lose the chance of getting covered from other insurer if this insurer does not disclose the circumstances which increase the risk. However, it has been observed by the Court of Appeal in the Westgate case that a particular insurer is not bound to disclose that another insurer “would be prepared to underwrite the same risk at a substantially lower premium.” (Banque Financière de la Cité S.A. v. Westgate Insurance Co. Ltd.; sub nom. Banque Kerser Ullmann S.A. v. Skandia (U.K.) Insurance Co. [1988] 2 Lloyd’s Rep. 513 at 545.) similarly, a particular insurer should not be bound to disclose that another insurer would like to underwrite the risk which this particular insurer would not underwrite.
them according to the general rule of the insurer’s duty of disclosure if that circumstance is caught by the proposed definition. For example, the China Insurance Regulatory Commission has promulgated an administrative regulation which requires the insurer to disclose the potential risks in certain investment insurance.\(^{745}\) However, it should be noted that one should be very prudent in interpreting a circumstance which does not fall into either of the categories to be material to the decision of the insured; otherwise the duty of disclosure would be unduly expanded and become “an engine of oppression”\(^{746}\) against the insurer.\(^{747}\) Whether a particular circumstance is material is a matter of fact in every case.

One may ask whether the insurer is obliged to disclose that the rival insurer may underwrite the same risk at a substantially lower premium. Many scholars do not believe that the insurer is so obliged.\(^{748}\) Then, how can the proposed definition exclude the circumstances of the rival insurer from what the insurer should disclose? These circumstances are what the insurer at least ought to know and they certainly have a substantial impact on the insured’s decision. However, they are what the insured ought to know. The premium provided by particular insurer is information open to public. The insured does not have much difficulty in gaining the information through broker or through his own market investigation. Therefore, the insurer does not need to disclose what a prudent insured ought to know.

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\(^{745}\) The Regulations Regarding Information Disclosure Regarding New Personal Insurance promulgated by the China Insurance Regulatory Commission (the CIRC). (This regulation is available online: CIRC <http://www.circ.gov.cn/policy/list_detail.asp?auto_id=171>.) Similarly, the Beijing Insurance Regulatory Commission also made local regulations requiring the insurer to disclose the adversity of the insurance product to the insured.

\(^{746}\) The insured’s duty of disclosure has been described as “an engine of oppression”. See H. Y. Yeo, “Of Reciprocity and Remedies - Duty of Disclosure in Insurance Contracts” (1991) 11 LS 131.

\(^{747}\) For example, Semin Park opposes the approach of including in the scope of disclosure any circumstances neither related to the risk nor to the recoverability of the claim. Semin Park, The Duty of Disclosure in Insurance Contract Law (Brookfield, Vt.: Dartmouth Pub. Co., 1996) at 195.

4. The Remedy for Breach of the Proposed Duty of Disclosure by the Insurer

As said above, the insurer’s duty of disclosure under Chinese law is composed of two plates and each plate of duty has its own remedy. The breach of the duty of general explanation of the terms of the contract makes the terms unexplained interpreted unfavourably to the insurer, the breach of the duty of explanation of exemption clauses renders the clause unexplained invalid, and, in marine insurance, the breach of the duty to inform the insured of the non-existence of the risk enables the insured to avoid the contract.749 If the proposed definition of the insurer’s duty of disclosure is introduced into Chinese law, what is the remedy for the breach of it? And what is the relationship between this remedy and those specific remedies for the breach of those two duties?

The basic remedy for the breach of the proposed duty by the insurer should be avoidance of the contract at the option of the insured and recovery of the premium, firstly because, in most circumstances, the remedy of avoidance is adequate, for example, where what the insurer fails to disclose are the circumstances that diminish the risk. Where the circumstances are about the credibility of the insurer, if the insured is unable to recover the loss that was covered by the policy due to the insolvency of the insurer and wants to claim damage alternatively, the insured may base his claim on article 24(2) of the Insurance Law.750

Secondly, making the avoidance of the contract as the basic remedy has the benefit that avoidance is “unconditional”: to claim damage, one has to prove the causal connection, the reasonable

749 Strictly, one should say, the insured’s remedy is to recover the premium paid or refuse to pay premium if not paid yet, but the legal effects are the same. If the proposed duty of the insurer’s disclosure is introduced into The Chinese law, the insurer’s duty in marine insurance to disclose any circumstances showing the non-existence of the risk sought to cover will no longer need to be set out in the Maritime Code since it is completely incorporated in the new proposed definition.

750 Article 24(2) is on the liability of the insurer for delaying payment of the claim. Article 24(1) provides that the insurer should pay for the claim within ten days after the insurer and the insured have concluded the payment agreement unless otherwise provided by the insurance contract. “Apart from paying the insurance benefit, the insurer who fails timely to execute the liability as provided in the preceding paragraph shall indemnify the insured or the beneficiary for losses therefrom.”
amount of the loss and the intention or negligence of the other party, while avoidance of contract never encounters these problems.

Thirdly, the insured’s avoidance of the contract should not affect his rights to claim damage or avail himself of other remedies under the *Insurance Law* or other laws if he is so entitled unless the remedies are incompatible. For example, avoidance of the contract and damage are compatible remedies, but if the insured has avoided the contract, he cannot ask the judge to interpret the terms of the contract unfavourably to the insurer, nor can he allege that the exemption clause invalid and that the insurer should pay the indemnity which is exempted otherwise. The insured has right of option to choose among these incompatible remedies. Therefore, where the basic remedy of avoidance of the contract is inadequate, the insured has many other choices to give full protection to his rights.
Chapter 8. Conclusions of Law Reform Suggestions

The comparison between the Chinese law and the common law has led to the conclusion that, as to the principle of utmost good faith in pre-contract stage, the Chinese law and the common law have many parallel concepts and they also share some similar problems, although there are also some problems peculiar to China. Most of the problems of the Chinese law mentioned above may be resolved through legal interpretation, and only a few require the law modification, so the judicial interpretation of the Insurance Law which is still in draft is highly expected to amend these problems and the author has also discussed this interpretation in relation to the principle of utmost good faith.

In both China and common law countries, the insured’s duty of disclosure is defined from four aspects, i.e., knowledge and constructive knowledge, circumstances which the insured need not disclose, the meaning of materiality and the actual inducement. The author has found that the Chinese law requires careful interpretation regarding, in particular, four aspects. First, the author has suggested that an object test should apply to what an insured ought to know, as well as what the insurer ought to know. An object test requires the insured/insurer to know what a reasonable insured/insurer in his position would know. Second, it has been suggested that the Chinese insurance law should stipulate that the insured need not disclose any circumstance which diminishes the risk, which is the subject of warranty, which the insurer has waived and which is the spent convictions. Third, the Chinese law should have both concepts of the materiality and the actual inducement, but they can be contained in one test, the “double check test”, which means that the insured only has to disclose material circumstances, and a circumstance is material if a prudent insurer, as well as the actual insurer, would have made a different decision had he known the truth.
As to the remedy system, the two jurisdictions have much difference. The Chinese law is more flexible, but there are also some ambiguities to be clarified. First, in China, the insurer and the insured are both eligible for the remedy of damages under the general contract law or the civil law. Thus, the insured has a more valuable relief where the avoidance or termination of the contract is not sufficient, but, to avoid the potential threat that the insurer may misuse the remedy of damage, it has been suggested that the insurance law should prohibit the insurer from utilizing other remedies which are not provided by the *Insurance Law* or the *Maritime Code*. Second, China has applied the nexus approach in non-fraudulent non-disclosure, but its defects must be noticed. Third, the author has suggested that the right to terminate the insurance contract cannot be perpetual and it should be limited as the time lapses. Fourth, the insurer has the right to increase premium instead of terminating the contract in marine insurance, but it has been argued that he should also have such a right in non-marine insurance.

The insurer’s duty of utmost good faith is peculiar in China. The insurer is obliged to explain the terms of the contract, failing which, the author suggests, the remedy should be interpreted *contra proferentem*. The insurer is also obliged to clearly explain the exemption clauses failing which the clause is not binding on the insured. It has been suggested that the Chinese law should have a unified duty of utmost good faith on the insurer instead of the piecemeal solution.

Since China has entered WTO, China’s insurance market will soon become highly open to foreigners. A fair competition and a market with good faith are urgently needed. A consummate insurance law on the principle of utmost good faith will certainly conduce to the establishment of fair competitions and good faith environments, which will benefit both parties of the insurance contract and accelerate the development of insurance industry in China.
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