

The Past and Future of Utmost Good Faith: A Comparative Study Between English and Chinese Insurance Law

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Abstract

An insurance contract is a contract of utmost good faith. The nature of the insurance bargain makes the duty a commercial necessity. Duties of disclosure and representation, which were two fundamental components of the principle of utmost good faith, operate in different ways in England and China. The insured and insurer in these two countries bears distinctive good faith related obligations pre- and post-contractually.

English insurance law exercise considerable influence in most common law countries and some civil law jurisdictions. The separation between utmost good faith and the duty of fair presentation, with the abolition of the avoidance remedy, under the Insurance Act 2015 could influence other jurisdictions to alter their remedies.

This thesis examines the application of the civil law notion of good faith and the common law duty of utmost good faith. It covers the operation of insured's pre-contractual duties of disclosure and representation in both countries. The thesis considers the insurer's duties as well as the continuing duties and the effect of utmost good faith taking in account the recent legislative changes on fraudulent claims and late payment. The thesis further examines the legal status of brokers and their disclosure duty in China and England. Finally, it also provides special considerations on consumers and micro-businesses.

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Table of Abbreviations

UCC-American Uniform Commercial Code

BoE-Bank of England

CI(DR)A-Consumer Insurance (Disclosure and Representation) Act 2012

CISG-United nations Convention on Contracts for the International Sale of goods

EU-European Union

FCA-Financial Conduct Authority

FOS-Financial Ombudsman Service

FAS-Financial Service Authority

GRE-Guardian Royal Exchange

IA-Insurance Act 2015

ICAA-Insurance Contracts Amendment Act 2013

IAC-Insurance Act of People's Republic of China

ICA-Insurance Contract Act 1984

IOB-Insurance Ombudsman Bureau

ICOBS-Insurance Conduct-of-Business Sourcebook

MIA 1906-Marine Insurance Act 1906

MIA 1909-Marine Insurance Act 1909

PRA-Prudential Regulatory Authority

PICC-People's Insurance Company of China

ROA-Rehabilitation of Offenders Act 1974

SGA-Sales of Goods Act 1979

SA-Standards Australia

TPRAIA-The Third Parties (Rights against Insurers) Act 2010

US-United States

UK-United Kingdom

Introduction

I. Background

Modern insurance in China has experienced transformation from an industry that was fully controlled by foreign enterprises, to a sophisticated and developed system that plays a significant role in international market. Insurance was introduced to China at the beginning of the 19th century as a by-product of the vicious invasion of foreign trade after the weak and corrupted the Qing government was defeated in the Opium War, and developed in that chaotic period. Thus, the Chinese insurance market was born with congenital malformations. Moreover, insurance legislation and monitoring and inspection measures were not brought in along with the import of insurance products. Consequently, foreign insurance entities gained exorbitant profits from China until the Country closed its door in 1949 – the year in which the new China announced its establishment. Since then, the Chinese government, for a long period of time, pursued a centrally-planned policy on economy, whereby all companies were owned by the state. In 1979, the central government made some significant changes on public policy which rocked the orientation of national economic development strategy. In conjunction with the Four Modernizations and the ‘Open Door’ Policy, China resumed its foreign trade and investment activities as of 1978. In recent years, China has achieved a spectacular success in its economic development and has come to play an increasingly important role in the world economy.

In 1995, the People's Republic of China (PRC) introduced its first piece of comprehensive insurance legislation. Good faith was put on a statutory footing in the Insurance Act of PRC 1995 (known as "1995 Act" or "IAC 1995") as a general principle. China is a civil law (also known as "continental legal system") country. The principle of "good faith" under the 1995 Act is inherited from the civil law notion of good faith prescribed in the Contract Law of PRC and The General Principles of the Civil Law of PRC (now the General Provisions of the Civil Law,¹ known as the first step towards adoption of a new Civil Code²). None of these pieces of legislation provides a definition of good faith. The principle of Good faith is a "pervasive" doctrine of contract law in civil law jurisdiction³ infiltrating into all civil activities including all contractual relationships, whereas in common law, the duty works in its utmost form. However, English courts do not impose an overriding obligation of good faith to every type of contract. The duty of utmost good faith only applies in certain categories of contract, in particular insurance contracts. An insurance contract is a contract of utmost good faith, in which it requires a higher standard of good faith from both parties to avoid non-disclosure and misrepresentation by the additional obligation to disclose all material facts that would induce the insurers to underwrite the risk.

¹ Order of the President of the People's Republic of China, No.66. The "General Provisions of the Civil

² Weihai YANG & Sha LUO, 'Zhongguo Minfa Zongze Dansheng – Kaiqi "Minfadian Shidai"' [General Provisions of the Civil Law of China Enacted, Start of the "Civil Code Era"] Xinhuashe (Beijing, 15 Mar 2017), republished in the *official website of the National People's Congress of the People's Republic of China* <http://www.npc.gov.cn/npc/lfzt/rlyw/2017-03/16/content_2019204.htm> accessed 1 Dec 2017; also see Laney ZHANG, 'China: First Step Towards Adoption of a New Civil Code' *The Library of Congress* (Washington DC, 30 Mar 2017) <<http://www.loc.gov/law/foreign-news/article/china-first-step-towards-adoption-of-a-new-civil-code/>> accessed 1 Dec 2017

³ Law Commission, *Insurance Contract Law: Damages for Late Payment and the Insurer's Duty of Good Faith* (Law Com IP No 6, 2010) para 7.7

By contrast, the civil law notion is intangible.

Due to historical reasons, Chinese insurance law reflects a blend of legal cultures, with Japanese and Western – in particular English insurance law, and more recently the United States – influence. Thus, the duty of utmost good faith, being a common law principle, is acknowledged and discussed by Chinese scholars in the insurance field, ensuring its' status as the most important principle for insurance law. However, it is not enacted in insurance legislation. Further, recognition in China is made in the duties of disclosure and representation, which are two fundamental components of the principle of utmost good faith. Chinese academics hold the view that the doctrines of warranty, waiver, and estoppel are also parts of this principle. A question arose to the necessity of providing legal ground to the duty of utmost good faith in the Chinese legal system. In China, marine insurance is governed by Chapter 12 of Maritime Code of the PRC 1993 (the "MC 1993"), where the duty to disclose and the duty not to misrepresent, imposed upon the insurer and insured, are somewhat different, with duties set out by the IAC 1995 and three of its Amendments. Moreover, significant distinctions are found between tests in accessing materiality for marine and non-marine insurance contracts. The inconformity of laws causes serious problems in legal practice. Apart from that, to the best of my knowledge, to no extent that rules are distinguished between consumer insurance and commercial insurance.

II. Aims and Objectives

This research focuses mainly on development of the insurance law in China in respect of the principle of good faith and the duty not to misrepresent, prescribed under the Insurance Act of P.R.China 2015 (the “IAC 2015”).⁴ The duty of disclosure under the MC 1993 will also be considered as a comparison to the obligation upon non-marine insureds. The purpose of this research is to take the English and Australian approaches as references to analyse Chinese insurance law, marine or non-marine, in respect of the duty of [utmost] good faith and its legal operation. Thus, the Law Commission process is of significant importance due to its identification of the defects and its’ transformation of them. The Law Commission has aided in the introduction of the Consumer Insurance (Disclosure and Representation) Act 2012. In Australia, the law reform body has recently amended their Insurance Contract Act 1984, but with regards to consumers. Consequently, this thesis will examine whether Chinese law should be distinguishing between consumer and commercial insurance contracts. The new business regime of Insurance Act 2015 (the “IA 2015”) is discussed in detail. A minute analysis on broker disclosure is considered in a separate chapter, given that brokers place risks in the London marine market.

The object of this thesis is to identify the weaknesses and defects in Chinese law, so as to develop a commercial presence akin to that of London, and to make it suitable for modern insurance market conditions. This thesis also aids in

⁴ Insurance Act of People’s Republic of China has been amended three times since its first enactment in 1995, the latest amendment is

mutual understanding and the dispelling of prejudice and misinterpretation between Chinese and English law pertaining to the principle of [utmost] good faith. It is noted that the thesis mainly focuses on the application of the doctrine of [utmost] good faith, specifically in contract law. Therefore, the use of good faith in public sector of law will not be discussed in this thesis.

III. Methodology

This thesis is a comparative doctrinal legal research as a whole. Methodologies used in this research are law reform study, case study, and more importantly comparative study. Comparative study is widely used in various research areas and is a very important discipline in communication between legal systems, particularly in present culture due to the rise of internationalism, economic globalisation, and democratisation. Comparative law study is an academic study of separate legal systems, each one analysed in its constitutive elements. It appears today the principal purposes of comparative law are: to obtain a better understanding of the legal systems in effect; to perfect the legal systems in effect; possibly, to contribute to a unification of legal systems, of a smaller or larger scale. In relation to this particular thesis a comparison between the

IV. Outcomes

The nature of the insurance bargain makes utmost good faith a commercial necessity. However, this fails to provide significant basis for confidence that the common law principle would fully take root in China, although as mentioned

earlier the principle of utmost good faith is widely accepted by Chinese scholars. Now, utmost good faith and the evolutionary new duty of fair presentation are now “entirely independent and unrelated” principles under English law.⁵ The duty of fair presentation, building on case law approaches and the statutory duty set out by Marine Insurance Act 1906 (the “MIA 1906” or “1906 Act”),⁶ is clearly confined to pre-contractual stage. The format of the disclosure must be appropriate and “in a manner which would be reasonably clear and accessible to a prudent underwriter”.⁷ The nature of duty of full disclosure retained from MIA 1906 s.18, with an importance modification as to the remedy, re-enacted in s. 3(4)(a) of the IA 2015. In addition, the Law Commission provides to the insured a cushioning device – the s. 3(4)(b). Accordingly, the insured, who has failed to satisfy the strict duty set out in s. 3(4)(a) but has nevertheless disclosed just enough information which would lead a prudent insurer to make further enquiries, which when answered, would reveal the material circumstances, might still comply with its duty of disclosure. It places an onerous duty on the insurers to ask follow up questions. Misrepresentation set out in s. 3(3)(c) of IA 2015 is a restatement of s. 20 of MIA 1906. There is a fair presentation of the risk where “every material representation as to a matter of fact is substantially correct, and every material representation as to a matter of expectation or belief is made in good faith.” Under the Insurance Act 2015, the objective test of materiality is “...defined by

⁵ R. Merkin, *Colinvaux’s Law of Insurance* (11th edn, Sweet & Maxwell 2017) at 6-006

⁶ Law Commission, *Insurance Contract Law: Business Disclosure; Warranties; Insurer’s Remedies for Fraudulent Claims; and Late Payment* (Law Com No 353, 2014) para 6.5

⁷ Insurance Act 2015, s. 3(3)(b)

reference to circumstance which would influence the judgement of a prudent insurer”.⁸ The IA 2015 has, for the first time, provided limited statutory guidance on materiality. The subjective inducement requirement was introduced on a statutory footing, as a separate concept, by the Insurance Act 2015, s. 8(1). The notion of requiring proof of inducement operates as a prerequisite to a remedy of avoidance rather than as the second limb of the test of materiality. Thus, there is no remedy until the insurer can prove that something different would actually have happened in underwriting terms had the duty of fair presentation not been broken. The remedy will be based upon that assumed outcome, albeit there is an automatic right of avoidance in cases of fraud or recklessness on the part of the assured.⁹

None of these requirements appear in Chinese insurance law. In fact, there is no disclosure obligation resting upon a non-marine assured under Chinese insurance law. The insured’s duty to disclose and the duty not to misrepresent material information to the insurer in relation to marine insurance is governed by art. 222 of MC 1993. This Section is, to a large extent, a copy of s. 18 of MIA 1906, although without remedy. The Supreme People’s Court of China (the “SPC”) clarified that the insurer refers to a prudent insurer in Art. 9 of the ‘Answers to Practical Issues of Maritime and Admiralty Trials concerning Foreign Affairs’. By contrast, there is no clear indication made for general

⁸ Law Commission, *Insurance Contract Law: Business Disclosure; Warranties; Insurer’s Remedies for Fraudulent Claims; and Late Payment* (Law Com No 353, 2014) para 6.5

⁹ R. Merkin, *Colinvaux’s Law of Insurance* (11th edn, Sweet & Maxwell 2017) at 7-087

insurance contracts as to the identity of the insurer. Under IAC 2015, the pre-contractual duty imposed upon non-marine insured is to provide honest statements in responding to specific enquiries made by the insurer. Failure to do so grants the insurer a right to rescind the contract. Information is material if it sufficiently influences the insurer's decision on whether or not to take the risk or charge for a higher premium. That test is vague and equivocal. In comparison to the common law approaches, evidently that the phrase "sufficiently influence the insurer's decision", in its ordinary meaning, literally leads to the "decisive influence" conclusion, which has further been confirmed by regional courts – the degree of influence remain unclear outside these regions. In the marine sector, many Chinese scholars are in favour of the "decisive influence" test¹⁰ due to its' consistent with the general contract law principle that contracts can only be rescinded in cases of radical breach. Proofing of materiality does not entitle the insurer to a remedy. The breach has to be made intentionally or through gross negligence. In England, the insurer's state of mind is also taken into account by IA 2015. The proportionate remedy is based on degrees of culpability of the insured. IA 2015 confines the automatic right of avoidance to deliberate or reckless breaches of duty. There has not been a sign of inducement under Chinese law. Considering the importance of that test, it might be the time for legislatures to think a step further from materiality

¹⁰ Tingzhong FU, 'Re-study on assured's duty of disclosure' (2012) 1 Chinese Journal of Maritime Law 32

The IAC 2015 art. 16 is silent on whether the duty continues post-contractually, although art. 52 imposes a post-contractual duty on the assured to inform the insurer any significant change of risk. Differences between Chinese and English law in the context of increase of risk are considered in Chapter 7. Insofar as the civil law notion of good faith is penetrable, it might be able to determine that good faith continues after the contract is concluded. In England, The removal of the avoidance remedy from s. 17 of the MIA 1906 by IA 2015 s. 14 gives life to post-contractual duties. Utmost good faith has now been re-designated as a general “interpretative principle”.¹¹ However the further operation of utmost good faith remains uncertain and will likely need to be tested in court proceedings to better understand how it will be interpreted and applied to different scenarios. The historic tangled ties between fraudulent claim rule and the duty of utmost good faith are now clear and coherent. The issue of fraudulent claims is dealt with in ss. 12-13 of the IA 2015. Therefore, the continuing duty of utmost good faith has no part to play in determining the remedies for the making of a fraudulent claim. Further, the matter as to late payment is now incorporated by implied term under s. 13A of the Insurance Act 2015, which was added subsequently to the Act by the Enterprise Act 2016, although the Law Commission had suggested that 13A liability should rest upon good faith and is intended to award a remedy of damages for a breach. This provision will importantly for the first time allow policyholders to pursue damages against underwriters for late payment. By contrast, In China, in performing of the

¹¹ Insurance Act 2015, s. 14

principle of honesty and good faith, paying valid claims timeously is a primary obligation to the insurer. An insurer who fails to fulfill the obligation shall compensate the policyholder or beneficiary for losses incurred therefrom, in addition to paying the insurance amount or claim.

The original formulation of the duty of utmost good faith in *Carter v Boehm*¹² indicated that the principle is bilateral. However, the MIA 1906 failed to expand the duty mutually, and was silent about the operation of insurer's pre-contractual duty of utmost good faith. China is in the same boat. The traditional view as to the origin of insurer's pre-contractual duty rests upon the proposition that this duty is a demonstration of the mutuality of utmost good faith. Thus, in theory, the insurer owes a corresponding duty to represent material information to the insured. However, the obligation actually imposed by IAC 2015 art. 17 is for the insurer to explain to the insured the contents of an insurance policy, particularly clauses exempting insurer's liabilities and obligations. Its legal objective and operational measure is highly consistent with the duty of explanation owed by the contract drafter under the Contract Act of PRC. Failure to perform the duties of prompt and clear explanation will lead to the exclusion clauses in question to be of no effect. The biggest problem about art. 17 is that it is lack of implementing rule. Hence, it becomes one of the most commonly disputed matters amongst all kinds of insurance disputes.¹³ In England, the

¹² (1766) 3 Burr 1905

¹³ Ning MA, 'Boxianren Mingqieshuoming Yiwu de Pipan' [Criticism of the Insurer's Duty of Clear Explanation] (2015) 3 Chinese Journal of Law 102, 102.

corresponding duty of disclosure falling upon the insurer was affirmed by the case law, notwithstanding the remedy of avoidance nevertheless renders the finding of the insurer's breach "worse than useless".¹⁴ The ambit of the insurer's duty of disclosure is confined to insured perils, and it does not extend to the legal meaning of contract terms.¹⁵ Again, the removal of the sole remedy of avoidance by IA 2015 s. 14 might be seen as a turning point. It is interesting to watch how English courts will react in the near future to this change on this point.

The law on brokers in China is undeveloped, because, for a long time, brokers were technically unnecessary where the Chinese insurance market had been monopolised by the one and only insurance company, namely, the People's Insurance Company of China (the "PICC"). The first generation of insurance brokers did not receive their approval from the CIRC until 1999.¹⁶ Before the role of brokers was introduced, in China, insurers used commission agents to solicit insurance agreements. The problem caused by the usual practice of commission agents has not been dealt with in Chinese law. English law used to permit insurers to avoid the policy for non-disclosure or misrepresentation in this circumstance on the ground that the insurer's appointee may become the assured's agent simply by taking the administrative role in filling in the proposal form, unless agents have actual or ostensible authorised to receive the relevant

¹⁴ R. Merkin, *Colinvaux's Law of Insurance* (11th edn, Sweet & Maxwell 2017) at 6-040.

¹⁵ *ibid* at 6-038.

¹⁶ Hui LIN (ed), *Bao Xian Zhongjie Lilun yu Shiwu* [Insurance Intermediaries: concepts and practice] (Tsinghua University Press 2006) 85

information on behalf of insurers.¹⁷ That problem has been resolved by the adoption of CI(DR)A 2012 and IA 2015. Under the CI(DR)A 2012, insurers' agents are treated as representatives of the insurers so that information received by them are deemed to be communicated to the underwriting department directly. Meanwhile consumers are no longer requested to volunteer material facts to the insurer, the problem will arise only where the broker receives a material fact but misstate it.¹⁸ In commercial cases, the issue is unlikely to arise concerning the custom of the market. Even if it, by any chance, does arise, it should still resolve the problem "by treating knowledge of an agent as the knowledge of the insurer itself and thus not required to be disclosed" under Insurance Act 2015. More importantly, it is worth noting a significant change made on the duty of disclosure owed by brokers. The separate duty of disclosure set up in s. 19(a) of MIA 1906 was substantially abolished. S. 19(b) is now replaced with a duty of disclosure imposed upon the assured by IA 2015 s. 3. The ordinary principle of agency applies. The insured is now deemed to have the same knowledge as the broker.

In England, matters as to consumer insurance are dealt with separately in CI(DR)A 2012. The consumer can no longer be required to volunteer information but only to take reasonable care in answering questions posed by the insurer fully and accurately and ensure that the information is not

¹⁷ *Biggar v Rock Life Assurance Co* [1902] 1 KB 516; *Newsholme Brother v Road Transport and General Insurance Co Ltd* [1929] 2 KB 356

¹⁸ R. Merkin, 'Consumers and Agency' (2009) 21 ILM 4, 4

misleading.¹⁹ To preserve “a wide and flexible approach to the issue of what amounts to a misrepresentation” in line with the common law concept of a misrepresentation interpreted by the English courts,²⁰ the term “misrepresentation” is deliberately not defined by CI(DR)A 2012.²¹ The duty imposed by s.17 of Marine Insurance Act 1906 is confined to the pre-contractual statement for consumer insurance contract. Whether or not a consumer has taken reasonable care not to make a misrepresentation will depend on all the relevant circumstances.²² Further, CI(DR)A 2012 s. 3(2) lists “examples of things which may need to be taken into account in making a determination”. However, this list is not exhaustive. The requirement of materiality set out in s. 20 of the MIA 1906, was not preserved by 2012 Act.²³ Instead, the specific underwriter must show that it relied on the misrepresentation and would have acted differently had they been in possession of all necessary facts. There is a three-part classification: reasonableness; deliberate or reckless breach of duty and careless breach of duty. CI(DR)A 2012 introduced the proportionate approach into insurance law: if the misrepresentation was “deliberate or reckless”, the underwriter may be entitled to avoid the contract and refuse all claims and retain premiums in most of cases “except to the extent (if any) that it would be unfair to the consumer to retain them”;²⁴ if a misrepresentation is

¹⁹ Law Commission, *Consumer Insurance Law: Pre-contract Disclosure and Misrepresentation* (Law Com No 319, 2009) para 4.7.

²⁰ *ibid* paras 5.50 & 5.52.

²¹ R. Merkin & M. Hemsworth, *The Law of Motor Insurance* (2nd edn, Sweet & Maxwell 2015) at 2-31.

²² CI(DR)A 2012, s. 3(1).

²³ Law Commission, *Consumer Insurance Law: Pre-contract Disclosure and Misrepresentation* (Law Com No 319, 2009) para. 6.10.

²⁴ CI(DR)A 2012, sched 1, para 2.

found to be “careless” the remedy will depend on an assessment of the effect of the misrepresentation in compliance with the loss to the insurer; if the underwriter would have simply charged a higher premium had there been no misrepresentation, the underwriter will be entitled to “reduce proportionately the amount to be paid on a claim.”²⁵ Unlike the current English position, in China consumer insurance is not separated as a distinctive issue from commercial insurance matters under IAC 2015. It might the time for Chinese legislature to start thinking the difference between these two types of insurance contract and the necessity to treat consumer insurance independently.

V. Structure

This thesis is made up of eight substantive chapters:

Considering the abnormal start of modern insurance, it is necessary to introduce the development and structures of China’s insurance industry and legislative history of insurance law as well as legislative and judiciary system in insurance litigation in China. The matter is dealt with in the First chapter. The aim of that chapter is to delineate a full picture of Chinese insurance industry and a framework of courts and judiciary system so as to attain a deeper knowledge of the duty of good faith as a general principle under Chinese law from perspective of legal and cultural background.

²⁵ CI(DR)A 2012, sched 1, para 5-8

Chapter Two makes comparison between the civil law notion of good faith and the common law duty of utmost good faith exploring substantial differences between these two norms. The remainder is composed of six chapters expounding hot discussion topics on controversial issues of utmost good faith. Comparisons made between Chinese and English law run through each part of this thesis.

Chapter Three concerns operation of the duty of fair presentation enacted in IA 2015 – fruit of the English insurance law reform, including changed and unaltered elements of insureds’ duty to disclose and the duty not to misrepresent. It is interesting to compare and contrast the new duty with the old forms stated under the Marine Insurance Act 1906.

Chapter Four covers both materiality and inducement. They are now separate concepts under English law. The duty of utmost good faith required reciprocity. Thus, insurer’s pre-contractual duties are given a particular consideration in Chapter Five.

Brokers play a significant role in insurance industry. London is a “broker market”.²⁶ In China, the absolute importance of brokers is beginning to be understood. Chapter Six deals with broker disclosure. Additionally, the legal status of brokers in China is examined in comparison with law reforms on

²⁶ R. Merkin, ‘Placement of Insurance and the Role of Brokers’ (Forthcoming in 2018)

commission agents.

Post-contractual duties, i.e. fraudulent claims and late payment, and the effects of utmost good faith are examined in Chapter Seven. In addition, this Chapter nevertheless includes the insured's duty to notify the increase of risk to the insurer, being identified by Chinese scholars as a post-contractual duty of good faith, although English law does not treat these issues as of good faith and deals with them on the basis of contract.

The Chapter Eight considers insurance law reform in the consumer context in England, including definition of "consumer insurance contract", duty of consumer assureds, qualifying misrepresentation and the insurer's remedies for breach under CI(DR)A 2012.

Chapter 1 Pursuing the Origin of Chinese Insurance Legislation

1.1 Historical antecedent of insurance legislation in China (Pre-1911)

The modern insurance legislation system in China reflects a blend of legal cultures, with Japanese and Western – in particular English insurance law and more recently United States (US) - influence. A commonly accepted view is that insurance was introduced to China in 19th century with the economic expansion of western capitalist countries. Considering insurance as a form of risk management, however, the origin of insurance can be traced back to ancient China. Early methods of transferring or distributing risk were practiced by Chinese traders as early as the 3rd millennia BC. These merchants travelling treacherous river rapids would cleverly distribute their wares across many vessels to spread the loss due to any single vessel's capsizing. To prevent the total loss of any one shipment, the businessmen established "collective agreements" to share the economic losses of any vessel incurred from sinking, rapids, bandits, and pilferage.²⁷

Up until modern insurance was established in the late 17th century, different forms of insurance had been used substantively in various industries and societies worldwide. Insurance soon became far more sophisticated and a well-developed industry in England. Meanwhile, insurance legislation was built up gradually. Before 19th century, the social, economic and cultural environment for

²⁷ Jennifer A. Meyer, 'Let the Buyer Beware: Economic Modernization, Insurance Reform, and Consumer Protection in China' (1994) 62 Fordham L. Rev. 2125, 2136.

insurance was not so established in China for a long period of time owing to an under-developed economy; development of China's modern insurance industry thereby became a course of learning and following the suit of western insurance system. After Qing government was forced to open its door to the outside world, China's market including insurance market was dominated by foreign enterprises. During the later years of the Qing Dynasty, the government attempted a range of legal reforms, including establishment in 1904 of the Imperial Law Commission. The Commission was tasked with compiling information on legal models in other countries, particularly Japan and Germany, and drafting legislation for application in China. This process was one of several initiatives taken by the declining Qing government to utilise foreign knowledge and technology while preserving the essence of Chinese values and identity.

China then started the overall transplantation of western laws including insurance law. Beginning with the traditions of the Qing imperial periods, legal initiatives of insurance under the Republic of China (est. 1911), during the revolutionary period, and after the foundation of the People's Republic of China (the "PRC"), reflected tensions between domestic concerns with increased international influence. Chinese legal system was and still is affected deeply by moral principles of Confucian propriety. While much of the law code of Qing Dynasty focused on criminal punishments for anti-social behaviour, many kinds of ordinary social and economic activities were also addressed, including commercial law, contracts and property. Understanding Chinese insurance

legislation today requires an appreciation for its historical antecedents and contemporary contexts.

1.1.1 Establishment of Modern Insurance Industry

The origins of insurance can be traced back to the time of the Pre-Qin period.²⁸

Going back to the time of the Warring States, the so-called relief material reserve system was highly regarded by the slave owners as the result of low level of productivity and ability to resist natural disasters. The modern insurance industry, however, was not established until the end of the Qing Dynasty (1644-1911),²⁹ China's last feudal dynasty. Initially, the Qing Dynasty pursued a 'closed door' policy resulting in serious trouble both at home and abroad. The western powers, which had already completed the industrial revolution, later compelled the weak and corrupted Qing government to accept trade, thus introduce modern insurance to China in conjunction with Western commodities.³⁰

Guangzhou was previously the only trade port in China before the Opium War (1839-1842) between China and England. In 1805, the Canton Insurance Society was established by a British businessman in Guangzhou City.³¹ Insurance businesses, however, did not gain any popularity until the Qing government was defeated in the Opium War and was forced to open more trade ports. Consequently, a sharp increase of foreign trade resulted in a tremendous

²⁸ Dongzhou (700 to 256 B.C.) had the Spring and Autumn Period and the Warring States Period. The Spring and Autumn period represents an early formation of the state of China.

²⁹ Fang SU & Jinliang XU, *Bao Xian Xue* [The Insurance] (Tsinghua University Press 2003-2004) 32.

³⁰ *Ibid.*

³¹ *Ibid.*

demand for insurance. Many foreign firms divested their insurance business and established separate insurance companies in China, which monopolized China's insurance market profitably for a long period of time.

In May 1865, the Shanghai Yihe Insurance Society, a freight insurer, was established. Yihe Insurance Society, as the first domestic insurer in China, introduced insurance policies written in both English and Chinese for the first time. Policies were written only in English prior to that, even in China.³² In December 1875, the Insurance Promotion Bureau was founded, which ended the monopoly of foreign insurers for hull insurance. The emergence of domestic insurance society was supported by the Chinese/local business community. Subsequently, the Renhe Marine Insurance Company which known as China's first marine insurance company, and Jihe Fire and Marine Insurance Company as well as other domestic insurance companies were set up by China Merchants. A year later, the first Chinese businessman's insurance company was founded in 1876, which marked – what accepted by most historians – the beginning of Chinese modern insurance industry³³ after the prolonged domination by foreign companies from the end of the Opium War in 1842 until the beginning of the 20th century. Chinese insurance industry retained this structure through World War II and the Civil War until the victory of the Communist Party and the establishment of the People's Republic of China (hereinafter the PRC).

³² Yide YE, Yue WU & Yuanren ZHU (eds), *Zhong Guo Bao Xian Shi* [Chinese Insurance History] (China Financial Publishing House 1998) 44.

³³ *Ibid.*

1.1.2 History of Insurance Legislation

The history of insurance legislation in China is relatively short. Compared to the development of criminal law, Chinese insurance legislation, as mentioned previously, can only be dated back to the end of the Qing dynasty. In 1902, with the development of domestic insurance industry and the initiative of law reform, the Qing government drafted the “Qing Commercial Code” consisting of the Company Code and Business Code, which has been considered to be the first piece of legislation expressly stating general rules as to the insurance industry and insurance entities. After a further five years, Mr Rui XU drafted the first insurance bill, namely, the Insurance Code Draft Bill. Although the Bill was sent to the Qing Imperial government by the Minister of Transportation of the Qing Empire³⁴ for approval, it failed to attract the Emperor’s attention and became ill-fated eventually.³⁵ In May 1908, the Qing government invited a Japanese insurance expert to draft the Qing Commercial Bill including two insurance chapters: life insurance and loss.³⁶ The Bill inevitably followed the Japanese legislation. The Qing Dynasty, however, collapsed before implementation of this law.³⁷ Most of these acts and regulations focused on compulsory insurance, especially for the property of state institutions and for the property of ship, train, and airplane passengers.³⁸

³⁴ Mr Xuanhuai SHENG, a founder and the first president of the Red Cross Society of China, was appointed head of the Board of Posts and Communications until the dynasty fell in 1911.

³⁵ *ibid*

³⁶ Dongxia YANG, *Zhongguo Jindai Baoxian Lifa Yizhi Yangjiu* [The Transplant of Modern Insurance Law in China] (Law Press 2009) 57

³⁷ Yide YE, Yue WU & Yuanren ZHU (eds), *Zhong Guo Bao Xian Shi* [Chinese Insurance History] (China Financial Publishing House 1998) 46.

³⁸ Linbo Fan, ‘The Insurance Market System’ in J. Norton, C.J. LI and Yangxin HUANG (eds), *Financial Regulation in the Great China Area: Mainland China, Taiwan and Hongkong SAR* (Kluwer Law

1.2 Republican Period (1912-1949)

After the downfall of Qing dynasty with the rise of Nationalists in 1911, the Chinese conducted their insurance business primarily to support foreign trade.³⁹ Until then, there were approximately 45 domestic insurers operating in China, where the majority were highly concentrated in trade ports in Shanghai. During the Republican era, the Chinese insurance industry was a thriving and growing. One of the most prominent foreign-invested insurance companies operating in China from 1912 to 1949 was the American International Assurance Company (Know as "AIA"), founded in Shanghai in 1919. The headquarters of AIA was moved from Shanghai to Hong Kong in 1949.

As being the major watershed in transition from a monarchy to a republic, the establishment of the central government of the Republic of China in 1911 marked the end of feudal dynastic regime. Later in 1929 and 1936, two subsequent attempts on insurance legislation were made by the central government of the Republic of China. The 1929 legislation was drafted by a French insurance lawyer appointed by the central government. That piece of legislation was not well received in the insurance industry and was ill fated because the civil war (1927-1937) broke out in China. The 1936 legislation that was in need of the industry to absorb principles and doctrines from the English insurance law was also aborted due to the Japanese war (1937-1945) and the civil war (1945-1949) after its enactment.

International, 2000) 158.

³⁹ Jennifer A. Meyer, 'Let the Buyer Beware: Economic Modernization, Insurance Reform, and Consumer Protection in China' (1994) 62 Fordham L. Rev. 2125, 2137.

1.3 Development of Insurance Industry of the PRC (1949-Present)

After the foundation of the PRC in 1949, China followed the steps of the previous Soviet Union and pursued a close door policy. Most large foreign insurance companies left China entirely after 1949, though some retreated to Hong Kong.⁴⁰ Since then, insurance business in China was almost closed. There was no legislation on insurance law or other commercial law until economic reform in the late 1970s. The modern law and practice of insurance in the PRC only started to develop over the last 20 years.

1.3.1 Prior to Economic Reform of the PRC (1949 – 1978)

On 20th October 1949, the Financial Committee of the State Council formed a state-owned enterprise – People’s Insurance Company of China (the “PICC”) in Beijing,⁴¹ which was a leap for the insurance industry in China. PICC developed a mission to “protect state assets, ensure industry safety, promote materials flow, provide stability,” and, more importantly, to “collect surplus funds and enriching state assets”.⁴² In its first decade of operation, the PICC made a rapid and steady progress by setting up regional branches and offices in each provinces, autonomous regions, and municipalities.⁴³ Meanwhile, the government interfered in the operation of private insurance companies, and incorporated them one by one into the PICC, thereby private insurance

⁴⁰ Yaohua LI, *Zhongguo Dangdai Baoxian Ye* [The Modern Insurance Industry in China] (Intellectual Property Publishing House, 2011) 14;

⁴¹ PICC Group Introduction, <<http://www.picc.com/html1/folder/0/2891-1.htm>> accessed 29 Nov 2017

⁴² Dingfu WU, *Zhongguo Baoxian Ye Gaige Baogao (1979-2003)* [Report on Development and Reform of Insurance Industry in China (1979-2003)] (China Economic Publishing House 2004) 4.

⁴³ Alberto Monti, ‘The Insurance Contracts in the People’s Republic of China – A Comparative Analysis of Policyholders’ Rights’ (2002) 1(3) *Global Jurists Topics* 1, 4.

companies disappeared gradually from the market.⁴⁴ Pursuant to the decision of the State Council, the PICC was designated in 1951 as the only institution to engage in mandatory insurance, i.e. mandatory insurance of state-owned enterprise.⁴⁵ In addition, the PRC government started imposing restrictions on foreign insurance institutions that had a presence in China. These restrictions included prohibitions on remitting foreign currency and severely penalised companies that violated laws and regulations. As a result, all foreign-invested insurance companies withdrew their business from China in early 1952.⁴⁶

On September 15 1954, the first plenum of the first National People's Congress (the NPC) – this year is the 19th NPC - was successfully held in Beijing, which marked the foundation of system of people's congress. The First Constitution of the P.R.China (the Constitution 1954) was promulgated in this meeting empowering the NPC and the People's Congresses at all levels that are elected to be the legislative bodies exercising "the legislative power of the state"⁴⁷. After 25 years of development, the NPC is deemed to be the "highest organ of state power",⁴⁸ which has the authority to enacts – or formally approves - legislation, and in addition has the power to elect, appoint or remove members from central state organs, for example, the President and Vice President, the Premier (the head of the State Council), the Chief Justice of the Supreme People's Court and

⁴⁴ Haomin Zhu, *Da Lu Jin Rong Zhi Du Yu Shi Chang* [Financial Regime and Market in Mainland China] (2002) 124.

⁴⁵ *ibid.*

⁴⁶ *ibid.*

⁴⁷ Constitution of the PRC (enacted in 1982, revised in 1988, 1993, 1999 and 2004, hereafter the "Constitution 2004") art. 58.

⁴⁸ Constitution 2004, art. 57.

the procuracy, and a number of other organisations.⁴⁹ The NPC is composed of a permanent body – the Standing Committee of the NPC⁵⁰, the Chairmen’s Council, and nine different Special Committees⁵¹. The Standing Committee is empowered “to interpret the Constitution and supervise its enforcement” and to enact and amend all laws except for those of which are enacted and amended by the NPC itself.⁵² The Standing Committee enacts amendments and provides interpretations for laws adopted by the NPC, with reference to the basic principles of these statutes.⁵³ It is to be noted here that the NPC, and the NPC only, has the power to amend the Constitution.⁵⁴

Before entering the market-directed economy epoch, the economy in China was centrally planned by the government resulting all companies were owned by the state. The Chinese government, by virtue of communist doctrine,⁵⁵ protected its entities and citizens through the People’s Communes System; thereupon other means of social security such as insurance was rendered meaningless.⁵⁶ Thus, in the period of Great Leap Forward Revolution (1958-1962), the central

⁴⁹ Constitution 2004, art. 62(4); also see Functions and Powers of the NPC, <http://www.npc.gov.cn/englishnpc/Organization/2007-11/15/content_1373013.htm> assessed 8 Dec 2017.

⁵⁰ Constitution 2004, art. 57.

⁵¹ They are Ethnic Affairs committee; Law Committee; Internal and Judicial Affairs Committee; Financial and Economic Affairs Committee; Education, Science, Culture and Public Health Committee; Foreign Affairs Committee; Overseas Chinese Affairs Committee; Environment Protection and Resources Conservation Committee and Agriculture and Rural Affairs Committee.

⁵² Constitution 2004, art. 67 par.1.

⁵³ Constitution 2004, art. 67 pars.3 and 4.

⁵⁴ Haomin Zhu, *Da Lu Jin Rong Zhi Du Yu Shi Chang* [Financial Regime and Market in Mainland China] (2002) 124.

⁵⁵ Ideology of Communism according to Marx, Engels, Lenin and Stalin.

⁵⁶ Haomin Zhu, *Da Lu Jin Rong Zhi Du Yu Shi Chang* [Financial Regime and Market in Mainland China] (2002) 124.

government applied the same policy to insurance industry.⁵⁷ The suspension of domestic insurance businesses lasted for the following two decades. Since then, the PICC was incorporated into the People's Bank of China (the "PBOC"), and became a department of the central bank.⁵⁸ Although the PICC maintained operations in the cities of Shanghai and Hangzhou, its businesses were limited to foreign trade activities, primarily insurance cargo and hull risks.⁵⁹

1.3.2 From the "Open Door" policy to WTO (1979-2001)

It was not until 1978 and the 3rd Plenary Session of the 11th Communist Party China Central Committee led by Xiaoping DENG that economic system reform and market-directed economic construction became the main theme of China's development. Given that Chinese government could not entirely uphold its responsibility to assume insurance-type claims, it re-authorized the industry in 1979. Subsequently, the State Council made its landmark decision on resuming insurance businesses by setting up insurance operational pilot zones in different areas throughout China, by which it changed the future of the industry. In 1980, the Chinese insurance industry was revived after twenty years of stagnation. After a further two years, the PBOC obtained the approval of the State Council to set up the Board for PICC, which was a milestone in corporate reconstitution in PICC's history. On January 1 1984, the State Council separated the insurance function from the PBOC and officially established, again, the People's

⁵⁷ Hongru Liu, 'Developments in the Reform of China's Banking and Financial System' (1988) 2 Journal of Chinese Law 323, 356.

⁵⁸ PICC Group Introduction, <<http://www.picc.com/html1/folder/0/2891-1.htm>> accessed 29 Nov 2017.

⁵⁹ Yide YE, Yue WU & Yuanren ZHU (eds), *Zhong Guo Bao Xian Shi* [Chinese Insurance History] (China Financial Publishing House 1998) 125.

Insurance Company of China.

In 1980, when the insurance market was first reopened as part of the financial reforms, the total insurance premium was only CNY 640 million. In conjunction with the Four Modernizations and the 'Open Door' Policy, China resumed its foreign trade and investment activities. On one hand, the economic system reform vitalised Chinese insurance market and thus laid the foundation for the direction of future development of the industry; on the other hand, the 'Open Door' Policy exposed the infant industry to a fierce international competition, which brought great opportunities along with sharp challenges to Chinese insurers. In order to promote new public policies and facilitate foreign investment, the National People's Congress passed "The Law of the People's Republic of China on Chinese Foreign Equity Joint Ventures" (the CFEJV).⁶⁰ Insofar as the PICC was the only authorised insurer in those days the CFEJVA 1979 was passed, it guaranteed domestic market dominance. Along with good growth momentum of economic reform and further market developing, the monopoly was eventually ended in 1985 with the promulgation of the Provisional Regulations Regarding the administration of Insurance Enterprises (The Regulations). The Regulations, opening the gate to other domestic insurers intending to operate in China, nevertheless reserved certain lines of

⁶⁰ Adopted on July 1, 1979 at the Second Session at the Fifth National People's Congress, Amendment to the Law in accordance with "The decision on Amendment to "The law of the People's Republic of China on Chinese-Foreign Equity Joint Venture" was adopted on April 4, 1990 at the Third Session at the Seventh National People's Congress, the second Amendment to the Law in accordance with "The decision on Amendment to "The law of the People's Republic of China on Chinese-Foreign Equity Joint Venture" was adopted on March 15, 2001 at the Fourth Session at the Ninth National People's Congress, the third Amendment to the Law in accordance with "The decision on Amendment to four pieces of legislations including "The law of the People's Republic of China on Wholly Foreign-Owned Enterprises" was adopted on September 3, 2016 at the Twenty-second Session at the Twelfth Standing Committee of National People's Congress.

insurance, such as foreign business projects, for the PICC.⁶¹ Xinjiang Agricultural Insurance Company was subsequently set up in 1986.⁶² After two years, the China Merchant Steam Navigation formed Ping An Insurance Company, and then followed by the establishment of China Pacific insurance Company in 1991.⁶³ Rapid growth in foreign-related insurance business and foreign-owned insurance companies could also be observed in this period.⁶⁴ By 1995, the PICC was in possession of nine foreign-related and overseas insurance institutions, some of which were holding companies or group companies. In 1996, the PICC was restructured as PICC Group, as a holding company for its life, property and reinsurance operation, named People's Insurance Company of China Holding Limited.⁶⁵ In October 1998, the State Council restructured PICC group, and three subsidiaries were renamed.⁶⁶

- PICC (Life) Insurance Company Limited
- PICC Property Insurance Company Limited
- PICC Reinsurance Company Limited

China opened its door to foreign-owned insurance enterprises from 1992. In September 1992, the PBOC first granted the American International Group

⁶¹ Linbo Fan, 'The Insurance Market System' in J. Norton, C.J. LI and Yangxin HUANG (eds), *Financial Regulation in the Great China Area: Mainland China, Taiwan and Hongkong SAR* (Kluwer Law International, 2000) 158.

⁶² Zhen ZHONG & Manni HUANG, 'Agricultural Insurance in China Takes off with Government Support' FFTC Agricultural Policy Platform (FFTC-AP) <http://ap.fftc.agnet.org/ap_db.php?id=523&print=1> accessed 29 Nov 2017> assessed 8 Dec 2017

⁶³ Ming ZHONG & Wenhua LIU, *WTO Yu Zhongguo Jinrong Falv Zhidu De Chongtu Yu Guibi* [Conflicts between WTO and Chinese Financial Law Regime] (China City Press 2001), 373.

⁶⁴ Yide YE, Yue WU & Yuanren ZHU (eds), *Zhong Guo Bao Xian Shi* [Chinese Insurance History] (China Financial Publishing House 1998) 125.

⁶⁵ PICC Group Introduction, <<http://www.picc.com/html1/folder/0/2891-1.htm>> accessed 29 Nov 2017.

⁶⁶ Ibid.

(AIG) a permit to sell personal life and property insurance in China's largest city, Shanghai.⁶⁷ In 1994, Tokyo Marine & Fire Insurance Company, the biggest property and casualty insurance company in Japan, initiated its business in Shanghai.⁶⁸ Thereafter, foreign insurance business started returning to the Chinese insurance market in the form of foreign-owned companies, representative offices or joint ventured with local companies. By the end of 1996, five foreign owned insurance companies and some 126 representatives and liaison offices from 77 foreign insurance companies were in operation in China.⁶⁹ From 1992 to 2000, China gradually approved the re-entry of 16 additional leading foreign insurers.⁷⁰ Economic reforms in china have increased the foreign participation in Insurance industry in China. The government however was and still is heavily involved in the industry, although its role is now changed from an administrator to a regulator.

1.3.3 In-depth economic reform (2002-Present)

In recent years, China has achieved a spectacular success in its economic development and has come to play an increasingly important role in the world economy. China's insurance industry has being one of the fastest developing industries in national economy. Since 2002, the average annual growth rate of China premium revenues was 17.3 per cent.⁷¹ By 2005, insurance institutions

⁶⁷ Yide YE, Yue WU & Yuanren ZHU (eds), *Zhong Guo Bao Xian Shi* [Chinese Insurance History] (China Financial Publishing House 1998) 125.

⁶⁸ Yadong Luo, *China's Service Sector: A New Battlefield for International Corporations* (Copenhagen Business School Press 2001) 159.

⁶⁹ Haomin ZHU, *Da Lu Jin Rong Zhi Du Yu Shi Chang* [Financial Regime and Market in Mainland China] (2002), 159.

⁷⁰ PICC Group Introduction, <<http://www.picc.com/html1/folder/0/2891-1.htm>> accessed 29 Nov 2017.

⁷¹ Yao Ma, Shengwen Xue, Pengming Bai, Xiaohua Huo, Xiaoyu Bian, *Analysis and Investment Consulting Report on China Insurance Industry 2012-2016*, CI Consulting <www.ocn.com.cn> accessed

had reached 100 and initially formed fair competition and common development market situation in which many kinds of organization forms and ownership elements coexisted such as state-owned holding (Group) company, joint-stock company, policy-oriented company, professional company, foreign insurance company, etc. From 2002 to 2005, China's premium revenues rose by 8 percentage points annually, higher than world average level, and in 2005 China premium revenues ranked the 11th of the world and occupied 1.8 per cent of global total premium revenues, increased by 0.4 percentage point than that in 2002.⁷² By 2007, there were 110 insurance companies including 43 foreign companies which increased by 21 than 22 at the end of 2002. By December 31, 2007, there were 2331 professional insurance intermediaries and 7 foreign ones. In 2007, total profits of national professional intermediaries were CNY 194.962 million, increased year-on-year 96.22 per cent. Especially for insurance broker institutions, total profits in the whole year 2007 were CNY 220.53 million, increased year-on-year 104.74 per cent, to be the best level in history.⁷³

As a great potential and opening up market, China attracts international insurance capital extraordinarily, and many famous international insurance companies have arranged the businesses developed in China as an important strategy. For domestic insurance enterprises, it means keener competition. China insurance industry has entered into a rapid developing period, and the operation model of insurance industry is developing toward diversification. As a

²⁹ Nov 2017.

⁷² *ibid.*

⁷³ *ibid.*

result of WTO negotiations, China has agreed to completely open its financial services market, including insurance. The WTO accession has stimulated much additional reform activity to prepare domestic insurance market in China for vastly increased foreign participation and competition. In 2014, the State Council released a new set of guidelines on strengthening coverage, innovation, functionality, fundamental protection and competitiveness for the insurance industry. The Directive is viewed as a key factor towards regulating the Mainland insurance landscape. An improved regulatory regime coupled with increasing domestic wealth, has substantially boosted the scalability of the market. In 2016, the growth of business scale hit a new high since 2008. Data shows that in 2016 the whole industry realised the original insurance premium income of CNY 3.1 trillion, a year-on-year increase of 27.5 per cent.⁷⁴ This was the first time the China insurance market surpassed Japan ranked second in the world, driven by five years of growth accompanying with transformation going on in the environment and regulation mechanisms of the insurance industry.⁷⁵ This accelerated market growth has prompted more companies to enter the market. A BMI Research report states that the Chinese insurance market will remain one of the strongest in the region in the years ahead, in line with the rising disposable income levels of Chinese households. The report anticipated total life premiums to grow from CNY 1.5 trillion in 2017 to CNY 1.86 trillion in

⁷⁴ 'CIRC 2016 Insurance Statistical Data Report'

<<http://www.circ.gov.cn/web/site0/tab5257/info4060001.htm>> accessed 29 Nov 2017.

⁷⁵ Ernst & Young 2016-2017 Insurance Risk Management White Book

<[http://www.ey.com/Publication/vwLUAssets/ey-2017-insurance-risk-management-white-book/\\$FILE/ey-2017-insurance-risk-management-white-book.pdf](http://www.ey.com/Publication/vwLUAssets/ey-2017-insurance-risk-management-white-book/$FILE/ey-2017-insurance-risk-management-white-book.pdf)> accessed 29 Nov 2017.

2020.⁷⁶ Most recently, as One Belt, One Road Initiative unfolds – China’s USD 4 trillion strategy to boost economic cooperation and investment among 65 countries across 3 continents – it has been hailed as one of the most ambitious infrastructure projects in the world,⁷⁷ China is seeking to provide a huge stimulus to economic growth and international trade, and also to insurance. Provided that more than 60 countries are to be connected by land and sea, the One Belt, One Road project could throw a new focus on both Chinese and other insurance market concerned – particularly in the area of marine insurance. Chinese insurers are being mobilised to pour the world’s biggest pool of premium income to help close a potential funding gap in the government’s multibillion yuan infrastructure build up along the old Silk Road.⁷⁸ Meanwhile, many global insurance giants have already seen opportunities brought by diverse levels of political, credit and security risks along the 10,000 kilometre route and are ready to join the battles.

1.4 Chinese insurance legislation framework and sources of law

The legal system in People’s Republic of China does not trace its roots to the private-law system of Rome or to any religious basis. Unlike England, the Chinese legal system is based on the civil law system which is structurally similar to Germany and France. The legal history of the PRC begins with the

⁷⁶ Ching-hoo HUI, ‘China’s Insurance Sector Growing at A Rapid Rate’ *Journal of Investments & Pensions* (Hong Kong, 8 Mar 2017). <http://www.asiaasset.com/news/ChinaInsurance_CH_DM_0706.aspx> accessed 29 Nov 2017

⁷⁷ Joe Blenkinsopp, ‘Sponsored: One Belt, One Road: Linking China to Europe’ *Global Trade Review* (London, 10 Aug 2017) <<https://www.gtreview.com/supplements/gtr-insurance-2017/sponsored-one-belt-one-road-linking-china-europe/>> accessed 29 Nov 2017.

⁷⁸ Maggie ZHANG, ‘China to Use Insurers to Close the Funding Gap in Silk Road Project’ *South China Morning Post* (Hong Kong, 22 May 2017) <<http://www.scmp.com/business/banking-finance/article/2095233/china-use-insurers-close-funding-gap-silk-road-projects>> accessed 29 Nov 2017.

abolition in 1949 of all the laws of the predecessor state – the Republic of China. Since then, there was for many years little need for a formal legal system in many areas of national life, as the economy was largely subject to state planning. It was not until the economic reforms of 1978 that a true institutional legal system was introduced, mostly to deal with the demands of the growing economy. Over a decade ago, since China joined the World Trade Organisation (the “WTO”), in complying with a number of WTO obligations, more than 3000 pieces of legislation⁷⁹ have been enacted and amended at the national level alone including laws, administrative regulations, implementing rules and measures, and regional rules on different aspects, not to mention the multitude of administrative regulations and provincial and municipal enactments. As Western business moved into China, laws governing foreign-invested enterprises and joint-ventures were to be enacted as well as its implementing rule and measures to fulfil WTO requirements.

1.4.1 A hierarchical structure of Chinese legal system

The “Reform and Open Door” policy initiated the on-going transition to a market economy, thus had enormous implications for China’s legal development. The Chinese legislation can be broken down into several parts in terms the level of enforcement empowered to it. The hierarchic rank is as follow:

- the constitution;
- basic laws (statutes) are enacted by NPC and SCNPC;

⁷⁹ ‘China in the WTO: Past, Present and Future’ <http://www.wto.org/english/thewto_e/acc_e/s7lu_e.pdf> accessed 29 Nov 2017, 14.

- administrative regulations are promulgated by the State Council;
- local People's Congress regulations are enacted by different levels of local People's Congress and their standing committees at the provincial level;
- regional ordinance including Government Rules and Ministry Rules are made by local governments of provinces, central-level ministries, commissions, and agencies directly under the State Council.

In addition, judicial interpretation issued by the Supreme People's Court is not recognised as a source of law, although judicial interpretation carries substantial weight in legal practice. Judicial interpretation stands independently without subjecting the courts to any other legislation, and may to some extent alter the laws by wielding its discretion in interpreting the law made by NPC and SCNPC.⁸⁰ International treaties ratified by China are directly applicable and prevail if they conflict with domestic law.

Rules laid down in Constitution rank highest, which are followed in descending order by the rules of basic laws, government decrees and, lastly, ministerial orders and regulations issued by lower authorities. Lower-ranking rules must be in harmony with higher-ranking ones. Judges and public servants, in performing their functions, may not apply a rule given in a government decree or lower-ranking enactment if it is contrary to basic law or the Constitution. In addition,

⁸⁰ Legislation Law of the People's Republic of China (2015 Amendment) [Effective].

the conflict of rules is also solved by the concept of meta-rules,⁸¹ namely, a law governing a specific subject matter (*lex specialis*) overrides a law governing only general matters (*lex generalis*);⁸² and the doctrine of “*lex posterior derogat legi priori*” – the younger law takes precedence of the older law.

1.4.2 The new Constitution of the PRC

Constitution, as the “mother-law”,⁸³ is the “fundamental law of the state” and has supreme legal authority.⁸⁴ The current Constitution of the PRC, adopted by the 5th NPC in 1982, has been revised four times in 1988, 1993, 1999, and 2004 respectively. Three prior constitutions from 1954, 1975, and 1978 have partially contributed to composition of the current Constitution. Under the Constitution, every citizen must perform the duties prescribed by the Constitution and the laws such as power of the state lies with the people, equality of all ethnic groups, equality of citizens, rights to elect and be elected etc., while they enjoys the rights⁸⁵. In addition to general principles of government and state affairs and the fundamental rights and duties of the people in China, the 1982 Constitution also delineates the national frame of government. Meanwhile, it furnishes an extensive legal framework for liberalising economic policies of the 1980s, which allows the collective economic sector not owned by the State to play a broader role and provides incentives for individuals to participate in economic activities.

⁸¹ Samuel Meira Brasil Jr, ‘Rules and Principles in Legal Reasoning’ (2001) 10(1) Journal of Information & Communications Technology Law 67.

⁸² The doctrine of *Lex specialis*

⁸³ Albert CHEN, *An Introduction to the Legal System of the People’s Republic of China* (4th edn, Butterworths 2011), 41

⁸⁴ Constitution Preamble 1982.

⁸⁵ Constitution 2004, art. 33

All of that set up a firm foundation for further economy reforms in China. More importantly, the new Constitution bestows the constitutional basis for the considerable body of laws passed by the NPC in subsequent years permitting and encouraging extensive foreign participation in all aspects of the economy.

1.4.3 NPC statutes and other enactments

The first Insurance Act of the PRC was promulgated by the NPC in 1995 – the Insurance Act 1995 (known as ‘the Act’ or the ‘IAC 1995’) – in which it provided guiding principles and rules for the insurers and the insureds in the insurance contracts. The 1995 Act also codified the regulatory rules for insurance companies and insurance intermediaries in the PRC. After China’s accession to the World Trade Organization (the “WTO”) in 2001, the Act was amended in 2002. The amendments were limited to the regulation of insurance business. In February 2009, the Standing Committee of the National People’s Congress of the PRC promulgated a further amendment to the Act. Compared to the previous change to the Act, which focused on regulations pertaining to China’s WTO commitments, this amendment placed more emphasis on settling insurance contract issues arising prior to the amendment and on the prudential regulation of insurance companies.

Insurance and reinsurance activities are mainly governed by the Insurance act. The legislation treats insurance and reinsurance activities as being largely synonymous. Although the China Insurance Regulatory Commission (CIRC) has in recent years promulgated a few guidelines and measures solely

regulating the reinsurance business, there is no comprehensive statutory framework for the regulation of reinsurance activities in the PRC. However, it does not appear that the provisions in the insurance act regarding the rights and obligations between the insured and insurer under an insurance contract should be automatically applied to the reinsured and reinsurer under a reinsurance contract. Other than the mandatory provisions of the Insurance Act, it is subject to the General Provisions of Civil Law of the PRC and the Contract Law of PRC. In addition to the Insurance Act, specific contract principles and rules for marine insurance are codified in Chapter 12 of the PRC Maritime Code which came into effect as of July 1, 1993.

Legislation is also created at local levels by local people's congress of provinces, municipalities, autonomous areas and cities. The Constitution provides the structure, authority and duties of the local people's congress in articles 95-111. All of the local regulations that are passed by these lower people's congress shall comply with the Constitution, statutes passed by the NPC, and the people's congresses above each of the local congresses in the hierarchy.

1.4.3.1 The Insurance Act 1995

On October 1 1995, the Standing Committee of the NPC promulgated the first Insurance Act of the People's Republic of China, which is the original and most significant law that governs the Chinese insurance industry. The Insurance Act 1995 was the first national legislation, providing a framework for understanding

China's insurance regulations.⁸⁶ This legislation consisted of 152 articles in eight chapters. The first chapter covered the purpose of the law, the definition of insurance, the scope of the law, and principles of the insurance industry. Chapter Two, pertaining to insurance contracts, consisted of three sections: (1) the general rules of the formation, amendment, and performance of the insurance contract; (2) property insurance; and (3) life insurance contract. Chapters Three through Five set forth the rules and requirements of insurance company administration and supervision, including licensing, scope of business management of premiums, liquidation, and continuous supervision. Chapter Six offered rules for supervision of insurance and related industries such as insurance agents and brokers. Finally, Chapters Seven and Eight included provisions regarding legal liabilities and sanctions.⁸⁷

1.4.3.2 The 2002 Amendment to the Insurance Act 1995

China's insurance industry changed drastically between 1995 and 2002. The number of insurance companies reached 53 by the end the 2002, and total annual premium income had risen from CNY 226.30 billion through the first three quarters of 2002.⁸⁸ This growth resulted in an increasing number of insurance consumers and products, also generating demand for higher quality service and upgraded regulatory systems. With these changed objectives, several parts of the Insurance Law 1995 ceased to be applicable to the market.

⁸⁶ Guanghua Yu & Minkang Gu, *Law Affecting Business Transactions in the PRC* (Kluwer Law International 2001) 126-127

⁸⁷ The Insurance Law of People's Republic of China 1995 (Revised).

<www.jus.uio.no/lm/china.insurance.law.1995/protrait.pdf> accessed 29 Nov 2017

⁸⁸ Kuan-Chun CHANG, 'Necessary Reform of Insurance Law in China after Its WTO Accession' (2004) 31(1) *Syracuse J. Int'l L. & Com.* 25, 42.

Some original provisions became obstacles to reasonable operation in the altered environment.⁸⁹ Soon after its establishment, the CIRC placed amending the Insurance Law of 1995 at the top of its list of priorities. Eventually, the People's National Congress granted legislative approval to this amendment on October 28th, 2002. This amendment was expected to accomplish four objectives:⁹⁰

- i. to sustain the reform and development of China's insurance industry;
- ii. to strengthen supervision and regulation of the industry;
- iii. to standardize the regulation of insurance enterprises and business operations;
- iv. to fulfil pledges to adopt international practices made during the WTO accession negotiations

1.4.3.3 The 2009 Amendment to the Insurance Act 1995

For the purpose of balancing the rights and interests between the insured and the insurer, and facilitating prudential supervisions on insurance companies, on 28th February 2009, the Standing Committee of National People's Congress adopted the long-awaited amendments to the Insurance Law, which came into effect on October 1st, 2009.⁹¹ The primary source of reference for this

⁸⁹ Xu Guojian & Richard L. Mertl, 'Amending the Insurance Law: Long-Term Policy or Expedient Measures' (2003) 10 China L. & Prac 21, 21.

⁹⁰ Ibid.

⁹¹ Insurance Law of People's Republic of China (Revised 2009), China Insurance Regulatory Commission <www.circ.gov.cn/web/site0/tab68/i94860.htm> accessed 29 Nov 2019.

amendment was American and British law.⁹² A number of new provisions were included and extensive amendments to existing provisions made, resulting in major changes to both substantive insurance contract law and insurance company regulations. Although the 2009 Amendment retains the structure and organization of the old law in the Amendment 2002 and the Insurance Act 1995, at least 80 per cent of the original articles were amended and the total number of articles increased from 158 to 187. The Amendment 2009 attempts to maintain a balance between the right of the insureds to settle their claims fairly and promptly and that of the insurance companies to effectively use of their resources. Compared to the Insurance Law Amendment 2002, the amended version expands the rights of policyholders while imposing heavier duties on insurance companies.⁹³ The Amendment 2009 has improved various aspects of the original Insurance Act by enhancing the protection for consumers under an adhesion contract, clarifying the insurer's right to rescind the contract due to the insured's misrepresentation, and the addition of a requirement specifying the insurer's duty to explain the contract.⁹⁴

Significant changes made in the Amendment 2009 included issues related to the insurance contract, the regulation of insurance companies, and the conduct of business. In particular, the insurance contract category, of which is divided

⁹² Kuan-Chun CHANG, 'Commentaries on the Recent Amendment of the Insurance Law of the People's Republic of China Regarding Insurance Contracts from the Perspective of Comparative Law' (2011) 10(4) Washington U. Global Studies L. Rev. 749, 750.

⁹³ Chongmiao Xu & Li Li, *Zui Xin Baoxian Fa: Shiyong Yu Anli Jingjie* [Newly Amended Insurance law: Application & Cases] (China Law Press 2009) 24.

⁹⁴ Huabo Yang, *Jie Du Xin Baoxian Fa* [The interpretation of new Insurance Act] (2009) 2 Journal of Baoxian Shijian Yu Tansuo <<http://www.circ.gov.cn/web/site0/tab4052/info99344.htm>> accessed 29 Nov 2017.

into three sections i.e. general rules, personal insurance contracts, and property insurance contracts, includes articles pertaining to the insurable interest, applicants' duty not to misrepresent, interpretation of the policy, timely notice of increased risks, insurance fraud and double insurance.⁹⁵ One of the most important reforms of the Amendment is in the clarification of the timeline within which an insurance claim should be settled by an insurance company. Under the 1995 Act, there was no clear and specific deadline within which an insurance company should settle the insured's claims. There have been many complaints from insureds for lack of mandatory time limits and resulting insurer's abuse of rights. The Amendment provides that an insured's claim shall be settled within a reasonably limited period of time.⁹⁶ Pursuant to Article 22(2), when the insured files his claim with supporting documents, the insurance company may request additional information only once, if it believes that the file is not complete. Previously, insurance companies could effectively delay the claim process by asking the insured to provide additional documents again and again. The insurance company must complete its verification process within 30 days after receipt of the insured's claim and shall make payment in 10 days after the agreement with the insured, unless otherwise specified in the contract.⁹⁷ If the insurance company decides to turn down the insured's claim, it shall inform the insured of the decision with reasons within three days after the

⁹⁵ Amendment 2009, Chapter two: The Insurance Contract, arts. 10-66.

⁹⁶ Amendment 2009, art. 23.

⁹⁷ Ibid.

verification process.⁹⁸

The 2009 revision has for the first time introduced incontestability provision into the Insurance Act, clarifying the insurer's right to rescind the contract for the insured's misrepresentation.⁹⁹ When the insurer knows about the facts that the insured fails to disclose intentionally or negligently after the conclusion of the policy, it has the right to terminate the insurance contract within 30 days after the insurer becomes aware of the misstatement. Insurers are entitled to exercise their right of termination within two years after conclusion of the contract. In addition, the 2009 Amendment in effect shortens the statutory limitation from four years to two years within which an insured must file his claim from the day that he knows or ought to know the occurrence of the insured incident.¹⁰⁰

In respect of the regulations to insurance companies, the 2009 Amendment established additional licensing criteria for the establishment of an insurance company, and a process for the approval, fit and requirements of directors. With respect to continuous supervision, although the list of permissible investment objects has been expanded, the CIRC has also been granted the authority to take prompt corrective action against insurance companies when necessary. Furthermore, provisions on the Administration of Insurance Companies were deliberated and adopted at the chairman's executive meeting of the CIRC on

⁹⁸ Amendment 2009, art. 24.

⁹⁹ Amendment 2009, art. 16 par.3.

¹⁰⁰ Amendment 2009, art. 26 par.1.

September 18th 2009 to confirm with and implement the Insurance Law Amendments.¹⁰¹ It focuses in particular on the amendments relating to insurable interest, the insured's duty of disclosure, the interpretation of contractual clauses, double insurance, and insurance fraud.

1.4.3.4 2015 revision

The Insurance Act has been lately amended at the 14th session of the Standing Committee of the 12th NPC on April 24, 2015. The Act's Amendment mainly covers issues involving operating and funding rules, supervision and management, and legal responsibility. No changes are made to the part on insurance contract law in this latest round of revising the insurance law which was last overhauled in 2009.¹⁰² Notably, in relation to insurance/reinsurance intermediaries, the 2015 revision abolishes the procedures to examine the qualification certificate of insurance agents and brokers. Insurers and the intermediaries must scrutinise and train their practitioners to ensure that they have good integrity and ability.¹⁰³ Practitioners of insurance brokers and agents is required to take pre-service training for at least 80 hours in total. In addition, each practitioner must receive post-training and education for at least 36 hours per year, including at least 12 hours of legal knowledge and professional ethics.¹⁰⁴

¹⁰¹ The CIRC Amended and Promulgated Provisions on the Administration of Insurance Companies, China Insurance Regulatory Commission <www.circ.gov.cn/web/site0/tab456/i112034.htm> accessed 29 Nov 2017.

¹⁰² Zhen JING, *Chinese Insurance Contracts: Law and Practice* (Informa 2017) 37.

¹⁰³ Insurance Act of PRC 2015, arts. 111& 122.

¹⁰⁴ CIRC Ordinance on the Supervision of Insurance brokerage Institutions, art. 30; CIRC Ordinance on the Supervision and Administration of Specialised Insurance Agencies, art. 29.

1.4.4 Administrative regulations

The State Council is formally responsible to the NPC and its Standing Committee in conducting a wide range of government functions both at the national and at the local levels. The State Council is recognised as the executive body of the highest organ of state power. It carries out the day-to-day work of central government including adoption of administrative regulations and issuing governmental decisions in compliance with the Constitution and statutory law. Administrative regulations must be formulated in accordance with the Constitution and statutes by the State Council and its ministries and commissions and local authorities. Comparing to acts, administrative regulations are operable measures or provisions providing detailed guidelines to individuals and/or entities for a better operational result of the existing statutory framework. For the purpose of standardisation of the procedures for formulating administrative regulations and to ensure the quality of such regulations, the State Council promulgated the Regulations on Procedures for the Formulation of Administrative Regulations in 2001, which came into force as of January 1, 2002.¹⁰⁵

After the promulgation of the Insurance Act 1995 and two of its amendments, the State Council issued a series of insurance regulations consisting of rules, administrative decisions, ordinances, methods, and notices covering various areas of insurance and reinsurance activities as well as market entry requirements of insurance companies. With an increasing participation of

¹⁰⁵ Promulgated by Decree No. 321 of the State Council on November 16, 2001.

foreign insurance enterprises, in 2001, the State Council adopted the Regulations of the PRC on Administration of Foreign-invested Insurance Companies,¹⁰⁶ which provides general administrative and registration rules for setting up a foreign-invested insurance company in China. The Regulations have been revised in 2013 by the State Council in accordance with significant changes on registered capital in the Company Law of the PRC Amendment 2013.

1.4.5 Implementation rules and other administrative regulations of the CIRC

In November 1998, because of the rapid growth in the insurance sector in China and the lack of sufficient industry oversight, the State Council devolved supervision functions from the People's Bank of China to the newly established CIRC.¹⁰⁷ The CIRC is the primary governmental agency regulating insurance and reinsurance activities in the PRC, which examines and approves the establishment of insurance companies, supervises insurance business operations, investigates irregularities, and imposes penalties in the event of illegal operations of insurance enterprises. The CIRC is not a legislator, but under delegated authority issues administrative regulations, rules and orders from time to time to ensure that the Chinese insurance market functions soundly and steadily.

¹⁰⁶ Promulgated by Decree No. 336 of the State Council on December 12, 2001, and effective as of February 1, 2002.

¹⁰⁷ The Notice of State Council on Establishment of the China Insurance Regulatory Commission, Guofa [1998] No.37.

As articles pertaining to the supervision and administration of insurance companies were still in the early stages of development, the CIRC promulgated the Regulation Regarding the Administration of Insurance Companies in 2000 and subsequently amended it in 2005.¹⁰⁸ The Regulation currently has seven Chapters with 105 articles, providing more detailed rules for supervision and the administration of insurance companies.¹⁰⁹ On March 2004, the CIRC issued the Detailed Implementing Rules for the Regulations of the PRC on the Administration of Foreign-invested Insurance Companies. The Rules, which entered into effect on June 15 2004, provide further guidelines on the establishment and operation of foreign-invested insurance companies, launched into an elaborate explanation on the rules set forth in the Regulations of the PRC on Administration of Foreign-invested Insurance Companies. The Rules comply with China's commitments under its World Trade Organisation Protocol of Accession to the World Trade Organisation.

1.4.6 Judicial interpretations of the Supreme Court of China

Formal judicial interpretations are issued by the judicial authorities, especially the SPC, from time to time to address uncertain legal issues existing in judicial practice. Whether judicial interpretation can be regarded as a legal source is debatable academically, but this rarely becomes a real issue in judicial practice. The Chinese court system has a strict hierarchical structure and, in such a system, a lower court would be likely to follow legal opinions, orders or

¹⁰⁸ Regulation Administration of Insurance Companies (CIRC Dec 22, 2005), <<http://www.circ.gov.cn/web/site45/tab2746/i21575.htm>> accessed 29 Nov 2017.

¹⁰⁹ Ibid.

guidelines from the higher court; therefore, judicial interpretations are valued as an important as well as a practical legal source by the courts.

The Supreme People's Court has officially published three judicial interpretations on various issues of insurance activities. Interpretation I of the Supreme People's Court on Several Issues concerning the Application of the Insurance Law of the PRC (the "Interpretation I") was published and taking effect not long after the Amendment 2009, which deals with insurance contracts made before the Amendment 2009 took effect but performed after that time. The Second Interpretation of the Supreme People's Court on Certain Issues concerning the Application of the Insurance Law of the PRC (the "Interpretation II") came into force on June 8, 2013. The Interpretation II clarifies a number of issues relating to insurable interest, duty of disclosure, and the insurer's obligations to explain insurance clauses. In addition to these two judicial interpretations concerning the applications of general requirements and principles, the Supreme People's Court also published judicial interpretations on marine insurance, namely, the Provisions of the Supreme People's Court on Several Issues about the Trial of Cases concerning Marine Insurance Disputes (the "Marine Insurance Provisions"), which addresses disputes arising out of marine insurance in particular. The Third Interpretation of the Supreme People's Court on Certain Issues concerning the Application of the Insurance Law of the PRC (the "Interpretation III") came into force on 1 December 2015, which focuses on issues as to insurable interest and beneficiaries.

1.4.7 International treaties and the case Law

Unlike common law jurisdictions, there is no strict precedential concept for case law in China. In theory, each case stands as its own decision and will not bind another court. In practice, however, judges of lower people's courts often attempt to follow the judicial interpretations of the Supreme People's Court. In the absence of national laws and regulations for a particular point, international customs and practice may be referred to. English insurance law as a source of international customs and practice may therefore be considered by the PRC courts for reference when it is necessary.

1.5 Chinese courts and judicial system in insurance litigation

The judicial system of the PRC is stipulated in Art. 123-125 of Constitution, consisting of the people's courts, the Supreme People's Court, the people's procuratorates, the Supreme People's Procuratorate, military court, and other special people's courts, i.e. Maritime Courts, Railway Transportation Courts and Forestry Courts. Art. 129 refers to the people's procuratorates as "state organs for legal supervision." In 1983 the NPC amended the Organic Law of the People's Procuratorates, which included an enumeration of the powers and functions of the procuratorates. The functions seem to set up an organisation which initially performs similar to a prosecutor in the United States, in that it oversees investigations by the public security organs and decides which cases will be prosecuted. However, the oversight of the procuratorates extends beyond investigation and trial, into supervision of the legal activities of the

people's courts, the execution of judgments, and the activities of prisons.

There is a hierarchy within the court structure from the top down: the Supreme People's Courts, the Higher People's Court, the Intermediate People's Courts and the Basic People's Courts. The Basic People's Courts are comprised of 3117 courts at county level, which are further subdivided into about 20,000 smaller units referred to as people's tribunals located in towns and villages. There are 409 Intermediate People's Courts and 32 Higher People's Courts located in the provinces.¹¹⁰ Litigants are generally limited to one appeal. The appeal judgment is final. Cases of second instances are often reviewed *de novo* as to both law and facts. Protests are filed by the procuratorate in criminal cases when it is believed that an error has occurred in the law or facts as determined by the judgment or order of the court of first instance. In civil cases the procuratorate does not possess a right to file a direct protest, but it can initiate adjudication supervision via a protest. Adjudication supervision refers to a type of discretionary post-"final" decision review, which may occur in certain situations in criminal cases.

1.6 Principles of Chinese insurance contract law

1.6.1 Insurable Interest

The principle of insurable interest was firstly adopted in the Insurance Act of the PRC in 1995.¹¹¹ Art. 12 of the 1995 Act provided that the insurance applicant

¹¹⁰ The official website of the Supreme People's Court of the People's Republic of China, <www.court.gov.cn/jgsz/rmfyj> accessed 29 Nov 2017.

¹¹¹ Article 12 of Insurance Act 1995 defined insurance interest as interest legally recognised in the subject matter insured.

shall have insurable interest in the subject matter insured. This indefinite and vague provision was revised substantially in 2009 in order to make the law clearer more sophisticated. The Amendment 2009 adopted two different rules on insurable interest for property and life insurance. The insured must have insurable interest at the time of loss under a property insurance contract; however, in a life insurance policy the insurance applicant shall have insurable interest on the insured at the time when the policy is made. Otherwise, the policy is void. Huge debate then rises on what could constitute insurable interest. The vast majority hold the view of that, in order to constitute an insurable interest, the interest i) has to be measurable in value; ii) must be legitimate; and iii) needs to be definite. Accordingly, it is believed that three types of interest in property and liability insurance are required, which are current interest, expected interest and liability interest. Current interest refers to interest arising out of existing property rights, charges, mortgages, liens, intellectual property rights, and shareholders' rights. Expect interest refers to the rights or benefits expected to incur from contractual relationships. Finally, the liability interest refers to liabilities to be incurred in times of breach of contract or tort.

With the Second Interpretations of the Supreme People's Court on Certain Issues Concerning the Application of the Insurance Law of the PRC (the "Judicial Interpretations II") came into force on June 8, 2013, the legal status of insurable interest of leases and carriers was clarified. Previously, the people's

court generally did not recognise that leasees or carriers have insurable interests in property being used, leased, or transported by them. Article 1 of the Interpretation provides where different parties have taken out insurances for the same property, the people's court will uphold their claim on the insurance claim to the extent of their insurable interest. The Interpretation formally clarifies that different parties, including leasees and carriers, have insurable interests in property even though they are not the legal owner and can purchase insurance for property leased or carried by them.

The requirement of insurable interest for life insurance is stricter. Article 31 of the Amendment 2009 provides that insurance applicant only has insurable interest in i) the insurance applicant self; ii) their spouse, children and parents; iii) other family members or relatives who have a supporting relationship with the insurance applicant apart from persons in the preceding category; iv) with whom the applicant has a labour relation. In addition, where an insured has agreed to be insured by the insurance applicant on his/her behalf, the applicant is deemed to have an insurable interest in the insured. However, the Insurance Act made it clear that, unless the insurance applicants are parent of the insured, anyone who is under ten-years-old cannot be insured against death by the applicants. The law also requires that in life insurance where payment is made against death of the insured, the insured amount must be agreed by the insured. Otherwise, the policy is void. Such policy must not be assigned or mortgaged without the consent of the insured unless the insurance applicant is

the parent of the minor being insured.

1.6.2 [Utmost] good faith

The PRC insurance law acknowledges the principle of utmost good faith in theory. However, neither the Insurance Act nor Maritime Code provides any provision on the principle. The contents of the principle are far from clear in the legislation although academics and judiciary refer to the principle as a matter of fact frequently to assist them in adjudicating difficult situations where the law has no clear rules. It has been widely recognised that disclosure and representation are two fundamental components of the principle of utmost good faith. Chinese academics somehow hold the view that the doctrines of warranty, waiver and estoppel are also counted to be parts of this principle.

Instead of using the actual wording of utmost good faith, the Insurance Act 1995 adopted concepts of disclosure and misrepresentation. The duty is a pre-contractual duty, which only arises during the negotiation period of the insurance contract. The law is silent on whether the duty continues after the contract is concluded. The provision on the duty of disclosure was entangled and twisted with the duty not to misrepresent. The Insurance Amendment 2009 has adopted substantial changes to the provision on such duties, which will be analysed in detail in the next two chapters. Pursuant to Article 16 of the Amendment 2009, now the 2015 Revision, when concluding the insurance contract, the insured is required to make true representations in response to the insurer's inquiries relating to the subject matter of insurance. The Judicial

Interpretation II limits the insured's duty as follows:

- i. The insured only needs to provide information limited to the scope and content of the insurer's queries. In other words, the insured only needs to provide information specifically requested by the insurer. If the insured and the insurer have different understanding about the scope and content of the inquiry, the insurer bears the burden of proving the scope of the inquiry.
- ii. The insured only needs to provide information that it clearly knows.
- iii. The insurer may not terminate the insurance contract if it has received premiums when it knew or ought to have known that the insured failed to provide truthful disclosure.

The Insurance Association of China (the "IAC") issued new policy model clauses designed to comply with the Amendment 2009, which are effectively pre-approved by the CIRC. The IAC has included provisions in its model wording which, in summary, provide that in concluding the policy, the proposer must make truthful representations concerning the insurer's enquiries on the relevant circumstances of the subject matter of the insurance or the insured (proposer's duty of disclosure). The insurer has the right to terminate the policy if the proposer deliberately, or due to gross negligence, fails to perform their duty of disclosure and that failure is sufficient to significantly affect the insurer's decision on whether to accept the risk; or increase the level of premium.

By contrast, in marine insurance which is governed by Maritime Code of the

PRC, the duty is imposed upon the insured and the insured is required to disclose all the material information to the insurer even if it has not been asked for.¹¹² The rationale for the difference between marine and non-marine insurance in the duty of disclosure is not clear. The drafting of the marine insurance provisions in the Maritime Code were influenced by the English Marine Insurance Act 1906, while the Insurance Act may have been influenced by other civil law jurisdictions in Europe due to the history of the Chinese general insurance legislation as discussed in the beginning of this chapter. The principle of utmost good faith will be discussed in much more detail in later chapters together with English law from the perspective of comparative law.

1.6.3 Causation

It is generally accepted that the principle of proximate cause is a fundamental principle of insurance law in the PRC. The Insurance Act, however, has no provision on this and there are no sophisticated rules on what would constitute a proximate cause in practice. In the absence of such, English case law is sometimes referred to for guidance by both the judiciary and the practitioners. However, it may be purely a matter of common sense rather than law for the judges in some cases. Nonetheless, the popular view is that the proximate cause is the effective or dominant cause which led to the occurrence of the insured accident. It does not necessarily have to be the cause proximate in time. Over the years, Chinese academic writers have summarized and discussed three situations where the courts will need to determine the causation

¹¹² Maritime Code 1993, art. 222.

issues: (i) multiple consecutive causes; (ii) multiple concurrent causes; and (iii) multiple interrupted causes. The problem will only arise when one of the multiple causes is an insured risk and another is not. These will be considered below.

Chapter 2 “*Good Faith*” and “*Utmost Good faith*”: Two Doctrines, or One?

2.1 Status of the principle of utmost good faith in Chinese legal system

In China, the principle of utmost good faith is widely acknowledged by insurance scholars, although the principle itself does not appear in Insurance Act of People’s Republic of China 2015, nor does in the Maritime Code 1993. IAC 2015 art.5 states as follow:

“The parties to insurance activities shall follow the principle of good faith in exercising their rights and performing their obligations.”

The principle of good faith, reserved from the General Provisions of Civil Law of People’s Republic of China,¹¹³ stands in the Chinese legal system as one of the four fundamental principles running through the whole civil law and governing all civil activities. Neither the definition of good faith nor its scope is provided by the Act. Moreover, the contents of the principle are far from clear in the legislation. In practice, judiciaries refer to the principle frequently, as a matter of fact, to assist them in adjudicating difficult issues where the law is unclear. At common law, it is commonly recognised that disclosure and representation are the two fundamental components of the principle of utmost good faith, although there is no long the case under the new English business insurance regime of Insurance Act 2015. Chinese scholars further accept that the principle of good faith also consists of doctrines of promissory warranties, waiver and estoppel,

¹¹³ Adopted at the 5th Session of the Twelfth National People’s Congress of the People’s Republic of China on March 15, 2017, are hereby issued, and shall come into force on October 1, 2017, Order No. 66 of the President.

while as the English law currently stands, the basic rule of warranty is that, with some exceptions, a warranty is independent of all questions of materiality. In implementing the general principle of good faith, the art.16 of the Insurance Act of PRC 2015 adopts a duty for insurance applicants to honestly provide related information upon insurers' request. A similar duty also appears in English law, under which an insureds is required to respond honestly to questions asked by their insurers.

The principle of utmost good faith, expressed by the Latin maxim '*uberrimae fidei*', originated from English insurance contract law case, *Carter v Boehm*.¹¹⁴

The initial elaboration of the duty was introduced into common law by Lord Mansfield, Lord Chief Justice of the King's Bench, who had great influence on English mercantile law reforms in the eighteen century. The duty of utmost good faith serves as a fundamental doctrine of insurance law in many jurisdictions around the world, either civil or common law. However, amongst those countries that recognise it, the doctrine does not hold the same meaning nor does it operate in the same way. Meanwhile, it is also appears that the principle of utmost good faith is not recognised in some jurisdiction. Therefore, questions arise here are whether the general principle of good faith under Chinese law and the duty of utmost good faith in English law pertaining duty of disclosure and representation, refer to the same obligation? If yes, is the notion of good faith the same with the principle of utmost good faith? The remainder of this

¹¹⁴ (1766) 3 Burr 1905.

chapter will discuss in detail the definitions of the concept of good faith, historically and contemporarily, and its operations in different legal systems, as well as its application in both Chinese and English contract law.

2.2 Meaning of good faith

Though the doctrine of good faith is regarded as vitally important ingredient in different areas of the law in most legal systems around world or even international conventions (i.e. CISG¹¹⁵), there is no agreement, among those countries that recognise it, as to what exactly constitutes its core principle and boundaries.¹¹⁶ It appears difficult to give it a precise, positive and unequivocal meaning. Each country has developed its own theory about good faith with nuance of application.¹¹⁷ Furthermore, it is noteworthy that different connotations of the principle have been employed in different sectors of law. This is to say that, in private law sector for example, the effect of good faith is perhaps aptly conveyed as to be faithful to the parties, fair dealing, honesty with no deliberate intent to defraud the others and exchange of equivalent value;¹¹⁸ or “by such metaphorical colloquialisms as ‘playing fair’, ‘coming clean’ or ‘putting one’s cards face upwards on the table’”.¹¹⁹ In contract law, the constitution of good faith based on an objective test and will depend on the nature of the relationship

¹¹⁵ The CISG fails to adequately define requirements of good faith.

¹¹⁶ R. Hooley, ‘Controlling contractual discretion’ (2013) 72 CLJ 65, 74.

¹¹⁷ Livia Mocanu, ‘Roman Marks to European Law of the Contracts Good-Faith’ (2011) CKS 382, 386-388.

¹¹⁸ see generally at *Mid Essex Hospital Services NHS Trust v Compass Group UK and Ireland Ltd (Trading as Medirest)* [2013] EWCA Civ 200; *Berkeley Community Villages Ltd & Another v Pullen & Ors.* [2007] EWHC 1330 Ch; Black’s Law Dictionary (Online Legal Dictionary 2nd edn), <<https://thelawdictionary.org>> assessed 9 Dec 2017; Tong Rou, ‘The General Principle of Civil Law of the PRC: Its Birth, Characteristics, and Role’ (Jonathan K. Ocko tr, 1989) 52(2) Law and Contemporary, 161. <<http://scholarship.law.duke.edu/cgi/viewcontent.cgi?article=3995&context=lcp>> accessed 29 Nov 2019.

¹¹⁹ *Interfoto Picture Library Ltd v Stiletto Visual Programmes Ltd* [1989] 1 QB 433, 439 (Lord Bingham).

between the parties.¹²⁰ When considering whether a party is acting in good faith, it is necessary to consider whether the conduct would be regarded as commercially acceptable by reasonable and honest people.¹²¹ Reference to the application of good faith, of which employed in civil litigation, is used against frivolous or malicious lawsuits and the abuse of process by litigants, such as intentionally delaying proceedings, falsifying evidence and the like.¹²² Having reviewed different developments of the principle, it appears that good faith is a notion which attracts great interests in contemporary law not only because of the function it performs, but also as a result of the uncertainties that surrounds it. It is, therefore, necessary to retrace the origins of the concept in order better to comprehend the difficulties associated with it.

2.2.1 Good faith: an historical perspective

The concept of *bona fides* has existed long before the development of Roman law¹²³, and has reached its milestone in the period of Roman law. The Romans converted a universal social norm/philosophical thought (similar to the notion of *bona fides*), governing the relationships of its citizens, recognised by the ancient Greeks, into a basis for legal action.¹²⁴ Good faith rights of action were initially designed to solve legal relationships, such as those between peregrines, for

¹²⁰ *Yam Seng Pte Ltd v International Trade Corporation Ltd (ITC)* [2013] EWHC 111 (QB).

¹²¹ *ibid.*

¹²² Zhong Ren, 'Minshi Susong Chengshixinyong Yuanze de Shishi' [Application of the Principle of Good Faith in Civil Litigation – A Study of German Law Practice] (2014) 4, *Fa Xue Jia*, 166.

¹²³ W. Tetley, 'Good faith in Contract, Particularly in the Contracts of Arbitration and Chartering' (2004) 35(4) *JMLC* 561.

¹²⁴ Edward J. Imwinkelried, 'The Implied Obligation of Good Faith in Contract Law: Is It Time to Write Its Obituary?' (2009) 42 *Tex Tech L Rev* 1.

which the law had never created a right of action.¹²⁵ Contracts of good faith were born on the basis of these good faith rights of action. In this type of contract, the judge's interpretation is thus dominated by the notion of good faith.¹²⁶

Under the law of actions, a good faith contract was distinguished from a *stricti iuris* (formal) contract.¹²⁷ A classic example of using good faith was a sale contract, in which the seller was required, by the Roman law, to inform the buyer with regard to the hidden defects guarantee and of any event that could disrupt its newly acquired right.¹²⁸ The *bona fides* forces the judge to determine what obligations each party owes to the other.¹²⁹ It is apparent that during this period, good faith allowed the judge to actively intervene in legal relations protected by good faith rights of action, especially in the determination of the amount of damages, and in the creation of new obligations founded on morality. The good faith right of action also allows the judge to determine whether one party's behaviour is in keeping with the attitude of an 'honest man'.¹³⁰ It is not too difficult to see that good faith operated not as "a yardstick merely for interpretation", but "as a standard to create an obligation binding the parties and giving the Roman judge ample discretion to deal with informal contracts."¹³¹

¹²⁵ Bénédicte Fauvarque-Cosson & Denis Mazeaud, *European Contract Law: Materials for a Common Frame of Reference: Terminology, Guiding Principles, Model Rules* (Walter de Gruyter 2008) 152.

¹²⁶ *ibid* 152-153.

¹²⁷ E. Metzger (ed), *A Companion to Justinian's Institutes* (Duckworth/Cornell University Press 1998), 217.

¹²⁸ Livia Mocanu, 'Roman Marks to European Law of the Contracts Good-Faith' (2011) *CKS* 382, 385.

¹²⁹ Bénédicte Fauvarque-Cosson & Denis Mazeaud, *European Contract Law: Materials for a Common Frame of Reference: Terminology, Guiding Principles, Model Rules* (Walter de Gruyter 2008) 153.

¹³⁰ *ibid*.

¹³¹ W. Tetley, 'Good faith in Contract, Particularly in the Contracts of Arbitration and Chartering' (2004) 35(4) *JMLC* 561.

From the 12th century onwards, in addition to the enrichment of good faith, Medieval law has also developed a notion of *aequitas*. There was, however, on a practical level, confusion between these two concepts. While the Germans were treating the two notions differently, the French Romanists considered that good faith was “simply a manifestation of equity”.¹³² In practice, the functions of these two notions were largely overlapping because of the enlargement of the notion of good faith.¹³³ This historical confusion between “good faith” and “equity” thus caused problems, e.g. terminological distinction, in certain contemporary jurisdictions.¹³⁴

2.2.2 Definition of good faith

“These words, good faith, have a very broad meaning. They express all the honest sentiments of a good conscience, without requiring a scrupulousness which would turn selflessness into sacrifice; the law banishes from contracts ruses and clever manoeuvres, dishonest dealings, fraudulent calculations, dissimulations and perfidious simulations, and malice, which under the guise of prudence and skill, takes advantage of credulity, simplicity and ignorance.”¹³⁵

The famous Roman orator Cicero has left this broad conception of good faith.¹³⁶

¹³² Bénédicte Fauvarque-Cosson & Denis Mazeaud, *European Contract Law: Materials for a Common Frame of Reference: Terminology, Guiding Principles, Model Rules* (Walter de Gruyter 2008) 154.

¹³³ Ibid.

¹³⁴ Ibid, the French Civil Code, for example, article 1134-3 and 1135.

¹³⁵ Bénédicte Fauvarque-Cosson & Denis Mazeaud, *European Contract Law: Materials for a Common Frame of Reference: Terminology, Guiding Principles, Model Rules* (Walter de Gruyter 2008) 152.

¹³⁶ Ibid. One thinks this is the “most complete” definition of good faith.

Good faith has been described as a “protean” phrase,¹³⁷ and the content of the duty is heavily dependent on context.¹³⁸ Defining good faith is a “formidable” task.¹³⁹ Many legal systems around the world have good faith requirements in their domestic law without a definition. The Sales of Goods Act 1979 (SGA 1979) vaguely defines good faith as “honestly, whether it is done negligently or not”. It appears that “honesty” is more of a “moral category”¹⁴⁰ rather than a legal term. Questions arising here are whether the purpose of the doctrine of good faith is to regulate standards of morality so as to strike the right balance between commercial certainty and limiting unethical behaviour, and how this standards of morality could be regulated, and finally to what extent. Additionally, it must be determined how the duty of good faith would apply. It can be a pre-contractual duty to negotiate, a post-contractual duty to perform, or a method for interpreting commercial contracts.

Good faith sometime is defined by what it is not. The concept of bad faith is used to show what is not good faith. The duty has been described vaguely in contract law in some jurisdiction, as a phrase with no general meaning but which operates to exclude various forms of bad faith.¹⁴¹ Good faith has also

¹³⁷ Mr Justice Leggatt, ‘Contractual duty of good faith’ Lecture to the Commercial Bar Association on 18 October 2016, <<http://www.combar.com/public/cms/260/604/384/2566/Mr%20Justice%20Leggatt%20lecture%2018.10.16.pdf?realName=qxp9PW.pdf&v=>> assessed 9 Dec 2017.

¹³⁸ *Yam Seng Pte Ltd v International Trade Corporation Ltd (ITC)* [2013] EWHC 111 (QB) 147

¹³⁹ W. Tetley, ‘Good faith in Contract, Particularly in the Contracts of Arbitration and Chartering’ (2004) 35(4) JMLC 561.

¹⁴⁰ Sylviane Colombo, ‘Good faith: The Law and Morality’ (1993) 18(1) *The Denning Law Journal* 23, <<http://bjll.org/index.php/dlj/article/viewFile/233/259>> assessed 9 Dec 2017.

¹⁴¹ Troy Keily, ‘Good Faith and the Vienna Convention on Contracts for the International Sale of Goods’ (1999) 3(1) *Vindobona Journal of International Commercial Law and Arbitration* 15, <http://cisgw3.law.pace.edu/cisg/biblio/keily.html#N_7> assessed 9 Dec 2017.

been compared, among those counties that recognise it, with unconscionability, “fairness, fair conduct, reasonableness, reasonable standards of fair dealing, decency, decent behaviour, a common ethical sense, a spirit of solidarity, community standards of fairness” and “honesty in fact”, indicating that good faith is an “extremely versatile concept”.¹⁴² The various meanings of good faith stated above all involve some form of honesty in contracting, whether it is pre-contractual or performance based. Contracting parties expect “the other will honestly and fairly perform his duties under the contract in a manner that is acceptable in the trade community”.¹⁴³ Historically, it seems that good faith is simply a manifestation of fairness, honest belief and the absence of malice. The requirement of good faith is one of many ways to reconciling morality with the law. Good faith is probably not a principle that can be defined with any degree of precision,¹⁴⁴ and this thesis does not seek to do so.

2.3 The good faith obligation around the world

The concept of good faith, known as the so-called “empire/king principle of the civil law”, has been asserted to be “one of the bases of our civilised society”.¹⁴⁵ It is therefore widely used nationally and internationally. Moreover, it is noteworthy that almost all international private law instruments make reference to the good faith doctrine. For example, the Vienna Convention on Contracts for the

¹⁴² *ibid.*

¹⁴³ Paul J. Powers, ‘Defining the Undefinable: Good Faith and the United Nations Convention on Contracts for the International Sale of Goods’ (1999) 18 *JL & Com* 333, 352.

¹⁴⁴ L. Sealey & R. Hooley, *Commercial Law – Text, Cases, and Materials* (4th edn, OUP 2009)

¹⁴⁵ Edward J. Imwinkelried, ‘The Implied Obligation of Good Faith in Contract Law: Is It Time to Write Its Obituary?’ (2009) 42 *Tex Tech L Rev* 1.

International Sales of Goods (hereinafter CISG) ¹⁴⁶ states that in its interpretation, regard is to be had to “the observance of good faith in international trade”.¹⁴⁷ Further, the doctrine of good faith are commonly used for various purposes by the European Union, for instance, the Principles of European Contract Law as proposed by the Lando Commission contain general provisions according to which in exercising his rights and performing his duties “each party must act in accordance with good faith and fair dealing”.¹⁴⁸ The Draft Common Frame of Reference, prepared by the Study Group on a European Civil Code, also incorporates the use of good faith and fair dealing as a standard that parties must meet during transactions. This principle has now attracted even more scholarly attention since all member states of the European Union have implemented the European Directive 93/13/EEC on Unfair Terms in Consumer Contracts (the Unfair Contract Terms Directive) and will thus have to come to terms with a general notional of ‘good faith’ in a central area of their contract law.

At a domestic level, many civil law countries around the world recognise the principle that contracting parties owe each other a duty of good faith in the formation and/or the performance or enforcement of the contract. For example, the Contract law of the P. R. China 1999,¹⁴⁹ in which it provides that “the parties

¹⁴⁶ United nations Convention on Contracts for the International Sale of goods (CISG), Vienna, signed 11 April 1980, entry into force 1 January 1988.

¹⁴⁷ CISG, art. 7(1).

¹⁴⁸ Principles of European Contract Law, art 1.201.

¹⁴⁹ Adopted at the 2nd Session of the 9th National People’s Congress on March 15, 1999 and promulgated by Order No.15 of the President of the People’s Republic of China on March 15, 1999, <http://www.npc.gov.cn/englishnpc/Law/200712/11/content_1383564.htm> assessed 9 Dec 2017.

shall observe the principle of good faith in exercising their rights and fulfilling their obligations".¹⁵⁰ Beyond the sphere of contract law, good faith affects almost all private law outside of the common law world. In China, the principle of good faith is enshrined in the GPCL 1986 as one of the basic/fundamental principles in the course of civil activities. Other jurisdictions such as the United States also recognise a general doctrine of good faith in commercial contracts. It is embraced in the American Uniform Commercial Code (UCC)¹⁵¹, which provided that "every contract or duty within this Act imposes an obligation of good faith in its performance or enforcement"¹⁵² However, the US standard fails to cover the negotiation stage. Meanwhile the courts in common law jurisdictions such as Canada, after a long process, has now recognised a general organising principle of common law duty of good faith.¹⁵³ Further, it is generally understood that Scottish law recognised a broad principle of good faith and fair dealing.¹⁵⁴ Furthermore, it is noteworthy that certain civil law jurisdictions, China for example, including German and Japan, have gone even further by overcoming the public law.¹⁵⁵

The requirement of good faith is evident in variety of circumstances in many

¹⁵⁰ Contract law of the PRC 1999, art. 6.

¹⁵¹ First promulgated in 1951.

¹⁵² U.C.C. s. 1-203; see also, Restatement (Second) of Contracts, s.205. The UCC is a uniform law sponsored by the American Law Institute and the Uniform Law Commission. It has been enacted in every state in whole or significant part.

¹⁵³ *Bhasin v Hrynew* 2014 SCC 71.

¹⁵⁴ *Yam Seng Pte Ltd v International Trade Corporation Ltd (ITC)* [2013] EWHC 111 (QB), 130; see also the decision of the House of Lords in *Smith v Bank of Scotland* (1997) UKHL 26, 121 (Clyde LJ); *Trade Development Bank v David W. Haig (Bellshill) Ltd* [1983] SLT 510, 517; *Rodger (Builders) Ltd v Fawdry* [1950] SC 483.

¹⁵⁵ Article 13, section 1 of the Civil Procedure Act of People's Republic of China (2012 Amendment) stated that: "Civil litigation shall follow the principle of honesty and good faith." <<http://www.inchinalaw.com/wp-content/uploads/2013/09/PRC-Civil-Procedure-Law-2012.pdf>> assessed 9 Dec 2017.

different legal and social traditions in various jurisdictions around the world. A more in-depth discussion of various models in contracting will be provided in the following section of this chapter in determining the main requirements of a duty to act in good faith. Despite the differences on face, the duty of good faith is at its core, very similar throughout world.¹⁵⁶ The public law practice and other models outside contract law field will not be considered in this thesis as those scenarios are far beyond the purpose of this research.

2.3.1 The Civil Law Concept of Good Faith

In *Interfoto Picture Library Ltd v Stiletto Visual Programmes Ltd*,¹⁵⁷ Lord Bingham stated:

“In many civil law systems, and perhaps in most legal systems outside the common law world, the law of obligations recognise and enforce an overriding principle that in making and carrying out contracts parties should act in good faith. This does not simply mean that they should not deceive each other, a principle which any legal system must recognise; its effect is perhaps most aptly conveyed by such metaphorical colloquialisms as ‘playing fair’, ‘coming clean’ or ‘putting one’s card face upwards on the table’. It is in essence a principle of fair and open dealing.”

Civil law regimes take a more expansive approach to the obligation of good faith

¹⁵⁶ Paul J. Powers, ‘Defining the Undefinable: Good Faith and the United Nations Convention on Contracts for the International Sale of Goods’ (1999) 18 *JL & Com* 333, 335.

¹⁵⁷ [1989] QB 433, 439.

applying it to both the formation of a contract and its performance, whereas the common law jurisdictions prefer a narrower view that the duty of good faith is applicable only to the performance of the contract. The primary point of divergence between civil law and common law approaches to the good faith obligation is derived from their general philosophy of contract law: the civil law concept of contract is based on the relationship between the parties. It is acknowledged by the courts in civil law jurisdictions that the parties are legally bound at an earlier stage of the negotiation process;¹⁵⁸ thus, the duty of good faith exists in pre-contractual stage, in other words, before the contract even exists between the parties.¹⁵⁹

2.3.2 The Common Law Approach

The Courts in some Common law jurisdictions have been reluctant to find an obligation to negotiate in good faith during the preliminary stages of contractual negotiation. In the United States, this reluctance is supported, as mentioned above, by the UCC and the Restatement (Second) of Contracts. Other Common law countries may or may not recognise at all the principle of good faith, in either negotiating or performance of a contract, in commercial transactions. The Supreme Court of Canada in *Bhasin v Hrynew*¹⁶⁰ acknowledged for the first time in Canada that good faith contractual performance is a general organising principle of the common law of contract requiring a common law duty which

¹⁵⁸ John Klein & Carla Bachechi, 'Precontractual Liability and the Duty of Good Faith Negotiation in International Transactions' (1994) 1 Hous J Int'l L 17, 17.

¹⁵⁹ *ibid.*

¹⁶⁰ [2014] SCC 71.

applies to all contracts to act honestly in the performance of contractual obligations, which was described, by Justice Cromwell, as a “modest, incremental change” to the existing law. The contract between the appellant and the respondent involved a renewal clause providing that the contract would automatically renew at the end of the three-year term unless one of the parties gave six months written notice to the contrary. Consequently, it is hard to justify for now, according to the judgment, whether the Canadian obligation of good faith is applicable to the formation of a contract as well as its performance.

In Australia, the courts have not yet committed themselves to a similar concept of good faith.¹⁶¹ Although the New South Wales Court of Appeal had once held that the principal had a duty to act reasonably and honestly when exercising powers under a standard form government contract; and stands for the proposition that reasonableness may overlap and be indistinguishable from the duty of good faith in *Renard Constructions (ME) Pty Ltd v Minister for Public Works*,¹⁶² this judgment has been disapproved by the High Court of Australia. The Australian judiciary has stressed, for many years, the importance of recognizing a general principle of good faith in the contractual performance. It seems that Australia may eventually be prepared to open its door to the general principle of good faith. In January 2015, Standards Australia (SA) Technical Committee MB-010 released a draft of its revised conditions of

¹⁶¹ *Royal Botanic Gardens and Domain Trust v South Sydney City Council* [2002] HCA 5.

¹⁶² (1992) 26 NSWLR 234, 263-265.

contract, the proposed SA 11000: 2015¹⁶³, a new suite of Standards, introduces a number of key changes, including a new overriding obligation on each party to act in good faith towards the other.¹⁶⁴ Whether this express obligation is beneficial or problematic is still too early to be justified at this stage. One major issue can be seen now is that “good faith” is undefined in SA 11000, thus the extent to which the new obligation imposes to both contracting parties are relatively unknown, which might trigger contractual disputes in this area.

English courts have made several rejections to the acknowledgement of such an overriding principle in commercial contracts in various occasions.¹⁶⁵ It is clear that the English common law, like the most common law jurisdictions, does not recognise the concept of duties of pre-contractual good faith.¹⁶⁶ In the absence of a general principle of good faith, English courts adopted a series of “piecemeal solutions” in order to police the fairness of contracts and their performance, including the common law rules on mistake and misrepresentation, duress (including economic duress) and undue influence, the objective interpretation of contracts, the concept of unconscionability, implied terms, waiver and estoppel.¹⁶⁷ A detailed discussion regarding the concept of good faith governing contractual performance in English contract

¹⁶³ AS11000 General Conditions of Contracts (“AS 11000”) from Standards Australia. AS11000 is a new standard contract that is intended to provide general guidance for legal contracts in all sectors of industry, including construction, engineering, health, manufacturing and infrastructure. It is intended to supersede AS2124:1992 and AS4000:1997. <<http://www.standards.org.au/OurOrganisation/News/Pages/For-Public-Comment--AS-11000-General-Conditions-of-Contract.aspx>> assessed 9 Dec 2017.

¹⁶⁴ Subclause 2.1 requires each party to act in good faith towards the other.

¹⁶⁵ *Walford v Miles* [1992] 2 AC 128 .

¹⁶⁶ *ibid.*

¹⁶⁷ W. Tetley, ‘Good faith in Contract, Particularly in the Contracts of Arbitration and Chartering’ (2004) 35(4) JMLC 561.

law, and its recent developments are considered in the following section.

2.4 English contract law approach: the concept of good faith

Historically, English courts are generally reluctant to recognise such an overarching duty, either in negotiation or performance of a contract, on the basis that good faith, as a general principle applicable to all types of contracts, does not have a sufficiently clear meaning and is contrary to the overriding principle of freedom of contract which allows commercial parties for the most part to act solely in their own self-interest in their contractual relations. For example, Lord Ackner once expressed his hostility to the concept of duties of pre-contractual good faith in *Walford v Miles*¹⁶⁸, where buyers and sellers of a company agreed orally for the sellers to deal with the buyers exclusively and to terminate any negotiations between the sellers and any other competing buyers, by declaring such a concept to be “unworkable in practise” and “inherently repugnant to the adversarial position of the parties when involved in negotiations”.¹⁶⁹ For this reason, commercial contracts are not subject to general duties of good faith and fair dealing and contracting parties do not have to exercise their contractual rights, once properly ascertained, reasonably. Each party to the negotiations is entitled to pursue his (or her) own interest, so long as he avoids making misrepresentations.¹⁷⁰ Thus, if a party has rights, the law will not concern itself with the motivation or rationale lying behind his exercise of

¹⁶⁸ [1992] 2 AC 128.

¹⁶⁹ Ibid 138.

¹⁷⁰ Ibid 138 (Lord Ackner).

them.¹⁷¹ In this traditionalist thought, each party attempts to attain the best bargain at the expense of the other party. Therefore, negotiation in good faith may not be of the interest to the contractual parties.

It is clear that an agreement to negotiate in good faith for an unspecified period was not enforceable, nor could a term to that effect be implied in a lock-out agreement for an unspecified period,¹⁷² whereas the English courts opened its door to the express good faith obligation in an agreement. A subsequent case, notably the *Petromec Inc v Petroleo Brasileiro SA*¹⁷³, revisited a familiar issue whether an express obligation in an agreement between the parties to negotiate in good faith was enforceable or not. Petromec had agreed to carry out an upgrade of an offshore oil platform in accordance with a different specification to that originally agreed. The contract included a provision whereby Petromec and Petroleo agreed to negotiate in good faith the amount of any additional costs. Reacting to the harsh judgment of Lord Ackner, Longmore LJ indicated in *obiter* that, had it been, he would have been inclined to find the obligation enforceable.¹⁷⁴ Since then, the parties to the contract may expressly bind themselves to negotiate in good faith in limited situations,¹⁷⁵ for example, to ascertain which extra costs would be recoverable in particular situations or to

¹⁷¹ See *White and Carter (Councils) v McGregor* [1961] AC 413, 431 (Lord Reid) and 445 (Lord Hodson).

¹⁷² *Walford v Miles* [1992] 2 AC 128.

¹⁷³ [2006] 1 Lloyd's Rep 121.

¹⁷⁴ See Longmore LJ's *obiter* comments in *Petromec Inc v Petroleo Brasileiro SA Petrobras*, [2006] 1 Lloyd's Rep 121.

¹⁷⁵ Longmore LJ had once indicated in *Petromec Inc v Petroleo Brasileiro SA Petrobras* [2006] 1 Lloyd's Rep 121, that: "it is not irrelevant that [the obligation to negotiate in good faith in this case] is an express obligation which is part of a complex agreement drafted by City of London solicitors and issued under the imprint of Linklater & Paines. It would be a strong thing to declare unenforceable a clause into which the parties have deliberately and expressly entered. I have already observed that it is of comparatively narrow scope."

agree on the future rent under a lease rent review clause.¹⁷⁶

The principle of good faith was first laid down, in English legal system, in the context of pre-contractual disclosure by Lord Mansfield in *Carter v Boehm*¹⁷⁷ in the 18th century. Surprisingly, this case also appears to be the acknowledged origin of the concept of utmost good faith in English common law which is, for many years, considered by both the courts and legal writers. The question now arising is whether the principle of utmost good faith and that of good faith are one principle, or two. If they are two distinguishable principles, what are the scopes of these two concepts? How are these principles developed recently in England? The first part of this section will consider the origin of the doctrine of [utmost] good faith in English contract law, including important distinctions drawn between the doctrine of good faith and the common law duty of utmost good faith. The remainder of this section will discuss in detail the recent development of the concept of good faith in the performance of contracts, as regards: terms which expressly formulate the imposition of a duty of good faith; the implied duty of good faith; and test of the duty of good faith.

2.4.1 “Good Faith” and “Utmost Good Faith”, two concepts or one?

There has been much discussion on the subject of good faith and a range of opinions as to the meaning of this doctrine. Even within those countries that recognise a general principle of good faith, there is no agreed definition of its

¹⁷⁶ *Petromec Inc v Petroleo Brasileiro SA Petrobras* [2006] 1 Lloyds Rep 121.

¹⁷⁷ (1766) 3 Burr 1905.

core principle.¹⁷⁸ Nevertheless, it is submitted that “good faith” and “utmost good faith” are separate concepts. “Good faith” should be seen as a subjective conscious-related standard, as it is exemplified in the example of the *bona fide* purchaser.¹⁷⁹ For example, s. 61(3) of Sale of Good Act 1979 state that “a thing is deemed to be done in good faith within the meaning of this Act when it is in fact done honestly, whether it is done negligently or not”. “Utmost good faith” has been found to be an expression which has conveyed a meaning beyond “good faith” for a very long period of time.¹⁸⁰ Cook J made a clear distinction between these two concepts in *SNCB Holding v UBS AG*.¹⁸¹ Earlier in his judgment Cooke J had said:

“A duty to exercise “good faith” in doing something is one which is usually to be contrasted with a duty to exercise reasonable care. It connotes **subjective** honesty, genuineness and integrity, not an **objective** standard of any kind, whether reasonableness, care or objective fair dealing. It cannot be equated with “utmost good faith” and although its exercise in practice may involve different actions or restraint, the concept is not one that goes beyond the notion of truthfulness, honesty and sincerity.”¹⁸²

The judge noted that the claimant had made no allegations of dishonesty or lack of belief on the part of UBS as to the justifiability of its position. He held that

¹⁷⁸ R. Hooley, ‘Controlling contractual discretion’ (2013) 72 CLJ 65, 74.

¹⁷⁹ *ibid*; also see Bills of Exchange Act 1882, s.90.

¹⁸⁰ *SNCB Holding v UBS AG* [2012] EWHC 2044 (Comm) [72].

¹⁸¹ *Ibid*.

¹⁸² R. Hooley, ‘Controlling contractual discretion’ (2013) 72 CLJ 65, 75.

there were no extra implied terms of good faith based on standards of reasonableness that controlled UBS's exercise of its rights under the funding agreement. In the proposition of Cook J, good faith exercise of right, in the context of calculating market value of these assets, means no more than honesty.

On the other hand, the duty of utmost good faith, in the context of insurance, legally obliges parties involved in negotiations for an insurance contract to disclose all material facts that might influence the others' decision to enter into the contract. This clearly extends beyond the mere avoidance of misrepresentation. The content of the utmost good faith obligation may well be vary with the context or contract in which it is found, and it has been held in other contexts, when used in commercial contracts, to impose "a contractual obligation to observe reasonable commercial standards of fair dealing, faithfulness to the agreed common purpose and consistency with the justified expectations" of the other party.¹⁸³ In fact, the duty of utmost good faith requires a higher standard of good faith, in either the context of insurance contract or that of other commercial contract.

Furthermore, taking a historical prospective,¹⁸⁴ the concept of "good faith", as a fundamental principle in human's life conducting a significant role in commercial

¹⁸³ See *Berkeley Community Villages v Fred Daniel Pullen* [2007] EWHC 1330 (Ch); *CPC Group Limited v Qatari Diar Real Estate Investment Company* [2010] EWHC 1535 (Ch).

¹⁸⁴ See generally at section 1.1 of this chapter and footnotes 12-22.

transactions nationally and internationally, has long been established by the ancient Greeks and well developed in the period of Roman law and Medieval Law. In comparison with the principle of “utmost good faith”, it seems that the phrases “utmost (good faith)” and the term “*uberrimae fidei*” had been unknown to Roman law and had no equivalent in Roman law.¹⁸⁵

2.4.1.1 The beginning: *Carter v Boehm*, a shared starter

Unlike most continental jurisdictions,¹⁸⁶ the doctrine of good faith was not introduced into English law until 1766. In the landmark case *Carter v Boehm*¹⁸⁷, the Court of Kings Bench did not accept the defendant’s arguments and held at the conclusion that there was no duty on the part of the claimant to disclose those facts as the underwriter ought himself to have been aware of them. One of many reasons why this decision significantly influential on the question of pre-contractual duty of disclosure is that Lord Mansfield explicitly stated the mutuality of such a duty between the insured and the insurer. Moreover, Lord Mansfield’s consideration about pre-contractual disclosure was not addressed as a special treatment of insurance contracts but generally applicable to all kinds of contracts. This becomes clear when he stated that:

“[t]he governing principle [of good faith] is applicable to all contracts and dealings. Good Faith forbids either party by concealing what he privately

¹⁸⁵ *Manifest Shipping Co Ltd v Uni-Polaris Shipping Co Ltd (The Star Sea)* [2001] UKHL 1, 492 (Lord Hobhouse); *Mutual and Federal Insurance Co Ltd v Oudtshoorn Municipality*, 1985 (1) SA 419, 432 (Joubert JA)

¹⁸⁶ For an illustrative comparative overview, see S. Whittaker & R. Zimmermann, ‘Good Faith in European Contract Law: Surveying the Legal Landscape’, in R. Zimmermann & S. Whittaker (eds), *Good Faith in European Contract Law* (CUP 2000) 48.

¹⁸⁷ (1766) 3 Burr 1905.

knows, to draw the other into a bargain, from his ignorance of that fact, and his believing the contrary. ... The reason of the rule which obliges parties to disclose, is to prevent fraud, and to encourage good faith. ... But either party may be innocently silent, as to grounds open to both, to exercise their judgment upon. ... This definition of concealment, restrained to the efficient motives and precise subject of any contract, will generally hold to make it void, in favour of the party misled by his ignorance of the thing concealed.”¹⁸⁸

This case is also the universally known acknowledged origin of the insurance duty of the utmost good faith in common law jurisdictions, including Australia, New Zealand, and some other common law countries. Apparently, this shared origin could and has in fact led to confusions and misunderstandings as to the terminological in exactitude between “good faith” and “utmost good faith” in the realm of insurance contract law.

Clarification is required, however, through the tracing of the doctrine back to 1766, Lord Mansfield was attempting to import, in *Carter v Boehm*, into English commercial law at the time was the civil law notion of good faith,¹⁸⁹ rather than a common law concept of utmost good faith, as there was not such a theory in the age of enlightenment. His Lordship explained that “the policy considerations underlying the duty are the prevention of fraud and the furtherance of good

¹⁸⁸ (1766) 3 Burr 1905, 1909 – 1910.

¹⁸⁹ J. Lowry, ‘Whither the Duty of Good Faith’ (2009) 16(1) UCILJ 97, 98; also see *Manifest Shipping Co Ltd v Uni-Polaris Shipping Co Ltd (The Star Sea)* [2001] UKHL 1, 491 (Lord Hobhouse)

faith: it therefore fulfils a prophylactic role.”¹⁹⁰ However, the commercial and mercantile law of England developed in a different direction preferring the benefits of simplicity and certainty which flow from requiring those engaging in commerce to look after their own interests.¹⁹¹ Therefore, Lord Mansfield’s universal proposition was proved unsuccessful and only survived for limited classes of transactions, including insurance.¹⁹² Insurance contract is a contract of *uberrimae fides*, in which it requires a higher standard of good faith from both parties to avoid non-disclosure and misrepresentation by the additional obligation to disclose all material facts that would induce the insurers to underwrite the risk. This contrasts with the law which applies to other types of commercial contracts, where parties must not misrepresent facts, but do not own any obligation to disclose related facts to the other party.

2.4.1.2 The origin and nature of the duty of utmost good faith

The origin of the formulation “utmost good faith” is obscure. It is actually surprising that *Carter v Boehm*¹⁹³ is commonly referred to as the leading authority for the principle of utmost good faith given that neither the term “utmost” nor its Latin expression “*uberrimae fidei*” was ever mentioned by Lord Mansfield in that case. In articulating the civil law principle of good faith, Lord Mansfield was primarily concerned with the insured’s pre-contractual disclosure obligations in insurance contract, and “there is nothing in the quotation which

¹⁹⁰ J. Lowry, ‘Whither the Duty of Good Faith’ (2009) 16(1) UCILJ 97, 104.

¹⁹¹ *Manifest Shipping Co Ltd v Uni-Polaris Shipping Co Ltd (The Star Sea)* [2001] UKHL 1; [2003] 1 AC 469, 492 (Lord Hobhouse).

¹⁹² *ibid* 491 (Lord Hobhouse).

¹⁹³ (1766) 3 Burr 1905

indicates that the principle is any wider”¹⁹⁴.

“Utmost” was a later refinement added in 1798 by Buller J in *Wolff v Horncastle*¹⁹⁵, in which from it became widely accepted.¹⁹⁶ In the 19th century, it then became the most commonly used epithet. The place of the principle of utmost good faith has been fixed by its codification in the Marine Insurance Act 1906,¹⁹⁷ together with non-disclosure and misrepresentation. Section 17 of the MIA 1906 imposes duties of utmost good faith on both contractual parties by stating: “A contract of marine insurance is a contract based upon the utmost good faith...” Sections 18 to 20 of the 1906 Act provides principle in relation to non-disclosure and misrepresentation. As enshrined in MIA 1906 s. 17, the doctrine imposes obligation on both parties to the contract, the insurers therefore are under a corresponding pre-contractual duty to disclose or not to misrepresent material facts to the assured. It has been said by the Court of Appeal, in *La Banque Financière de la Cite SA v Westgate Insurance Co. Ltd*,¹⁹⁸ that:

“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

¹⁹⁴ R. Merkin, *Colinvaux’s Law of Insurance* (11th edn, Sweet & Maxwell 2017) at 6-003.

¹⁹⁵ (1798) 1 B & P 316; see R. Merkin, *Colinvaux’s Law of Insurance* (11th edn, Sweet & Maxwell 2017) at 6-003.

¹⁹⁶ W I B Enright & R. Merkin, *Sutton on Insurance Law*, vol 1 (4th edn, Thomson Reuters 2015) at 6-10

¹⁹⁷ *Manifest Shipping Co Ltd v Uni-Polaris Shipping Co Ltd (The Star Sea)* [2001] UKHL 1; [2003] 1 AC 469, 492 (Lord Hobhouse)

¹⁹⁸ [1989] 2 All ER 952

not to place the risk for which he seeks cover with that insurer.”¹⁹⁹

To date there has been, however, no decided case in which the assured has rescinded the policy as a result of non-disclosure on the part of the insurer. The reason behind that would simply be that, where the insurer has actually behaved towards the assured with bad faith before the contract is concluded, the assured would want a remedy in damages, not avoidance of the policy. Yet English courts provide no such remedy is available for breach of the duty of disclosure because of the fact that damages are simply not mentioned in the sections of the 1906 Act.²⁰⁰ Thus even deliberate non-disclosure does not give rise to liability to damage in English law, as deceit or fraud requires a positive misrepresentation.²⁰¹ So the superficial even-handedness of the doctrine is an illusion.²⁰²

In the second half of the 20th century, the Courts began to consider the wider implications of the principle outside a policyholder’s duty to disclose since s. 17 of the MIA 1906 failed to confine the principle to pre-contractual negotiation.²⁰³ Unlike the duty of disclosure originally explained by Lord Mansfield, the mutual obligation of utmost good faith is not confined to pre-contractual obligation but also applies after the contract is made throughout the performance of the

¹⁹⁹ *ibid*, at 990

²⁰⁰ See *La Banque Financière de la Cite SA v Westgate Insurance Co. Ltd* [1990] 1 QB 781, per Slade LJ

²⁰¹ *HIH Casualty and General Insurance Ltd v Chase Manhattan Bank* [2003] Lloyd’s Rep IR 230 [75] Lord Hoffmann held that “non-disclosure (whether dishonest or otherwise) does not as such give rise to a claim in damages.” Also see *Banque Keyser Ullmann SA v Skandia (UK) Insurance Co. Ltd* [1990] 1 QB 665, 777-781 and 788 (“without a misrepresentation there can be no fraud in the sense of giving rise to a claim for damages in tort”)

²⁰² Christopher Butcher, ‘Good Faith in Insurance Law: A Redundant Concept?’ (2008) 5 JBL 380

²⁰³ R. Merkin, *Colinvaux’s Law of Insurance* (11th edn, Sweet & Maxwell 2017) at 6-004

contract.²⁰⁴ Two further categories emerged: post-contractual duty by the insured; post-contractual duty by the insurer.²⁰⁵ Though in a post-contractual stage, there is considerable uncertainty over its effect.²⁰⁶ Something that has been made clear by English courts is that the continuing duty of utmost good faith does not extend to fraudulent claims,²⁰⁷ thus the duty of the assured not to make fraudulent claim was not governed by s. 17 of MIA 1906 but rather by either an implied term or by a special rule of public policy.²⁰⁸ The appropriate scope of the common law rule relating to fraudulent insurance claims has been held to forfeit the whole of the claim to which the fraud related.²⁰⁹ Now fraudulent claims are dealt with by s. 12 of the Insurance Act 2015. Detailed discussion as to continuing duty of utmost good faith is provided in chapter 7.

The earliest authorities identify the nature of the principle as a duty imposed by the law merchant or natural law. In *The Litsion Pride*,²¹⁰ the Court held that the duty of utmost good faith is in all cases based upon an implied term of contract, and thus damages were made a remedy available for non-disclosure. The development of this concept was hampered again by the consideration of the

²⁰⁴ See *Black King Shipping Corporation v Massie (The Litsion Pride)* [1985] 1 Lloyd's Rep 437; *The Bank of Nova Scotia v Hellenic Mutual War Risks Association (Bermuda) Ltd (The Good Luck)* [1989] 2 Lloyd's Rep. 238; *Manifest Shipping Co Ltd v Uni-Polaris Shipping Co Ltd (The Star Sea)*, [2001] UKHL 1; [2003] 1 A.C. 469; *K/S Merc-Scandia XXXXII v Lloyd's Underwriters (The Mercandian Continent)* [2001] EWCA Civ 1275, [2001] 2 Lloyd's Rep. 563; and *Agapitos v Agnew (The Aegeon) (No. 1)* [2002] EWCA Civ 247, [2003] Q.B. 556

²⁰⁵ R. Merkin, *Colinvaux's Law of Insurance* (11th edn, Sweet & Maxwell 2017) at 6-004

²⁰⁶ See *Manifest Shipping Co Ltd v Uni-Polaris Shipping Co Ltd (The Star Sea)*, [2001] UKHL 1; This was discussed in Law Commission, *Insurance Contract Law: Post Contract Duties and Other Issues* (Law Com CP No 201, 2012) paras 6.28 – 6.36

²⁰⁷ *Manifest Shipping Co Ltd v Uni-Polaris Shipping Co Ltd (The Star Sea)* [2001] UKHL 1; [2003] 1 AC 469.

²⁰⁸ R. Merkin, *Colinvaux's Law of Insurance* (11th edn, Sweet & Maxwell 2017) at 6-005.

²⁰⁹ *Manifest Shipping Co Ltd v Uni-Polaris Shipping Co Ltd (The Star Sea)* [2001] UKHL 1; AXA General Insurance Ltd v Gottlieb [2005] EWCA Civ 112.

²¹⁰ See *Black King Shipping Corporation v Massie (The Litsion Pride)* [1985] 1 Lloyd's Rep 437

statutory remedy prescribed in s. 17 of the 1906 Act. The Court of Appeal firmly rejected the proposition that the duty was founded upon an implied term²¹¹ or is tortious duty of care in nature,²¹² and eliminated the availability of a damages award. Because of the mutual obligation of utmost good faith arose by operation of law as an incident of the contract of insurance.²¹³ In *La Banque Financière de la Cite SA v Westgate Insurance Co. Ltd*,²¹⁴ the Court of Appeal held that the duty is at common law extra-contractual.²¹⁵ The only remedy available for breach of which was avoidance *ab inito*. This was confirmed by the House of Lords in the case *Pan Atlantic Insurance Co. Ltd v Pine Top Insurance Co. Ltd*,²¹⁶ and *The Star Sea*.²¹⁷ So English Courts have retained the statutory remedy with the insurer's duty of utmost good faith continues to be treated as an extra-contractual term, for which no damages claim is available.

Courts have been mindful that the remedy of avoidance *ab inito* creates legal incongruity,²¹⁸ and other common law jurisdictions have adopted different solutions to resolve it. For example, Australian legislation adopted a different

²¹¹ See *La Banque Financière de la Cite SA v Westgate Insurance Co. Ltd* [1988] 2 Lloyd's Rep 513 (CA) 548 (Slade LJ); also see *The Bank of Nova Scotia v Hellenic Mutual War Risks Association (Bermuda) Ltd (The Good Luck)* [1989] 2 Lloyd's Rep 238 (CA) 263, May LJ relied on the judgment of Slade LJ and held in the Court of Appeal decision that "the duty of pre-contractual disclosure is not founded upon an implied term of a contract".

²¹² See *The Bank of Nova Scotia v Hellenic Mutual War Risks Association (Bermuda) Ltd (The Good Luck)* [1989] 2 Lloyd's Rep 238 (CA), at 263, the court considered four reasons why the pre-contractual duty of disclosure in a contract of utmost good faith could not be held to constitute a tort so as to give rise to a claim of damages; also see *Manifest Shipping Co Ltd v Uni-Polaris Shipping Co Ltd (The Star Sea)* [2001] UKHL 1; [2003] 1 AC 469, 473, it stated that "it is simply not possible to define 'the utmost good faith' as the absence of the tort of deceit".

²¹³ *The Bank of Nova Scotia v Hellenic Mutual War Risks Association (Bermuda) Ltd (The Good Luck)* [1989] 2 Lloyd's Rep 238 (CA) 263.

²¹⁴ [1988] 2 Lloyd's Rep 513.

²¹⁵ W I B Enright & R. Merkin, *Sutton on Insurance Law*, vol 1 (4th edn, Thomson Reuters 2015) at 6-10.

²¹⁶ [1994] 3 All ER 581.

²¹⁷ [2001] Lloyd's Rep IR 247.

²¹⁸ W I B Enright & R. Merkin, *Sutton on Insurance Law*, vol 1 (4th edn, Thomson Reuters 2015) at 6-10.

approach to that of English Law, introducing a statutory implied term of utmost good faith, making damages available. The Insurance Contracts Act 1984 fundamentally alters the nature of utmost good faith.²¹⁹ The duty of utmost good faith is stated by s. 13 of the 1984 Act in the following terms:

“A contract of insurance is 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.”

Accordingly, utmost good faith is an implied term which applies to both parties to the contract. The wording appears to preclude a duty of utmost good faith owed by insurers to a third party who is not a contracting party but who may have rights under the policy. However, Australian Courts held in a series of cases that insurers owe a duty to a third party.²²⁰

2.4.1.3 The meaning of utmost good faith

The attempts to define the meaning of the duty have proven it to be a difficult task. Apart from the well-established pre-contractual duty of utmost good faith, the definition of this duty remain elusive. The expression “utmost good faith” – the enhancements were not used by Lord Mansfield - certainly not appear to have derived from civil law - was finalised by s. 17 of the 1906 Act. Yet the MIA

²¹⁹ R. Merkin, ‘Reforming Insurance Law: Is There a Case for Reverse Transportation?’ A Report for the English and Scottish Law Commissions on the Australian Experience of Insurance Law Reform, para 3.6.

²²⁰ *ibid* footnote 47; also see *Wyllie v National Mutual Life Association of Australasia Limited* (1997) 217 ALR 324; *Hannover Life Re of Australasia Limited v Sayseng* [2005] NSWCA 214; *Dumitrov v S C Johnson & Son Superannuation Pty Ltd* [2006] NSWSC 1372.

1906 contains no definition of utmost good faith. The coining of the phrase “utmost” led to the need to distinguish Lord Mansfield’s principle and the principle of utmost good faith which only seem to have become current in the 19th century. Utmost good faith has been endowed with different meanings in different occasions, for example, “greatest good faith”, “the most abundant good faith”, “perfect good faith”, “full and perfect faith”,²²¹ or “the most full and copious” good faith.²²² This has been considered and clarified by Lord Hobhouse in *The Star Sea*,²²³ in which he indicated that “the connotation [of the phrases “utmost” good faith] appears to be the most extensive, rather than the greatest, good faith.”²²⁴ Justice Bollen of the Supreme Court of South Australia held, in *Sheldon v Sun Alliance Australia Limited*²²⁵ that the expression “utmost good faith” means what it says – utmost good faith, not a measure of good faith. There has been argument for criteria of ‘candour’, ‘absence of recklessness’, ‘sacrificing commercial advantage’ and so on.²²⁶

Recently, there are two prevailing competing theories on the definition of the general duty of utmost good faith. One focuses on that the opposite of utmost good faith, which arises to some extent from the considerations of the concept of “good faith” in other common law jurisdictions outside England.²²⁷ In other

²²¹ *Manifest Shipping Co Ltd v Uni-Polaris Shipping Co Ltd (The Star Sea)* [2001] UKHL 1, [2003] 1 AC 469, 492 (Lord Hobhouse).

²²² *Ibid*; Lord Trayner, *Latin Maxims and Phrases* (2nd edn, 1876) 590.

²²³ [2001] UKHL 1; [2003] 1 AC 469.

²²⁴ *Ibid* 492

²²⁵ (1989) 53 SASR 97, 152

²²⁶ Masel G, ‘The Post-contractual Duty of Utmost Good Faith’ (1998) 13(8) Australian Insurance Law Bulletin 101.

²²⁷ Section 1-201(19) of the American Uniform Commercial Code defines good faith as “honesty in fact in the conduct or transaction concerned”.

words, the concept concerns the utmost bad faith, so that “nothing short of recklessness or fraud on the part of the party allegedly in breach would suffice.”²²⁸ For example, in the New Zealand decision of *Vermeulen v SIMU Mutual Insurance Association*,²²⁹ the Court held that there was no breach of the duty of good faith where the failure to disclose information as required by the policy was not dishonest. In fact, it is not surprising that the principle of honesty has been seen to be a central tenet of the duty given that the duty of utmost good faith had historically been considered primarily in reference to issues of disclosure.²³⁰ The alternative view sees the duty as a wider concept beyond mere honesty. It draws on the principles of “fairness, reasonableness and community standard of decency and fair dealing.”²³¹ Acting with utmost good faith must involve more than merely acting honestly, otherwise no effect is given to the word “utmost”.²³² Recently, this proposition has been well illustrated and authoritatively confirmed by the High Court of Australia in *CGU Insurance Ltd v AMP Financial Planning Pty Ltd*.²³³

2.4.1.3.1 *CGU v AMP*

AMP, the respondent insured, was an authorised securities dealer. AMP’s authorised representatives were involved in a failed investment, which resulted

²²⁸ R. Merkin, *Colinvaux’s Law of Insurance* (11th edn, Sweet & Maxwell 2017) at 6-008.

²²⁹ (1987) 4 ANZ Ins Cas 60-812.

²³⁰ *Ibid.*

²³¹ W I B Enright & R. Merkin, *Sutton on Insurance Law*, vol 1 (4th edn, Thomson Reuters 2015) at 6-30.

²³² M. Ellis, ‘Utmost good faith: The scope and application of s. 13 of the Insurance Contracts Act in the wake of *CGU v AMP*’ (2009) 20 ILJ 92, citing *Gutteridge v Commonwealth*, unreported, Old SC, Ambrose J, 25 June 1993, BC9302579.

²³³ [2007] HCA 36.

in a complete loss for a number of clients. The insured subsequently made a claim under its professional indemnity insurance policy with CGU, the appellant insurer, in respect of the liability the insured had for the conduct of its representative. Although the High Court of Australia held in favour of the insurer with a majority of 4:1, all members of the High Court were unanimously accepted that acting with the utmost good faith requires an insurer to do more than act honestly,²³⁴ and may require it to have regard not only to its own interests, but also to the legitimate interests of its insured. It will usually “require affirmative or positive action on the part of the person owing the duty”.²³⁵

The High Court of Australia stated that s. 13 of the ICA does not “empower a court to make a finding of liability against an insurer as punitive sanction for not acting in good faith”.²³⁶ Breach of the duty of utmost good faith by insurers do not necessarily lead to the conclusion that insurers are liable to indemnify assureds without some principled process of reasoning. It shows that the essence of the duty from the insurer’s point of view is about process rather than substance. Therefore, the proceeding court will review the insurer’s decision-making process rather than ordering payment for the assured.²³⁷ More importantly, in the leading judgment of Gleeson CJ and Crennan J, it was stated that “utmost good faith may require an insurer to act with due regard to the legitimate interests of an insured, as well as to its own interests” and that

²³⁴ Ibid.

²³⁵ [2007] HCA 36 [257].

²³⁶ [2007] HCA 36 [16].

²³⁷ R. Merkin, *Colinvaux’s Law of Insurance* (11th edn, Sweet & Maxwell 2017) at 6-011.

“an insurer’s statutory obligation to act with utmost good faith may require an insurer to act, consistently with commercial standards of decency and fairness, with due regard to the interests of an insured. Such an obligation may well affect the conduct of an insurer in making a timely response to a claim for indemnity.”²³⁸

Alternatively, Callinan JJ and Heydon JJ introduced an equitable clean hands principle suggesting a requirement that a plaintiff seeking relief [must] not himself be guilty of improper conduct.²³⁹ Borrowing from equity law, the principle dictates that “he who seeks equity must do equity”.²⁴⁰ Thus the duty of utmost good faith required reciprocity. In the context of claims, this would seem to indicate that an insured cannot claim for a breach if they have not conducted themselves adequately. Kirby J in his dissenting judgment noted that emphasis must be placed on the word “utmost”: “The exhibition of good faith alone is not sufficient. It must be good faith in its *utmost* quality”.²⁴¹ So whereas the concept of ‘good faith’ appears limited to an obligation of honesty, the standard expectation in respect of the duty of ‘utmost good faith’ is much higher.

2.4.1.3.2 Implication of *CGU v AMP*

First, the requirement is for the insurer to have “due regard” for the insured’s interests but does not give rise to a fiduciary duty whereby the insured’s interests would usurp their own. Therefore, there is no requirement for either

²³⁸ [2007] HCA 36 [15].

²³⁹ [2007] HCA 36 [25].

²⁴⁰ [2007] HCA 36 [257].

²⁴¹ [2007] HCA 36 [130].

party for forego their own best interests but they must act with “due regard” to the other party when asserting their rights. In other words, when exercising a right, an insurer should consider the impact on the insured. Accordingly, the relationship between insurers and insureds falls somewhere between a standard commercial relationship and that of a fiduciary relationship. It seems that the purpose of the duty is not to limit the rights of the insurer, but rather to guide their actions in exercising those rights. Second, the test of utmost good faith is now subjective, requiring parties to comply with “commercial standards of decency and fairness”.²⁴² Kirby J interpreted the duty to require efficient, reasonably prompt, candid and business-like conduct in determining indemnity. The matter was revisited by Supreme Court of New South Wales in the most recent decision of *Small Business Consortium Lloyd’s Consortium No. 9056 v Angas Securities Ltd*²⁴³, it suggested that not only the subjective state of mind of the insurer should be considered when judging its compliance of the duty of utmost good faith, but also the objective position might have to be taken into account.²⁴⁴ Third, the duty is reciprocal, so that breach by the assured may negate the effects of any breach by the insurers.²⁴⁵ Previously, there was little authorities to suggest that apart from instances of non-disclosure, an insured’s right to damages for a breach by the insurer may be jeopardised should “tainted relevant conduct” be found. However, it is for the courts to decide whether

²⁴² *ibid*, Kirby J referred favourably to the view of Owen J in *Kelly v New Zealand Insurance Co Ltd* that the common law duty encompassed notions of fairness, reasonableness, standards of decency and fair dealing.

²⁴³ [2015] NSWSC 1511.

²⁴⁴ *ibid* [69]

²⁴⁵ R. Merkin, *Colinvaux’s Law of Insurance* (11th edn, Sweet & Maxwell 2017) at 6-011.

coming with “clean hands” is equivalent to acting in line with the duty of utmost good faith. It would be likely that the courts hold “clean hands” to be identical to the duty because if “clean hands” were held to a higher standard, this would in effect replace the duty for insureds by imposing a higher standard. Therefore, the practical effect of the introduction of this equitable principle is that in instances where both parties are found to be in breach of the duty, relief is not available to either of them.

The matter has not been given detailed consideration in England.²⁴⁶ In *The Star Sea*,²⁴⁷ the House of Lords rejected an argument on a very narrow ground that the alleged false statements made by the assured in the course of legal proceedings on the policy gave the insurers the right to avoid and held that the duty of utmost good faith no longer applied once the parties were engaged in litigation because the parties were governed by the Rules of Court. It appears that to date there is no attempt of definition of utmost good faith in that the vast majority of authorities related to the pre-contractual duty of assureds since there has been little need for the English courts to do so.²⁴⁸ Unsurprisingly, English jurisprudence is not the only one in the world adopted such proposition. The Australian courts find an intriguing echo in defining the duty. The High Court’s decision in *CGU v AMP*²⁴⁹ has provided some clarification of the meaning of utmost good faith, but it also holds the position that it is not necessary to seek

²⁴⁶ *ibid.*

²⁴⁷ [2001] UKHL 1.

²⁴⁸ R. Merkin, *Colinvaux’s Law of Insurance* (11th edn, Sweet & Maxwell 2017) at 6-008.

²⁴⁹ [2007] HCA 36.

any comprehensive definition of the duty. In fact, it is necessary that the terminology employed to define the duty of utmost good faith remain broad and imprecise. The duty embraces a standard of conduct in both pre- and post-contractual negotiations between contracting parties in insurance contracts. Any attempt to define the duty with more precision will render the duty too inflexible for universal application. Kirby J noted “inflexible formulae and precise rules, whilst they may achieve certainty in the marketplace, lend themselves to injustices, the applicable doctrine having no inherent flexibility to deal with the nuances of differing fact situations.”²⁵⁰ It is better that the jurisprudences that recognise the duty of utmost good faith continue to develop it on a case-by-case basis.

2.4.2 Recent development of the duty of good faith

Generally speaking there is a considerable body of case law to the effect that obligations to negotiate in good faith are, almost without exception, unenforceable where the agreement was not sufficiently certain, because there were no objective criteria by reference to which the obligation could be policed by the court.²⁵¹ Therefore, it is generally understood that English courts have traditionally preferred to impose the duty, between commercial contractual parties, only in particular situations, e.g. insurance contracts; or have relied on other duties or doctrines, i.e. misrepresentation or estoppel. In addition, even if

²⁵⁰ Justice M Kirby, ‘Marine Insurance: Is the Doctrine of “Utmost Good Faith” Out of Date?’ (1995) 13(2) Aust Bar Rev 1, 19.

²⁵¹ *Shaker v Vista Jet Group Holding SA*, [2012] 2 All E.R. (Comm) 1010 (Teare J).

the parties expressly included an obligation of good faith in their commercial contract, there was room for doubt about how such a term would be interpreted by a court.²⁵² For example, an English court may not interpret, as it currently stands, an express good faith obligation in a way that would require a party to give up a freely negotiated right or financial advantage that is clearly established in the contract. This view however appeared, according to Leggatt J, to be “swimming against the tide”.²⁵³ Judging from the statement and reasoning from Leggatt J in this case, it evidently raised the expectations that the English courts may be on their way to recognising an overarching duty of good faith being implied to commercial contract.

Concerning the theoretical gap between the laws of the Continent and that of the British Isles, commentators have suggested for a long time that a general duty of good faith would be introduced into English law as a result of efforts to standardize contract law within the European Union (EU). In fact, English legislative system is increasingly originating from the EU. The requirement for contracting parties to act in a fair manner, in accordance with the principle of good faith, has already entered into English law, via EU legislation, in consumer contracts in order to protect consumers against one-sided contract favouring businesses. Section 62(4) of the Consumer Rights Act 2015²⁵⁴ states that “a term is unfair if, contrary to the requirement of good faith, it causes a significant

²⁵² R. Merkin, *Colinvaux's Law of Insurance* (11th edn, Sweet & Maxwell 2017) at 6-001.

²⁵³ *Yam Seng Pte Ltd v International Trade Corporation Ltd* [2013] EWHC 111 (QB [124]).

²⁵⁴ The Consumer Rights Act 2015 (Schedule 4, Amendments Consequential on Part 2) revoked and replaced the Unfair Terms in Consumer Contracts Regulations 1999 (S.I. 1999/2081) - the implementation of the European Directive 93/13/EEC on Unfair Terms in Consumer Contracts.

imbalance in the parties rights and obligations under the contract to the detriment of the consumer”. It is therefore worth taking a closer look at the recent development of the duty of good faith in the commercial sector in English contract law.

2.4.2.1 *Yam Seng Pte Ltd v International Trade Corporation Ltd*

The most eye-catching authority specifically in this context in England over the last couple of years is the Queen’s Bench decision of the case *Yam Seng Pte Ltd v International Trade Corporation Ltd*,²⁵⁵ in which the High Court has implied a duty of good faith into a long term distribution agreement. In this case, Leggatt J suggested that, given such duties are increasingly being recognised in other common law jurisdictions, the traditional English “hostility” towards a generally applicable duty of good faith in performing contracts is “misplaced”.²⁵⁶ The acceptance of good faith in its judgment as a source of contractual obligations has received judicial attention as well as criticism from commentators nationally and internationally. Leggatt J commented that the relevant background against which contracts are made include not only matters of fact known to the parties but also “shared values and norms of behaviour” including but not limited to “an expectation of honesty”,²⁵⁷ derived from “general social acceptance” or from the specifics of “a particular trade or commercial activity” or even from “features of the particular contractual relationship”.²⁵⁸ Such shared values and norms of

²⁵⁵ [2013] EWHC 111 (QB).

²⁵⁶ *ibid* [153].

²⁵⁷ *ibid* [135].

²⁵⁸ *ibid* [134].

behaviour are naturally taken for granted by the parties without being set out explicitly in their written agreements.²⁵⁹

It was the first decision to review the general duty of good faith in the performance of contracts, and, although the implication of ethical standards into commercial parties' contractual obligations might seem to be novel to English case law, concepts herein are not unfamiliar to English courts. The case of *HIH Casualty and General Insurance Ltd v Chase Manhattan Bank*²⁶⁰ invoked by Leggatt J in exemplifying the recognition of expectation of honesty in commercial contracts may not be entirely competent, given an insurance contract is a contract of utmost good faith. What is clear is that the fact that good faith indeed exists in commercial dealings is incontestable, albeit it may appear, the other way round, in different forms of bad faith conducts and be described as "improper", "commercially unacceptable" or "unconscionable".²⁶¹

Leggatt J emphasised that "what good faith requires is sensitive to context". The suggested test of good faith is objective in the sense that it depends on whether, in the particular context, the conduct would be regarded as commercially unacceptable by reasonable and honest people²⁶² and its content "is established through a process of construction of the contract".²⁶³ The approach of the High Court in *Yam Seng* was endorsed in *Bristol Groundschool*

²⁵⁹ *ibid.*

²⁶⁰ [2003] 2 Lloyd's Rep 61.

²⁶¹ *Yam Seng Pte Ltd v International Trade Corporation Ltd* [2013] EWHC 111 (QB) [138]

²⁶² *ibid* [144]

²⁶³ *ibid* [147]

Ltd v Intelligent Data Capture Ltd,²⁶⁴ in which it was held that the contract in question was a ‘relational’ agreement which did contain an implied duty of good faith.

2.4.2.2 Mid Essex Hospital Services NHS Trust v Compass Group UK & Ireland Ltd (t/a Medirest)²⁶⁵

The Court of Appeal did not wait long to give its view, albeit obiter, in *Mid Essex Hospital*, where Jackson LJ dismissed the idea of English contract law knowing a general doctrine of good faith. It was held that, as a matter of contractual interpretation, clause 3.5 did not impose a general obligation on the parties to co-operate with each other in good faith. Rather, the obligation to operate in good faith was specifically focused upon the two purposes stated in the clause. Thus, in terms of contractual provisions, a specific contractual provision to act in good faith in relation to certain specific clauses would probably be more likely to be enforceable than a general duty to act in all respects in good faith. If the parties wanted to do so, they should have expressly provided for it in the contract.²⁶⁶

In *MSC Mediterranean Shipping Company SA v Cottonex Anstalt*,²⁶⁷ the Court of Appeal once again made clear that there is no “general organising principle”

²⁶⁴ [2014] EWHC 2145 (Ch), it was held that the agreement between the parties was a hybrid between a joint venture and product distribution agreement, and that is sufficient to import an implied duty of good faith.

²⁶⁵ [2012] EWHC 781 (QB), [2012] 2 All ER (Comm) 300, revd [2013] EWCA Civ 200, [2013] B.L.R. 265, [2013] C.I.L.L. 3342.

²⁶⁶ [2013] EWCA Civ 200 [105].

²⁶⁷ [2016] EWCA Civ 789.

of good faith in English law, considering risks undermining express terms that have been agreed by the parties might be brought by the application of the duty. Therefore, the situations where an implied duty could be applied remain very limited. The key points to note are that on balance, it is likely that express good faith obligations, whilst enforceable, will continue to be interpreted very narrowly and implications of good faith terms will only be in particular circumstances. The English courts are more likely to be willing to apply good faith obligation to dishonest behaviour by a party, if a good faith provision, either express or implied, were breached, if it would amount to a repudiatory breach of contract entitling the innocent party to terminate the agreement and claim damages.

Generally, an agreement to negotiate in good faith is not enforceable. Notwithstanding, Leggatt J was not prepared to conclude that a duty of good faith would be implied into all contracts of a commercial nature after all. Instead, he accepted the traditional view that good faith only existed in English law in certain categories of contract, namely contracts of employment and partnering contracts, where the relation of the parties has a fiduciary character; and extended the notion to what was termed “relational contracts”, such as joint venture agreements, franchise agreements and contracts involving a long-term relationship between the parties to which they make a substantial commitment, where agreements:

“may require a high degree of communication, co-operation and predictable performance based on mutual trust and confidence and

involving expectations of loyalty which are not legislated for in the express terms of the contract but are implicit in the parties' understanding and necessary to give business efficacy to the agreements".²⁶⁸

Leggatt J preferred to imply such a duty in "any ordinary commercial contract" by use of the established methodology of English law for the implication of terms in fact based on the presumed intention of the parties.²⁶⁹ The law should still be developed on a case by case basis in the long run.

²⁶⁸ Ibid [142]

²⁶⁹ Ibid [131]

Chapter 3 Utmost Good Faith and Duty of Fair Presentation

3.1 Prior to August 16: the Marine Insurance Act 1906

The Marine Insurance Act 1906, drafted by Sir Mackenzie Dalzell Chalmers, was mostly based on principles developed by judges in the eighteenth and nineteenth centuries for the purpose of protecting “a fledgling insurance industry against exploitation by the insured”.²⁷⁰ Thus, in that case, the law offers wide-ranging mechanisms for the insurer to avoid the contract and encourages unmeritorious refusals.²⁷¹ The principle of utmost good faith was highly competent in doing this job and was codified in Marine Insurance Act 1906, s. 17:

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.

However, as mentioned in Chapter 2, the statutory duty is differ from what Lord Mansfield was formulated in *Carter v Boehm*²⁷² in terms of the phrase, the remedy and treatments to the notion of deemed fraud.²⁷³ It is in particular worth noting that the wording of s. 17 of the 1906 Act was not confined to pre-contractual presentation of the risk, whereas other sections of the 1906 Act

²⁷⁰ Law Commission, Insurance Contract Law: Business Disclosure; Warranties; Insurer’s Remedies for Fraudulent Claims; and Late Payment (Law Com No 353, 2014) para 1.25

²⁷¹ *ibid* paras 1.44 and 1.25-1.26

²⁷² (1766) 3 Burr 1905

²⁷³ See R. Merkin, *Colinvaux’s Law of Insurance* (11th edn, Sweet & Maxwell 2017) at 6-004. It indicates that the statutory duty of utmost good faith is differ from Lord Mansfield’s formulation in four important respects: the use of the term ‘utmost’; the remedy is that of avoidance rather than the policy becoming automatically void; the removal of the notion of deemed fraud; and the failure to confine the principle to pre-contractual negotiation.

relating to utmost good faith, namely, ss. 18-20 have been all limited to pre-contractual negotiations. Over the years, the principle has been developed in a series of cases from the 1970's onwards. The use of the term "utmost" have pushed the notion of good faith much further than simply the absence of bad faith.²⁷⁴ Despite its name, the 1906 Act has been taken to apply to all forms of insurance.²⁷⁵

A number of problems as to the duty of disclosure, which has received major criticisms over the years, are here noteworthy. Mainly, the wording of section 18, as one of the mechanisms to refuse claims, appears to allow insurers to play a passive role without clear indication as to what they wish to know. "This encourages 'underwriting at claims stage', where insurers ask questions only when a claim arises, and then use that information to threaten refusal of the claim."²⁷⁶ Further, the duty was acknowledged to be unclear and difficult to comply with. In particular, the effect of section 18 is that policyholders are required "to look into the mind of a hypothetical prudent insurer and to work out what would have influenced it, with little additional guidance".²⁷⁷ As a matter of fact, most policyholders, consumers in particular, have only little ideas about

²⁷⁴ See *Manifest Shipping Co Ltd v Uni-Polaris Insurance Co Ltd (The Star Sea)* [2001] 1 Lloyd's Rep 389

²⁷⁵ See *Black King Shipping Corp v Massie (The Litsion Pride)* [1985] 1 Lloyd's Rep. 437; *Pan Atlantic Insurance Co Ltd v Pine Top Insurance Co Ltd* [1994] 2 Lloyd's Rep 427, 447 (Lord Mustill); *Manifest Shipping Co Ltd v Uni-Polaris Insurance Co Ltd (The Star Sea)* [2001] 1 Lloyd's Rep 389 [47] (Lord Hobhouse); *Assicurazioni Generali SpA v Arab Insurance Group* [2003] Lloyd's Rep IR 131 [55]; *Brotherton v Aseguradora Colseguros SA (No.2)* [2003] Lloyd's Rep IR 746 [12]; *HIH Casualty & General Insurance Ltd v Chase Manhattan Bank* [2003] 2 Lloyd's Rep 61 (HL) [42] (Lord Hoffmann); *Highlands Insurance Co v Continental Insurance Co* [1987] 1 Lloyd's Rep 109, 114

²⁷⁶ Law Commission, *Insurance Contract Law: Business Disclosure; Warranties; Insurer's Remedies for Fraudulent Claims; and Late Payment* (Law Com No 353, 2014) para 3.11, point (4)

²⁷⁷ *ibid* para 3.8

“what is known or ought to have known” so as to satisfy the test.²⁷⁸ Medium or large business entities on the other hand may find the duty of disclosure appears almost “insurmountable”²⁷⁹ due to the large amount of employees working in different countries and difficulties in identifying every piece of information that an underwriter might deem material. These initiate the practical problem of data dumping. Additionally, avoidance, as “a powerful negotiating tool which can be used to reduce the scale of payments”, is often invoked by the insurer to decline insurance claims. The single, draconian “all or nothing” remedy causes adversarial disputes, even though in practice complete refusals are rare. Last but not least, most parties continue to contract on the basis of the Marine Insurance Act 1906 concerning difficulties of contracting out the default regime.²⁸⁰ Problems, including but not limited to above mentioned, caused by the 111-years-old act have allowed a series of insurance law reforms to be introduced in the UK following an extensive consultation carried out by the Law Commissions.

3.2 Outcome of the English business insurance law reform – the IA 2015

The long-awaited Insurance Act received Royal Assent in February 2015; and the vast majority of its provisions came into force on 12 August 2016. This eighteen months timeframe was built into the 2015 Act to allow the market time to adjust its practices and make necessary changes to their policy documents.

²⁷⁸ *ibid* para 5.15

²⁷⁹ *ibid* paras 3.11 and 5.14

²⁸⁰ See generally at Law Commission, Insurance Contract Law: Business Disclosure; Warranties; Insurer’s Remedies for Fraudulent Claims; and Late Payment (Law Com No 353, 2014) chapter 29

Together with the CI(DR)A 2012, it represents the greatest change to insurance contract law in England in over a century. Based on recommendations for reform by the Law Commissions of England and Wales and of Scotland, the Insurance Act aims to align business insurance rules more closely with those that govern consumer insurance laws.

Following the Law Commission Report which aimed “at ensuring a better balance of interests between policyholders and insurers”,²⁸¹ the IA 2015 makes wide-ranging and fundamental reforms to the insurance contract law relating to non-consumer matters, including reinsurance, which, inter alia, makes it harder for the insurers to void claims as a result of technical breaches by the insured. The 2015 Act applies in full to contracts concluded and renewed after 12 August 2016, eighteen months after the Act received the Royal Assent.²⁸² Parts three and four of the Act apply to variations to insurance contracts made after 12 August 2016,²⁸³ and the provisions on fair presentation are applicable to variations made after that date to existing non-consumer insurance contracts entered into at any time.²⁸⁴ In other words, the assured’s pre-contractual duties are to be applied purely to the variation and not retrospectively to the contracts of insurance prior to its variation. The Insurance Act 2015 was widely supported by the industry. The provisions mainly regulate all business and other non-

²⁸¹ Law Commission, Insurance Contract Law: Business Disclosure; Warranties; Insurer’s Remedies for Fraudulent Claims; and Late Payment (Law Com No 353, 2014) para 1.6

²⁸² Insurance Act 2015, s. 22(3)

²⁸³ Insurance Act 2015, s. 22(2)

²⁸⁴ Insurance Act 2015, s. 22(1)

consumer insurance²⁸⁵ – Insurance Act 2015, ss. 1&2(1) – including micro-businesses and small or medium enterprises as well as large risks such as marine insurance and reinsurance;²⁸⁶ and covers the following issues: the pre-contractual duty of disclosure; the insurer’s remedies for breach of the duty of fair presentation; the law of insurance warranties; “irrelevant” risk mitigation clauses; insurer’s remedies for fraudulent claims; good faith and contracting out. The Insurance Act 2015 does not exhaustively address every eventuality and instead sets out rules intended to be flexible enough to apply broadly to different situations. A detailed discussion concerning the development of the duty of fair presentation including disclosure and misrepresentation is provided in the following section. Issues relating to fraudulent claims are considered separately in chapter 7 together with other matters in relation to post-contractual duty of utmost good faith.

3.3 Fair presentation of the risk

The original principle of utmost good faith codified in ss. 18-22 of the Marine Insurance Act 1906 has now been repealed²⁸⁷ and replaced by ss. 2-8 of the Insurance Act 2015. The principle of utmost good faith, now good faith, works quite the other way under IA 2015. It applies, as an interpretative principle, to both pre- and post-contractual stages of all types of insurance contracts. Details as to the new form of utmost good faith – giving life to post-contractual duties,

²⁸⁵ Insurance Act 2015, s. 14, applies to consumer and non-consumer contracts

²⁸⁶ Law Commission, Insurance Contract Law: Business Disclosure; Warranties; Insurer’s Remedies for Fraudulent Claims; and Late Payment (Law Com No 353, 2014) para 6.4

²⁸⁷ Insurance Act 2015, s. 21(2)

governed by s. 17 of the MIA 1906 as amended by s. 14 of IA 2015, is discussed in section 3.3.5 below. Consequently, utmost good faith and the new duty of fair presentation are now “entirely independent and unrelated” principles.²⁸⁸ As a matter of fact, “fair presentation” is not at all new to English jurisdiction. The term is not cut out of whole cloth, nor is it borrowed from the concept of other jurisdictions. The duty of “fair presentation” – an evolutionary new approach introduced by the Law Commission in their second Consultation Paper – as it is referred to by s. 3 of IA 2015, is built on common law approaches developed by the English courts and the statutory duty set out by the 1906 Act,²⁸⁹ i.e. the duty of utmost good faith in the context of the assureds or their agent’s pre-contractual obligations. Notably, the constituent elements including positive elements to disclose material information (1906 Act, s. 18) and passive elements not to misrepresent them (1906 Act, s. 20) are retained yet modified. The duty is now clearly confined to the period “before the contract is made”. Under s. 3(1) of the IA 2015, the assured is obliged, before the contract is entered into, to make to the insurer a fair presentation of the risk, which requires policyholders to volunteer to the insurer every material facts known or ought to know to them that would influence the judgement of a prudent insurer in deciding whether to insure the risk and on what terms,²⁹⁰ or to at least draw attention of a prudent insurer to further enquiries;²⁹¹ or to make

²⁸⁸ R. Merkin, *Colinvaux’s Law of Insurance* (11th edn, Sweet & Maxwell 2017) at 6-006.

²⁸⁹ Law Commission, *Insurance Contract Law: Business Disclosure; Warranties; Insurer’s Remedies for Fraudulent Claims; and Late Payment* (Law Com No 353, 2014) para 6.5.

²⁹⁰ Insurance Act 2015, s. 7(3).

²⁹¹ Insurance Act 2015, s. 3(3) as amplified by 3(4), detailed discussions are considered in the following paragraphs.

material representation as to a matter of fact is “substantially correct” or that of “expectation or belief is made in good faith”.²⁹² The brokers’ independent duty of disclosure set out by MIA 1906 s. 19 is abolished and literally replaced with a duty of disclosure imposed upon the assured by IA 2015 s. 3.²⁹³ Now, knowledge held by brokers is included within the scope of what an insured either knows or ought to know, meaning, the insured is now deemed to know what the broker knows.²⁹⁴ Thus the assured loses its defence if the broker has obtained the knowledge and nevertheless failed to pass it on to the insurer. Knowledge of brokers is dealt with as a separate issue in Chapter 6.

Fair representation appeared as long ago as in the seminal judgement of *Carter v Boehm*²⁹⁵. Despite the failure of amplifying its constituents, Lord Mansfield laid particular emphasis on the need for a fair presentation of risk in the following statement:

“...whether there was, under all the circumstances at the time the policy was underwritten, a fair representation; or a concealment; fraudulent, if designed; or, though not designed, varying materially the object of the policy, and changing the *risqué* understood to be run.”²⁹⁶

The courts have developed the concept of “a fair presentation of the risk”

²⁹² Insurance Act 2015, s. 3(3)(c).

²⁹³ R. Merkin, ‘Placement of Insurance and the Role of Brokers’ (Forthcoming in 2018)

²⁹⁴ Insurance Act 2015, s. 4(2)(b), 4(3)(b) and 4(8)(b).

²⁹⁵ (1766) 3 Burr 1905.

²⁹⁶ *ibid* 1165

thereafter. Lord Esher MR stated in *Asfar v Blundell*²⁹⁷ as follows:

“But 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 underwriters in such a manner that they can see that if they require further information they ought to ask for it.”

Then “fair presentation” has been further interpreted in the case of *Container Transport International Inc and Reliance Group Inc v Oceanus Mutual Underwriting Association (Bermuda) Ltd*²⁹⁸ in the following statements:

“Having regard to all the circumstances known or deemed to be known to the insured and to his broker, and ignoring those which are expressly excepted from the duty of disclosure, was the presentation in summary form to the underwriter a fair and substantially accurate presentation of the risk proposed for insurance, so that a prudent insurer could form a proper judgement – either on the presentation alone or by asking questions if he was sufficiently put on enquiry and wanted to know further details – whether or not to accept the proposal, and , if so, on what terms?”²⁹⁹

This was borne out by the authorities. The leading authority as to “fair presentation of the risk”, on which the English courts have reached a

²⁹⁷ [1896] 1 QB 123, 129

²⁹⁸ [1984] 1 Lloyd's Rep 476.

²⁹⁹ *Ibid* 496.

consensus,³⁰⁰ is the case of *WISE Underwriting Agency Ltd v Grupo Nacional Provincial SA*³⁰¹, in which the Court of Appeal affirmed that the test, as to what put a underwriter on inquiry about the existence of other material facts, “had to be applied by reference to a reasonably careful insurer rather than the actual insurer”, and by reference to the actual presentation of the assured together with reference to the general knowledge of the insurer. The test is objective. In this case, the presentation was considered by the Court of Appeal (by a majority) to be unfair, thereby the contract was avoided because of an translation error.

The statutory definition of “fair presentation” can be found at the first part of IA 2015 s. 3 in the following terms:

- (1) Before a contract of insurance is entered into, the insured must make to the insurer a fair presentation of the risk.
- (2) The duty imposed by subsection (1) is referred to in this Act as “the duty of fair presentation”.
- (3) A fair presentation of the risk is one—
 - (a) which makes the disclosure required by subsection (4),
 - (b) which makes that disclosure in a manner which would be reasonably clear and accessible to a prudent insurer, and
 - (c) in which every material representation as to a matter of fact is

³⁰⁰ Law Commission, *Insurance Contract Law: Business Disclosure; Warranties; Insurer’s Remedies for Fraudulent Claims; and Late Payment* (Law Com No 353, 2014) para 5.50, “the phrase “fair presentation of the risk” has appeared in at least 15 cases in the past ten years.”

³⁰¹ [2004] EWCA Civ 962

substantially correct, and every material representation as to a matter of expectation or belief is made in good faith.

(4) The disclosure required is as follows, except as provided in subsection

(5) —

(a) disclosure of every material circumstance which the insured knows or ought to know, or

(b) failing that, disclosure which gives the insurer sufficient information to put a prudent insurer on notice that it needs to make further enquiries for the purpose of revealing those material circumstances.

It is clear from IA 2015 s. 3(1) that the duty of fair presentation, falling only on the assured, is confined to the period prior to the formation of the contract. The duty still encompasses both a duty to disclose and a duty not to misrepresent material information, retaining essential elements of ss. 18-20 of the 1906 Act.³⁰²

In addition to IA 2015 s. 3, a supplementary provision of the duty of fair presentation is provided under s.7 of the IA 2015: s. 7(1) states that a fair presentation does not have to be made in a single document or oral presentation; s. 7(2) concerns the scope of the term “circumstance”; s. 7(3) defines a material circumstance; s. 7(4) sets out examples of things which may constitute material circumstances. All of those will be discussed in more details below.

³⁰² Explanatory Notes to the Insurance Act 2015, para 40
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3.3.1 Disclosure of Circumstances

The duty of disclosure, as appeared in Lord Mansfield's seminal judgment of *Carter v Boehm*,³⁰³ was codified in s. 18(1) of the MIA 1906 in the following terms:

“The assured must disclose to the insurer, before the contract is concluded, every material circumstance which is known to the assured, and the assured is deemed to know every circumstance which, in the ordinary course of business, ought to be known by him. If the assured fails to make such disclosure, the insurer may avoid the contract.”

Unlike the position applicable to consumer insurances, the essence of s. 18(1), with an importance modification as to the remedy, has now been restated in s. 3(4)(a) of the IA 2015, as the nature of the duty of full disclosure. The earlier reference to “the ordinary course of business” has been dropped. IA 2015 s. 3(4)(a) serves as the primary means of disclosure.³⁰⁴ In addition, the insured, who has failed to satisfy the strict duty set out in s. 3(4)(a) but has nevertheless disclosed just enough information which would lead a prudent insurer to make further enquiries, which when answered, would reveal the material circumstances, is granted an alternative, by s. 3(4)(b), might still comply with its duty of disclosure. This is the codification of common law approach – as mentioned previously – taken by the courts.³⁰⁵

³⁰³ (1766) 3 Burr 1905

³⁰⁴ Law Commission, Insurance Contract Law: Business Disclosure; Warranties; Insurer's Remedies for Fraudulent Claims; and Late Payment (Law Com No 353, 2014) para 7.39

³⁰⁵ Explanatory Notes to the Insurance Act 2015, para 45

The “fall back duty”³⁰⁶ provides to the insured a cushioning device. Accordingly, failing to satisfy the absolute duty set out by s. 3(4)(a) is no longer automatically discharge the obligation of the insurer unless appropriate questions have been asked. The Insurance Act 2015, s. 3(4)(b) has put the insurers in a position to play a more active role in assessing the risk, by which it places an onerous duty on the insurers to ask follow up questions. This provision, considered as central to the duty of disclosure,³⁰⁷ replicates the common law, in that:

“If the insurers (thereby) receive information from the assured or his agent which, taken on its own or in conjunction with other facts known to them or which they are presumed to know, would naturally prompt a reasonably careful insurer to make further inquiries, then, if they omit to make the appropriate check or inquiry, assuming it can be made reasonably, they will be held to have waived disclosure of the material fact which the inquiry would have necessarily revealed.”³⁰⁸

It is therefore notable that this concept is derived from the doctrine of “waiver”.³⁰⁹ The waiver principle was set out in s. 18(3)(c) of the MIA 1906 and has now been re-enacted as s. 3(5)(e) of the IA 2015. Further, English courts, for the purpose of mitigating the draconian nature of the remedy of avoidance, have bestowed a much broader meaning upon the relatively narrow common law doctrine of waiver than it has originally in other areas of law, whereby an insurer

³⁰⁶ R. Merkin & M. Hemsworth, *The Law of Motor Insurance* (2nd edn, Sweet & Maxwell 2015) at 2-47

³⁰⁷ Law Commission, *Insurance Contract Law: Business Disclosure; Warranties; Insurer’s Remedies for Fraudulent Claims; and Late Payment* (Law Com No 353, 2014) para 6.7

³⁰⁸ J. Birds, S. Milnes and B. Lynch, *MacGillivray on Insurance Law* (13th edn, Sweet & Maxwell 2015) para 17-089

³⁰⁹ Detailed discussion as to the doctrine of waiver is provided in chapter 4, section 4.2.5.3 (C).

may waive by omission in the context of insurance.³¹⁰ This change makes a shift in English insurance law and will doubtlessly encourage insurers to ask specific express questions rather than taking a passive stance in relying on the assureds and their broker to provide all relevant information.³¹¹

3.3.1.1 The “sufficient information” standard

The duty might be discharged where the assured makes either full disclosure or partial disclosure. It is a matter of fact as to what circumstances or information are considered to be one of the kinds whereby it will put a prudent insurer on notice to further inquire.³¹² There is no absolute standard as to the precise weight prudent underwriters would place to the undisclosed facts. It is generally accepted to be sufficient to put the insurers on enquiry about further information of the risk, if the omitted information is normal basis of contracting terms, such as a lump-sum freight under a voyage charter.³¹³ The question is whether it has given the insurer sufficient “signposts” which would lead a prudent insurer to make further enquiries which, when answered, would reveal material circumstances.³¹⁴ In *WISE Underwriting Agency Ltd v Grupo Nacional Provincial SA*,³¹⁵ Rix LJ made it clear that mere possibilities of the existence of other material circumstances will not put the reasonably careful underwriter on

³¹⁰ Law Commission, Insurance Contract Law: Business Disclosure; Warranties; Insurer’s Remedies for Fraudulent Claims; and Late Payment (Law Com No 353, 2014) paras 4.20-4.21

³¹¹ *ibid* paras 6.7 and 7.34 *et seq*

³¹² see *Iron Trades Mutual Insurance Co Ltd v Compania de Seguros imperio* (1992) 1 Re LR 213; *Pan Atlantic Insurance Co Ltd v Pine Top Insurance Co Ltd* [1994] 2 Lloyd’s Rep 427, [1995] 1 AC 501; *Garnat Trading & Shipping (Singapore) Pte Ltd v Baominh Insurance Corporation* [2011] Lloyd’s Rep IR 366.

³¹³ *CTI v Oceanus* [1984] 1 Lloyd’s Rep 476 498 (Kerr LJ)

³¹⁴ Law Commission, Insurance Contract Law: Business Disclosure; Warranties; Insurer’s Remedies for Fraudulent Claims; and Late Payment (Law Com No 353, 2014) para 7.37

³¹⁵ [2004] EWCA Civ 962.

inquiry.³¹⁶ The disclosure of facts “would raise in the mind of a reasonable insurer at least a suspicion that there were other circumstances which would or might vitiate the presentation made to him”.³¹⁷

Where non-disclosed facts are unusual or special to the circumstances, which are not to be expected in ordinary business practice – the presentation is not considered to be fair because such a non-disclosure distorts the fairness of presentation of risk – the waiver cannot be applied to.³¹⁸ Apparently, an insured intentionally disclose a limited amount of information with an aleatory thought would not be protected by this provision as the presentation must be “reasonably clear and accessible” to the insurer.³¹⁹ This requirement is considered in more detail in the following section. Further, assureds or their broker who disclose the “bare minimum” information may put themselves in a risky and inadvisable position,³²⁰ given that the English courts “would treat s. 3(4)(b) of the Insurance Act 2015 as an alternative only where the insured has tried but failed to comply with s. 3(4)(a) of the 2015 Act and shows that it has given the insurer a good base on which to make its enquires”.³²¹

³¹⁶ *ibid*, para 64; also see *Harrower v Hutchinson* (1870) L.R. 5 Q.B. 584; *Greenhill v Federal Insurance Co. Ltd* (1926) 24 Ll. L. Rep 383, [1927] 1 K.B. 65.

³¹⁷ *CTI v Oceanus* [1984] 1 Lloyd’s Rep 476, 511 (Parker LJ)

³¹⁸ *CTI v Oceanus* [1984] 1 Lloyd’s Rep 476, 498 K(err LJ); also see *WISE Underwriting Agency Ltd v Grupo Nacional Provincial SA* [2004] EWCA Civ 962 [64]

³¹⁹ Law Commission, *Insurance Contract Law: Business Disclosure; Warranties; Insurer’s Remedies for Fraudulent Claims; and Late Payment* (Law Com No 353, 2014) para 7.40

³²⁰ *ibid* paras 5.66-5.67

³²¹ *ibid* para 7.39

3.3.1.2 Form of Disclosure - “A reasonably clear and accessible manner”

The format of the disclosure, under s. 3(3)(b) of the Insurance Act 2015, must be appropriate and “in a manner which would be reasonably clear and accessible to a prudent underwriter”, failure to fulfil this requirement will amount to breach of duty of fair presentation. This new requirement is independent of the duty of disclosure set out by s. 3(4)(a) and (b) and is aimed primarily at the practice of “data dumping”.³²² Hence, a policyholder is not considered as having been satisfied its duty of disclosure by dumping overwhelming amount of unsorted information without a well-structured or indexed summary; or with little or no signposting undermines the underwriting process, usually with the aim to guard against inadequate disclosure but, more rarely, to bury material information.³²³ Consequentially it may be regarded as that the presentation of the risk is not fair, which amounts to a breach.³²⁴

The question of whether this requirement has been breached will be “highly fact specific”,³²⁵ but fulfilment of this requirement is nevertheless related to clear and effective data sorting methods rather than the amount of information. Insofar as “a fair and accurate presentation of a summary” is sufficient if it would navigate an insurer to form a proper judgement,³²⁶ it might be acceptable in practice that a large volume of data accompanied with “an overview highlighting material

³²² *ibid* paras 5.28 and 5.29

³²³ *ibid* paras 5.28, 6.9 and 7.43

³²⁴ *ibid* paras 6.9 and 7.41 *et seq*

³²⁵ *ibid* para 7.43

³²⁶ *Garnat Trading & Shipping (Singapore) Pte Ltd and Another v Baominh Insurance Corporation* [2010] EWHC 2578 (Comm), [2011] 1 Lloyd’s Rep 589, 135 (Clarke J); that was confirmed in *Container Transport International Inc and Reliance Group Inc v Oceanus Mutual Underwriting Association (Bermuda) Ltd* [1984] 1 Lloyd’s Rep 476, 529 (Stephenson LJ)

points".³²⁷ In addition, the 2015 Act does make clear indication, by IA 2015 s. 7(1), that the disclosure need not be contained within a single document or oral presentation, it can be done through a series of exchanges between the parties. Further, the assureds' duty do not extend any further than making material facts known to them or ought to know available to the insurer; in other words, the assured is not required to emphasize the significance of any particular information disclosed.³²⁸ Because the point of disclosure in insurance is to make the information available so that the underwriter is able to assess the significance of the disclosed information and reach a decision on whether to insure and on what terms.

3.3.1.3 Knowledge of the assured for the purpose of disclosure

The 2015 Act prescribes under ss. 4-6 in detail the matters which will be regarded as "known" or "ought to be known" by insurers and those who are insured, including matters known by employees of insurers and senior management of those who are insured. This is a reformulation of "knowledge" defined under s. 18(1) of the MIA 1906, and a restatement of the best principles of current case law. This section concerns only knowledge of the assured. Circumstances which the insurer knows, ought to know and is presumed to know are set out in s. 5 of the IA 2015. It is to be noted that knowledge of the insurer will be considered in detail under Section 4.1.5.3(b) – knowledge of the

³²⁷ Law Commission, Insurance Contract Law: Business Disclosure; Warranties; Insurer's Remedies for Fraudulent Claims; and Late Payment (Law Com No 353, 2014) para 7.44

³²⁸ R. Merkin & M. Hemsworth, *The Law of Motor Insurance* (2nd edn, Sweet & Maxwell 2015) at 2-47

insurer for disclosure purposes – in Chapter 4, it thus needs not elaborate any further here.

The concept of knowledge is defined in IA 2015 s. 4 as follow.

Section 4 Knowledge of insured

- (1) This section provides for what an insured knows or ought to know for the purposes of section 3(4)(a).
- (2) An insured who is an individual knows only –
 - (a) what is know to the individual, and
 - (b) what is known to one or more of the individuals who are responsible for the insured's insurance.
- (3) An insured who is not an individual knows only what is known to one or more of the individual who are –
 - (a) part of the insured's senior management, or
 - (b) responsible for the insured's insurance
- (4) An insured is not by virtue of subsection (2)(b) or (3)(b) taken to know confidential information known to an individual if –
 - (a) the individual is, or is an employee of, the insured's agent; and
 - (b) the information was acquired by the insured's agent (or by an employee of that agent) through a business relationship with a person who is not connected with the contract of insurance.
- (5) For the purposes of subsection (4) the persons connected with a

contract of insurance are –

(a) the insured and any other persons for whom cover is provided by the contract, and

(b) if the contract re-insurer risks covered by another contract, the persons who are (by virtue of this subsection) connected with that other contract.

(6) Whether an individual or not, an insured ought to know what should reasonably have been revealed by a reasonable search of information available to the insured (whether the search is conducted by making enquiries or by any other means).

(7) In subsection (6) “information” includes information held within the insured’s organisation or by any other person (such as the insured’s agent or a person for whom cover is provided by the contract of insurance).

(8) For the purposes of this section –

(a) “employee”, in relation to the insured’s agent, includes any individual working for the agent, whatever the capacity in which the individual acts,

(b) an individual is responsible for the insured’s insurance if the individual participates on behalf of the insured in the process of procuring the insured’s insurance (whether the individual does so as the insured’s employee or agent, as an employee of the insured’s agent or in any other capacity), and

(c) “senior management” means those individuals who paly significant roles in the making of decisions about how the insured’s activities are to be managed or organised.

Knowledge in this provision, as it is prescribed in IA 2015 s. 6(1), would include actual knowledge and “blind eye” knowledge, consisting of “matters which the individual suspected, and of which the individual would have knowledge but for deliberately refraining from confirming them or enquiring about them”.

Section 4, as one of the key features, has clarified the nature of the assured’s knowledge.³²⁹ In order to do so the IA 2015 has removed the independent duty of an “agent to insure” set out in s. 19 of the MIA 1906, and has replaced it with the general agency law concept for attribution of knowledge to the authority, and so here to the assured. Thus, “the sole disclosure obligation is on the assured.”³³⁰ Issues as to the broker’s duty are discussed in that context in chapter 6. Moreover, the IA 2015 has drawn a distinction, which did not appear in the previous legislation, between the knowledge of an assured who is an individual (IA 2015 s. 4(2)) and the knowledge of an assured who is not (IA 2015 s. 4(3)).

3.3.1.3.1 The assured is an individual

If the assured is an individual (such as a sole trader or practitioner),³³¹ s/he is

³²⁹ R. Merkin, *Colinvaux’s Law of Insurance* (11th edn, Sweet & Maxwell 2017) at 7-046

³³⁰ *ibid*

³³¹ Explanatory Notes to the Insurance Act 2015, para 51

treated as knowing: (1) actual knowledge to the individual (IA 2015 s. 4(2)(a)) – this reflects s. 18(1) of the 1906 Act; (2) the blind-eye knowledge to the individual (IA 2015 ss. 4(2)(a) & 6(1)); (3) matters should reasonably have been revealed by a reasonable search of information available to the insured (whether the search is conducted by making enquiries or by any other means) (IA 2015 s. 4(6)) – this concept is discussed below; (4) matters known to one or more of the individuals who are responsible for the assured’s insurance (IA 2015 s. 4(2)(b)). By IA 2015 s. 4(8)(b), “an individual is responsible for the insured’s insurance if the individual participates on behalf of the insured in the process of procuring the insured’s insurance (whether the individual does so as the insured’s employee or agent, as an employee of the insured’s agent or in any other capacity)”. This provision “catches individuals within the assured’s organisation who are responsible for placing insurance.”³³²

3.3.1.3.2 The assured is not an individual

If the assured is a legal person, the assured is treated as have knowledge in the following circumstances. First, information that is known to one or more individuals who are part of the assured’s senior management (IA 2015 s. 4(3)(a)). By s. 4(8)(c) of the IA 2015, “senior management” is defined as “those individuals who play significant roles in the making of decisions about how the insured’s activities are to be managed or organised”. In this scenario, “senior management” may include, but not limited to, members of the board of

³³² R. Merkin & M. Hemsworth, *The Law of Motor Insurance* (2nd edn, Sweet & Maxwell 2015) at 2-70

directors.³³³ However, the knowledge of those individuals who do not fall within the category of senior management, yet who do perform management roles or otherwise possess relevant information or knowledge about the risk to be insured, may be captured by the “reasonable search” referred to in IA 2015 s. 4(6).³³⁴

Second, the assured ought to know, again, as referred to in s. 4(6) of the IA 2015, information that should reasonably have been revealed through a reasonable search of information available to the insured (whether the search is conducted by making enquiries or by any other means). IA 2015 s. 4(7) makes clear that “information” includes “information held within the insured’s organisation or by any other person (such as the insured’s agent or a person for whom cover is provided by the contract of insurance)”. The requirement of a “reasonable search” potentially imposes a far more onerous obligation on insureds comparing to the old law which related to knowledge of the insured in the ordinary course of its business. The degree of thoroughness of a reasonable search for potentially material information will vary.³³⁵ The Law Commission have stated that what is reasonable “will depend on the size, nature and complexity of the business ... [T]he question should be judged objectively, by reference to a reasonable, prudent assured in that class”.³³⁶ For large insurance contracts, the Law Commission hopes that “the parties will

³³³ Explanatory Notes to the Insurance Act 2015, para 54

³³⁴ *ibid* para 55

³³⁵ Law Commission, Insurance Contract Law: Business Disclosure; Warranties; Insurer’s Remedies for Fraudulent Claims; and Late Payment (Law Com No 353, 2014) para 8.84

³³⁶ *ibid* para 8.83

discuss and reach agreement on the nature of the search to be undertaken. This process would be made much easier by the development of industry-produced protocols on the types of search which are expected”.³³⁷ The concept of “reasonable search” is new to English law.³³⁸

An assured required to conduct a reasonable search may need to go beyond its own business and make reasonable enquiries of its employees or third parties. The Law Commission suggested that “any other person” might include brokers and other agents such as lawyers, technical advisors and suppliers who may know about matters which are relevant to the insurer.³³⁹ There is no simple test on determining which agents, among that wide range, should be included in the search. It will depend on “the circumstances and the type of insurance”.³⁴⁰ However, the assured cannot be regarded as having unlimited access to its agent’s records – the information in this context “must be *available to the insured*”.³⁴¹ Further, there is no obligation on an agent to undertake a reasonable search, any failure by the agent in conducting the reasonable search would be counted as a failure by the insured.³⁴² The notion of a “person for whom cover is provided” is left unidentified, but it may well refer to beneficiaries under the policy such as directors of a company holding a Directors and Officers policy, or sub-contractors to whom cover has been

³³⁷ *ibid* para 8.85

³³⁸ R. Merkin, *Colinvaux’s Law of Insurance* (11th edn, Sweet & Maxwell 2017) at 7-054

³³⁹ Law Commission, *Insurance Contract Law: Business Disclosure; Warranties; Insurer’s Remedies for Fraudulent Claims; and Late Payment* (Law Com No 353, 2014) para 8.90

³⁴⁰ *ibid* para 9.38

³⁴¹ *ibid* para 9.39

³⁴² *ibid* para 9.40.

extended under a policy issued to the head contractor.³⁴³

Third, an assured is deemed to know information known by the individual responsible for the insurance which is defined under IA 2015 s. 4(8)(b) – as stated previously in the last section. It is to be noted that “this provision is concerned with actual and blind-eye knowledge and not matters which ought to be known to the person responsible for insurance”.³⁴⁴ This definition is intended to catch “all those individuals who participate in the insurance buying process” including, for example, the insured’s risk manager or broker,³⁴⁵ albeit a broker is not obliged to disclose confidential information acquired through a business relationship unconnected to the relevant contract of insurance (IA 2015 s. 4(4)). Brokers at this point refer to not only the agent of the assured in placing a risk but also the so-called “ad hoc” agents, i.e. “organisation that is only incidentally involved in arranging insurance to support a particular transaction,” for example, a bank in respect of a loan and a car dealership in respect of motor insurance.³⁴⁶ Knowledge of any individuals participating in procuring insurance as an “ad hoc” agent is deemed to be knowledge of the assured.³⁴⁷ Issues as to knowledge of the broker are discussed separately in Chapter 6.

³⁴³ R. Merkin, *Colinvaux’s Law of Insurance* (11th edn, Sweet & Maxwell 2017) at 7-054.

³⁴⁴ *ibid* at 7-049.

³⁴⁵ Law Commission, *Insurance Contract Law: Business Disclosure; Warranties; Insurer’s Remedies for Fraudulent Claims; and Late Payment* (Law Com No 353, 2014) para 8.64.

³⁴⁶ R. Merkin, *Colinvaux’s Law of Insurance* (11th edn, Sweet & Maxwell 2017) at 7-051.

³⁴⁷ *ibid*.

3.3.1.3.3 Limits of the assured's knowledge: concealing fraud

In *Re Hampshire Land Co*,³⁴⁸ the Court held that where an officer or employee of a company commits a fraud upon the company itself then the knowledge of his own fraud is not the knowledge of the company. The principle expounded in that judgment has become a common law exception to the general rules of attribution –i.e. a principal is not deemed to have the knowledge held by an agent engaged in a fraud against him³⁴⁹ – known as the *Re Hampshire Land* principle. The principle of *Re Hampshire Land* in its modern formulation by *Buckley LJ* in *Belmont Finance v Williams Furniture*³⁵⁰ applied in insurance cases. Thus if the underwriting agent acting for an reinsured committed a fraud against the reinsured, assuming the fraud is material to the risk, the reinsured is under no obligation to disclose that fraud unless he is in possession of that information.³⁵¹ This principle however has extended by *Rix J* in *Arab Bank Plc v Zurich Insurance Co*³⁵² to cover the agent's fraud against the insurers with the assured is being the secondary victim of that fraud. Such an “extension” was subsequently rejected by Court of Appeal in *Moore Stephens v Stone & Rolls Ltd*.³⁵³ The Court of Appeal's decision was upheld on other grounds by the House of Lords, albeit Lord Mance, in his dissenting judgment, approved the *Rix LJ*'s approach. The House of Lord's decision in *Moore Stephens* was re-

³⁴⁸ [1896] 2 Ch 743.

³⁴⁹ *PCW Syndicates v PCW Reinsurers* [1996] 1 WLR 1136; *Stone & Rolls Ltd v Moore Stephens* [2009] 1 AC 1391; *Safeway Stores v Twigger* [2010] EWCA Civ 1472.

³⁵⁰ [1979] Ch 250, 261.

³⁵¹ See *PCW Syndicates v PCW Reinsurers* [1996] 1 WLR 1136.

³⁵² [1999] 1 Lloyd's Rep 262.

³⁵³ [2008] EWCA Civ 644, the Court of Appeal decision was further upheld on other grounds by the House of Lords, *Moore Stephens v Stone & Rolls Ltd* [2009] UKHL 39.

examined by the Supreme Court in *Jetivia SA v Biltta (UK) Ltd.*³⁵⁴ The Court held that Moore Stephens should be limited to its facts and be put on one side and not looked at again: “it is not in the interests of the future clarity of the law for it to be treated as authoritative or as assistance save as already indicated”.³⁵⁵

The principle of *Re Hampshire Land* has now been put on a statutory footing in the new regime under the 2015 Act. Accordingly, IA 2015 s. 6(2)(a) states that nothing in the Act relating to the duty of fair presentation “affects the operation of any rule of law according to which knowledge of a fraud perpetrated by an individual (F) either ... the insured ... is not to be attributed to the insured ... where ... F is” any of the individuals responsible for the assured’s insurance or, in the case of an assured who is not an individual, any individual who is part of the assured’s senior management. The legal effect of that section is that the *Re Hampshire Land* rule has been extended to fraud engaged by an employee or a member of senior management of the assured. The Law Commission specially emphasized that the wider interpretation of the *Re Hampshire Land* principle should not be applied to limit the intentionally designed knowledge provisions. Thus it seems that the Law Commission is in favour of wider interpretation of the rule in this context. The question then arises on whether IA 2015 s. 6(2)(a) applies where the principal is a secondary victim of a fraud directed at another. The provision is “potentially of much wider scope than was probably intended”,

³⁵⁴ [2015] UKSC 23.

³⁵⁵ *ibid* [20].

³⁵⁶ if it does. It will be interesting to see how English Courts would interpret s. 6(2)(a) of IA 2015.

3.3.1.4 Duty of disclosure under Chinese insurance law

In China, the insured's duty to disclose and duty not to misrepresent to the insurer material information in relation to marine insurance are governed by the Chapter 12 of Maritime Code of PRC, namely, Marine Insurance. The Insurance Act of PRC 2015 deals with general insurance policies outside the sector of marine insurance. It is submitted that there is no disclosure obligation rest upon a non-marine assured under Chinese insurance law. Art. 16 par. 1 of the IAC 2015 states: in concluding an insurance contract, the proposer shall make an honest disclosure where the insurer makes inquiries about relevant circumstances of the subject insured or matters relating to the insured. The phrase "make an honest disclosure" is the English interpretation of Chinese characters "如实告知". The translating method here used is apparently the "literal translation", which led to a loss of faithful translation. Reading the phrase in between the lines – special attention should be paid to the wording "where the insurer makes inquiries about the relevant circumstances..." – "如实告知" simply refers to "an honest statement" in answering questions arose by insurers, which just happen to be consistent with the duty not to make false statement set out in s. 20 of the MIA 1906, as restated in s. 3(3)(c) of the new regime in Insurance Act 2015.

³⁵⁶ R. Merkin, *Colinvaux's Law of Insurance* (11th edn, Sweet & Maxwell 2017) at 7-059.

Unlike the Insurance Act of PRC 2015, Maritime Code 1993 has adopted the duty of disclosure, which is provided in art. 222 in the following terms:

“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 his ordinary business practice and which would influence the insurer in deciding the premium or determining whether or not he will take the risk.

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

This section is, to a large extent, a copy of s. 18 of Marine Insurance 1906, although the remedy is missing in that provision. In accordance with art.1 of the Provision of the Supreme People’s Court on Several Issues about the Trial of Cases Concerning Marine Insurance Disputes, the governing law for marine insurance disputes is the Maritime Code 1993; if there is any issue that is not prescribed in the Code, the courts shall seek to apply relevant provisions in the Insurance Act of PRC; if there is no such provision in both the Code and the Insurance Act, rules in Contract Act 1999 shall be applied. Thus insurers might entitle to rescind the contract for breach of the duty of disclosure in the context of marine insurance. It is noteworthy that the Maritime Code is now going through a historic legislative reform undertaken by the NPC.

3.3.2 Misrepresentation

The law of misrepresentation under the Insurance Act 2015 remains largely untouched. The duty not to make false statement set out in s. 20 of the MIA1906 is now restated in s. 3(3)(c) of IA 2015. There is a fair presentation of the risk where “every material representation as to a matter of fact is substantially correct, and every material representation as to a matter of expectation or belief is made in good faith.” S. 7(3) of the IA 2015, mirrored ss. 18(2) and 20(2) of MIA 1906, articulates the definition of materiality as that “a circumstance or representation is material if it would influence the judgement of a prudent insurer in determining whether to take the risk and, if so, on what terms. The test is, again, objective. Although “representation” is not defined in the IA 2015, it is not difficult to notice an echo of s. 20(3) of MIA 1906, in which it reads that “a representation may be either a representation as to a matter of fact, or as to a matter of expectation or belief”. Nevertheless, it is noteworthy at this point that not every statement said by the assured is capable of being referred to as a representation.³⁵⁷ A statement for these purposes must be specific and “made in circumstances that is appropriate for a reasonable insurer to rely upon it”.³⁵⁸ A general statement which is not one that was reasonably designed to be relied upon is not a representation but a mere “puff”.³⁵⁹ Further, any representation made by the assured’s broker has to be on behalf of the

³⁵⁷ R. Merkin & M. Hemsworth, *The Law of Motor Insurance* (2nd edn, Sweet & Maxwell 2015) at 2-43

³⁵⁸ *ibid*

³⁵⁹ See *Allianz Via Assurance v Marchant* 1997, unreported

assured.³⁶⁰

“In practice the distinction between misrepresentation and non-disclosure may be blurred.”³⁶¹ English courts have acknowledged that silence could amount to misrepresentation where an express question is deliberately left blank.³⁶² Further, where a statement was correct at the time when it was made and yet rendered untrue before the contract is concluded, failure to correct such a statement which the assured is under a duty to do so, is classified as misrepresentation rather than non-disclosure.³⁶³ Thus a partially corrected statement might probably be classified as a misrepresentation.³⁶⁴ Further IA 2015 s. 7(6), repeating MIA 1906 s. 20(6), states that “a representation may be withdrawn or corrected before the contract of insurance is entered into”. Thus if a representation made during the placement may be initially correct, but then subsequently become incorrect prior to the conclusion of the contract, the insured is under an obligation to correct it by the date of the contract.³⁶⁵ If he/she does so, there is no breach of duty.

3.3.2.1 Misrepresentation in China

In respect to non-marine insurance, making an honest representation, as being the only duty in transmitting information by the assured prior to entering into an

³⁶⁰ R. Merkin & M. Hemsworth, *The Law of Motor Insurance* (2nd edn, Sweet & Maxwell 2015) at 2-43

³⁶¹ *ibid* at 2-47

³⁶² *Roberts v Avon Insurance* [1956] 2 Lloyd's Rep 240; *Roberts v Plaisted* [1989] 2 Lloyd's Rep 341

³⁶³ R. Merkin & M. Hemsworth, *The Law of Motor Insurance* (2nd edn, Sweet & Maxwell 2015) at 2-47

³⁶⁴ *ibid*

³⁶⁵ *Limit No 2 Ltd v AXA Versicherung AG* [2007] EWHC (Comm) 2321, [2008] Lloyd's Rep IR 330 [89]-[102]

insurance contract, is stated in art.16 of the IAC 2015 in the following terms,

Article 16³⁶⁶

In concluding an insurance contract, the proposer shall make an honest disclosure thereof where the insurer makes inquiries about relevant circumstances of the subject insured or matters relating to the insured.

The insurer shall have the right to rescind the insurance contract if the proposer fails to perform the obligation of making an honest disclosure as prescribed in the preceding paragraph intentionally or [through] gross negligence (recklessly), thereby materially affecting the insurer's decision on whether or not to underwrite the risk or to increase the premium.

The right to rescind an insurance contract as prescribed in the preceding paragraph shall be annulled after 30 days or more from the day when the insurer knows the cause of rescission. After two years or more from the day when an insurance contract is entered into, the insurer shall not rescind the contract; where an insured incident occurs, the insurer shall be liable for paying indemnity or insurance money.

Where the proposer intentionally fails to perform the obligation of making an honest disclosure, the insurer shall not be liable for paying indemnities or insurance money for an insured occurring prior to the rescission of the contract, and shall not refund the insurance premium.

³⁶⁶ Author translation, with reference to various versions of English translation of IAC 2015 art.16 including the official one undertaken by the Legislative Affairs Office of the State Council – Laws and Regulations of the People's Republic of China (Civil and Commercial Law). References used in translating this provision are provided in Appendix 1 incorporated in this thesis.

Where the proposer fails to perform the obligation of making an honest disclosure for gross negligence, which has a material effect on the occurrence of an insured incident, the insurer shall not be liable for paying indemnities or insurance money for the insured incident occurring prior to the rescission of the contract, but shall return the insurance premium.

Where the insurer, knowing the truth that the proposer failed to make an honest disclosure, enters into an insurance contract with the proposer, the insurer shall not rescind the contract, and if an insured incident occurs, the insurer shall be liable for paying indemnities or insurance money.

An insured incident means an event falling within the agreed coverage under the insurance policy.

The law is silent on whether the duty continues after the contract is concluded. Unlike the current English position, consumer insurance is not separated as a distinctive issue from commercial insurance matters under IAC 2015. There is no evidence showing in the provision that the duty not to misrepresent should be carried mutually by both the assured and the insurer. Thus it rests upon the insured only.³⁶⁷ This is similar to the new duty of fair presentation under the English regime of IA 2015. Pursuant to IAC 2015 art. 16 par. 6, if insurers were aware of the breach at the conclusion of the contract, they cannot rescind the

³⁶⁷ Zhen JING, *Chinese Insurance Contracts: Law and Practice* (Informa 2017) 239

contract on the basis of misrepresentation. The purpose of this rule is to discourage any potential abuse of the defence of misrepresentation.

Bearing in mind that the inappropriate English translation mentioned earlier, the pre-contractual duty is imposed upon the insurance applicants to provide honest statements in responding to specific enquiries made by the insurer. Art.4 par.1 of the Court Hearing Guidance on Insurance Disputes (Trial) ³⁶⁸, published by Shandong High People's Court, provides that the insurance proposers' duty of making an honest representation is limited only to the matters about which the insurer raises inquiries. Insurance applicants are not obliged to volunteer information to the insurers in the absence of inquiry. The construction of art. 16 par. 1 is affirmed by the SPC in the Interpretation II.³⁶⁹ The burden of proof as to the scope and content of the inquiries rests upon the insurer.³⁷⁰ Hereinafter such a duty will be referred to as the duty of making an honest representation.

In practice, the key problem in performing the duty not to misrepresent is that, for most non-marine insurance contracts, the applicants are required to complete an application form, in which they are asked to answer accordingly, in good faith, all questions arose by the insurer. Notably, a common problem arose at this point in determining on whether or not the duty has been satisfied is the open-ended question that exists in the standard application form of

³⁶⁸ Published on March 17th, 2011

³⁶⁹ The Interpretation II, art. 6 para. 1

³⁷⁰ *ibid*

certain types of insurance policies. A classic open-ended question, which is generally phrased as “any other information or circumstances related to the matter mentioned above”, appears normally in the last section of a clause of insurance contracts, such as a question related to medical history in a life insurance policy. It may give rise to difficulties and complications in legal practice. What has happened to Mr Bai in *Yong BAI v China Life Insurance (Group) Co Shanghai Sub-office*³⁷¹ is a classic example of the kind.

3.3.2.1.1 *Yong BAI v China Life Insurance (Group) Co Shanghai Sub-office*

On December 10th 1996, Mr Bai, known as the proposer and the assured, sought a life insurance policy with three special extraneous risks against Medicaid plus an additional cover against hospital care expenses from China Life Insurance (Group) Co. Shanghai Branch (the “CLSH”), which covered the cost of his hospitalisation and that of his medical treatment expenses. The period covered in the insurance policy is one year. The policy was then renewed afterwards. In the policy, there is a Health Condition Clause in which it provided ten types of diseases listed in section (a) to (i) with an open-ended question in relation to his medical history contained in section (j) – the last section of the Health Condition Clause. The assured had had medical treatments for 60 days due to duodenal ulcer (with haemorrhage), which was not listed in section (a) to (i), from 9th June to 7th August 1998. Consequently,

³⁷¹ [2000] Hu (Shanghai) Yi Zhong (the No. 1 Intermediate People’s Court) Min (civil) Zhong (final) Zi (report) No. 1722

the assured made a claim to CLSH against ¥4,486.92 medical expenses, but was declined by the insurer on the ground of the failure to comply with his obligation set out in IAC 2015 art. 16 par. 1. The court of first instance held that the applicant had fully complied with the duty as duodenal ulcer was not expressly listed in the health condition clause. Thus, the insurer is obliged to pay the claim. The appeal court overrode the decision and held that duodenal ulcer is considered to be included in section (j), the open-ended question, of the Health Condition Clause. Given that the assured knew clearly that he had serious duodenal ulcer owing to his persistent pain over the last twenty years and his long-term prescription, even though it was prescribed in 1988, the assured deliberately kept back his medical history; thereby the assured is not entitled to the claim.

3.3.2.1.2 Trial guidance on performance of open-ended questions

The issue of open-ended questions had increasingly caught Chinese courts' attention. As early as 2004, Beijing High People's Court made it clear in its 'Court Hearing Guidance on 'A Number of Issues Concerning Insurance Disputes (Trial)' that any provision designed to cover open-ended questions in an insurance proposal form, which is to be phrased as "other [circumstances relating to the matter mentioned above]" shall be deemed invalid as a result of that open-ended questions violate the "limited duty of disclosure"³⁷², namely the assured is only required to answer specific questions made by the insurer in

³⁷² The duty to provide honest statements in responding to questions asked by the insurer is also known as the "limited duty of disclosure".

good faith. In 2011, Shandong High People’s Court adopted a similar approach in its ‘Court Hearing Guidance on Insurance Disputes (Trial)’,³⁷³ *inter alia*, art.4 para.2 provides that any open-ended questions stated in the Inquiry Form or Information Notice using the term “others” or “besides [the above mentioned]” are deemed to be that no question has ever being asked. High people’s courts in other provinces had nevertheless been reluctant to deal with such an issue in implementing art. 16 par. 2 of IAC 2015. Apparently, the inconsistency will lead to legal uncertainty in practice as the insured may face a totally opposite decision in different regions of China, and Mr Bai would indeed have been paid should the case be heard in Beijing instead of Shanghai. The legal uncertainty brought by the inconformity of the laws did not resolve until, in 2013, the problem was eventually recognised by the Supreme People’s Court. In the Interpretation II, the SPC indicates that in the event that the insurer seeks to rescind the insurance contract on the ground of misrepresentation by the assured in answering a generalised question – questions arose by the insurer has to be clear and specific – contained in the Inquiry Form, the people’s courts shall not uphold. The issue of open-ended questions in the context of a consumer insurance contract under English law is considered in Chapter 8.

3.3.2.1.3 Incontestability provision

A more important change made by the 2009 Amendment, and preserved by IAC 2015, in respect with the duty of representation was the addition of the

³⁷³ Published on March 17th, 2011

incontestability provision. Art. 16 par. 3 provides two time limits on the insurer's right to rescind the contract upon an insured's misrepresentation: (1) at least thirty days from the day when the insurer knows the cause of rescission, or (2) at least two years from the date of contract formation. These changes are intended to prevent insurers from abusing their right to terminate policies and create new incentives for insurers to be diligent when underwriting new business.³⁷⁴ However, it is not clear if the provision equally applies to property insurance while it applies to life insurance.³⁷⁵ In England, incontestability clause is often used in life insurance.³⁷⁶

3.3.2.2 “Substantially correct”

Every representation must be “substantially correct”, if as to a matter of fact.³⁷⁷ That is expressed in the new regime of 2015 Act. IA 2015 s. 7(5), restating s. 20(4) of the MIA 1906, provides that “A material representation is substantially correct if a prudent insurer would not consider the difference between what is represented and what is actually correct to be material.” It is clear that a literally correct but nevertheless highly misleading statement made by the assured towards a clear and specific question is to be regarded as a misrepresentation.³⁷⁸ In *Commonwealth Insurance Company of Vancouver v Groupe Sprinks SA and Compagnie Française d'Assurances Européenes and*

³⁷⁴ Zhen JING, *Chinese Insurance Contracts: Law and Practice* (Informa 2017) 272

³⁷⁵ *ibid*, 273

³⁷⁶ R. Merkin, *Colinvaux's Law of Insurance* (11th edn, Sweet & Maxwell 2017) at 7-213

³⁷⁷ Insurance Act 2015, s. 3(3)(c).

³⁷⁸ R. Merkin, *Colinvaux's Law of Insurance* (11th edn, Sweet & Maxwell 2017) at 7-071

Others,³⁷⁹ the broker for the plaintiff proposer stated that the gross ratio on the previous year's quota share reinsurance stood at 69.30 per cent settled with 20.65 per cent outstanding, but that these figures failed to take account of the fact that 10 per cent of the income on the reinsurance was still to be received. The broker therefore effectively represented the gross loss ratio to be 85 per cent, while in fact figure was 108 per cent. Lloyd J held that the difference between the represented and actual information was not material, and that the representation was therefore substantially correct. There is no single test for the correctness of a statement. Whether or not a representation made by the assured is "substantially correct" is to be assessed "in the context of the custom and practice of the trade to which it relates."³⁸⁰ Thus in *Iron Trades Mutual Insurance Co Ltd and Others v Companhia de Seguros Imperio*³⁸¹, Hobhouse J held that whilst a representation that the cedant's retained line under a retrocession was 50 per cent when in fact it was 6.5 per cent was material, where the retention was in fact 40 per cent the misrepresentation was not material.

3.3.2.3 "Expectation or Belief"

S. 3(3)(c) of IA 2015, restating Marine Insurance Act 1906, s. 20(5), provides that every material representation as to a matter of expectation or belief must be made in good faith. This reflects the common law rule that if the assured is

³⁷⁹ [1983] 1 Lloyd's Rep 67

³⁸⁰ R. Merkin, *Colinvaux's Law of Insurance* (11th edn, Sweet & Maxwell 2017) at 7-071

³⁸¹ [1991] 1 LRLR 213

required to state his intention or opinion, the test for falsity is whether or not the assured held that intention³⁸² or opinion.³⁸³ The distinction between a representation of fact and one of belief is a matter of construction.³⁸⁴ In terms of determination of “good faith” in this context, the Law Commission suggested that the representation might be made in good faith, if the relevant information did not reveal by a reasonable search.³⁸⁵ However, a representation made merely on a reasonable ground does not suffice, although a reasonable ground³⁸⁶ is necessary.

3.3.2.4 Warranties and representations

The common law allowed a representation to be converted into warranties, regardless the misstatement is material or not.³⁸⁷ That practice continued operating in the business insurance world after its abolition in the consumer realm in 2012. With the birth of the Insurance Act 2015, the basis of the contract clause has now officially stepped down from the stage of history. The necessary measure is provided in IA 2015 s. 9, repeating the equivalent provision applicable to consumer insurance in CI(DR)A 2012 s. 6. Details are provided in that context in Chapter 8.

9 Warranties and representations

³⁸² *Gan Insurance Co Ltd v Tai Ping Insurance Co Ltd (No.2)* [2001] Lloyd's Rep IR 667.

³⁸³ *Bisset v Wilkinson* [1927] AC 177; *Eagle Star Insurance Co Ltd v Games Video Co (GVC) SA, (The Game Boy)* [2004] EWHC 15 (Comm).

³⁸⁴ Law Commission, *Insurance Contract Law: Business Disclosure; Warranties; Insurer's Remedies for Fraudulent Claims; and Late Payment* (Law Com No 353, 2014) para 7.48

³⁸⁵ *ibid* para 7.53

³⁸⁶ *ibid* para 7.57

³⁸⁷ *Dawsons Ltd v Bonnin* [1922] 2 AC 413, 1922 SC (HL) 156

(1) This section applies to representations made by the insured in connection with –

(a) a proposed non-consumer insurance contract, or

(b) a proposed variation to non-consumer insurance contract.

(2) Such a representation is not capable of being converted into a warranty by means of any provision of the non-consumer insurance contract (or if the terms of the variation), or of any other contract (and whether by declaring the representation to form the basis of the contract or otherwise).

In accordance with s. 16(1) of the IA 2015, the parties cannot contract out of the prohibition on basis of the contract clauses. However, it is still possible for the insurer to use warranties of past or present fact, but they must be included specifically in the contract.³⁸⁸ It is to be noted at this point that if a warranty is included in a policy, then it is subject to the provisions of ss. 10 and 11 of the IA 2015.

3.3.3 Remedy for breach of the duty of fair presentation

In China, the insured's state of mind requirement was introduced by the 2009 Amendment. The purpose is to limit the ability of insurers to unilaterally terminate policies, effectively increased feasibility of sound underwriting practices. Art. 16 pars. 4-5 of the 2009 Amendment provides that the insurers

³⁸⁸ Law Commission, Insurance Contract Law: Business Disclosure; Warranties; Insurer's Remedies for Fraudulent Claims; and Late Payment (Law Com No 353, 2014) paras 15.3 & 16.11

can only rescind the contract where insureds intentionally made material misrepresentation, and breach the duty of honest representation through gross negligence, and the misstatement made thereon would have had an impact on the insurer's decision to underwrite the risk or set the premium. Previously, mere negligent omission of such information by the insured was sufficient to trigger the insurer's right to rescind the insurance contract.³⁸⁹ This provision stays untouched in the Insurance Act of PRC 2015.

At common law, the assured's state of mind was irrelevant. Since IA 2015, it is no longer the position. The 2015 Act adopted a proportionate approach based on degrees of culpability of the insured, which expressly stated in ss. 8(4)-(5) as follow:

(4) A qualifying breach is either –

(a) deliberate or reckless, or

(b) neither deliberate nor reckless

(5) A qualifying breach is deliberate or reckless if the insured –

(a) knew that it was in breach of the duty of fair presentation, or

(b) did not care whether or not it was in breach of that duty.

This reflects the approach set out by s. 5(1) of 2012 Act, namely, classification of qualifying misrepresentations. By s. 8(6), it is for the insurer to show that a

³⁸⁹ Insurance Act of PRC 1995, art.17 para 4, provided that Where the proposer fails to perform the obligation of making an honest disclosure negligently, materially effecting the occurrence of an insured incident, the insurer shall not be liable for paying indemnities or insurance money for the insured incident occurring prior to the rescission of the contract, but shall return the insurance premium. Art.17 remained untouched in 2002 Amendment.

qualifying breach was deliberate or reckless, while, on the other side, the insured is going to prove that they were not being deliberate or reckless in providing information.³⁹⁰ Remedy for a deliberate or reckless qualifying breach is set out in Schedule 1 para.2 as follow:

Schedule 1

“2 If a qualifying breach was deliberate or reckless, the insurer –

- (a) may avoid the contract and refuse all claims, and
- (b) need not to return any of the premiums paid.”

IA 2015 confines the common law automatic right of avoidance to deliberate or reckless breaches of duty. The Law Commission have suggested that a deliberate breach of the duty of fair presentation could involve intentionally: refraining from disclosing a circumstances which the insured knows to be material; making a data dump or otherwise presenting risk in a particular way in order to conceal certain information (as in the case where a summary is very misleading); or lying about a material representation, either in the initial presentation or by knowingly giving a false response to an insurer enquiry.³⁹¹ Recklessness indicates circumstances where the insured “did not care” whether the statement is true or false, but the phrase “did not care” does not refer to “careless” actions, but to a “greater degree of culpability than acting ‘carelessly’”.³⁹² “Deliberate and reckless” will include fraudulent behaviour.³⁹³ As

³⁹⁰ R. Merkin, *Colinvaux's Law of Insurance* (11th edn, Sweet & Maxwell 2017) at 7-198

³⁹¹ Law Commission, *Insurance Contract Law: Business Disclosure; Warranties; Insurer's Remedies for Fraudulent Claims; and Late Payment* (Law Com No 353, 2014) para 11.43.

³⁹² Explanatory Notes to the Insurance Act 2015, para 80.

³⁹³ *Ibid.*

to meaning to the question of what a deliberate or reckless should be left to the courts, applying common law principles.³⁹⁴

Where the breach is neither reckless nor deliberate, the remedies set out in IA 2015 are less draconian. They are intended to be proportionate and to reflect what the insurer would have done if he had known the undisclosed information or the misrepresentation at the conclusion of the contract. If the insurer is unable to show a deliberate or reckless breach, it may only refuse the claim in its entirety and avoid the policy if it can show that he had been induced, and therefore would not have written the policy at all. If the insurer would have written the policy only on different terms and/or charged a higher premium, the contract is treated as entered into on those terms or the claim is reduced proportionately in line with the higher premium. One thing that is worth noting at this point is that “if there would have been a contract but on different terms, the insurer is entitled to the benefit of those different terms, but that may not give the insurers a defence to the claim in question if the loss was entirely unrelated to the terms to be added”.³⁹⁵ Under CI(DR)A 2012, innocent insured has a good claim and negligent insured has a proportionate remedy. IA 2015 does not draw such a distinction between honest breaches and negligent breaches. Thus innocent breach of the duty of fair presentation under IA 2015 would result in a reduction of the amount paid out on the claim.

³⁹⁴ Law Commission, *Insurance Contract Law: Business Disclosure; Warranties; Insurer’s Remedies for Fraudulent Claims; and Late Payment* (Law Com No 353, 2014) para 11.45.

³⁹⁵ R. Merkin, *Colinvaux’s Law of Insurance* (11th edn, Sweet & Maxwell 2017) at 7-200.

3.3.4 Contracting Out

In contrast with position of consumer insurance, parties is entitled to agree terms which are less favourable to the insured than those set out in the 2015 Act subject to certain transparency requirements set out in s. 17. Restrictions to the use of contract terms in relation to business contract and other non-consumer contracts of insurance are prescribed in s. 16 of the IA 2015. Other provisions of the 2015 Act can be contracted out but only if:

- the insurer takes sufficient steps to draw the disadvantageous term to the attention of the insured (or its broker) before the contract is entered into or the variation agreed;³⁹⁶ and
- the disadvantageous term must be clear and unambiguous as to its effect in the contract.³⁹⁷

Thus, it will not be possible for insurers to avoid provisions of IA 2015 by introducing a simple additional clause into their policy documentation excluding the application of the 2015 Act without bringing it to the insured's attention. "Sufficient steps" depend on the characteristics of the insured and the circumstances of the transaction,³⁹⁸ as steps that are sufficient for one insured may not necessarily be sufficient for another. The Law Commission has explained further in different scenarios that additional steps by the insurer would be needed where a small business purchases insurance online but, conversely,

³⁹⁶ Insurance Act 2015, s. 17(2).

³⁹⁷ Insurance Act 2015, s. 17(3).

³⁹⁸ Insurance Act 2015, s. 17(4).

more leniency will be allowed where a sophisticated insurance buyer purchases cover through Lloyd's. The more lenient approach applies where a broker is involved, even if the insurance buyer is unsophisticated.³⁹⁹

3.3.5 Good Faith

Section 14(1) of the Insurance Act 2015, reshaping the section 17 of the Marine Insurance Act 1906, provides that any law permitting an insurer to avoid a policy on the basis that the duty of utmost good faith had not been observed by the other party has been abolished. Thus a breach of the duty utmost good faith can no longer give rise to the remedy of avoidance. In other words, any rule of law, including s. 17 of MIA 1906 and any other similar provisions with the same effect, which would have entitled the insurer to avoid the contract for breach of utmost good faith, can no longer be relied upon. The duty of good faith is now concerned to be a general interpretative principle,⁴⁰⁰ and to that extent the contracts of insurance remain contracts of utmost good faith.⁴⁰¹ As noted throughout this chapter, it was noted that insured's pre-contractual duty to disclose and not to misrepresent, which transformed under IA 2015 as an independent duty of fair presentation, has been pulled away from the general concept of utmost good faith. Thus the removal of the avoidance remedy from s. 17 of the MIA 1906 by IA 2015 s. 14 – meaning there is no alternative remedy – places utmost good faith in a brand-new position to play a more flexible role in

³⁹⁹ Law Commission, Insurance Contract Law: Business Disclosure; Warranties; Insurer's Remedies for Fraudulent Claims; and Late Payment (Law Com No 353, 2014) paras 29.62-29.67

⁴⁰⁰ *ibid* paras 30.22-30.24

⁴⁰¹ Insurance Act 2015, s. 14(2).

relation to the insurer's pre-contractual duties and the post-contractual conduct of both parties. The further operation of utmost good faith remains uncertain and will likely need to be tested in court proceedings to better understand how it will be interpreted and applied to different scenarios.

3.3.6 The Third Parties (Right Against Insurers) Act 2010

The Third Parties (Rights against Insurers) Act 2010 (the TPRAIA 2010 or the 2010 Act), intended to enable victims of wrongdoers (third parties) to proceed directly against insurers of liabilities in the case where the insured has become insolvent by removing the restoration requirement, received Royal Assent on March 25, 2010; but has not yet come into force due to a number of technical deficiencies. The 2015 Act rectifies the deficiencies, namely, amended the definition of the "insured" and, more specifically the type of insolvency event which the insured must undergo in order to trigger the application of the 2010 Act.⁴⁰² Thus, the TPRAIA 2010 is up to date with all changes known to be eventually in force on August 1, 2016.⁴⁰³

⁴⁰² The Third Parties (Rights against Insurers) Act 2010, part 6, ss. 19-20

⁴⁰³ <<https://www.gov.uk/government/news/changes-to-the-third-parties-rights-against-insurers-act-2010>> assessed 9 Dec 2017

Chapter 4 Business Insurance: Materiality and Inducement

4.1 Materiality and inducement

The Marine Insurance 1906 referred only to the test of materiality. Inducement, as the second limb of the test, was added by the decision of the House of Lords in *Pan Atlantic Insurance Co Ltd v Pine Top Insurance Co Ltd*.⁴⁰⁴ Now both tests have been codified in the new business insurance regime of Insurance Act 2015.

4.2 Materiality

It has always been a crucial qualification to the right to avoid a contract of insurance, that the breach of the duty of utmost good faith, now as the duty of fair presentation, was “material to the risk”.⁴⁰⁵ Prior to 12th August 2016, the central element of utmost good faith was Section 18 of Marine Insurance Act 1906, in which it places an onerous duty on the assured to volunteer to the insurer every material fact which the assured known or ought to know in the ordinary course of business before concluding an insurance contract. Every circumstance is material if it would influence the judgment of a hypothetical prudent insurer in fixing the premium, or determining whether he will take the risk.⁴⁰⁶ Thus, the meaning of materiality as it is applied to insurance contracts is inextricably tied to a standard of prudence. Materiality is tested by reference to the mind of a hypothetical prudent insurer, which had been widely criticised on

⁴⁰⁴ [1994] 3 All ER 581

⁴⁰⁵ ss. 18 and 20 of the MIA 1906; *Container Transport International Inc. v Oceanus Mutual Underwriting Association (Bermuda) Ltd* [1984] Lloyd’s Rep 476; *Pan Atlantic Insurance Co Ltd v Pine Top Insurance Co Ltd* [1995] 1 A.C. 501; S 13 of the Insurance Contract Act 1984 (Australia);

⁴⁰⁶ Marine Insurance Act 1906, s. 18(2)

the basis that the assured has little idea about the mind of a hypothetical prudent insurer in assessing the risk.⁴⁰⁷ Consequentially, the Law Commission introduced a new test of materiality in its first Consultation Paper in 2007, in which the “prudent insurer” was replaced with a “reasonable insured”. Instead of asking whether the information was something that would influence the judgement of a prudent insurer, the question became what a reasonable insured in the circumstances would consider to be relevant to the insurer. It was, however, recognised that this approach would bring “an unknown and untested concept” which did not materially assist given the numerous different factual situations and risks.⁴⁰⁸ That proposal was not taken forward. Under the Insurance Act 2015, the test is being continued “to be defined by reference to circumstance which would influence the judgement of a prudent insurer”.⁴⁰⁹

Over the years, the test of materiality has been variously defined in series of cases in common law jurisdictions in the following phrase: something a prudent insurer would have wanted to be aware of;⁴¹⁰ something which would reasonably affect a prudent insurer,⁴¹¹ or at least which has the capacity reasonably to affect a prudent insurer;⁴¹² or something that “has influenced a

⁴⁰⁷ *Joel v Law Union & Crown Insurance Company* [1908] 2 KB 863; *Reynolds v Phoenix Assurance Co Ltd* [1978] 2 Lloyd's Rep 440, 475 (Forbes J).

⁴⁰⁸ Law Commission, *Insurance Contract Law: Business Disclosure; Warranties; Insurer's Remedies for Fraudulent Claims; and Late Payment* (Law Com No 353, 2014) para 5.48

⁴⁰⁹ *ibid* para 6.5

⁴¹⁰ *Container Transport International Inc. v Oceanus Mutual Underwriting Association (Bermuda) Ltd* [1984] Lloyd's Rep 476; *Pan Atlantic Insurance Co Ltd v Pine Top Insurance Co Ltd* [1995] 1 A.C. 501; *St Paul Fire & Marine Insurance Co. (UK) Ltd v McConnell Dowell* [1995] 2 Lloyd's Rep 116

⁴¹¹ *St Paul Fire & Marine Insurance Co. (UK) Ltd v McConnell Dowell* [1995] 2 Lloyd's Rep 116; *Randall v Atlantica Insurance Co Ltd* (1984) 80 F.L.R. 253; *Barclay Holdings v British National Insurance Co Ltd* (1987) 8 N.S.W.L.R. 514; *Akedian Co Ltd v Royal Insurance Australia Ltd* (1997) 148 A.L.R. 480

⁴¹² *Itohar Pty Ltd v Mackinnon & Commercial Union Assurance Co Plc* (1985) 3 A.N.Z. Ins. Cas. 60-610

reasonable insurer to decline the risk or to have stipulated for a higher premium”;⁴¹³ or something which is determinative of the acceptance or rejection of the risk by a prudent insurer;⁴¹⁴ and one case does not attempt a definition but merely refers to circumstances which are either “obviously material” or not.⁴¹⁵ To summarise, the key point is whether the non-disclosed or misrepresented circumstances would have been taken into account by a prudent insurer when assessing the risk. It seems unnecessary “for the [English] court to distinguish between the various interpretations of the test so minutely examined in the arguments”.⁴¹⁶ Nevertheless it continues to be worth taking a closer look at the leading authorities and Acts⁴¹⁷ together with Chinese approaches with respect of materiality from perspective of a comparative law. Materiality is relevant to both consumer insurance under CI(DR)A 2012 and business insurance under IA 2015. However, the two regimes approach the matter in different ways.⁴¹⁸ The following discussion is therefore focused on business insurance. Materiality as to consumer insurance is considered in that context in chapter 8.

4.2.1 Statutory guidance on materiality in the Insurance Act 2015

The objective test of materiality has been retained by s. 7(3) of IA 2015, in which it has been stated in similar terms that “a circumstance or representation

⁴¹³ *Mutual Life Insurance Co. of New York v Ontario Metal Products* [1925] A.C. 344

⁴¹⁴ *Barclay Holdings v British National Insurance Co Ltd* (1987) 8 N.S.W.L.R. 514 (per Kirby J)

⁴¹⁵ *Visscher Enterprises Pty Ltd v Southern Pacific Insurance Co Ltd* [1981] QD. R. 561

⁴¹⁶ *Pan Atlantic Insurance Co Ltd v Pine Top Insurance Co Ltd* [1995] 1 A.C. 501, 541 (per Mustill LJ)

⁴¹⁷ Marine Insurance Act 1906; Consumer Insurance (Disclosure and Representations) Act 2012; Insurance Act 2015

⁴¹⁸ R. Merkin, *Colinvaux's Law of Insurance* (11th edn, Sweet & Maxwell 2017) at 7-102.

is material if it would influence the judgment of a prudent insurer in determining whether to take the risk and, if so, on what terms.” In IA 2015 s. 7(2), repeating MIA 1906 s. 18(5), the term “circumstance” includes any communication made to, or information received by, the insured. A detailed analysis of the degree of “influence” is considered below. A further discussion of prudent insurer test and differences between Chinese law and English approaches are provided thereafter.

The Insurance Act 2015, for the first time, provides some statutory guidance on materiality. S. 7(4) of the Act lists indicative and non-exhaustive examples, emerging from relevant case law, which may be considered to be ‘material circumstances’ in the following context:

- (a) special or unusual facts relating to the risk;
- (b) any particular concerns which let the insured to seek insurance cover for the risk, and;
- (c) anything which those concerned with the class of insurance and field of activity in question would generally understand as being something that should be dealt with in a fair presentation of risks of the type in question.

The Law Commission expected that the Act will be backed up by industry guidance developed by insurers and insurance buyers, so that insurers, brokers and policyholders could work together to provide further guidance, protocols

and understandings of this type over what a standard presentation of a risk should include in certain circumstances.⁴¹⁹ Perhaps different protocols would cover different types of insurance.⁴²⁰

4.2.2 The test of materiality under Chinese insurance law

In China, the duty of disclosure and the duty not to misrepresent in relation to marine insurance are governed by the Maritime Code of PRC 1993. The Insurance Act of PRC deals only with general insurance policies outside the sector of marine insurance.

4.2.2.1 Non-marine insurance – The Insurance Act of PRC 2015

The definition of materiality as to the non-marine insurance policy is stipulated in art. 16 par. 2 of the IAC 2015, which is stated in the following phrase,

“Where insurance applicants fail to comply with the duty imposed by subsection (1) intentionally or [through] gross negligence (recklessly), which *sufficiently influences* the insurer’s decision on whether or not to take the risk or charge for a higher premium, the insurer is entitled to rescind the contract.”

The test of materiality, first set out by art. 17 par. 2 of the IAC 1995, is being retained in all three subsequent Amendments including the large-scale amendment in 2009 and the latest revision in 2015. There are two things need

⁴¹⁹ Law Commission, *Insurance Contract Law: Business Disclosure; Warranties; Insurer’s Remedies for Fraudulent Claims; and Late Payment* (Law Com No 353, 2014) para 6.41 and 7.30.

⁴²⁰ *ibid* para 7.29.

to be clarified at this point; and both of which are considered thereafter in this chapter. First, it is vague and equivocal on whether the test is a mere influence test or the decisive one; and second, it is also ambiguous whether the insurer defined in this provision is a hypothetical prudent insurer or the actual insurer who in fact entered into the insurance contract with the assured.

4.2.2.2 Marine insurance - Maritime Code 1993

Unlike the Insurance Act of PRC, art.222 par.1 of MC 1993 adopted a different approach. Its English interpretation is as follow,

“... the insured shall truthfully disclose 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 would influence the insurer in deciding the premium or determining whether or not he will take the risk.”

It means that, to constitute materiality, a circumstance which the insured knows or ought to know has to affect the insurer in deciding the premium or determining whether to take the risk. Thus, whether or not a fact amounts to material circumstance is judged by either of the following two criteria, which are, first, whether such a fact makes an impact on the insurers' willingness to insure and if so, on what premium rate. This Section is, to a large extent, a copy of s 18 of Marine Insurance 1906. Consequently, it is worth taking a closer look at common law approaches as to test of materiality in two aspects, in particular,

the degree of influence, and identity of underwriter.

4.2.3 The degree of influence

The insured must disclose material information that he knows or ought to know. Materiality is decided by reference to the judgment of the prudent insurer. Lord Mustill has amplified, at some length, the test of materiality as laid down in ss. 18(2) and 20(2) of MIA 1906 and pursued a “purely verbal analysis” to the words “influence the judgment of prudent insurer in...determining whether he **will** take the risk”. He stated in his judgment,

“To my mind, this expression clearly denotes an effect of the thought processes of the insurer in weighing up the risk, quite different from words which might have been used but were not, such as ‘influencing the insurer **to take the risk**.’”⁴²¹

In this case, it is interesting to see how the English courts would interpret the modified provision “influence the judgment of a prudent insurer in determining whether **to take the risk** and, if so, on what terms” as it is set out in IA 2015, s. 7(3). Given that the 2015 Act has just come into force on 12 August 2016, it is still too early to perorate if the omission of the word “will” might affect the current common law in terms of the test of influence. Other than that, IA 2015 makes no change in the law and indeed to be taken as preserving the common law position described below.⁴²²

⁴²¹ *Pan Atlantic Insurance Co Ltd v Pine Top Insurance Co Ltd* [1995] 1 A.C. 501, 531

⁴²² R. Merkin, *Colinvaux's Law of Insurance* (11th edn, Sweet & Maxwell 2017) at 7-081

The pre-2016 leading authorities as to the test of materiality are *Container Transport International Inc v Oceanun Mutual Underwriting Association (Bermuda)*⁴²³ and *Pan Atlantic Insurance Co Ltd v Pine Top Insurance Co Ltd*⁴²⁴.

While the 1906 Act laid down the guidelines governing materiality of facts in ss. 18 and 20, it failed to address the critical issue, namely, definition of ‘influence’. The degree of influence therefore is limitless as there is no absolute standard in the Act. There are broadly speaking three possibilities: first, the undisclosed information is material which leads to the refusal of the contract; second, the non-disclosure is material which causes the adjustment of the contract terms, especially as to the premium; third, the information is not so material thereby the insurer would have considered it relevant rather than to have refused the contract or insisted on different terms.⁴²⁵ The test has been widely argued about in respect of the term “influence”, of which the meaning to the term received extensive consideration in *CTI v Oceanus*.

4.2.3.1 *CTI v Oceanus* – the “decisive” influence test

An early formulation of the “decisive influence” test was set out by the Supreme Court of Canada in the case of *Mutual Life Insurance Co. of New York v Ontario Metal Products*⁴²⁶ for the purposes of life insurance in the year of 1925. This test

⁴²³ [1982] 2 Lloyd’s Rep 178

⁴²⁴ [1995] 1 A.C. 501

⁴²⁵ Malcolm Clarke, ‘Failure to Disclose and Failure to Legislate: Is it Material? – II’ [1988] JBL, 298-299

⁴²⁶ [1925] A.C. 344, (1925) 1 D.L.R. In *Pan Atlantic Insurance Co Ltd v Pine Top Insurance Co Ltd* [1995] 1 A.C. 501, 539, Lord Mustill quoted that *Mutual Life Insurance Co. of New York v Ontario Metal Products* [1925] A.C. 344 was ‘the most important case by far’.

was later employed by Lloyd J at first instance in *CTI v Oceanus*⁴²⁷ and reaffirmed by him in his dissenting speech in *Pan Atlantic v Pine Top*.⁴²⁸ In *CTI*, the question was whether ‘influence’, resulting from non-disclosure or misrepresentation, on the hypothetical prudent insurer has to be ‘decisive’ for it to be a breach of utmost good faith. Lloyd J held that a circumstance was only material if “the mind of the reasonable insurer must have been influenced so as to induce him to refuse the risk or alter the premium”.⁴²⁹

The Court of Appeal later rejected the stiff test for materiality. Kerr LJ explained further in his judgment as to the interpretation of the meaning of “judgment” referred to in s. 18(2) as “the assessment or evaluation of the risk” – i.e. the prudent underwriter’s thought processes – rather than the “final decision” of a underwriter;⁴³⁰ and defined, quoting particularly, that “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).”⁴³¹

4.2.3.2 *Pan Atlantic v Pine Top* – the “mere” influence test

The rejection of the “decisive influence test” by the Court of Appeal in *CTI v Oceanus* was further affirmed on a bare majority by the House of Lords in *Pan*

⁴²⁷ [1982] 2 Lloyd’s Rep 178

⁴²⁸ [1995] 1 A.C. 501

⁴²⁹ *Container Transport International Inc. v Oceanus Mutual Underwriting Association (Bermuda) Ltd* [1982] 2 Lloyd’s Rep 178, 187-189

⁴³⁰ *Container Transport International Inc. v Oceanus Mutual Underwriting Association (Bermuda) Ltd*

[1984] Lloyd’s Rep 476 (CA), 491-492

⁴³¹ *ibid.*, 492

Atlantic v Pine Top as a result of that such a test placed “an almost impossible task”⁴³² on the shoulder of the prospective assured, before the event,⁴³³ to prognosticate a certain circumstance is material in the eyes of a prudent underwriter when fixing a premium or determining whether to accept the risk. It seems more feasible for the assured to consider circumstances that may be of interest to a prudent underwriter. Given that materiality of a circumstance is a matter of fact in each case, “experienced and prudent underwriters are just as likely... to disagree about what they would want to know as about what they would have done”.⁴³⁴

Further, Lord Mustill concluded the interpretation of the statutory material test in terms of the degree of influence as follows:

“I can see nothing in them [authorities and textbook] to suggest that before 1906 materiality was understood as extending only to such circumstances as would definitely have changed the underwriter’s mind; and they furnish substantial support for the view that the duty of disclosure extended to all matters which would have been taken into

⁴³² *Pan Atlantic Insurance Co Ltd v Pine Top Insurance Co Ltd* [1995] 1 A.C. 501, 531 per Mustill LJ; also in *CTI v Oceanus* [1984] Lloyd’s Rep 476 (CA), 526-527, Stephenson LJ provided two considerations preventing him from adopting the decisive influence test, “*The first, stressed by my brethren, is the practical difficulty, if not impossibility, of deciding what factors would affect the result of a hypothetical prudent insurer’s consideration of a risk, whether to accept it and on what terms; whereas there is no great difficulty in answering the question whether any particular factor would be one which he would want to know and take into consideration in determining whether to accept a risk and on what terms, without having to decide whether he would ultimately disregard it altogether or give it much or little weight. The second consideration is the overriding duty of utmost good faith imposed by s. 17. That duty seems to require full disclosure and full disclosure seems to require disclosure of everything material to the prudent underwriter’s estimate of the character and degree of the risk; and how can that be limited to what can affirmatively be found to be a circumstance which would in fact alter a hypothetical insurer’s decision?*”

⁴³³ *ibid.*, at 531

⁴³⁴ *ibid.*, 558 (Lloyd LJ)

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.”⁴³⁵

The House of Lords held that the correct test for materiality to both marine and non-marine insurance is based on the natural and ordinary meaning of section 18(2) of the 1906 Act, whether a “material circumstance” was one that would have an effect on the thought process of a prudent insurer in weighing up the risk in question.⁴³⁶ The word “influence” in its ordinary meaning did not mean “change the mind of”, therefore a decisive effect on the acceptance of the risk or on the amount of premium is not necessary. The main concern as to the “mere” influence test was as being too favourable to insurers.⁴³⁷ For example, insurers could excise the remedy of avoidance without prejudicing their consent in concluding the contract where underwriters decide to take the risk on the same term after taking the withheld or concealed information into account. One may argue that the threshold is too low and an insurer, who could avoid the insurance contract, was not required to prove that the withholding or misstatement of circumstances in question have had a decisive influence upon the judgment of the prudent underwriter in calculating the premium or in his decision to accept or reject the risk.⁴³⁸ Thus, the House of Lords introduced a further requirement for the insurer to prove that he has been induced to enter

⁴³⁵ *ibid*, 538

⁴³⁶ *ibid*, 517, 530-531, 541, 550-552

⁴³⁷ J. Lowry, P. Rawlings, R. Merkin, *Insurance Law: Doctrine and Principles* (3rd edn, Hart Publishing 2011) 93

⁴³⁸ Howard Bennett, *The Law of Marine Insurance* (2nd edn, OUP 2006) 111

into the contract, if the insurer could avoid. The concept of inducement is provided in detail in the second part of this chapter.

There was strong dissent from Lord Templeman and Lord Lloyd, both of whom suggested that nothing could be construed as being decisive if the insurer would not have acted differently.⁴³⁹ In other words, a circumstance is not material if it would not have affected acceptance of the risk or the amount of the premium. It is precisely not an easy task, in practice, to determine the status of the insurer's belief, given the increasing number of contested cases of non-disclosure after the decision of *CTI v Oceanus*.⁴⁴⁰ Lloyd LJ analysed the phrase word-by-word and stated in his judgment that "the ordinary meaning of 'influence' is to affect or alter."⁴⁴¹ The difficulty arises here is the problem of proof, especially when there is conflicting expert testimony, therefore it will always be for the court to decide what evidence to accept. The Court seems to have opted for proof as an expedient measure merely because that a prudent underwriter would want to have known about the circumstance and not that the non-disclosure or misrepresentation would have led to a different decision or have had a decisive influence on the prudent insurer.⁴⁴²

4.2.3.3 The undefined degree of influence in China

Clearly, the IAC 2015, so far as the degree of influence is concerned, failed to

⁴³⁹ *Pan Atlantic Insurance Co Ltd v Pine Top Insurance Co Ltd* [1995] 1 A.C. 501, 515 & 564

⁴⁴⁰ *ibid* 558 (Lloyd LJ)

⁴⁴¹ *ibid* 559 (Lloyd LJ)

⁴⁴² Howard Bennett, *The Law of Marine Insurance* (2nd edn, OUP 2006) 111

clarify whether the phrase “sufficiently influence” referred to in art. 16 par. 2 presents the “decisive influence” test or the “mere influence” test. Theoretically, pursuant to the Contracts Act 1999, without knowing the non-disclosed or misstated facts insurers would highly likely enter into the contract against his true willingness.⁴⁴³ Thus, it is generally accepted that the meaning of this Article is that the insurer must prove, before the contract is rescinded, that he would not underwrite the same risk or will do so only with a higher premium had he known the fact concealed or withheld by the proposer. The burden is upon the insurer. Compare to the common law approaches, it seems that the phrase “sufficiently influence the insurer’s decision”, in its ordinary meaning, literally leads to the “decisive influence” conclusion, which has further been confirmed by regional courts in the implementation of the Insurance Act. For example, both Guangdong and Zhejiang High People’s Courts emphasised, in their Guidance as to Adjudication of Insurance Disputes⁴⁴⁴, a circumstance is material if it would influence the judgment of an insurer decisively in fixing the premium or determining whether he will enter into the same contract.

With regards to the assured’s duty of disclosure laid down in art.222 of MC 1993, the term “influence” is left unadorned. Despite absence of indication in the provision as to the degree of influence, it is evident that without the term “sufficiently”, the information is material if it is of interest to the underwriter, not whether it would have had any form of influence on his decision. In spite of the

⁴⁴³ Contract Law of People’s Republic of China art. 54 para. 2

⁴⁴⁴ Article 6, Yue (Guangdong) Gaofa (High Court) [2011] No. 44

ambiguity in statutory legislation and the lack of authoritative judicial interpretation concerning this issue, many Chinese scholars, however, are in favour of the “decisive influence” test⁴⁴⁵ with various reasons. A pertinent observations is that the “decisive influence” test is consistent with the general contract law principle in which contracts can only be rescinded in cases of radical breach. In other words, if the concealed or misrepresented circumstances are the influential factors to the decision as to whether to take the risk or to the assessment of the rate of the premium, non-disclosure is considered, in this case, to be a “material” breach of contract. In *Chenco International Inc v China Pacific Insurance Co., Shanghai Branch*,⁴⁴⁶ regarding a vessel insurance contract, Shanghai Maritime Court has adopted the approach of “decisive influence” and held that any circumstance is to be material if it increased the risk insured, thereby the underwriter would have charged a higher premium. A similar proposition was once provided by Lloyd J in *CTI v Oceanus*,⁴⁴⁷ and was rejected by Steyn LJ in the Court of Appeal in his principal judgment of *Pan Atlantic v Pine Top*.⁴⁴⁸ Steyn LJ clarified the test employed in the former in an important respect, namely, not every fact which an underwriter might wish to take into account was material; only those facts which might “increase the risk”, or make it a different risk from that which the underwriter had

⁴⁴⁵ Tingzhong FU, ‘Re-study on assured’s duty of disclosure’ (2012) 1 Chinese Journal of Maritime Law 32.

⁴⁴⁶ (1997) Hu(Shanghai) Hai Fa(Maritime Court) Shang) No. 486.

⁴⁴⁷ [1982] 2 Lloyd’s Rep 178. This approach was rejected in the Court of Appeal and it was held that it was only necessary to ask whether, in the words of Kerr LJ, there was a “fair and substantially accurate presentation of the risk proposed for insurance, so that a prudent insurer could form a proper judgment”. [1984] 1 Lloyd’s Rep 476, 496-497.

⁴⁴⁸ [1993] 1 Lloyd’s Rep 496 (CA).

agreed to accept, were material.⁴⁴⁹ Nevertheless, this test was not mentioned by the House of Lords. The House of Lords, however, confirmed the objective nature of the test laid down in *CTI v Oceanus*⁴⁵⁰ for the purposes of assessing materiality, along with the introduction of an extra, subjective, element of actual inducement to the insurer.

In fact, the mind of an insurer could be influenced by many factors such as market fluctuations, economic aims, and political elements when assessing a risk. Thus the universal standard of the decisive influence test is practically problematic. To meet the materiality requirement is certainly not an easy task for the insurer as the Chinese courts usually have sympathy for the assured. The Courts have held that the sailing date⁴⁵¹ and the carrying vessel⁴⁵² are not deemed to be material circumstances.

4.2.4 Identity of the insurer

In China, neither Insurance Act of PRC including its amendments, nor Maritime Code of PRC clarifies whether the term “insurer” as referred to in the articles denotes as a hypothetical “prudent insurer” or an “actual insurer”. For a long time, the formulation of “prudent underwriter” test has been widely discussed theoretically by Chinese scholars. In Art.9 of the ‘Answers to Practical Issues of

⁴⁴⁹ *ibid* 505-508

⁴⁵⁰ [1984] Lloyd’s Rep 476 (CA).

⁴⁵¹ See *Nanjing Resources Group v. Tian An Insurance Co Ltd*, Wuhan Maritime Court case no. (2000) Wu Hai Fa Shang Zi Di, at 91.

⁴⁵² See *Ningbo Liangyou v. PICC P&C Shanghai*, Shanghai Maritime Court case no. (1998) Hu Hai Fa Shang Chu Zi 539. This case was upheld by the higher court with case no (1999) Hu Gao Jing Zhong Zi 612.

Maritime and Admiralty Trials concerning Foreign Affairs’, the Supreme People’s Court of China clarified that the insured, in a contract of marine insurance, must disclose to the insurer, before the contract is concluded, material circumstances which affect the judgment of a prudent insurer in fixing the premium or determining whether to take the risk. By contrast, there is no clear indication made for general insurance contracts as to the identity of the insurer. It is nonetheless that the definition of “prudent insurer” is omitted from the acts, marine or non-marine.

Unlike the Chinese statutes, the phrase “prudent insurer” was set out by ss. 18(2) and 20(2) of Marine Insurance Act 1906. However, that English statute was also silent on what is meant by prudent insurer. The same approach is adopted by Marine Insurance Act 1909 in Australia. By contrast, another Australian statute – the Insurance Contract Act 1984, instead of the long-established common law prudent insurer test for what must be disclosed, adopted the “reasonable assured” test.⁴⁵³ The utility of the “prudent insurer” test and that of the “reasonable insured” test are widely discussed in various cases across different jurisdictions such as England and Australia. A detailed analysis as to the two seminal tests is provided in the following paragraphs.

4.2.4.1 The “reasonable insured” test

In Australia, the ICA 1984 has dramatically altered the law on misrepresentation, in particular by abolishing the long-established common law test of prudent

⁴⁵³ The Insurance Contract Act 1984, s. 21(A)(5)(b)(ii).

underwriter. Instead, it is replaced with a reasonable insured test which echoes the test applicable to disclosure, which was found working well in the Australian market up until 2005.⁴⁵⁴ Then the Review Panel, in the final report on the review of the ICA 1984, have noted that the main criticism is that it put an unreasonable burden on insured by the expectation of knowledge as to what the insurer regards as relevant. Since 2006, two Bills have been proposed to amend s. 22 of the 1984 Act and to clarify how the test should be applied, though neither has been enacted.

At one time, particularly as regards life insurance, the English courts were attempted to modify the test of materiality, by substituting the test of prudent assured's opinion, for that of the prudent underwriter.⁴⁵⁵ For example, the approach adopted by Fletcher Moulton LJ in *Joel v Law Union and Crown Insurance Co*,⁴⁵⁶ when considering the measure of the insured's duty of disclosure, proceeds on the basis that "if a reasonable man would have recognised that the knowledge in question was material to disclose, it is no excuse that you did not recognise it." Accordingly, the question should be whether a reasonable man in the position of the insured ought to have realized that the alleged facts were material to the risk. The assureds obtain benefits from this test in at least two aspects: it considers, first, the actual knowledge of the insured; and second, the difficulties the assureds are facing when considering whether a circumstance would be considered material in the eyes

⁴⁵⁴ R. Merkin, *Reforming Insurance Law: is there a case for reverse transportation?* – A report for the English and Scottish Law Commissions on the Australian Experience of insurance law reform.

⁴⁵⁵ *Colinvaux & Merkin's Insurance Contract Law*, vol 1, para A-0698

⁴⁵⁶ (1908) 99 LT 712.

of the insurer. The latter was discussed again by Lord Justice Mustill during his leading judgment in *Pan Atlantic v Pine Top*.⁴⁵⁷ Even though the test adopted by Mustill LJ was the prudent insurer mere influence test, he recognised that:

[i]t is not the court after the event, but the prospective assured and his broker before the event, at whom the test is aimed; it is they who have to decide, before the underwriter has agreed to write the risk, what material they must disclose.

The “reasonable man” test was considered again in *Horne v Poland*⁴⁵⁸ by Lush J, in which he embraced the two tests with no clear line drawn between the view of a reasonable assured and that of a prudent underwriter.⁴⁵⁹ In 1975, the “reasonable assured” test suffered a fatal blow from the Court of Appeal in *Lambert v Co-operative Insurance Society Ltd*⁴⁶⁰. Here, it was clarified that the definition of materiality, irrespective of the kind of risks, is rested with the influence to the judgment of a prudent insurer after re-examination of the necessity for introducing reasonable insured test to different types of risks. This approach has not been followed in more recent cases in England.⁴⁶¹

In 2007, the Law Commissions proposed the same approach to replace the problematic prudent insurer test with a more flexible test based on the mind of a reasonable insured considering variety of policyholders in so many different

⁴⁵⁷ *Pan Atlantic Insurance Co v Pine Top Insurance Co* [1995] 1 A.C. 501

⁴⁵⁸ [1922] 2 K.B. 364, [1922] Lloyd's Rep 275

⁴⁵⁹ *Lamber v Co-operative Insurance Society Ltd* [1975] 2 Lloyd's Rep 485 (CA) 490

⁴⁶⁰ [1975] 2 Lloyd's Rep 485 (CA)

⁴⁶¹ *Colinvaux & Merkin's Insurance Contract Law*, vol 1, para A-0698

situations.⁴⁶² With regard to the extent of the knowledge of a reasonable insured, it would count with the knowledge of the broker. Further, although it was made clear in the Consultation Paper that definition of materiality depends upon the objective view of a reasonable person in the position of the insured in question, the Law Commission expected the courts to take into consideration in the proceedings other ingredients such as professional advice received from intermediaries and insurer's explanations, quoting particularly that "this evidence may be given by a range of experienced professionals, including insureds, brokers or underwriters."⁴⁶³ This proposal proved more controversial than the prudent insurer test set out originally in Marine Insurance Act 1906. The flexibility brought great uncertainties to the then current law in assessing the mind of a reasonable man in the circumstance of the insured in question. The main argument against the reasonable insured test is that as there was no paradigm of reasonable insured can be recognised in the insurance market, judges would substitute their own version of the test. Moreover, whether or not a broker is involved in the business transaction and difficulties of obtaining expert evidence would leave the trial judge a very wide discretion in each case.⁴⁶⁴ "This reduced the justification for introducing such a fundamental reform",⁴⁶⁵ and the reasonable insured test did not move any further.

⁴⁶² Law Commission, *Insurance Contract Law: Misrepresentation, Non-disclosure and Breach of Warranty by the Insured* (Law Com CP No 182, 2007) paras 5.83, 12.31 and 5.68-5.69

⁴⁶³ Law Commission, *Insurance Contract Law: Misrepresentation, Non-disclosure and Breach of Warranty by the Insured* (Law Com CP No 182, 2007) para 5.73

⁴⁶⁴ *ibid* paras 4.64-buyer

⁴⁶⁵ Law Commission, *Insurance Contract Law: Business Disclosure; Warranties; Insurer's Remedies for Fraudulent Claims; and Late Payment* (Law Com No 353, 2014) para 5.47

The “reasonable insured” test is arguably unfeasible in common law jurisdictions in several ways. Difficulties will certainly arise where expert evidence provided by the reasonable insureds, depending on availability, considerably distinguish from that given by brokers or underwriters. Thus, it would not be an easy road ahead to apply such a test in China. “It would take time for judges to develop a consistent approach, and during this time it would be even more difficult to advise businesses about what they were expected to disclose”.⁴⁶⁶

4.2.4.2 The “prudent insurer” test

The prudent insurer test, operating in common law in determining the materiality of a circumstance undisclosed or misrepresented, was first formulated by Blackburn J in *Ionides v Pender*⁴⁶⁷ in England. The essential purpose of the test was to establish an objective test of materiality of the withheld or misstated circumstances, thus the subjective views of the particular insurer is irrelevant.⁴⁶⁸ With absence of a statutory definition, Atkin J however, imposed a standard of prudence in the case of *Associated Oil Carriers Ltd v Union Insurance Society of Canton Ltd*,⁴⁶⁹ in which he stated,

⁴⁶⁶ *ibid* para 5.48

⁴⁶⁷ (1874) LR 9 QB 531, at 583; also see J. Lowry, P. Rawlings and R. Merkin, *Insurance Law: Doctrine and Principles* (3rd edn, Hart Publishing 2011) 89, footnote 36

⁴⁶⁸ *Container Transport International Inc. v Oceanus Mutual Underwriting Association (Bermuda) Ltd* [1984] Lloyd’s Rep 476; *Pan Atlantic Insurance Co Ltd v Pine Top Insurance Co Ltd* [1995] 1 A.C. 501, at 557, per Lloyd LJ; also see J. Lowry, P. Rawlings and R. Merkin, *Insurance Law: Doctrine and Principles* (3rd edn, Hart Publishing 2011) 89

⁴⁶⁹ [1917] 2 KB 184, 192. The prudent underwriter has been described as no more than the anthropomorphic conception of standards of professional underwriting which the court finds it appropriate to uphold: *St Paul Fire & Marine Insurance Co (UK) Ltd v McConnell Dowell Constructors Ltd* [1996] 1 All ER 96, 104.

“I think that [the alleged] standard of prudence indicates an under-writer much too bright and too good for human nature’s daily food. There seems no good reason to impute to the insurer a higher degree of knowledge and foresight than that possessed by the more experienced and intelligent insurers carrying on business at that time . . . [If] the standard of prudence is the ideal one contended for . . . there were in July 1914, no prudent insurers in London, or if there were, they were not to be found in the usual places where one would seek for them.”

Under the prudence standard provided in this paragraph, the prudent insurer will be the one that “possessed by the more experience and intelligent” acting with care, skill set and diligence under the circumstances, rather than an omnipotent underwriter that stays above such humanlike constraints. Therefore, “in assessing what is objectively material, it may be necessary for a comparison to be made with other insurers in the market who operate the same approach to underwriting and risk assessment. Although the test is expressed objectively, it may also be necessary to consider special characters of the insurer in question so that a proper comparison can be made. If the insurer’s approach is unique, that may give rise to difficulty.”⁴⁷⁰

In recent years, new forms of marketing insurance products rely less on face-to-face dealings, and increasingly on impersonal interactions such as online applications. This emerging reality for marketing insurance products, coupled

⁴⁷⁰ R. Merkin & M. Hemsworth, *The Law of Motor Insurance* (2nd edn, Sweet & Maxwell 2015) at 2-48

with the insurer's right of nullification of the insurance contract in the event of breach of the duty of disclosure, rises to the question of whether the prudent insurer test should still be used to determine materiality. Technically, the prudent insurer test for determining materiality of the withheld or misstated facts will not benefit all insureds. Be that as it may, the Law Commission, after some vacillation, has intentionally taken the concept of "prudent insurer" from the MIA 1906 and kept it in the IA 2015, ss. 3(3)(b), 3(4)(b), 7(3) and 7(5), for the reason that, in a business context, many insureds are represented by large brokers "with strong negotiating power"⁴⁷¹ and considerable knowledge of what might be material to a prudent insurer.⁴⁷² As discussed earlier in Chapter 3, the prudent insurer test under IA 2015 acted multi-functionally in determining not only the materiality of a false statement but also whether the false statement is substantially correct. Further, it is also used to test the clearness and accessibility of the manner in which the disclosure is made by the assured; and lastly, whether the disclosure made by the assured would have given cause for further questions to be asked.⁴⁷³ It is to be noted that, as mentioned earlier, there will be no further duty for the assured to point out to the insurer the significance of that information as the insurer is required to make the underwriting decision for themselves.⁴⁷⁴

⁴⁷¹ Law Commission, *Insurance Contract Law: Business Disclosure; Warranties; Insurer's Remedies for Fraudulent Claims; and Late Payment* (Law Com No 353, 2014) para 5.59

⁴⁷² R. Merkin & M. Hemsworth, *The Law of Motor Insurance* (2nd edn, Sweet & Maxwell 2015) at 2-48

⁴⁷³ *ibid*, at 2-48

⁴⁷⁴ *ibid*, at 2-47

4.2.5 Material facts

Materiality, in every case, is a matter of fact, to be decided by the courts. There are, however, some categories of facts that are obviously material, and others which have arisen frequently in decided cases that they would normally be so regarded. Thus, it is appropriate to describe and illustrate some of these categories. In practice, some insurers or insurance brokers may in fact provide a list of examples of material facts.

Material circumstances, based on the relevance of a fact to the calculation of the premium or acceptance or rejection of the risk, have been held in general to be consisted of two classes of fact, namely, the physical hazard, those which concerns facts increase the risk of loss of the insured subject matter; and the moral hazard, a category of material facts which is more likely related to the “character of the assured”⁴⁷⁵ including, in general, matters such as criminal record, previous refusal of insurance and history of insurance claims. In this case, the proposer is considered as a highly undesirable person with whom to have contractual relations.⁴⁷⁶ A detailed consideration is provided as follows.

4.2.5.1 Physical hazard

Physical hazard refers to risks that are related typically to the physical features of the subject matter insured, therefore these may be found in all varieties, and in different types of insurance. Matters affecting the most physical hazards have

⁴⁷⁵ R. Merkin & M. Hemsworth, *The Law of Motor Insurance* (2nd edn, Sweet & Maxwell 2015) at 2-51.

⁴⁷⁶ *Locker & Woolf Ltd v Western Australian Insurance Co* [1936] 54 LI L Rep 211, 215 (Slessor LJ).

long been subject to questions expressly asked by underwriters in the proposal form, and are thereby presumed to be material to the risk insured, for example, in the case of life insurance, risks would be assessed in terms of the age, health conditions or the results of health tests, medical history, occupation, excessive consumption of alcohol. With respect to property insurance, the construction, location and use of property are obvious examples. Concerning marine insurance, the weather conditions in particular seasons, the location of the vessel and the loading and destination ports may be regarded material. It is clear that particular features of the port and detentions within the period twelve to eighteen months before the inception date of a policy were held as being material, which should be disclosed.⁴⁷⁷ The list of examples is non-exhaustive. By contrast, facts as to the moral hazard of the applicant are less likely to be solicited by express questions.

Lord Bingham of Cornhill, in *Zeller v British Caymanian Insurance Co Ltd*,⁴⁷⁸ delivered the principal opinion as to the interpretation of an express question, and clarified that the duty of an applicant was to answer questions honestly and to the best of his knowledge. Thus, it appears that the Court have already taken into consideration in assessing the answers consumer give to questions presented in the proposal form. “The applicant is expected to exercise his judgment on what appears to him to be worth disclosing. He does not lose his

⁴⁷⁷ *Sea Glory Maritime Co, Swedish Management Co SA v AL Sagr National Insurance Co* [2013] EWHC 2116 (Comm).

⁴⁷⁸ [2008] UKPC 4.

cover if he fails to disclose a complaint which he thought to be trivial but which turns out later to be a symptom of some much more serious underlying condition”,⁴⁷⁹ so to that extent there is a duty for the insured to disclose relative information, applying to issues both consumer and commercial related. The underwriter will need to be as specific as possible in drafting question in their proposal form, and to an insured's responses to questions, because English courts are unwilling to allow insurer to reject claims where the insured has acted honestly and to their best knowledge and belief in answering the proposed questions.

4.2.5.2 Moral hazard

Moral hazard is somewhat inherent in human nature.⁴⁸⁰ An Insurance contract is a personal contract between the insurers and the assureds for the payment of a sum of money,⁴⁸¹ which underwrites the insured against losses arising from his relationship with the subject matter insured, rather than the safety of particular objects. The nature of the insurance contract brings into operation an assessment of particular character of the assured. The best definition of “moral hazard” was perhaps given by Slesser LJ in the following phrase,

“It is elementary that one of the matters which may be considered by an insurance company in entering into contractual relations with a proposed insured is the question of his moral integrity – what has been called the

⁴⁷⁹ Ibid [20].

⁴⁸⁰ *Trading Company L&J Hoff v Union Insurance Society of Canton Ltd* (1929) 34 Ll L Rep 81, 89 (Scrutton LJ)

⁴⁸¹ *Raynor v Preston* [1881] 18 ch D 1 (CA), 11 (Brett LJ)

moral hazard.⁴⁸²

The overall integrity of the insured was material to the risk insured as part of the moral hazard. This is a matter of fact in each case. The general question is whether the assured is a person with whom the insurers would be happy to do business.⁴⁸³ Thus the identity of the insured person is necessarily a material fact, particularly to a motor insurance policy.

Moral hazard is occasionally regarded by the underwriter as being of greater importance than physical hazard. Thus, a history of previous claims will certainly put an insurer on his guard.⁴⁸⁴ In certain circumstances, the nationality of the assured may be considered material, or even his name.⁴⁸⁵ However, it is clear that, on the particular facts of the case, the failure of the insured to pay premiums under an earlier policy was held not of itself to be a material fact for the reason that late payment was not sufficient to substantiate an assertion of shortage of financial resources.⁴⁸⁶ Characteristics of the proposer such as age, gender and disability may now be affected by legislation, for example, discrimination against proposer on the grounds of sex and race is prohibited by the Equality Act 2010.⁴⁸⁷

⁴⁸² *Locker & Woolf Ltd v Western Australian Insurance Co* (1936) 54 LI L Rep 211, at 215, per Slesser LJ

⁴⁸³ *Insurance Corporation of the Channel Islands v Royal Hotel* [1998] Lloyd's Rep IR 151

⁴⁸⁴ *Rozanes v Bowen* (1928) 32 LI L Rep 98

⁴⁸⁵ *Horne v Poland* [1922] 2 KB 364

⁴⁸⁶ *O'Kane v Johns* [2004] Lloyd's Rep IR 389

⁴⁸⁷ Equality Act 2010, section 29

(a) Past Criminal convictions and dishonesty

Convictions for criminal offence previously committed by assured will be a material fact in almost all circumstances and must be disclosed.⁴⁸⁸ The materiality of a criminal conviction will depend upon its nature, its seriousness and the date on which it occurred,⁴⁸⁹ although this will ultimately depend on the facts. Proven dishonesty, even in the absence of a criminal conviction, may be a material fact. In *Insurance Corporation of the Channel Islands v Royal Hotel Ltd*,⁴⁹⁰ a director of the insured, who was also its company secretary, had prepared false invoices in order to give the insured's bankers a more favourable impression of its profitability. Although these had not been used by the time of the insurance proposal, and no criminal offence had actually been committed, it was held that dishonesty was material. Moore-Bick J later reaffirmed this finding in *James v CGU Insurance plc*.⁴⁹¹ Here, the Court held that the fact that Mr James deliberately failed to process many of the warranties was essentially dishonest, which was relevant to moral hazard and therefore material. Thus the policy could be avoided. The ruling demonstrates the potential width of the moral hazard principle.⁴⁹² It is clear that an insured who has been guilty of dishonesty, regardless whether or not he has been prosecuted for it, has to disclose that dishonesty to the underwriters. Failure to do so will render the contract avoided. However, there are two important qualifications to it.

⁴⁸⁸ *March Cabaret v London Assurance* [1975] 1 Lloyd's Rep 169

⁴⁸⁹ R. Merkin & M. Hemsworth, *The Law of Motor Insurance* (2nd edn, Sweet & Maxwell 2015) at 2-56

⁴⁹⁰ [1998] Lloyd's Rep IR 151

⁴⁹¹ [2002] Lloyd's Rep IR 206 [73]-[75] (Moore-Bick J).

⁴⁹² R. Merkin, 'Utmost Good Faith – The Moral Hazard' (2002) 14 2, 5

First, it is noteworthy that the duty of disclosure in respect of criminal convictions may be affected by the provisions of the Rehabilitation of Offenders Act 1974 (The “1974 Act” or “ROA 1974”). Under the 1974 Act, as amended, minor convictions are to be regarded as “spent” after a specified period of time, known as the “rehabilitation period”, and the length of which varies depending on the nature of the conviction or caution imposed.⁴⁹³ Once, spent, the conviction is treated for all legal purposes as never having occurred.⁴⁹⁴ The proposer, therefore, is not required to disclose previous convictions which are ‘spent’.⁴⁹⁵ Any express questions seeking information with respect to an insured’s previous conviction is to be treated as not referring to such a conviction. No liabilities are to be placed on the insured if he failed to disclose it.⁴⁹⁶ In the case of business insurance, the fact that the assured has not disclosed an unspent conviction to an insurer may be material in relation to applications for later insurance covers, even at a time when the conviction itself is spent.⁴⁹⁷ However, s. 7(3) of the 1974 Act confers discretion on the court to admit evidence as to spent convictions if the court is satisfied that “justice cannot be done in the case except by admitting it”, although it is difficult to see how justice can so require when the insured has no duty to disclose the conviction.

Second, insurers may fail to persuade the courts that a conviction for a

⁴⁹³ Rehabilitation of Offenders Act 1974, s. 5.

⁴⁹⁴ Rehabilitation of Offenders Act 1974, s. 4(1).

⁴⁹⁵ Rehabilitation of Offenders Act 1974, s. 4(3).

⁴⁹⁶ Rehabilitation of Offenders Act 1974, s. 4(2).

⁴⁹⁷ *Parker v National Farmers Union Mutual Insurance Society* [2012] EWHC 2156 (Comm)

relatively trivial offence of dishonesty in the remote past would influence the judgment of a prudent underwriter. In *Corcos v De Rougement*,⁴⁹⁸ the assured claimed under a motor insurance policy in respect of a genuine loss. The insurer alleged that the assured had failed to disclose the fact that she had for prolonged periods of time driven a motor vehicle without a driving licence in breach of the law. McCardie J expressed his view as to past convictions in his judgment considering materiality of the alleged non-disclosure, as follow:

“... in considering the question of materiality one must look at the consequences. If there is a duty on the part of one to disclose that when driving one had on licence, it would lead to curious results. [It has been submitted] that where people had been guilty of any breach of law it should be revealed to the insurance companies so that they might ascertain the character of the person proposing. But the result of that would be that not only must you reveal to the insurance companies that omission to take out a driving licence but any breach of law with regard to anything; and I cannot myself see where the result would end if a person’s character is to be weighed in connection with the insurance of a car; and [the] argument comes to this, that he would say it was the duty of a person to reveal to the insurance companies every irregularity in his past life.”

McCardie J held, at least in respect of motor insurance policies, that the assured is not obliged to reveal every illegality or irregularity in his past life. On

⁴⁹⁸ (1925) 23 LI L Rep 164

the other hand, there are occasions where previous conviction should be disclosed. It is a question of degree.⁴⁹⁹ In *Regina Fur Company Ltd v Bossom*,⁵⁰⁰ given that the conviction of receiving stolen furs was so related to the risk insured, Mr. Justice Pearson, took into consideration the special facts in this case, and held that Mr Waxman held a predominant position within the assured company and the previous conviction was material to a proposal for all risks insurance on furs, although such a conviction, being twenty years old, was too ancient and remote. This decision may not have been so concluded today taking into account the Rehabilitation of Offenders Act 1974.

(b) Allegations of criminality and rumours

The courts are inconsistent as to whether there is a duty to disclose the allegation, if it is devoid of merit, if an allegation has been made against the assured and the allegation is proved unfounded and false.⁵⁰¹ Evidently, allegations of criminality attributable to materiality of a given circumstance must be determined by reference to the position as it existed at the time of the placing of the risk.⁵⁰² Thus only acquittal, which has been justified, before placement of the insurance contract renders the fact immaterial.⁵⁰³

⁴⁹⁹ *Gate v Sun Alliance Insurance Ltd* [1995] LRLR 385; *Insurance Corporation of the Channel Islands Ltd v The Royal Hotel Ltd* [1998] Lloyd's Rep IR 151, 156-158

⁵⁰⁰ [1957] 2 Lloyd's Rep 466

⁵⁰¹ *Reynolds v Phoenix Assurance Co Ltd* [1978] 2 Lloyd's Rep 440, 459-460 (Forbes J); *Strive Shipping Corporation & Another v Hellenic Mutual War Risks Association (The Grecia Express)* [2002] 2 Lloyd's Rep 88 (QB Comm); *Brotherton v Aseguradora Colseguros SA (No.2)* [2003] Lloyd's Rep IR 746

⁵⁰² *Strive Shipping Corporation & Another v Hellenic Mutual War Risks Association (The Grecia Express)* [2002] 2 Lloyd's Rep 88 (QB Comm), at 131, per Colman J; *Brotherton v Aseguradora Colseguros SA (No.2)* [2003] Lloyd's Rep IR 746

⁵⁰³ *Lynch v Dunsford* (1811) 14 East 494, also see 'Materiality, Non-disclosure and False Allegations: Following The North Star?' (2006) 4 LMCLQ 520.

In *Strive Shipping Corp v Hellenic Mutual War Risks Association (The Grecia Express)*,⁵⁰⁴ Colman J concluded, which was later overruled by the Court of Appeal in the case of *Brotherton v Aseguradora Colseguros SA (No.2)*,⁵⁰⁵ that there was no duty for the insured to disclose facts merely because they are objectively suspicious as to his previous misconduct if it could be proved at trial that the supposed suspicion were groundless. By contrast, Phillips J, in *Inversiones Manria SA v Sphere Drake Ins (The Dora)*,⁵⁰⁶ following the approach of May J in *March Cabaret Club v London Assurance*,⁵⁰⁷ held that even unfounded allegations should be disclosed because the question is whether or not the prudent underwriter would have wished to have all material facts disclosed and whether they would have influenced his assessment of the risk at the time of placing. Colman J clarified, in *The Grecia Express*,⁵⁰⁸ that if the assured knows of facts which would increase the magnitude of the risk and the known facts would have influenced the judgment of a prudent underwriter, “the known facts do not cease to be material because it might ultimately be demonstrated that the suggested facts did not exist”. This approach has received some support from the Court of Appeal in *Brotherton v Aseguradora Colseguros SA (No.2)*.⁵⁰⁹ In considering materiality in terms of a perverse acquittal or conviction, Mance LJ summarised the following principles:

(a) If, at the time of placing, the insured himself or his employee was

⁵⁰⁴ [2002] 2Lloyd’s Rep 88 (QB Comm), 132.

⁵⁰⁵ [2003] Lloyd’s Rep IR 746.

⁵⁰⁶ [1989] 1 Lloyd’s Rep 69, 93.

⁵⁰⁷ [1975] 1 Lloyd’s Rep 169,177, May J stated that a pending prosecution, particularly for an offence involving dishonesty, would normally be material, even if the defendant were in fact innocent.

⁵⁰⁸ [2002] 2Lloyd’s Rep 88 (QB Comm), 132.

⁵⁰⁹ [2003] Lloyd’s Rep IR 746.

under investigation for or had been charged with an offence, even if the assured knows that he is innocent, and of which he was subsequent to the placing indeed acquitted – in such a case, the insured was nonetheless bound to disclose the charge but he is entitled to submit to the insurers evidence showing his innocence, then the insurer therefore would have embraced all aspects of the insured's knowledge, including his own statement of his innocence and such independent evidence as he had to support that by the time of placing;⁵¹⁰

- (b) in the case of an insured who, prior to a placing, had been both charged and acquitted of an offence, but was in reality guilty of it, the fact of guilt was a material fact;⁵¹¹
- (c) if, at the time of the proposal, the insured had been charged with and convicted of a criminal offence, but he was in fact innocent, it nevertheless remained necessary for him to disclose the conviction although he could attempt to prove his innocence to the insurers.

Thus, the insured must disclose to the underwriter any relative information, in his possession, as to allegation of criminal convictions of himself, his business or his employee, including both the known fact of guilt in case of an acquittal, and the known fact of conviction in case of innocence, given that this may increase the risk to be underwritten, although "idle rumours" need not be

⁵¹⁰ *ibid* [22].

⁵¹¹ *ibid* [23].

disclosed; but in circumstances (a) and (c), the insured can disclose not only the allegation, but also evidences supporting his statement that he was wrongly convicted.⁵¹² Further, Lord Mance drew a clear distinction between material “intelligence” that might ultimately be proved as unfounded, but which should nevertheless be disclosed, and the immaterial “loose or idle rumours” which need not be disclosed by an insured or his agent.⁵¹³ The applicant does not have to disclose “mere speculations, vague rumours or unreasoned fears”.⁵¹⁴ The burden is rest with the underwriter to demonstrate that there were facts or circumstances known to the insured, and that it was not disclosed. But the rumour with “some real substance” that later turns out to have been untrue must be disclosed.⁵¹⁵

Subsequently, the decision was followed in *North Star Shipping Ltd v Sphere Drake Insurance plc*.⁵¹⁶ Colman J was confronted with the insurer’s defence that the insured failed to disclose that they were alleged to have committed fraud and were facing both criminal and civil proceedings, arguing that this information would have influenced the judgment of a prudent underwriter. The facts were plainly material. However, the assured’s counsel argued “allegations that related to the risk itself were one thing but allegations of dishonesty, which had nothing to do with the risk and nothing to do with either the particular

⁵¹² O. Gurses, *Marine Insurance Law* (2nd edn, Routledge 2016) 69.

⁵¹³ *Brotherton v Aseguradora Colseguros SA (No.2)* [2003] Lloyd’s Rep IR 746 [28].

⁵¹⁴ *Decorum Investments Ltd v Atkin (The Elena G)* [2002] 1 Lloyd’s Rep 378 [27] (David Steel J), with reference to *Carter v Boehm* (1766) 3 Burr 1905.

⁵¹⁵ *Strive Shipping Corporation & Another v Hellenic Mutual War Risks Association (The Grecia Express)* [2002] 2 Lloyd’s Rep 88 (QB Comm), 132 (Colman J).

⁵¹⁶ [2006] Lloyd’s Rep IR 519 (CA).

insurance or with insurance at all, were another”, to which Lord Waller found himself tempted to follow.⁵¹⁷ Moreover, because the law in this area is indeed capable of producing serious injustice,⁵¹⁸ given the duty requiring the insured to disclose every false allegation of dishonesty might create unfairness and become onerous. The issue was considered in *Norwich Union Insurance Ltd v Meisels*.⁵¹⁹ The High Court held that an allegation of criminality was not necessarily itself material and that materiality depended upon a combination of dishonesty, age and importance.⁵²⁰ Tugendhat J expressly indicated that as follow:

“The test of materiality is by reference to what would influence the judgment of a prudent insurer. This is an objective test, and the characteristics to be imputed to a prudent insurer are in substance a matter for the courts to decide. There is room for a test of proportionality, having regard to the nature of the risk and the moral hazard under consideration. There may be things which are too old, or insufficiently serious to require disclosure, whether or not there is exculpatory material. And in cases where the information would be material and disclosable if there were no exculpatory material, the degree of conviction that the exculpatory material must carry, must depend on all the circumstances known to the insurer.”⁵²¹

⁵¹⁷ *ibid* [18].

⁵¹⁸ *ibid* [17].

⁵¹⁹ [2007] Lloyd’s Rep IR 69 (QB).

⁵²⁰ J. Lowry, P. Rawlings and R. Merkin, *Insurance Law: Doctrine and Principles* (3rd edn, Hart Publishing 2011) 108.

⁵²¹ *Norwich Union Insurance Ltd v Meisels* [2007] Lloyd’s Rep IR 69 (QB) [25]

(c) Insurance claims history and prior refusals of cover

One area so far as moral hazard is concerned generating a clear disparity between marine and non-marine insurance is in respect of refusals of cover by previous underwriters. Traditionally, in marine insurance a previous refusal is not material and need not to be disclosed,⁵²² whereas previous refusals in connection with general contract of insurance, whether life, property, liability or reinsurance, have generally been held to be material.⁵²³ Questions need to be taken into account at this point is what amount to a refusal. It was held that the lapse of a policy by non-payment of a premium did not amount to a refusal by the insurers to renew the policy.⁵²⁴ It is also clear that the fact that the insured was in arrears with his premiums on another policy was held not to be a material fact.⁵²⁵ In *Holts Motors Ltd v South East Lancashire Insurance Co Ltd*⁵²⁶ the Court of Appeal decided that a statement by insurers that they would choose not to invite renewal by reason of the insured's record amounted to a refusal to renew. Questions may not be confined to policies of the same type. In *Locker & Woolf Ltd v Western Australian Insurance Association*,⁵²⁷ a previous refusal of motor insurance on the ground of misrepresentation and non-

⁵²² *Glasgow Assurance Corporation v Symondson* 16 Com Cas 109, 119; *Glicksman v Lancashire & General Assurance Co* [1925] 22 Ll L Rep 179 (CA), 183; *Container Transport International Inc v Oceanus Mutual Underwriting Association (Bermuda) Ltd* [1982] 2 Lloyd's Rep 178, 198-199; [1984] 1 Lloyd's Rep 476

⁵²³ *Austin v Zurich General Accident & Liability Insurance Co Ltd* (1944) 77 Ll L Rep 409; *Schoolman v Hall* [1951] 1 Lloyd's Rep 139; *Regina Fur Co v Bossom* [1958] 2 Lloyd's Rep 425; *March Cabaret Club v London Assurance* [1975] 1 Lloyd's Rep 169; *Reynolds v Phoenix Assurance Co Ltd* [1978] 2 Lloyd's Rep 22; *Pan Atlantic Insurance Co Ltd v Pine Top Insurance Co Ltd* [1994] 2 Lloyd's Rep 427; *James v CGU Insurance plc* [2002] Lloyd's Rep IR 206;

⁵²⁴ *Zurich General Accident & Liability Insurance v Buck* (1939) 64 Ll LR 115

⁵²⁵ *O'Kane v Jones* [2004] 1 Lloyd's Rep 389

⁵²⁶ (1930) 37 Ll LR 1

⁵²⁷ [1936] 1 KB 408

disclosure had affected the avoidance of the fire policy in question. However, in *Ewer v National Employers' Mutual & General Insurance Association*,⁵²⁸ MacKinnon J held that past refusals by insurer in respect of any other policies were not material.

With respect to claim history, claims made by the insured may be considered as a material fact for the proposed insurance,⁵²⁹ as this is indicative of the attitude which the insured placed on his insurance and the subject matter insured. Compared to other moral hazards, claim history and past experience of losses, made either in respect of the subject matter insured by the same insurer or any other properties by different underwriters, are the most direct and convenient way in which the underwriter could contemplate his potential risk brought by characteristics of the insured, although previous claims or losses on policies relating to a different subject matter may not be material.⁵³⁰ It is noteworthy that “in relation to claims history, the fact that the business of the insured may have substantially changed since the previous claims because, for example, the management has been replaced, or its place of business has been relocated and the workforce is different, will not necessarily excuse the insured’s non-disclosure”.⁵³¹

⁵²⁸ [1937] 2 All ER 193

⁵²⁹ *Norman v Gresham Fire & Accident Insurance Society Ltd* (1935) 52 Ll L Rep 292; *Lyons v JW Bentley Ltd* (1944) 77 Ll L Rep 335; *Container Transport International Inc v Oceanus Mutual Underwriting Association (Bermuda) Ltd* [1984] 1 Lloyd’s Rep 476

⁵³⁰ *Ewer v National Employers' Mutual & General Insurance Association* [1973] 1 All ER 193

⁵³¹ J. Lowry, P. Rawlings and R. Merkin, *Insurance Law: Doctrine and Principles* (3rd edn, Hart Publishing 2011) 102

4.2.5.3 Matters which need not be disclosed

The Insurance Act 2015 s. 3(5) lists the matters which the assured is not required to disclose in the absence of enquiry. In other words, the assured must provide answers accordingly so as to comply with the duty to avoid misrepresentation, if the underwriter has made a specific request for information. The assured does not need to disclose a circumstance if:

- (a) it diminish the risk,
- (b) the insurer knows it,
- (c) the insurer ought to know it,
- (d) the insurer presumed to know it, or
- (e) it is something as to which the insurer waives information

Sections (a) and (e) replicate ss. 18(3)(a) and 18(3)(c) of MIA 1906. S. 18(3)(d) of the MIA 1906 concerning disclosure of warranted matter has been omitted because the changes to the law of warranties by the Insurance Act 2015 have made it “superfluous”.⁵³²

(a) Diminution of risk

Any material circumstance which diminishes the risk does not need to be disclosed. In *Carter v Boehm*,⁵³³ Lord Mansfield illustrated this principle as follow:

“The underwriter need not to be told what lessens the risqué agreed and

⁵³² Law Commission, *Insurance Contract Law: Business Disclosure; Warranties; Insurer’s Remedies for Fraudulent Claims; and Late Payment* (Law Com No 353, 2014) paras 10.73-10.74

⁵³³ (1766) 3 Burr 1905, 1910.

understood to be run by the express terms of the policy...if he insures for three years, then he need not be told of any circumstance to show that it may be over in two.”

The principle was once applied in *Dawsons Ltd v Bonnin*,⁵³⁴ in which the House of Lords held that the fact that the lorry was to be garaged in Glasgow rather than kept on a farm on the outskirts of Glasgow was not material. In *Inversiones Manria SA v Sphere Drake Insurance Co Plc (The Dora)*⁵³⁵ Phillips J noted that the fact that a yacht had been in the builder’s yard at the inception of the policy was a fact that reduced, rather than increased, the risk. More recently, David Steel J, applying the same principle in the case of *Decorum investments Ltd v Atkin (The Elena G)*,⁵³⁶ decided that there was no obligation on the assured to disclose that a yacht was kept in a secure and guarded mooring.

(b) Knowledge of the insurer for disclosure purposes – Insurance Act

2015 s. 3(5)(b)(c)(d)

IA 2015 s. 3(5) outlines three types of knowledge of the insurer. These types of knowledge constitute an “expended and clarified” re-enactment of MIA1906, s. 18(3)(b).⁵³⁷ Each of these types has been defined by s. 5 of the IA 2015.

- Actual knowledge

⁵³⁴ [1922] 2 AC 413.

⁵³⁵ [1989] 1 Lloyd’s Rep 69.

⁵³⁶ [2002] Lloyd’s Rep IR 450.

⁵³⁷ Law Commission, *Insurance Contract Law: Business Disclosure; Warranties; Insurer’s Remedies for Fraudulent Claims; and Late Payment* (Law Com No 353, 2014) para 10.31-10.32; also see R. Merkin & M. Hemsworth, *The Law of Motor Insurance* (2nd edn, Sweet & Maxwell 2015) at 2-67.

First, circumstances which the insurer knows. For this purpose, s. 5(1) illustrates that “an insurer knows something only if it is known to one or more of the individual who participate on behalf of the insurer in the decision whether to take the risk, and if so on what terms (whether the individual does so as the insurer’s employee or agent, as an employee of the insurer’s agent or in any other capacity)”, whereby the person who actually involved in underwriting decision making process is captured.⁵³⁸ More importantly, “only the knowledge of the underwriter(s), including underwriting agent,⁵³⁹ involved in decisions about the policy in question” rather than the insurer’s senior management team or board should be directly attributed to the insurer, only if the risks insured is to be “very large” thereby were reported to the board.⁵⁴⁰

The term “knowledge” is subject to IA 2015 s. 6, in which it provides general rules as to attributing knowledge applicable not only to insurers but also to insured and the intermediaries. The meaning of “knowledge” extends to the so-called “blind eye knowledge”,⁵⁴¹ namely, as expressed by subsection (1), “matters which the individual suspected, and of which the individual would have had knowledge but for deliberately refraining confirming them or enquiring about them”. The knowledge attributed to the insurer is limited by IA 2015 s. 6(2)(b), which was intended to codify the common law rule in *Re Hampshire Land*

⁵³⁸ Law Commission, *Insurance Contract Law: Business Disclosure; Warranties; Insurer’s Remedies for Fraudulent Claims; and Late Payment* (Law Com No 353, 2014) para 10.37.

⁵³⁹ R. Merkin & M. Hemsworth, *The Law of Motor Insurance* (2nd edn, Sweet & Maxwell 2015) at 2-67.

⁵⁴⁰ Law Commission, *Insurance Contract Law: Business Disclosure; Warranties; Insurer’s Remedies for Fraudulent Claims; and Late Payment* (Law Com No 353, 2014) para 10.37-10.38.

⁵⁴¹ *Economides v Commercial Union Assurance Co plc* [1997] 3 All ER 635

*Company*⁵⁴². If an agent defrauds the principal, then the principal is not treated as knowing of the fraud for the obvious reason that the agent cannot be expected to tell the principal about it. The main problem, discussed earlier in Chapter 3, appears to be the scope of *Hampshire Land* principle. The section now equally applies to insurers, whereas all of the binding precedents on the point relate to fraud by the insured's agent.⁵⁴³

- Constructive knowledge

Circumstances which the insurer ought to know. For this purpose, IA 2015 s. 5(2) provides that an insurer ought to know something only if:

- (a) an employee or agent of the insurer knows it, and ought reasonably to have passed on the relevant information to an individual who participate on behalf of the insurer in the decision whether to take the risk, and if so on what terms (whether the individual does so as the insurer's employee or agent, as an employee of the insurer's agent or in any other capacity); or
- (b) the relevant information is held by the insurer and is readily available to an individual who participate on behalf of the insurer in the decision whether to take the risk, and if so on what terms (whether the individual does so as the insurer's employee or agent, as an employee of the insurer's agent or in any other capacity).

⁵⁴² [1896] 2 Ch 743

⁵⁴³ Insurance Act 2015, s. 6(2)

The common law rule as to exactly which individuals, within the insurer's organisation, have knowledge that is treated to be known to the underwriters has been expressed by Gallen J in the judgment of *Green v State Insurance General Manager*⁵⁴⁴ in the following terms:

“Knowledge must be in the possession or deemed to be in the possession of the person whose responsibility it is to make the decision in relation to the proposal ... Knowledge can be imputed from the knowledge of an agent, who may include obviously a servant of the company, but only when that agent was acting in the capacity of the insurer's agent in the transaction affected and it was his duty in that capacity to place at the insurer's disposal the knowledge which he had.”

Notably, subsection (a) has been codified in substantially similar terms, which clarifies particularly circumstances “where the information has been gathered specifically for the purpose of assisting the underwriter in his assessment of the risk” such as “a doctor commissioned by an insurer to examine a prospective policyholder” or “a surveyor who is asked to make a report of a prospective insured site”.⁵⁴⁵ Further, English courts⁵⁴⁶ have ruled that insurers who appointed auditors to examine the physical security and the control systems of a bank was not deemed to know material facts as to fraud of officers of the bank for the

⁵⁴⁴ R. Merkin, *Colinvaux's Law of Insurance* (11th edn, Sweet & Maxwell 2017) at 7-152, citing *Green v State Insurance General Manager* (1992) 7 ANZ Insurance Cases 61-142, 77, 732,

⁵⁴⁵ Law Commission, *Insurance Contract Law: Business Disclosure; Warranties; Insurer's Remedies for Fraudulent Claims; and Late Payment* (Law Com No 353, 2014) para 10.47

⁵⁴⁶ Queen's Bench Division (Commercial Court) in *Brotherton v Aseguradora Colseguros SA (No. 3)* [2003] Lloyd's Rep IR 762 [36] (Morison J)

reason that the auditors were simply not engaged to audit such matters, therefore made them unrelated to the appointment.⁵⁴⁷ Then it cannot be said that the agent “ought reasonably to have passed on the relevant information” to the underwriter in question.

With the advent of computerised records systems, modern communication offers new ways in which modern professional insurers are being able to access much more information quicker and easier than they could ever imagine in times when communications were far slower without internet. As IT systems improve, underwriters are expected to know information, such as previous dealings including rejections, loss and claims,⁵⁴⁸ “held” in their records, almost certainly electronically,⁵⁴⁹ but only if it is “readily available” to the particular underwriter within his/her organisation.⁵⁵⁰ Problems can be raised where the underwriter deliberately deletes its record so that the information is no longer “held”.⁵⁵¹ As of August 2016, information gathered in the course of investigation of a claim under a different policy might be treated to be known to the insurer if it is included in a report that is available to the underwriter in his/her record to which he/she has access, electronically or not,⁵⁵² although the Court of Appeal had concluded by a majority that the knowledge from the claims department

⁵⁴⁷ R. Merkin, *Colinvaux's Law of Insurance* (11th edn, Sweet & Maxwell 2017) at 7-152

⁵⁴⁸ R. Merkin, *Colinvaux's Law of Insurance* (11th edn, Sweet & Maxwell 2017) at 7-153

⁵⁴⁹ *ibid*

⁵⁵⁰ Law Commission, *Insurance Contract Law: Business Disclosure; Warranties; Insurer's Remedies for Fraudulent Claims; and Late Payment* (Law Com No 353, 2014) para 10.27

⁵⁵¹ R. Merkin & M. Hemsworth, *The Law of Motor Insurance* (2nd edn, Sweet & Maxwell 2015) footnote 235

⁵⁵² Law Commission, *Insurance Contract Law: Business Disclosure; Warranties; Insurer's Remedies for Fraudulent Claims; and Late Payment* (Law Com No 353, 2014) paras 10.48 & 10.52

was not imputed to the underwriting department of the same insurer because the two departments were in different locations.⁵⁵³ English courts were reluctant to find that an insurer has constructive knowledge of the policyholder's circumstances.⁵⁵⁴ IA 2015 s. 5(2)(b) has rendered such a precedent futile.⁵⁵⁵ The Law Commission is of the view that "an insurer would be expected to check its computer systems, but would not be expected to carry out elaborate or impractical enquiries, or to match information across the organisation".⁵⁵⁶

If insurers are imposed an implied duty, by subsection (b), to search electronic files within their organisation for the purpose of revealing relative information, it is but a small step to suggest that every information elsewhere revealed by a simple search could be treated as ought to be known by the underwriter. Judiciaries may find attempting to do so, given that such a search is likely to take no more than a few seconds,⁵⁵⁷ particularly in the context of marine insurance, for example, where insurers can subscribe to databases that contain extensive information on vessel and their owners.⁵⁵⁸ Although cases under the 1906 Act have not recognised any duty on insurers to search the internet to check information related to the subject matter insured,⁵⁵⁹ the ability of insurers

⁵⁵³ *Mahli v Abbey Life Assurance Co Ltd* [1996] LRLR 237

⁵⁵⁴ *Strive Shipping Corporation & Another v Hellenic Mutual War Risks Association (The Grecia Express)* [2002] 2 Lloyd's Rep 88 QB (Comm); *Mahli v Abbey Life Assurance Co Ltd* [1996] LRLR 237.

⁵⁵⁵ R. Merkin, *Colinvaux's Law of Insurance* (11th edn, Sweet & Maxwell 2017) at 7-154.

⁵⁵⁶ Law Commission, *Insurance Contract Law: Business Disclosure; Warranties; Insurer's Remedies for Fraudulent Claims; and Late Payment* (Law Com No 353, 2014) para 10.26.

⁵⁵⁷ R. Merkin, *Colinvaux's Law of Insurance* (11th edn, Sweet & Maxwell 2017) at 7-153.

⁵⁵⁸ H. Bennett, *The Law of Marine Insurance* (2nd edn, OUP 2006) para 4.97.

⁵⁵⁹ *Sea Glory Maritime Co & Anor v Al Sagr National Insurance Co & Anor (The Nancy)* [2014] 1 Lloyd's Rep IR 112; *Hua Tyan Development Ltd v Zurich Insurance Co Ltd (The "Ho Feng 7")* [2013] HKCA 414, [2014] Lloyd's Rep IR 2.

to search for and retrieve information seems necessary to be taken into account in the modern era in which “specialist information is increasingly made available through dedicated electronic produces”.⁵⁶⁰ Furthermore, it is also worthy of consideration whether there would be imputed knowledge that would have been revealed where a simple search would have put an insurer on notice that it needs to make further enquiries for the purpose of revealing relevant circumstances. The Law Commission was seemingly reluctant to take the small step. The statutory test has nevertheless been so confined within the scope which is no wider than information that is available within the insurer’s organisation. One issue will be at the discretion of judges is whether interpretation of the phrase “readily available” is to be construed objectively (prudent insurer) or subjectively (the actual insurer).⁵⁶¹

- Presumed knowledge

Circumstances which the insurer presumed to know. For this purpose, s. 5(3) states that an insurer presumed to know: (a) things which are common knowledge, and (b) things which an insurer offering insurance of the class in question to insureds in the field of activity in question would reasonably be expected to know in the ordinary course of business.

This provision is to be read as a modernised and clarified restatement of MIA 1906 s. 18(3)(b). The term “notoriety” has been replaced because of its

⁵⁶⁰ H. Bennett, *The Law of Marine Insurance* (2nd ed, OUP 2006) para 4.97.

⁵⁶¹ R. Merkin, *Colinvaux’s Law of Insurance* (11th edn, Sweet & Maxwell 2017) at 7-153.

changed meaning since 1906.⁵⁶² No change in law was intended by the Law Commission in terms of common knowledge and matters of commercial nature.⁵⁶³

Generally, the fact that information published in a newspaper does not make it of common knowledge. The courts have concluded that an insurer was not presumed to have knowledge or particular facts of particular ships on the ground that such facts had reported in newspaper.⁵⁶⁴ The same principle was applied in HongKong in *Hua Tyan Development Ltd v Zurich insurance Co Ltd (The Ho Feng 7)*.⁵⁶⁵ In this case, Mr Lam Sek Kong, the plaintiff's handling solicitor, had located the gross tonnage and its deadweight of *Ho Feng 7* on the internet Lloyd's List Intelligence which is based on Lloyd's List, the leading newspaper for the maritime industry, and two other websites. The Court held that insurers are not presumed to be fixed with constructive knowledge of the deadweight capacity merely because the information had reported in Lloyd's List or similar industry sources. Thus, information that is available on internet is not necessarily considered to be common knowledge of insurer,⁵⁶⁶ particularly where the insurer had no access to the database,⁵⁶⁷ even when they are marine insurers and the information is published in a specialist media forum targeted at

⁵⁶² Law Commission, *Insurance Contract Law: Business Disclosure; Warranties; Insurer's Remedies for Fraudulent Claims; and Late Payment* (Law Com No 353, 2014) para 10.57.

⁵⁶³ *ibid* para 10.58

⁵⁶⁴ *Bates v Hewitt* (1867) LR 2 QB 595; *Kingscroft Ins Co Ltd v Nissan Fire & Marine Ins Co Ltd (No 2)* [1999] Lloyd's Rep IR 603

⁵⁶⁵ [2013] HKCA 414; affirmed [2014] HKCFA 72

⁵⁶⁶ R. Merkin & M. Hemsworth, *The Law of Motor Insurance* (2nd edn, Sweet & Maxwell 2015) footnote 234

⁵⁶⁷ *Sea Glory Maritime Co & Anor v Al Sagr National Insurance Co & Anor (The Nancy)* [2014] 1 Lloyd's Rep IR 112

the maritime community.⁵⁶⁸ An insurer was not to be presumed to have knowledge of matters simply because he had the means of ascertaining them by appropriate enquiry.⁵⁶⁹ By contrast, the Supreme Court of Canada has kept abreast of the times. In *Canadian Indemnity Co v Canadian Johns-Manville Co*,⁵⁷⁰ Gonthier J concluded that “an insurer was expected to know facts which went beyond political and natural perils and generally matters known to all and included a certain amount of information regarding the activity which was being insured”.⁵⁷¹ Mr Justice who emphasised that articles as to the health hazards of asbestos and the scientific papers were “at hand and available to anyone who was interested in the details”, and the seriousness of the risk of asbestosis from inhalation of asbestos fibres was a matter of “public character” and “notoriety”, and therefore “an insurance underwriter ought to have known of their existence and their seriousness”.⁵⁷²

An insurer is also presumed to know the practices of the trade, in other words, the market in which he/she is writing business. This proposition has become the common law rule, emphasised by Lord Mansfield in *Noble v Kennaway*,⁵⁷³ in which he stated that “Every underwriter is presumed to be acquainted with the practice of the trade he insures, and whether it is established or not if he does

⁵⁶⁸ H. Bennett, *The Law of Marine Insurance* (2nd ed, OUP 2006) para 4.96

⁵⁶⁹ *Hua Tyan Development Ltd v Zurich Insurance Co Ltd (The “Ho Feng 7”)* [2013] HKCA 414; [2014] Lloyd’s Rep IR 2 [16.12].

⁵⁷⁰ M. Clarke, *Law of Insurance Contracts* (6th edn, Informa 2016) 23-9B1A, citing *Canadian Indemnity Co v Canadian Johns-Manvilles Co* (1988) 54 DLR (4th) 468 (CA Quebec); (1990) 2 SCR 549, (1990) 72 DLR (4th) 478.

⁵⁷¹ *ibid* 500.

⁵⁷² *ibid* 478 – 480.

⁵⁷³ (1780) 2 Doug KB 510, 512.

not know it, he ought to inform himself.” Underwriters will be expected to have a better knowledge which affects the business that they writes than the layman, even if the range of circumstances that the prudent underwriter can be expected to have is inevitably very broad in the context of open cover for worldwide oil trade, i.e. the scope of the proposed insurance cover is broad.⁵⁷⁴ The Court held in *Glencore International v Alpina Insurance Co Ltd*⁵⁷⁵ that an oil trader did not have to disclose that there were no real methods for verifying the quantities of oil held in storage for the assured, which exposed the insurer to greater risk than necessary, given that the practice does not fall outside the range of possibilities that the underwriter ought to have in mind in the normal procedures, thereby the insured’s duty of disclosure is correspondingly limited to matters which are unusual in the sense that they fall outside the contemplation of the reasonable underwriter familiar with the business of oil trading”.⁵⁷⁶

(c) Waiver

The waiver exception set out in s. 18(3)(c) of MIA 1906 has been retained in IA 2015 s. 3(5)(e), yet in slightly different form, which stated that, in the absence of enquiry, the assured is not required to disclose a circumstance “if it is something as to which the insurer waives information”. The English court held that the insurer’s failure to ask further questions in the situation where the

⁵⁷⁴ *Glencore International v Alpina Insurance Co Ltd* [2003] EWHC 2792 (Comm).

⁵⁷⁵ [2003] EWHC 2792 (Comm).

⁵⁷⁶ *ibid* [41].

information provided by an insured in answering the insurer's question was insufficient for a reasonably prudent insurer to be alerted would amount to a waiver of the obligation.⁵⁷⁷ This only happens when a policyholder made a fair presentation of the risk.⁵⁷⁸ The codification of IA 2015 s. 3(4)(b) however renders this conclusion less important.⁵⁷⁹

- Implied waiver

A waiver can be explicit or implicit. An insurer who asks limited questions on a proposal form may be taken to have waived information which falls outside the scope of the limited question.⁵⁸⁰ In *Laing v Union Marine Insurance Co*,⁵⁸¹ Mathew J stated that an assured "is not bound to give information which the underwriter waives or as to which the assured may reasonably infer that the underwriter is indifferent".⁵⁸² The courts have further clarified that, in terms of limited questions, waiver can only be implied in cases involving limited yet specific information. No waiver can be found where an express question seeking information about the claims history was formulated in a way in which it was "too general and gave rise to a great deal of uncertainty as to what was

⁵⁷⁷ *Container Transport international Inc v Oceanus Mutual Underwriting Association (Bermuda) Ltd* [1984] 1 Lloyd's Rep 476; *Pan Atlantic Insurance Co Ltd v Pine Top Insurance Co Ltd* [1993] 1 Lloyd's Rep 496 (CA); [1994] 2 Lloyd's Rep 427 (HL) [10.15] & [10.29]; *WISE (Underwriting Agency) Ltd v Grupo Nacional Provincial SA* [2004] Lloyd's Rep IR 764 (CA); *Garnat Trading & Shipping (Singapore) Pte Ltd v Baominh Insurande Corporation* [2011] 1 Lloyd's Rep 589 [135] (Christopher Clarke J); *Sea Glory Maritime Co & Another v Al Sagr National Insurance Co (The "M/V Nancy")* [2013] EWHC 2116 (Comm); [2014] 1 Lloyd's Rep IR 112 [56].

⁵⁷⁸ *New Hampshire Insurance Co v Oil Refineries Ltd* [2002] 1 Lloyd's Rep 462 QB (Comm)

⁵⁷⁹ Law Commission, *Insurance Contract Law: Business Disclosure; Warranties; Insurer's Remedies for Fraudulent Claims; and Late Payment* (Law Com No 353, 2014) para 10.70

⁵⁸⁰ *ibid* para 10.71.

⁵⁸¹ (1895) 1 Com Cas 11.

⁵⁸² *ibid* [15].

and was not waived”.⁵⁸³

In *Noblebright Ltd v Sirius International Corp*,⁵⁸⁴ the insurer asked whether there had been any claims in respect of his business premises in excess of £10,000 at any time, or any smaller claims in the previous five year. The assured had not made any claims, but had experienced three incidents that had taken place at his premises, which consisted of a violent attack on the managing director and two armed robberies. The assured, given no claims had been made previously, answered these questions in the negative, and contended that the insurer had waived disclosure of the incidents by reason of the limited nature of the information that it had chosen to seek by way of the claims declaration contained in the proposal form. The Court held that there had been no waiver by the insurer of any obligation to disclose an incident that might have given rise to an insurance claim but did not do so and three incidents had fallen into that category. Clearly, in circumstances of a similar kind, it is not open to the insured to argue that the insurer had waived the information that has been misstated if the insured have tried to avoid touching the important points and dwell on the trivial. Moreover, it is, however, important to note that while it is the case that limited questions may give rise to a waiver of disclosure, an absence of express questions does not normally lead to the same result as the assured is required to make full disclosure of material facts even where no question is asked.

⁵⁸³ R. Merkin, *Colinvaux's Law of Insurance* (11th edn, Sweet & Maxwell 2017) at 7-164

⁵⁸⁴ [2007] Lloyd's Rep IR 584

- Express waiver

An express waiver requires a statement of waiver. The question arising here is the effectiveness of such a clause in policy wording. The House of Lords held that the wording of a “truth of statement” clause⁵⁸⁵ in an insurance contract excluding liability to make statement did not prevent the assured from consequence of deliberate and dishonest or reckless non-disclosure by broker.⁵⁸⁶ It is therefore worthy of consideration whether the wording, on the true construction of the contract for insurance, can operate sufficiently to achieve the drafting objective. Clear wording of restricting the duty to disclose specific types of information and/or limiting authority of an agent to make any disclosure on behalf of the assured is necessary for an expressed waiver clause to be effectively construed.⁵⁸⁷

4.2.5.4 Chinese approaches

4.2.5.4.1 Non-marine insurance contract

In respect to general insurance law, art. 16 par. 6 of the Insurance Act of PRC provides that the insurer is not entitled to rescind the contract where the insurer has known the misrepresentation at the time of contract; in the event of an insured loss, the insurer shall be liable for compensation or payment of the

⁵⁸⁵ In *HIH Casualty & General Insurance Ltd v Chase Manhattan Bank* [2003] Lloyd's Rep IR 230, the clause stated that “[the assured] will not have any duty or obligation to make any representation, warranty or disclosure of any nature, express or implied (such duty and obligation being expressly waived by the insurers) ...”

⁵⁸⁶ *HIH Casualty & General Insurance Ltd v Chase Manhattan Bank* [2003] Lloyd's Rep IR 230

⁵⁸⁷ R. Merkin, *Colinvaux's Law of Insurance* (11th edn, Sweet & Maxwell 2017) at 7-159

insurance premium. That is to say that the insurer cannot rescind the contract of insurance on the ground of non-disclosure of misrepresentation, if he/she before the contract is concluded knew the fact that the applicant has failed to disclose material circumstance or answer questions contained in the proposal form, and he/she nevertheless entered into the contract. The same principle, namely, the doctrine of implied waiver, has long been established in the common law system. This point is considered in detail in Section 4.2.5.3(c) of this chapter, in the context of waiver by the insurer. Clearly, if the underwriter chooses not to ask further questions in the situation that there might be other material facts relating to the subject matter insured, judging from information provided by the assured, it will then lead to the same result. The law on this point is blurry where the applicant clearly refuses to answer a question, and the insurer nevertheless accepts their proposal. It is not clear if art.16 par.6 is applicable in such circumstances. It is likely to be the case, given that such an omission would undoubtedly put a prudent underwriter on notice that it needs to make further enquiries for the purpose of revealing other material facts.

Notably, this formulation indicates that, at the time of proposal, the insurer must be in possession of the actual knowledge of the misstatement by the insured. Constructive knowledge of such information does not give rise to exclusion of the pre-contractual duty of representation. Additionally, art. 7 of the Interpretation of the Supreme People's Court Concerning Some Issues on

Application of the Insurance Law of the PRC (II) (The 'Interpretation II')⁵⁸⁸ provides that, after the contract of insurance is concluded, if the insurer knows or ought to know that the insured failed to comply with the obligation of making truthful representations, and he/she nevertheless collects the premium, the people's court shall not uphold the requisition of terminating the contract in accordance with art. 16 par. 2 of the Insurance Law of PRC. In the context that the loss occurs in the period between conclusion of the contract and collection of premium, an insurer who is actually aware of the fact as to the non-fulfillment of such a duty by the insured cannot terminate the contract regardless whether or not premium is paid; on the other hand, the insurer, after the contract is concluded, without sufficient evidence of actual knowledge, is entitled to evade his/her liability by rescinding the insurance contract so long as no premium is to be collected, even if constructive knowledge of non-fulfillment of the duty can be proven.

The insured is to be urged, as a common practice, to do a medical examination by a physician designated by the insurer before applying for life insurance, so that health conditions inconsistent with insured's disclosure may be discovered. The Supreme People's Court has further clarified, in the Interpretation of the Supreme People's Court Concerning Some Issues on Application of the Insurance Law of the PRC (III) (The Interpretation III)⁵⁸⁹ legal effect of a health check in terms of life insurance. Such a medical examination does not

⁵⁸⁸ Fa Shi [2013] No. 14

⁵⁸⁹ Fa Shi [2015] No. 21

constitute a waiver unless the insurer is in possession of the actual information in relation to the result of the health examination.⁵⁹⁰ In other words, medical history and other health conditions excluded from the medical report may still enable the insurer to reach a conclusion as to termination of the contract.

Further, other exceptions of duty of disclosure have appeared in the Guidance Notes and Guidelines of some of the Higher People's Courts at the provincial and municipal level, i.e. Beijing, Jiangxi and Zhejiang. The 'Guidance Notes concerning Adjudication of Insurance Contract Disputes' published by the Higher People's Court of Beijing Municipality, art. 14, listed the following matters which the assured is not required to disclose:

- (1) facts undisclosed by the assured diminish the risk;
- (2) facts which is known or ought to be known to the insurer;
- (3) a waiver of relative information as to which is to be clearly declared by the insurer.

The provision has been formulated in a similar wording as the s. 3(5) of the English Insurance Act 2015, which is provided in Section 4.2.5.3 above. Jiangxi and Zhejiang Higher Courts have provided a similar provision in different terms. Art. 6 of the 'Guidance Notes concerning Adjudication of Insurance Contract Disputes' of Jiangxi Higher Court and art. 9 of the 'Guidance Notes concerning Adjudication of Insurance Contract Disputes' of Zhejiang Higher Court formulated such exceptions in the following phrase.

⁵⁹⁰ *ibid*, art. 5; also see explanations of this provision made by Zhumei LIU, deputy chief judge of the second civil tribunal of the Supreme People's Court of China, on the press conference concerning the Interpretation III on 26th Nov 2015, available at <http://www.court.gov.cn/zixun-xiangqing-16101.html>

The assured's non-compliance with enquires of an insurer does not amount to a breach of the duty of honest disclosure if:

- (1) the circumstance is known to the insurer;
- (2) the circumstance, as a matter of common sense, ought to be known to the insurer;
- (3) the insurer clearly declares that the circumstance is not necessary to be disclosed.

4.2.5.4.2 Marine Insurance

Instead of fully inheriting MIA 1906 s. 18(3), art. 222 par. 2 of MC 1993, borrowed from MIA 1906 s. 18(3)(b), states the limits to the duty of disclosure in the context of marine insurance, in the following terms:

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

Actual and constructive knowledge of the insurer for the purpose of disclosure in terms of English law approach is discussed at length in Section 4.2.5.3(b) above. It is worth noting, again, that the effect of the wording “about which the insurer made no inquiry” is that the insured is obliged to comply with the duty of representation, if the underwriter have made a specific request for information.

Unlike the common rule, namely, the insurer is under a duty to require further

information if the insured makes a limited disclosure which puts the underwriter on notice that there may be concealed material circumstances,⁵⁹¹ now codified by IA 2015 s. 3(4)(b), Shandong Higher People's Court held that insurer is under no legal obligation to make such enquiries. In *Nisitani Co (Japan) Ltd v People's Insurance Company of China, Qingdao Branch (The "Hang Tuo 2001")*,⁵⁹² the insurer, PICC Qingdao office, entered into a contract of insurance with the assured, North Sea Shipyard, against all risks, war risk and strike risk. All policies were later transferred to Nisitani by endorsement of North Sea Shipyard. The L/C and the commercial invoice have stated following information: "ONE SET OF SHIP-LOADER CONVEYOR", Carrying vessel: "HANG TUO 2001", Net Weight: "534.805 ton". Nisitani asserted that the insurer had waived the duty of disclosure as he failed to perceive, from the L/C and the commercial invoice, that there might be further material information which may otherwise be discovered, given that information stated on the L/C and the commercial invoice was sufficient to put a prudent underwriter on notice. The court was of the view that "HANG TUO 2001" did not indicate "航拖(Air drag) 2001". "An ordinary person including an insurer", as a matter of common sense, cannot be expected to carry an "unreasonably heavy burden" to discover further information which may otherwise be material if it was disclosed by reference to "fragmentary statements" expressed on the L/C and the commercial invoice. Thus, the insurer ought not to be known in the ordinary course of his/her business. Accordingly, the suggestion of waiver and constructive knowledge

⁵⁹¹ This point is considered in section 4.1.5.3(c) in the context of waiver.

⁵⁹² (2002) Lu(Shandong) Min(Civil) Si(the Fourth Tribunal) Zhong(Final) Zi No. 45

was rejected. Shangdong Higher People's Court also held that information published in a local newspaper or reported on local TV program does not necessarily make it a "public affair" which comes to light. The same principle has also been adopted in common law jurisdiction. A detailed discussion is provided in section 4.2.5.3(b), in the context of presumed knowledge.

4.3 Inducement

Given that the test of materiality held by the House of Lords is regarded as being too lenient, and therefore generous to the insurer, in July 1994, the House of Lords in *Pan Atlantic Insurance Co v Pine Top Insurance Co Ltd*⁵⁹³ conclusively adopted the concept of inducement as the second limb of the test of materiality for the purpose of preventing potential abuse of the remedy of avoidance by the insurer, with the benefit of hindsight, for a breach of the duty of disclosure. Inducement is presented at this context as a prevention mechanism. It was held that the insurer should only have a remedy of avoidance for non-disclosure or misrepresentation if it can show that the actual underwriter in question must have been induced by the circumstances withheld or misstated to enter into the contract on the same term.⁵⁹⁴ Since then the test of inducement became the dominant issue in the vast majority of cases.⁵⁹⁵

⁵⁹³ [1995] 1 A.C. 501

⁵⁹⁴ Earlier authorities rejecting the subjective test ceased to be effective. See, in particular, *Zurich General Accident and Liability Insurance Co v Morrison* [1942] 2 KB 53; *Container Transport International v Oceanus Mutual Underwriting Association* [1984] 1 Lloyd's Rep 476

⁵⁹⁵ *Sea Glory Maritime Co & Another v AL Sagr National Insurance Co* [2013] EWHC 2116 (Comm); *Lewis v Norwich Union Healthcare Ltd* [2010] Lloyd's Rep IR 198; *Drake Insurance plc v Provident Insurance plc* [2004] 1 Lloyd's Rep 268

4.3.1 Effect of IA 2015

The subjective inducement requirement has now entered on a statutory footing, as a separate concept, by the Insurance Act 2015, s. 8(1). It is phrased in the following terms:

(1) The insurer has a remedy against the insured for a breach of the duty of fair presentation only if the insurer shows that, but for the breach, the insurer –

(a) would not have entered into the contract of insurance at all,

or

(b) would have done so only on different terms.

Accordingly, there is no remedy until the insurer can prove that something different would actually have happened in underwriting terms had the duty of fair presentation not been broken. The remedy will be based upon that assumed outcome, albeit there is an automatic right of avoidance in cases of fraud or recklessness on the part of the assured.⁵⁹⁶ The notion of requiring proof of inducement, as a prerequisite to a remedy of avoidance, rather than as the second limb of the test of materiality, was borrowed from the Australian approach, i.e. the Insurance Contracts Act 1984, s. 29.⁵⁹⁷

4.3.2 Test of inducement

This is to be contrasted with the test of materiality: so far as the requirement of

⁵⁹⁶ R. Merkin, *Colinvaux's Law of Insurance* (11th edn, Sweet & Maxwell 2017) at 7-087

⁵⁹⁷ R. Merkin & O. Gurses, *The Insurance Act 2015: Rebalancing the Interests of Insurer and Assured* (2015) 78(6) Mod. L. Rev. 1004, footnote 28

inducement is concerned, a causal connection between non-disclosure and the conclusion of the policy must be shown. This is to be understood in the same sense in which it was used in the general law of contract.⁵⁹⁸ It was held that, to prove inducement, the insurer must show that the circumstance withheld or misstated had a decisive influence, in that it was a contributory cause, although not necessarily the only cause, in the making of the contract of insurance.⁵⁹⁹ Further, a detailed consideration to this issue was revealed by the Court of Appeal in *Drake Insurance plc v Provident Insurance plc*,⁶⁰⁰ in which it was clarified that it is necessary for the insurer to show that he was actually induced by the non-disclosure to accept the risk on terms that it would not otherwise have agreed to. In other words,

“it is not, however, sufficient for the insurer to show that the fact in question affected underwriting judgment, it is necessary for the insurer to go on to show that something different would actually have happened.”⁶⁰¹

Rix and Clarke LJJ thus took the view that, in determining whether the non-disclosure had induced the actual insurer to enter the contract, it is necessary to examine what would have happened, had the facts in question been disclosed or not misrepresented.⁶⁰² Pill LJ, in his dissenting judgment, expressed his deprecation to speculation of the court on these matters, and held that the burden is on the shoulder of the assured to demonstrate to the court that the

⁵⁹⁸ [1995] 1 A.C. 501, 549 (Lord Mustill).

⁵⁹⁹ *Assicurazioni Generali v Arab Insurance Group* [2002] EWCA Civ 1642.

⁶⁰⁰ [2004] Lloyd's Rep IR 277; see also *Toomey v Banco Vitalicio de Espana SA de Seguros y Reaseguros* [2004] EWCA Civ 685.

⁶⁰¹ R. Merkin & M. Hemsworth, *The Law of Motor Insurance* (2nd edn, Sweet & Maxwell 2015) at 2-64.

⁶⁰² *Drake Insurance plc v Provident Insurance plc* [2004] Lloyd's Rep IR 277 (Rix and Clarke LJJ).

course events have taken the suggested turn.⁶⁰³ The principle of inducement was recently highlighted in the view of Christopher Clarke J:

“To justify avoidance, the non-disclosure must be a real and substantial cause affecting the decision of the insurer to enter into the contract, or to do so on the terms agreed, the insurer bearing the onus of proving inducement on the balance of probabilities. No presumption of fact applies where the underwriter is called to give evidence.”⁶⁰⁴

It is important to note here that, in order to demonstrate inducement, it is not necessary to prove that the representee believed the representation to be true.⁶⁰⁵ Further, in *Involnert Management Inc v Aprilgrange Ltd*,⁶⁰⁶ Leggatt J pointed out that the legal test of inducement is not the same for misrepresentation as it is for non-disclosure.⁶⁰⁷ He then explained that in order to determine whether the making of a misrepresentation induced the representee to enter into a contract, the critical counterfactual question to ask must in principle be whether the representee would still have contracted on the same terms if the representation had not been made,⁶⁰⁸ while, in the case of non-disclosure, the question arises is what the insurer would have done if he had been told the truth.⁶⁰⁹ Therefore, the consequences of misrepresentation

⁶⁰³ *ibid* [179]-[181] (Pill LJ).

⁶⁰⁴ *Garnat Trading & Shipping (Singapore) Pte Ltd v Baominh Insurance Corp* [2010] EWHC 2578 (Comm); [2011] 1 Lloyd's Rep 589, at [135(i)]

⁶⁰⁵ *Zurich Insurance Co plc v Hayward* [2016] UKSC 48; [2016] 3 WLR 637; [2016] All ER (D) 138 (Jul)

⁶⁰⁶ [2015] EWHC 2225 (Comm)

⁶⁰⁷ *ibid* [211]

⁶⁰⁸ *ibid* [212]

⁶⁰⁹ *ibid* [213]

and non-disclosure may differ. Moreover, the distinction is not merely theoretical. Leggatt J stressed in particular that, when a misrepresentation is made to insurer, the facts which insurer would have been told if told the truth do not necessarily coincide with facts which the insured had a duty of disclosure.⁶¹⁰

It is worth noting that, by proving materiality, the burden of proof is shifted on to the insurer. In practice, it is generally difficult to prove that the insured did not disclose a material fact, in particular where there is only a standard proposal form. In *Greenhill v Federal Ins Co*,⁶¹¹ neither party obtained a clear recollection of correspondence as to the negotiation of the contract. The insurer argued that the fact was so material that he, as a prudent underwriter, would never have written the policy had he known the undisclosed fact, while the agent of the insured contradicted that the fact was so material that he, as an honest broker, must have disclosed it. In this situation, Scrutton LJ found that “it is inconceivable to me that the ordinary rate of premium should be charged for a cargo as to which an underwriter knew” the relative facts.⁶¹² Therefore, it seems that the insurer may be helped by the judge who, having listened to the evidence, may be persuaded that, had the facts been disclosed at the time of proposal, the particular insurer would have acted differently.⁶¹³ In this case, the broker was unable to find any reference to the fact in his documents relating to the transaction. However, it is not the broker, agent of the insured, but the

⁶¹⁰ *ibid* [215]

⁶¹¹ [1927] 1 KB 65

⁶¹² *ibid*, 79

⁶¹³ M. Clarke, *Law of Insurance Contract* (6th edn, Informa 2016), para 23-2.

insurer himself who must establish what has or has not happened.

It is clear from the decision of *Pan Atlantic* that an insurer must prove both materiality and inducement, although the adoption of the inducement test has rendered materiality more or less redundant. Materiality operated as a filter, taking out obvious cases where facts are plainly immaterial. Virtually every case since *Pan Atlantic* has turned on inducement. However, the House of Lords in that case left the question open on how materiality and inducement are to operate together. The issue here is whether proof of materiality in some way affects the degree – or even the burden – of proof required of the insurer for inducement.⁶¹⁴ IA 2015 does not take the matter any further. One possibility is the “presumption of inducement” propounded by Lord Mustill. Details are provided in next section. Clarke LJ has provided some guidelines on the relationship between materiality and inducement in *Assicurazioni Generali SpA v Arab Insurance Group (BSC)*⁶¹⁵ in the following phrase:

- (i) In order to be entitled to avoid a contract of insurance or reinsurance, an insurer or reinsurer must prove on the balance of probabilities that he was induced to enter into the contract by a material non-disclosure or by a material misrepresentation.

⁶¹⁴ R. Merkin, *Colinvaux's Law of Insurance* (11th edn, Sweet & Maxwell 2017) at 7-088.

⁶¹⁵ [2002] EWCA Civ 1642.

- (ii) There is no presumption of law that an insurer or reinsurer is induced to enter in the contract by a material non-disclosure or misrepresentation.
- (iii) The facts may, however, be such that it is to be inferred that the particular insurer or reinsurer was to induced even in the absence from evidence from him
- (iv) 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.⁶¹⁶

4.3.3 Presumption of inducement

Lord Mustill, vigorously opposed by Lord Lloyd, held that in *Pan Atlantic*, if the matter undisclosed was objectively material, there was a “presumption of inducement”, i.e. if a non-disclosure or misrepresentation would influence a prudent insurer, then it is likely to be the case that it in fact influenced the actual underwriter, and that the assured faces an “uphill task” in demonstrating to the court that the material facts have made no difference to the actual insurer in making the contract, “even where the underwriter is shown to have been

⁶¹⁶ *ibid* [62] (Clarke LJ).

careless in other respects".⁶¹⁷ Subsequently, the presumption of inducement have received some consideration and succeeded in *St Paul Fire & Marine Insurance Co (UK) Ltd v McConnell Dowell Constructors Ltd*.⁶¹⁸ In brief, one would, in practice, expect a finding of inducement to follow freely from a finding of materiality as a convenient excuse entitling the insurer in the event of a trial, not to be cross-examined on the assertion of inducement but instead permitting the insurer to rely on the presumption, then much of the benefit of the requirement of inducement from the point of view of the insured will be lost. It was for that reason that, in the marine case of *Marc Rich & Co AG v Portman*,⁶¹⁹ the Rt Hon Lord Justice Longmore suggested that, unless there was a good reason for the insurer who wrote the risk not to be called to give evidence,⁶²⁰ the presumption would be unlikely to apply, since the court would decide the point on the evidence that was before it rather than on the basis of any presumption.

It is now clear that the presumption of inducement is an exception rather than the rule.⁶²¹ Inducement cannot be inferred from proved materiality, as a matter of law.⁶²² Thus, there is no link between materiality and inducement.⁶²³ The insurer must prove inducement on the balance of probabilities, though there may be cases which may sometimes be possible to infer inducement from the

⁶¹⁷ *Pan Atlantic Insurance Co Ltd v Pine Top Insurance Co Ltd* [1995] 1 A.C. 501, 551 (Mustill LJ)

⁶¹⁸ [1995] 2 Lloyd's Rep 116

⁶¹⁹ [1996] 1 Lloyd's Rep 430 QB, 442

⁶²⁰ e.g. that the insurer was dead or unable to attend for inevitable reasons

⁶²¹ R. Merkin, 'Current Issues in Marine Insurance and Reinsurance Law' Seminar paper of Yeditepe University.

⁶²² *St Paul Fire and Marine Ins Co (UK) Ltd v McConnell Dowell Constructors Ltd* [1995] 2 Lloyd's Rep 116, 127, citing Lord Hailsham of Marylebone (ed), *Halsbury's Laws of England*, vol 31 (4th edn, Butterworth 1998) para 1067.

⁶²³ *Assicurazioni Generali v Arab Insurance Group* [2002] EWCA Civ 1642.

facts in the absence of direct evidence.⁶²⁴ Nevertheless, there is room for presumption of inducement where, “as it is not uncommon, the passage of time mean that the actual underwrite cannot be identified, or cannot be recall the particular transaction,” but it should only arise where materiality is clearly established.⁶²⁵ In *AXA Versicherung AG v Arab Insurance Group (BSC)*⁶²⁶, Males J commented that the presumption of inducement was not as a matter of law limited to cases where the insurer could not give evidence, but that this would generally be true as a matter of fact.⁶²⁷

4.3.4 Necessity of introducing test of inducement into Chinese insurance law

Whilst the principle of inducement is coming of age in English insurance law, Chinese insurance law has not commenced in paving its way on the test. Notably, judging from their guidelines concerning insurance disputes, some provincial higher courts in China have recognised the need for a causal connection when considering the reckless non-disclosure or misrepresentation by the assureds. Clearly, Chinese courts do not require demonstration of causation if the insured deliberately breach the duty of disclosure. The onus of proof is upon the insurer.

The Higher People’s Court of Shandong Province provides, in art. 7 of its

⁶²⁴ *Assicurazioni Generali v Arab Insurance Group* [2002] EWCA Civ 1642 [62(i)]; *Laker Engineering Ltd v Templeton Insurance Ltd* [2009] EWCA Civ 62.

⁶²⁵ Francis Rose, *Marine Insurance: Law and Practice* (2nd ed, Informa 2012) para 5.82.

⁶²⁶ [2015] EWHC 1939 (Comm).

⁶²⁷ R. Merkin, *Colinvaux’s Law of Insurance* (11th edn, Sweet & Maxwell 2017) at 7-089.

Guidance Notes as to Adjudication of Insurance Contracts Disputes (Trial),⁶²⁸ that the obligation of insurer shall not be discharged because of the assured's non-fulfillment of the duty of disclosure and that of the duty not to misrepresent, if there is no causal connection can be shown between the recklessly withheld or misstated facts and the occurrence of the loss. Meanwhile, the Higher People's Court of Zhejiang Province adopted a different approach. It is stated, in art. 7 of its *Guidance Notes concerning Adjudication of Insurance Contract Disputes*, that the obligation of insurer shall not be discharged because of the assured's non-fulfillment of the duty of disclosure and that of the duty not to misrepresent, if the facts undisclosed or misrepresented due to the insured's recklessness are not the main cause to the occurrence of the loss, therefore no decisive causal link between the facts and the insurers' obligation. By contrast, art. 6 of the Guideline published by the Higher People's Court of Guangdong Province indicates that insurer is not obliged to insurance indemnity, even if there is no causal connection is shown between the relevant facts recklessly concealed or distort by the proposer or the insured. Obviously, Guangdong Higher Court takes a stricter measurement than Shandong and Zhejiang provincial courts as to the enquiry of causal connection. The remarkable inconsistency between provisions of provincial guidelines constantly causes problems, in particular, contrarious decisions in different regions in China.

⁶²⁸ Published on Mar 17, 2011, passed on Mar 2nd, 2011 on 12th Meeting of the Judicial Committee of the Higher Court of Shandong Province. In order to correctly handle cases concerning insurance contracts, the Guidelines are formulated in accordance with the Contract Law of the People's Republic of China, the Insurance Law of the People's Republic of China and the relevant laws, regulations and judicial interpretations and with the legal practice of insurance disputes in Shandong province.

Although some have suggested that the definition of materiality stated in the MIA 1906 impliedly carries within it the essential concept of a causal link between the misrepresented or undisclosed facts and the insurer's right to avoid because of loss,⁶²⁹ it is not necessary to show, in common law, in order to avoid the policy on the ground of non-disclosure or misrepresentation, that the loss should have arisen from a cause connected with the circumstance concealed or misstated.⁶³⁰ Further, the Law Commissions have taken a special consideration on the idea, concerning negligent misrepresentation,⁶³¹ that the insurer would be required to show a link between a non-disclosure and any loss that had occurred. This idea was nevertheless rejected for the reason that "the test of causal connection would prove very difficult to apply in practice", particularly in circumstances of moral hazard.⁶³² It would be irrational for the insurer to have no remedy in the cases where he, with a negligent misrepresentation, accepted a proposal with a record of criminal conviction. "It would be wrong to hold an insurer to such a contract."⁶³³ The test of inducement is, as Lord Mustill noted in *Pan Atlantic*, a "question which concerns the need or otherwise, for a causal connection between the misrepresentation or non-disclosure and the making of the contract of insurance."⁶³⁴ The "causal link" considered by Chinese provincial courts is not the kind that referred in the test of inducement. Therefore, it might

⁶²⁹ Norma J Hird, 'Pan Atlantic – Yet More to Disclose' [1995] JBL 608

⁶³⁰ *Pan Atlantic v Pine Top* [1995] 1 A.C. 501, 528.

⁶³¹ The Law Commission has made clear that this approach does not apply to cases of deliberate or reckless misrepresentation, nor to "innocent" misrepresentation. See Law Commission, *Insurance Contract Law: Misrepresentation, Non-disclosure and Breach of Warranty by the Insured* (Law Com CP No 182, 2007) footnote 85.

⁶³² Law Commission, *Insurance Contract Law: Misrepresentation, Non-disclosure and Breach of Warranty by the Insured* (Law Com CP No 182, 2007) paras 4.174-4.175.

⁶³³ *ibid* para A. 33.

⁶³⁴ [1995] 1 A.C. 501.

be the time for legislatures in China to think a step further from materiality. And one thing that is necessary for Chinese judiciaries bear in mind when making judgments is the objective nature of the test.

Chapter 5 Insurer's Pre-Contractual Duty of Utmost good faith

5.1 Origin of the insurer's pre-contractual duty

It is accredited that the original formulation of the duty of utmost good faith, despite the missing term "utmost", in *Carter v Boehm*⁶³⁵ indicating that the principle is bilateral. It was recorded in the classic statement of Lord Mansfield,

"Good faith forbids either party by concealing what he privately knows, to draw the other into a bargain, from his ignorance of the fact, and his believing the contrary."

Marine Insurance Act 1906 embodied the bilateralism in s. 17 but, intentionally or unintentionally, failed to expand the duty mutually and omitted the corresponding test for determining materiality in terms of the insurer's duty of disclosure. Other sections of the legislation expanding on the s. 17, i.e. ss. 18 and 20, defined the test of materiality only as a duty imposed on the assured.⁶³⁶

While the 1906 Act was silent about the operation of insurer's pre-contractual duty of utmost good faith, Lord Mansfield may have left prophetic traces of instruction in certain passages of the judgment in *Carter v Boehm*⁶³⁷ which indicate that "the definition of materiality in respect of the insurer's duty is the mirror image of that operating for the assured's duty".⁶³⁸

⁶³⁵ (1766) 3 Burr. 1905

⁶³⁶ R. Merkin, *Colinvaux's Law of Insurance* (11th edn, Sweet & Maxwell 2017) at 6-035

⁶³⁷ (1766) 3 Burr 1905

⁶³⁸ *ibid.*

In China, the traditional view as to the origin of insurer's pre-contractual duty rests upon the proposition that this duty is a demonstration of the mutuality of utmost good faith, which has however been challenged in recent years since the second reform of the Insurance Act of PRC, namely, the 2009 Amendment. It is worth mentioning at this point that, unlike the common law position, a Chinese insurer is not required to disclose material facts to an assured but does own a statutory duty to explain to the insured the contents of an insurance policy, particularly clauses exempting insurer's liabilities and obligations, meanwhile an insurer must leave sufficient marks on those clauses so that the insured is not ignorant of and unable to discover them - the so-called "insurer's duty of prompt and explanation". It is suggested that this duty is based on the contract law concept of autonomy of the will⁶³⁹ and the civil law notion of honesty and good faith, which is conceptually distinctive from the common law principle of utmost good faith.⁶⁴⁰ Although the principle of honesty and good faith also requires conscience, integrity and goodwill, and resist concealment and fraudulent, the intension and extension of the concept are rather different.⁶⁴¹ Utmost good faith is not simply the maximization of honesty and good faith.⁶⁴² It is, therefore, doubtful to say that the insurer's pre-contractual duty of prompt

⁶³⁹ Ning MA, 'Boxianren Mingqueshuoming Yiwu de Pipan' [Criticism of the Insurer's Duty of Clear Explanation] (2015) 3 Chinese Journal of Law 102, 103 & 114.

⁶⁴⁰ Xinli HE & Chaowei FU, 'A Study of Explanation of Obligation of the Insurer' (2007) 17 Annual China Maritime Law 217; Yongmin WU & Bin HU, 'A Reflection on and Reconstruction of China's Insurance System of Insurer's Explanation Obligation: Comments on Article 17 of the New Insurance Law' (2010) 40(3) Journal of Zhejiang University (Humanities and Social Sciences) 88, 91.

⁶⁴¹ Xinli HE & Chaowei FU, 'A Study of Explanation of Obligation of the Insurer' (2007) 17 Annual China Maritime Law 217.

⁶⁴² Tian YIN, Peng SUN & Linqing JIA, 'Legal Regulation and Control on Chinese Insurance Market' (2000) Social Science Academic Press 115.

and explanation is theoretically originated from the two-way stretch of utmost good faith.

The duty of explanation owed by the contract drafter, in the realm of contract law, is one of the general pre-contractual duties of contracting parties generated by the notion of good faith,⁶⁴³ its legal objective and operational measure of which is highly consistent with that of the insurer's duty of prompt and explanation. Thus, it is clear that, unlike the common law position, the insurer's duty of prompt and explanation under Chinese law, with its own peculiar characteristics, is not a corresponding duty of but independent to insured's duty of misrepresentation. Details as to the insurer's pre-contractual duties under Chinese law are provided in the next section. The common approach of the insurer's duty of disclosure is discussed in detail thereafter.

5.2 Insurer's duty of explanation – the Chinese law innovation

The terms of contract, in particular insurance contract - a paradigm of standard form of contract which is unilaterally drafted by the insurer - are notoriously complex documents riddled with insurance jargon, and their layout is often muddled to the untrained eye.⁶⁴⁴ It has been reported that 74.8 per cent of consumer life insurance policyholders did not understand the precise meanings

⁶⁴³ Yongmin WU & Bin HU, 'A Reflection on and Reconstruction of China's Insurance System of Insurer's Explanation Obligation: Comments on Article 17 of the New Insurance Law' (2010) 40(3) Journal of Zhejiang University (Humanities and Social Sciences) 88, 91.

⁶⁴⁴ Zhen JING, *Chinese Insurance Contracts: Law and Practice* (Informa 2017) 288.

of insurance clauses.⁶⁴⁵ The information asymmetry resulted from the insured's deprivation of specialised knowledge as to standard terms and the misapprehension of contract terms that are above the insured's comprehension may lead to a false representation of the true intention of the insured on whether to enter into a contract of insurance. This issue was dealt with by an innovative legal method, namely, the insurer's duty of explanation, originated by Chinese legislatures,⁶⁴⁶ although the originality of the duty might be somewhat arguable.⁶⁴⁷ It is suggested that the mandatory requirement resting upon the insurer to produce detailed explanations of certain type of clauses in the policy nevertheless exists only in Chinese legal system.⁶⁴⁸

When the duty first appeared in the Insurance Act 1995, it reads: "If there are exclusion clauses provided by the insurer in the insurance contract, then the insurer shall make clear explanation in respect thereof to the proposer at the time of concluding the contract. Where such clauses are not clearly explained, they shall not be effective".⁶⁴⁹ It can be seen from this formulation that the duty of explanation owned by insurers relates to exclusion clauses in the policy. This provision had been redrafted in the second insurance law reform in 2009. There were two main developments: first, the scope of the exclusion clauses was broadened to all causes which exempt or limit obligation of an insurer; second,

⁶⁴⁵ Ibid.

⁶⁴⁶ Ning MA, 'Boxianren Mingqueshuoming Yiwu de Pipan' [Criticism of the Insurer's Duty of Clear Explanation] (2015) 3 Chinese Journal of Law 102, 102; Qirong FAN, *Baoxian Qiyue Gaozhi Yiwu Zhidu Lun* [The Regime as to the Duty of Disclosure in Insurance Contract] (CUPL Press 2004), 309.

⁶⁴⁷ Ning MA, 'Boxianren Mingqueshuoming Yiwu de Pipan' [Criticism of the Insurer's Duty of Clear Explanation] (2015) 3 Chinese Journal of Law 102, footnote [1].

⁶⁴⁸ Ibid.

⁶⁴⁹ Zhen JING, *Chinese Insurance Contracts: Law and Practice* (Informa 2017) 293.

a new duty was added against the insurer in respect of standard form of clauses.⁶⁵⁰ In 2015, the Insurance Act was revised again for the third time by the Standing Committee of the National People's Congress.⁶⁵¹ This time article 17 remained unchanged.

5.2.1 "Article 17"

Art.17 of the Insurance Act of PRC 2015 places concrete obligations on the shoulder of an insurer to explain policy terms when standard terms are deployed in an insurance policy; and to produce well-defined explanation of exclusion clauses to the applicant. The provision is phrased as follow:

Article 17 In the formation of contract, the insurer must provide insurance policy with the standard terms attached to the proposer where such clauses are deployed, and explain to the proposer the contents of the contract.

The insurer must give sufficient prompt, on the insurance application form, the insurance policy or any other insurance certificate, to bring clauses exempting insurer's obligations to the proposer's attention before the contract is entered into; and produce a clear explanation of the exemption clauses embodied in the policy in either a written or oral form; failure of compliance renders the provision null and void.⁶⁵²

⁶⁵⁰ Insurance Act of PRC 2009, art.17.

⁶⁵¹ Order of the President of the People's Republic of China No.26.

⁶⁵² Author translation.

The legislative purpose of art. 17 is to balance information asymmetry between contractual parties so as to protect the insured, mainly consumers, against a misuse of insurer's superiority in drafting terms of an insurance policy.⁶⁵³ There are four duties of insurer that are listed in the provision:

- a duty to present the standard terms attached to the insurance policy;
- a duty to explain the content of the contract;
- a duty to give sufficient prompt to draw clauses exempting insurer's liabilities and obligations embodied in the policy to the proposer's attention; and
- a duty to provide an unambiguous and definite illustration, oral or written, of clauses exempting insurer's liabilities and obligations.

While the insurer is, under English law, required to disclose to the insured all material known to him facts relating to the risks insured in the policy, the scope of insurer's statutory pre-contractual duties formulated in art. 17 have been confined to explanation of certain types of policy terms. Disclosure sounds a far narrower concept than explanation, insofar as art. 17 is silent about the definition of explanation, the wide conceptual term "explanation" only leads to a great uncertainty. Its interpretation is unclear. There are two levels of obligations indicated in art. 17 in respect of different types of clauses: the first two duties are aiming at the contents of standard form attached in insurance policy, the purpose of which is to allow the insured to gain a better

⁶⁵³ Yongmin WU & Bin HU, 'A Reflection on and Reconstruction of China's Insurance System of Insurer's Explanation Obligation: Comments on Article 17 of the New Insurance Law' (2010) 40(3) Journal of Zhejiang University (Humanities and Social Sciences) 88, 89.

understanding of contract terms, mainly clauses as to the scope of risks sought to be covered in the policy; and the further two higher-level duties are in allusion to exclusion clauses, the purpose of those duties is more obvious, that is to protect the insured against the insurer's abuse of exemption.

5.2.2 Practical issues

The enforceability of the duties at both levels are problematic, especially the latter. Insofar as no implementing rules are given under the Act, art. 17, as the most controversial provision both theoretically and practically, have become one of the most commonly disputed matters amongst all kinds of insurance disputes.⁶⁵⁴ From 2009 to 2013, i.e. before publication of the Second Judicial Interpretation of the Supreme People's Court on Several Issues Concerning the Application of the Insurance Law of the PRC in May 2013 (the "Interpretation II")⁶⁵⁵, 96.2 per cent of insurers among 482 insurance cases have lost in their lawsuit on the ground of failure to comply with art. 17: in 385 of which, insurer failed to provide evidence in support of fulfillment of their pre-contractual duties; and in the residual 97 cases, the Chinese courts have again rejected insurers' allegation on the ground that implementing measures taken by the insurer were insufficient even where there was supportive evidence.⁶⁵⁶

⁶⁵⁴ Ning MA, 'Boxianren Mingqueshuoming Yiwu de Pipan' [Criticism of the Insurer's Duty of Clear Explanation] (2015) 3 Chinese Journal of Law 102, 102.

⁶⁵⁵ Interpretation No. 14 [2013], adopted at the 1577th meeting of the Judicial Committee of the Supreme People's Court on May 6, 2013.

⁶⁵⁶ Ning MA, 'Boxianren Mingqueshuoming Yiwu de Pipan' [Criticism of the Insurer's Duty of Clear Explanation] (2015) 3 Chinese Journal of Law 102, 104.

Market practice in the past decade shows that some insurers, in accordance with requirements under art. 17, have managed to insert into an insurance policy: (a) an insurer's obligation section and a functional provision to remind the insured of the standard terms and exemption clauses contained in the contract;⁶⁵⁷ and (b) an "Insured's Declaration" sector requiring the insured to read the exemptions and ask questions if there is any.⁶⁵⁸ Meanwhile, insurers also made the exemptions in bold and bigger typefaces for heavier emphasis to grab the reader's attention.⁶⁵⁹ However, the above methods are not quite satisfactory to the courts. One of the interesting grounds given by the courts for a refusal was that, the insured claimed that he himself did not understand the meaning of the exemption clauses, even the insured had been informed and explained the exemption clauses and he had indeed signed in the "insured's Declaration" sector.⁶⁶⁰ Hence the art. 17 has to some extent become the assureds' shield and buckler, which therefore placed insurance firms in an adverse position in trial.

⁶⁵⁷ Yongmin WU & Bin HU, 'A Reflection on and Reconstruction of China's Insurance System of Insurer's Explanation Obligation: Comments on Article 17 of the New Insurance Law' (2010) 40(3) Journal of Zhejiang University (Humanities and Social Sciences) 88, 89.

⁶⁵⁸ Ning MA, 'Boxianren Mingqueshuoming Yiwu de Pipan' [Criticism of the Insurer's Duty of Clear Explanation] (2015) 3 Chinese Journal of Law 102, Table 1 at 104; Yongmin WU & Bin HU, 'A Reflection on and Reconstruction of China's Insurance System of Insurer's Explanation Obligation: Comments on Article 17 of the New Insurance Law' (2010) 40(3) Journal of Zhejiang University (Humanities and Social Sciences) 88, 89.

⁶⁵⁹ Yongmin WU & Bin HU, 'A Reflection on and Reconstruction of China's Insurance System of Insurer's Explanation Obligation: Comments on Article 17 of the New Insurance Law' (2010) 40(3) Journal of Zhejiang University (Humanities and Social Sciences) 88, 92.

⁶⁶⁰ Ning MA, 'Boxianren Mingqueshuoming Yiwu de Pipan' [Criticism of the Insurer's Duty of Clear Explanation] (2015) 3 Chinese Journal of Law 102, Table 1 at 105.

5.3 The common law position

Although the concept that the duty of utmost good faith is reciprocal has been made patently clear and put on an explicit statutory footing in England, there were barely any cases to hold in terms that the insurer owes a duty of utmost good faith to the assured until *Banque Keyser Ullman SA v Skandia (UK) Insurance Co Ltd*,⁶⁶¹ in which this point was first addressed and heavily discussed by Steyn J.

5.3.1 The “*La Banque Financière*”

In this case, syndicates of banks, including La Banque Financière (LBF) (formerly Banque Keyser Ullman SA) entered into separate loan agreements totalling 80 million Swiss francs with four companies owned or controlled by B, secured by the deposit of gemstones with certified valued at 95 million Swiss francs and by a credit insurance policy for 37 million Swiss francs. N, a reputable firm of Lloyd’s brokers who was appointed to act as the banks’ agent, were instructed by the banks to arrange the credit insurance. The banks were named as co-insured or assignees under those policies. L, an employee of the brokers, found it impossible to place the required insurance as one risk, and therefore sought to arrange insurance in layers. In January 1980 cover notes certifying that total insurance of the initial loan had been effected were issued by L who was subsequently found to have acted fraudulently, in that the primary layer insurance which was to be underwritten by Westgate Insurance (WI)

⁶⁶¹ [1987] 2 All E.R. 923.

(formerly Hodge General & Mercantile Insurance Co Ltd) had not been arranged when cover notes were issued; by June 1980, the full amount of insurance had nevertheless been obtained by L. Further advances were made. By May 1980, D, an employee of WI, became aware of L's fraud, but he failed to disclose this to LBF. In the event, that fraud proved to be of no significance as matters were rectified by L. By March 1981, LBF and five other banks made a total amount loaned, i.e. 80 million Swiss francs, to B. Subsequently, a further insurance to cover the advances was needed and further false cover notes were again issued by L. Upon the default of repayments, the gemstones were found to be virtually worthless and the additional insurance did not exist. In 1983 LBF and other banks brought actions against N and L for negligence and fraud respectively. LBF also sought to recover under such insurance as did exist, but was rejected as the result of a fraud exclusion clause in the policies, which stated that the insurers were not liable "for any claim or claims arising directly or indirectly out of or caused directly or indirectly by fraud attempted fraud misdescription or deception by any person firm organisation or company". LBF however raised an alternative argument in the proceedings against the insurer, and alleged that the insurers, being aware through D of L's fraud, owed a pre-contractual duty of disclosure to the banks.

At first instance, Steyn J reaffirmed the mutuality of the duty of disclosure, which was later approved in principle on appeal by the Courts of Appeal and the House of Lords in *La Banque Financière de la Cité SA v Westgate Insurance*

*Co Ltd.*⁶⁶² It was held, by the Court of Appeal, that the insurer's failure, during the negotiations leading to the contract of insurance in respect of the second loan, to inform the banks of L's deceit had indeed been a breach of the insurer's duty of utmost good faith. However, Slade LJ was opposed to the scope of the duty and the test of materiality in determining such a duty.

5.3.2 Scope of the insurer's duty of the disclosure

In *Carter v Boehm*,⁶⁶³ Lord Mansfield had provided an example of what an insurer has to disclose:

“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.”

It might be able to infer from “the arrival of a ship” that, as a matter of principle, those circumstances which are material and which are to be disclosed by an insurer are circumstances which decrease rather than increase the risk to the assured.⁶⁶⁴ However, this approach was not quite fit the circumstances of *La Banque Financière*, because the fact alleged to be material were that the leading underwriter had failed to disclose to the banks the earlier fraud of their broker, which in fact related not the insured risk but to the circumstances

⁶⁶² [1989] 2 All E.R. 952; [1990] 2 All E.R. 947.

⁶⁶³ (1766) 3 Burr. 1905.

⁶⁶⁴ R. Merkin, *Colinvaux's Law of Insurance* (11th edn, Sweet & Maxwell 2017) at 6-035.

relating to the setting up of the policy itself; and that did not involve material facts as defined in *Carter v Boehm*.⁶⁶⁵

In considering the ambit of the duty, Steyn J at first instance was of the view that the duty of disclosure of insurers will cover matters peculiarly 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”.⁶⁶⁶ However, the “good faith and fair dealing” test, which are not the tests embodied in Section 18 of the Act of 1906, was rejected by the Court of Appeal as being far too broad and vague, therefore uncertain for determining the existence of a duty which might arise “even in the absence of any dishonest or unfair intent”, for example, the fact that other insurers offered similar cover but at a lower premium.⁶⁶⁷ By contrast with the “mirror image” concept raised by Lord Mansfield, Slade LJ thought that:

“in adapting the well established principles relating to the duty of disclosure falling upon the insured to the obverse case of the insurer himself, due account must be taken of the rather different reasons for which the insured and the insurer require the protection of full disclosure”,

⁶⁶⁵ *ibid*, at 6-036.

⁶⁶⁶ *Banque Keyser Ullmann SA v Skandia UK* [1990] 1 QB 665, 703.

⁶⁶⁷ *ibid* 772.

Upon which his Lordship provided a general statement of principle:

“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 or to the recoverability of a claim under the contract, which a prudent insured would take into account in deciding whether to place the risk with the insurer.”⁶⁶⁸

Applying that test, the Court of Appeal held that the leading underwriter was in breach of the duty of utmost good faith because the insured would have recognised a possible danger that the policy might prove to be unenforceable because of the fraud exclusion clause, or voidable.⁶⁶⁹ The House of Lords, opposing the conclusion, argued that a fraud exclusion clause in a policy does not extend to fraud by the assured’s broker in setting up the policy.⁶⁷⁰ L’s fraud thus did not affect the recoverability of a claim within the Court of Appeal formulation of the test of materiality. The question then arose at this point is whether the fact in question would have been material, had the fraud exception applied to L’s fraud. The answer is no. The loss suffered by the assured is the inability to recover under the policy,⁶⁷¹ but this were not the consequences of the failure of the insurer to disclose the misconduct of L.⁶⁷² No authority was cited for the proposition that a negotiating party owed a duty to disclose to the opposing party information that the broker of the opposite party committed a

⁶⁶⁸ *ibid* 772.

⁶⁶⁹ *ibid* 773.

⁶⁷⁰ *La Banque Financière de la Cité SA v Westgate Insurance Co Ltd* [1990] 2 Lloyd’s rep 377, 380.

⁶⁷¹ *ibid* 389 (Jauncey of Tullichettle LJ).

⁶⁷² *ibid* 380, 384, 385, 388 and 389.

breach of the duty he owed to his principal in an earlier transaction.⁶⁷³ The House of Lords followed closely the narrow *Cater v Boehm* test, and confined the insurer's duty of disclosure to insured perils, however, it does not extend to the legal meaning of contract terms.⁶⁷⁴ This was confirmed in *Norwich Union Life Insurance Society v Qureshi*.⁶⁷⁵ Mummery LJ held in the leading judgment that the duty of good faith applied only to matters material to the risk covered by the life policy, i.e. to the recoverability of a claim in respect of the assured's life under the policy.

5.4 The duty to explain policy terms

Compared to the duty of explanation, the insurer's duty of presentment, applying only to the standard terms attached to the insurance policy not to the entire contract, is nicely set out by art. 17 par. 1. No issues at all have ever arisen out of it.⁶⁷⁶ The duty to explain to the assured the content of contract was codified in such a broad and general terms and it seems unreasonably ambiguous: for example, (a) no legal consequence was identified; (b) no definition of "content of contract" was clarified; (c) no operational measures were indicated; (d) the silence on the issue of to what extent an insurer should explain; and (e) the omission in respect to the matter on whether an insurer must volunteer a full illustration of policy terms. However, surprisingly, there is an absence of disputes involving insurer's failure of explanation. The only

⁶⁷³ *ibid* 384 (Templeman LJ).

⁶⁷⁴ R. Merkin, *Colinvaux's Law of Insurance* (11th edn, Sweet & Maxwell 2017) at 6-038.

⁶⁷⁵ [1999] Lloyd's Rep IR 263.

⁶⁷⁶ Ning MA, 'Boxianren Mingqueshuoming Yiwu de Pipan' [Criticism of the Insurer's Duty of Clear Explanation] (2015) 3 Chinese Journal of Law 102, 104.

possibility to expound this phenomenon is that the duty is the inability to perform. Leaving the matters (a), (b), (c) and (d), so long as (e) is considered: if the answer was yes, the insurer will undertake unbearable costs in acting out this duty;⁶⁷⁷ even if the duty were entirely passive, the difficulty in gathering evidence might again turn the light off. In fact, the real question that is of a quiet contemplation here is whether it is necessary to exert such a troublesome duty on the insurer in the era of market economics. At this point it is useful to consider the English approaches along with the Australian experience to see what might be improved in the near future.

5.4.1 The English approaches

Generally, there is no obligation on the insurer to disclose policy terms under English law, any duty of disclosure owed by insurers relates to recoverability of a claim in the policy. There might be an exception offered by s. 2(1) of the Misrepresentation Act 1967, where the insurers are aware of assured's wrongful belief as to the coverage provided by the policy but have not corrected it, particularly where that mistake has been induced by a positive misstatement by the insurers as to the scope of cover.⁶⁷⁸ In such circumstances, assureds are granted a statutory permission to claim damages. Further, estoppel can be an alternative if insurers knew that assureds rely upon a misapprehension of a contract term; but the common law is not "promising" on this point; one thing

⁶⁷⁷ *ibid.*

⁶⁷⁸ R. Merkin, *Colinvaux's Law of Insurance* (11th edn, Sweet & Maxwell 2017) at 6-044.

almost certain is that the insurer's passive action would not amount to an estoppel, so a positive statement might be needed.⁶⁷⁹

Insurers might in some circumstances, be under an obligation to disclose inadequacy of cover to the assured. This issue has been given some concern by the Court of Appeal in the case of *La Banque Financière de la Cité SA v Westgate Insurance Co Ltd*.⁶⁸⁰ The Court held that there was no duty of care on the insurers to ensure that material facts as to the fraud of the assured's broker were disclosed to the banks. This finding did not receive much consideration as it should be when it was appealed to the House of Lords, but Lord Jauncey stated that any duty of care could not go beyond what was required by the insurer's duty of disclosure. The duty of care can arise if "the usual requirements for the imposition of that duty are satisfied", i.e. the insurers undertake additional responsibility towards the assured.⁶⁸¹ So far:

"The courts have not been readily persuaded that insurers have gone beyond their ordinary responsibilities under a contract of insurance and have not undertaken any additional duty to warn the assured of the risky nature of the policy".⁶⁸²

This finding coincides with New Zealand approach confirmed in *Lovett v Crown Worldwide (NZ) Ltd*,⁶⁸³ that the principle of utmost good faith can never exert an

⁶⁷⁹ *ibid.*

⁶⁸⁰ [1989] 2 All E.R. 952; [1990] 2 All E.R. 947.

⁶⁸¹ R. Merkin, *Colinvaux's Law of Insurance* (11th edn, Sweet & Maxwell 2017) at 6-046.

⁶⁸² *ibid.*

⁶⁸³ (HCNZ, 29 October 2004,) Auckland Registry.

extra contractually duty on an insurer to disclose or ensure that an insured party understands terms and conditions already settled between them by agreement.⁶⁸⁴ It is arguable that the gate is opened in Australia where cases are decided under the implied terms for utmost good faith. Details are provided below.

5.4.2 The Australian position

Insurers are under a statutory duty to notify the assured of matters relating to the policy.⁶⁸⁵ This duty, explicitly stated in s. 13 of the Insurance Contract Act 1984, is contractual; hence it is by its words unlikely to impose a pre-contractual duty of utmost good faith.⁶⁸⁶ Nevertheless, the generous formulation of the words “in respect of any matter arising under or in relation to” an insurance policy may possibly be construed to be wide enough to deal with pre-contractual matter.⁶⁸⁷ The insurer’s pre-contractual duty of utmost good faith under Australian law is conferred by a legislative framework composing by various provisions of ICA 1984, namely, s. 22, s. 23, ss. 33A-D and ss. 34 to 37E.⁶⁸⁸ Some detailed analysis as to the potential scope of the duty is provided below.

Before that, it is worth mentioning that mere silence of the insurer does not amount to a breach of utmost good faith. In *Speno Rail Maintenance Australia*

⁶⁸⁴ R. Merkin, *Colinvaux’s Law of Insurance* (11th edn, Sweet & Maxwell 2017) at 6-042.

⁶⁸⁵ R. Merkin, “*Reforming Insurance Law: Is There a Case for Reverse Transportation?*” – A report for the English and Scottish Law Commissions, para 5.6.

⁶⁸⁶ *Speno Rail Maintenance Australia Pty Ltd v Hamersley Iron Pty Ltd* [2000] WASCA 408 [28]

⁶⁸⁷ W I B Enright & R. Merkin, *Sutton on Insurance Law*, vol 1 (4th edn, Thomson Reuters 2015) at 6-110.

⁶⁸⁸ *ibid* .

Pty Ltd v Hamersley Iron Pty Ltd,⁶⁸⁹ as a result of the negligence of employees of Hamersley, two employees of Speno were injured while they were performing certain rail grinding work under a contract between Speno and Hamersley. It was a term of the contract that Speno would indemnify Hamersley against all liability to the injured workers. Speno obtained a general liability policy and an umbrella policy with Zurich pursuant to its contract with Hamersley. There was no express representation by Zurich that the cover would be provided. Zurich remained silent and simply issued policies which did not meet the required specification. The question was whether Zurich, as the insurer, was under a positive duty to disclose that it had not covered the liability. Wheeler J, having stated that by analogy to the counter-offer concept an insurer is under no obligation to specifically draw to the attention of the insured every way in which the policy proposed may differ from that sought by the insured, continued that in the absence of any express representation by Zurich that the proposed terms would respond in the way requested by Speno, and in the context of an insurer negotiating with a party who would appear to have some experience in commercial and insurance matter, there was no breach of utmost good faith in the course taken by Zurich.⁶⁹⁰ The insured's commercial knowledge and the legal advice received have also been taken into consideration in the judgment of *Small Business Consortium Lloyd's Consortium No 9056 v Angas Securities Ltd*,⁶⁹¹ in which it was held that there was no breach of the duty of utmost good

⁶⁸⁹ [2000] WASCA 408.

⁶⁹⁰ *ibid* [177]-[178].

⁶⁹¹ [2015] NSWSC 1511.

faith in failure by the insurers to explain the terms of the release.⁶⁹² By this token, the outcome might be reversible in respect of consumer matters.

5.4.2.1 Key Facts Sheet

For the purpose of giving greater clarity to consumers about their insurance cover, part IV Division IV of the ICA 1984 concerns “Key Facts Sheet” (KFS) for home building and home content (combined and individual) insurance policy imposing a duty upon the insurer to provide a single-page disclosure document in the prescribed format to consumers for them to obtain a quick and easy access of key information, including the nature of cover and any key exclusions.⁶⁹³ The content of the KFS is set out in the Regulation.⁶⁹⁴ A KFS, subject to the exceptions, must be provided as soon as reasonably practicable, but no later than 14 days, after the consumer first requests information about the contract, and enters (including renewals, but any extension, variation or reinstatement are excluded) into the contract or potential contract with the insurer.⁶⁹⁵ The requirement to provide a KFS rests with the insurer.⁶⁹⁶ There is no direct obligation on an insurance broker to provide a client with a KFS. This document, however with the limited nature of the information provided, does not cover everything and it does not take into account any specific circumstances of individuals. It is of significant importance to note that, pursuant to s. 33(D), “the

⁶⁹² R. Merkin, *Colinvaux's Law of Insurance* (11th edn, Sweet & Maxwell 2017) at 6-042.

⁶⁹³ Insurance Contract Act 1984 s. 33(C); The Treasury Discussion Paper, February 2012

<http://archive.treasury.gov.au/documents/2322/PDF/KFS_homebuilding.pdf> accessed 29 Nov 2017.

⁶⁹⁴ Insurance Contract Act 1984 s. 33(B),

⁶⁹⁵ Insurance Contracts Regulations 1985, part 4 division 4 regulation 4C(2).

⁶⁹⁶ Insurance Contract Act 1984 s.33(C).

provision by an insurer of a KFS to a person does not constitute clearly informing the person of the matter contained in the KFS". Thus providing a KFS will not discharge an insurer's duty to notify an assured certain terms of an insurance policy.

5.4.2.2 Notification of non-standard and unusual terms

S. 14(3) of the ICA 1984 provides that:

In deciding whether reliance by an insurer on a provision of the contract of insurance would be to fail to act with the utmost good faith, the court shall have regard to any notification of a kind mentioned in s. 37 or otherwise.

S. 37 of the ICA 1984 requires an insurer to "clearly inform" an insured in writing, prior to the making of the contract, of the effect of any unusual terms of a kind not usually included in contract of insurance (not being a prescribed contract)⁶⁹⁷. Unless the insurer does so, the unusual terms become void. Meanwhile, by virtue of s. 35 of the 1984 Act, insurers are also under a statutory duty to notify the insured, before the contract was entered into, any non-standard policy terms of a prescribed contract, regardless the utmost good faith. By contrast, the requirements of presentment and explanation of standard clauses stipulated in art. 17 par. 1 of the IAC 2015 looks rather unnecessary at this point. In fact, non-standard and unusual terms are more challenging in

⁶⁹⁷ Definition of "prescribed contract" and "prescribed event" are stipulated by s. 34 of Insurance Contract Act 1984, namely, motor vehicle insurance, home building insurance, home contents insurance, sickness and accident insurance, consumer credit insurance and travel insurance (see Part II of the Insurance Contracts Regulations 1985 (as amended)).

practice as standard insurance contracts or standard clauses of an insurance policy are generally written and/or approved and recorded by CIRC for the purpose of protecting public interest.⁶⁹⁸

The proper construction of the phrase “clearly informed the insured in writing”, appearing in ICA 1984 s. 35(2), was considered by the New South Wales Supreme Court in *Hams v CGU Insurance Ltd*.⁶⁹⁹ Prior to this case, however, the words in that section have not been considered in any reported case, despite only the phrase received much discussion in *Suncorp General Insurance v Cheihk*⁷⁰⁰, for the purpose of ICA 1984 s. 22(1). The affinity of s. 35(2) with s. 22(1) was, for the first time, referred to in *Hams v CGU Insurance Ltd*.⁷⁰¹ S. 22(1) of the ICA 1984 imposes on insurers a statutory duty to inform the assured of the nature and effect of the duty of disclosure, failure to do so preventing the insurer from relying upon that duty.

In *Suncorp*, Stein JA, citing *Lumley General Insurance Limited v Delphin*,⁷⁰² accepted that “inform” means to “make known”. He continued stating that “the adverb ‘clearly’ is a plain English word and its ordinary meaning would convey the need for some precision in the making known of the relevant duty”.⁷⁰³ In addition to that, the Court held that, without appropriate cross-referencing or

⁶⁹⁸ Insurance Act of PRC 2015, art. 135.

⁶⁹⁹ [2002] NSWSC 273.

⁷⁰⁰ [1999] NSWCA 238.

⁷⁰¹ [2002] NSWSC 273 [236]-[237] and [240].

⁷⁰² (1990) 6 ANZ InsCas 60-986, 76,565.

⁷⁰³ *Suncorp General Insurance Ltd v Cheihk* [1999] NSWCA 238 [14] (Stein JA).

highlighting, the mere supply to the insured by the insurer of a statement of the duty of disclosure on the reverse side of a certificate of insurance failed to “clearly inform” the insured of his duty of disclosure.⁷⁰⁴ Einstein J in *Hams v CGU*, adopting the Suncorp approach, held that, in the ordinary course, the insurer’s obligation to “clearly inform” of unusual policy terms could be met by simply providing the insured with a copy of the policy wording which in plain English language.⁷⁰⁵ Thus, the insurer is in most circumstances not obliged to provide extra documentation identifying and explaining the construction of particular provision of the insurance policy. In addition, the Supreme Court of New South Wales has also recognised that there may be special circumstances in which the complexity of, or confusions within, the policy wording prevent this from being so.⁷⁰⁶ Therefore in each case the content of the document and all of the circumstances of its provision would need to be considered in order to determine if the insurer had effectively informed the insured of the limitation.⁷⁰⁷ This approach was followed recently by the Northern Territory Supreme Court of Appeal in *Marsh v CGU Insurance Ltd t/as Commercial Union Insurance*.⁷⁰⁸ In this case, the court found that an insured had been “clearly informed” that there was no cover for flood under the policy because the insured had been provided with a copy of the policy wording and the policy wording contained a flood exclusion in clear and unambiguous language and was in a manner which a

⁷⁰⁴ *ibid* [10] (Stein JA).

⁷⁰⁵ *Hams v CGU Insurance Ltd* [2002] NSWSC 273 [243].

⁷⁰⁶ *ibid* [242].

⁷⁰⁷ *ibid* [243].

⁷⁰⁸ [2003] NTSC 71.

person of average intelligence and education was likely to have little difficulty in finding and understanding.

5.4.3 Treatment for exclusion clauses

Art. 17 par. 2 of the IAC 2015 imposes on insurers some higher-level obligations to volunteer an unambiguous and well-defined explanation of exclusion clauses in the policy, which is named the duty of “clear illustration”. The duty is not dependent on any prior request by the insured. Unlike the insurer’s general duty to explain the contents of contract to which no operation measure has ever been indicated in either the Act or any of the judicial interpretations, the “Interpretation II” has set up trial criteria for the performance of art. 17 par. 2.

5.4.3.1 Scope of exclusion clauses

The original wording set out in the IAC1995 was as follow:

If there are exclusion clauses provided in an insurance contract, the insurer shall make clear explanation in respect thereof to the proposer before the contract is entered into. Where such clauses are not clearly explained, they shall not be effective.⁷⁰⁹

In 2009, during the second insurance law reform, the words “exclusion clauses” was superseded by the phrase “clauses exempting insurer’s liabilities and obligations” so as to broaden the so limited definition of “exclusion clauses” and

⁷⁰⁹ Author translation.

so cover clauses which are indeed limits or exempts insurer's liability but are not labeled as an "exclusion clause".⁷¹⁰ There are strong divergences of views on determination of the scope of "clauses exempting insurer's liabilities and obligations".⁷¹¹ This issue has now been clarified by the Interpretation II art. 9, in which it states that the "insurance liability exemption" indicated in the Insurance Act of PRC 2015 art. 17 par. 2 shall include any deductible and franchise clause, pro rata liability clause and any other clauses excluding or limiting the obligations of insurer contained in the standard form of insurance contract. A clause conferring upon an insurer the right to terminate the contract where an insured breaches statutory or contractual obligations is nevertheless beyond the definition of "insurance liability exemption."⁷¹² Further, insurance exclusions that consist of statutory and/or administrative rules/regulations on actions expressly prohibited by law have also been eliminated from the scope of the insurer's duty of clear explanation. Art.10 of the Interpretation II provides that where an insurer incorporates rules/regulations on actions expressly are prohibited by laws or regulations, as exemption clauses, into an insurance contract and prompts for the insured, a proposer, an insured or a beneficiary claims that such a clause is ineffective on the ground that the insurer has not fulfilled the obligation of clear explanation, the People's Courts shall not uphold such claims. It means that, for this type of insurance exclusions, an insurer is only obliged to draw those to an insured's attention. No explanation is needed at this point. It should be noted

⁷¹⁰ Zhen JING, *Chinese Insurance Contracts: Law and Practice* (Informa 2017) 293-294.

⁷¹¹ Ning MA, 'Boxianren Mingqueshuoming Yiwu de Pipan' [Criticism of the Insurer's Duty of Clear Explanation] (2015) 3 Chinese Journal of Law 102, 102.

⁷¹² The Interpretation II, art. 9 par. 2.

that here the laws and administrative regulations refer to those enacted by the National People's Congress and the State Council.⁷¹³

5.4.3.2 General operation rules

The Supreme People's Court founded, in the Interpretation II, art. 11 requisite criteria for Chinese courts to determine whether an insurer has fulfilled its obligations set forth in art. 17 par. 2 of the IAC 2015. Art.11 has also confirmed that the duty of prompt is an obligation that is independent of duty of clear explanation; it is not a subsidiary of the latter duty. Art. 11 par. 1 provides that, in the making of an insurance contract, where the insurer has given prompt, on the insurance application form, the insurance policy or any other insurance certificate, by using certain words, font, symbol or any other conspicuous marks that are sufficient to bring insured's attention to the clauses excluding obligations of an insurer, the court shall hold that the insurer shall be discharged from its duty of prompt. As to the duty of clear explanation, the Interpretation II art. 11 par. 2 states that the illustration of concepts, contents and legal consequence of the relevant insurance exemption clauses made by the insurer, in either a written or oral form, must be comprehensible to ordinary minds. If so, the courts shall affirm the fulfillment of the duty of clear explanation stipulated in art. 17 par. 2 of the IAC 2015. The test is objective.⁷¹⁴ Satisfaction of the test offers judicial guarantees to the insurers. The Supreme People's Court was

⁷¹³ Zhen JING, *Chinese Insurance Contracts: Law and Practice* (Informa 2017) 303 & footnote 55.

⁷¹⁴ Zhiqiang LI, *Zui Gao Renmin Fayuan Baoxianfa Sifa Jieshi Jingshi Jingjie* [Understanding and Application of Judicial Interpretations of Insurance Act] (China Legal Publishing House 2016), 115.

silent on the definition of “ordinary minds”, which will be left to individual court to decide. Discretion of judges will almost certainly lead to multiple, therefore uncertain, standards in different regions of China. It is suggested that “ordinary mind” refers to one who is middle school or junior high school graduates.⁷¹⁵

Further, even if a written form of explanation is produced, the insurer is still required to answer the insured’s questions about exclusion clauses, until the insured fully understands them.⁷¹⁶ In regard to the method, an analogy is the transparency requirements imposed by s. 17(2) of the IA 2015, under which “the insurer must take sufficient steps to draw the disadvantageous term to the insured’s attention” prior to the making of the contract. There is no need for the insurer to ensure that the insured has actual and full knowledge of the terms being contracted out. What exactly amounts to sufficient steps will depend on the characteristics and sophistication of the insured and the circumstances of the transaction.⁷¹⁷ The issue as to contracting out is considered in Chapter 3.

The Interpretation II further clarifies the method for performing the duty of clear explanation for online or telephone sales of insurance contracts. Art. 12 indicates that for contracts that are formed via internet or by telephone, the people’s courts shall recognise the fulfillment of insurer’s obligation of prompt and that of clear explanation where the insurer performs its duties by providing

⁷¹⁵ *ibid*

⁷¹⁶ Zhen JING, *Chinese Insurance Contracts: Law and Practice* (Informa 2017) 310.

⁷¹⁷ Insurance Act 2015, s. 17(4).

webpage, audio, video or other forms of materials to the insured. The oral or written form of explanation can be provided via email or online communication tools.⁷¹⁸ Moreover, the Interpretation II art. 13 par. 2 has made it clear that the insurer's obligation is deemed to have been fully complied pursuant to Interpretation II art. 11 par. 2, where the proposer signed or stamped the relevant documents, or has confirmed in any other forms, in the absence of sufficient evidence to the contrary. The burden of proof rests upon insurer.⁷¹⁹ The common law authority for the proposition that an insurer must disclose to the assured limitation or exclusions in the policy is not coherence. The Supreme Court of Western Australia held in *Kelly v New Zealand Insurance Co Ltd*⁷²⁰ under a house and contents insurance policy that there was no breach of utmost good faith where the insurer renewed the policy with limitation on cover unless items in the house specified and accepted increased premiums with full knowledge that the itemised valuation of the household contents had not been provided. *Porter v GIO Australia Ltd* was however concluded on the contrary. It was suggested that the failure of an insurer to draw the assured's attention to an exclusion clause contravened the duty of utmost good faith.⁷²¹

5.5 Effect of the Insurance Act 2015

Under Chinese law, the insurer's failure to perform its duties of prompt and clear explanation will lead to the exclusion clauses in question to be of no effect,

⁷¹⁸ Zhen JING, *Chinese Insurance Contracts: Law and Practice* (Informa 2017) 310.

⁷¹⁹ The Interpretation II, art. 13 par. 1.

⁷²⁰ [1993] WASC 515.

⁷²¹ R. Merkin, *Colinvaux's Law of Insurance* (11th edn, Sweet & Maxwell 2017) at 6-043.

meaning, the insurer is not able to rely on such exemptions.⁷²² No remedy of damages is available to the insured if further losses are occurred as a result of insurer's non-compliance, notwithstanding the insured might still be paid for the claim. Steyn J was of the view that, having found a breach of the duty of disclosure, the remedy for the breach should be damages rather than avoidance of the policy⁷²³ as it has been described as "worse than useless" where the insurer's breach is to be found after the risk has occurred.⁷²⁴

Although there is not yet any authority in England supporting the award of damages, the amendment of s. 17 of the MIA 1906 by s. 14 of the IA 2015, and the removal of the sole remedy of avoidance, might be seen as a turning point. It is interesting to see how English courts will react in the near future to this change on this point.

5.6 The Insurance Act of PRC 2015, Art. 116 par. 3

Chapter IV of the Insurance Act of PRC 2015, among all Chapters of the Act, formulates administrative rules for insurance business operation. The last article of that Chapter, i.e. art. 116, explicitly indicates thirteen actions from which insurers and their employees are prohibited doing; under which, its third paragraph enjoins insurance companies and their employees, in the course of insurance business operation, from obstructing insurance applicants to perform,

⁷²² Zhen JING, *Chinese Insurance Contracts: Law and Practice* (Informa 2017) 315.

⁷²³ *Banque Keyser Ullman SA v Skandia (UK) Insurance Co Ltd* [1987] 2 All ER 923.

⁷²⁴ R. Merkin, *Colinvaux's Law of Insurance* (11th edn, Sweet & Maxwell 2017) at 6-040.

or inducing the proposers not to perform, the duty of presentation as prescribed in this Act. As to the interpretation of this provision, there are two conflicting views: one is that it is only a statutory administrative provision supervising operation and management of insurance entities;⁷²⁵ the other is that art. 116 par. 3 imposes on insurers a duty not to mislead the insureds in negotiating the contract, meaning, “the insurers must not mislead the insureds by concealing or misrepresenting material information relevant to the insurance contract”.⁷²⁶

Therefore, two questions arise at this point: 1) whether this provision reflects the civil law notion of good faith and fair dealing; 2) whether this provision should be treated as one of the insurer’s duties analogous to the duty of clear explanation discussed above. It is clear as to the first question that this article itself, as it appears under Chapter IV, has nothing to do with the principle of good faith.⁷²⁷

The second issue merits a full exploration in this section. It might be worthy of giving an example herein so as to reify the abstract subsection: C, an insurance applicant, has been visited by B, an insurance sales representative armed with proposal forms and other information supplied by A, an insurer. B has then solicited an insurance agreement and has thereafter further assisted the proposer - most of the time filled in the application form - in completing of a proposal. There has arisen some material information that discouraged C from

⁷²⁵ Telephone interviews with Tingzhong FU, Professor of Law, Tsinghua University Law School, Dr. Rui ZHEN, Lecturer in Law, Shanghai Maritime University and Dr. Peihai YU, Lecturer in Law, Sun Yat-Sen University (London, September 2017).

⁷²⁶ Zhen JING, *Chinese Insurance Contracts: Law and Practice* (Informa 2017) 320.

⁷²⁷ Telephone interviews with Tingzhong FU, Professor of Law, Tsinghua University Law School, Dr. Rui ZHEN, Lecturer in Law, Shanghai Maritime University and Dr. Peihai YU, Lecturer in Law, Sun Yat-Sen University (London, September 2017).

purchasing the policy. B, paid by commission, cut corners in order to sell insurance and C then signed the form. A has subsequently sought to rescind the contract for misrepresentation.

The remedy for this class of cases is stipulated by the IAC 2015 art. 161. Where an insurance company commits any of the conducts prescribed in art. 116 of this Act, the competent insurance regulatory body shall order it to make a correction and impose a fine between 50,000 and 300,000 Yuan; and, for a worse case, the regulatory body may restrict its line of business, pursue a banning order for the new business or revoke its Business Operation Permit. One may therefore assert that art. 116 par. 3 cannot be regarded as an insurer's duty if breach of which generates administrative remedies. This allegation has nevertheless been negated in Australia by the introduction of a special enforcement provision in the ICA 1984 s. 14A.⁷²⁸ ASIC may exercise its powers under the Corporations Act 2001 to vary, suspend or cancel a licence to provide financial services, and to ban persons from providing financial services pursuant to s. 14A(2)-(3),⁷²⁹ "if an insurer under a contract of insurance has failed to comply with the duty of the utmost good faith in the handling or settlement of a claim or potential claim under the contract".⁷³⁰ Thus, an administrative remedy is not inconsistent with a breach of an insurer's civil duty. Even so, it would be too slapdash to determine that art. 116 par. 3 can be

⁷²⁸ s. 14A was added by the Insurance Contracts Amendment Act 2013.

⁷²⁹ W I B Enright & R. Merkin, *Sutton on Insurance Law*, vol 1 (4th edn, Thomson Reuters 2015) at 6-50.

⁷³⁰ The Insurance Contract Act 1984, s. 14A(1).

recognised as an obligation of insurers upon the discussion above. It might be possible theoretically only if the non-compliance of art. 116 par. 3 would constitute a breach of liability for *Culpa in contrahendo* expressed by the Contract Law of PRC 1999 art. 42. The provision applies if the contracting party negotiates in bad faith; or deliberately conceals material facts relating to the conclusion of the contract or provide false information to the other party; or performs any other actions in violation of the principle of good faith and fair dealing. Breach of art. 42 gives rise to damages. The issue is worthy of an article in its own right, and therefore will not be covered here. Up until now the attitude of Chinese courts towards this matter is unclear, yet art. 116 par. 3 is unlikely to be amplified to this extent.⁷³¹ It is only a manifestation of a public law prohibitory rule in private law.⁷³²

What is left undetermined is the legal effect of the policy. Doubtlessly, the insurer should not be bound by a contract where both the insured and the agent have committed a fraud together. Reading between the lines of the provision, mere silence of B is probably less convincing to give rise to a breach of art. 116 par. 3. What is questionable is where B stands in the way of an honest insured. In *Newsholme Brothers v Road Transport and General Insurance Co Ltd*,⁷³³ the plaintiffs had insured a motor omnibus through a man named Willey, appointed

⁷³¹ Telephone interviews with Tingzhong FU, Professor of Law, Tsinghua University Law School, Dr. Rui ZHEN, Lecturer in Law, Shanghai Maritime University and Dr. Peihai YU, Lecturer in Law, Sun Yat-Sen University (London, September 2017).

⁷³² Telephone interview with Tingzhong FU, Professor of Law, Tsinghua University Law School (London, 2 September 2017).

⁷³³ [1929] 2 KB 356.

by the defendant to canvass and procure proposals form for them, who had been given the true facts and nevertheless managed to fill in the erroneous answer, negligently or intentionally committed a fraud on his own initiative, e.g. to obtain the commission, in answering express questions on the proposal and concealed important facts. The insurer then avoided the policy. The Court of Appeal held that the insurer was entitled to repudiate liability since in completing the proposal form Willey had been acting as the agent of *Newsholme Brothers*. Further, by signing the proposal, the insured is bound by their signature. Thus, it is the duty of the proposer for insurance to see and make sure that the information contained in the proposal form is accurate, it being no argument that he did not read it properly or was not fully apprised of its contents. The *Newsholme* rule is in many ways unsatisfactory, despite in *Newsholme* Willey was indeed not authorised by the insurance company to fill in proposal forms.

In the usual course of events, B would have been considered the insurer's agent; and the ultimate concept involved in the matter of the completion of proposal forms by intermediaries is known as "transferred agency", which will be considered in detail in chapter 6 where the role of brokers and their duty of disclosure is analysed. Even though the *Newsholme* rule represents English law where information has actually been communicated to B,⁷³⁴ the Law Commission has recognised that "if a sales representative is employed by the insurer as the insurer's agent, it might be thought that the insurer should carry

⁷³⁴ This line of authority is no longer of much significance in England, details are considered in chapter 6.

greater responsibility for the fraud than the insured”.⁷³⁵ Therefore, the insurer must not rely on misrepresentation of the insured, and ought to pay the sum insured as if it were a valid claim.

⁷³⁵ Law Commission, *Insurance Contract Law: Intermediaries and Pre-contract Information* (Law Com IP No 3, 2007) para 3.13

Chapter 6 The Role of Brokers in Respect of Information Disclosure and Presentation

6.1 Definition

Insurance brokers are defined by the Insurance Act of PRC 2015 art. 118 in the following statement:

Insurance brokers is an entity that, in the interests of the applicant, provides intermediary services between proposers and insurers for the conclusion of an insurance contract and receives a commission in accordance with law.

A broker is required to observe the Administrative Rules on Supervision of Insurance Brokers (Revised in 2015, hereinafter the 2015 Rules)⁷³⁶ and to obey the principles of free will, good faith and fair competition.⁷³⁷ In accordance with art. 2 par. 1 of the Rules, insurance brokers include brokerage companies and its subsidiaries. The statutory definition has deliberately confined the role of intermediaries between proposers and insurers in pre-contractual services, although in practice brokers in China execute various functions including post-placement assistance and claims handling service, which are identical to which brokers in England carry out⁷³⁸. A licensed insurance broker is, in accordance to

⁷³⁶ Promulgated by Order of China Insurance Regulatory Commission [2009] No.6 on September 25, 2009; first revision on April 27, 2013 in accordance with the Decision of the China Insurance Regulatory Commission on Revising the Administrative Rules on Supervision of Insurance Brokers, by Order of China Insurance Regulatory Commission [2013] No.6; second revision on October 19, 2015 according to the Decision of the China Insurance Regulatory Commission on Revising Eight Regulations Including the Administrative Measures for the Establishment of Overseas Insurance Institutions by Insurance Companies, by Order of China Insurance Regulation Commission [2015] No.3.

⁷³⁷ Administrative Rules on Supervision of Insurance Brokers (2015 Revision), art. 3.

⁷³⁸ See R. Merkin, *Colinvaux's Law of Insurance* (11th edn, Sweet & Maxwell 2017) at 16-031 for functions of brokers in England.

art. 27 of the 2015 Rules, permitted to carry out the following activities:

- (1) drafting the insurance plan, choosing insurance company and application process handling;
- (2) assisting the assured or beneficiary in claiming;
- (3) reinsurance broking;
- (4) risk assessment and risk management consultancy work; and
- (5) other activities permitted by the China Insurance Regulatory Commission.

In common law jurisdictions, it was suggested as being axiomatic⁷³⁹ that insurance brokers, appointed by the assured, act as “independent agents” for the assured to effect an insurance contract between the assured and the insurer⁷⁴⁰ – “errors made by the broker within the scope of his actual or ostensible authority bind the assured”⁷⁴¹ – although they were defined by Hobhouse J in *The Zephyr*⁷⁴² as “servants of the market” who in fact in practice act in a dual capacity as agent for both said.⁷⁴³ Thus, any information disclosed to the broker is not deemed to have been received by the insurers.⁷⁴⁴ On the contrary, there has been no mention of the role of brokers in respect of presentation and disclosure of information in the placement process under IAC

⁷³⁹ *Velos Group Ltd v Harbour Insurance Services Ltd* [1997] 2 Lloyd's Rep 461, 462.

⁷⁴⁰ *Anglo-African Merchants v Bayley* [1969] 1 Lloyd's Rep 268; *General Accident Fire & Life Assurance Corp Ltd v Tanter, The Zephyr* [1984] 1 Lloyd's Rep 58; *Staatssecretaris van Financien v Arthur Andersen & Co (C-472/03)* [2007] Lloyd's Rep IR 484.

⁷⁴¹ R. Merkin, *Colinvaux's Law of Insurance* (11th edn, Sweet & Maxwell 2017) at 16-031.

⁷⁴² *General Accident Fire & Life Assurance Corp Ltd v Tanter, The Zephyr* [1984] 1 Lloyd's Rep 58, 66.

⁷⁴³ *HIH Casualty & General Insurance Ltd v JLT Risk Solutions Ltd* [2007] 2 Lloyd's Rep 278 [60].

⁷⁴⁴ R. Merkin, *Colinvaux's Law of Insurance* (11th edn, Sweet & Maxwell 2017) at 16-032.

2015. What is worse, the legal status of brokers in China is left undefined. If the legal status of brokers can be identified under Chinese legal system, it might be possible to have a discussion as to the duty of disclosure by intermediaries by applying civil law and general contract law concepts. There have been three possibilities accepted by academic research, each of which is considered in the next section below. In accordance with the IAC 2015 art.16, the insured is under no obligation to volunteer information to the insurer without request, from which a question arises at this point is, as brokers are insurance professionals armed with specialised knowledge and even legal advice, whether art.16 is to be the legal basis unleashing brokers from the duty of disclosure, providing one of the legal purposes of art.16 is to protect the vulnerable group.

6.2 Brokers in China

While, in England, the use of insurance brokers is as old as the London marine insurance market itself, this emerging profession is still under-development in China because, for a long time, brokers were technically unnecessary where the Chinese insurance market had been monopolised by the one and only insurance company, namely, the PICC. In 1995, the first Insurance Act of People's Republic of China officially placed brokers on a statutory footing, which opened up a whole new era for the future development of Chinese insurance market, but the first generation of insurance brokers did not receive their approval from the CIRC until 1999.⁷⁴⁵ Until the most recent times the new-born

⁷⁴⁵ Hui LIN (ed), Bao Xian Zhongjie Lilun yu Shiwu [Insurance Intermediaries: concepts and practice]

baby is still hypo-genesis in three main aspects: lack of qualified brokers, indeterminate lines of business, and ineffective oversight.⁷⁴⁶ In recent years, vast majority of commercial risks, particularly marine insurance such as hull & machinery and cargo insurance, are being conducted through brokers.⁷⁴⁷ Before the role of brokers was introduced, in China, insurers used commission agents – often being employees of an insurer – to solicit insurance agreements. This form is still in common use for consumer insurance sales today, and there are yet any signs of use of brokers in the consumer sector. Problems caused by the commission agents are discussed in the following section.

6.2.1 The canvassing agents

The direct sales model, being the crudest, yet most efficient technique of promoting products, has been widely using by insurers since modern insurance established in China. The process that an employee of an insurance company – appointed by the insurer – known as the insurer's agent, demonstrating and selling insurance policies directly to the end consumers probably in their homes, often involves a circumstance that proposal forms are being completed by the insurer's agent. That practice leaves great uncertainty on whether information disclosed to the insurer's agent had been validly communicated to the insurer

(Tsinghua University Press 2006) 85.

⁷⁴⁶ Liming ZHANG, 'Baoxian Jingjiren Tanjiu' [Analysis of Insurance Brokers] <http://pl.sinoins.com/2015-06/16/content_159167.htm> assessed 9 Dec 2017; Fei CHEN & Fei GAO, 'Woguo Baoxian Jingji Ye Cunzai de Wenti ji Duice' [Problems of Insurance Brokers and the Countermeasures in China] (2006) 3 Finance and Accounting Monthly; Xiuhui LIANG & Fangfang WANG, 'Woguo Baoxian Jingjiren Fazhan Fangxiang Tanjiu' [A Research as to Development Orientation of Insurance Brokers] (2015) 37 Business 42; Lin YUAN, 'Qiantan Woguo Baoxian Jingjiren Zhidu de Xiangzhuang ji Wenti' [Recent Development and Problems of Insurance Brokers in China] <<http://www.chinarm.cn/Insurance/2009/0121/20565.html>> assessed 9 Dec 2017.

⁷⁴⁷ Zhiyong ZHANG & Fei XU, 'Guanyu Haishang Baoxian Hetong Fa Xiuding de Sikao' [Some Thoughts on Revision of the Law of Marine Insurance Contract] (2014) 3 Chinese Journal of Maritime Law 72, 72.

itself because the action of completing the form for the assured may have successfully metamorphosed the agent of the insurer into “the amanuensis of the assured for that limited purpose”.⁷⁴⁸ Given that during the period of this research there have been no findings of any regulations or rules, nor any cases regarding the nature of the canvassing agents, it is assumed that such a matter has not been dealt with by Chinese insurance law which makes it sensible to consider the common law approaches.

6.2.1.1 The English methods of dealing with canvassing agents

Courts in all common law jurisdictions supported the concept that the insurer’s appointee may become the assured’s agent simply by taking the administrative role in filling in the proposal form, despite that, under general agency principles, any description of the role of the insurer’s appointee in completing the proposal falls outside the technical legal sense of the word “agent”.⁷⁴⁹ English law permitted insurers to avoid the policy for non-disclosure or misrepresentation in this circumstance, unless agents have actual or ostensible authorised to receive the relevant information on behalf of insurers.⁷⁵⁰ Although the ruling is less significant in English these days because: first, technical innovation in the digital age, agents of that type have generally disappeared from the consumer market which has been substituted by online placement directly with insurers; second, under the CI(DR)A 2012, insurers’ agent are treated as representatives of the

⁷⁴⁸ R. Merkin, ‘Placement of Insurance and the Role of Brokers’ (Forthcoming in 2018).

⁷⁴⁹ R. Merkin, ‘Transferred Agency in the Law of Insurance’ (1984) 13 *Anglo-Am L Rev* 33, 35-36.

⁷⁵⁰ *Biggar v Rock Life Assurance Co* [1902] 1 KB 516; *Newsholme Brother v Road Transport and General Insurance Co Ltd* [1929] 2 KB 356.

insurers so that information received by them are deemed to be communicated to the underwriting department directly; and finally, consumers are no longer requested to volunteer material facts to the insurer, the duty of disclosure in consumer insurance contract is abolished by the 2012 Act⁷⁵¹ – the problem will arise only where the broker receives a material fact but misstates it;⁷⁵² it is worthwhile to trace its development in England as direct insurance sales are largely utilised in mainland China.

At one time, cases used to be decided solely on the question of whether the agent's authority to receive information, reconciling with ordinary principle of agency.⁷⁵³ Thus it was held in *Wing v Harvey*⁷⁵⁴ that information conveyed to an agent of the insurer was deemed to have been received by the insurer on the basis that the agents had ostensible authority to receive such information. Over the same period the U. S. Supreme Court stressed the responsibility that need to be taken by the insurer to its agent within the scope of his employment, and pointed out that the danger that the agent, to whom was paid large commissions, might seek to cut corners in order to sell insurance should be borne by the person appointing him rather than the person upon whom he is imposed.⁷⁵⁵ Before the twentieth century, English courts generally accepted the insureds favourable approach that the fact known to the agent could be imputed

⁷⁵¹ R. Merkin, 'Placement of Insurance and the Role of Brokers' (Forthcoming in 2018)

⁷⁵² R. Merkin, 'Consumers and Agency' (2009) 21 ILM 4, 4.

⁷⁵³ R. Merkin, 'Transferred Agency in the Law of Insurance' (1984) 13 Anglo-Am L Rev 33, 36

⁷⁵⁴ *Wing v Harvey* (1854) 5 De GM & G 265, see J. Lowry & P. Rawlings, Insurance Law: Cases and Materials (Hart Publishing 2004) case no. 309.

⁷⁵⁵ *Union Mutual Life Ins. Co. of Maine v Wilkinson* 80 US (13 Wall.) 222 (1871), 234-235

to the insurer⁷⁵⁶ on the ground that insurance companies should not be allowed to take advantage of its own appointee's mistake⁷⁵⁷ and to transfer the burden of its agents' breaches of duty onto insureds,⁷⁵⁸ although the decision might be reversed by an express notice stating that information communicated to the agent but not passed on to the insurer contained in the proposal.⁷⁵⁹

No notion of agency was mentioned until the ruling of the case *Biggar v Rock Life Assurance Co*,⁷⁶⁰ in which the insured, was, for the first time, held liable for misrepresentations incorporated into the proposal by the insurer's appointee, on the ground that by signing the proposal the insured had adopted all statements contained therein, and that as the appointee had no express authority to complete the proposal he could only have done so as agent of the insured. However, the case which received extensive consideration was *Newsholme Brothers v Road Transport and General Insurance Co Ltd*.⁷⁶¹ The Court of Appeal dismissed the appeal on three grounds: the insured's negligence, the parol evidence rule, and transferred agency. None of them can hold water. The insured's duty to check before signing the form may not be practical in real life as: on a practical level, the agent might himself start filling in the form in absence of any requests from the insured; the assured may not be given an opportunity to do so, especially where deals are to be concluded via

⁷⁵⁶ *Brewster v National Life Ins. Society* (1892) 8 T.L.R. 648; *Bawden v London, Edinburgh and Glasgow Ass. Co* (1892) 2 Q.B. 534.

⁷⁵⁷ *Brewster v National Life Ins. Society* (1892) 8 T.L.R. 648.

⁷⁵⁸ *Bawden v London, Edinburgh and Glasgow Ass. Co* (1892) 2 Q.B. 534, at 540, per Lindley LJ.

⁷⁵⁹ *Levy v Scottish Employees' Ins. Co.* (1901) 17 TLR 229.

⁷⁶⁰ (1902) 1 KB 516.

⁷⁶¹ [1929] 2 KB 356.

telemarketing; or even if the proposal is read, errors may be missed or regarded as trivial or within the agent's discretion; and ultimately insurers should in no circumstance be equipped any mechanism for denying liability for the errors of their own appointee.⁷⁶² The parol evidence rule was clearly an unfitted norm applying to the Newsholme situation.⁷⁶³ The transferred agency argument was based on a misunderstanding of the American authority *N.Y. Life Insurance Co v Fletcher*,⁷⁶⁴ where the proposal form stated that no statement made to the appointee would be binding on the insurer unless it appeared in the proposal form. Signing the form by the insurer had thus been taken to have had notice of the limitation of the agent's authority. This case, concerning only with the effect of a clause denying authority of the agent to receive information, however, cannot be treated as authority in the absence of any express limitation of authority.⁷⁶⁵ Moreover, comparing to the first wrong made by Wright J in *Biggar* in generating the transferred agent rule, the narrower approach adopted by Scrutton LJ made the concept worse than unjustifiable. In *Biggar*, the fundamental defect in Wright J's reasoning is that he stopped at the consideration of authority to complete the proposal form and ignored the further question of authority to receive information arising by estoppel, on the basis of which previous cases were decided.⁷⁶⁶ Scrutton LJ's formulation of the rule - even actual or apparent authority to complete the proposal would not prevent B from becoming C's agent for the purpose of errors in the proposal - is

⁷⁶² R. Merkin, 'Transferred Agency in the Law of Insurance' (1984) 13 *Anglo-Am L Rev* 33, 38

⁷⁶³ *ibid* 39.

⁷⁶⁴ 117 US 519 (1886).

⁷⁶⁵ R. Merkin, 'Transferred Agency in the Law of Insurance' (1984) 13 *Anglo-Am L Rev* 33, 39-40.

⁷⁶⁶ *ibid* 37-38.

suggested as being “repugnant to common sense” and “legally unsupportable”.⁷⁶⁷ Later, the judgment of *Newsholme* was distinguished by the Court of Appeal in *Stone v Reliance Mutual Insurance Society Ltd*,⁷⁶⁸ in which the judgment of Lord Denning was based upon the actual authority of the agent. Although the Court of Appeal considered *Stone* upon its own special facts, the crucial point is the confrontation with the judgment of Scrutton LJ.⁷⁶⁹ It was held that the insurer cannot avoid the policy for non-disclosure, because the inspector - agent of the insurer - who failed to warn the insured’s wife of the duty of disclosure and the earlier claim was not mentioned in the proposal, had actual authority to complete the proposal.

6.2.1.2 Reform

The problem was addressed by the Law Commission in its Issue Paper 3.⁷⁷⁰ The original test was set out in the 2007 Consultation Paper, in which it was suggested that, in accordance with FSA requirements, an intermediary should be regarded as acting for the insurers unless he is clearly an independent intermediary conducting “a fair analysis of the market” on the insured’s behalf.⁷⁷¹ In this way, the narrow approach of *Newsholme* would be abolished.⁷⁷² Meanwhile, the Law Commission further proposed that the policyholder’s

⁷⁶⁷ *ibid* 40.

⁷⁶⁸ [1972] 1 Lloyd’s Rep 469.

⁷⁶⁹ R. Merkin, ‘Transferred Agency in the Law of Insurance’ (1984) 13 Anglo-Am L Rev 33, 40

⁷⁷⁰ Law Commission, *Insurance Contract Law: Intermediaries and Pre-contract Information* (Law Com IP No 3, 2007).

⁷⁷¹ Law Commission, *Insurance Contract Law: Misrepresentation, Non-disclosure and Breach of Warranty by the Insured* (Law Com CP No 182, 2007) paras 9.110, 10.17, 10.32-10.33.

⁷⁷² *ibid* paras 10.36-10.38.

signature should no longer be taken to be conclusive evidence that the insured knew of or adopted the statements on the proposal completed by the agent.⁷⁷³ Criticism as to the 2007 Consultation Paper in respect to status of intermediary was the failure for the Law Commission to provide a clear definition of exactly when an intermediary was and was not independent.⁷⁷⁴ The Law Commission, in responding to that matter, published the 2009 Policy Statement,⁷⁷⁵ indicating the underlying principle as to this issue - “insurers should bear responsibility for those intermediaries within their control, and have appropriate incentives to exercise that control in a way that prevents problems from occurring. Insurers should not, however, be liable for the actions of genuinely independent agents.”⁷⁷⁶

The Law Commission have provided three circumstances, in which an intermediary is always considered to act for the insurer: 1) the intermediary has authority to bind the insurer to cover; 2) the intermediary is the appointed representative of the insurer; 3) the intermediary has actual express authority from the insurer to collect pre-contract information on its behalf; thereby, in any of these cases, the *Newsholme* reasoning is reversed and information communicated to the intermediary is imputed to the insurer.⁷⁷⁷ In other cases, the intermediary will be treated as acting for the assured “unless there is a close

⁷⁷³ *ibid* paras 10.39-10.44.

⁷⁷⁴ R. Merkin, ‘Consumers and Agency’ (2009) 21 ILM 4, 4.

⁷⁷⁵ Law Commission, *Reforming Insurance Contract Law – for whom does an intermediary act in transmitting pre-contract information from consumer to insurer?* (Policy Statement: The Status of Intermediaries, 2009).

⁷⁷⁶ *ibid* para 1.8.

⁷⁷⁷ R. Merkin, ‘Consumers and Agency’ (2009) 21 ILM 4, 4.

relationship between the intermediary and the insurer, so as to indicate that the insurer has granted the intermediary implied or apparent authority to act on the insurer's behalf."⁷⁷⁸ A list of factors indicating a close relationship between the intermediary and the insurer include the following: (a) the intermediary only places insurance with a limited number of insurers. (The smaller the number of insurers, the greater the indication that the intermediary acts for the insurer); (b) the insurer sells that particular policy through only a limited number of intermediaries; (c) the insurer permits the intermediary to brand its services with the insurer's name, thereby giving the intermediary apparent authority to act on its behalf; (d) the insurer permits its policies to be branded with the intermediary's name, thereby representing that the consumer is dealing with an insurer rather than an intermediary; (e) the insurer requests the intermediary to approach the consumer to market the insurer's particular product; (f) the insurer exerts substantial control over the way that the intermediary conducts its business.⁷⁷⁹ Factors appointing the other way include: (a) the intermediary undertakes to act in the consumer's interest by, for example, giving impartial advice or providing a fair analysis of the market; (b) the consumer pays the intermediary a fee; (c) the intermediary provides full disclosure to the consumer of the commission it has received from the insurer.⁷⁸⁰ Both lists are indicative and non-exhaustive.⁷⁸¹ The determination of the status of the intermediary will

⁷⁷⁸ Law Commission, *Reforming Insurance Contract Law – for whom does an intermediary act in transmitting pre-contract information from consumer to insurer?* (Policy Statement: The Status of Intermediaries, 2009) para 1.11.

⁷⁷⁹ *ibid* para 1.12(1).

⁷⁸⁰ *ibid* para 1.12(2).

⁷⁸¹ *ibid* para 1.12.

ultimately depend on “all the circumstances, weighing the various factors in the case”,⁷⁸² which reconciles with general agency principles.⁷⁸³ Last but not the least, the Law Commission placed special emphasis on that the intermediary will be taken to act for the consumer under this test if no factors were shown either that the intermediary acts for the consumer or for the insurer.⁷⁸⁴

The 2012 Act has implemented the Law Commission proposals and abolished the rule in *Newsholme* for consumer insurances by elaborating, in the Schedule 2, examples of factors which may tend to show the status of an agent and clarifying any statements made to an agent of the insurer as made to the insurer itself. Thus where consumer insurance policies offered by suppliers of goods or services along with the supply contracts, such supplier – who was held previously to be the agent of the assured – are likely to be treated as the agent of the insurer so that misrepresentation made by the agent would not be imputable to the assured under CI(DR)A 2012.⁷⁸⁵ In the commercial cases, first of all, the point is most unlikely to arise concerning the custom of the market, where the present practice is for the assured to use an independent placing broker rather than apply through an agent of the insurers.⁷⁸⁶ Thus that matter is not dealt with in particular in the Insurance Act 2015, nevertheless, it should still resolve the problem “by treating knowledge of an agent as the knowledge of the insurer itself and thus not required to be disclosed”, should it by any chance

⁷⁸² *ibid* para 1.11 & 4.4.

⁷⁸³ *ibid* footnote 4.

⁷⁸⁴ *ibid* para 4.4.

⁷⁸⁵ R. Merkin, *Colinvaux's Law of Insurance* (11th edn, Sweet & Maxwell 2017) at 7-027.

⁷⁸⁶ *ibid* at 16-021.

arise.⁷⁸⁷

The rapid development of Chinese insurance industry, with the rise of insurance intermediaries, is bound to provoke China into legislative activity. The vexed question of canvassing agent of the insurer should come into legislature's notice and be written into law as a matter of urgency. In codifying that, section 10 of the Insurance Law Reform Act 1977,⁷⁸⁸ as it is submitted,⁷⁸⁹ a quintessence definition of the agents of insurer, removing *Newsholme* from its jurisprudence, might be a good lesson to draw from New Zealand. The Section is as follows:

(1) A representative of the insurer who acts for the insurer during negotiation of any contract of insurance, and so acts within the scope of his actual or apparent authority, shall be deemed, as between the insured and the insurer and at all times during the negotiations until the contract comes into being, to be the agent of the insurer.

(2) An insurer shall be deemed to have notice of all matters material to a contract of insurance known to a representative of the insurer concerned in the negotiation of the contract before the proposal of the insured is accepted by the insurer.

(3) In this section the term representative of the insurer includes any servant or employee of the insurer and any person entitled to receive

⁷⁸⁷ Ibid.

⁷⁸⁸ Reprinted on 24 May 2016

<<http://www.legislation.govt.nz/act/public/1977/0014/latest/whole.html#DLM442556>> accessed 29 Nov 2017.

⁷⁸⁹ R. Merkin, 'Consumers and Agency' (2009) 21 ILM 4,4.

from the insurer commission or other valuable consideration in consideration for such person's arranging, negotiating, soliciting, or procuring the contract of insurance between a person other than himself and such insurer.

6.2.2 The legal status of insurance brokers in China

The nature of the brokers is another puzzle of insurance law. Neither civil law nor common law jurisdictions reject the proposition that insurance brokers are independent intermediaries who carry out various functions in building up contractual relationships between insurers and assureds in order to receive remuneration. London, home of insurance, is a “broker market”,⁷⁹⁰ and brokers here are paid by the insurers based on the custom of the market.⁷⁹¹ The Chinese insurance market has adopted the same practice. What has not been preserved in China is that insurance brokers are not recognised as agents of the insureds because that operation, i.e. acting in their own name not the name of insureds and being paid by the underwriters,⁷⁹² are theoretically discrepant with general rules of agency under Chinese law, whilst the brokers with the same practice is accepted in English law as being the insureds' agents. Thus it might deserve mentioning at this point the theoretical differences as to the law of agency between civil law and common law system, albeit they are inherently

⁷⁹⁰ R. Merkin, 'Placement of Insurance and the Role of Brokers' (Forthcoming in 2018).

⁷⁹¹ R. Merkin, *Colinvaux's Law of Insurance* (11th edn, Sweet & Maxwell 2017) at 16-045.

⁷⁹² Kewu LI & Qi ZHOU, 'An Analysis on the Legal Status of Insurance Brokers in China' (2006) 2 Journal of Henan Administrative Institute of Politics and Law 86, 87.

logical.⁷⁹³ The theoretical foundation of the modern concept of agency in common law system is the doctrine of identity of the principal and agent⁷⁹⁴ which has further generated some broader concept of agency which avoided the complexities of fragmentation typical of the civil law situation – this general concept could be used as the theoretical basis of all forms of agency encountered in practice,⁷⁹⁵ whereas the doctrine of agency in civil law system was founded in the theory of separation which has contributed to the strict conceptual separation of the mandate from the authority: mandate points to the internal relations between the mandator (the principal) and the mandatory (the agent); authority on the other hand, refers to the external aspects of the transaction – the relation of principal and agent towards third parties, i.e. the limitation of the authority of the agent by the mandate is, on principle, ineffective with respect to the third party.⁷⁹⁶ In respect of the power of the agent to contract for the principal with the third party, the emergence of the doctrine of separation in the civil law system has contributed a considerable degree in discriminating the distinctions between direct and indirect representation, depending upon whether the intermediary acts in a representative or a personal capacity (the name test): the intermediaries, acting in his representative capacity, normally on behalf of his principal, bind the principal in the legal rights and obligations created by them under the contract vis-à-vis the third party in the case of direct

⁷⁹³ C.M. Schmitthoff, 'Agency in International Trade: A Study in Comparative Law' in C.J. CHENG (ed), *Clive M. Schmitthoff's Select Essays on International Trade Law* (Martinus Nijhoff 1988) 307.

⁷⁹⁴ W. Müller-Freienfels, 'Law of Agency' (1957) 6(2-3) *Am J Comp L* 165.

⁷⁹⁵ C.M. Schmitthoff, 'Agency in International Trade: A Study in Comparative Law' in C.J. CHENG (ed), *Clive M. Schmitthoff's Select Essays on International Trade Law* (Martinus Nijhoff 1988) 317.

⁷⁹⁶ *ibid* 310.

representation; the indirect agents act in their own name but for the account of the principal,⁷⁹⁷ while no difference on terminology is expressed in the broad sense of common law principle of agency, the nomenclature for both types of representatives is “agent”.⁷⁹⁸

Inheriting the civil law concept, the term “agency” is confined, under Chinese law, in the strictly narrow definition referring only to direct representation.⁷⁹⁹

According to the permitted activities of insurance brokers listed at the beginning of this chapter, there are two mainstream views as to the legal status of insurance brokers: a) the agent of the assured,⁸⁰⁰ or b) an independent intermediate mechanism – a middleman (居间人)– between the insurer and the assured.⁸⁰¹ The latter for the time being is in a leading position.⁸⁰² In accordance with art.424 of the Contract Act of PRC 1999, a brokerage contract (居间合同) is “a contract whereby the broker presents to the client an opportunity for entering into a contract or provides the client with intermediary services in connection with the conclusion thereof, and the client pays the remuneration”. Therefore, considering the statutory definition of “insurance brokers” stated under art.118 of the IAC 2015, strictly speaking, perhaps the legal status of an insurance

⁷⁹⁷ *ibid* 322.

⁷⁹⁸ *ibid* 324.

⁷⁹⁹ Kewu LI & Qi ZHOU, ‘An Analysis on the Legal Status of Insurance Brokers in China’ (2006) 2 *Journal of Henan Administrative Institute of Politics and Law* 86, 89.

⁸⁰⁰ Youtu TAN, *Baoxian Fa Gailun* [Introduction to the Insurance Law] (PKU Publishing 1993), 189

⁸⁰¹ Wentao CHEN, ‘Study on Legal Status of Insurance Brokers in China’ (2009) 62(2) *Wuhan University Journal (Philosophy & Social Sciences)* 174.

⁸⁰² Xiaoming XI (ed), *Xin Baoxian Fa ji Xiangguan Guiding Shiwu Zhinan* [Legal Practice Guidance on the New Insurance Act and Related Regulations] (People’s Court Press 2010) 605, it refers to arts. 424-427 of the Contract Act 1999 which deals with “brokerage contracts” as the relevant provisions in implementing IAC 2015 art, 118.

broker is a brokerage – the “brokerage” here is a term used to denote a middleman who performs a matchmaking function between the insurer and assured in the placing the risk, whereas in practice a broker does act, beyond the statutory function, as an agent of the assured in providing post-contractual assistance and claims handling services.⁸⁰³ As above, the legal status of insurance brokers is intangible, and the IAC 2015 on this point lies in a serious lag situation. A better view for now, it is submitted, is to treat the matter in a sectional form, i.e. an insurance broker is, to be an brokerage in advising and placing insurance proposal, and to be an agent of the assured in assisting claims handling process and other post-placement dealings.

6.2.3 Obligations of insurance brokers

In respect to information disclosure, art. 131 of the Insurance Act of PRC 2015 states in the following terms,

“Article 131, No insurance agent, broker or their practitioners may in any insurance transactions commit any of the following acts:

2 Conceal material information with respect to the insurance contract;

...

10 Disclose any commercially confidential information of an insurer, a policyholder or an insured obtained during business

⁸⁰³ Kewu LI & Qi ZHOU, ‘An Analysis on the Legal Status of Insurance Brokers in China’ (2006) 2 Journal of Henan Administrative Institute of Politics and Law 86, 89

activities.”

Three problems are to be noted from this article: first, reading between the lines, these two provisions, it is submitted, cannot be treated as the legal basis of the brokers' duty as to disclosing information, in its own or the assured's capacity, to the insurer in placing the risk. At least the wording of those provisions themselves failed to do so after all. In particular, art. 131 par. 10 seems only indicated a general obligation of brokers not to disclose relevant confidential information to any third parties. Thus, it leaves open the question whether confidential information acquired by the broker through a business relationship with a third party is disclosable to the insurer. Moreover, the phraseology of art. 131 par. 2 is vague and ambiguity in terms of identifying exactly to whom – the insurer or the assured – a broker must not conceal material information in relation to the insurance contract, and if to the insured, what information is considered material with respect to the insurance contract, for example, is the rate of commission disclosable under art. 131 par. 2. Finally, the remedy for breaching those duties is omitted in the article, although the answer might be found in art. 128, namely an insurance broker shall be liable for losses or damages caused to the policyholder or the insured due to his or her faults/negligence. Answers to questions arose previously are considered in the following Section where the duty of brokers under English law is analysed, especially the changes and new adoptions for the brokers in the IA 2015.

Notably, the IAC 2015 has no mention to the duty of brokers in information

transmission to the insurer in the placement process. However, it is to be noted that, where the broker is acting as the assured's agent, it is apparently unreasonable and contrary to the purpose of protecting underprivileged groups to surmise from art. 16 of the IAC 2015 that the obligation of brokers is limited to provide correct answers in accordance with questions arose from the underwriter, provided that insurance brokers are groups professionals armed with specified knowledge and possibly legal teams, and the concept should also apply to consumers – the view has been taken by the English Law Commission⁸⁰⁴ that the level of care expected from consumers will depend on the way that the insurance was sold – a higher level of care would be reasonable if the consumer was helped by an agent; where the broker is acting as a brokerage, art. 425 of Contract Act 1999 imposes upon this type of intermediary a duty to disclose honestly to their mandatory matters relating to the conclusion of a contract; and the brokerage who deliberately conceals material facts relating to the conclusion of a contract or makes false state of affairs which vitiates the interest of the mandatory is not entitle of any remuneration and is liable for damages caused by breach of the duty. Therefore any breach of duty of disclosure or any misstatement made by the broker will lead the insurance contract to be rescinded. No matter what legal status a broker is, the assured in any event has a statutory right of action to bring a claim against the negligent or fraudulent broker. No exceptions were indicated in IAC 2015.

⁸⁰⁴ Law Commission, *Consumer Insurance Law: Pre-contract Disclosure and Misrepresentation* (Law Com No 319, 2009) para 4.17.

6.3 Brokers in the UK

Having located an appropriate insurer, as a matter of normal practice, the role of a broker in placement process is to present the risk to the insurers.⁸⁰⁵ In the commercial market, the assured, under IA 2015, owes a duty of fair presentation including a duty of disclosure. English courts generally hold producing brokers to a high standard of care to warn the assured of the duty of fair presentation. In particular the crucial issue of an insured's duty of disclosure.⁸⁰⁶ Among all pre-contract functions, insurance brokers in placing the risk must: adequately advise insureds of their duty to disclose all material circumstances, indicating the sort of matters that ought to be disclosed as being material or arguably material; explain the consequences of failure to disclose; take reasonable care to elicit matters which clients ought to disclose but might consider unnecessary to mention, bearing in mind that the client may not realise without assistance that a particular matter is or is arguably material.⁸⁰⁷ In addition to the common law rule, brokers are likely, by reason of the Insurance Act 2015, to be required to advise insureds as to the requirement to carry out a reasonable search and that a reasonable search might entail.⁸⁰⁸ Failure of proper advice will enable insureds to bring claims against brokers for breach of duty. The producing broker, in *Involnert Management Inc v Aprilgrange Ltd and*

⁸⁰⁵ *Insurance Broking Practice and the Law*, para 4-1 (issue 20).

⁸⁰⁶ R. Merkin, *Colinvaux's Law of Insurance* (11th edn, Sweet & Maxwell 2017) at 16-058.

⁸⁰⁷ *Jones v Environcom Ltd (No.2)* [2010] 1 Lloyd's Rep IR 676; *Synergy Health (UK) Ltd v CGU Insurance Plc* [2010] EWHC 2583 (Comm); *Involnert Management Inc v Aprilgrange Ltd and Others* [2015] Lloyd's Rep IR Plus 23.

⁸⁰⁸ *Insurance Broking Practice and the Law*, para 4-3.30 (issue 20).

Other,⁸⁰⁹ was held by Leggatt LJ to be in breach of duty of care in failing to take care to ensure that the proposal form stated the opinion of the market value of the super yacht. That failure had cost the Greek broker two million Euros. Moreover, the necessary chain of causation must be established between the broker's breach of duty and the loss.⁸¹⁰ In *Jones v Environcom Ltd and MS plc t/a Miles Smith Insurance Brokers*,⁸¹¹ David Steel J at first instance concluded that, although the broker had negligently failed to advise the insured properly on its disclosure obligations, he was not liable to the loss suffered by the assured because the nature of its business operation made it uninsurable and thus the prospect that the insurer would have accepted the substantial risk improvements required and the premium charged were too remote.

As to performing the obligation of fair presentation, other than serving appropriate advice to the insured, one of the essential functions of a broker is to acquire all material facts from the assured and correctly transmit them to the insurer. Insofar as the duty of disclosure was abolished by the Consumer Insurance (Disclosure and Representations) Act 2012, the duty of a consumer assured is limited to exercising reasonable care in giving answers to express questions listed by the insurer. CI(DR)A 2012 s. 12(5) expressly preserves the common law rule that "a principal is liable for the misdeeds of an agent".⁸¹² In non-consumer cases, the IA 2015 "leaves untouched the ordinary common law

⁸⁰⁹ [2015] Lloyd's Rep IR Plus 23.

⁸¹⁰ R. Merkin, *Colinvaux's Law of Insurance* (11th edn, Sweet & Maxwell 2017) at 16-089.

⁸¹¹ [2010] 1 Lloyd's Rep IR 676.

⁸¹² R. Merkin, *Colinvaux's Law of Insurance* (11th edn, Sweet & Maxwell 2017) at 16-054 & 16-056.

rules on agency in this regard”,⁸¹³ albeit knowledge known only to the broker might be treated as the knowledge of the insurer where the assured uses an independent placing broker rather than apply through an agent of the insurers.⁸¹⁴ Thus there is no doubt that the insured is without recourse where a consumer assured who fails to act with reasonable care in providing answers to the broker, and in commercial cases an assured conceal material facts from the broker. The problem arises where information that has been properly given to the broker does not successfully convey to the insurer by virtue of the broker’s fraud, negligence or mere accidental error.⁸¹⁵ The broker’s state of mind, as an omission of the 2015 Act, may well be a considerably influential element on the right of the insurers.⁸¹⁶

It is notable that the European Commission the Insurance Distribution Directive (IDD)⁸¹⁷ – a recast of the Insurance Mediation Directive (IMD)⁸¹⁸ which was introduced by the FSA in 2005. It came into force in February 2018, introducing enhanced information and conduct of business requirements⁸¹⁹ including:

- additional knowledge and competency requirements for distributors
- product oversight and governance requirements
- an insurance product information document for non-life products

⁸¹³ *ibid* at 16-054.

⁸¹⁴ *ibid* at 16-021.

⁸¹⁵ *ibid* at 16-056.

⁸¹⁶ R. Merkin, ‘Placement of Insurance and the Role of Brokers’ (Forthcoming in 2018).

⁸¹⁷ Directive (EU) 2016/97 of the European Parliament and of the Council of 20 January 2016 on insurance distribution (recast).

⁸¹⁸ Directive 2002/92/EC of the European Parliament and Council of 9 December 2002 on insurance mediation.

⁸¹⁹ Directive 2016/97, chapter V.

- disclosure of cross-selling and product bundling
- Additional disclosure requirements in relation to insurance based on investment products
- remuneration disclosures requirements

The Directive is also aiming to enhance consumer protection. UK is expected to implement the IDD into national laws and regulations before February 2018 on which date it will repeal the IMD. It remains to be seen any reforms will actually materialise in the near future.

6.3.1 Separate duty of disclosure owed by broker – MIA 1906 s. 19

Brokers, as agent of the insured, were previously imposed, courtesy of s. 19 of the Marine Insurance Act 1906, an independent and separate duty to disclose to the insurer all material circumstances known to him, breach of which gave the insurers the right to avoid the policy as against the assured, although it has been suggested that this practice was perhaps a ramification of a misinterpretation of s. 19 – the true imposition of the duty suggested by this section might well be that the insurer still has to pay the claim but has a right of recourse against the broker as failure of disclosure is a breach by the broker – after all the section itself did not spell out the avoidance remedy of the insurer.⁸²⁰

In the UK, such a duty was repealed and abolished in its entirety: in consumer cases the CI(DR)A 2012 has removed disclosure and so it is no longer an issue; in the commercial market, IA 2015 has logically drawn in the concept of general

⁸²⁰ R. Merkin, 'Placement of Insurance and the Role of Brokers' (Forthcoming in 2018).

agency law - “the law may impute to a principal knowledge relating to the subject-matter of the agency which the agent acquires whilst acting within the scope of his authority”⁸²¹ – and so the law for business insurance is unchanged in nature: the abolished s. 19(b) has been literally replaced with a duty of disclosure imposed upon the assured by IA 2015 s. 3.⁸²² Knowledge held by brokers is included within the scope of what an insured either knows or ought to know, meaning, the insured is now deemed to know what the broker knows.⁸²³ Thus the assured loses its defence if the broker has obtained the knowledge and nevertheless failed to pass it on to the insurer.

Moreover, s. 19(a) of the 1906 Act was substantially abolished by the new business insurance regime. It provides that: “Where an insurance is effected for the assured by an agent, the agent must disclose to the insurer ... every material circumstance which is known to himself, and an agent to insure is deemed to know every circumstance which in the ordinary course of business ought to be known by, or to have been communicated to, him.” The basis of s.19(a) – “a distinct duty of disclosure on the part of the broker” – was formed, *inter alia*, by decisions of two nineteenth century authorities, namely, *Blackburn Low & Co v Vigors*⁸²⁴ and *Blackburn Low & Co v Haslam*⁸²⁵: it was held in the former that information unknown to the assured but known to the producing broker was not imputed to the assured; the latter was ruled only on the ground

⁸²¹ P. Watts (ed), *Bowstead & Reynolds on Agency* (20th ed, Sweet & Maxwell 2017) para 8-207.

⁸²² R. Merkin, ‘Placement of Insurance and the Role of Brokers’ (Forthcoming in 2018).

⁸²³ Insurance Act 2015, s 4(2)(b), 4(3)(b) and 4(8)(b).

⁸²⁴ (1887) 12 App Cas 531.

⁸²⁵ (1888) 21 QBD 14.

that the duty of brokers to reinsure and thus to disclose material facts to the reinsurer, disregarded the issue that the default of the producing broker was deemed to be the default of the assured - attribution of knowledge - as the non-disclosure of the non-arrival of the vessel had been the direct responsibility of the producing broker who had been instructed to insure.⁸²⁶ The producing broker is therefore unleashed, since the assured will take the blame for him under s. 18.⁸²⁷ S. 19(a) was problematic in several ways: first, the well-established consequence of breach pointed towards the innocent insured not the broker who was at fault; second, the phrase “agent to insure” is undefined, despite English courts were arguably in favour of placing brokers⁸²⁸ – the approach itself was controversial;⁸²⁹ finally, whether confidential information that brokers received in a different capacity falls within s. 19(a). All of these problems have been dealt with in IA 2015: both first and second issues are on their deathbed when s. 19(a) marked the end of its service; confidential information has been specialised in s. 4(4) of the 2015 Act. Details are considered in the following section.

⁸²⁶ R. Merkin, ‘Placement of Insurance and the Role of Brokers’ (Forthcoming in 2018).

⁸²⁷ It was held in *Simner v New India Assurance* [1995] LRLR 240 that the agent’s knowledge would be imputed to the assured only where: (1) the assured was reliant upon the agent for information; or (2) the agent was in a predominant position.

⁸²⁸ *Blackburn Low & Co v Vigors* (1887) 12 App Cas 531; *Blackburn Low & Co v Haslam* (1888) 21 QBD 14; *PCW Syndicates v PCW Reinsurers* [1996] 1 WLR 1136; *Group Josi Re v Walbrook Insurance Co Ltd* [1996] 1 WLR 1152.

⁸²⁹ Law Commission, *Insurance Contract Law: Intermediaries and Pre-contract Information* (Law Com IP No 3, 2007) para 4.18.

6.3.2 Exceptions to the imputation of knowledge – IA 2015 ss. 4(4) & 6(2)

6.3.2.1 Confidential information

Under s.19 of MIA 1906, an agent is required to disclose material facts known to him, whereas the knowledge of an “agent to insure” must include “every circumstance which in the ordinary course of business ought to be known by, or to have been communicated to, him.” In 1993, Hoffman LJ (as he then was) has first expressed his comments in obiter as to the scope of the duty laid down in s. 19(a) in the case of *El Ajou v Dollar Land Holdings plc*⁸³⁰ that “an insurance policy may be avoided on account of the broker’s failure to disclose material facts within his knowledge, even though he did not obtain that knowledge in his capacity as agent for the insured”. This approach was followed by him in *Société Anonyme d’Intermediaires Luxembourgeois (SAIL) v Farex Gie.*⁸³¹ In the view of Hoffman LJ, the only restriction on the duty of disclosure of an agent to insure is materiality. Although in *PCW Syndicates v PCW Reinsurer*⁸³² that suggestion was challenged by Staughton LJ and the duty was confined to information received as agent to insure, it left the door open to the possibility that confidential information obtained through a business relationship unconnected to the relevant contract of insurance falls within s. 19(a). The matter has now specified by s. 4(4) of the 2015 Act, in which it explicitly states that an assured “is not ... taken to know confidential information known to an individual if – (a) the individual is, or is an employee of, the insured’s agent; and

⁸³⁰ [1994] BCC 143, 156.

⁸³¹ [1994] CLC 1094.

⁸³² [1996] 1 WLR 1136.

(b) the information was acquired by the insured's agent (or by an employee of that agent) through a business relationship with a person who is not connected with the contract of insurance." The Insurance Act 2015 is silent on how such information is to be assessed as confidential.

6.3.2.2 Fraud by an agent

The other important scenario to prevent the knowledge of a broker from being attributed to the assured is where the broker has been defrauding the insured in a manner that may be material to the insurers, known as principle of *Re Hampshire Land*,⁸³³ because a principal cannot be expected to be aware of the fraud committed by his agent, given that in real life the agent is highly unlikely to disclose to his principal, or anyone else, as to his own fraud on his principal. The question is how this rule applies to MIA 1906 s. 19(a). In *PCW Syndicates v PCW Reinsurers*,⁸³⁴ the Court of Appeal has reached the same decision that an insurer could not avoid a contract of insurance on the grounds of non-disclosure by an agent of the insured of the fact he had been defrauding his principal through different routes. Saville LJ dismissed the claim for avoidance on the ground that an underwriting agent was not the agent to insure within s. 19(a), and held that "agent to insurer" in s. 19 only encompassed those who actually dealt with the insurers concerned and made the contract in question. Staughton LJ by contrast rested his decision on the wording of s. 18, and, in consistent with the approach of ss. 18 and 19, adopted a "freestanding concept of deemed

⁸³³ [1896] 2 Ch. 743.

⁸³⁴ [1996] 1 WLR 1136.

knowledge in defined circumstances”,⁸³⁵ namely, the insurer did not have a defence under s. 19 where the assured’s agent failed to disclose material facts obtained in his own capacity other than in his capacity as agent for the assured, and in any event an broker perpetrating a fraud against the assured in accordance with *Re Hampshire Land* is not to be treated as being the assured’s agent. Rose LJ agreed with both judgments. Saville LJ later in *Group Josi v Walbrook Insurance*⁸³⁶ arguably agreed the approach adopted by Staughton LJ, then the fraud exception gained a firm foothold in English jurisdiction.⁸³⁷ Originally, the *Re Hampshire Land* rule in an insurance realm applies to fraud engaged by the agent to insurer against his own client. The exception was nevertheless extended by Rix J in *Arab Bank Plc v Zurich Insurance Co*⁸³⁸ to a senior manager of the assured whose fraud was against both the assured and the insurers in the placement process. This common law rule is now preserved by s. 6(2) of the 2015 Act, details of which are provided in Chapter 3 and so repetitious discussion here is a tautology.

⁸³⁵ Alison Pardfield, *Insurance Claims*, at 11.11

⁸³⁶ [1996] 1 All ER 791

⁸³⁷ R. Merkin, *Colinvaux’s Law of Insurance* (11th edn, Sweet & Maxwell 2017) at 7-057

⁸³⁸ [1999] 1 Lloyd’s Rep 262

Chapter 7 Post-contractual Duties and Effects of Utmost Good Faith

7.1 The existence of the continuing duty of utmost good faith

Insofar as the Marine Insurance Act 1906 s. 17 had failed to confine the principle of utmost good faith to pre-contractual matters, it was settled, in a series of cases from the 1970s onwards,⁸³⁹ that the duty applies not only in the making of the contract but also in the course of its performance.⁸⁴⁰ However, the post-contract operation of utmost good faith has proved problematic, one of which has been that the “wholly one-sided” remedy of avoidance, left little or no assistance to the helpless policyholder,⁸⁴¹ would not achieve the desired result for the assured. The scope of the duty continues to be the subject of debate amongst judges and others. There was one thing clear that a continuing duty of utmost good faith, imposed on both the insured and the insurer, came to an end on the commencement of proceedings.⁸⁴²

Relevant questions have now been partially clarified in the Insurance Act 2015 and its new insertion of section 13A by the Enterprise Act 2016. Two of the most-discussed potential post-contractual duty of utmost good faith, i.e. fraudulent claims and late payment, are considered in details from a comparative perspective in this chapter. In addition, issues as to notification of increase of risk are thought to be noteworthy here as it is one of the insured’s

⁸³⁹ R. Merkin, *Colinvaux’s Law of Insurance* (11th edn, Sweet & Maxwell 2017) at 6-004.

⁸⁴⁰ *Manifest Shipping Co Ltd v Uni-Polaris Insurance Co (The Star Sea)* [2001] UKHL 1, [2003] 1 AC 469.

⁸⁴¹ *ibid* [57].

⁸⁴² R. Merkin, *Colinvaux’s Law of Insurance* (11th edn, Sweet & Maxwell 2017) at 10-060, citing *Agapitos v Agnew (The Aegeon)* [2003] QB 556.

continuing duties of good faith in China. By contrast, although notification of increase of risk is indeed a post-contractual duty under English law, it does not relate to the principle of utmost good faith. Further, such a duty is not to be recognised by English courts, despite alteration of risk has been dealt with as quite another matter. Details are provided in Section 7.2. *The Versloot* is discussed in some length in this chapter for two reasons: firstly, the case is of significant importance to the definition of fraudulent claims; secondly, the judgment is the “final nail in the coffin” of the concept of utmost good faith in insurance contract.

7.2 The post-contractual duty to notify the increase of risk

Art. 52 par. 3, written under Chapter 2 of the IAC 2015, that applies only to property insurance contracts⁸⁴³, formulates the principle of increase of risk in the following phrase:

“The assured shall by agreement, without undue delay, notify the insurer in any event where the danger of loss of the subject-matter insured has significantly increased during the currency of the policy, the insurer is subject to contract terms entitled to raise the premium accordingly or to rescind the contract. Where the insurer opts for termination of contract, the residual insurance premium shall be returned to the assured after recouping the amount attributable to the operational period of the policy

⁸⁴³ IAC 2015 art. 95 states that property insurance includes property damage insurance, liability insurance, credit insurance and bond insurance.

from the date of contract to the date of termination.

If the assured fails to perform the obligation of notification prescribed in the previous paragraph, the insurer shall not be liable for claims caused by the significantly increased danger of loss of the subject-matter insured.

Art. 52 concerns in particular the assured's obligation to give notice to the insurer in the event where the danger of loss significantly increases during the course of the policy. An insured who fails to perform the obligation, stated in the second part of the provision, will risk failure of the claim. The provision however is somewhat ambiguous. A number of issues may arise from it: a) what is an increase of risk; b) to what degree should the significance be to provide grounds for insurers to discharge the policy; c) consequences for the insured's failure to perform the duty of notification. Detailed analysis of each question is provided below.

The relationship between increase of risk and good faith is not clear. In China, suggestions were that art. 52, operating as a continuing duty of good faith, imposes a post-contractual duty on the assured to inform the insurer any significant change of risk.⁸⁴⁴ On the contrary, the common law rule does not seem to treat the issue as one of good faith but deals with it on the basis of contract. Notably, under both Chinese and English insurance law, the insurers remain liable where the risk has merely increased. In England, the insurer

⁸⁴⁴ Baoshi WANG & Fan YANG, *Property Insurance Law: Legal Interpretation and Case Studies*, 86. Although the IAC 2002 art.37 has now been replaced by IAC 2015 art.52, the proposition as the principle is being a continuing duty remain unchanged.

should bear the downside of an increase of risk⁸⁴⁵ unless there is a complete change in the nature of the risk (alteration of risk). English courts does not tolerate hindsight underwriting, whereby the insurer seeks to re-write the risk on the basis that they may have got the original assessment wrong.⁸⁴⁶ The increase of risk clause has very little value.⁸⁴⁷ It was therefore clear that, in absence of an “abundantly clear” notification clause, the insured should not be under onerous continuing obligation of notifying the insurer.⁸⁴⁸ It was held in *Kausar v Eagle Star Insurance Co Ltd*,⁸⁴⁹ in the case of a clause which required notification to the insurers in the event of an increase of risk, that the clause was to be construed as doing no more than codifying the common law distinction between increase of risk (which has no adverse effects on the policy) and change of risk (which operates automatically to discharge the insurer on the basis that what was agreed between parties has ceased to exist), and that the clause applied only to the latter situation.⁸⁵⁰ Here a clear distinction has been drawn between an increase of risk and a change of risk. There is an alteration of the risk if there is a change in the circumstances which are to form the basis of the insurance, and the risk is thereby altered contrary to the implied conditions of the contract. In other words, material alteration of the nature of the risk will discharge

⁸⁴⁵ M. Smith, ‘The Effect of Subsequent Increases of risk on Contracts of Insurance’ [2009] LMCLQ 368. Smith comments: “It might be said that allowing an insurer to escape his obligations by relying upon subsequent changes in circumstances rather undermines the very purpose of insurance, by bringing the protection purchases by the insured to an end in circumstances that the insured may not have anticipated.”

⁸⁴⁶ *Kausar v Eagle Star Insurance Co Ltd* [1997] CLC 129, 131.

⁸⁴⁷ In *Baxendale v Harvey* (1859) 4 Hurl. & N. 445, Sir Frederick Pollock CB observed: “The insurer, when it has had notice of the risk, is not entitled to any notice by reason of the increase in danger. A person who insurers may light as many candles as he pleases in his house, though each additional candle increases the danger of setting the house on fire.”

⁸⁴⁸ *Kausar v Eagle Star Insurance Co Ltd* [1997] CLC 129,133.

⁸⁴⁹ [2000] Lloyd’s Rep IR 154.

⁸⁵⁰ R. Merkin, *Colinvaux’s Law of Insurance* (11th edn, Sweet & Maxwell 2017) at 5-023 - 5-027.

insurers from liability. Considering the “significant increase” requirement set out in IAC 2015 art. 52 par. 1, it is necessary to draw a clear distinction between the term “significant increase” and the phrase “material alteration”. A detailed discussion is provided in the following paragraphs.

7.2.1 The meaning of increase of risk

In China, the definition of increase of risk, omitted in IAC 2015, has however been strictly limited by the courts.⁸⁵¹ It was held that a change in the use of a car from private to business purpose falls outside the scope.⁸⁵² The essence as to the issue on whether the risk had increased, considered by Beijing Railway Transport Court in *Li CHEN v Yingda Taihe Property Insurance Co Ltd*,⁸⁵³ was whether the nature of use of the insured vehicle has changed at the time of loss. The insurer asserted that renting out the “family-occupied” vehicle by its owner Li CHEN had changed the motor’s “nature” of use, i.e. the insured “family-occupied” vehicle was used for business purposes at the time of loss, and that had significantly increased the danger of loss. The Court’s view was that, although at the time of loss the insured vehicle was driven by Jian Zhang who hired it from Li CHEN, its nature of use remain the same because the vehicle was still used as a private car, therefore fell short of affecting the risk. The allegation was nevertheless rejected by the court. In this case, it is an unfathomable enigma for the Court to conclude that the nature of use of the

⁸⁵¹ Hongtao Sun, ‘A Study as to the Development of the Duty to Notify Increase of the Risk in the Insurance Act of People’s Republic of China – Article 52 of the Insurance Act of PRC’ (2016) 6 Journal of Political and Law 107.

⁸⁵² *Li CHEN v Yingda Taihe Property Insurance Co Ltd* [2014] Jing Tie Min Chuzi No. 18.

⁸⁵³ *ibid.*

insured vehicle had not changed, given that the automobile lease service is in fact a business activity, even the motorcar was hired out for the purpose of family use.

Under Chinese insurance law, first, the increase of risk must be enduring. Ephemerality automatically renders a change futile. It is essential to distinguish between temporary increases of risk and changes of use. For example, an increase of risk is not attributable to a car accident caused by an occasional brake failure. Under English law, it is subject to the actual wording of contract terms. “An endorsement prohibiting an increase in risk ‘unless expressly provided for by endorsement’ is an indication that a temporary or isolated increase of risk is not within the scope of the exception.”⁸⁵⁴ The leading authority is *Dawson v Monarch Insurance Co of New Zealand Ltd.*⁸⁵⁵ The Court held that an inflatable fairground rabbit was lost by fire after the assured had used a welding torch to repair the trailer on which it rested was amounted to a change of risk. It is noteworthy that where the contractual provisions against increase of risk are expressed as a warranty in a policy, insurers can no longer evade their obligations by relying upon a temporary increase of risk since the common law principle that the contract of insurance terminates automatically as from the date of the breach has been abrogated by s. 10 of the Insurance Act 2015.⁸⁵⁶ The warranty may nevertheless be relied upon if there is non-compliance at the

⁸⁵⁴ R. Merkin, *Colinvaux's Law of Insurance* (11th edn, Sweet & Maxwell 2017) at 5-027.

⁸⁵⁵ [1977] 1 N.Z.L.R. 372 SC.

⁸⁵⁶ R. Merkin, *Colinvaux's Law of Insurance* (11th edn, Sweet & Maxwell 2017) at 5-031.

time of the loss,⁸⁵⁷ but it is only subject to clear wordings. Second, the increase of risk must not be contemplated by the insurer from the outset. In China, if in practice the insurance premium is to be arranged upon anticipated conduct of assured which leads to an increase in risk during the operational period of the cover, the assured cannot be said to have increased the risk.⁸⁵⁸ For example, ascertaining premium or rate-making process for hull insurance is influenced by various factors, one of which is the vessel's operation zone. General, the increase of risk is deemed to be significant if the insured vessel enters into any unanticipated operation zone, e.g. a war zone in particular. The same approach has also been adopted by the common law.⁸⁵⁹ There is no doubt that "conduct anticipated by the policy clearly cannot be said to have increased the risk as defined by the policy".⁸⁶⁰ For example, an insurer was expected to have had in mind the possibility that the sprinkler system would be turned off temporarily, for example, for maintenance or repairs, or for other reasons.⁸⁶¹ Thirdly and most importantly, the increase of risk has to be significant. A mere increase in the risk is not sufficient. The problem arises on this point is that the statutory expression is far from clear for establishing a test of significance. It is therefore essential to determine what exactly the term "significant" refers to in this provision.

⁸⁵⁷ Ibid.

⁸⁵⁸ Hongtao Sun, 'A Study as to the Development of the Duty to Notify Increase of the Risk in the Insurance Act of People's Republic of China – Article 52 of the Insurance Act of PRC' (2016) 6 Journal of Political and Law 107.

⁸⁵⁹ see *Kausar v Eagle Star Insurance Co Ltd* [1997] C.L.C. 129; *Qayyum Ansari v New India Assurance Ltd* [2008] EWHC 243 (Ch).

⁸⁶⁰ R. Merkin, *Colinvaux's Law of Insurance* (11th edn, Sweet & Maxwell 2017) at 5-027.

⁸⁶¹ *Qayyum Ansari v New India Assurance Ltd* [2009] EWCA Civ 93 [46].

7.2.2 Significance of the changes

What is sufficiently central to the consequences of the increase of risk is, ultimately, a matter of degree. It should be noted that, although the IAC 2015 articulates that the effective increase of risk should be “significant”, the Act however fails to establish statutory criteria of significance, nor does it give any examples of things which may, from the insurer’s point of view, be significant to the increase of risk. In respect of English interpretation of Chinese articles of law, it is noteworthy that one may prefer to translate the Chinese phrase “显著增加” set out in art.52 par.1 as “material alteration” rather than “significant increase”. Literally, the term “material alteration”, in Chinese, presenting substantial changes which refers to a higher level change in risk than the word “significant” does, means a change to the nature of the risk. While the English courts, as mentioned above, have clearly expressed the important distinction between a material alteration and a mere change in the risk which will not entitle the insurer to terminate the contract,⁸⁶² It is somewhat of equal importance to distinguish “material alteration” and “significant increase” at this point. Accordingly, the question that has to be considered here is whether the phrase “significant increase” referred in the article should not to be read literally, and whether it nevertheless implicates an extended meaning, i.e. a material change to the nature of the risk. Details are provided below.

⁸⁶² *Kausar v Eagle Star Insurance Co Ltd* [1997] CLC 129.

7.2.2.1 English approaches

The meaning of “material change” has once been considered in *Scottish Coal Co Ltd v Royal and Sun Alliance Plc*,⁸⁶³ where David Steel J adopted the common law principle, to which the court referred in *Kausar v Eagle Star*,⁸⁶⁴ and held that there was only a material change in the risk if there was a fundamental change to its nature.⁸⁶⁵ It was held that a change in working practices is not a material change. The leading authority on the matter now is *Qayyum Ansari v New India Assurance Ltd*,⁸⁶⁶ in which an appropriately worded policy term has widened the basis upon which a change in risk might provide grounds for insurers to discharge the policy. In this case, the policy included in General Condition a “Changes in Facts” clause as follow:

“2 This insurance shall cease to be in force if there is material alteration to the Premises or Business or any material change in the facts stated in the Proposal Form or other facts supplied to the insurer unless the insurer agrees in writing to continue the insurance.”

The premises, which were protected by an automatic sprinkler installation, were let to a friend of Mr. Ansari, who used them for the wholesaling of kitchens. During the period of cover, the assured’s tenant was carrying on the rather different business of selling motor cycles and had turned off the sprinkler system. As the sprinkler system had not been working at the time of the loss by fire, the insurer rejected the claim and cancelled the policy. It was submitted by

⁸⁶³ [2008] Lloyd’s Rep IR 718.

⁸⁶⁴ [1997] CLC 129.

⁸⁶⁵ also see *Swiss Reinsurance Co v United India Insurance Co Ltd* [2005] Lloyd’s Rep IR 341.

⁸⁶⁶ [2009] Lloyd’s Rep IR 562; [2009] EWCA Civ 93.

the insured that the fact that the inoperability of the functioning system could not in fact constitute a material alteration in the subject matter so as to discharge the insurers from the policy, given that the common law has traditionally been concerned not with an increased danger of loss but in a complete change of use of premises.⁸⁶⁷ Moor-Bick LJ indicated that, with regard to the true construction of General Condition 2,⁸⁶⁸ the relevant question to ask here with regard to what was “material” was whether the alterations or changes have taken the risk outside that which was in the “reasonable contemplation of the parties at the time the policy was issued”. The position at common law was stated in in *Law Guarantee Trust and Accident Society v Munich Re-insurance Company*.⁸⁶⁹ The essence of the principle is that “... the obligation of the insurer is confined to the particular risk insured” by the contract into which he has entered, thus the insurers were discharged from liability if an alteration that takes the risk outside that which was within the contemplation of the parties at the time the policy was issued.⁸⁷⁰ The Court of Appeal therefore held that a prudent insurer would not regard the risks being the same for a building with a functioning sprinkler system and a building without one, hence, permanently disabling the sprinkler system did amount to a “material change” in the facts stated in the proposal form.

⁸⁶⁷ *Kausar v Eagle Star Insurance Co Ltd* [1997] C.L.C. 129, the Court of Appeal held that an insurer could not rely on a term requiring the insured to notify it of changes that increased the risk to avoid liability; also see *Swiss Reinsurance Co v United India Insurance Co Ltd* [2005] Lloyd’s Rep IR 341; *Scottish Coal Co Ltd v Royal and Sun Alliance Plc* [2008] Lloyd’s Rep IR 718.

⁸⁶⁸ The judge was of the view that the position concerning alterations to the premises and changes in the facts stated in the proposal form are governed not by the common law but by Condition 2 of the policy; and the Condition 2 should nevertheless be construed with the common law in mind. See *Qayyum Ansari v New India Assurance Ltd* [2009] EWCA Civ 93 [45].

⁸⁶⁹ [1912] 1 Ch. 138.

⁸⁷⁰ *Ibid* [154].

The insurers alleged that the word “material” in the context of General Condition 2 was to have the same well established meaning as in *Pan Atlantic v Pine Top*.⁸⁷¹ The Court of Appeal firmly rejected the argument and held that the test of materiality, operating in the context of pre-contractual negotiations, is “relatively undemanding” and only utilised in separating circumstances that could merely influence a prudent underwriter in assessing the risk.⁸⁷² Importantly, materiality now operates as a filter, taking out obvious cases where facts are plainly immaterial; and the consequences of adopting it are to a large extent controlled by establishment of inducement. It is in fact that virtually every case since *Pan Atlantic* has turned on inducement. Condition 2 in the present case is concerned with events occurring after the contract has been concluded, hence if the term “material” were to import the test of materiality for the duty of utmost good faith (now, fair presentation), it would lead to unacceptable uncertainty for insureds since virtually any circumstances arising mid-term, no matter it would actually lead the insurers alter contract terms in any way, would risk the cover being jeopardized; meanwhile, the insurers would be bestowed the invidious right to re-think the underwriting exercise every time there is a minor change.⁸⁷³ Moore-Bick LJ distinguished Condition 2 in the present case from the common law rule which requiring a fundamental change in the nature of the risk and acknowledged in his judgment that “a material alteration or

⁸⁷¹ *Qayyum Ansari v New India Assurance Ltd* [2009] EWCA Civ 93 [17].

⁸⁷² *Ibid* [40]

⁸⁷³ *Ibid* [41].

change is one which significantly affects the risk.”⁸⁷⁴ Although the Court of Appeal lay particular emphasis on the terms of the clause in *Ansari* rather than on the common law principle, it may be necessary for the assureds to embark on an altogether more delicate assessment, recognising that certain features of an insured property are themselves descriptive of its use. The widened scope upon which facts and matters might amount to a “significant” alteration in the subject matter of the insurance resulting termination of the policy will have a recognisable impact on the meaning of the term “material”.

7.2.2.2 Treatment in the civil law systems

Statutory criteria as to the degree of significance can be found in many civil law jurisdictions. For example, in Greek Insurance Contract Act art.4 par.1,⁸⁷⁵ the test has explicitly stated in the following phrase:

“Throughout the contract period ... such [a significant aggravation of risk] had the insurer been aware, it would not have concluded the insurance contract, or would not have concluded it under the same terms.”

Similar tests have also been adopted in Norway and Belgium. With reference to the wording of the provision, an increase of risk should be notified to the insurer if its degree of significance is sufficient to influence the judgment of the insurer on whether to underwrite the risk or in fixing the contract terms, if the insurer had known the particular from the outset. It is noteworthy that this set of terms is

⁸⁷⁴ See *Qayyum Ansari v New India Assurance Ltd* [2009] EWCA Civ 93 [45].

⁸⁷⁵ No. 2496/1997.

strikingly similar to the wording used for the test of materiality for pre-contractual duty of utmost good faith.

It is clear now, as seen from the last section, that the allegation that the term “material” should bare the same meaning as that which it was given in *Pan Atlantic* has nevertheless been dismissed by the Court of Appeal on the ground that the “mere influence” test adopted by the common law, if it were to be imported in the context of increase of risk, would jeopardise the performance of the policy by bringing in uncertainty and unfairness for the insureds. Unlike the English approach, instead of adopting the “mere influence” test, art. 16 par. 2 of the IAC 2015 – concerning the duty of presentation - has employed the “decisive influence” test, whereby requiring that a changed circumstance must have a decisive effect on the acceptance of the cover by the underwriter so as to constitute a material fact, and hence, in that context has prevented resulting to the same problem that might be caused by the “mere influence” test, i.e. policy will automatically lapse on the occurrence of any minor changes arising mid-term in which a prudent underwriter would be interested. Meanwhile, the consistency with the test in art. 16 par. 2 of the IAC 2015 is propitious to unify application of Chinese insurance law and its legal interpretations. In market practice, this measure has in fact long been embraced by Chinese underwriters for the purpose of saving transaction costs, namely, the assured is not required to give notice to the insurer if the degree of significance is not sufficient to

influence the insurer's decision in accepting the risk.⁸⁷⁶

It is evident that, in the provision, the adjunct word confining the phrase "aggravation [alteration] of risk" is "significant" and not "material". Generally, it is submitted that "material" is more likely to be referred to in this context as a complete change of use of subject matter insured or a fundamental alteration to the nature of the risk.⁸⁷⁷ Accordingly, where the nature of the risk is materially altered, the promise upon the insurance agreed is negated. The changed circumstance would constitute a new risk which substitute the original cover, and should be dealt with in a new policy under a pre-contractual duty of fair presentation. It is incumbent upon the insurer to prove that there has been a change or alteration in the risk such that it is no longer the same risk. It is therefore reasonable to presume that the underwriters are entitled to discharge liability by reason of the increase in risk in situations where the alteration to the subject matter insured has a significant bearing on the risk but not yet being sufficient to alter the basis of the contract. Speaking of the meaning of "significance", it has been suggested by Chinese scholars that there is a significant increase of risk if the change made on the insurance subject seriously count against the insurer.⁸⁷⁸

⁸⁷⁶ 'A Discussion as to the Duty of Notification of the Significant Increase of Risk', written by China Property & Casualty Reinsurance Co Ltd for the 2013 Insurance Law joint conference, 111.

⁸⁷⁷ See *Kausar v Eagle Star Insurance Co Ltd* [1997] CLC 129.

⁸⁷⁸ Zhaoguo JIANG, *Basic Principles of Insurance Law*, 240.

7.2.3 Consequences for breach of the duty of notification

In the Chinese legal system, right to rescind a contract can be promissory or statutory.⁸⁷⁹ The right of termination by reason of breach of the duty of notification, set out by art. 52 of the IAC 2015, is the latter. Article 52 serves to offer the insurer statutory force for exercising termination right. To determine whether or not there has been a significant change in the subject-matter, it is subject to the construction of the policy to determine exactly what subject-matter falls within its coverage. Clear wording is necessary.

Where the insured fails to perform his duty of notification in the event of a significant increase in risk, the Chinese law discharges the insurer from all liability for loss to the subject-matter.⁸⁸⁰ The insurer is to be conferred an optional right choosing from termination of the contract or rise of the premium.⁸⁸¹ Whether or not the insurer opts to terminate the contract or charge additional premium is subject to express terms of the contract.⁸⁸² The burden of proof is on the insurer, who must show evidence that the loss is in fact caused by the significant increase in risk.⁸⁸³ A causal connection between the loss and the increase of risk is required. This issue is not considered in any detail here in this thesis, as it is not so related to the matter of utmost good faith.

⁸⁷⁹ Contract Law of People's Republic of China, art. 94.

⁸⁸⁰ Insurance Act of PRC 2015, art. 52 par. 2.

⁸⁸¹ Insurance Act of PRC 2015, art. 52 par. 1.

⁸⁸² Ibid.

⁸⁸³ Jing ZHEN, *Chinese Insurance Contracts: Law and Practice* (Informa Law 2017) 354.

7.3 Fraudulent Claims

The Association of British Insurers (ABI) estimated that, in 2014, insurers uncovered 130,000 fraudulent claims worth £1.32 billion across all insurance produces and this adds an extra £50 to the annual insurance bill for every UK policyholder,⁸⁸⁴ hence this is a key issue both for insurers and insureds. The common law rule of fraudulent claims originated in *Britton v Royal Insurance Co*,⁸⁸⁵ and is now restated in s.12 of the IA 2015. The fraudulent claims rule operates to forfeit a claim made by the insured in its entirety when that claim is fabricated or fraudulently exaggerated, including any genuine parts⁸⁸⁶, irrespective of whether the insurer was deceived.⁸⁸⁷ The deceitful insureds not only do they risk failure of the claim but also run the risk of their entire policy being terminated from the time of the fraudulent act with no ability to seek the return of premiums, despite the insurer will still be liable for genuine claims made prior to the avoidance of the policy. Whether or not the policy comes to an end is at the insurer's option; it is not automatic. Insurers are also conferred a right to recover from the insured sums paid in respect of the claim.

Likewise, in China, insurers are not liable for fraudulent claims. However, the scope of fraudulent claims rule under Chinese insurance law is much constrained, comparing to the rules in England. Article 27 of the Insurance Act

⁸⁸⁴ 'The Association of British Insurers Report: Key Facts 2015'
<<https://www.abi.org.uk/globalassets/sitecore/files/documents/publications/public/2015/statistics/key-facts-2015.pdf>> accessed 25 Nov 2017.

⁸⁸⁵ (1866) 4 F & F 905.

⁸⁸⁶ This principle, endorsed by the House of Lord in *the Star Sea* [2003] 1 AC 469, has now confirmed by the Supreme Court in *Versloot Dredging BV v HDI Gerling Industrie Versicherungs AG (The DC Merwestone)* [2016] UKSC 45.

⁸⁸⁷ *Agapitos v Agnew (The Aegeon)* [2003] QB 556, 564.

of PRC 2015 provides an exhaustive list of fraud and the effect for each type of fraudulent claims. Insurers are bestowed a right to terminate the contract in the event of fabrication of and/or deliberately giving occasion to the occurrence of an insured event,⁸⁸⁸ however, exaggerated loss and fraudulent means/devices are both excluded.⁸⁸⁹ Issues concerning valid claims supported by fabricated documents, false information and/or other fraudulent devices are considered in detail below. The assured is nevertheless entitled to recover for his actual loss despite exaggeration,⁸⁹⁰ whilst English courts held that, “even where the exaggerated part is eminently severable in fact”, it is not possible to sever the fraud from the rest of the claim,⁸⁹¹ based on rules that which applies in the law of illegality, namely, an illegal contract will not be severed.⁸⁹² What had been squarely rejected by English courts has nevertheless gained a firm foothold in China. A fraudulent claim can be apportionable under Chinese law. Despite the unknown basis of this provision, it seems clear that art.27 par.3 is not deployed to deter policyholders from acting fraudulently. Insofar as the problem as to exaggeration of loss nowadays is heavily corroding the entire insurance industry worldwide, this issue seems to be wrongly conceptualised in China. It was stated by Lord Hobhouse in *The Star Sea*, indeed, that, “the fraudulent insured must not be allowed to think: if the fraud is successful, then I will gain; if it is

⁸⁸⁸ Insurance Act of PRC 2015, art. 27 pars. 1&2.

⁸⁸⁹ Insurance Act of PRC 2015, art. 27 par. 3.

⁸⁹⁰ Ibid.

⁸⁹¹ *Versloot Dredging BV v HDI Gerling Industrie Versicherungs AG (The DC Merwestone)*. [2016] UKSC 45, [25] (Lord Sumption JSC) and [93] (Lord Hughes).

⁸⁹² R. Merkin, *Colinvaux's Law of Insurance* (11th edn, Sweet & Maxwell 2017), para 10-051 and footnote 171.

unsuccessful, I will lose nothing”.⁸⁹³ The premiums paid are generally not refundable, subject to the exception for life insurance policyholders stated in art.43 par.1 of Insurance Act of PRC 2015. That is, where the proposer deliberately causes death, injury, disability or illness to the insured, the insurer is required to return the cash value of the insurance policy in accordance with contract terms to other obligees under the policy, if a life insurance proposer has paid premiums in full for two years or more.

It is noteworthy that, in addition to IAC 2015 art.27, the Chinese Insurance Act imposes administrative sanctions on deceitful proposers, insureds and beneficiaries in cases that fall short of a criminal offence.⁸⁹⁴ Article 8 of the Law of the People’s Republic of China on Administrative Penalty (The “Administrative Penalty Act”) lists six types of administrative sanctions and a miscellaneous provisions: (1) disciplinary warning; (2) fine; (3) confiscation of illegal gains or confiscation of unlawful property or things of value; (4) ordering of suspension of production or business; (5) temporary suspension or rescission of permit or that of license; (6) administrative detention; and (7) other administrative penalties prescribed by laws and administrative rules and regulations. This punitive measure also applies to appraisers, accessors and testifiers who in fact provide forged documents or other related means in support of the fraudulent claims.⁸⁹⁵ The problem is that neither the Insurance Act

⁸⁹³ [2003] 1 AC 469 [62].

⁸⁹⁴ Jing ZHEN, *Chinese Insurance Contracts: Law and Practice* (Informa 2017) 478.

⁸⁹⁵ Insurance Act of PRC 2015, art. 174 par. 2.

of PRC 2015 nor the Administrative Penalty Act indicates any measure of sanctions in the context of fraudulent insurance claims. The absence of specific measure, coupled with excessive judicial discretion of judges, will highly likely bring more uncertainty and inconsistency into insurance law and its legal practice.

The Supreme Court clarified, in the ruling of *Versloot Dredging BV v HDI Gerling Industrie Versicherungs AG (The DC Merwestone)*,⁸⁹⁶ the definition of fraudulent claim on which the IA 2015 is deliberate silent.⁸⁹⁷ The term “fraudulent means/devices” is rephrased as “collateral lies”. The extension of the fraudulent claims rule to collateral lies were found to be disproportionately harsh to the insured and contrary to public interest. The judgment consigns fraudulent devices to legal history and, most importantly, limits the term “fraudulent claim” in s.12 of the IA 2015. “A claim can only be fraudulent if the assured is dishonest or at the very least culpably reckless” therefrom, and mere negligence on the part of the assured will be no longer sufficient.⁸⁹⁸ By contrast, Chinese insurance law requires deliberate intention of the insured to constitute a fraud. Lord Hughes JSC has intentionally given in his seminal judgment a comprehensive overview on the historic tangled ties between fraudulent claim rule and the duty of utmost good faith. Considerations of those issues are discussed below.

⁸⁹⁶ [2016] UKSC 45.

⁸⁹⁷ R. Merkin & O. Gurses, ‘The Insurance Act 2015: Rebalancing the Interests of Insurer and Assured’ (2015) 78 (6) Mod. L. Rev. 1004, footnote 86 quoting “IA 2015 s.12 was amended by the Law Commission I the consultation process to removing wording which appeared to codify the principle.”

⁸⁹⁸ R. Merkin, *Colinvaux’s Law of Insurance* (11th edn, Sweet & Maxwell 2017) at 10-045.

7.3.1 The “*Versloot*”⁸⁹⁹

A vessel was incapacitated by a flood in the engine room. The insureds claimed against the defendant insurer, stating that the bilge alarm had gone off at around noon on the day of the incident. Popplewell J, the judge at first instance, found this statement to be a “reckless untruth” and took the opportunity to voice strong criticisms of the all-or-nothing effect of the fraudulent device rule originated in the dicta in *Agapitos v Agnew (The Aegeon)*,⁹⁰⁰ although he upheld the insurer’s refusal of the claim.⁹⁰¹ The owner brought an appeal. The Court of Appeal agreed with Popplewell J’s refusal of the claim, but declined to endorse his criticisms of the rule and returned to the underlying public interest in deterring fraud as the principal justification for applying the fraudulent claim rule to fraudulent devices.⁹⁰² In further appeal, the Supreme Court has for the first time drawn a sharp distinction between a fraudulently exaggerated claim and a justified claim supported by fraudulent devices, and ruled in the keenly anticipated judgment that collateral lies, considered to be irrelevant to the existence or amount of the insured’s entitlement and therefore immaterial to the claim, is not sufficient to defeat a claim. Lord Sumption noted that the insured’s right to an indemnity arises as soon as the loss is suffered, and amount payable can be objectively assessed and does not depend on how the insured puts its

⁸⁹⁹ *Versloot Dredging BV v HDI Gerling Industrie Versicherungs AG (The DC Merwestone)* [2016] UKSC

45.

⁹⁰⁰ *Agapitos v Agnew (The Aegeon)* [2003] QB 556 (Mance LJ).

⁹⁰¹ *Versloot Dredging BV v HDI Gerling Industrie Versicherungs AG (The DC Merwestone)* [2013] 2 All ER (Comm) 465.

⁹⁰² *Versloot Dredging BV v HDI Gerling Industrie Versicherungs AG (The DC Merwestone)* [2015] QB 608 (CA).

claim.⁹⁰³ Fraudulent means or devices are no longer a basis for refusing claims, but might be a basis for claiming damages for breach of contract.⁹⁰⁴ The decision of Supreme Court narrows the scope of a fraudulent claim, but it was made in a manner commensurate with provisions of the IA 2015. Although this was a marine insurance claim, the court was clear the decision is intended to apply to all consumer and commercial insurance policies. Lord Mance, in dissenting, argued that the majority in the Supreme Court have run counter to the basis of the insurance contract – utmost good faith has long been fundamental as a result of “general imbalance in information and control and the significance of moral hazard in insurance relationships”⁹⁰⁵ - and wrongly considered the issue from the perspective of hindsight, thereby the judgment may provide an insured with the ability to lie with impunity. Some considerations between fraudulent claims and the principle of utmost good faith are discussed in the following section.

7.3.2 Fraudulent claims and utmost good faith

Given that the duty of utmost good faith is not confined to pre-contractual matters but also continues to operate in the course of contract performance, Willes J pointed out in *Britton v Royal Insurance Co*⁹⁰⁶ that the fraudulent claims rule was merely a manifestation of the duty of utmost good faith. This view, inherited in many cases, was adopted by Christopher Clarke LJ as the juridical

⁹⁰³ *Versloot Dredging BV v HDI Gerling Industrie Versicherung AG (The DC Merwestone)* [2016] UKSC 45 [26]

⁹⁰⁴ *ibid* [98]

⁹⁰⁵ *ibid* [114]

⁹⁰⁶ (1866) 4 F & F 905.

basis for the fraudulent claims rule in the leading judgment of *The Versloot* in the Court of Appeal,⁹⁰⁷ although it has been clarified by Lord Hobhouse as long ago as in *The Star Sea* that fraudulent claims - the paradigm example of post-contract bad faith – does not give the insurer the right to avoid the policy *ab initio*.⁹⁰⁸ Further, the removal of the sanction of avoidance for breach of the duty of utmost good faith from s.17 of the MIA 1906 by the IA 2015, coupled with the implementation of ss.12 and 13 of the IA 2015 whereby the forfeiture rule is put on a statutory footing, has confirmed the Lord Hobhouse's proposition that "the continuing duty of utmost good faith has no part to play in determining the remedies for the making of a fraudulent claim".⁹⁰⁹ However, in cases where there was an express clause avoiding the policy in the event of fraudulent devices, then the general law was not in point.⁹¹⁰

The Court of Appeal's decision raises significant questions as to the relevance of good faith and fair information in the formation and operation of insurance contract. The claimant, again, alleged on their appeal to the Supreme Court that "to enable an insurer to escape liability when he has suffered no harm would be unjust and contrary to the spirit of mutual good faith."⁹¹¹ Thus the Supreme Court took a meticulous examination on both the notion itself and the "attenuated" test of materiality – meant to be operated distinctively to the test of

⁹⁰⁷ *Versloot Dredging BV v HDI Gerling Industrie Versicherung AG (The DC Merwestone)* [2015] QB 608 (CA) [76]-[77].

⁹⁰⁸ This view was confirmed by the Court of Appeal in *K/S Merc Skandia XXXXII v Certain Lloyd's Underwriters* [2001] Lloyd's Rep IR 802 and in *Agapitos v Agnew (The Aegeon)* [2003] QB 556.

⁹⁰⁹ R. Merkin, *Colinvaux's Law of Insurance* (11th edn, Sweet & Maxwell 2017) at 10-062.

⁹¹⁰ [2016] UKSC 45 [82] (Lord Hughes JSC).

⁹¹¹ *Versloot Dredging BV v HDI Gerling Industrie Versicherung AG (The DC Merwestone)* [2016] UKSC 45, [5]

materiality of pre-contractual misrepresentations and non-disclosures - that was “tentatively” proposed by Mance LJ in *The Aegeon*,⁹¹² while he indicated that the fraudulent claims rule does not require the insurer to prove inducement.⁹¹³ As to the usability of the pre-contractual test of materiality at the claim stage, the Supreme Court rebuffed its application on the ground that the mind of the hypothetical prudent insurer is rather pointless in assessing a claim, as it is of a completely different character from the assessment of a risk at the formation of contract,⁹¹⁴ therefore the concept of materiality is not transposable between the pre- and post-contract (claim) stages.⁹¹⁵ The primary question to the present issue is whether the lie is material to the liability of the insurer, namely, the acceptance of a lie told by the insured with the aim of improving the position of the liar, collateral or not, provides the insured with something to which he is not entitled in law.⁹¹⁶ Hereupon, the fraudulent claims rule is untied entirely from the notion of utmost good faith. The troublesome decision of *The Litsion Pride*, overruled in part by Lord Hobbhouse in *The Star Sea*,⁹¹⁷ has been firmly squashed by Lord Hughes JSC in *The Versloot*.⁹¹⁸ His lordship expressed in the judgment that “the lie told was not part of the presentation of the claim at all, but rather part of a dishonest antecedent attempt to avoid liability to pay the

⁹¹² [2003] QB 556.

⁹¹³ *ibid* [36]-[37].

⁹¹⁴ *Versloot Dredging BV v HDI Gerling Industrie Versicherungs AG (The DC Merwestone)* [2016] UKSC 45 [33]-[36] (Lord Sumption JSC).

⁹¹⁵ *Versloot Dredging BV v HDI Gerling Industrie Versicherungs AG (The DC Merwestone)* [2016] UKSC 45 [87]-[91] (Lord Hughes JSC).

⁹¹⁶ *Versloot Dredging BV v HDI Gerling Industrie Versicherungs AG (The DC Merwestone)* [2016] UKSC 45 [92].

⁹¹⁷ [2003] 1 AC 469 [71], in which Lord Hobbhouse stated: “In so far as it is based upon the principle of the irrecoverability of fraudulent claims, the decision is questionable upon the fact since the actual claim was valid claim for a loss which had occurred and had been caused by peril insured against when the vessel was covered by a held cover clause.”

⁹¹⁸ [2016] UKSC 45.

additional premium for taking the ship into a war zone.”⁹¹⁹ That is to say, it is not a fraudulent claims case at all. In *The Litsion Pride*, the underwriter may discharge its liability if payment of the additional premium had constituted a condition precedent to coverage, however, Hirst J held that the premium clauses does not constitute a condition precedent. Either way, the insurer would not be able to wiggle out of its liability to pay the claim.

7.4 Damages for late payment

The common law recognised the existence of insurers’ duty of utmost good faith after the formation of the contract. This position was rooted by the Court of Appeal in *Bank of Nova Scotia v Hellenic War Risks Association (Bermuda) Ltd (The Good Luck)*.⁹²⁰ However, the underlying circumstances were unique – those who claimed damages for the alleged breach of the insurer’s continuing duty of utmost good faith were not the assured but their banks. The Court of Appeal ruled that the insurer indeed owned a continuing duty of utmost good faith, but only to the insured owner not to the bank - a non-contracting party who was deprived of its right to the proceeds of the policy. It was indicated, in obiter, in *Drake Insurance plc v Provident Insurance plc*⁹²¹ that insurers are required to act in good faith in deciding whether or not to avoid a policy for the insured’s breach.⁹²² The only duty that might matter to an assured is one imposed on the

⁹¹⁹ Ibid [75]

⁹²⁰ [1990] 1 QB 818, was on appeal on different grounds [1991] 3 All E.R. 1.

⁹²¹ [2004] Lloyd’s Rep IR 277.

⁹²² R. Merkin & M. Hemsworth, *The Law of Motor Insurance* (2nd edn, Sweet & Maxwell 2015) at 2-87.

insurer to pay valid claims.⁹²³ However, the insured's door on relying on the principle has been closed by the remedy, being "inadequate"⁹²⁴ and of no practical value to the insured,⁹²⁵ spelt out at the original version of s. 17 of Marine Insurance Act 1906.⁹²⁶ An attempt was made to give rise to damages for a breach of duty of utmost good faith. The possibility was however denied by the Court of Appeal in *La Banque Financière de la Cité v Westgate Insurance Co Ltd*,⁹²⁷ where the insurer failed to disclose material facts to the assured resulting that the assured's cover was less than he had been let to believe.⁹²⁸ Though the case was related to a pre-contractual duty, the ruling has been entrenched in subsequent case law.⁹²⁹ The English courts were constrained in the rule of law on utmost good faith and were inadmissible to extent the duty or the consequences of breach of any such duty any further in insurance law, or to expand the meaning of a contract provision.⁹³⁰ A different approach has been taken in other jurisdictions. The Canadian courts have nevertheless recognised that the insurer's duty of utmost good faith is a fiduciary duty, breach of which gives rise to damages.⁹³¹ Given that the insured's post-contractual duty of utmost good faith "can derive from express or implied terms of the contract"⁹³² -

⁹²³ R. Merkin, *Reforming insurance law: is there a case for reverse transportation?* - The report for the English and Scottish Law Commissions, paras 5.8 – 5.10.

⁹²⁴ *La Banque Financière de la Cité v Westgate Insurance Co Ltd* [1990] 1 QB 665 (CA) 775.

⁹²⁵ *Manifest Shipping v Uni-Polaris Insurance Co (The Star Sea)* [2001] UKHL 1; [2003] AC 469 [57].

⁹²⁶ Law Commission, *Insurance Contract Law: Post Contract Duties and Other Issues* (Law Com CP No 201, 2012) para 3.1.

⁹²⁷ [1990] 1 QB 665.

⁹²⁸ Slade LJ advocated that "on the particular facts of some cases" such a post-contractual duty of good faith could be said to arise under the terms of the contract.

⁹²⁹ Law Commission, *Insurance Contract Law: Post Contract Duties and Other Issues* (Law Com CP No 201, 2012) para 3.7.

⁹³⁰ *Gan Insurance v Tai Ping Insurance (No.2)* [2001] CLC 1103, 1134, 1138-1139.

⁹³¹ R. Merkin, *Colinvaux's Law of Insurance* (11th edn, Sweet & Maxwell 2017) at 11-110.

⁹³² In *Black King Shipping Corp v Massie (The Litsion Pride)* [1985] 1 Lloyd's Rep 437, 518, Mr Justice Hirst suggested that "the duty not to... make claims in breach of [post-contractual duty of] utmost good

although a pre-contractual duty is not based on an implied term as before the formation of the contract the duty cannot arise from the contract itself⁹³³ - the mutuality of the duty of utmost good faith thus opens the possibility that unreasonable refusal or arrearage by an insurer may result in a breach of the continuing duty of utmost good faith which is implied in the insurance contract. This was denied by English courts.⁹³⁴ Mance J held, in *Insurance Corp of the Channel Islands v McHugh (No.1)*,⁹³⁵ that even if there was a continuing duty of utmost good faith owed by the insurer, it did not give rise to an implied term obliging the insurer to negotiate, settle and pay a claim in good faith and with reasonable speed.⁹³⁶

English courts have also refused to imply a term in the policy to the effect that insurers must pay claims promptly.⁹³⁷ This is based on the legal fiction that an insurer's primary obligation is not to pay valid claims in return for payment of the premium but to prevent the loss occurring in the first place.⁹³⁸ The operation of the "hold harmless" principle was clearly illustrated in *Sprung v Royal Insurance (UK) Ltd*,⁹³⁹ and the *Sprung* principle was followed even where the insurers had

faith is an implied term of the policy". Some support for this view can also be found in remarks by Lord Hobhouse in *The Star Sea*, in which he made his best attempt to make sense of section 17 by drawing distinctions between a lack of good faith in negotiation and a lack of good faith during the performance of the contract. This classic comment has been elaborated at paragraph 52 of the judgment.

⁹³³ A Nandoo & D Oughton, 'The confused post-formation duty of good faith in insurance law: from refinement to fragmentation to elimination?' [2005] JBL 346.

⁹³⁴ R. Merkin, *Colinvaux's Law of Insurance* (11th edn, Sweet & Maxwell 2017) at 11-112.

⁹³⁵ [1997] LRLR 94, 136-137.

⁹³⁶ R. Merkin, *Colinvaux's Law of Insurance* (11th edn, Sweet & Maxwell 2017) at 6-060.

⁹³⁷ *Sprung v Royal Insurance (UK) Ltd* [1999] Lloyd's Rep IR 111.

⁹³⁸ English law regards an contract of insurance as analogous to a contract with a security firm, in which the security firm undertakes to prevent a break-in. See *Firma C-Trade SA v Newcastle Protection and Indemnity Association (The Fantia)* [1989] 1 Lloyd's Rep 239; *Secony Mobil Oil v West of England Shipowners Mutual Insurance Association (The Padre Island)* [1991] 2 AC 1, 35 (Lord Goff).

⁹³⁹ [1999] 1 Lloyd's Rep 111.

expressly undertaken that they would “always try to be fair and reasonable whenever you have need of the protection of this policy. We will also act quickly to provide that protection”,⁹⁴⁰ despite that explicitly well-worded terms might be exceptionally enforceable as a separate contractual obligation, such as clause 46.7 of the International Hull Clauses 2003 confines the claims handling period for the leading underwriter in 28 days.⁹⁴¹ Where payment is late, there can be no remedy for assureds as English law does not allow damages for late payment,⁹⁴² other than interest on a sum due.⁹⁴³ This is because payment under the policy represents damages, and further damages cannot be awarded for non-payment.⁹⁴⁴ The law on late payment, being unfair and less protective of assureds, was described as a “blot on English common law jurisprudence”.⁹⁴⁵

The matter, after having experienced a careful and circumspective process of reform, has now been dealt with by implied term under s. 13A of the Insurance Act 2015, added by the Enterprise Act 2016. This provision will for the first time allow policyholders to pursue damages against underwriters for late payment. The duty of good faith has now been redesignated as a general “interpretative principle”⁹⁴⁶ under the IA 2015 - the avoidance remedy is now abolished -

⁹⁴⁰ *Tonkin v UK Insurance Ltd* [2006] EWHC 1120 (TCC), 34.

⁹⁴¹ Law Commission, *Insurance Contract Law: Business Disclosure; Warranties; Insurer’s Remedies for Fraudulent Claims; and Late Payment* (Law Com No 353, 2014) paras 25.16 – 25.21.

⁹⁴² *The President of India v Lips Maritime Corporation (The Lips)* [1988] AC 395.

⁹⁴³ *Sempra Metals Ltd v HM Commissioners of Inland Revenue* [2007] UKHL 34, in which the House of Lords recognised a restitutionary right to compound interest, where one party had wrongly received and held insurance money during a period when it should not have had it.

⁹⁴⁴ The operation of the “hold harmless” principle is clearly illustrated in *Sprung v Royal Insurance (UK) Ltd* [1999] 1 Lloyd’s Rep 111.

⁹⁴⁵ Law Commission, *Insurance Contract Law: Business Disclosure; Warranties; Insurer’s Remedies for Fraudulent Claims; and Late Payment* (Law Com No 353, 2014) para 26.4 – 26.14 & 26.51.

⁹⁴⁶ Insurance Act 2015, s.14.

breach of which does not give rise to a standalone action, however, that may no longer be significant in the situation where late payment occurs.⁹⁴⁷ In the course of the insurance contract law reform, the Law Commission indeed suggested that 13A liability should rest upon good faith and intended to award a remedy of damages for a breach. The mission nevertheless failed, albeit such an extension to the ambit of the insurer's duty of utmost good faith succeeded in Australia. The Australian High Court recognised that an insurer's duty of good faith is not limited to acting honestly and extends to an obligation to determine a claim for indemnity in a timely manner and without due delay.⁹⁴⁸ Specific considerations as to the reform of late payment of insurance claims and the role of utmost good faith are provided as follow.

7.4.1 The reform

In December 2011, the Law Commission of England and Wales and the Scottish Law Commission produced a joint consultation paper on the post contract duties and other issues,⁹⁴⁹ in which they proposed that insurers should be under a contractual obligation to pay valid claims within a "reasonable time" and that a failure could result in liability to pay damages for any foreseeable losses caused. In July 2014 the Law Commission published their report – *Insurance contract law: business disclosure; warranties; insurer's remedies for*

⁹⁴⁷ R. Merkin, *Colinvaux's Law of Insurance* (11th edn, Sweet & Maxwell 2017) at 6-051.

⁹⁴⁸ *CGU Insurance Ltd v AMP Financial Planning Pty Ltd* [2007] HCA 36.

⁹⁴⁹ Law Commission, *Insurance Contract Law: Post Contract Duties and Other Issues* (Law Com CP No 201, 2012).

*fraudulent claims; and late payment.*⁹⁵⁰ Evidence to the Law Commissions shown majority support for the reform among insurance companies and insurance trade bodies, despite the argument that damages might be disproportional to the amount of claim, that the additional amount may only act as a substitute of business interruption cover which can be purchased separately from the market, that insurers always under a strong competitive pressure to pay claims timeously so that the measures were rendered superfluous, and that FOS does not apply the rule in *Sprung* to consumer cases so that damages for distress are in practice awardable. Three broad approaches were outlined, one of which was to enable policyholders to claim foreseeable or foreseen loss where bad faith can be shown.⁹⁵¹ The Law Commission had eventually moved away from this solution as a result of a fear to the uncertainty that might be brought by a possibility of development of US-style substantial punitive damages.⁹⁵² Further, the contractual route, thought to be the best, was nevertheless refused by the Government for being too controversial to be included in the Law Commission Bill that would attract an expedited Parliamentary procedure.⁹⁵³ The Bill eventually passed without late payment provisions.

⁹⁵⁰ Law Commission, *Insurance Contract Law: Business Disclosure; Warranties; Insurer's Remedies for Fraudulent Claims; and Late Payment* (Law Com No 353, 2014).

⁹⁵¹ See generally at Law Commission, *Insurance Contract Law: Post Contract Duties and Other Issues* (Law Com CP No 201, 2012) part 3, Damages for late payment: other routes to redress

⁹⁵² Law Commission, *Insurance Contract Law: Business Disclosure; Warranties; Insurer's Remedies for Fraudulent Claims; and Late Payment* (Law Com No 353, 2014) paras 26.43-26.45.

⁹⁵³ R. Merkin, *Colinvaux's Law of Insurance* (11th edn, Sweet & Maxwell 2017) at 11-117 & 11-118.

7.4.1.1 The Insurance Act 2015, s. 13A

The matter, as promised,⁹⁵⁴ was revisited and is now dealt with under the Enterprise Act 2016, which received the Royal Assent on 4 May 2016. This ‘U-turn’ in law has brought significant implications for insurers. For insurance contracts, the crucial points lie in Part V (ss. 28-30), which amends the IA 2015 by incorporating s. 13A, implying a term in every contract of insurance that any sums due in respect of a claim will be paid “within a reasonable time” where it includes time to “investigate and assess” the claim,⁹⁵⁵ breach of which will give rise to the usual contractual remedies, including damages in addition to interest and the sum due under the policy.⁹⁵⁶ Reasonableness will depend on all the relevant circumstances. Examples of circumstances that need to be taken into account are listed in IA 2015 s. 13A(3), namely, the type of insurance, the size and complexity of the claim, compliance with any relevant statutory or regulatory rules or guidance and factors outside the insurer’s control. The test is simply what is reasonable. It is necessary to demonstrate a breach of duty was unreasonable, frivolous or unfounded. Notwithstanding it is apparent that s. 13A is not about good faith but failure to pay, the High Court of New Zealand has held in *Young v Tower Insurance Ltd*⁹⁵⁷ that utmost good faith, as a necessary incident of insurance contracts, is an implied term at common law, and has in effect incorporated s. 13A of the IA 2015 into New Zealand law. Gendall J finds that the duty of utmost good faith extends beyond a mere obligation on the

⁹⁵⁴ The government did undertake to review the matter after the election.

⁹⁵⁵ Insurance Act 2015, s. 13A(2).

⁹⁵⁶ Insurance Act 2015, s. 13A(5).

⁹⁵⁷ [2016] NZHC 2965.

insurer and the insured of continued disclosure, and requires the insurers to “act reasonably, fairly and transparently, including but not limited to the initial formation of the contract and during and after the lodgement of a claim”; and “process the claim in a reasonable time”.⁹⁵⁸

7.4.1.2 Contracting out - the “shield” of good faith

IA 2015 s. 16A permits parties to a non-consumer⁹⁵⁹ contract to contract out of the implied term subject to the strict transparency requirements in the IA 2015, requiring the term to be clear and unambiguous and that the insurer to take sufficient steps to draw the disadvantageous term to the policyholders’ attention before the contract is concluded, but the insurer will lose right to rely upon exclusion if breach of the term implied by IA 2015 s. 13A is deliberate or reckless.⁹⁶⁰ It reflects the Australian approach and was described by the Law Commission as “a shield” of good faith,⁹⁶¹ preventing an insurer who has acted in bad faith from relying upon the exclusion clause.⁹⁶² If there is an exclusion clause in a non-consumer insurance contract, the concept of “deliberate or reckless” is to be put into service. The burden of proof will fall on the policyholder, although insurer will in any defence have to explain reasons behind its refusal or delay.⁹⁶³ This is not straightforward.⁹⁶⁴ Knowledge of the

⁹⁵⁸ *ibid* 163.

⁹⁵⁹ No exception at all is to be allowed in consumer insurance.

⁹⁶⁰ Insurance Act 2015, s. 16(2).

⁹⁶¹ Law Commission, *Insurance Contract Law: Business Disclosure; Warranties; Insurer’s Remedies for Fraudulent Claims; and Late Payment* (Law Com No 353, 2014) para 26.63 and 28.96.

⁹⁶² *ibid* para 26.59.

⁹⁶³ *ibid* para 28.99-28.101.

⁹⁶⁴ R. Merkin, *Colinvaux’s Law of Insurance* (11th edn, Sweet & Maxwell 2017) at 11-123.

insurers' actual awareness or of their recklessness as to the irrationality of their conduct is required. Examples of deliberateness or recklessness given by the Law Commission are: knowingly delaying or rejecting a claim known to be valid in order to secure a bonus payment or with a view to any internal budgets or quotas; or the insurers' approach to a claim is blameworthy to the point of recklessness.⁹⁶⁵ Proof will be complex and there will be issues as to whose knowledge or recklessness is material for this purpose.⁹⁶⁶

7.4.2 Compensatory damages for late payment in China

In China, paying valid claims timeously is and has always been, in performing of the principle of honesty and good faith, a primary obligation to the insurer. Provisions as to remedies for the insurer's unreasonable delay or refusal are provided in the art. 23 par. 2 of the 2015 Act, which is stated as follow,

An insurer who fails to fulfill the obligation as prescribed in the preceding paragraph shall compensate the policyholder or beneficiary for losses incurred therefrom, in addition to paying the insurance amount or claim.

It is apparent from this provision that the sums awardable by way of damages are in addition to the sums due under the policy. Interest is not specified in the Act but has been recognised by the courts.⁹⁶⁷ However, there is no measure of damages specified by the Act, thereby the ordinary contractual rule in the

⁹⁶⁵ Law Commission, *Insurance Contract Law: Business Disclosure; Warranties; Insurer's Remedies for Fraudulent Claims; and Late Payment* (Law Com No 353, 2014) para 28.98.

⁹⁶⁶ R. Merkin, *Colinvaux's Law of Insurance* (11th edn, Sweet & Maxwell 2017) at 11-123.

⁹⁶⁷ Zhen JING, *Chinese Insurance Contracts: Law and Practice* (Informa 2017), 462, citing *Shanghai Zhenan Company v PICC Property Co. Wenzhou Branch*, Ningbo Maritime Court, Civil Judgment (2007) no. 25.

Contract Law of PRC 1999 is to be applied.⁹⁶⁸ Art. 113 par. 1 of the 1999 Act states that the amount of compensation shall equal damages for breach of contract, including any loss of profit under the contract, but must not exceed foreseeable or foreseen losses which was in the contemplation of both parties at the time the contract was made, as the probable result of the breach. Likewise, IA 2015 provides no measure of damages, and so the ordinary common law test, set out in *Hadley v Baxendale*,⁹⁶⁹ is likely to be deployed.⁹⁷⁰ The rule of remoteness operates in a similar manner with the above Chinese provision, namely, damages are recoverable if the actual loss suffered by the assured was in the contemplation of the insurers from the inception. In principle the assured can recover: 1) losses which the parties ought to have contemplated in the ordinary course of events when the contract was made; and 2) special losses arising from circumstances actually known to the parties when the contract was made, although claiming special losses might be somewhat impractical.⁹⁷¹ Insofar as the infant IA 2015 does not provide much guidance on how late payment might operate, those Australian authorities are of particular importance on this matter. A claim for damages arising from personal injuries under a Combined Home Building and Home Contents Insurance Policy against insurer for breach of contract including breach of duty of utmost good faith was held to be too remote by the New South Wales Court of Appeal

⁹⁶⁸ Zhen JING, *Chinese Insurance Contracts: Law and Practice* (Informa 2017) 456.

⁹⁶⁹ (1854) 9 Ex 341.

⁹⁷⁰ R. Merkin, *Colinvaux's Law of Insurance* (11th edn, Sweet & Maxwell 2017) at 11-120.

⁹⁷¹ *ibid.*

(NSWCA) in *Sudesh Sharma v Insurance Australia Ltd t/as NRMA Insurance*.⁹⁷²

The NSWCA upheld findings of the judge at first instance that the insurer was not in breach of its duty of utmost good faith by reference to the landmark judgment in *CGU Insurance v AMP Financial Planning*⁹⁷³, and concluded that it was not “in the usual course of things”⁹⁷⁴ that one may suffer personal injury as a result of a breach of an insurance contract covering property damages, and that it would be unreasonable to contemplate that the insured would undertake repair work and end up a fall from a ladder. As such, even if the insurer had breached its duty of utmost good faith, the personal injuries claimed were to be too remote to be compensable. The question is: would the loss be foreseeable if the insured is a builder, whereby repair work is expected, so is a fall from a ladder?

One of the functions of the 1999 Act art. 113 part. 1 is to set a ceiling on the amount of compensation. In contrast, IA 2015 s. 13A(5) does not cap damages at policy limits, so that the assured can recover sums due under the policy plus any loss suffered, whatever the total amount.⁹⁷⁵ There will not be interest on the sum insured as it will be reflected in the damages awarded, although there may be interest on the damages.⁹⁷⁶ In the majority of cases, claims might be limited to simple or compound interest only to reflect the cost of borrowing money at

⁹⁷² [2017] NSWCA 55.

⁹⁷³ [2007] HCA 36.

⁹⁷⁴ *European Bank Ltd v Evans* [2010] HCA 21 [13].

⁹⁷⁵ R. Merkin, *Colinvaux's Law of Insurance* (11th edn, Sweet & Maxwell 2017) at 11-120.

⁹⁷⁶ *ibid* at 11-131.

commercial rates or the loss of use of money at commercial lending rates,⁹⁷⁷ as insureds are required to prove on the balance of probability that any loss for which it claims damages was actually caused by the insurer's breach of the implied term, and many insureds will be unable to show loss.

Though IA 2015 s. 13A(3) has provided examples of relevant issues, what constitutes a "reasonable time" is a congenitally vague standard under English law.⁹⁷⁸ Case law will be required for clarity. Chinese law, by contrast, tackles the problem by specifying timeframe for claim settlement. The Act requires the insurer to notify the insured, in one comprehensive list, of all the documents and evidence it needs to assess a claim,⁹⁷⁹ and to make a decision on liability promptly: if the claim is complicated, the insurer should make a decision within 30 days from receiving notice of the claim in the absence of express terms to the contrary;⁹⁸⁰ by implication, the period is relatively less for simple claims. Payment must be made within 10 days of the insured's agreement to the settlement proposed unless there is different time frame indicated to the contrary in the policy.⁹⁸¹ Failure to do so will lead to damages payable to policyholders or beneficiaries on or over the sum owing under the policy. The insurer is obliged to make a payment on account of the sums that can be agreed, if the settlement amount cannot be determined within 60 days of

⁹⁷⁷ *ibid* at 11-120.

⁹⁷⁸ M. Clarke & B.Soyer, *The insurance Act 2015: A new regime for commercial and marine insurance law* (Informa 2016), paras 6.3.& 6. 93.

⁹⁷⁹ Insurance Act of PRC 2015, art. 22.

⁹⁸⁰ Insurance Act of PRC 2015, art. 23 par.1.

⁹⁸¹ *ibid*.

notification with full documents and evidence provided; balance must be paid after final determination.⁹⁸²

⁹⁸² Insurance Act of PRC 2015, art. 25.

Chapter 8 Treatment for Consumers

The Consumer Insurance (Disclosure and Representations) Act 2012

8.1 The Path to Reform

It is well acknowledged that, by 2013, the insurance law did not keep the pace with the change in the economic and technological environment in which commercial insurance is transacted and failed to meet the expectations of the policyholders.⁹⁸³ The need for reform in the field of insurance law was initiated as long ago as 1957. There have been several reports calling for the reform of the law in light of misrepresentation and non-disclosure in insurance contract during these years.⁹⁸⁴ The Law Reform Committee, the forerunner of the Law Commission, reported that the state of English insurance law with respect to pre-contractual misrepresentation and non-disclosure, and consumer-assureds' breach of warranties was capable of leading to abuse.⁹⁸⁵ Limited suggestions made in the proposal eventually went down like a lead balloon but formed the basis of the Law Commission's 1980 proposal for reform. From 1979 to 1980, for the purpose of forestalling a harmonisation of insurance contract law of the member states at the time under consideration by the European Commission,⁹⁸⁶ the Law Commission produced a working paper and a report,⁹⁸⁷ advocating a

⁹⁸³ Law Commission, *Consumer Insurance Law: Pre-contract Disclosure and Misrepresentation* (Law Com No 319, 2009) para 1.8.

⁹⁸⁴ *ibid* para 1.5.

⁹⁸⁵ Law Reform Committee, *Conditions and Exceptions in Insurance Policies* (Fifth Report, 1957) Cmnd 62.

⁹⁸⁶ Commission of the European Communities, Proposal for a Council Directive on the coordination of laws, regulations and administrative provisions relating to insurance contracts, COM (79) 335 final, 6 July 1979.

⁹⁸⁷ Law Commission, *Law of Contract: the Parol Evidence Rule* (Law Com Working Paper No 70, 1979); Law Commission, *Insurance Law non-disclosure and Breach of Warranty Report on a Reference Under Section 3(1)(e) of the Law Commission Act 1965*, (Law Com No104, 1980)

reform on the problematic duty of disclosure and breach of warranty. Thus it is doubtless that “when the risk of the latter dissipated, the incentive to implement the former evaporated.”⁹⁸⁸ Nevertheless, the 1980 report concluded that the law was “undoubtedly in need of reform”.⁹⁸⁹ Reform was also urged in a report published by the National Consumer Council in 1997.⁹⁹⁰ More importantly, the reform was, again, triggered by a report produced by the British Insurance Law association (BILA) in 2002.⁹⁹¹

In 2006, the Law Commissions of England and the Scottish Law Commission embarked on a project to review insurance contract law, and produced scope paper, inviting views on which areas of insurance contract law were in need of reform. The Law Commissions published a series of issues papers to consider the main areas of the current law that were thought to be problematic, including misrepresentation and non-disclosure, post-contractual utmost good faith, the status of intermediaries, warranties, insurable interest, damages for late payment and requirements contained in statute for formal marine policy. Since then, three Consultation Papers have been published. In July 2007, the Law Commissions produced their first Consultation Paper⁹⁹² which set out in detail the Commissions’ provisional proposals for the reform of insurance contract law

⁹⁸⁸ Rob Merkin & Ozlem Gurses, *The Insurance Act 2015: Rebalancing the Interests of Insurer and Assured* (2015) 78 (6) Mod L Rev 1004.

⁹⁸⁹ Law Commission, *Insurance Law non-disclosure and Breach of Warranty Report on a Reference Under Section 3(1)(e) of the Law Commission Act 1965*, (Law Com No104, 1980) para 1.21.

⁹⁹⁰ National Consumer Council, *Insurance Law Reform: the Consumer Case for Review of Insurance Law* (May 1997).

⁹⁹¹ British Insurance Law Association, ‘Insurance Contracts Law Reform’ (September 2002)

⁹⁹² Law Commission, *Insurance Contract Law: Misrepresentation, Non-disclosure and Breach of Warranty by the Insured* (Law Com CP No 182, 2007).

with particular reference to the key areas of utmost good faith, warranties and agency. It begins by noting that the ways in which modern insurance contracts are concluded differ significantly from those when insurance law was last reviewed by the Law Commission in 1980.⁹⁹³ In 2009, the joint Law Commission's first report concerned key issues related to consumer insurance and led to the Consumer Insurance (Disclosure & Representation) Act 2012, which came into force in April 2013.

In addition, the Consumer Rights Act 2015 (CRA 2015),⁹⁹⁴ which applies to consumer insurance contracts, will reform and consolidate consumer law in England, in particular the Unfair Contract Terms Act 1977 and the Unfair Terms in Consumer Contracts Regulations 1999. For insurers offering consumer products, the main impact of the Act is likely to be seen in the new laws for digital content and ancillary contracts, unfair contract terms and the changes to the mechanisms for consumer redress. Consumers now may have the statutory power of challenging unduly onerous terms which appear in the small print in an insurance contract. The most importantly, the CRA 2015 introduces more strenuous remedies resulting from unfair terms, by which it allows customers to terminate the contract and claim compensatory payments.

⁹⁹³ R. Merkin and J. Lowry *Reconstructing Insurance Law: The Law Commissions' Consultation Paper* (2008) 71(1) Mod L Rev 95.

⁹⁹⁴ The Consumer Rights Act 2015 replaces a number of laws with regards to business-to-consumer transactions, including the Supply of Goods (Implied Terms) Act 1973; the Sale of Goods Act 1979; the Supply of Goods and Services Act 1982; the Sale and Supply of Goods Act 1994; the Sale and Supply of Goods to Consumers Regulations 2002 and the Unfair Contract Terms Act 1997. The Unfair Terms in Consumer Contracts Regulations 1999 is replaced by the Consumer Rights Act 2015.

8.2 Treatment for consumers

Despite some modifications provided by European Union in respect of restrictions to the insurer on limited use of draconian policy provisions, in UK statutory force have been given to the Financial Ombudsman Service by the Financial Services and Markets Act 2000⁹⁹⁵ coupled with the legally-enforceable regulatory requirements in the Financial Services Authority's Handbook promising fair handling of claims.⁹⁹⁶ However, there has been no legislative change until the introduction of the CI(DR)A 2012. The 2012 Act closely follows recommendations made by the Law Commission in a joint report published in December 2009, aiming to bring the law into line with consumers' reasonable expectations and good practice; and targets the most problematic area, namely, definition of "consumer insurance contract", duty of consumer assureds, qualifying misrepresentation and the insurer's remedies for breach. Each of these matters is considered in the following paragraphs.

8.2.1 Meaning of "Consumer Insurance Contract"

CI(DR)A 2012 covers only consumer insurance policy; business is subject to the 2015 Act. "Consumer insurance contract" is defined by CI(DR)A 2012, s. 1 as follow:

"consumer insurance contract" means a contract of insurance between—

- (a) an individual who enters into the contract wholly or mainly

⁹⁹⁵ Replaced by the Financial Service Act 2012

⁹⁹⁶ R. Merkin, Australia: Still A Nation of Chalmers? [2011] 30(2) UQLJ 194.

for purposes unrelated to the individual's trade, business or profession, and

- (b) a person who carries on the business of insurance and who becomes a party to the contract by way of that business (whether or not in accordance with permission for the purposes of the Financial Services and Markets Act 2000);

“consumer” means the individual who enters into a consumer insurance contract, or proposes to do so;

“insurer” means the person who is, or would become, the other party to a consumer insurance contract.

S. 1(a) states that, “the contract wholly or mainly for purposes unrelated to the individual's trade, business or profession”. A similar phrase is used in the Consumer Rights Act 2015, defining “consumer” as “an individual acting for purposes that are wholly or mainly outside that individual's trade, business, craft or profession”. This was classified by the Law Commission as “mixed-use policies”,⁹⁹⁷ “where the insurance covers some private and some business use, one needs to look at the main purpose of the insurance. This is a matter of fact in each case. For example, insurance on a car used mainly as a taxi, with only occasional private trip would be considered commercial insurance.”⁹⁹⁸ It seems that there is no obstacle to identify that “ a self-employed window cleaner who uses a van primarily for window-cleaning would be taking out insurance in a

⁹⁹⁷ Law Commission, *Consumer Insurance Law: Pre-contract Disclosure and Misrepresentation* (Law Com No 319, 2009) para 5.17, 5.18 & 5.19.

⁹⁹⁸ *ibid* para 5.6 and Explanatory Notes to the Report, Clause 1, A.5.

business capacity. However, a self-employed contractor who used a car mainly for private use would insure the car as a consumer.”⁹⁹⁹

The Law Commission have clarified that insurance for purposes of business would be business insurance¹⁰⁰⁰ and accepted that “trade or profession” are likely to include employees.¹⁰⁰¹ However, it is probably not easy to determine whether the main use of a vehicle is for “trade, business or profession”, if a self-employed freelance designer who uses his/her own motor car to drive to and from business meetings; and meanwhile it also used privately for their daily life, i.e. picking up his/her families, going to supermarket, meeting with friends and families etc. Furthermore, greater difficulty exists in whether a policy on a privately owned vehicle will fall within or outside CI(DR)A 2012, if for instance the motor car is used as a non-professional Uber taxi only when he/she drives to and from his/her work place for the purpose of saving petrol cost. The definition of consumer under this Act will undoubtedly be tested by the courts in due course. Taking into account the above scenarios, the judge might consider the use of a vehicle as a whole to determine whether its predominant purpose is for business or private use at this point.

8.2.2 Duty of a consumer assured

CI(DR)A 2012 follows the practice of the Financial Ombudsman Service, which

⁹⁹⁹ ibid para 5.18.

¹⁰⁰⁰ ibid para 5.18.

¹⁰⁰¹ ibid para 5.14.

abolished the consumer contract from ss. 18-20 of the Marine Insurance Act 1906, and instead, imposes on the consumer a duty “to take reasonable care not to make a misrepresentation to the insurer”.¹⁰⁰² The consumer would no longer be required to volunteer information but only to take reasonable care in answering question posed by the insurer fully and accurately and ensure that the information is not misleading.¹⁰⁰³ Attentions will be paid to the clarity and specificity of the questions by the court in assessing whether or not the consumer’s response was reasonable,¹⁰⁰⁴ and yet insurers are not precluded from asking general or open-ended questions.¹⁰⁰⁵ Such broad questions may have only limited effect.

In order to avoid “instant ossification”¹⁰⁰⁶ of the law, the term “misrepresentation” is deliberately not defined by CI(DR)A 2012¹⁰⁰⁷ because the Law Commission was willing to preserve “a wide and flexible approach to the issue of what amounts to a misrepresentation” in line with the common law concept of a misrepresentation interpreted by the English courts.¹⁰⁰⁸ For example, an omission of a declaration on the application form¹⁰⁰⁹ or a failure to answer a question fully may constitute a misrepresentation.¹⁰¹⁰ The Law Commission

¹⁰⁰² CI(DR)A 2012, s. 2(2).

¹⁰⁰³ Law Commission, *Consumer Insurance Law: Pre-contract Disclosure and Misrepresentation* (Law Com No 319, 2009) para 4.7.

¹⁰⁰⁴ *ibid* paras 5.34-5.36.

¹⁰⁰⁵ R. Merkin & M. Hemsworth, *The Law of Motor Insurance* (2nd edn, Sweet & Maxwell 2015) at 2-31.

¹⁰⁰⁶ As Lord Justice Rix suggested to the Law Commission, *Consumer Insurance Law: Pre-contract Disclosure and Misrepresentation* (Law Com No 319, 2009) para 5.41.

¹⁰⁰⁷ R. Merkin & M. Hemsworth, *The Law of Motor Insurance* (2nd edn, Sweet & Maxwell 2015) at 2-31.

¹⁰⁰⁸ Law Commission, *Consumer Insurance Law: Pre-contract Disclosure and Misrepresentation* (Law Com No 319, 2009) paras 5.50 & 5.52.

¹⁰⁰⁹ *Roberts v Avon Insurance Co* [1956] 2 Lloyd’s Rep 240.

¹⁰¹⁰ *Winter v Irish Life Assurance plc* [1995] 2 Lloyd’s Rep 274.

goes further by explaining that: “in particular, it should cover cases where an answer is misleadingly incomplete. However, if the applicant clearly refuses to answer a question, and the insurer nevertheless accepts their proposal, then this would not be a misrepresentation.”¹⁰¹¹ In other words, if a question is left unanswered or is ambiguous and incomplete but the insurer does not press for an answer or for clarification, the insurer would be assumed to have waived the question required.

The duty set out in CI(DR)A 2012, s. 2(2) applies equally on renewal and variations since they both are treated simply as a fresh contract.¹⁰¹² For example, consumers who failed “to respond to a renewal letter asking if the previous particulars are correct” would be considered a misrepresentation.¹⁰¹³ Failing to comply with the insurer’s request to confirm or amend particular information previously given by the assured is treated to be a misrepresentation by CI(DR)A 2012, s. 2(3). Then questions left at this point would be whether the consumer acted with reasonable care in responding to the request.¹⁰¹⁴ Failure to reply to an insurer’s letter on renewal might not constitute a misrepresentation on analogy with the existing case law, in which it is concerned, as stated above, with “a failure to answer specific questions on a form, rather than a failure to reply to a form altogether.”¹⁰¹⁵ The law concerning variation remains unchanged,

¹⁰¹¹ Law Commission, *Consumer Insurance Law: Pre-contract Disclosure and Misrepresentation* (Law Com No 319, 2009) para 5.50.

¹⁰¹² R. Merkin & M. Hemsworth, *The Law of Motor Insurance* (2nd edn, Sweet & Maxwell 2015) at 2-31.

¹⁰¹³ Law Commission, *Consumer Insurance Law: Pre-contract Disclosure and Misrepresentation* (Law Com No 319, 2009) para 4.9.

¹⁰¹⁴ R. Merkin & M. Hemsworth, *The Law of Motor Insurance* (2nd edn, Sweet & Maxwell 2015) at 2-31.

¹⁰¹⁵ Law Commission, *Consumer Insurance Law: Pre-contract Disclosure and Misrepresentation* (Law

only information relating to the variation itself must be disclosed.¹⁰¹⁶

The duty imposed by s. 17 of Marine Insurance Act 1906 is confined to the pre-contractual statement for consumer insurance contract. Section 2(5)(a) made clear that CI(DR)A 2012 does not affect any duty of utmost good faith after the contract has been entered into. Thus no statutory obligation of this kind is required by assureds to notify their insurer of a change of circumstances, unless there is an express term in the policy.¹⁰¹⁷ Such a term is subject to review under the Consumer Rights Act 2015.¹⁰¹⁸ Any consumer insurance contracts which are also marine insurance, such as insurance on private yachts, are subject to CI(DR)A 2012. Accordingly, an insurer should proceed with caution when entering into a contract of insurance with an individual owner of a private or pleasure vessel/yacht unless it is clear that the main purpose of that policy is for trade, business or profession.

8.2.3 “Reasonableness” – a reasonable consumer test

The standard applied to decide whether the consumer has taken reasonable care is defined by s. 3 of CI(DR)A 2012. Whether or not a consumer has taken reasonable care not to make a misrepresentation will depend on all the relevant circumstances.¹⁰¹⁹ A list of factors as to whether reasonable care was taken are

Com No 319, 2009) paras 5.49.

¹⁰¹⁶ *ibid* para 5.58.

¹⁰¹⁷ *ibid* para 5.62.

¹⁰¹⁸ It was the Unfair Terms in Consumer Contracts Regulations 1999, which was replaced by the Consumer Rights Act on 1st October 2015.

¹⁰¹⁹ CI(DR)A 2012, s. 3(1).

particularly stressed by CI(DR)A 2012 s.3(2), in which it gives “examples of things which may need to be taken into account in making a determination”, namely:

- (a) the type of consumer insurance contract in question, and its target market,
- (b) any relevant explanatory material or publicity produced or authorised by the insurer,
- (c) how clear, and how specific, the insurer’s questions were,
- (d) in the case of a failure to respond to the insurer’s questions in connection with the renewal or variation of a consumer insurance contract, how clearly the insurer communicated the importance of answering those questions (or the possible consequences of failing to do so),
- (e) whether or not an agent was acting for the consumer.

However, this list is indicative and not exhaustive. Accordingly, a misrepresentation might be reasonable where the question was general whereas it is not understandable by a reasonable consumer; the consumer had reasonable grounds for believing that their statement was true; a reasonable consumer would not have assumed that the fact was the one which the insurer would want to know about; a reasonable consumer would presume that the insurer would obtain such information from itself or the third party.¹⁰²⁰

¹⁰²⁰ Law Commission, *Consumer Insurance Law: Pre-contract Disclosure and Misrepresentation* (Law Com No 319, 2009) para 5.71.

Whether the assured has taken reasonable care to answer questions outlined by the insurer in a proposal form is an objective test looked at in context. The key question arise at this point in determining reasonableness is whether the reasonable assured is “a reasonable consumer” or “a reasonable consumer in the circumstances of the insured”. Particular characteristics of the actual consumer such as the consumer’s age or knowledge of English do not usually be considered,¹⁰²¹ unless these were known or ought to have known by the insurer.¹⁰²² The reasonable consumer expressed by CI(DR)A 2012, s. 3(3) “denotes an average consumer with no special skills or knowledge taking into account the examples listed in subsection (2)”.¹⁰²³

Section 3(5), confirming that a misrepresentation made dishonestly is always to be taken as showing lack of reasonable care, is somewhat controversial. The main concern of this provision is the criteria to be taken into account in considering a consumer’s dishonesty, e.g. where a well-informed consumer with particular characteristic or knowledge acted dishonestly, an average consumer might have made a reasonable mistake on the same issues.¹⁰²⁴ Consequently, s. 3(5) might be abused where an insurer is trying to find a way to reject a claim.¹⁰²⁵

¹⁰²¹ *ibid* para 5.75

¹⁰²² CI(DR)A 2012, s. 3(4)

¹⁰²³ Explanatory Notes to the Consumer Insurance Bill [HL Bill 68], para. 28

¹⁰²⁴ *ibid* para 30

¹⁰²⁵ R. Merkin & M. Hemsworth, *The Law of Motor Insurance* (2nd edn, Sweet & Maxwell 2015) at 2-33

8.2.4 Qualifying Misrepresentation

Section 4 of CI(DR)A 2012 deals with the circumstances in which an insurer is entitled to a remedy where there is the breach of the duty by assured. An insurer has a remedy against a consumer for a misrepresentation made by the consumer before a consumer insurance contract was entered into or varied only if: (a) the consumer failed to comply with the duty set out by s. 2(2) of CI(DR)A; and (b) “the insurer shows that without the misrepresentation, that insurer would not have entered into the contract (or agreed to the variation) at all, or would have done so only on different terms.” The latter requirement codifies the common law approach on inducement as developed following the House of Lord decision which applies to business insurance in *Pan Atlantic Insurance Co Ltd v Pine Top Insurance Co Ltd*,¹⁰²⁶ that the actual underwriter would have declined the risk or accepted it only on different terms had the insurer known the fact misrepresented or non-disclosed before the contract is concluded. The requirement of materiality set out in s. 20 of the MIA 1906 that a misrepresentation is actionable only if it is material and influenced the judgment of a hypothetical ‘prudent insurer’, was not preserved by CI(DR)A 2012.¹⁰²⁷ This is intended to be a high evidential threshold. It is not sufficient for the insurer to show that the hypothetical prudent underwriter would have been influenced. Instead, the specific underwriter must show that it relied on the misrepresentation and would have acted differently had they been in

¹⁰²⁶ [1995] 1 AC 51

¹⁰²⁷ Law Commission, *Consumer Insurance Law: Pre-contract Disclosure and Misrepresentation* (Law Com No 319, 2009) para 6.10.

possession of all necessary facts.

There is a three-part classification: reasonableness; deliberate or reckless breach of duty; careless breach of duty. “Deliberate or reckless” is defined by CI(DR)A 2012, s. 5(2), whereas “careless”, being discussed in the context of classification below, is residual category. A misstatement is careless if a consumer did not act with reasonable care resulting a “qualifying misrepresentation”, but was not deliberate or reckless.¹⁰²⁸ No remedy is afforded to the insurer for the first category, namely, where the consumer has acted reasonably. The only Remedies available to the insurer, as set out in CI(DR)A 2012, schedule 1, paragraph 2, will depend on the insured’s state of mind. The burden of proving a misrepresentation is “deliberate or reckless” lies on the shoulder of the insurer unless the contrary is shown.¹⁰²⁹ This is discussed in detail below in the context of deliberate and reckless misrepresentation.

8.2.4.1 The Threefold Classification

The three-part classification employed by the FOS – “reasonable”, “careless”, and “deliberate or reckless” misrepresentation – has been given legislative effect by CI(DR)A 2012. The term “deliberate or reckless” is used to differentiate a special treatment made for the insurer by CI(DR)A 2012 from the common law concepts of fraud that “require an exceptionally high standard of proof” and that

¹⁰²⁸ CI(DR)A 2012, s. 5(3).

¹⁰²⁹ CI(DR)A 2012, ss. 5(4) & (5).

was considered, by the Law Commission, to be too difficult to prove.¹⁰³⁰

Definitions are set out by s. 5(2) of the Act, which is stated as follows:

A qualifying misrepresentation is deliberate or reckless if the consumer—

(a) knew that it was untrue or misleading, or did not care whether or not it was untrue or misleading, and

(b) knew that the matter to which the misrepresentation related was relevant to the insurer, or did not care whether or not it was relevant to the insurer.

Consequently, judging from a circumstance on whether or not it constitutes a deliberate misrepresentation will need to examine if the misstatement is untrue or misleading, and its relevance to the insurer. The second requirement of relevance of knowledge is rather necessary. In practice, unrelated, minor matters were being used to avoid the policy for serious illnesses and death.¹⁰³¹

“By knowing that ‘a matter was relevant’, it means that the consumer thinks it is something the insurer would want to know.”¹⁰³² The second requirement of relevance of knowledge is considered to be the most controversial part of this test.¹⁰³³ The key problem to be concerned is the difficulty as to evidence gathering where proposer thought that the non-disclosed information is trivial at

¹⁰³⁰ Law Commission, *Consumer Insurance Law: Pre-contract Disclosure and Misrepresentation* (Law Com No 319, 2009) paras 6.15-6.16.

¹⁰³¹ Peter J Tyldesley, ‘Reform at Last’, in Peter J Tyldesley (ed), *Consumer Insurance Law: Disclosure, Representations and Basis of the Contract Clauses* (Bloomsbury 2013) at 4.6.

¹⁰³² Law Commission, *Consumer Insurance Law: Pre-contract Disclosure and Misrepresentation* (Law Com No 319, 2009) para 6.32.

¹⁰³³ *ibid* para 6.21.

the time and irrelevant to fairly general questions asked, such as providing medical details in the last five years, but regarded as relevant early symptoms of complaints by the insurer.¹⁰³⁴ Given a certain condition of individuals, whether a particular misstatement or non-disclosure is relevant or not might be, in each case, a question of fact. For example, a consumer might act unreasonably but honestly as he/she was having trouble recognising the matter misrepresented, thereby genuinely but incorrectly believed that the answer provided was true.¹⁰³⁵ Nevertheless, where consumers genuinely believe their answer is true would at most be considered as being careless regardless whether they put their minds to whether it was relevant; the Law Commission suggested a compensatory remedy for such circumstance which “aims to put the insurer in the position in which it would have been had it know the information”. Conversely, if they genuinely thought that the fact was irrelevant, it would be concerned to be careless no matter whether or not they put their minds to whether the information was true.¹⁰³⁶

The reckless category first appeared in April 2003 issue of Ombudsman News.¹⁰³⁷ This approach has been “over-enthusiastically” invoked by many insurers to label any fault made by assured as “clearly reckless”, entitling them to avoid the policy.¹⁰³⁸ It was common practice that an insurer exam closely a

¹⁰³⁴ *ibid* para 6.22-6.23.

¹⁰³⁵ *ibid* para 6.24-6.26.

¹⁰³⁶ *ibid* para 6.27.

¹⁰³⁷ Issue 27.

¹⁰³⁸ Peter J Tyldesley, ‘Reform at Last’, in Peter J Tyldesley (ed) *Consumer Insurance Law: Disclosure, Representations and Basis of the Contract Clauses* (Bloomsbury 2013) at 4.6.

consumer's medical records at the point of claim, looking for anything, even a minor matter, which could be used to defeat valid claims.¹⁰³⁹ Obviously, the reckless category was misunderstood and wrongly applied by the insurer.¹⁰⁴⁰

Defining "reckless" is complex. The Law Commission redoubled their efforts in exploring a better explanatory method of this term, but continued to be undefined and followed the common law approach. Taking a closer look at some previous common law approaches, it was held in the early case of *Derry v Peek*¹⁰⁴¹ concerning fraudulent misrepresentation, that a consumer acts recklessly, if they act without care and regard for the truth of an answer. It was argued that the relevant test as to recklessness was that what articulated in *Fraser v B N Furman (Productions) Ltd*,¹⁰⁴² in which Diplock LJ observed: "...it must be at least reckless, that is to say, made with actual recognition by the insured himself that a danger exists, and not caring whether or not it is averted..." It reflects the approach adopted by the ABI in its Code of Practice covering misrepresentation and claims in which it defines the concept as acting "without any care".¹⁰⁴³ "In this context, 'not caring' is different from act 'carelessly', by not taking sufficient care to check the facts. It requires a lack of interest in whether a statement is true, or whether a statement is relevant."¹⁰⁴⁴

¹⁰³⁹ *ibid.*

¹⁰⁴⁰ *ibid* para 4.7.

¹⁰⁴¹ (1889) LR 14 App Cas 337.

¹⁰⁴² [1967] 2 Lloyd's Rep 1.

¹⁰⁴³ ABI Code of Practice, 'Managing Claims for Individual and Group Life, Critical Illness and Income Protection Insurance Products' (January 2009), para 2.1.

¹⁰⁴⁴ Law Commission, *Consumer Insurance Law: Pre-contract Disclosure and Misrepresentation* (Law Com No 319, 2009) para 6.18.

Drawing lessons from the approach adopted by the FOS, a misrepresentation will be considered to be reckless where it is difficult to believe that the proposer could have overlooked a matter which is typically of significance and well known to him, but there is not enough evidence to show deliberate misrepresentation.¹⁰⁴⁵ On the face of it, proofing of reckless requires a lesser test than that of deliberate.¹⁰⁴⁶

“Careless” is deliberately not defined in the Act; alternatively, the Law Commission introduced a “blanket solution”, by which it presumptively includes all of qualifying misrepresentations that are not deliberate or reckless. The term of this category was chosen from variety of labels, namely, “inadvertent” – which was employed by the FOS to describe such misrepresentation, but was concerned to be too narrow covering only mild carelessness by the Law Commission; and “negligence” – which was used in the ABI Code of Practice.¹⁰⁴⁷ The Law Commission, again, expressed their concern as to confusion of legal concepts and stated in the report that “the only reason for using the term “careless” is to emphasise that this is a new, stand-alone category. It is not intended to draw on any existing concepts or case law within the law of negligence.”¹⁰⁴⁸

¹⁰⁴⁵ J. Summer, *Insurance Law and the Financial ombudsman Service* (Informa 2013) para 13.46.

¹⁰⁴⁶ R. Merkin & M. Hemsworth, *The Law of Motor Insurance* (2nd edn, Sweet & Maxwell 2015) at 2-36.

¹⁰⁴⁷ Law Commission, *Consumer Insurance Law: Pre-contract Disclosure and Misrepresentation* (Law Com No 319, 2009) para 6.55.

¹⁰⁴⁸ *ibid* para 6.56.

8.2.4.2 “Deliberate or reckless” misrepresentation: the contract may be avoided

The remedy of avoidance, set out in MIA 1906, s. 20(2), is retained. Under schedule 1(2) of CI(DR)A 2012, if the misrepresentation was “deliberate or reckless”, the underwriter may be entitled to avoid the contract and refuse all claims and retain premiums in most of cases “except to the extent (if any) that it would be unfair to the consumer to retain them”. “Avoidance involves a penal element, designed to show society’s disapproval of the consumer’s conduct and to discourage wrongdoing.”¹⁰⁴⁹ The exception set out in para. 2(b) balances the aim of deterring wrongdoing with the need for some flexibility in those cases where retaining the premium might be unfair, such as in life insurance policies that include an investment element, or joint policies where only one of the policyholders has acted fraudulently.¹⁰⁵⁰

Under s. 5(4), the onus is on the insurer to show that a qualifying misrepresentation was deliberate or reckless, followed by two rebuttable presumptions set out in s. 5(5) aiming to smooth the onus of proof and shift the burden to the consumer,¹⁰⁵¹ if it is shown “(a) that the consumer had the knowledge of a reasonable consumer, and (b) that the consumer knew that a matter about which the insurer asked a clear and specific question was relevant to the insurer”.¹⁰⁵² Accordingly, it is then for the consumer to rebut these

¹⁰⁴⁹ *ibid* para 6.26.

¹⁰⁵⁰ *ibid* paras 4.20 & 6.48-6.53.

¹⁰⁵¹ *ibid* para. 6.34.

¹⁰⁵² CI(DR)A 2012, s. 5(5).

presumptions by providing evidence to show that he/she had less knowledge than that normally expected, or that he/she had a reasonable ground to believe that the issue was irrelevant, despite the clear question.¹⁰⁵³ In other words, where the fact is obvious and well known to someone in their position, consumers would normally be expected to know such matter.

8.2.4.3 “Careless” misrepresentation: a compensatory remedy

Avoidance is admittedly a harsh remedy, providing too much protection than was necessary to the insurer. CI(DR)A 2012 finally introduced the proportionate approach into insurance law for consumer contracts, with the purpose of establishing a fairer remedy when the draconian threat of avoidance is inappropriate. The compensatory remedy now has statutory force under English law. This system is akin to that applicable to business insurance.

Accordingly, if a misrepresentation is found to be “careless” the remedy will depend on an assessment of the effect of the misrepresentation in compliance with the loss to the insurer. If the underwriter would have simply charged a higher premium had there been no misrepresentation, the underwriter will be entitled to “reduce proportionately the amount to be paid on a claim.”¹⁰⁵⁴ In particular:

- First, no remedy is available for the insurer if the insurer would have

¹⁰⁵³ Law Commission, *Consumer Insurance Law: Pre-contract Disclosure and Misrepresentation* (Law Com No 319, 2009) paras 6.35-6.37.

¹⁰⁵⁴ CI(DR)A 2012, sched 1, para 5-8.

entered into the contract on the same terms had it known the truth. This follows the common law approach embraced by the case of *Pan Atlantic Insurance Co v Pine Top Insurance Co Ltd* [1994] All ER 581, in which the test of inducement was first espoused.¹⁰⁵⁵

- Second, if the insurer would not have entered into the consumer insurance contract on any term, the insurer may avoid the contract and refuse all claims, but must return the premiums paid (para.5). This remedy of avoidance is a “self-help” remedy that does not require the sanction of court. However, if it is found that the remedy is wrongfully applied, the insurer will face liability in damage to the assured as a result of repudiation of contract.¹⁰⁵⁶
- Third, if the insurer would have entered into the consumer insurance contract, but on different terms (excluding terms relating to the premium), the contract is to be treated as if it had been entered into on those different terms if the insurer so requires (para.6). If, for instance, the insurer would have imposed a warranty or excess in the policy, the claim would be treated as if the policy were made on those terms;¹⁰⁵⁷ but if it would have included a particular exclusion in the policy but the claim falls outside that exclusion, the assured would still be entitled to the claim fully.¹⁰⁵⁸ Thereby, this may or may not always serve the insurer in claims

¹⁰⁵⁵ R. Merkin & M. Hemsworth, *The Law of Motor Insurance* (2nd edn, Sweet & Maxwell 2015) at 2-37.

¹⁰⁵⁶ *ibid.*

¹⁰⁵⁷ Law Commission, *Consumer Insurance Law: Pre-contract Disclosure and Misrepresentation* (Law Com No 319, 2009) para 6.59.

¹⁰⁵⁸ *ibid* para 6.73.

handling process.¹⁰⁵⁹ Additionally, the insurers are required to show not only that they would have entered into the contract on different terms; but also the specification of those terms.¹⁰⁶⁰

- Finally, as an additional point to the third possibility, if the insurer would have entered into the consumer insurance contract (whether the terms relating to matters other than the premium would have been the same or different), but would have charged a higher premium, the insurer may reduce proportionately the amount to be paid on a claim (para.7). Definition of “reduce proportionately” and its methodology is set out in para.8, by which the amount of the assured’s claim is reduced accordingly.

A careless qualifying misrepresentation will have the effect on the future treatment of the policy where the insurer demands continued performance of the policy on different terms or with higher premium. In non-life insurance, the insurer can choose to treat the contract as subsisting and give the consumer notice of the amended terms. The consumer can then choose to accept those terms or terminate the contract on reasonable notice. Alternatively, the insurer has the option of terminating future cover on reasonable notice. Where the contract is wholly or mainly life insurance, however, the insurer will not have the option of termination. The contract will continue on amended terms and the

¹⁰⁵⁹ R. Merkin & M. Hemsworth, *The Law of Motor Insurance* (2nd edn, Sweet & Maxwell 2015) at 2-37.

¹⁰⁶⁰ Law Commission, *Consumer Insurance Law: Pre-contract Disclosure and Misrepresentation* (Law Com No 319, 2009) para 6.80.

insurer must give the consumer notice. If the contract is terminated by either party, the consumer will be entitled to a refund of future premiums. Claims arising in the period up to the termination will not be affected.

8.2.5 Basis of Contract Clause

Common law permits an insurer to include a declaration in an insurance proposal form or in a document which refer to proposal form to undertake the accuracy or the truth of any pre-contractual statement made to the insurer, whereby it converts pre-contractual representation into policy warranties, thereby the insurer is discharged from liability for all claims if the statement concerning past or present fact was untrue, whether or not it was material or induced the insurer to conclude the insurance policy. More importantly, in contrast with burden of proofing lack of utmost good faith, there was no need for the insurer to prove materiality or inducement, only breach.¹⁰⁶¹

Clauses of this nature, creating a significant imbalance in the pre-contractual burden imposed on consumers, have long been of questionable status in relation to consumers. Moreover, the use of “basis of contract clause” is already restricted in other jurisdictions, for example, the clause has long been abolished in Australia when the Insurance Contracts Act 1984 came into force in 1986. Although the ICA 1984, dedicating to strike a fair balance between the assured and the insurer, is replaced by the Insurance Contracts Amendment Act 2013

¹⁰⁶¹ R. Merkin & M. Hemsworth, *The Law of Motor Insurance* (2nd edn, Sweet & Maxwell 2015) at 2-32.

(ICAA 2013),¹⁰⁶² the s. 24, inheriting from its predecessor, states that “a statement made in or in connection with a contract of insurance, being a statement made by or attributable to the insured, with respect to the existence of a state of affairs does not have effect as a warranty but has effect as though it were a statement made to the insurer by the insured during the negotiations for the contract but before it was entered into,” whereby the insurer only has recourse to the remedies set out in ss. 28-30 of the ICAA 2013.

CI(DR)A 2012, s. 6, rendered basis of contract clause ineffective in consumer insurance policies, states as follow:

- (1) This section applies to representations made by a consumer—
 - (a) in connection with a proposed consumer insurance contract, or
 - (b) in connection with a proposed variation to a consumer insurance contract.
- (2) Such a representation is not capable of being converted into a warranty by means of any provision of the consumer insurance contract (or of the terms of the variation), or of any other contract (and whether by declaring the representation to form the basis of the contract or otherwise).

The abolition of basis of contract clause brings the law into line with recognised good practice. However, it would defeat this provision if insurers included

¹⁰⁶² Insurance Contracts Amendment Act 2013 received Royal Assent on June 28, 2013; and came into force on December 28, 2015.

specific warranties from the insured as to past or present fact in a proposal form or elsewhere. As to contracting out, s. 10 of CI(DR)A 2012 provides that “a term of a consumer insurance contract, or of any other contract, which would put the consumer in a worse position ... is to that extent of no effect.”

8.3 Micro-businesses

As of August 2015, 95 per cent of all businesses in the UK are micro-enterprises, which make a crucial part of contribution to the economy.¹⁰⁶³

Insurance, as a financial security method, does not seem to be fully functioning as to providing efficient safeguard to micro-businesses against financial losses at the time of the risk insured occurring. As a matter of fact, in terms of the abilities of dealing with money matters, micro-businesses are not necessarily in a stronger position than private individuals concerning nature and characteristics of businesses of this scale as shown by the study of sample cases of the FOS complaints. The FOB Review of Complaints shows that only fewer micro-enterprises had legal or accountancy support at the time of the events that led to their complaint, either from external professionals or in-house expertise.¹⁰⁶⁴ In accordance with the Review, main reasons for complaint involved are rejection or reduction of claims (40 per cent) and mis-sold insurance policies and misrepresentation from the insurers (21 per cent).¹⁰⁶⁵ In general, more than half of micro-businesses policyholders have trouble

¹⁰⁶³ The FOB Review of Complaints: Micro-Enterprises and Financial Services (August 2015) 2, <<http://www.financial-ombudsman.org.uk/publications/pdf/Micro-enterprise-complaints-Aug-2015.pdf>> assessed 9 Dec 2017.

¹⁰⁶⁴ Ibid.

¹⁰⁶⁵ ibid 21.

understanding terms and conditions of insurance contracts as to matters related to non-disclosure or misrepresentation particularly; nor do they comprehend the consequences of breach those terms.¹⁰⁶⁶

The Law Commission reviewed this issue in their Consultation Paper in July 2007¹⁰⁶⁷ and concluded “less sophisticated businesses needed more protection than other enterprises”.¹⁰⁶⁸ Initially the Law Commissions suggested placing controls on insurers’ written standard set of terms to prevent insurers giving themselves greater rights to avoid claims than under the business insurance default regime, if such terms would defeat the insured’s “reasonable expectations of cover”.¹⁰⁶⁹ After acknowledging this would introduce too much uncertainty over the constitution of standard terms,¹⁰⁷⁰ the Law Commission suggested removing micro-businesses from the business regime altogether and, for the purpose of retaining uniformity of the law with the rules used by FOS, treating them in the same way as consumers within the consumer regime for pre-contractual disclosure and representation on the basis that most such businesses, if not all, would have no greater understanding of insurance law than consumers.¹⁰⁷¹ However, this plan has been rejected for four reasons: first, there was the difficulty of clearly defining a micro-business; second, insurers

¹⁰⁶⁶ *ibid* 24

¹⁰⁶⁷ Law Commission, *Insurance Contract Law: Misrepresentation, Non-disclosure and Breach of Warranty by the Insured* (Law Com CP No 182, 2007)

¹⁰⁶⁸ Law Commission, *Reforming Insurance Contract Law: Should micro-businesses be treated like consumers for the purposes of pre-contractual information and unfair terms?* (Law Com IP No 5, 2009) para 3.1

¹⁰⁶⁹ *ibid* para 3.2

¹⁰⁷⁰ *ibid* para 3.7

¹⁰⁷¹ *ibid* para 4.3,

would have to re-programme their systems to differentiate between micro-businesses and enterprises that fell outside the definition, incurring additional cost; additionally, there was no compelling evidence of systemic problems to be found in practice as to micro-businesses non-disclosure and misrepresentation; more significantly, Micro-business has already been protected by the FOS, under which they are entitled to file complains if they feel that an insurer has unfairly turned down a claim for misrepresentation or non-disclosure or if other terms of the contract are unfair and obtain consumer-type protection.¹⁰⁷²

The process of defining the term “micro-businesses” has been complicated and formidable. As early as when it was discussed in the Issues Paper 5, for the purposes of pre-contractual information and unfair terms in insurance contract, the Law Commission has measured the test with caution in three perceived ways: a number-based method, a turnover-based assessment and the FOS jurisdiction limit; and ultimately concluded each of the test is considered to be problematic in practice.¹⁰⁷³ Although the first two tests, accompanied with varying degrees of technical problems on their performance involving staff headcount to the employee requirement and susceptibility of exchange rate fluctuations plus inaccurate representation of the annual turnover/balance sheet at the time of contracting to the annual turnover and balance sheet requirements, have not received much support, the third option has attracted

¹⁰⁷² Law Commission, *Insurance Contract Law: The Business Insured’s Duty of Disclosure and the Law of Warranties* (Law Com No 204, 2012) para A.3

¹⁰⁷³ See generally at Law Commission, *Reforming Insurance Contract Law: Should micro-businesses be treated like consumers for the purposes of pre-contractual information and unfair terms?* (Law Com IP No 5, 2009) section D: Definition of Micro-Business

the most attentions, i.e. 80 per cent of consultees responded to this question were in favour of the FOS approach as to the definition of micro-businesses.¹⁰⁷⁴

It is considered in the following paragraphs.

As a result of the implementation of the Payment Services Directive, the FOS has adopted the general European definition of a micro-enterprise as set out by the Commission of the European Communities¹⁰⁷⁵, namely, micro-business is businesses which employ fewer than ten staff and have an annual turnover or balance sheet that does not exceed two million euros.¹⁰⁷⁶ In this definition, the term “enterprise” means any person engaged in an economic activity, irrespective of its legal form and includes, in particular, self-employed persons and family businesses engaged in craft or other activities, and partnerships or associations regularly engaged in an economic activity.¹⁰⁷⁷ In determining whether an enterprise meets the tests for being a micro-enterprise, account should also be taken to the enterprise’s ‘partner enterprises’ or ‘linked enterprises’.¹⁰⁷⁸ In such circumstances, staff headcount and financial details of partner/linked enterprises must be added to those of the enterprises to determine if the business falls within the definition of micro-businesses.¹⁰⁷⁹ For example, where a parent company holds a majority shareholding or exercise

¹⁰⁷⁴ Law Commission, *Insurance Contract Law: The Business Insured’s Duty of Disclosure and the Law of Warranties* (Law Com No 204, 2012) paras A.31, A.36-49.

¹⁰⁷⁵ In the Commission Recommendation 2003/361/EC of 6 May 2003 concerning the definition of micro, small and medium-sized enterprises.

¹⁰⁷⁶ Commission Recommendation 2003/361/EC, art. 2(3) Annex.

¹⁰⁷⁷ Payment Services Directive, art. 4(26); Commission Recommendation 2003/361/EC, art. 1 Annex.

¹⁰⁷⁸ Law Commission, *Insurance Contract Law: The Business Insured’s Duty of Disclosure and the Law of Warranties* (Law Com No 204, 2012) para A.50.

¹⁰⁷⁹ *ibid* paras A.55-59.

dominant influence in a complainant, if the parent company does not meet the tests for being a micro-enterprise then neither will the complainant.¹⁰⁸⁰ It has proved that, “under the above rules, determining the status of a business will be no simple task, with the risk of creating uncertainty for both insurers and insureds” .¹⁰⁸¹

Defining micro-businesses has encountered great difficulty. Alternatively, the Law Commission considered having a stab at specification of sole traders and small partnerships consisting of two natural partners with unlimited liability and found out that it will put such businesses in a discomfiture dilemma.¹⁰⁸² Following a long and careful analysis, the Law Commission eventually decided not to propose to conduct special treatments for micro-businesses at this stage.¹⁰⁸³ Nevertheless, nothing will prevent micro-enterprises seeking for more remedies from the FOS where it is necessary.

8.4 Alternatives to law reform

On December 3, 1980, the Guardian Royal Exchange (GRE) first abandoned the use of duty of disclosure and that of basis of the contract clauses in non-life insurances,¹⁰⁸⁴ which initiated a new journey for consumer insurance. One year later, the Insurance Ombudsman Bureau (IOB), replaced by the Financial

¹⁰⁸⁰ ibid para A.57(1).

¹⁰⁸¹ ibid para A.60.

¹⁰⁸² ibid paras A. 72-73.

¹⁰⁸³ ibid para A.126.

¹⁰⁸⁴ Peter J Tyldesley, 'Reform at Last', in Peter J Tyldesley (ed), *Consumer Insurance Law: Disclosure, Representations and Basis of the Contract Clauses* (Bloomsbury 2013) at 2.40.

Ombudsman Service (FOS) in 2001, commenced operations as a substitute for law reform¹⁰⁸⁵ resolving consumer disputes by reference to “good insurance practice” rather than legal principle. The FOS, strongly influenced by the IOB, was set up under the Financial Services and Market Act 2000 in 2001, by which the ombudsman is obliged to make decisions fairly and reasonably under the compulsory jurisdiction. Over the years, the FOS developed a framework to resolve consumer disputes.

The insurance industry also set up series of guidelines and codes to mitigate the harshness of the law and overcome problematic issues in the reported areas of the Marine Insurance Act 1906. The first self-regulatory code: the Statement of General Insurance Practice, promising fair treatment to consumers, was promulgated by the British Insurance Association¹⁰⁸⁶ in return for an exemption from key provisions of the Unfair Contract Terms Act 1977. The Statement of Practice was not legally binding. The terms of the Statement were not particularly robust, compliance was not monitored and until the advent of the Insurance Ombudsman Bureau there was no route by which a consumer could enforce the rights they supposedly gave.¹⁰⁸⁷ The Statement was subsequently amended and strengthened in 1986¹⁰⁸⁸ and continued in use until the adoption of statutory regulations for general insurers: the Insurance

¹⁰⁸⁵ Law Commission, *Insurance Contract Law: Misrepresentation, Non-disclosure and Breach of Warranty by the Insured* (Law Com CP No 182, 2007) para 1.21.

¹⁰⁸⁶ The British Insurance Association represents insurance industry in Britain until 1985, and the Association of British Insurers thereafter.

¹⁰⁸⁷ Peter J Tyldesley, ‘Reform at Last’, in Peter J Tyldesley (ed) *Consumer Insurance Law: Disclosure, Representations and Basis of the Contract Clauses* (Bloomsbury 2013) at 2.16.

¹⁰⁸⁸ Law Commission, *Consumer Insurance Law: Pre-contract Disclosure and Misrepresentation* (Law Com No 319, 2009) para 2.31.

Conduct-of-Business Sourcebook (ICOBS) issued by the Financial Service Authority (FSA) in 2005, in which it requires an insurer to pay a claim in a case of innocent misrepresentation.¹⁰⁸⁹ ICOBS, was developed to redress the balance of the legal requirement upon the insured to disclose information to the insurer and to ensure consumer protection, requiring insurers, or those acting for them, to inform their customers of clear and fair information when selling insurance products. Practically, it is noteworthy that, for the insurance sector, the conduct rules in ICOBS and COBS differ, so the first challenge is to identify whether to apply COBS or ICOBS in relation to a particular circumstance. Now ICOBS has followed and largely amended in consistence with CI(DR)A 2012.

The Financial Services Act 2012(FSA 2012), under which the function of the Financial Services Authority is divided between the Bank of England (BoE), a new Prudential Regulatory Authority (PRA – a new subsidiary of BoE) and a new Financial Conduct Authority (FCA),¹⁰⁹⁰ received Royal Assent on 19 December 2012, from which a new financial regulation framework is operative in the UK. By replacing the FSA with the FCA and PRA, the FSA 2012 clarified the focus and supervisory power of these two new regulators. With introduction of a much stricter and more intrusive regulatory structure, the FCA has been awarded new product intervention powers and its investigatory powers has also been intensified.¹⁰⁹¹ In accordance with the FSA 2012 insurers are dual-

¹⁰⁸⁹ ICOBS 8, for the full terms of the ICOBS go to: www.fsahandbook.info/FSA/html/handbook/ICOBS

¹⁰⁹⁰ FSA 2012, s. 2(3), the PRA and the FCA are the corporate successor to the FSA.

¹⁰⁹¹ See s. 6 of FSA 2012, chapters 1 and 2 for details.

regulated by two independent groups for conduct and prudential issues. In contrast, insurance intermediaries are only regulated by the FCA for both prudential and conduct purposes as those firms that do not carry out PRA-regulated activities. The PRA, as the name suggested, is taking responsibilities and statutory objectives to promote the safety and soundness of PRA-authorized persons. In respect of regulating insurers, the PRA has an insurance objective: to contribute to securing an appropriate degree of protection for policyholders against unreasonable insurers.

The FSA 2012, with approaches of a high-level principle-based regulation focusing on high quality consumer outcomes to ensure fair treatment of customers, shifted emphasis away from the light touch rule-based regulation. Principles for Businesses (PRIN) include explicit and implicit guidance on the fair treatment of customers, which is a fundamental concept that FCA inherited from its predecessor, the FSA, applicable to all firms at all stages of a product life-cycle, no matter wholesale or retail.¹⁰⁹² Since the decision of the court in *British Bankers Association v Financial Services Authority and Financial Ombudsman Service*,¹⁰⁹³ the regulator is able to enforce a breach of a principle.

Essentially, Principle 6 requires that firms regulated by the FCA must pay general attention to the interests of customers and treat them fairly,¹⁰⁹⁴ meaning

¹⁰⁹² Principles for Businesses, FCA Handbook.

¹⁰⁹³ [2001] EWHC 999.

¹⁰⁹⁴ *FCA: Treating Customers Fairly-essentials*, Lexis PSL Financial Services view topics, see <<https://www.lexisnexis.com/uk/lexispsl/financialservices/document/393814/59JC-1WG1-F18F-P23M->

firms should “place the consumer at the heart of its business”¹⁰⁹⁵ and must not place its own commercial interests in higher priority to the requirement to treat customers fairly,¹⁰⁹⁶ failure to do so will result to enforcement action being taken by the FCA for breach, e.g. negative publicity, fines, withdrawal of the firm’s regulatory authorization etc.¹⁰⁹⁷ If the detriment of the consumer is found, then the FCA will expect appropriate redress to be paid to the consumer by the firm. The Financial Ombudsman Service oversees cases where problems cannot be settled between customers and firms. As part of its work it takes account of whether firms have paid due regard to the interest of customers and treated them fairly (Principle 6). The FOS will also take into account all the other FCA rules guidance and standards to decide what is fair and reasonable.

For example, in contrast with the approach eventually adopted in the CI(DR)A 2012, the FSA rules do not require insurers to ask question about those matters which are generally found to be material.

Neither of these mechanisms produces new legal precedents.

[00000-00/FCA%3A-Treating-Customers-Fairly—essentials](#)> assessed 10 Dec 2017

¹⁰⁹⁵ Swinton Group Ltd was fined £7.38 million for mis-selling monthly add-on insurance policies, see FCA press release at <<http://www.fca.org.uk/news/firms/swinton-group-fine-mis-selling-add-on-insurance-policies>> assessed 10 Dec 1027

¹⁰⁹⁶ Clydesdale Bank was fined £8.9 million for failing to treat its mortgage customers fairly, see FCA press release at <<http://www.fca.org.uk/news/clydesdale-bank-fined-89-million>> assessed 10 Dec 2017

¹⁰⁹⁷ Decision Procedure and Penalties Manual, FCA Handbook, DEPP 6

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