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# UTMOST GOOD FAITH IN MARINE INSURANCE: A COMPARATIVE STUDY OF ENGLISH AND CHINESE LAW

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**UTMOST GOOD FAITH IN MARINE INSURANCE:  
A COMPARATIVE STUDY OF ENGLISH AND CHINESE LAW**

by

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**A thesis submitted to the Plymouth University**

**In partial fulfilment for the degree of**

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## **Feng Shi - Abstract**

### **Utmost Good Faith in Marine Insurance:**

#### **A Comparative Study of English and Chinese Law**

As one of the most distinctive characteristics of English insurance law, the duty of utmost good faith is essentially stated in sections 17-20 of the Marine Insurance Act 1906. According to the statutory rules, both of the insurance parties must observe utmost good faith before the conclusion of an insurance contract. After one century of its application, both the judiciary and academics expressed their concerns in terms of its legislative defects and complexity in practice. Some developments have been made in recent judicial decisions and in statutory reform, e.g. the English Consumer Insurance (Disclosure and Representations) Act 2012, and Recommendations, Statutes and Explanations on the Amendments of Chinese Maritime Code of the People's Republic of China. Therefore, debatable issues and law reform programs in both English and Chinese law are considered in the main body of this thesis.

The examination is essentially based upon, (1) the materiality test of the concealed/misrepresented circumstances which can empower the injured party to rescind the insurance *ab initio*; (2) the duration of utmost good faith and specific issues; (3) the protective measures related to innocent misconduct; (4) the legal status of good faith and its application to fraudulent behaviour; and (5) whether the classic English utmost good faith doctrine can be extended to Chinese law.

Therefore, the main objective of this thesis is to provide a comprehensive study of the current status and developments of the duty of utmost good faith in both English and Chinese law, which is of fundamental importance, not only at the negotiation stage, but also throughout the performance and at the claiming stage of an insurance

contract. After identifying and analysing these crucial issues, this thesis concludes with some possible solutions.

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## List of Abbreviations

1. ABI – Association of British Insurer
2. ACML – Annual of China Maritime Law
3. ATC –Africa Trading Company
4. BIA – British Insurance Association (predecessor to the ABI)
5. BILA – British Insurance Law Association
6. C.P. – Court of Common Pleas
7. CCLR – Civil and Commercial Law Review
8. CIL 2009 – Chinese Insurance Law 2009
9. CL – Chinese Lawyer
10. CMC – Chinese Maritime Code of the People’s Republic of China 1992
11. CMI – Comité Maritime International
12. CMT – Chinese Maritime Trial
13. CP 1 - The Law Commission and the Scottish Law Commission, *A Joint Consultation Paper, Misrepresentation, Non-disclosure and Breach of Warranty by the Insured.*
14. CP 2 – The Law Commission and the Scottish Law Commission, *A Joint Consultation Paper, Insurance Contract Law: Post Contract Duties and other Issues.*
15. CP 3 – The Law Commission and The Scottish Law Commission, *A Joint Consultation Paper, Insurance Contract Law: The Business Insured’s Duty of Disclosure and the Law of Warranties.*
16. DCFR Insurance – Draft Common Frame of Reference of European Insurance Contract Law
17. EEA – European Economic Area



18. FCA – Financial Conduct Authority
19. FisMA 2000 – Financial Services and Market Act 2000
20. FOS – Financial Ombudsman Service
21. FSA – Financial Services Authority (the FSA was split into FCA and PRA)
22. HM – Her Majesty’s
23. ICA –Insurance Co of Africa
24. ICOBS – Insurance Conduct of Business sourcebook
25. ILM – Insurance Law Monthly
26. ITCH 2009 – Institute Time Clauses Hulls 2009
27. IWG – International Working Group on Marine Insurance
28. JBL – Journal of Business Law
29. JCL – Journal of Comparative Law
30. LLP – Lloyd’s Law Report
31. LMCLQ – Lloyd’s Maritime and Commercial Law Quarterly
32. MAT – Marine, aviation and transport insurance
33. MIA 1906 – Marine Insurance Act 1906
34. MLR – Modern Law Review
35. MRI – Maritime Risk International
36. MUJIEL – Merkourios Utrecht Journal of International and European Law
37. PEICL – Principles of European Insurance Contract Law
38. PICC – the People’s Insurance Company of China
39. PRA – Prudential Regulation Authority
40. PRC – People’s Republic of China
41. RMB – Ren Min Bi (Chinese currency)
42. S.&T.L. – Shipping & Trade Law

43. SUP – Supervision (of the original FSA Handbook and FCA Handbook)

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## Author's Declaration

At no time during the registration for the degree of Doctor of Philosophy has the author been registered for any other University award without prior agreement of the Graduate Committee.

Relevant scientific seminars and conferences were regularly attended at which work was often presented.

### ***Publications:***

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Signed \_\_\_\_\_ Feng Shi \_\_\_\_\_

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# INTRODUCTION

## Background

The principle of 'utmost good faith' is a legal doctrine which governs insurance contracts. *Black's Law Dictionary* defines 'good faith' as:

'[A] state of mind consisting in (1) honesty in belief or purpose, (2) faithfulness to one's duty or obligation, (3) observance of reasonable commercial standards of fair dealing in a given trade or business, or (4) absence of intent to defraud or to seek unconscionable advantage.'<sup>1</sup>

Although this doctrine is not a statutory default rule in contract law, it has been construed as a moral requirement for all of the contractual parties at common law.<sup>2</sup> On the one hand, 'good faith' is an elusive principle with varied circumstances,<sup>3</sup> while on the other, some judicial and scholarly statements confer this term with more specialized interpretations.<sup>4</sup>

When it comes to insurance contracts, the requirements for good faith are much higher. The duty of utmost good faith in insurance, also known as *uberrimae fidei*, requires the contractual parties to act with such good faith during pre-contractual negotiations. This doctrine is also well known for distinguishing insurance contracts from other general contracts<sup>5</sup> since 'contracts of insurance provide the only true example of a contract *uberrimae fidei*'.<sup>6</sup> In English case-law, the duty of utmost good

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<sup>1</sup> Bryan Garner, et al., *Black's Law Dictionary* (9<sup>th</sup> ed., Thomson Reuters, 2009).

<sup>2</sup> For example, see Peter MacDonald Eggers, et al., *Good Faith and Insurance Contract* (3<sup>rd</sup> ed., London: LLP, 2010).

<sup>3</sup> Roger Brownsword, et al., *Good Faith in Contract: Concept and Context*, (Ashgate/Dartmouth, 1999).

<sup>4</sup> For example, Eggers, et al., *Good Faith and Insurance Contract*, paras. 1.12-1.28.

<sup>5</sup> Good faith is the basic moral threshold for the general contractual parties. In practice, for general contracts, the law has put the responsibility on the parties to obtain all relevant information surrounding the undertaking before entering into the contract, as opposed to entitling them to expect such information to be provided to them by the other party. Please see *Ibid*, para. 1.09.

<sup>6</sup> Charles Wild and Stuart Weinstein, *Smith & Keenan's English Law* (16<sup>th</sup> ed., Longman, 2010), p. 338; Eggers, et al., *Good Faith and Insurance Contract*, para 1.09.

faith was firstly referred to in *Carter v Boehm*<sup>7</sup> by Lord Mansfield, who clarified the underlying basis for the principle of disclosure. He ruled, 'insurance is a contract upon speculation...good faith forbids either party by concealing what he privately knows, to draw the other into a bargain, from his ignorance of that fact, and his believing the contrary'.<sup>8</sup> This doctrine was further developed in subsequent cases, which detailed its contents and imposed limitations, to avoid being abused by insurance companies as a technical defence.<sup>9</sup>

Under English law, statutory support was initially provided by the Marine Insurance Act 1906.<sup>10</sup> With the codification of the MIA 1906, the principle found expression in sections 17 to 20: section 17 presents the general duty to observe utmost good faith, with the following sections introducing particular aspects of the doctrine, namely, the duty of the assured (section 18) and the broker (section 19) to disclose material circumstances, and to avoid making misrepresentations (section 20). The MIA 1906 plays a very important role in the insurance law area, because the House of Lords (which was replaced by the Supreme Court in 2009 in the English judicial system) has confirmed that sections 17-20 in effect codified this branch of the law, both in respect of marine insurance expressly and, by extension, non-marine insurance.<sup>11</sup>

The non-discriminatory attitude of the duty of good faith to the type of insurance

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<sup>7</sup> (1766) 3 Burr 1905.

<sup>8</sup> *Ibid*, pp. 109 and 110.

<sup>9</sup> *Container Transport International Inc v Oceanus Mutual Underwriting Association (Bermuda) (CTI)* [1984] 1 Lloyd's Rep. 476; *Banque Keyser Ullmann v Scandia* [1987] 1 Lloyd's Rep. 69; *Pan Atlantic Insurance Co Ltd and Another v Pine Top Insurance Co Ltd (Pan Atlantic)* [1992] 1 Lloyd's Rep. 101; (1993) 2 Re LR 119; [1994] 2 Lloyd's Rep. 427, etc.

<sup>10</sup> Marine Insurance Act 1906 (1906 CHAPTER 41 6 Edw 7). The English codification of marine insurance was initiated in 1745 by the first Marine Insurance Act which provided a limited prohibition on wagering policies and reinsurance. This was followed by the Marine Insurance Act 1788, which required the name of the assured to be inserted in all policies. These Acts were repealed by the Marine Insurance Act 1906(MIA 1906). The latter Act, which was codified by Mr Mackenzie D Chalmers, heralded a return to the original concept of marine insurance, viz, that it is to protect the shipowner or merchant from the risks of maritime adventure and it is this Act which was ultimately followed in Australia.

<sup>11</sup> For academic support, for example, Francis Rose, *Marine Insurance: Law and Practice* (2<sup>nd</sup> ed., London: Informa, 2012), p. 66. For judicial support, see *Pan Atlantic Insurance Co Ltd and Another v Pine Top Insurance Co Ltd* [1994] 2 Lloyd's Rep. 427.

concerned has enabled the courts to apply the principle of utmost good faith laid down in section 17 of the MIA 1906 and the rules set out in sections 18-20 to cases of non-marine insurance, given that the Act is said to have been declaratory of the common law.<sup>12</sup> At the same time, apart from its application to both marine and non-marine insurance events, utmost good faith equally applies to primary cover and all levels of reinsurance.<sup>13</sup> Therefore in English law, the duty of utmost good faith consists of two aspects: the duties of disclosure and representation, which are addressed below in chapters one and two respectively.

It can be said that the codification of the MIA 1906 actually took this doctrine to its culmination. However, this regime seems to be threatened by a variable environment, on the grounds that the social, economical and technical changes, and even political change, have reversed the unequal positions of the insurer and insured at the beginning of their relationship.<sup>14</sup> In the view of this author, this factor also seems to be strong enough to shake the root of this doctrine. In addition to the enquiries regarding its fundamentals, this doctrine has been questioned: on its 'prudent insurer' test of materiality which requires the non-expert policyholder to act in the position of the professional insurer; the overly harsh remedies (avoidance) awarded in cases

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<sup>12</sup> For academic support, see Eggers, et al., *Good Faith and Insurance Contract*, para 1.32; John Birds, et al., *MacGillivray on Insurance Law* (12<sup>th</sup> ed., Sweet & Maxwell, 2012).

For case examples, see *Yorke v Yorkshire Insurance Company Limited* [1918] 1 KB 662, p. 667 (per McCardie J); *Regina Fur Company Ltd v Bossom* [1957] 2 Lloyd's Rep. 466, p. 483 (per Pearson, J); *Australia & New Zealand Bank Ltd v Colonial & Eagle Wharves Ltd* [1960] 2 Lloyd's Rep. 241, pp. 251-253 (per McNair, J); *March Cabaret Club & Casino Ltd v The London Assurance* [1975] 1 Lloyd's Rep. 169, p. 174 (per May, J); *Lambert v Co-operative Insurance Society Ltd* [1975] 2 Lloyd's Rep. 485, pp. 487, 492-493 (per MacKenna, J); *Woolcott v Sun Alliance and London Insurance Ltd* [1978] 1 Lloyd's Rep. 629; *Highlands Insurance Co v Continental Insurance Co* [1987] 1 Lloyd's Rep. 109, p. 113 (per Steyn, J); *Pan Atlantic Insurance Co Ltd v Pine Top Insurance Co Ltd* [1994] 2 Lloyd's Rep. 427, pp. 444, 452 (per Lord Mustill), 455 (per Lloyd, LJ); *Société Anonyme d'Intermédiaires Luxembourgeois v Farex Gie* [1995] LRLR 116, p. 141 (per Dillon, LJ).

<sup>13</sup> Howard Bennett, 'Mapping the doctrine of utmost good faith in insurance contract law' (1999) 2 *LMCLQ*, p. 165.

<sup>14</sup> The establishment of the doctrine of utmost good faith was originally aimed at protecting the insurer from the inferior of unbalanced information between the insurer and insured. Currently, most insurance companies rely on their own powerful databases, and as a matter of fact, some insureds do not have as much information as the insurance companies themselves.

where even in relation to trivial mistakes during the assured's performance; its elusive application to post-contract events, for example, amendments and renewals to insurance, the held-covered clauses, fraudulent claims and so on. All the aforementioned concerns including its continuity in practice and its statutory reform are partially addressed in chapters one and two, but mainly expounded in chapters 3 and 5.<sup>15</sup>

The legal status of an insurance intermediary is changeable in the insurance scenario. Principally, he acts on behalf of his assured, however, because of commercial complexities, there seems to be a conflict of interest at the claim investigation stage, where the insurance broker needs to cooperate with the insurer when he is still acting on behalf of the assured. In such cases, should the assured bear the liabilities of his broker's utmost good faith breach, and consequently, should the assured be awarded damages from the defaulting broker? In order to clarify the insurance broker's legal position and utmost good faith duty when transmitting material information to the insurer, concerns are examined in chapter 7. In the meanwhile, in order to avoid the legislative defects at English case law, the Law Commission, which is joined by the Scottish Law Commission, started and is proceeding with law reforming actions with regard to the insurance legislation, including both consumer and business insurance.<sup>16</sup> In consumer insurance, one remarkable accomplishment is the Consumer Insurance (Disclosure and

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<sup>15</sup> The MIA 1906 applies to marine insurance as specified in sections 1 and 2 of that Act, including both consumer and business insurance. However, with the statutory reform undergoing in the Law Commissions specifically in consumer insurance, MIA 1906 will be limited to business insurance (including marine and non-marine business insurance), and the newly launched Consumer Insurance (Disclosure and Representations) Act 2012 is anticipated to be fully applied to consumer insurance (including marine and non-marine consumer insurance) shortly after one year of its enactment (March 2012). Compared to the classic MIA 1906, the new Act will make significant alterations to pre-information events, which are addressed in chapters 3 and 5. In this work, as long as it is not clarified, the marine insurance contract will mean one dealing with business insurance.

<sup>16</sup> Current status of the insurance law reform project is addressed in chapters 3 and 5.



Representations) Act 2012,<sup>17</sup> which is expected to be fully enforced shortly after one year of its enactment. Historic changes in consumer insurance are addressed in chapter 3, including the abolition of the consumer's disclosure, the adoption of a new 'reasonable assured' test and protective manners to protect innocent assureds, and so on. At the same time, this author also expresses her understanding of and recommendations to insurance statutory reform in the above chapters.

Compared to the relatively high system developed in English law, the principle of utmost good faith in Chinese law is still uncertain. On the one hand, this duty has never been recognized by statutory or judicial interpretations; on the other, the duty of good faith is only statutorily recognised.<sup>18</sup> Academics, at the same time, are affirmatively trying to transplant this doctrine from common law to Chinese law, which is embodied by the Recommendations, Statutes and Explanations on the Amendments of Chinese Maritime Code of the PRC (Recommendations).<sup>19</sup> This was published in 2003 by the project team under the Ministry of Communications of the People's Republic of China (PRC).<sup>20</sup> Under this documentation, section 17 of the MIA 1906 is suggested to be respected and followed by Chinese marine insurance law in the future, which gives rise to massive arguments, which centre chiefly around the practicability of a common law model in a civil law country and also around the English model's inherent defects.

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<sup>17</sup> Consumer Insurance (Disclosure and Representations) Act 2012 (2012 CHAPTER 6).

<sup>18</sup> For example, article 5 of Chinese Insurance Law 2009 (hereinafter referred to as CIL 2009), articles 42 and 60 of Chinese Contract law, and article 4 of the General Principles of Civil Law, which are analysed with depth in chapter 6.

<sup>19</sup> People's Republic of China, hereinafter referred simply as PRC.

<sup>20</sup> The Project of Amendments on Chinese Maritime Code was approved by the Ministry of Communications of PRC in 2000. In September 2003, the project team published its product with the issue of Recommendations, Legislations Samples and Explanations on the Amendments of Chinese Maritime Code (Chinese version).

## **Structure**

Following this Introduction, in the remaining chapters, the author first introduces the current situation of the duty of (utmost) good faith in Chinese law by detailing its main contents as implied by leading codes in chapter 4. This is followed by an examination of both the pre-contractual and post-contractual duties of insurance contract parties in China in the remaining chapter 4 and also in chapter 6. In chapter 8, the insurance broker's duty of good faith in Chinese law is discussed. Additionally, the difficulties and practicability of the 2003 Recommendations relating to the simple duplication of duty of utmost good faith under MIA 1906 in Chinese maritime law are evaluated (chapters 4, 6 and General Conclusion).

Finally, after a detailed examination of utmost good faith in English and Chinese law, this author concludes with a comparative study in the General Conclusion chapter, which is believed to be based on sound fundamental theories, including notable judicial decisions and legislation in both jurisdictions.

## **Methodology**

Therefore, a comparative study is adopted as one of the main research methods in this thesis. In relation to English law, one part of the comparative research briefly introduces the concepts and applications of 'good faith' and 'utmost good faith' at common law and in general insurance law. The second part of the comparative study is about different degrees of 'good faith' in different circumstances, for instance, the absence of 'bad faith', a standard 'good faith', or an extremely high 'good faith'. The statutory support and judicial support are also compared, to strengthen the research in respect of the legislative defects underlying insurance legislation, self-regulation in

practice and supplementary restrictions derived from consequential judicial decisions, in terms of the insurance parties (insurers and assureds), and also the intermediaries. In order to reveal a comprehensive picture of 'good faith'/'utmost good faith' and its historical development, comparisons are made between the current 'good faith' and 'utmost good faith' legislation and future statutory reform, as proposed by the Law Commissions.

The comparative law approach is utilised in the chapters regarding Chinese law. First of all, characteristics of civil law and common law are briefly summarized, on a general scale. Secondly, as another subject interest covered by this research, Chinese law is compared with English law, especially in terms of the insurance contract parties' and agents' duties of good faith on a narrow scale. The comparative studies involve 'good faith' and 'utmost good faith' in Chinese law and English law; the use of 'good faith' and 'utmost good faith' in Chinese codes and insurance practice, and the applications in general Chinese law and special laws. A close observation is also made between the current Chinese codes, practical regulations and the recommendations for reforms in China. Some notable Chinese case decisions are also analyzed in these chapters, although there is no binding precedent doctrine in a civil law country.

Apart from the comparisons made between English law and Chinese law (in a general sense), and between the essences of the duties of 'good faith' and 'utmost good faith' within English law and Chinese law respectively (in a narrow sense), the scope of study is widened to European<sup>21</sup> and international legislation and also some other countries' insurance or maritime legislation,<sup>22</sup> to investigate whether the

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<sup>21</sup> For example, Principles of European Insurance Contract Law (PEICL), etc.

<sup>22</sup> For example, Australian contract law and insurance law, Norwegian marine insurance law, and Swedish Insurance Plan 2006, etc.

statutory reforms proposed in the UK and China are appropriate and feasible, against the backdrop of the global environment.

When it comes to the evaluation on which one(s) of the various solutions is (are) workable and efficient, convergences and divergences of these different elements are analyzed and compared in the 'recommendations' paragraphs of this thesis, by distinguishing the differences and similarities between different types of insurance policies, for example, consumer insurance and business insurance, general insurance and marine insurance, etc.

The second approach employed in this thesis is what is commonly referred to as the dogmatic method. This method, also referred to as the 'legal' approach is a method where the law for analytical and explanatory purposes is derived or extracted from legal texts and instruments and usually forms the principal basis for legal analysis. The source materials used are primarily legal instruments of sorts including legislation both principal as well as sub-ordinate, international treaties, customary law, learned treatises, case law, legal commentaries and other scholarly works including text books and journal articles. Needless to say, regardless of what other methodologies may be used, the dogmatic method is one that is used in virtually all legal research and writing.

In the conclusive paragraphs at the end of each chapter and the General Conclusion chapter at the end of this thesis, conclusions are made for each special issue and also this research as a whole. It is worthwhile to indicate that the 'conclusions' are not confined to law itself, but also based upon various sources which are listed in the previous paragraphs.

## **Purpose**

Due to the very nature of the subject matter, this thesis naturally has multiple aims. The principal purpose is to provide a comprehensive study of the current status and development of the duty of 'utmost good faith' in both English and Chinese law. Secondly, this thesis aims at elaborating on the general obligations of 'good faith' or 'utmost good faith' and derived special issues, which are not confined to the negotiation stage but also throughout the currency and the claiming stage of an insurance contract. Thirdly, the research objectives also involve legislative defects and possible statutory reforms in both English and Chinese laws, which are strengthened by referring to self-regulations in insurance practice. As a result, at the end of each chapter and the whole thesis, various recommendations are evaluate and feasible solutions are proposed. Last but not least, the future developments of 'good faith' and 'utmost good faith' in both English and Chinese laws are analysed by referring to lessons provided by each other, to examine whether the doctrine in English law could be duplicated in Chinese law.

## CHAPTER 1

# PRE-CONTRACTUAL DUTIES OF UTMOST GOOD FAITH AND DISCLOSURE IN THE UK

### 1.1. Introduction

This chapter is concerned with the overall structure of the utmost good faith principle, both at common law and English insurance legislation. It establishes a coherent framework of principle within which the doctrine and its duties can be developed. Therefore, attention is concentrated on the MIA 1906, sections 17 and 18, which can be extended to the overriding duty of utmost good faith and the duty of disclosure.<sup>23</sup>

### 1.2. Marine Insurance Act 1906, section 17: an overriding duty

‘Good faith’ means honesty or sincerity of intention;<sup>24</sup> it also connotes a measure of honesty and fairness.<sup>25</sup> This is the basic moral threshold for the general contractual parties, which means each party should act in good faith because they are responsible for each other. In practice, for general contracts, the law has put the responsibility on the parties to obtain all relevant information surrounding the undertaking before entering into the contract, as opposed to entitling them to expect such information to be provided to them by the other party.<sup>26</sup> In contrast, contracts of insurance are treated differently: section 17 of the MIA 1906 states that ‘a contract of

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<sup>23</sup> The other duty of representation is addressed in chapter 2.

<sup>24</sup> *Oxford English Dictionary Online*.

<sup>25</sup> Eggers, et al., *Good Faith and Insurance Contract*, para 1.12.

<sup>26</sup> *Ibid*, para 1.07.

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'.<sup>27</sup> 'Utmost' is defined to be 'most extreme' and 'greatest',<sup>28</sup> and this term suggests that a high degree of good faith is required to satisfy the insurance contract compared with other general contracts. As a result, the 'utmost good faith' doctrine distinguishes the insurance contract from the general contract as an overriding duty because 'contracts of insurance provide the only true example of a contract *uberrimae fidei*'.<sup>29</sup>

However, section 17 is still too general and gives rise to a series of arguable issues: first, how to judge the degree of good faith in practice. In *Container Transport International Inc v Oceanus Mutual Underwriting Association (Bermuda)*,<sup>30</sup> Lord Justice Stephenson, despite his reservations whether it was possible to go into degrees of good faith, was nevertheless prepared to accept that, 'it is enough that much more than an absence of bad faith is required of both parties to all contract of insurance'.<sup>31</sup> Although he was reluctant to enter into a discussion on the different shades of good faith, he was clear that the minimum standard required something more than the absence of bad faith.<sup>32</sup> Undeniably, Stephenson LJ's judgment opened the floodgates to more circumstances of the utmost good faith breach examples; thus, apart from the obvious fraudulent acts, an assured's negligent non-disclosure or wholly innocent concealment also should be considered. Nevertheless, in *Banque Keyser Ullmann v Skandia*,<sup>33</sup> Steyn J remarked that, 'reciprocal duties rest

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<sup>27</sup> Section 17, MIA 1906.

<sup>28</sup> *Oxford English Dictionary Online*.

<sup>29</sup> Wild and Weinstein, *Smith & Keenan's English Law*, p. 339; and Eggers, et al., *Good Faith and Insurance Contract*, para 1.06.

<sup>30</sup> [1984] 1 Lloyd's Rep. 476, CA.

<sup>31</sup> *Ibid*, p. 525.

<sup>32</sup> Susan Hodges, *Law of Marine Insurance* (Cavendish Publishing Limited, 1996), p. 83.

<sup>33</sup> [1987] 1 Lloyd's Rep. 69, p. 93, QB (Com. Ct.).

on both parties to an insurance contract not only to abstain from bad faith but to observe in a positive sense the utmost good faith by disclosing all material circumstances’.

The other formidable obstacle is the following: section 17 is ambiguous in respect to the duration in which the utmost good faith duties should be observed. It consists of three elements: a marine insurance contract is *uberrimae fidei*; the utmost good faith must be observed by either party; the innocent party can avoid the contract if the other party fails to observe the duty. However, section 17 has recently been treated as a preamble to the following three sections (sections 18-20),<sup>34</sup> and their respective subsections have been deemed as supplementary contents. The problem here is that Sir Mackenzie Chalmers, the draftsman of MIA 1906, only indicated the duties before the contract is concluded, viz., sections 18(1) and 20(1),<sup>35</sup> and there is no notion expressed if the duty can be extended beyond the formation of the contract. In addition, section 21 is concerned with ‘when [the] contract is deemed to be concluded’, which potentially creates a misunderstanding of the previous contents (at least, it seems that sections 17-20 are more about the pre-contractual duties rather than the duties after the contract formation).

As to whether the doctrine is applicable beyond the formation of the contract, there are several controversial arguments. One factor is that Chalmers did not mention this point at all, although, this reason is untenable. While it is known that the MIA 1906 was codified and consolidated from numerous cases in addition to established trading customs and practice before its enactment, with all due respect, we cannot

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<sup>34</sup> Rose, *Marine Insurance: Law and Practice*, p. 70.

<sup>35</sup> Section 18(1) stipulates that ‘... 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....’. Then section 20 (1) notes that ‘[e]very material representation made by the assured or his agent to the insurer during the negotiations for the contract, and before the contract is concluded, must be true....’.



deny its limitations. In other words, since the Act is just a guideline for the marine insurance contract, nobody can be assured of what Chalmers could have ignored or intentionally avoided. Although there is no legal basis to categorize post-contractual duties into sections 18-20, they can still fall within the overriding scope of section 17. Thus, some authorities argue that the following special sections are not exhaustive<sup>36</sup> and section 17 is extended throughout the formation and currency of the policy.<sup>37</sup> This statement is also approved by Lord Justice Stephenson in *CTI*.<sup>38</sup> Additionally, apart from section 17, 'good faith' may require varying conduct in response to different stages of a contract's life. Although Lord Mansfield focused on the duty as it applies before the contract was made, 'good faith' is not only relevant to the making of the contract, but also to its performance and treatment of any breach.<sup>39</sup> As long as this problem is solved, people can continue the discussion about the post-contractual duties, which is addressed in chapters 5 and 6.

### **1.3. Pre-contractual duty of disclosure in the UK**

The doctrine of utmost good faith is recognized as the fountainhead of a series of derivative duties, thus, both disclosure and representation are admitted to be closely related to the doctrine of utmost good faith. In the following paragraphs, we continue a study of further situations in which a contract may be avoided or affected by non-disclosure.

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<sup>36</sup> For example, Hardy Ivamy, *Chalmers' Marine Insurance Act 1906* (10<sup>th</sup> ed., London, Dublin and Edinburgh, Butterworths, 1993).

<sup>37</sup> Rose, *Marine Insurance: Law and Practice*, para. 5.93.

<sup>38</sup> [1984] 1 Lloyd's Rep. 476, p. 525, CA.

<sup>39</sup> Lord Mansfield's opinion is summarized by Eggers, et al., *Good Faith and Insurance Contract*.

### 1.3.1. Disclosure at common law and under the Marine Insurance Act 1906

The highly developed regime of disclosure is one of the most distinctive characteristics of insurance law, both within marine and non-marine insurance. On the other hand, at common law or in equity, the disclosure duty has never been recognized as a matter of general contract law.<sup>40</sup> At common law, principally speaking, silence or non-disclosure has no effect except for several circumstances, one of which is where the contract is *uberrimae fidei* (of utmost good faith).<sup>41</sup> Although recent years have seen scholarly advocacy of the desirability of a general duty to disclose material facts, whatever the merits of such a development, there is still little evidence of any significant common law movement in that direction.<sup>42</sup> Thus, the duty of disclosure arises as an incident of the contract of insurance, deriving from the historical equitable tradition in English law which is now clothed in statutory form.<sup>43</sup>

Section 18(1) of the MIA 1906 imposes the duty of disclosure on the assured (initially, this duty was imposed on all assured, including both the business and consumer assured; after the enactment and eventual coming into force of the Consumer Insurance (Disclosure and Representations) Act 2012, this section will be confined to business insurance – both marine and non-marine insurance only) – one aspect of the overriding duty of the utmost good faith mentioned in section 17.<sup>44</sup>

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<sup>40</sup> This argument is supported by Howard Bennett, *The Law of Marine Insurance* (2<sup>nd</sup> ed., London, Oxford University Press, 2006); Wild and Weinstein, *Smith & Keenan's English Law*, etc.

<sup>41</sup> The circumstances include: (a) failure to disclose a change in circumstances; (b) where the contract is *uberrimae fidei* (of utmost good faith); (c) where there is a confidential or fiduciary relationship between the parties; (d) where statute requires disclosure; (e) in cases of concealed fraud. For details, see Wild and Weinstein, *Smith & Keenan's English Law*, pp. 338-339.

<sup>42</sup> Rose, *Marine Insurance: Law and Practice*, p. 67.

<sup>43</sup> Robert Merkin, *Marine Insurance Legislation* (4<sup>th</sup> ed., London: Informa, 2010), p. 32.

<sup>44</sup> Section 18(1) of the MIA 1906 stipulates that, 'subject to the provisions of this section, 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'.

Section 18(1) is composed of three elements: the assured must disclose information to the insurer before the contract is concluded; it is important to bear in mind that only the material circumstances need to be disclosed; if the assured fails to make such disclosure, the insurer may avoid the contract.

### **1.3.2. When to disclose and mutuality**

In the non-marine *Carter v Boehm* case,<sup>45</sup> Lord Mansfield clarified the underlying basis for the principle of disclosure. In this fundamental English case, on the basis of which the MIA 1906's draftsman consolidated section 17, the defence argued that the plaintiff failed to disclose the real function of the insured subject (a fort) to the insurer. Lord Mansfield in his judgment stated that 'insurance is a contract upon speculation...good faith forbids either party by concealing what he privately knows, to draw the other into a bargain, from his ignorance of that fact, and his believing the contrary'.<sup>46</sup> In that case, the facts led the Court to decide that the defence of non-disclosure failed.

In the first place, the assured must disclose information to the insurer before the contract is concluded. What should be clarified here is the timing of disclosure, which should be completed before the contract is formed. Thus, the duty will cease on the conclusion of the insurance contract. Another noteworthy point here is that disclosure must be made voluntarily,<sup>47</sup> and not based on enquiries.

Moreover, according to section 18(1), it seems that only the assured is obliged to disclose material information to the insurer and not *vice versa*. One reasonable conjecture is that the Act did not mean to impose the duties of disclosure falling on

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<sup>45</sup> (1766) 3 Burr 1905.

<sup>46</sup> *Ibid*, pp. 1910 and 1911.

<sup>47</sup> Bennett, *The Law of Marine Insurance*, p. 102.

the insured. This issue relates to the reciprocal nature of the utmost good faith duty mentioned in section 17 as well. The mutuality of utmost good faith is based on two principal cases *Carter v Boehm*<sup>48</sup> and *Banque Financiere de la Cite SA (formerly Banque Keyser Ullmann SA) v Westgate Insurance Co (formerly Hodge General & Mercantile Co Ltd)*.<sup>49</sup> In *Carter v Boehm*, in addition to his main judgment in terms of an assured's utmost good faith, Lord Mansfield further noted that 'good faith forbids either party by concealing what he privately knows, to draw the other into a bargain, from his ignorance of that fact, and his believing the contrary'.<sup>50</sup> In *Banque Keyser Ullmann v Scandia*, it was revealed that the defendant insurer concealed their brokers' deceit from the banks. Justice Steyn for the High Court explained whether reciprocal duties of good faith were owed to one another by an insurer and an insured. In his subsequent statement, Justice Steyn explained that:

'In other words, reciprocal duties rest on both parties to an insurance contract not only to abstain from bad faith but to observe in a positive sense the utmost good faith by disclosing all material circumstances....'<sup>51</sup>

The reciprocal nature principle was further favoured by Lord Justice Slade's judgment of the Court of Appeal in the same case:

'In our judgment, however, there is no doubt that the obligation to disclose material facts is a mutual one imposing reciprocal duties on insurer and insured.'<sup>52</sup>

The reasons for why the Act seems to impact the duty of disclosure specifically on the assured are quite practical. On the one hand, the ratio under the reciprocal rule is the information asymmetry between the insurer and assured. In particular in the

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<sup>48</sup> (1766) 3 Burr 1905.

<sup>49</sup> Also known as *Banque Keyser Ullmann SA v Skandia (UK) Insurance Co*. [1987] 1 Lloyd's Rep. 69.

<sup>50</sup> (1766) 3 Burr 1905, p. 1910.

<sup>51</sup> [1987] 1 Lloyd's Rep. 69, at p. 93, QBD.

<sup>52</sup> *Banque Financière de la Cité SA (formerly Banque Keyser Ullmann SA) v Westgate Insurance Co Ltd (formerly named Hodge General & Mercantile Insurance Co Ltd)* [1988] 2 Lloyd's Rep. 513, CA, p. 544.

previous century, the poor communication and transport measures made people believe that the assured would know much more about the insured property than the insurer. Nevertheless, after more than one century, with the rapid development of the modern communication and transport sectors, the insurer might know much more than the assured himself. On the other hand, the supposed mutuality of the principle has not been turned into binding authority at common law.<sup>53</sup> The MIA 1906 was codified from old precedents, but rare cases happened because of the insurer's breach of the duty of disclosure, especially after the loss has been caused by perils of the sea. In fact, there seems to be no case in which an insured has rescinded because of the insurer's non-disclosure. Technically speaking, the non-disclosure of the insurer is hardly likely to be investigated and revealed if the assured wants to enforce a claim under the policy. The root cause is the nature of the insurance contract, and that once the contract is made and premium is paid, the advantage, in fact, favours the insurer to escape liability. Consequently, the reasonable assured is supposed to accept the defective contract and get recovery, rather than choose to avoid the whole insurance contract.

### **1.3.3. Test for materiality – the prudent insurer and actual inducement test**

The second noteworthy element of the duty of disclosure is the test for material information. Section 18(2) further details the requirements for material information, which would influence the judgment of a prudent insurer in fixing the premium, or determining whether he will take risk.<sup>54</sup> This clause includes objective and subjective

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<sup>53</sup> Francis Rose, 'Information asymmetry and the Myth of Good Faith: Back to Basics', (2007) 2 *LMCLQ*, 181, p. 201.

<sup>54</sup> Section 18(2), MIA 1906.

materiality. The term 'circumstance' then is explained by Chalmers to embrace any communication made to, or information received by, the assured.<sup>55</sup>

'Objective materiality' requires the information to be capable of influencing a prudent underwriter's judgment. The judicial interpretation of 'influence' requires the disclosed circumstance to be one which would have had an impact on the formation of the insurer's opinion and on his decision-making process in relation to the matters concerned.<sup>56</sup> The term 'prudent' is stipulated to be 'acting with or showing care and thought for the future'.<sup>57</sup> With regard to the same issue, *Black's Law Dictionary* defines a 'prudent person' as '[a] hypothetical person used as a legal standard, esp. to determine whether someone acted with negligence; specif., a person who exercises the degree of attention, knowledge, intelligence, and judgment that society requires of its members for the protection of their own and of others' interests'.<sup>58</sup> It is further defined that, a reasonable person acts sensibly, does things without serious delay, and takes proper but not excessive precautions.<sup>59</sup> One must bear in mind that, whether the disclosure is material or not is according to the 'prudent insurer's judgement', and not the actual or particular insurer. It is supposed to be the reason why this yardstick is objective, because from the assured's view, it is based on the other party known as the prudent insurer's judgement. Obviously, this standard relies on a hypothetical basis and it creates a series of problems, one of which questions whether there is absolute fairness since the current law requests an assured to act from an experienced insurer's angle.

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<sup>55</sup> Section 18(5), MIA 1906.

<sup>56</sup> *CTI, CA*, p. 492, (per Kerr LJ).

<sup>57</sup> *Oxford English Dictionary Online*.

<sup>58</sup> Garner, et al., *Black's Law Dictionary*.

<sup>59</sup> *Black's Law Dictionary* does not provide any direct definition of a 'prudent insurer', but defines a 'reasonable person' and 'reasonably prudent person', which can be considered similar to a 'prudent person' by the editors.

Under the alternative test, reliance is placed not on the judgment of a prudent insurer, but on that of the reasonable assured. The critical question is whether a reasonable man in the position of the insured and with his knowledge of the relevant circumstances would have realized that they were material to the risk.<sup>60</sup> Although the prudent insurer test is questioned to be unfair for imposing challenges to the non-professional assured in some cases, the leading authority still favours it as opposed to that of the reasonable insured.<sup>61</sup>

The definition of 'subjective materiality' requires an understanding of the historical background of 'material'. Before the drafting of the MIA 1906, no case had demanded a precise definition of materiality. Although the formula in sections 18(2) and 20(2) accurately reproduces a number of judicial statements, it should be taken into account that this formula has only recently been subjected to detailed scrutiny.<sup>62</sup> It is recognized that the symbolic case with regard to the test for material is *Pan Atlantic*,<sup>63</sup> which also established the 'actual inducement' test.

The subject about the yardstick for 'material' was thought to be exclusively established by *the CTI* case.<sup>64</sup> At first instance, Justice Lloyd held that, on the true construction of section 18(2), a non-disclosed circumstance was material only if its disclosure would have led a prudent underwriter either to decline the risk altogether or to charge a higher level of premium; the non-disclosure must, therefore, have exerted a 'decisive influence' on the judgment of the prudent insurer by inducing a

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<sup>60</sup> Australian Law Reform Commission, *Insurance Contracts*, (1982, Australian Law Reform Commission 20), available at <http://lawcommission.justice.gov.uk/areas/insurance-contract-law.htm>, accessed in January 2013, p. 94; *Joel v Law Union & Crown Insurance Company* [1908] 2 KB 863, pp. 883-884.

<sup>61</sup> For example, *St Paul Fire & Marine Insurance Co. (UK) Ltd. v McConnell Dowell Constructors Ltd.* [1995] 2 Lloyd's Rep. 116; (the admissibility of the evidence of other underwriters was originally denied as pure hearsay); *Carter v Boehm* (1766) 3 Burr 1905; *Campbell v Rickards* (1833) 5 B & Ad 840.

<sup>62</sup> Bennett, *The Law of Marine Insurance*, p. 109.

<sup>63</sup> *Pan Atlantic Insurance Co Ltd and Another v Pine Top Insurance Co Ltd* [1992] 1 Lloyd's Rep. 101

<sup>64</sup> [1982] 2 Lloyd's Rep 178; [1984] 1 Lloyd's Rep. 476, CA.

‘different decision’ with respect to the risk.<sup>65</sup> This is the famous ‘decisive influence’ test. The question is whether this test was held to be purely objective without any consideration of whether the assured appreciated the materiality of the fact, or whether the underwriter in question was actually influenced by it.<sup>66</sup>

This issue was considered again by both the Court of Appeal and House of Lords in *Pan Atlantic*,<sup>67</sup> and the latter finally resolved what it has regarded as a ‘long-standing controversy’ with a history of more than 200 years.<sup>68</sup> The judgment upheld *CTI* on ‘materiality’, confirming the rejection of the pure ‘decisive influence’ test which was made in the Court of Appeal judgment of *CTI* in 1984. According to the leading judgment delivered by Lord Mustill (which was agreed by Lord Goff and Lord Slynn), the unadorned word ‘influence’ adopted by Parliament should be literally understood by its meaning at a mild degree of influence – a mere ‘effect on the thought processes of the insurer’, rather than of a phrase such as ‘decisive influence’.<sup>69</sup> It can be argued that the ‘decisive influence’ test is still too limited to be applied in general practice, especially in some cases which focus on the information which is ‘decisive’ but ignore ‘something less decisive’.<sup>70</sup> Therefore, attention was unanimously

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<sup>65</sup> [1982] 2 Lloyd’s Rep. 178, p. 187, QBD, Justice Lloyd reasoned that:

‘It seems to me that this should be the general rule, if only because the defence under s. 18 is capable of working such great hardship on the assured. Take a case where the fact is known to the assured, but not the materiality of the fact. Suppose that the prudent insurer, if he had known the fact, would have accepted the risk, but charged a small additional premium; suppose further that there is a substantial claim under the policy. In other jurisdictions, the assured could enforce the claim, by tendering the additional premium. But not so in England. The fairness of the English rule is not at once obvious and hardly seems to reflect the duty of utmost good faith under s. 17 which, be it noted, is owed both ways. Why, if the insurer would have accepted the risk in any event, albeit at an increased premium, should he be able to avoid the claim altogether? Since the English law is so favourable to the underwriter in this respect, the least that should normally be expected of the underwriter is to show that a prudent insurer would have charged an increased rate.’

Also see Bennett, *The Law of Marine Insurance*, p. 111.

<sup>66</sup> Merkin, *Marine Insurance Legislation*; and Rose, *Marine Insurance: Law and Practice*, chapter 5.

<sup>67</sup> [1992] 1 Lloyd’s Rep. 101, QBD; [1993] 1 Lloyd’s Rep. 496, CA; [1994] 2 Lloyd’s Rep. 427, HL.

<sup>68</sup> [1994] 2 Lloyd’s Rep. 427, pp. 432 and 442 (per Lord Mustill).

<sup>69</sup> *Ibid.*

<sup>70</sup> Malcolm Clarke, *Law of Marine Insurance Contracts* (4<sup>th</sup> ed., London: Informa, 2012), para. 23-7A. Here, Clarke listed three types of information and three possibilities of degrees of influence: Type A is information such that, if the insurer had known it, after due consideration (e.g.: *Anglo-African*



reversed to inducement.<sup>71</sup> In consideration of such rejection, it made the formulation of a tenable test to be further required. It was confirmed that there is a need for a causal connection between the misrepresentation or non-disclosure and the making of the contract of insurance.<sup>72</sup> Thus, the House of Lords rejected the 'decisive influence' test, and also established the exclusive 'actual inducement' test,<sup>73</sup> which is currently the most appropriate standard for law till now. In the judgment by the House of Lords, Lord Mustill stated that 'if the misrepresentation or non-disclosure of a material fact did not in fact induce the contract (in the sense in which that expression is used in the general law of misrepresentation) the underwriter is not entitled to rely on it as a ground for avoiding the contract'.<sup>74</sup> After conducting a thorough examination for the legal position, Lord Mustill concluded that '...there is to be implied in the 1906 Act a qualification that a material misrepresentation will not entitle the underwriter to avoid the policy unless the misrepresentation induced the making of the contract, using 'induced' in the sense in which it is used in the general law of contract'.<sup>75</sup>

In other words, although section 18 makes no mention of inducement, the judicial opinion and precedent above prove that inducement is required in insurance law. Then the attention is concentrated on its conceptual difficulty at a practical level. In general contract law, just the objective materiality is not sufficient to measure

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*Merchants v Bayley* [1970] 1 QB 311, p. 319, per Megaw J) he would have refused to make the contract at all. Type B is information such that, if the insurer had known of it, the insurer would have made a contract of insurance but only on terms, especially (but not only) as to premium, different from that which he did make. Type C is information such that, if the insurer had known it, the insurer would have considered it relevant but, unlike Type A, not so relevant that a contract would have been refused and, unlike Type B, not so relevant that the insurer would have insisted on different terms. Clarke further stated that in England, the issue was mainly whether the law should require information Type B or be content with information Type C.

<sup>71</sup> [1994] 2 Lloyd's Rep. 427, HL.

<sup>72</sup> At common law, the causal link was established by *Edgington v Fitzmaurice* (1885) 29 Ch D 459, p. 467, per Denman LJ; and p. 483, per Bowen LJ (CA).

<sup>73</sup> [1994] 2 Lloyd's Rep. 427, HL.

<sup>74</sup> *Ibid*, p. 453.

<sup>75</sup> *Ibid*, p. 529.

misrepresentation, the subjective materiality is also needed.<sup>76</sup> When it refers to the duty of disclosure in marine insurance contracts, the proposition brought up for consideration is establishing the requirement for inducement as a matter of legal principle,<sup>77</sup> and borrowing the inducement mechanism adopted at common law. The reference can be referred to Lord Mustill's judgment in *Pan Atlantic*.<sup>78</sup> In this case he accepted the close connection between misrepresentation and non-disclosure, and held that the test for inducement in insurance contract law was the same as that applied in general contract law.<sup>79</sup> Therefore, the innocent party cannot avoid the insurance contract, unless the other party's concealment and misrepresentation induced the contract to be concluded. However, some other difficulty surrounds the role of inducement as a causal factor in the general law of contract. There appear to be a number of views. First, the general law is concerned with misrepresentations (fraudulent, negligent/innocent) and not with non-disclosure, as there is no general duty on contracting parties to disclose material facts in negotiations. Secondly, in the general law a concept of 'materiality' is deployed, but it cannot be too readily assumed that its role is analogous to its synonym in insurance law.<sup>80</sup>

We can see that the term 'material' is general and inexplicit at the beginning of section 18(1) of MIA 1906. But, despite it being clarified in section 18(2), the understanding of 'material' is still hard to achieve. Policies are negotiated in varying circumstances and depend on different considerations. This means that different underwriters (irrespective of the prudent, reasonable or actual underwriters) will treat

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<sup>76</sup> *Attwood v Small* (1838) 6 Cl & F 232, 338; *JEB Fasteners v Marks, Bloom & Co* [1983] 1 All ER 583.

<sup>77</sup> Bennett, *The Law of Marine Insurance*, p. 116. In *the Berger & Light Diffusers Ltd v Pollock* [1973] 2 Lloyd's Rep. 442, Kerr LJ held that, to render a marine insurance contract voidable, it was not sufficient that a non-disclosure or misrepresentation was objectively material. In addition, it must have subjectively induced the underwriter to conclude the contract on the terms agreed.

<sup>78</sup> [1992] 1 Lloyd's Rep. 101, QBD; [1993] 1 Lloyd's Rep. 496, CA; [1994] 2 Lloyd's Rep. 427, HL.

<sup>79</sup> [1994] 2 Lloyd's Rep. 427, HL, p. 449.

<sup>80</sup> For details, see Rose, *Marine Insurance: Law and Practice*, pp. 82-83.

different factors as material.<sup>81</sup> These factors create a difficulty for the judiciary to consider this term. Therefore, the draftsman added one more clause in section 18, clarifying that whether any particular circumstance which is not disclosed, be material or not, is in each case a question of fact.<sup>82</sup>

#### **1.3.4. Information requiring disclosure: physical hazard and moral hazard**

Subject to section 18(2), the assured must disclose the material information 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. Thus, the assured cannot conceal information he actually knows or is presumed to know. Then, a practical difficulty is raised which questions, what kind of information is treated as the knowledge of the assured? For this enquiry, the most authoritative opinion is dividing the 'knowledge' into two types: physical hazard and moral hazard.<sup>83</sup>

In the first case, any fact which directly affects the risk insured (physical hazard) is material. In other words, physical hazard is used to describe the condition of the insured property, which will affect the assessment of the risk. *Liberian Insurance Agency Inc v Mosse*<sup>84</sup> is one example in marine insurance law where the assured failed to disclose the material information about the shipped cargo described as 'enamelware (cups and plates) in wooden cases'. Another example is *International Lottery Management v Dumas*.<sup>85</sup> Here, the insurers were entitled to avoid the insurance policy for the assured's misrepresentation (neither the registration of the lottery tickets under Decree 33, nor the necessary documents for legal operations

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<sup>81</sup> Eggers, et al., *Good Faith and Insurance Contract*.

<sup>82</sup> Section 18(4), MIA 1906.

<sup>83</sup> The physical hazard and moral hazard division is supported by Bennett, *The Law of Marine Insurance*; Merkin, *Marine Insurance Legislation*; Clarke, *Law of Marine Insurance Contracts*; and Rose, *Marine Insurance: Law and Practice*.

<sup>84</sup> [1977] 2 Lloyd's Rep. 560.

<sup>85</sup> [2002] Lloyd's Rep. IR 237.

was obtained at the time of effecting insurance), non-disclosure (of the existence or the effect of Decree 33), and breach of warranty. In *Marine Insurance Legislation*, Professor Robert Merkin exemplifies several circumstances in which the assured must disclose of the insured property:

- '(a) any physical attributes of the insured subject-matter which render it a greater risk than would normally be assumed must be disclosed;
- (b) previous losses and claims may constitute material facts;
- (c) any particular hazards of the voyage constitute material facts if the underwriter could not have discovered those facts or if they have been misstated;
- (d) the assured must disclose that he has entered into a contract with a third party, not found in the ordinary course of commerce, which potentially increases the underwriter's liability or diminishes its right of subrogation in the event of a loss.'

In the second case, any fact which goes to the 'moral hazard' is material. 'Moral hazard' is a term describing facts which suggest that the proposed insured, by reason of his previous experience of matters relevant to the insurance, is not a person whose proposal can be accepted in the ordinary course of business and without special consideration.<sup>87</sup> It is related to information asymmetry, a situation in which one party in a transaction has more information than another, especially in terms of the facts of the assured himself. It is elementary that one of the matters to be considered by an insurance company in entering into contractual relations with a proposed assured is the question of the moral integrity of the proposer. In insurance, the phrase embraces the human aspects of the risk, related not to any insured property but rather to the character and history of the assured and other persons relevant to the risk given the position they occupy in relation to the subject-matter insured.<sup>88</sup> Judicial support is available from the case of *Lambert v Co-operative*

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<sup>86</sup> Merkin, *Marine Insurance Legislation*, p. 23

<sup>87</sup> Ivamy, *Chalmers' Marine Insurance Act 1906*, p. 86.

<sup>88</sup> Bennett, *The Law of Marine Insurance*, p. 127.

*Insurance Society Ltd*,<sup>89</sup> where the insurance was avoided because of the assured's non-disclosure of her husband's previous convictions. This case also illustrates the problems with the duty to disclose since, as a genuine customer, Mrs Lambert should not have noticed the degree of influence of her husband's previous convictions in the absence of inquiries.<sup>90</sup> Merkin also provides a moral hazard list:

- '(a). If the assured has overinsured to an excessive amount, the overinsurance must be disclosed, although this is less significant in an unvalued policy as the assured is unable to recover more than his actual loss.
- (b). Information as to other policies on the same risk is material if it converts the risk from genuine to speculative, as is information as to previous losses or claims under other policies.
- (c). The master's qualifications or previous conduct are immaterial unless they relate directly to the hazard.
- (d). There is authority for the proposition that the nationality of the shipowner or the vessel may be a material fact.
- (e). The assured's criminal convictions are material.
- (f). General dishonesty on the assured's part is material, e.g. where the assured has fraudulently prepared invoices intended to be used to defraud its bankers or has defrauded customers or the tax authorities.'<sup>91</sup>

There are several observations which need to be discussed. First, in marine insurance, there is a long-established rule that the previous refusals of cover by other underwriters are not material and do not need to be disclosed.<sup>92</sup> On the contrary, the general insurance law has established a rule on the opposite basis that previous refusals are held to be material.<sup>93</sup> Thus, marine insurance is also distinguished from non-marine insurance in respect of previous refusals of cover by other underwriters. Secondly, as to the assured's criminal convictions, the leading tendency now is to

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<sup>89</sup> [1975] 2 Lloyd's Rep. 485.

<sup>90</sup> This case is admitted as a milestone for abolishing the genuine assured's duty of disclosure in consumer insurance by most authorities, including the Law Commission (e.g.: The Law Commission and the Scottish Law Commission, *Insurance Contract Law: A Joint Scoping Paper*, (January 2006), available at <http://lawcommission.justice.gov.uk/areas/insurance-contract-law.htm>, accessed in January 2013, p. 39.).

<sup>91</sup> Merkin, *Marine Insurance Legislation*.

<sup>92</sup> *Glasgow Assurance v Symondson* (1911) 16 Com Cas 109.

<sup>93</sup> *Glicksman v Lancashire & General Ass Co* (1925) 21 Ll. L. Rep. 352, KBD; (1926) Vol. 26 Ll. L. Rep. 69, HL.

hold this kind of information to be material and must be disclosed. This requirement is also a long-existing matter of common law that previous criminal convictions of the assured are material and must be disclosed, albeit the cases are generally from outside the marine context.<sup>94</sup> On the issue of disclosing previous convictions, it is noted by the judiciary that there is no ascertained determination with regard to the materiality of past convictions and the underwriters expressed in evidence a wide range of differing views.<sup>95</sup> At a practical level, discretion is granted to the judiciary by referring to the Rehabilitation of Offenders Act 1974.<sup>96</sup>

It has been recently held that allegations of misconduct which may not in fact have been substantiated have to be disclosed by the would-be assured.<sup>97</sup> Furthermore, irrespective of whether the would-be assured is guilty or innocent, the charges must be disclosed to the would-be insurer. Besides, an apparently well-founded rumour, though it turns out afterwards to be incorrect, must be disclosed since 'mere rumour could amount to a material fact even though it was subsequently proved to be untrue'.<sup>98</sup>

Of course, the categories of physical hazard and moral hazard are not exhaustive and the duties under the disclosure rule are not confined to circumstances which fall within these two groups. They are just useful short hands for categorizing the material information. There are still some other circumstances relevant to the

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<sup>94</sup> Rose, *Marine Insurance: Law and Practice*, paras. 5.50-5.51.

<sup>95</sup> *Reynolds v Phoenix Assurance Co Ltd* [1978] 2 Lloyd's Rep. 440, pp. 457-458. In this case, the Court held that the non-disclosure of an eight-year-earlier conviction for receiving stolen property was not material to avoid the insurance contract. Also see *James v CGU* [2002] Lloyd's Rep. IR 206; *Laker Vent Engineering Ltd v Templeton Ins Ltd* [2009] Lloyd's Rep. IR 704.

<sup>96</sup> Section 6, Rehabilitation of Offenders Act 1974. The situation is quite similar to the issue of inducement at English common law.

<sup>97</sup> *Brotherton v Aseguradora Colseguros* [2003] EWCA Civ 705 (largely disapproving of *Strive Shipping Corp v Hellenic Mutual War Risks Assoc (The Grecia Express)* [2002] 2 Lloyd's Rep. 88.)

<sup>98</sup> 'Previous losses, rumours, suspicions and the duty of disclosure in marine contracts', *S.&T.L.*, 1<sup>st</sup> May 2002, available at <http://www.i-law.com/ilaw/doc/view.htm?id=40141>, accessed in January 2013. Also see Merkin, *Marine Insurance Legislation*; *The Grecia Express*, 'The Duty of Disclosure and Material Rumors', (2003) 2 *LMCLQ*, pp. 158-164.

assessment of risks. Professor Howard Bennett exemplifies several cases in his book. One example is provided by circumstances relevant to the insurer's possibilities of recoupment of lost moneys through the doctrine of subrogation. Additionally, the potential for materiality of past default on payment of premium<sup>99</sup> and the scope of materiality affected by the risk the insurer is being asked to accept (for instance, in the context of open covers), are also mentioned.<sup>100</sup>

### 1.3.5. Limits on disclosure

Section 18(3) of the MIA 1906 emphasizes that in the absence of inquiry the following circumstances need not be disclosed, namely:

'Any circumstance which diminishes the risk;  
Any circumstance which is known or presumed to be known to the insurer. The insurer is presumed to know matters of common notoriety or knowledge, and matters which an insurer in the ordinary course of his business, as such, ought to know;  
Any circumstance as to which information is waived by the insurer;  
Any circumstance which it is superfluous to disclose by reason of any express or implied warranty.'<sup>101</sup>

So, in order to ease the assured's burden of disclosure, section 18(3) exempts the assured from four particular cases in the absence of inquiry. This includes diminution of the risk,<sup>102</sup> the assured's actual and presumed knowledge (including the information of general knowledge and special insured subject),<sup>103</sup> waiver by the insurer,<sup>104</sup> and warranties.<sup>105</sup> It should be noticed that the condition precedent to the

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<sup>99</sup> *O'Kane v Jones (The Martin P)* [2004] 1 Lloyd's Rep. 389, paras. 224-230; *North Star Shipping Ltd v Sphere Drake Insurance plc (No 2)* [2005] 2 Lloyd's Rep. 76, paras. 232-236.

<sup>100</sup> Bennett, *The Law of Marine Insurance*, pp. 129-132.

<sup>101</sup> Section 18(3), MIA 1906.

<sup>102</sup> *Inversiones Manria SA v Sphere Drake Insurance Co plc (The Dora)* [1989] 1 Lloyd's Rep. 69, pp. 89-90. In this case, the alleged non-disclosure that at the inception of the risk, the risk was a builder's risk and not a navigation risk was a circumstance which diminished the risk and was not disclosed by virtue of section 18(3)(a) of the MIA 1906. Equally, moving to a safer and securer area is also diminishing risks insured against.

<sup>103</sup> Merkin, *Marine Insurance Legislation*.

<sup>104</sup> *CTI v Oceanus* [1984] 1 Lloyd's Rep. 476, p. 529, CA (per Stephenson LJ).

exemptions for disclosure is the absence of the insurer's inquiry; in cases where the insurer inquires, the limits cannot be relied on any more.<sup>106</sup>

As a matter of fact, each of these exceptions is applicable at common law to both marine and non-marine insurance.<sup>107</sup> However, some difficulty surrounds the third category, that of waiver, which causes the most practical difficulty. Section 18(3) provides that in the absence of inquiries, the assured needs not disclose 'any circumstance as to which information is waived by the insurer'. This gives rise to the first question: must the waiver be express or could it also be implied? A waiver formality may be oral, written, or inferred from conduct<sup>108</sup> voluntarily, even though the provision waived is found in a contract required to be evidenced by writing.<sup>109</sup> In English law, generally speaking, an insurer seldom expressly waives disclosure. Thus, he may be judged impliedly to have waived disclosure of a particular fact. The test has been stated as follows:

'If the insurer receives information from the assured or his agent which, by its content or form, should suggest a doubt to the mind of the reasonably prudent insurer and put him on inquiry, then, if he omits to make the check or inquiry, assuming it can be made simply, he will be held to have waived disclosure of the material facts which that inquiry would necessarily have revealed.'<sup>110</sup>

In insurance practice, waiver may nevertheless arise in the following ways:

- (a). Blanket waiver of all disclosure on the part of the assured;
- (b). Disclaimer by the underwriters of the relevance of the facts at issue, particularly by policy terms or by an authorised agent;
- (c). Limited requests by the underwriters for information which excludes facts otherwise material, although not all limited express questions amount to waiver;

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<sup>105</sup> Section 33, MIA 1906.

<sup>106</sup> Merkin, *Marine Insurance Legislation*, at section 18.

<sup>107</sup> *Carter v Boehm* (1766) 3 Burr 1905, p. 1910. It is notable that after the full enforcement of the new Act, the MIA 1906 is limited to business insurance only and consumer marine insurance would be governed by the new Act instead, which is addressed in chapters 3 and 5.

<sup>108</sup> *Bruner v Moore* [1904] 1 Ch. 305; *Bremer Handelsgesellschaft mbH v Vanden Avennelzegem P.V.B.A* [1978] 2 Lloyd's Rep. 109.

<sup>109</sup> Hugh Beale, et al., *Chitty on Contracts* (30<sup>th</sup> ed., London: Sweet & Maxwell, 2008), vol. 2, p. 1470.

<sup>110</sup> MacGillivray and Parkington, *MacGillivray and Parkington on Insurance Law Relativity to All Risks* (8<sup>th</sup> ed., Carswell Legal Publications, 1988), para. 686f.



(d). Failure by the underwriters to seek further information when alerted by existing disclosure. There is no waiver by failure to ask a material question.<sup>111</sup>

It can be concluded that, although at common law, the waiver is normally judged impliedly, it cannot be easily presumed. Especially that the omission to make inquiry is no-waiver if the insurers are not put on inquiry. Furthermore:

'[T]here can...be no waiver of material information unless it would and should have been disclosed by an inquiry by the underwriter which common prudence demanded, and no affirmation of a contract unless the underwriter enters into it or carries it out after he has full knowledge of the information.'<sup>112</sup>

### **1.3.6. Consequences and remedies for non-disclosure: avoidance**

In accordance with section 18(1), if the business assured fails to make such disclosure, the insurer may avoid the contract. In addition, even in section 17, the consequence of the breach of the overriding utmost good faith duty is 'avoidance',<sup>113</sup> although this is not the only one. There are several issues which require observation. Firstly, both in section 17 and section 18(1), the avoidance of the contract is not the sole consequence. In terms of the MIA 1906, the innocent party may avoid the contract if the other party fails to observe the duty. To make it clear, the contract is voidable or may be avoided at the innocent party's option. Therefore, one party will have the right to elect whether to avoid the transaction or to affirm it. Thus, in business insurance law, the innocent party (normally this is the insurer) can choose for the contract to be continued, together with some other requirements to rescue the insurance contract, for instance, claim for higher premium from the assured. Nevertheless, regarding the breach of disclosure in section 18, the only statutory

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<sup>111</sup> Merkin, *Marine Insurance Legislation*, at section 18.

<sup>112</sup> *CTI v Oceanus* [1984] 1 Lloyd's Rep. 476, p. 529, CA (per Stephenson LJ).

<sup>113</sup> The remedies for consumer insurance are flexible, to protect innocent assureds, which is addressed in chapters 3 and 5.

remedy suggested and codified by Sir Mackenzie Chalmers is avoidance, so the only remedy allowed for the innocent party is avoiding the contract from the beginning,<sup>114</sup> which has been criticized for being draconian to an innocent assured who unintentionally breached the duty of utmost good faith.

Secondly, if the contract is avoided, the consequence is severe. Voidable is usually used to distinguish *void ab initio* from the other rules. *Void ab initio* is a Latin phrase, which means void from the beginning. Therefore, avoidance is a retrospective measure, which returns the parties to the position they were in before the contract was concluded. In an insurance contract, this favours the insurer to select whether to rescind the transaction or to affirm it. However, in practice it is quite unjust for the assured, since he does not have any influence of the situation.<sup>115</sup>

Thirdly, is 'avoidance' in insurance law equal to 'rescission' in general contract law? In contract law, rescission is the unwinding of a transaction, which is done to bring the parties, as far as possible, back to the position in which they were before they entered into a contract. A contract which is rescinded by agreement is completely discharged and cannot be revived.<sup>116</sup> One similarity between 'avoidance' and 'rescission' is that both of them are discretionary remedies which appear to be self-rescue measures that do not require judicial interventions. However, the Court may still confirm the innocent party's right to avoid or decline to rescind a contract if one party has affirmed the contract by his action, a third party has acquired some rights, or there has been substantial performance in implementing the contract. Notwithstanding this, there are still some differences between them. The most outstanding one is that avoidance is applicable for all the duties under utmost good

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<sup>114</sup> *Banque Keyser Ullmann v Scandia* [1988] 2 Lloyd's Rep. 513, CA; [1990] 2 Lloyd's Rep. 377, HL.

<sup>115</sup> The current situation of the information controlling at the insurance practical level is addressed especially in chapters 3 and 5 regarding the insurance law reform in the UK.

<sup>116</sup> Beale, et al., *Chitty on Contracts*, p. 1462; *R v Inhabitants of Gresham* (1786) 1 Term Rep 101.

faith (such as disclosure and representation) as mentioned in section 17, while rescission is a remedy at common law in the case of misrepresentation, but not non-disclosure, since there is no duty of disclosure at common law.<sup>117</sup>

In consideration of these factors, is 'avoidance' in insurance law equal to 'rescission' in general contract law? When it comes to the theoretical level, the situation becomes quite problematic. There are several reasons for this. In the first place, for the purpose of the MIA 1906, it is understandable that the MIA 1906 was created and codified by Chalmers particularly for marine insurance contracts, and therefore undoubtedly the language and terms of the Act are more appropriate for marine insurance contracts. Secondly, in the context of marine insurance, 'avoidance' is not the real 'rescission or avoidance' in general contract law. As mentioned earlier, avoidance or rescission is considered to be a kind of remedy which returns the parties to the position they were in before the contract is concluded at the beginning. In cases where the assured has suffered the losses caused by the perils of the sea, avoiding the contract does not return the assured to the position he was in at the beginning.<sup>118</sup> Finally, as mentioned previously, one fine distinction between avoidance in insurance law and rescission in general contract law is that the latter is applicable in the case of misrepresentation, but not non-disclosure. This is because there is no duty of disclosure at common law, while the former is applicable for all the duties under the heading of utmost good faith mentioned in section 17. This is a formidable obstacle to the argument which favours that they are the same at the root. Till now, it can be concluded that differentiating avoidance in insurance law from rescission or avoidance at common law is necessary. Consequently, it can be questioned, what the rule is for avoidance in insurance law or the MIA 1906?

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<sup>117</sup> See 1.3.1.

<sup>118</sup> See 1.3.2.

Therefore, the modern leading authority is considering them the same in practice, but only in practice.<sup>119</sup>

In the judgment of the Court of Appeal in *HIH Casualty and General Insurance Ltd and Others v Chase Manhattan Bank and Others*,<sup>120</sup> Rix LJ tried to separate the heading of avoidance from rescission. Despite this, he held that:

[A]lbeit that in the insurance context the MIA 1906 uses the verb 'avoid', the language of avoidance and rescission is often found more or less interchangeably within and without that context to describe both the remedy for breach of the duty of good faith and the common law response to misrepresentation.<sup>121</sup>

Rix LJ further held that 'for the purposes of the MIA 1906 itself the remedy of rescission for misrepresentation had in practice been subsumed into the right to avoid'.<sup>122</sup> And Lord Mustill insisted in *Pan Atlantic* that this opinion should only be favoured in practice.<sup>123</sup>

Finally, avoidance is a self-evident remedy, which does not require judicial intervention. The innocent party can avoid the contract when the other party breaks the disclosure duty. The avoidance effects at the time it is declared, without any intervention from the Court. Of course, when the contractual parties have divergences about this point, the Court may use judicial discretion to make the final decision.

#### **1.4. Conclusion**

The question of utmost good faith is always an intriguing one; it promotes uncertainty and leaves too much discretion to the court. To date, research in the

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<sup>119</sup> Favoured by Rix LJ in the judgment of the Court of Appeal in *HIH Casualty and General Insurance Ltd and Others v Chase Manhattan Bank and Others* [2001] Lloyd's Rep. I.R. 703, CA, and Lord Mustill in *Pan Atlantic* [1994] 2 Lloyd's Rep. 427.

<sup>120</sup> [2001] Lloyd's Rep. I.R. 703, CA.

<sup>121</sup> *Ibid*, paras.171 -177.

<sup>122</sup> *Ibid*, para.174.

<sup>123</sup> [1994] 2 Lloyd's Rep. 427, p. 448.

doctrine of utmost good faith has focused on two sets of concerns: test for materiality and issues pertaining to legal effects of breach of duty.

In this chapter, I introduced the current situation of utmost good faith at English case law, and analysed the theory of the pre-contractual duty of disclosure.<sup>124</sup> Subsequently, this author compared different situations in insurance and general contract law, introduced its duration, the actual inducement test for materiality, information requiring disclosure, limits on disclosure, and finally the remedies for non-disclosure under contracts of business marine insurance.<sup>125</sup> Till now, one problem left undecided is the identification of 'avoidance' in insurance law from 'rescission' in general contract law from the prospective of legal evidence. The issues regarding the utmost good faith doctrine's application to misrepresentation and extension beyond the conclusion of contracts is stated below.<sup>126</sup>

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<sup>124</sup> Initially in all insurance contracts, and will be limited to business insurance after the enactment of the new Consumer Insurance (Disclosure and Representations) Act 2012, since this duty is totally removed from the consumer assured according to the latter legislation.

<sup>125</sup> After the full enforcement of the Consumer Insurance (Disclosure and Representations) Act 2012, all types of consumer insurance, including consumer marine insurance, will fall within its scope.

<sup>126</sup> See chapters 2, 3 and 5.

## CHAPTER 2

### PRE-CONTRACTUAL DUTIES IN THE UK: REPRESENTATION

#### 2.1. Introduction

In contrast with the duty of disclosure, the duty of making a right representation is recognized by common law.<sup>127</sup> As another aspect of the duty of utmost good faith, the assured's duty to make exact representations of material circumstances before the conclusion of insurance policies is noteworthy. The following discussion includes its legal status at general common law and in marine insurance, and also remedies available for the assured's misrepresentation and correspondent criticisms raised. In order to ascertain the extent of current knowledge about representing material information, a comparison between this concept and the notion of warranty is also provided in this chapter. However, with the enactment of the Consumer Insurance (Disclosure and Representations) Act 2012, which is anticipated to be fully enforced shortly after one year after its enactment (March 2012), it is revealed that there are significant alterations of the consumer's pre-contract information duties. These relate to the abolition of the average consumer's voluntary duty of disclosure, the adoption of a reasonable assured test, the establishment of a two-part categorisation

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<sup>127</sup> Including case law, Statute law – Misrepresentation Act 1967 and also academic support. The Consumer Insurance (Disclosure and Representations) Act 2012 is addressed in chapters 3 and 5. For academic support, see Edwin Peel, *Treitel on The Law of Contract* (13<sup>th</sup> ed., London: Sweet & Maxwell, 2011); Hodges, *Law of Marine Insurance*; Wild and Weinstein, *Smith & Keenan's English Law*; Rose, *Marine Insurance: Law and Practice*, etc.

misrepresentation, and the protective manners provided to an honest misrepresenter.<sup>128</sup>

## 2.2. Misrepresentation at common law

### 2.2.1. What is representation?

Representation is defined by the *Black's Law Dictionary* as:

'A presentation of fact – either by words or by conduct — made to induce someone to act, esp. to enter into a contract; esp., the manifestation to another that a fact, including a state of mind, exists <the buyer relied on the seller's representation that the roof did not leak>. Cf. misrepresentation (MISREPRESENTATION)'.<sup>129</sup>

At common law, there are three ingredients of a 'representation':<sup>130</sup>

1. There must be a statement.<sup>131</sup>
2. The statement is about specific existing and verifiable fact or past event.<sup>132</sup>

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<sup>128</sup> Paragraphs 2-5, Schedule 1, Consumer Insurance (Disclosure and Representations) Act 2012. All these amendments are discussed in chapter 3 in order to compare the situations in business insurance, see 3.4.1.3.

<sup>129</sup> Garner, et al., *Black's Law Dictionary*. In order to strengthen its definition of representation at common law, the *Black's Law Dictionary* also provides the following authoritative statement as follows: 'Representation ... may introduce terms into a contract and affect performance: or it may induce a contract and so affect the intention of one of the parties, and the formation of the contract.... At common law, ...if a representation did not afterwards become a substantive part of the contract, its untruth (save in certain excepted cases and apart always from fraud) was immaterial. But if it did, it might be one of two things: (1) it might be regarded by the parties as a vital term going to the root of the contract (when it is usually called a 'condition'); and in this case its untruth entitles the injured party to repudiate the whole contract; or (2) it might be a term in the nature only of an independent subsidiary promise (when it is usually called a 'warranty'), which is indeed a part of the contract, but does not go to the root of it; in this case its untruth only gives rise to an action *ex contractu* for damages, and does *not* entitle the injured party to repudiate the whole contract.' See William Anson, *Principles of the Law of Contract* (Arthur L. Corbin ed., 3d Am. ed. 1919, pp. 218, 222). A similar discussion is addressed below.

<sup>130</sup> Which is supported by Wild and Weinstein, *Smith & Keenan's English Law*, p. 338.

<sup>131</sup> However, it has been suggested that in consequence, silence or non-disclosure has no effect except in the following circumstances: 'a. failure to disclose a change in circumstance; b. where the contract is *uberrimae fidei* (utmost good faith); c. where there is a confidential or fiduciary relationship between the parties, as where they are solicitor and client; d. where statute requires disclosure; e. in cases of concealed fraud'. *Ibid*, pp. 338-339.

<sup>132</sup> The following cases are excluded: 'a. statements of law; b. statements as to future conduct or intention – these are not actionable, though if the person who makes the statement has no intention of carrying it out, it may be regarded as a representation of fact; c. statements of opinion; d. sales talk, advertising, 'puffing' (what is called these days 'hype')'. *Ibid*, pp. 338-339.

3. The statement must induce the contract.<sup>133</sup>

### 2.2.2. Misrepresentation and actionable misrepresentation at common law

In the *Black's Law Dictionary*, misrepresentation is defined as '[t]he act of making a false or misleading assertion about something with the intent to deceive'; or '[t]he assertion so made; an assertion that does not accord with the facts'.<sup>134</sup>

Misrepresentation at common law is an area of the law of contract, which allows a claimant to escape an obligation or claim compensation for losses. A misrepresentation can be an outright lie (fraud), an unintentional but careless falsehood (negligence), or an innocent slip of the tongue (innocent misrepresentation). These are sometimes referred to as fraudulent misrepresentation, negligent misrepresentation and innocent misrepresentation respectively.

(a) Fraudulent misrepresentation is a false representation of a material fact made knowing it to be false, or believing it to be false, or recklessly not caring whether it to be true or false.<sup>135</sup> Fraudulent misrepresentation is also defined as '[a] false statement that is known to be false or is made recklessly – without knowing or caring whether it is true or false – and that is intended to induce a party to detrimentally rely on it'.<sup>136</sup> (b) Negligent misrepresentation is a false statement made by a person who

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'Mere puffs', being statements which are not seriously meant and as to which it should have been obvious to the representee that the statements was not seriously meant, are not actionable. For details, please see Jonathan Gilman, et al., *Arnould's Law of Marine Insurance and Average* (17<sup>th</sup> ed., London: Sweet & Maxwell, 2008), p. 710.

<sup>133</sup> It must therefore: 'a. have been relied on by the person claiming to have been misled who must not have relied on his own skill and judgment or some other statement; b. have been material in the sense that it affected the claimant's judgment; c. have been known to the claimant; d. have been addressed to the person claiming to have been misled'. See Wild and Weinstein, *Smith & Keenan's English Law*, pp. 338-339.

<sup>134</sup> Garner, et al., *Black's Law Dictionary*.

<sup>135</sup> Wild and Weinstein, *Smith & Keenan's English Law*.

<sup>136</sup> Garner, et al., *Black's Law Dictionary*.



had no reasonable grounds for believing the statement to be true.<sup>137</sup> (c) Innocent misrepresentation is false statement of fact made by a person who had reasonable grounds to believe that the statement was true, not only when he made it but also at the time the contract was entered into – the division between possible states of mind of the representor. It is also defined as '[a] false statement that the speaker or writer does not know is false; a misrepresentation that, though false, was not made fraudulently'.<sup>138</sup>

Both (b) and (c) are comparatively recent.<sup>139</sup> Until the 1960s the only necessary distinction was between fraudulent and non-fraudulent (including negligent) misrepresentation,<sup>140</sup> which is supported by section 2 of the Misrepresentation Act 1967 and the recent section 5 of the Consumer Insurance (Disclosure and Representations) Act 2012, regarding the qualifying misrepresentations in consumer insurance.<sup>141</sup>

Misrepresentation and a concealment have been distinguished as follows: a misrepresentation is a false representation of a material fact, by one of the parties to the other, tending directly to induce the other to enter into the contract, or to do so on terms less favourable to himself when he otherwise might not do so, or might demand terms more favourable to himself, whereas, a material misstatement by the assured through misconstruction of his information is a misrepresentation, and the unwitting omitting to state a material fact is a concealment.<sup>142</sup> This definition almost

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<sup>137</sup> Wild and Weinstein, *Smith & Keenan's English Law*, pp. 341-343. In *Black's Law Dictionary*, negligent misrepresentation is defined as '[a] careless or inadvertent false statement in circumstances where care should have been taken', see Garner, et al., *Black's Law Dictionary*.

<sup>138</sup> Garner, et al., *Black's Law Dictionary*.

<sup>139</sup> After the enactment of Misrepresentation Act 1967.

<sup>140</sup> Rose, *Marine Insurance: Law and Practice*, § 5.14.

<sup>141</sup> As section 5, Consumer Insurance (Disclosure and Representations) Act 2012 provides, there are two types of misrepresentations falling within the scope of qualifying misrepresentations in consumer insurance, including deliberate/reckless (fraudulent) or careless (non-fraudulent/negligent) misrepresentations, which could be lessons for business insurance.

<sup>142</sup> Leslie Buglass, *Marine Insurance and General Average in the United States: An Average Adjusters*

leads to the conclusion that all misrepresentation is material.<sup>143</sup> Therefore, in the general law of contract, the principle is that no relief will be given for a misrepresentation as such unless it is a statement of existing fact, or of current legislation.<sup>144</sup>

Actionable misrepresentation is another concept in English contract law, which requires the claimant to establish that the information misrepresented is the statement of facts, which has induced the conclusion of a contract between them.<sup>145</sup> This common law concept does not include the cases of the misrepresenter's opinion and statement,<sup>146</sup> which are clarified as an individual category of misrepresentation in section 20(5), MIA 1906.

### **2.2.3. Representation in statute law – Misrepresentation Act 1967**

Prior to the administrative fusion of common law and equity made by the Supreme Court of Judicature Acts 1873 and 1875, the availability of rescission for misrepresentation was radically different at common law and equity. At common law, the contracts are only rescinded for fraudulent misrepresentation; while in equity, the rescinded situation includes innocent, fraudulent and total failure of consideration.<sup>147</sup> Since the Judicature Acts, the current common law and equitable jurisdictions in respect of fraudulent misrepresentation and total failure of consideration remain.<sup>148</sup> However, a duty of disclosure has never been recognized as an element of general

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*Viewpoint* (3<sup>rd</sup> ed., Cornell Maritime Press, 1991), pp. 26-33.

<sup>143</sup> William Gow, *Marine Insurance: A Handbook* (Reprint, BiblioBazaar, 2008), p. 273.

<sup>144</sup> Peel, *Treitel on The Law of Contract*, p. 362.

<sup>145</sup> Ewan MacIntyre, *Business Law* (6<sup>th</sup> ed., Britain: Longman, 2012), p. 167.

<sup>146</sup> Generally speaking, the misrepresentation of the defaulting party's opinion or statement is not actionable at common law. However, in exceptional cases, the professional or expert's opinion or statement is actionable. For example, the different knowledge degrees of a car dealer and a genuine customer and the notable case examples are *Oscar Chess v Williams* [1957] 1 WLR 370 and *Dick Bentley Productions v Harold Smith Motors* [1965] 1 WLR 623.

<sup>147</sup> Bennett, *The Law of Marine Insurance*, p. 101.

<sup>148</sup> *Ibid.*

contract law, either at common law or equity. But it should be noted that there is still a continuing duty to correct the inaccuracy after the statement.<sup>149</sup>

In the Misrepresentation Act 1967, section 2(1) mentions fraudulent misrepresentation and section 2(2) discusses non-fraudulent misrepresentation. It is mentionable that the latter allows the court to exercise discretion in the event of a non-fraudulent misrepresentation, inducing the making of any contract. For example, to substitute a remedy of damages in the event the rescission is sought, if the court considers that 'it would be equitable to do so' taking into account (a) the misrepresentation, (b) the loss to each party if the contract was rescinded and (c) the loss to each party if the discretion were exercised and the contract continued in existence.<sup>150</sup>

A possible solution to the harshness of an 'all or nothing' remedy for both fraudulent and non-fraudulent misrepresentations, might be the extension of section 2, Misrepresentation Act 1967, to the specialized insurance area. However, it is stated that there are few, if any, insurance cases to which this Act has been applied, even though damages have been sought by insurers for a misrepresentation inducing the insurance contract.<sup>151</sup> In contrast to the possibility of introducing this provision to insurance, its application to reinsurance is definitely rejected by one leading academic.<sup>152</sup>

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<sup>149</sup> *Ibid.*

<sup>150</sup> Rhidian Thomas, *Marine Insurance: The Law in Transition* (1<sup>st</sup> ed., London: Informa, 2006), § 3.68

<sup>151</sup> *Ibid.*, § 3.69.

<sup>152</sup> Confirmed by Merkin, *Marine Insurance Legislation*, by quoting *Highlands Insurance Co v Continental Insurance Co* [1987] 1 Lloyd's Rep. 109n.

## 2.3. Misrepresentation in the MIA 1906

In the MIA 1906, section 20(1) provides that the assumed assured or his agent must make right representations pending negotiation of contract, before the conclusion of contracts.<sup>153</sup> The ordinary principle of misrepresentation is confirmed by *Pan Atlantic*,<sup>154</sup> in which it was held (overruling earlier authority) that the underwriter himself must have been influenced by the misrepresentation.<sup>155</sup>

### 2.3.1. Material misrepresentation

Like the duty of disclosure imposed on the assured under section 18 MIA 1906, a representation is material which would influence the judgment of a prudent insurer in fixing the premium, or determining whether he will take the risk.<sup>156</sup> Hence, the duty to avoid making a material misrepresentation is confined to be a pre-formation duty.<sup>157</sup> Similarly, section 20(2) spells out that a representation is material which would influence the judgement of a prudent insurer in fixing the premium or determining whether he will take the risk. However, the draftsman of the Act did not explain about the test for 'materiality' here either, and this leaves enough discretion to the courts and judges to make decisions.<sup>158</sup>

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<sup>153</sup> Section 20(1), MIA 1906.

<sup>154</sup> *Pan Atlantic Insurance Co Ltd v Pine Top Insurance Co Ltd* [1994] 2 Lloyd's Rep. 427, HL.

<sup>155</sup> Merkin, *Marine Insurance Legislation*.

<sup>156</sup> Section 20(2), MIA 1906. Under the general contract law, the material misrepresentation is defined as '[a] false statement that is likely to induce a reasonable person to assent or that the maker knows is likely to induce the recipient to assent'. See Garner, et al., *Black's Law Dictionary*.

<sup>157</sup> Section 20(1), MIA 1906, it is provided that 'every material representation made by the assured or his agent to the insurer during the negotiations for the contract, and before the contract is concluded, must be true. If it be untrue the insurer may avoid the contract'.

<sup>158</sup> For example, *Pan Atlantic* [1994] 2 Lloyd's Rep. 427, HL, p. 452, per Lord Mustill. It is noticeable that after the full enforcement of the Consumer (Disclosure and Representations) Insurance Act 2012, the consumer assured's duty of disclosure would be totally abolished in consumer insurance and a 'reasonable assured' test would be adopted instead to judge a qualifying misrepresentation. The finalized test after being reformed in business insurance, including marine insurance is still uncertain.

There are some fundamental cases which are worth being mentioned here. In *Pan Atlantic*, it was fully unanimously supported by the judges that the subjective inducement should apply to non-disclosure as well as misrepresentation.<sup>159</sup> Lord Mustill alleged that the inducement was applicable to misrepresentation in marine insurance:

‘... I conclude that there is to be implied in the Act of 1906 a qualification that a material misrepresentation will not entitle the underwriter to avoid the policy unless the misrepresentation induced the making of the contract, using “induced” in the sense in which it is used in the general law of contract. This proposition is concerned only with material misrepresentations.’<sup>160</sup>

Therefore, it is suggested that in the first instance, the material test for misrepresentation is the same as that for non-disclosure in marine insurance. This means the actual inducement test is applicable to misrepresentation as well, although the inducement requirement has been created at general common law. However, as mentioned above, the ‘prudent insurer’ test of materiality is deemed to assign unfair workload to the non-professional assured against the backdrop of a prudent insurer, which becomes a strong reason in favour of modifying the law in favour of the assured, not just in the UK but also in some other countries.<sup>161</sup>

Furthermore, it is clarified that only a material misrepresentation avoids the policy. This factor further appears through the definition that a representation is a statement of the existence of some fact, or state of facts, ‘which is likely to induce an underwriter more readily to assume the risk by diminishing the estimate he would otherwise have formed of it’.<sup>162</sup> Logically, the facts which may reasonably be presumed likely to have such an influence on the judgment of a prudent underwriter

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<sup>159</sup> [1994] 2 Lloyd’s Rep. 427, HL, pp. 430, 431, 452, 453, 454, 465-467.

<sup>160</sup> *Ibid*, p. 452.

<sup>161</sup> For example, Australian Law Reform Commission, *Insurance Contracts*, p. 112.

<sup>162</sup> Gilman, et al., *Arnould’s Law of Marine Insurance and Average*, p. 709.

are called 'material facts', and literally, a statement of such facts is called a material representation.<sup>163</sup> The falsehood of a representation, on the other hand, will produce no effect on the insurance policy unless the statement misrepresented is material.<sup>164</sup> Finally, whether a particular representation be material or not is in each case a question of fact.<sup>165</sup>

After the materiality of the representation has been determined, then the next step of the inquiry is to ascertain whether the representation of circumstances is 'true'.<sup>166</sup> However, for this, sections 20(4) and (5) in the same Act list different criteria for different types of representations. The representation of fact must be substantially correct, and the representation of expectation or belief must be made in good faith. For this reason, it is required that the 'prudent insurer test' has been applied twice. The first time, it applies in terms of the materiality of the representation,<sup>167</sup> and secondly, in terms of the truth of the representation (especially in the case of representing a matter of fact).<sup>168</sup>

In addition to the principles which were firstly confirmed by *Pan Atlantic*, some limitations were further created by subsequent cases. In the first place, a misrepresentation must be made by the assured or his agent,<sup>169</sup> but not by an independent expert appointed by the underwriters to give advice on the risk. In

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<sup>163</sup> Sections 20(2) and (3), MIA 1906.

<sup>164</sup> Gilman, et al., *Arnould's Law of Marine Insurance and Average*, p. 709. For statutory support, see section 20, MIA 1906.

<sup>165</sup> Section 20(7), MIA 1906; also see case *Edwards v Footner* (1808) 1 Camp 530.

<sup>166</sup> Hodges, *Law of Marine Insurance*, p. 93.

<sup>167</sup> See previous paragraphs regarding the test of materiality to misrepresentation in insurance.

<sup>168</sup> Section 20(4), MIA 1906. It is noted that the prudent insurer is entitled with discretions to judge whether the difference between what is represented and what is actually correct would be considered material.

<sup>169</sup> According to Clarke's observation, reported cases include misstatements about bonus quotations, the conduct of the insurance company itself, the level of rates compared with those of other insurers, the terms of the cover on offer, and the amount of cover the insured would need. For details, see Clarke, *Law of Insurance Contracts*, para. 22-2C1.

*International Lottery Management v Dumas*,<sup>170</sup> it was held by the Queen's Bench Division that a reliable expert with little knowledge of the significance of material information did not satisfy the qualified duty of disclosure. In the second instance, for the general meaning of materiality, the post-contractual misrepresentation is submitted to be immaterial;<sup>171</sup> it is also proposed by a leading academic that a fraudulent misrepresentation always gives the underwriters the right to avoid, whether or not it is material.<sup>172</sup> Thirdly, in regards to the connection to the loss, under English law, whether or not the non-disclosure or misrepresentation has a causal connection with the loss is immaterial (if it materially affected the risk), the underwriter may avoid the policy. However, in the United States the effect of a material misrepresentation having no connection with the loss may depend upon State Statutes.<sup>173</sup>

### 2.3.2. Categorization

Section 20(3) of the MIA 1906 lists three circumstances in which the assumed assured or his agent must represent. It states that 'a representation may be either a representation as to a matter of fact, or as to a matter of expectation or belief.'<sup>174</sup> In practice, the distinction between a representation of fact and one of expectation is hard to draw.<sup>175</sup> In general, an unequivocal statement is likely to be construed as one

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<sup>170</sup> [2002] Lloyd's Rep. 596, para. 65, cited by Merkin, *Marine Insurance Legislation*, at section 17. Another example of academic support, see Clarke, *Law of Insurance Contracts*. This case is addressed with detail below.

<sup>171</sup> *Ionides v Pacific Fire & Marine Insurance Co* (1871) LR 6 QB 674; affirmed by the Court of Exchequer Chamber (1872) L.R. 7 Q.B. 517, cited by Merkin, *Marine Insurance Legislation*, at section 18.

<sup>172</sup> Merkin, *Marine Insurance Legislation*, at section 20(2).

<sup>173</sup> Buglass, *Marine Insurance and General Average in the United States: An Average Adjusters Viewpoint*, p. 27.

<sup>174</sup> Section 20(3), MIA 1906.

<sup>175</sup> *Highlands Insurance v Continental Insurance* [1987] 1 Lloyd's Rep. 109n; *Sirius International Insurance Corporation v Oriental Assurance Corporation* [1999] Lloyd's Rep IR 343.

of fact, whereas a statement as to a matter over which the assured has no control is more likely to be construed as a matter of expectation or belief.<sup>176</sup> Sections 20(4) and (5) then prescribe a criterion for determining whether the representation is true. Nevertheless, in general contract law, only false statements of existing or past fact are eligible to become an actionable misrepresentation.<sup>177</sup>

However, Templeman argues that there are three categories of representation: a representation as simply of a fact, a material fact, and of expectation or belief.<sup>178</sup> Moreover, *Arnould* holds that statement or misrepresentation may be either: (1) a positive affirmation by the assured, as of his own knowledge and upon his own responsibility, that the facts represented either do or will exist/positive representations, or (2) a mere declaration of his belief or expectation that such facts do or will exist/representations of belief, or (3) a mere communication of information which he has received from others respecting them/ representations of information. The MIA 1906 only recognizes the first two of these classes in section 20(3).<sup>179</sup> One reason for this understanding might be that the information misrepresented by the principal's broker is tantamount to a misrepresentation committed by the principal himself.<sup>180</sup>

### **2.3.2.1. Representation of fact**

As section 20(4) stipulates, a representation as to a matter of fact is true, if it is substantially correct. If the difference between what is represented and what is

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<sup>176</sup> Merkin, *Marine Insurance Legislation*; see also *Bowden v Vaughan* (1809) 10 East 415.

<sup>177</sup> For academic support, see Bennett, *The Law of Marine Insurance*, p. 152; and MacIntyre, *Business Law*, p. 144.

<sup>178</sup> Frederick Templeman and R. J. Lambeth, *Templeman on Marine Insurance: Its Principles and Practice* (6<sup>th</sup> Revised ed., Pitman, 1986), p. 34.

<sup>179</sup> Gilman, et al., *Arnould's Law of Marine Insurance and Average*, p. 713. According to *Arnould*, it is acceptable to treat the third class as a branch of the first class.

<sup>180</sup> Section 20, MIA 1906.



actually correct would not be considered material by a prudent insurer, the representation of fact is true.<sup>181</sup> Therefore, the representation of fact does not need to be the perfect truth. The truth or falsity of a representation is judged by reference to the time of conclusion of the contract (or such earlier time at which the [re]insurer commits itself to an obligation binding in the eyes of the market to accept the risk on certain terms), as is materiality.<sup>182</sup> And, a commercial man may be called as a witness to prove the meaning of any commercial statement; for instance, if it is said in a letter on a commercial subject that a ship will sail from St. Domingo in the month of October, it is generally understood that she will not sail till the 25<sup>th</sup> of the month.<sup>183</sup> One fundamental case on the subject of misrepresentation is *Pawson v Watson*,<sup>184</sup> in which it was represented that the ship carried 12 guns and 20 men while in fact she carried only nine guns, six swivels, 16 men, and nine boys. As this was held to be substantially correct, the insurer was unable to avoid the contract.

Thus, compared to the duty of disclosure, the usage of the 'prudent insurer' test in misrepresentation is more complex. In cases of disclosure, whether the information concealed is material or not, the prudent insurer's perspective is only made once. However, in the situation of making a right representation, the misrepresentation must be material from the prudent insurer's perspective by weighing whether it would influence him in fixing premium and whether accepting risks in question. Subsequently, the representation of fact must be substantially incorrect compared with the real fact, also judged by a prudent insurer. Thus, the 'prudent insurer' test

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<sup>181</sup> Section 20(4), MIA 1906.

<sup>182</sup> Bennett, *The Law of Marine Insurance*, p. 152.

<sup>183</sup> *Chaurand v Angerstein* (1791) Peake 43, cited by Merkin, *Marine Insurance Legislation*, at section 20(3).

<sup>184</sup> (1778) 2 Crowp 785.

has been applied twice in the latter case (especially in the case of representing a matter of fact).<sup>185</sup>

### **2.3.2.2. Representation of expectation and belief**

In the general law of contract, only false statements of existing or past fact are eligible to become actionable. Nevertheless, in marine insurance, apart from section 20(3), MIA 1906, about the representation of fact, it is also required that the representation of expectation and belief must be true. It has been stated that the wording of the MIA 1906 compels insurance contract law to diverge from general contract law with respect to such secondary representations.<sup>186</sup>

Furthermore, section 20(5) in the same law states that a representation as to a matter of expectation or belief is true if it is made in good faith, which also leads to the fine distinction drawn between the statement of fact, and statement of expectation and belief. With respect to this, Professor Bennett highlighted three principal cases.<sup>187</sup> In the leading contract law case of *Bissett v Wilkinson*,<sup>188</sup> a vendor of land made a representation regarding its sheep-bearing capacity. Although the vendor was a sheep farmer, the land in question had never been used for sheep farming, a circumstance the Privy Council regarded as the most material in concluding that the statement was one of belief. In *Bowden v Vaughan*,<sup>189</sup> a cargo owner's statement concerning the date of future sailing of the carrying vessel was held to be capable of constituting a representation of expectation only, a cargo owner having no control over the vessel's movements. Similarly, in *Rendall v Combined*

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<sup>185</sup> See the literal meaning of section 20(4), MIA 1906.

<sup>186</sup> Bennett, *The Law of Marine Insurance*, p. 153.

<sup>187</sup> *Ibid.*

<sup>188</sup> [1927] AC 177.

<sup>189</sup> (1809) 10 East 415.

*Insurance Co of America*,<sup>190</sup> a statement of 'estimated travel days' to be undertaken by employees in a proposal for business travel accident insurance was held to be a statement of belief.<sup>191</sup>

The case of *International Lottery Management Ltd v Dumas*<sup>192</sup> also reflects a practical phenomenon, in which the insurance policy is based on a proposal form, and the declaration that 'the answer given are true and complete to the best of the proposer's knowledge and belief' is covered as a clause in the proposal.<sup>193</sup> In fact, this kind of declaration only works within the proposal form, and any other misrepresentation made outside of the proposal form is not governed.<sup>194</sup> However, as viewed by Professor Bennett, there are some problems which need to be clarified. According to Bennett, it is clear from the decision of the House of Lords in *Pan Atlantic*<sup>195</sup> that section 20 is not to be read as an exhaustive code of the law of misrepresentation for the purposes of (marine) insurance contracts. Therefore, he suggested that section 20 should be read, if at all possible, in line with general contract law.<sup>196</sup>

### **2.3.2.3. Fraudulent and negligent /innocent misrepresentation**

To meet another different classification criteria, in general insurance law (also in contract law), it is commonplace to divide misrepresentation into fraudulent, negligent and innocent misrepresentation. In this situation, the classification criterion is the

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<sup>190</sup> [2005] 1 CLC 565.

<sup>191</sup> Bennett, *The Law of Marine Insurance*, p. 153.

<sup>192</sup> [2002] Lloyd's Rep IR 237, para. 65.

<sup>193</sup> Similarly, *Economides v Commercial Assurance Co plc* [1998] QB 587; also *Hummingbird Motors Ltd v Hobbs* [1886] RTR 276.

<sup>194</sup> *International Lottery Management Ltd v Dumas* [2002] Lloyd's Rep IR 237, para. 66. In this case the expert which was appointed by the underwriters on the risks in question unsatisfied the breach of disclosure.

<sup>195</sup> [1995] 1 AC 501, esp. 544-5, 570-1.

<sup>196</sup> Bennett, *The Law of Marine Insurance*, pp. 155-7. Chapter 3 of this thesis addresses the concerns of the insurance reform project in the Law Commissions.

notion of representors.<sup>197</sup> In one of the House of Lords cases, a fraudulent misrepresentation was finally defined to be one made either knowing that it was false, or without belief in its truth, or recklessly careless as to whether it was true or false.<sup>198</sup> Section 2(1) of the Misrepresentation Act 1967 provides the requirement of a negligent misrepresentation, which is that the maker of the misrepresentation cannot prove that it is made on an honest belief or reasonable grounds. On the contrary, as long as the representor can prove that the misrepresentation is made on his honest belief or reasonable grounds, then the misrepresentation can be treated as innocent.<sup>199</sup>

Accordingly, different remedies available for different types of misrepresentations are provided at common law. A remedy mechanism is supplemented by section 2, Misrepresentation Act 1967, granting different types of damages to the injured party.<sup>200</sup>

The current consequence of a misrepresentation in business insurance is more severe than at common law. It can render the insurance contract to be avoidable, irrespective of whether the misrepresentation is fraudulent or innocent (including negligent).<sup>201</sup> First of all, judging from the literal meaning of the statutory language itself, section 20 of the MIA 1906 does not express any intention to touch the difference between consequences caused by fraudulent and non-fraudulent misrepresentation. Secondly, it is supported by the judicial precedent of *MacDowell v Fraser* which held that a non-fraudulent misrepresentation rendered a marine policy

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<sup>197</sup> An assured who has not addressed his mind to the correctness or otherwise of his statement cannot be said to have acted in good faith. See *International Lottery Management v Dunas* [2002] Lloyd's Rep IR 237.

<sup>198</sup> *Derry v Peek* (1889) 14 App Cas 337, cited by MacIntyre, *Business Law*, p. 148.

<sup>199</sup> MacIntyre, *Business Law*.

<sup>200</sup> See previous paragraphs of this chapter in terms of the Misrepresentation Act 1967, which is repeated below regarding remedies available for misrepresentation in insurance.

<sup>201</sup> However, a proportionate remedy is provided to protect an innocent misrepresentor in consumer insurance by the Consumer Insurance (Disclosure and Representations) Act 2012, which is expounded in chapter 3.

voidable.<sup>202</sup> Also in the other leading case of *Ionides v Pacific Fire & Marine Ins.*<sup>203</sup> a cargo policy was held to be vitiated by an innocently made misrepresentation. Nevertheless, such division could be changed in the future, since the Consumer Insurance (Disclosure and Representations) Act 2012 simply identifies two types of qualifying misrepresentations, which are fraudulent (with dishonesty) and non-fraudulent (honest/innocent conducts including negligent and wholly innocent conducts) misrepresentations.<sup>204</sup>

### 2.3.3. Duration of duty

In business insurance, it is provided that every material representation made by the assured or his agent to the insurer during the negotiations for the contract, and before the conclusion of contracts, must be true.<sup>205</sup> Thus, like the duty of disclosure, the duty to make right representations is also a pre-contractual duty, and the duty will cease on the conclusion of the insurance contract. Finally, the representation can be withdrawn or corrected before the contract is concluded.<sup>206</sup>

The new Consumer Insurance (Disclosure and Representations) Act 2012 will be ideal in its application, although it is limited to consumer insurance only,<sup>207</sup> which could be a lesson to business insurance legislation. According to paragraphs 2-3 and part 2 of Schedule 1, the consumer's duty of misrepresentation is not limited to the negotiations of an insurance contract, but extended to any consequential pre-variation stages. It is not expressly extended to any reinsurance or renewal. However,

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<sup>202</sup> (1779) 1 Dougl 260, per Lord Mansfield.

<sup>203</sup> (1872) LR.7 QB 517.

<sup>204</sup> Section 5, Consumer Insurance (Disclosure and Representations) Act 2012. For more details, see chapter 3.

<sup>205</sup> Section 20(1), MIA 1906.

<sup>206</sup> Section 20(6), MIA 1906. Also see *Jones v Bangor Mutual Shipping Ins Society Ltd* (1890) 61 L.T. 727.

<sup>207</sup> In terms of the definitions of 'consumer' and 'consumer insurance' in the area of consumer insurance, see chapter 3.

in relation to the latter event, the Law Commission implies it as a negotiation of a new contract which falls within the pre-contract scope again.<sup>208</sup>

## 2.4. Remedies for misrepresentation

### 2.4.1. Actionable misrepresentation at common law

The general rule is that a misrepresentation generally has no legal effect unless it is material. That is, it must be one which would affect that judgement of a reasonable person in deciding whether, or on what terms, to enter into the contract without making such inquiries as he would otherwise make.<sup>209</sup>

There should be a pre- and post-era regarding the rescission for misrepresentation. Before the Judicature Act 1873-1875,<sup>210</sup> which administratively merged common law and equity, they adopted different manners to govern misrepresentation. At common law, the principal doctrine was that a contract could be rescinded for misrepresentation only on the ground of fraud, but this requirement of fraud was subject to several qualifications. If an innocent misrepresentation became a term of the contract, it might give rise to a right to rescind the contract for breach.<sup>211</sup> Whereas in equity, by contrast with common law, there was a general rule that a contract could be rescinded for 'innocent misrepresentation', and this phrase covers

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<sup>208</sup> The Law Commission and the Scottish Law Commission, *Consumer Insurance Law: Pre-contract Disclosure and Misrepresentation (Joint Report with Draft Bill)* (December 2009, Law COMNo 319/SCOT LAW COM No 219), available at <http://lawcommission.justice.gov.uk/areas/insurance-contract-law.htm>, accessed in January 2013, p. 58.

<sup>209</sup> Peel, *Treitel on The Law of Contract*.

<sup>210</sup> The Judicature Act 1873 was an Act of Parliament by the Parliament of the United Kingdom in 1873. It reorganized the English court system to establish the High Court and the Court of Appeal, and also originally provided for the abolition of the judicial functions of the House of Lords with respect to England (although under the Act it would have retained those functions in relation to Scotland and Ireland for the time being). However, the Gladstone Liberal government fell in 1874 before it came into force. The succeeding Disraeli Tory government suspended the Acts enforcement by means of further Acts passed in 1874 and 1875.

<sup>211</sup> Peel, *Treitel on The Law of Contract*.

every misrepresentation which was not fraudulent.<sup>212</sup> It is apparent that in current marine insurance, the equity approach prevails. In the view of this author, this conclusion is committed for the principal reason that each time common law conflicts with equity, equity prevails. This is a famous rule which was established by *The Earl of Oxford's Case* in Chancery<sup>213</sup> and subsequently applies to marine insurance.

After the Judicature Act 1873-1875, the general case-law rule for rescission for misrepresentation is that misrepresentation makes the contract voidable at the option of the representee.<sup>214</sup> In insurance, the MIA 1906 also adopts the same approach. At present, under the English legal system, the effects of different types of misrepresentations are distinguished. However, both types of misrepresentations (fraudulent and non-fraudulent) can avoid the whole contract.

It is submitted that there are five grounds based on which damages can be recovered for misrepresentation and the relationship between them.<sup>215</sup> First of all is fraud. At common law, a person who suffers loss as a result of acting in reliance on a fraudulent statement can recover damages based on the tort of deceit. The second ground, is negligence. At common law, a misrepresentation is negligent if it is made carelessly and in breach of a duty owed by the representor to the representee to take reasonable care that the representation is accurate. The third ground is fraudulent misrepresentation. The fourth ground, is if the representation became a contractual term. The fifth ground, is non-fraudulent misrepresentation under section 2 of the Misrepresentation Act 1967. Similarly, Rhidian Thomas also suggests that as

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<sup>212</sup> *Redgrave v Hurd* (1881) 20. Ch.D.1.

<sup>213</sup> 21 E.R. 485. Tensions between equity and the common law came to a head in 1615 in *The Earl of Oxford's Case*, where conflicting judgments of the common law courts and the Court of Chancery were referred to the king for a decision; he advised that where there was conflict, equity should prevail. Had this decision not been made, equity would have been worthless – it could not fulfil its role of filling in the gaps of the common law unless it was dominant.

<sup>214</sup> *Clough v L & NW Ry* (1871) L.r.7 Ex. 26 at 34; *Urquhart v Macpherson* (1878) 3 App. Cas. 831, p. 838.

<sup>215</sup> For example, see Peel, *Treitel on The Law of Contract*, chapter 8.

regards the pre-contractual duty, there may be an award of damages, (a) in the tort of deceit, (b) pursuant to the Misrepresentation Act 1967 (as of right if made without reasonable grounds or pursuant to the court's discretion if made innocently), (c) if a failure to observe a duty of care can be established, or (d) if a breach of a contractual promissory obligation can be proved.<sup>216</sup> Part of Professor Thomas' opinion is supported by the judgment in *Banque Keyser v Skandia*, which is addressed below.

Then, do damages co-exist with equitable rescission in this situation? If damages are available on these alternative grounds, it is difficult to see why compensation should not be available for a simple breach of the duty of good faith,<sup>217</sup> which is also concerned regarding the insurance broker's utmost good faith breach event. However, in *Banque Keyser v Skandia*<sup>218</sup> the Court of Appeal held that in insurance, damages were not available for a breach of the duty of good faith simpliciter,<sup>219</sup> and it has been said that the court's reasons 'do not stand up to scrutiny'.<sup>220</sup> This part of judgment was then confirmed by Lord Templeman in the House of Lords in the same case.<sup>221</sup> The exclusive position of an avoidance remedy in insurance was further strengthened by subsequent cases.<sup>222</sup> The coexisting authorities and principles still cannot keep the insurance remedies mechanism for utmost good faith breach from being criticised. Till now, it becomes logical and apparent that when people are blaming the draconian remedy for the wholly innocent defaulting parties, in the

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<sup>216</sup> Thomas, *Marine Insurance: The Law in Transition*, § 3.74

<sup>217</sup> *Ibid*, § 3.75, and Professor Thomas's opinion is that since the duty (of good faith) is a common law duty and the classic common law remedy is that of damages, it is difficult to imagine any other case of a breach of a common law duty not attracting a remedy in damages.

<sup>218</sup> *Banque Keyser v Skandia* [1988] 2 Lloyd's Rep. 513, CA.

<sup>219</sup> The court also held that damages were not available for negligence because a duty of care to make full disclosure did not usually arise out of the relationship between the insurer and assured.

<sup>220</sup> For more commentary on this decision, please see Thomas, *Marine Insurance: The Law in Transition*, § 3.76-3.83.

<sup>221</sup> *Banque Keyser v Skandia* [1990] 2 Lloyd's Rep. 377, HL, p. 387, per Lord Templeman.

<sup>222</sup> For example, *Bank of Nova Scotia v Hellenic Mutual War Risk Association (Bermuda) Ltd (The Good Luck)* [1989] 2 Lloyd's Rep. 238; *Norwich Union Life Insurance Co Ltd v Qureshi* [2000] Lloyd's Rep. I.R. 1.



meanwhile, they are planning to extend the equitable remedy in the Misrepresentation Act 1967 to insurance. It is still deemed to be strange by some leading academics that the lack of a remedy in damages is not accepted as part of the background to the duty of good faith.<sup>223</sup>

#### **2.4.2. Equitable remedy in section 2(2) of the Misrepresentation Act 1967**

In section 2(1), it is stated that if one party has entered into a contract after a fraudulent misrepresentation committed by the other party, and as a result he has suffered loss, the defaulting party should be liable for damages.<sup>224</sup> A statutory proportionality remedy is introduced into resolutions for misrepresentation in the general law of contract by section 2(2) in the same Act. It provides that:

‘Where a person has entered into a contract after a misrepresentation has been made to him otherwise than fraudulently, and he would be entitled, by reason of the misrepresentation, to rescind the contract, then, if it is claimed, in any proceedings arising out of the contract, that the contract ought to be or has been rescinded, the court or arbitrator may declare the contract subsisting and award damages in lieu of rescission, if of opinion that it would be equitable to do so, having regard to the nature of the misrepresentation and the loss that would be caused by it if the contract were upheld, as well as to the loss that rescission would cause to the other party.’<sup>225</sup>

It can be concluded that, in the Misrepresentation Act 1967, the consequence for a fraudulent or negligent misrepresentation, is that the injured party can rescind the contract, and claim for damages in tort. On the other hand, the consequence for a non-fraudulent misrepresentation (especially the wholly innocent misrepresentation)

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<sup>223</sup> Thomas, *Marine Insurance: The Law in Transition*, § 3.83.

<sup>224</sup> Section 2(1) of the Misrepresentation Act 1967 states that ‘[w]here a person has entered into a contract after a misrepresentation has been made to him by another party thereto and as a result thereof he has suffered loss, then, if the person making the misrepresentation would be liable to damages in respect thereof had the misrepresentation been made fraudulently, that person shall be so liable notwithstanding that the misrepresentation was not made fraudulently, unless he proves that he had reasonable ground to believe and did believe up to the time the contract was made that the facts represented were true’.

<sup>225</sup> Section 2(2), Misrepresentation Act 1967.

is that the other party can require rescission of the contract, but, the court is awarded the discretion to sentence damages, in lieu of rescission.

Therefore, section 2(2) of the Act creates a judicial discretion in cases of non-fraudulent misrepresentation, to declare ineffective a rescission of the contract (or deny the remedy if not already exercised) and instead to effect a financial adjustment between the parties through an award of damages.<sup>226</sup> However, it should be noticed that the statutory discretion cannot be exercised in respect of reinsurance contracts.<sup>227</sup> Furthermore, this statutory provision should not be considered as removing any residing discretion in the court of equity. It merely gives the court a power to award damages in cases of misrepresentation, in lieu of rescission, which it did not previously have.<sup>228</sup>

It can be concluded that in English case-law for general contracts, all three types of actionable misrepresentations (fraudulent, negligent and wholly innocent misrepresentations) may have the whole contract rescinded up to the injured party's option, and in the meanwhile, these three types of misrepresentations could give rise to discretionary damages by court.<sup>229</sup> Accordingly, at the practical level, in cases of fraudulent misrepresentation, the injured party is awarded with a right of contract rescission and damages assessed on tort of deceit. In cases of negligent misrepresentation, the injured party is usually awarded a right to rescind the contract, but the discretionary contract damage might be awarded in lieu of rescission on the basis of section 2(2), Misrepresentation Act 1967. At the same time, more damages assessed on a tort of deceit basis are also available. In cases of innocent misrepresentation, the injured party is usually awarded with the right to have the

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<sup>226</sup> Bennett, *The Law of Marine Insurance*, p. 161.

<sup>227</sup> Merkin, *Marine Insurance Legislation*, at section 20(3); Thomas, *Marine Insurance: The Law in Transition*, § 3.69.

<sup>228</sup> Thomas, *Marine Insurance: The Law in Transition*, § 3.69.

<sup>229</sup> MacIntyre, *Business Law*, pp. 148-149.

contract rescinded, but the discretionary contract damage might be awarded in lieu of rescission on the basis of section 2(2), Misrepresentation Act 1967.

### **2.4.3. Remedies for misrepresentation under the MIA 1906 and timing of such claims**

#### **2.4.3.1. Remedies for misrepresentation and timing of such claims**

In section 20(1) of the MIA 1906, the representation must be true, or the insurer may avoid the contract. Thus, as with breach of the duty of disclosure, the consequence is that the contract may be avoided by the innocent party. Hence according to *Arnould*, on the principles of equity and justice, the non-disclosure or misrepresentation by the assured, whether intentional or not, of any facts which if truly represented or disclosed would be likely to influence the judgement of a prudent insurer and the misrepresentation or non-disclosure of which did in fact influence the underwriter in taking the risk or fixing the rate of premium, will give the latter a right to avoid the policy.<sup>230</sup>

Nevertheless, by contrast, avoidance could not be justified as the response to post-contractual breaches of good faith, where the rewarding could be 'anomalous and disproportionate'.<sup>231</sup> In *The Star Sea*,<sup>232</sup> according to Lord Hobhouse's judgment, such remedy would become effectively penal. The MIA 1906 does not mandate the time for election in relation to remedies. However, in almost all cases, the fact has been that the non-disclosure or misrepresentation by the assured was only

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<sup>230</sup> Gilman, et al., *Arnould's Law of Marine Insurance and Average*, p. 741.

<sup>231</sup> Rose, *Marine Insurance: Law and Practice*, § 5.91. See also *Manifest Shipping Co Ltd v Uni-Polaris Insurance Co Ltd (The Star Sea)* [2001] 1 Lloyd's Rep. 389, HL, para. 51.

<sup>232</sup> *Manifest Shipping Co Ltd v Uni-Polaris Insurance Co Ltd (The Star Sea)* [1995] 1 Lloyd's Rep. 651, Q.B.; [1997] 1 Lloyd's Rep. 360, C.A.; [2001] 1 Lloyd's Rep. 389, HL. In the House of Lords' judgment, Lord Hobhouse provided an example to illustrate the avoidance remedy's harshness for the assured's breach of good faith after the making of but still during the currency of insurance.

discovered after a total loss had become known, or after the insured voyage had terminated.<sup>233</sup> In such circumstances, the question of election is of no practical importance and has never arisen. However, when the underwriter becomes aware that he is entitled to avoid the contract (before the voyage or period insured has come to an end), it may make a great difference to the assured whether the underwriter makes his election immediately or delays making it. Till now it is still left undecided whether the party entitled to elect must do so within a reasonable time, or whether he may repudiate the contract at anytime.<sup>234</sup>

Apart from the aforementioned issues, there is another question which is noticeable here. Is a 'materiality' factor required for fraudulent misrepresentation? At this point, the academic scholars and judiciary have reached a consensus. When it refers to fraud, materiality should be excluded.<sup>235</sup> Therefore, a fraudulent misrepresentation always gives the underwriter the right to avoid, whether or not it is material.<sup>236</sup> And if a policy be avoided by a mere misrepresentation without actual fraud, the assured is entitled to a return of premium.<sup>237</sup> Whereas, a fraudulent misrepresentation will deprive the defaulting assured from a return of premium.<sup>238</sup>

In addition to the express affirmation of a policy with knowledge of facts which can prevent the insurer from avoiding the policy, *Arnould* further states that the underwriter is also precluded from avoiding the policy if the rights of third parties have intervened, or if the assured has altered his position in the belief that the

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<sup>233</sup> Michael Mustill and Jonathan Gilman, *Arnould's Law of Marine Insurance and Average* (1981, 16<sup>th</sup> ed., London, Stevens & Sons), Volume II, p. 439. However, the latest edition does not mention this point at all for some reasons.

<sup>234</sup> *Ibid.*

<sup>235</sup> This is supported by *Arnould*, Professor Howard Bennett, Dr Susan Hodges, Professor Robert Merkin, etc. For judicial support, see *Sibbald v Hill* (1814) 2 Dow 263; *Bedouin, The* [1894] P. 1.

<sup>236</sup> Merkin, *Marine Insurance Legislation*.

<sup>237</sup> Unless the policy otherwise provides. See *Duckett v Williams* (1834) 2 Crompt. & M. 348; *Thomson v Weems* (1884) 9 App. Cas. 671.

<sup>238</sup> Section 84 (1), MIA 1906.

contract was a subsisting one.<sup>239</sup> However, the precondition is that before this doctrine can operate, the underwriter must have full knowledge of the facts entitling him to avoid the policy.

#### **2.4.3.2. Query in relation to remedies for innocent misrepresentation**

It has been stated that the legal consequence is too harsh for the party at fault, (particularly a party who made a negligent or innocent misrepresentation), since the remedy is a standard 'all or nothing'.<sup>240</sup> Consequently, an inadvertent breach resulting from an innocent mistake is as fatal as a calculated concealment. Therefore, introducing the 'proportionality approach' at common law to the marine insurance area is raised as a decisive issue. Reference to this can be found in the Australian report, *Review of the Marine Insurance Act 1909*,<sup>241</sup> and the reports made by Law Commissions in the UK.<sup>242</sup>

There are some practical restrictions on the applicability of section 2(2) of the Misrepresentation Act 1967 in insurance contract law. First, section 2(2) requires that a 'misrepresentation' be 'made'. It has been argued by scholars<sup>243</sup> and accepted by

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<sup>239</sup> Mustill and Gilman, *Arnould's Law of Marine Insurance and Average*, Volume II, p. 442. However, this paragraph is not found in the latest edition. See *McCormick v Naitonal Motor & Accident Ins. Union* (1934) 49 L1. L. Rep. 361; *Evans v Bartlam* [1937] A.C. 473; *Suisse Atlantique Societe d'armament maritime S.A. v N.V. Rotterdamsche Kolen Centrale* [1967] 1 A.C. 361, p. 426.

<sup>240</sup> For example, Bennett, *The Law of Marine Insurance*, p. 160, note 343.

<sup>241</sup> Australia Law Reform Commission, *Review of the Marine Insurance Act 1909* (2001, ALRC 91), available at <http://lawcommission.justice.gov.uk/areas/insurance-contract-law.htm>, accessed in January 2013.

<sup>242</sup> Available at <http://lawcommission.justice.gov.uk/areas/insurance-contract-law.htm>, accessed in January 2013. The reforming history is addressed deeply in chapter 3. This relates to a joint review of insurance contract law conducted by the Law Commission and Scottish Law Commission, including Issue Papers (1-9), Scoping Paper, Consultation Papers 1-3, Responses to Consultation Papers, Report and draft bill, and also The Consumer Insurance (Disclosure and Representations) Act 2012 (which was approved on the 8 March 2012 and hopefully it will come into force shortly after one year after its enactment), etc. Moreover, the discussion range covers almost each aspect of insurance matters, including both consumer and business insurance.

<sup>243</sup> Sir Guenter Treitel, *Law of Contract* (11<sup>th</sup> edition, Thomson, 2003), pp. 402-403; Bennett, *The Law of Marine Insurance*, p. 162.

the Court of Appeal,<sup>244</sup> that this wording should not include pure non-disclosure although half-truth should be covered.<sup>245</sup>

Secondly, in *Highlands Insurance Co v Continental Insurance Co*,<sup>246</sup> Justice Steyn expressed the view that avoidance should never be denied in commercial insurance for fear of undermining the policing function of the remedy in ensuring a fair presentation of the risk. It may be argued that the unqualified reference to avoidance rights in sections 17 and 20 of the MIA 1906 should not be read as impliedly modified by the Misrepresentation Act 1967 since there is no evidence found.

Thirdly, and more fundamentally, the question arises of whether the remedy of 'avoidance', as prescribed by the MIA 1906, for failure to act in good faith is the same remedy as 'rescission' for misrepresentation under section 2, Misrepresentation Act 1967. As previously discussed in reference to the business assured's disclosure, if avoidance is but another label for rescission, section 2(2) of the Misrepresentation Act 1967 will confer a discretion to refuse (to recognize) avoidance of an insurance contract in cases of non-fraudulent misrepresentation, albeit not for non-disclosure. If it is technically a different remedy, albeit one that operates in the same way as rescission, section 2(2) of the Misrepresentation Act 1967 will have no application.

In Professor Francis Rose's work on marine insurance, it is stated that the difference between consequences at common law and marine insurance contract law is that misrepresentation in general contract law may give rise to a number of remedies which can often be cumulative, such as equitable rescission and damages

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<sup>244</sup> *Banque Keyser Ullman SA v Skandia (UK) Insurance Co Ltd* [1988] 2 Lloyd's Rep. 513, CA.

<sup>245</sup> At common law, a statement which is not entirely false but a half-truth may be a misrepresentation. *Dimmock v Hallett* (1866-67) LR 2 Ch App 21 held that a statement that a property was let, and therefore producing income, was a misrepresentation because it was not revealed that the tenants had given notice.

<sup>246</sup> [1987] 1 Lloyd's Rep. 109, p. 118.

on a contract or tort basis.<sup>247</sup> In the context of insurance, the interest of the insurer will ordinarily be met if he can reject the claim made, or more generally set aside the policy which resulted from the misrepresentation or non-disclosure. This is usually termed 'avoidance' in the insurance context, in contrast to 'rescission' in the general law, although it appears no different in practice.<sup>248</sup> The dissonance that would result from a discretion that extended to misrepresentation but not to non-disclosure perhaps suggests that this view is preferable.<sup>249</sup>

Whether the 'proportionality approach' in the Misrepresentation Act 1967 can be extended to marine policies is always a critical issue. *Arnould's* reasons to oppose this suggestion are:

'(1). [B]eing specifically concerned with marine policies, provisions of the MIA 1906 prevail over the 1967 act (Misrepresentation Act 1967); (2). even if the 1967 Act is to be regarded as giving the courts jurisdiction to restrict a party to a marine policy to a remedy in damages for non-fraudulent misrepresentations, it is submitted that having regard to the fact the avoidance of the policy has been firmly established as the appropriate remedy it is in the highest degree unlikely that a court would regard it as equitable so to restrict the rights of the parties. Thus at most the effect of s 2(2) of the Misrepresentation Act 1967, in relation to marine policies, is to enable a party who wishes to claim damages as an alternative to avoidance of a policy for a purely innocent misrepresentation to invite the court to adopt this course.'<sup>250</sup>

Bennett has made suggestions about the 'proportionality approach' in the insurance context. He states that in deciding whether to exercise its discretion, a court could take into account the innocence or negligence of the assured's breach (it may be relevant whether responsibility for the breach lies with the assured or with the broker who placed the risk), and the relative consequences of denying or permitting

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<sup>247</sup> See 2.4.2 of this chapter for detailed analysis. For Francis Rose's discussion, see Rose, *Marine Insurance: Law and Practice*, chapter 5.

<sup>248</sup> See chapter 1 of this thesis.

<sup>249</sup> Bennett, *The Law of Marine Insurance*, p. 163.

<sup>250</sup> Gilman, et al., *Arnould's Law of Marine Insurance and Average*, pp. 742-3.

allowance.<sup>251</sup> So where no loss has occurred, allowing avoidance does not prejudice the assured's benefit and the assured can seek an alternative cover. However, where loss has occurred, avoidance will prejudice the assured by denying any indemnities. For example, after one year's enforcement of an insurance contract, the premium has been paid appropriately and a claim for a loss covered by the insurance has arisen and been paid. However, towards the end of the period, the assured fails to observe utmost good faith which discharges the insurer from both his further liabilities and that which has gone perfectly properly before.<sup>252</sup>

According to Professor Bennett, in cases where compliance with the duty to make right representation would have resulted in merely a higher premium which the assured would have paid, the contract could be declared continued subject to an award of damages equivalent to that additional premium. In cases where the insurer would either have declined the risk altogether or would have insisted on certain limitations in the policy, it might be appropriate to allow avoidance or, alternatively, to award a more substantial sum by way of damages. Additionally, Bennett also suggests that in considering whether to allow avoidance in such a situation, a court would have to take into account, not merely the existing losses claimed by the assured, but also the prospect and scale for further losses arising under the voidable policy.<sup>253</sup> In the view of this author, any consequential losses are recoverable on a tort basis, as long as the general contract and tort law rules are introduced to insurance, which can be described as a big challenge.

Additionally, Professor Robert Merkin emphasizes that, in principle, section 2(2) of the Misrepresentation Act 1967 ought not to be used in reinsurance cases, although

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<sup>251</sup> Bennett, *The Law of Marine Insurance*, p. 162.

<sup>252</sup> *Manifest Shipping Co Ltd v Uni-Polaris Insurance Co Ltd (The Star Sea)* [2001] 1 Lloyd's Rep. 389, HL, p. 495.

<sup>253</sup> Bennett, *The Law of Marine Insurance*, p. 162.



its use in marine insurance remains possible,<sup>254</sup> which is fully supported by Thomas.<sup>255</sup> This opinion just brings out another pitfall of extending the general rule to a specialized insurance area.

Reflecting the modifications made to the Consumer Insurance (Disclosure and Representations) Act 2012, it can be concluded that the harshness is appropriately redressed. This is especially significant for the innocent misrepresenter by providing a proportionate reduction of claim amount without excluding other possible remedies, including avoidance under some circumstances.<sup>256</sup> However, for commercial marine insurance, whether it will be changed or not, is still under consultation.

## 2.5. Representation and warranty

### 2.5.1. Warranty in contract law and insurance law

Sections 33 to 41, MIA 1906, refer to the marine insurance warranty. According to general contract law, a warranty is a minor term in a contract, and the breach of which is negligible. Therefore, the warranty breach results in a remedy only for damages.<sup>257</sup> The fundamental cases of *Bettini v Gye*<sup>258</sup> and *Poussard v Spiers*<sup>259</sup> firstly finalized the main differences between a condition and a warranty term in contract law. Under these two leading cases, the performer in question missed the

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<sup>254</sup> Merkin, *Marine Insurance Legislation*.

<sup>255</sup> Thomas, *Marine Insurance: The Law in Transition*, § 3.69. In this book, it is stated that '[i]ndeed, Steyn J (as he then was) said that, as a matter of policy, the discretion should not be exercised in respect of reinsurance contracts'. This comment should not be taken as legislating against the exercise of this statutory discretion in all cases of a non-fraudulent misrepresentation inducing the making of an insurance contract. See also *Highlands Insurance Co v Continental Insurance Co* [1987] 1 Lloyd's Rep. 109, 118. This comment should not be taken as legislating against the exercise of this statutory discretion in all cases of a non-fraudulent misrepresentation inducing the conclusion of an insurance contract.

<sup>256</sup> Schedule 1, Consumer Insurance (Disclosure and Representations) Act 2012. For details, see chapter 3.

<sup>257</sup> MacIntyre, *Business Law*.

<sup>258</sup> (1876) 1 QB 183.

<sup>259</sup> (1876) 1 QB 410.

first six rehearsals and another performer missed the first four performances of the performance contract. Based on the degrees of importance of the breached terms, the first employee was judged to be in a warranty breach, while the second employee was judged to be in a conditional breach. According to these two cases, it can be concluded that the breach of a conditional term, which goes to the root of a contract, may entitle the injured party to a right of terminating the contract and claiming contractual damages. On the one hand, a breach of a warranty term, which is inessential to a contract, may entitle the injured party to a right of remedy for contractual damages only. Meanwhile, in order to deal with the contract term, which is hard to tell from its superficial value whether it goes to the root of contract, the innominate term was created. It was established in *Hong Kong Fir Shipping Co Ltd v Kawasaki Kisen Kaisha Ltd*<sup>260</sup> which also further confirmed that in order to judge the remedies available for breach, the effect of such a breach needs to be checked.<sup>261</sup> Therefore, with an absence of clarifications, if the injured party is substantially deprived of the whole benefit of the contract, the breach can be treated as a conditional breach, so the contract can be repudiated and the injured party can claim contractual damages. On the contrary, if the breach is equal to a warranty breach, the injured party is entitled to a right of contractual damages only.<sup>262</sup>

Unlike contract law, a warranty in insurance amounts to a major conditional term in contract law, the breach of which may discharge the injured party from his liability as from the date of the breach of warranty.<sup>263</sup> The promissory warranty in insurance is divided into two groups: express warranty<sup>264</sup> and statutory implied warranty particular

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<sup>260</sup> [1961] 2 Lloyd's Rep. 478, CA.

<sup>261</sup> MacIntyre, *Business Law*.

<sup>262</sup> This rule has been applied for many cases in English contract law.

<sup>263</sup> Section 33(3), MIA 1906.

<sup>264</sup> Sections 33-38, MIA 1906. For judicial support, see *Bean v Stupart* (1778) 1 Doug 11; *De Hahn v Hartley* (1786) 1 TR 343; *Pawson v Watson* (1778) 2 Cowp 786; *Muirhead v Forth & North Sea*

to marine insurance.<sup>265</sup> In addition to the expressed warranties of neutrality and good safety listed by the Act,<sup>266</sup> some more examples are provided by current clauses subject to English law and practice.<sup>267</sup> For example, Clause 1.1 of the ITCH 2009 stipulates that:

‘The vessel is covered subject to the provisions of this insurance at all times and has leave to sail or navigate with or without pilots, to go on trial trips and to assist and tow vessels or craft in distress, but it is warranted that the vessel shall not be towed, except as is customary or to the first safe port or place when in need of assistance, or undertake towage or salvage services under a contract previously arranged by the Assured and/or Owners and/or Managers and/or Charterers. This Clause 1.1 shall not exclude customary towage in connection with loading and discharging.’

In its subsequent clauses, the ITCH 2009 provides more practical examples of expressed warranties, such as the classification clause,<sup>268</sup> and the disbursements warranty.<sup>269</sup>

Sections 39-41, MIA 1906, address examples of implied warranties, such as the implied warranty of ship seaworthiness and portworthiness,<sup>270</sup> cargoworthiness,<sup>271</sup>

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*Steamboat Mutual Insurance Association* [1894] AC 72, etc. A warranty can be committed concerning matters such as the navigation time and areas, voyage duration and purposes, the number of crew, etc.

<sup>265</sup> Sections 39-41, MIA 1906.

<sup>266</sup> Sections 36 and 38, MIA 1906.

<sup>267</sup> Susan Hodges, *Cases and Materials on Marine Insurance Law*, (Reprint, Routledge, 1999), pp. 289-290.

<sup>268</sup> Clause 4.1, ITCH 2009, notes that:

‘Unless the Underwriters agree to the contrary in writing, this insurance shall terminate automatically at the time of

4.1 change of the Classification Society of the vessel, or change, suspension, discontinuance, withdrawal or expiry of her Class therein, provided that if the vessel is at sea such automatic termination shall be deferred until arrival at her next port. However where such change, suspension, discontinuance or withdrawal of her Class has resulted from loss or damage which would be covered by an insurance of the vessel subject to current Institute Time Clauses Hulls or Institute War and Strikes Clauses Hulls-Time such automatic termination shall only operate should the vessel sail from her next port without the prior approval of the Classification Society,...

For judicial support, see *Gandy v Adelaide Marine Insurance Co* (1871) LR 6 QB 746.

<sup>269</sup> Clause 22, ITCH 2009. For judicial support, see *Thames and Mersey Marine Insurance Co Ltd v ‘Gunford’ Ship Co Ltd* [1911] AC 529, HL.

<sup>270</sup> Section 39, MIA 1906.

<sup>271</sup> Section 40(2), MIA 1906.

and adventure legality.<sup>272</sup> However, the time policy is distinguished from the voyage policy, by verifying that there is an implied warranty of seaworthiness in a voyage policy, but no such warranty at any stage of the adventure in a time policy.<sup>273</sup> For a voyage policy, section 40(2) provides that an implied warranty of cargoworthiness is required for a voyage policy, at the commencement of the voyage.

A warranty requires exact compliance, a breach of which leads to the insurance policy to be terminated by the injured party. As section 33(3) suggests, a warranty must be exactly complied with, and a breach of warranty will discharge the insurer from his liability as from the date of the breach of warranty. Therefore, according to this Act, if there is any deviation from the warranty term, both trivial and vital, there is a breach of warranty in insurance established, and whether there is a causal link between the breach and loss does not matter.<sup>274</sup> Afterwards, *Bank of Nova Scotia v Hellenic Mutual War Risks Association (Bermuda) Ltd*<sup>275</sup> affirmed that a warranty breach might discharge the insurer from his liability from the date of the breach, without considering if the defaulting party himself was aware of the breach or not. Finally, it is notable that as long as the warranty breach is proved, no further remedy is available to have it fixed.<sup>276</sup>

### **2.5.2. Representation and warranty in insurance law**

There are some distinctions between a representation and a warranty in insurance. Firstly, representation is a verbal or written statement made by the assured or his

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<sup>272</sup> Section 41, MIA 1906.

<sup>273</sup> Sections 39(1) and (5), MIA 1906. See *Christie v Secretan* (1799) 8 TR 192 – a voyage policy and *Gibson v Small* (1853) 4 HL Cas 353, a time policy.

<sup>274</sup> For example, *Bond v Nutt* (1777) 2 Cowp 601; *Bennett v Axa Insurance plc* [2004] Lloyd's Rep. IR 615.

<sup>275</sup> *The Good Luck* [1991] 2 Lloyd's Rep. 191, HL, pp. 201-203, per Lord Goff.

<sup>276</sup> *Forshaw v Chabert* (1821) 3 Br & B 159.

agent to the underwriter at the time of the making of the contract. Hence, representation only has effect at or before the contract is concluded, and it is not inserted as a contract term. However, warranty must be a contract term.

Secondly, the test of materiality must be applied to non-disclosure and misrepresentation. Since a representation is not inserted into the contract, the assured is not tied down to the same rigid and literal compliance with its terms as he is in the case of a warranty.<sup>277</sup> A warranty must be exactly complied with, whether material or not, and even a minor deviation from the term warranted under the insurance policy constitutes a breach.<sup>278</sup> It is sufficient that a representation be merely substantially correct.<sup>279</sup>

Thirdly, in terms of the nature of remedies under these two circumstances, a distinction is drawn below in marine insurance. In cases of an utmost good faith breach, including non-disclosure and misrepresentation at the contemplation of insurance policies, the whole insurance is avoidable up to the injured party's option, which is described as a retrospective remedy.<sup>280</sup> Nevertheless, in cases of a warranty breach, the injured insurer is entitled a right to terminate the contract as from the date of the warrant is breached with no extra remedy considered.<sup>281</sup>

Despite the above main distinctions drawn between representation and warranty in insurance, it is interesting to find that at the practical level, the assured's representation is capable of being converted into a warranty by adding extra

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<sup>277</sup> Gilman, et al., *Arnould's Law of Marine Insurance and Average*, pp. 706-9.

<sup>278</sup> As to the interpretation of contract terms, after 1998 the courts have manipulated the meaning of contractual language where they felt it necessary to reflect the commercial object or purpose of the contract (the purposive approach). See *GE Frankona Reinsurance Ltd v CMM Trust No 1400 (The Newfoundland Explorer)* [2006] EWHC 429, Insurance and Marine Insurance, which demonstrates the purposive approach of construction of contractual terms. Subsequently, this approach has been firmly entrenched and most commonly used as the *contra proferentem* rule and the *ejusdem generis* rule.

<sup>279</sup> Buglass, *Marine Insurance and General Average in the United States: An Average Adjusters Viewpoint*, p. 31.

<sup>280</sup> Sections 17-20, MIA 1906.

<sup>281</sup> Section 33, MIA 1906.

provisions. According to *Dawsons Ltd v Bonnin*,<sup>282</sup> an insurer may add a declaration or extra provisions to a proposal form, stating that the consumer warrants the answers are accurate. As a result of this declaration, the assured's representation is turned into warranties and even immaterial misrepresentation is considered as a warranty breach, which leads to the termination of an insurance contract. However, on the basis of the newly enacted Consumer Insurance (Disclosure and Representations) Act 2012, such conversion is prohibited.<sup>283</sup>

## 2.6. Conclusion

Like the duty of disclosure in marine insurance, the principles to make right representations also stem from the fountain of *uberrimae fidei* in section 17 of the MIA 1906. However, such a statement could be changed after the enactment and eventually coming into force of the Consumer Insurance (Disclosure and Representations) Act 2012. The similarities between the duties of disclosure and representation in marine insurance are the test for materiality, and also the legal consequences of non-disclosure and misrepresentation. Additionally, the 'actual inducement' test which is finally established by the *Pan Atlantic* case for material non-disclosure is applicable to material misrepresentation as well.<sup>284</sup>

The differences between these two duties are purposes, and thresholds for 'materiality'. Just as Dr Susan Hodges summarizes, a representation is not a term of the contract of insurance, but a statement made during negotiations to induce the insurer to enter into the contract. Its purpose is to persuade the potential insurer to

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<sup>282</sup> (1922) 12 Ll. L. Rep. 237.

<sup>283</sup> Section 6, Consumer Insurance (Disclosure and Representations) Act 2012.

<sup>284</sup> [1995] 1 AC 501, p. 549.

accept the risk, or to accept the risk at a lower premium. On the other hand, non-disclosure is a concealment of facts which tend to show the risk to be greater than it would otherwise appear.<sup>285</sup> As to the different threshold(s) for materiality in non-disclosure and misrepresentation in marine insurance, as discussed above, the 'prudent insurer' test is applied only once in former cases, while twice in misrepresentation cases.

There are increasing calls for reforms, with regard to the test for materiality (prudent insurer or reasonable assured), and the remedies for wholly innocent misrepresentation (the opponents allege that 'rescission' *ab initio* is too harsh in this circumstance). It is also hoped to extend the concise two-part classification of qualifying misrepresentations and the 'proportionality approach' in statute law to non-consumer marine insurance contracts, which has been successfully introduced to consumer insurance with the enactment of the Consumer Insurance (Disclosure and Representations) Act 2012.<sup>286</sup>

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<sup>285</sup> Hodges, *Law of Marine Insurance*, p. 93.

<sup>286</sup> This newly launched legislation is focused on consumer insurance only. However, relevant topics are expounded in chapter 3.

## CHAPTER 3

### UTMOST GOOD FAITH IN ENGLISH MARINE INSURANCE LAW: PRE- CONTRACTUAL INFORMATION AND THE QUEST FOR REFORM

#### 3.1. Introduction

As stated in chapters 1 and 2, both duties of disclosure and representation in marine insurance stem from the source of utmost good faith addressed in the MIA 1906 section 17, which distinguishes insurance contracts from other general contracts. The key issues include the test for materiality, duration of duty, limits on duty, and the controversial avoidance nature of remedies for the breach of duties. Recently, the utmost good faith doctrine has been construed to be a continuing duty in a contract.<sup>287</sup> The pre-contractual duties in marine insurance include duty of disclosure<sup>288</sup> and representation<sup>289</sup> imposed on both parties,<sup>290</sup> and intermediaries if appropriate.<sup>291</sup> Whether the avoidance remedies would be addressed to the injured party<sup>292</sup> will be tested if the misrepresented/non-disclosed information has actually induced the insurance contract<sup>293</sup> and whether the specified information has influenced the prudent insurer's judgement.<sup>294</sup>

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<sup>287</sup> For example, see *CTI* [1984] 1 Lloyd's Rep. 476, p. 525, CA; Eggers, et al., *Good Faith and Insurance Contract*.

<sup>288</sup> Section 18, MIA 1906.

<sup>289</sup> Section 20, MIA 1906.

<sup>290</sup> Section 17, MIA 1906; also see *Carter v Boehm* (1766) 3 Burr 1905.

<sup>291</sup> Section 19, MIA 1906.

<sup>292</sup> Section 17, MIA 1906.

<sup>293</sup> Also known as the 'actual inducement' test, which was finally established by *Pan Atlantic v Pine Top* [1992] 1 Lloyd's Rep. 101, QBD; [1993] 1 Lloyd's Rep. 496, CA; [1994] 2 Lloyd's Rep. 427, HL, for details see chapter 1. However, in the Consumer Insurance (Disclosure and Representations) Act 2012, this test is changed. A detailed discussion is addressed below in this chapter.

<sup>294</sup> Section 18(2), MIA 1906.



After an observation of the pre-contract information peculiar to marine insurance, it is revealed that the utmost good faith regime is considered to be one characteristic of insurance contracts which has been standing for more than a century. However, there are increasing calls for reform. One reason is that the MIA 1906 was created at an early era and some rules are now probably outdated. The most pressing aspects for pre-contract information reform require critical examination. Firstly it is questioned whether the range of information to be disclosed should be adjusted (since the voluntary duty of disclosure is addressed mainly to the assured), and whether the 'prudent insurer' test needs to be changed. Subsequently, criticism of the avoidance remedy being too harsh for the party in breach (especially for wholly innocent insureds) is analysed. Finally, it is discussed whether the 'proportionality approach' in statute law (Misrepresentation Act 1967 at common law) can be extended to marine insurance.

### **3.2. Quest for reform**

There are some arguments opposing the reform have been proposed. According to Bakes,<sup>295</sup> the first concern is that businesses are more likely than consumers to get professional advice from brokers and assureds are more likely to be aware of their legal obligations. The second argument states that the changes of law will weaken the London market's competitive strength. Thirdly, some people claim that the parties are allowed to contract out of the strict legal provisions.<sup>296</sup> These

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<sup>295</sup> For details, see Martin Bakes, 'Pre-contractual information duties and the Law Commission's review', in Baris Soyer, et al., *Reforming Marine and Commercial Insurance Law* (London: Informa, 2008), p. 35.

<sup>296</sup> This statement reflects the controversial issue before the opinion proposed by the first consultations paper issued jointly by the Law Commission and the Scottish Law Commission – the

concerns are understandable if the reform will be taking place without adequate governmental scrutiny and guidance. Despite these disagreements, the Law Commission still launched the first leapfrog step for reform in 2006 with the publication of the first Scoping Paper.<sup>297</sup> Nevertheless, it must be considered that the opponents might be less worried about the post legislative scrutiny, since the law revision and supervision task is also complemented by judicial intervention, which can adjust the enforcement of legislation appropriately.

In fact, the reform had been deliberated by the Law Reform Committee even earlier in 1957 and the Law Commission in 1980. However, these two reports did not result in any change to law. The Law Commission expressed its anxiety for the revision of insurance contractual legislation since 2006. According to the issues observed by the Law Commission, the current insurance legislation regarding pre-contract information, warranties, insurable interest, post-contract duty of good faith and the requirements for a formal marine insurance policy are worth a closer observation and statutory reform.<sup>298</sup> Accordingly, correspondent Consultation Papers were issued on each topic. These covered the issues relating to pre-contractual information and warranties for both consumer and business insurance,<sup>299</sup> the issues

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rules in business context should be default or mandatory, see the Law Commission and the Scottish Law Commission, *A Joint Consultation Paper, Misrepresentation, Non-disclosure and Breach of Warranty by the Insured (CP 1)*, (July 2007, Law COM No 182/SCOT LAW COM No 134), available at <http://lawcommission.justice.gov.uk/areas/insurance-contract-law.htm>, accessed in January 2013.

<sup>297</sup> The Law Commission and the Scottish Law Commission, *Insurance Contract Law: A Joint Scoping Paper*.

<sup>298</sup> The Law Commission, *Issues Paper 1, Misrepresentation and Non-disclosure*, September 2006, *Issues Paper 2, Warranties*, November 2006; *Issues Paper 3, Intermediaries and Pre-contract Information*, March 2007; *Issues Paper 4, Insurable Interest*, January 2008; *Issues Paper 5, Micro-businesses – should micro-businesses be treated like consumers for the purposes of pre-contractual information and unfair terms?*, April 2009; *Issues Paper 6, Damages for Late Payment*, March 2010; *Issues Paper 7, The Insured's Post-contract Duty of Good Faith*, July 2010; *Issues Paper 8, The Broker's Liability for Premiums (Section 53)*, July 2010; *Issues Paper 9, The Requirements for a Formal Marine Policy (Section 22)*, October 2010. Available at <http://lawcommission.justice.gov.uk/areas/insurance-contract-law.htm>, accessed in January 2013.

<sup>299</sup> The Law Commission and the Scottish Law Commission, *A Joint Consultation Paper, Misrepresentation, Non-disclosure and Breach of Warranty by the Insured (CP 1)*.

relating to post-contract duties and other issues,<sup>300</sup> and the issues relating to the business assured's duty of disclosure and warranties.<sup>301</sup> The statutory reform in consumer insurance peculiar to pre-contract information was jointly completed successfully by the Law Commission and the Scottish Law Commission, through the issue of two main documentations. This included the Reports, with recommendations on Consumer Insurance Law, such as Pre-contract Disclosure and Misrepresentation,<sup>302</sup> and the Consumer Insurance (Disclosure and Representations) Act 2012. It is expected that the latter will be fully in force shortly after one year after its enactment (March 2012).

The main reasons for implementing the insurance law reform in the UK are as follows:

### **3.2.1. Retaining sustainability of legislation**

Most of all, the Law Commission triggered the reform in order to retain the sustainability of insurance legislation. Firstly, social, political, economic and technological changes influence not only the Law Commission, but the whole industry to confront the need to reform. The MIA 1906 was codified by Sir Mackenzie Dalzell Chalmers more than 100 years ago. Without any question, it is recognized widely that this codified Act started a new era for both marine and non-marine

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<sup>300</sup> The Law Commission and the Scottish Law Commission, *A Joint Consultation Paper, Insurance Contract Law: Post Contract Duties and other Issues (CP 2)*, (December 2011, Law COM No 201/SCOT LAW COM No 152), available at <http://lawcommission.justice.gov.uk/areas/insurance-contract-law.htm>, accessed in January 2013.

<sup>301</sup> The Law Commission and The Scottish Law Commission, *A Joint Consultation Paper, Insurance Contract Law: The Business Insured's Duty of Disclosure and the Law of Warranties (CP 3)*, (June 2012, Law COM No 204/SCOT LAW COM No 155), available at <http://lawcommission.justice.gov.uk/areas/insurance-contract-law.htm>, accessed in January 2013.

<sup>302</sup> The Law Commission and the Scottish Law Commission, *Consumer Insurance Law: Pre-contract Disclosure and Misrepresentation (Joint Report with Draft Bill)*, (December 2009, Law COM No 319/SCOT LAW COM No 219), available at <http://lawcommission.justice.gov.uk/areas/insurance-contract-law.htm>, accessed in January 2013.

insurance law. However, the contemporary economic and cultural attitudes are radically different, and circumstances have inevitably changed in the past century. Longmore LJ noted, 'despite one Member of Parliament (MP) saying rather oddly that the Bill (drafted Bill for MIA 1906) was 20 times more complicated than *Arnould*, now, a century later, it is operating as too tight a straitjacket'.<sup>303</sup> For instance, the primary objective to create the duty of disclosure is to adjust the imbalanced information between the insurance company and assureds; however, nowadays, the insurance company is not in a weak position anymore.

Secondly, the disadvantages of codification of law lead legislation to depart gradually from real circumstances. On the one hand, the codification of law simplifies laws in the common law system. The MIA 1906 was codified through the application of relevant judgments and its enactment is deemed as one of the most important things that happened in 1906.<sup>304</sup> Nevertheless, the codification of law hinders the great advantage of the English common law system that the law develops through cases and precedent in a controlled fashion.<sup>305</sup> Codification is considered as rigid, precise, restricted, and even ossified,<sup>306</sup> and is particularly denounced by the scholars who favour the common law system. As a matter of fact, even within the civil law system, codification does not lead to absolute silence. Based on Longmore LJ's opinion, the best way of celebrating Sir Mackenzie Chalmers' considerable

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<sup>303</sup> See Andrew Longmore, 'An Insurance Contracts Act for a new Century?', in British Insurance Law Association, *Insurance Contract Law Reform: Recommendations to the Law Commission – A Report of the Sub-Committee of the British Insurance Law Association*, (1<sup>st</sup> September, 2002), available at [http://www.bila.org.uk/pdfs/Insurance\\_Law\\_Reform\\_Report.pdf](http://www.bila.org.uk/pdfs/Insurance_Law_Reform_Report.pdf) (assessed in January 2013), Appendix A, p. 12.

<sup>304</sup> Andrew Longmore, 'An Insurance Contracts Act for a new Century?', (2001) 3 *LMCLQ*, pp. 356-368. Longmore LJ mentioned the return of a reforming Liberal Government after many years in opposition, and the enactment of the Marine Insurance Act 1906 as two of the most important things happened in 1906.

<sup>305</sup> David Hertzell, 'Insurance contract law reform in England/Wales and Scotland', in Baris Soyer, et al., *Reforming Marine and Commercial Insurance Law* (London: Informa, 2008), p. 1.

<sup>306</sup> The Law Commission and Scottish Law Commission, *Reforming Insurance Contract Law: A summary of Responses to Consultation on Business Issues* (October 2008), available at [http://lawcommission.justice.gov.uk/docs/ICL\\_summary\\_of\\_responses.pdf](http://lawcommission.justice.gov.uk/docs/ICL_summary_of_responses.pdf), accessed in January 2013, para. 4.89.

achievement would have been to have a new Act to mark the centenary of the 1906 Act so that it might be possible to enact sensible reform for insurance law as a whole.<sup>307</sup> And Longmore LJ's statement is confirmed by the recently launched Consumer Insurance (Disclosure and Representations) Act 2012.

Thirdly, the movement of reform is also aiming at following in the footsteps of the European Union (EU); thus, there is the possibility that the European Community will take steps to harmonise the law across Europe, or possibly to create a European law of insurance contracts which becomes a further reason to review the UK's insurance contract law.<sup>308</sup> As a Member State of the EU, all of the British legislation must be compatible with EU legislation.<sup>309</sup> Otherwise, the British Parliament is responsible for revision and amendments. The compatibility with EU legislation is only the minimum legislative requirement but not the Law Commission's ultimate goal. Its eventual aim is to sell the up-to-date insurance law regime in the UK as the basis of a European regime.<sup>310</sup> However, based on the first Consultations Paper,<sup>311</sup> the work is being conducted by the Restatement of European Insurance Contract Law Project Group ('the Innsbruck Group'), which is drafting the rules of the Common Frame of Reference on Insurance Contract Law. The Project Group released their Principles of European Insurance Contract Law (PEICL)<sup>312</sup> in 2009, and submitted it to the European Commission as a Draft Common Frame of Reference of European

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<sup>307</sup> Longmore, 'An Insurance Contracts Act for a new Century?', in *LMCLQ*, pp. 356-368.

<sup>308</sup> The Law Commission and the Scottish Law Commission, *A Joint Consultation Paper, Misrepresentation, Non-disclosure and Breach of Warranty by the Insured (CP 1)*, p. 19.

<sup>309</sup> Section 2(1), European Communities Act 1972. According to section 2(1):

'All such rights, powers, liabilities, obligations and restrictions from time to time created or arising by or under the Treaties, and all such remedies and procedures from time to time provided for by or under the Treaties, as in accordance with the Treaties are without further enactment to be given legal effect or used in the United Kingdom shall be recognised and available in law, and be enforced, allowed and followed accordingly ...'

<sup>310</sup> The Law Commission and the Scottish Law Commission, *A Joint Consultation Paper, Misrepresentation, Non-disclosure and Breach of Warranty by the Insured (CP 1)*, p. 20.

<sup>311</sup> *Ibid.*

<sup>312</sup> Project Group Restatement of European Insurance Contract Law, *Principles of European Insurance Contract Law (PEICL)* (Munich: Sellier European Law Publishers, October 2009).

Insurance Contract Law (DCFR Insurance), which 'should be integrated into a body of European contract law and should be revised and pursued further'.<sup>313</sup>

According to the Restatement, the assured is required to perform the duty of disclosure when concluding the contract, by informing the insurer of material circumstances of which he is, or ought to be, aware on an inquiry basis.<sup>314</sup> A flexible mechanism is provided by the Project Team to encourage the assured's good faith performance, by proposing both a reasonable variation of the contract and a contract termination options (with extra proportionate remedies provided) to the insurer providing reasonable notice given, in particular to protect innocent assureds.<sup>315</sup> Subsequently, the Restatement also imposes exceptions to the duty of disclosure, by excluding obvious incomplete or incorrect answers, immaterial circumstances, information which the insurer led the policyholder to believe did not have to be

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<sup>313</sup> The European Parliament, European Parliament resolution of 8 June 2011 on policy options for progress towards a European Contract Law for consumers and businesses 2011/2013(INI).

<sup>314</sup> Article 2:101 of the Restatement of European Insurance Contract Law provides that:

'(1) When concluding the contract, the applicant shall inform the insurer of circumstances of which he is or ought to be aware, and which are the subject of clear and precise questions put to him by the insurer.

(2) The circumstances referred to in para. 1 include those of which the person to be insured was or should have been aware.'

<sup>315</sup> Article 2:102 of the Restatement of European Insurance Contract Law subsequently stipulates that:

'(1) When the policyholder is in breach of Article 2:101, subject to paras. 2 to 5, the insurer shall be entitled to propose a reasonable variation of the contract or to terminate the contract. To this end the insurer shall give written notice of its intention, accompanied by information on the legal consequences of its decision, within one month after the breach of Article 2:101 becomes known or apparent to it.

(2) If the insurer proposes a reasonable variation, the contract shall continue on the basis of the variation proposed, unless the policyholder rejects the proposal within one month of receipt of the notice referred to in para. 1. In that case, the insurer shall be entitled to terminate the contract within one month of receipt of written notice of the policyholder's rejection.

(3) The insurer shall not be entitled to terminate the contract if the policyholder is in innocent breach of Article 2:101, unless the insurer proves that it would not have concluded the contract, had it known the information concerned.

(4) Termination of the contract shall take effect one month after the written notice referred to in para. 1 has been received by the policyholder. Variation shall take effect in accordance with the agreement of the parties.

(5) If an insured event is caused by an element of the risk, which is the subject of negligent non-disclosure or misrepresentation by the policyholder, and occurs before termination or variation takes effect, no insurance money shall be payable if the insurer would not have concluded the contract had it known the information concerned. If, however, the insurer would have concluded the contract at a higher premium or on different terms, the insurance money shall be payable proportionately or in accordance with such terms.'

disclosed, and the circumstances which should have fallen within the scope of the insurer's knowledge from the general duty of disclosure.<sup>316</sup> Regardless of the protection provided for innocent assureds, the Restatement also shows its zero tolerance to fraud, and the avoidance remedy is allowed to be available to the insurer for the assured's fraudulent breaches with reasonable notice given.<sup>317</sup>

Distinguished from the ambiguous manner adopted by the MIA 1906, by leaving the alteration of risk issue open to practice, the Restatement has it covered and separated from the general pre-contract information of the assured. In the Restatement, providing a contract clause agreed to require the assured to notify the aggravation of risk to the insurer, a forfeiture of relevant claims is made available to the insurer,<sup>318</sup> and at the same time, both contract termination and proportionate remedies are also available.<sup>319</sup>

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<sup>316</sup> Article 2:103 of the Restatement of European Insurance Contract Law reads that:

- 'The sanctions provided for in Article 2:102 shall not apply in respect of
- (a) a question which was unanswered, or information supplied which was obviously incomplete or incorrect;
  - (b) information which should have been disclosed or information inaccurately supplied, which was not material to a reasonable insurer's decision to enter into the contract at all, or to do so on the agreed terms;
  - (c) information which the insurer led the policyholder to believe did not have to be disclosed; or
  - (d) information of which the insurer was or should have been aware.'

<sup>317</sup> Article 2:104 of the Restatement of European Insurance Contract Law provides that:

'Without prejudice to the sanctions provided for in Article 2:102, the insurer shall be entitled to avoid the contract and retain the right to any premium due, if it has been led to conclude the contract by the policyholder's fraudulent breach of Article 2:101. Notice of avoidance shall be given to the policyholder in writing within two months after the fraud becomes known to the insurer.'

<sup>318</sup> Paragraph 3, Article 4:202 of the Restatement of European Insurance Contract Law provides that:

'(3) In the event of breach of the duty of notification, the insurer shall not on that ground be entitled to refuse to pay any subsequent loss resulting from an event within the scope of the cover unless the loss was caused by the aggravation of risk. Other losses resulting from events within the scope of the cover shall remain payable in accordance with Article 4:203 para. 3.'

<sup>319</sup> Article 4:202 of the Restatement of European Insurance Contract Law provides that:

- (1) If the contract provides that, in the event of an aggravation of the risk insured the insurer shall be entitled to terminate the contract, such right shall be exercised by written notice to the policyholder within one month of the time when the aggravation becomes known or apparent to the insurer.
- (2) Cover shall expire one month after termination or, if the policyholder is in intentional breach of the duty under Article 4:202, at the time of termination.'

It can be said that the harmonisation of insurance contract law is still a distant prospect as one component of a single market in the EU, since these Principles primarily apply to all types of insurance, excluding reinsurance, but no special rules on individual branches have been drafted, which are intended for the future.<sup>320</sup> However, it is still a good reason to start revision and reform in the UK.

### 3.2.2. Practical pressures in the insurance industry

There are also some substantial reasons in insurance fields for reform. Firstly, despite the fact that the consumer insurance industry adopts some comparatively formal self-regulations, such as Statements of Practice,<sup>321</sup> the Financial Conduct Authority (FCA) Handbook,<sup>322</sup> the practice of the Financial Ombudsman Service

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(3) If an insured event is caused by an aggravated risk, of which the policyholder is or ought to be aware, before cover has expired, no insurance money shall be payable if the insurer would not have insured the aggravated risk at all. If, however, the insurer would have insured the aggravated risk at a higher premium or on different terms, the insurance money shall be payable proportionately or in accordance with such terms.'

<sup>320</sup> For details, see Helmut Heiss, et al., *Principles of European Insurance Contract Law: A Model Optional Instrument* (Sellier European Law Publishers, May 2011); Mandeep Lakhan and Helmut Heiss, 'An Optional Instrument for European Insurance Contract Law', (2010) vol. 27/71 *MUJIEL*, available at [www.merkourios.org](http://www.merkourios.org), accessed in January 2013.

<sup>321</sup> Now ICOBS – Insurance Conduct of Business Sourcebook.

<sup>322</sup> The Financial Services Act 2012 and ICOBS of the FCA Handbook.

On 19 December 2012 the Financial Services Act 2012 (2012 CHAPTER 21) received Royal Assent and came into force on 1 April 2013. The act created a new regulatory framework for financial services and abolished the FSA. Therefore, the original FSA is superseded by the Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA). The PRA is functioning as one part of the Bank of England and it is responsible for the prudential regulation and supervision of banks, building societies, credit unions, insurers and major investment firms. For more details, see <http://www.bankofengland.co.uk/pru/Pages/default.aspx>, accessed in August 2013. More released publications are available at <http://www.fca.org.uk/your-fca/list?ttypes=Handbook&year=&search=>, accessed in August 2013.

The original FSA Handbook was split between the FCA and the PRA to form new Handbooks, one for the FCA and one for the PRA. Most provisions in the FSA Handbook will then be incorporated into the FCA Handbook, the PRA Handbook or both, in line with each new regulator's set of responsibilities and objectives. However, publication of the new Handbooks began in early March 2013. See FCA and PRA, 'Reader's Guide: an introduction to the Handbook', version 2, March 2013, p. 4.

Since the FCA is responsible for insurance, this thesis will focus on the FCA Handbook. In terms of the insurance industry, the ICOBS is incorporated into Block 3 of the FCA Handbook, by setting out the conduct of business requirements which apply to the non-investment business of insurers. See FCA and PRA, 'Reader's Guide: an introduction to the Handbook', version 2, March 2013, p. 11. The



(FOS), and the Association of British Insurers (ABI) Code of Practice,<sup>323</sup> there is still no sufficient statutory legislation to supervise its operation. On the other hand, the existence of different regimes causes substantial difficulties for parties wishing to check their rights and obligations,<sup>324</sup> which makes it unacceptably confusing to insurance contractual parties.<sup>325</sup> What worsens the situation is that the FOS has never published its decisions, and this makes the position unclear and inaccessible for both the insurers and customers. The Law Commission therefore provisionally concluded in its first Consultation Paper (CP 1) that there should be a clear statutory statement of the obligations on consumers to give pre-contract information and the remedies available to insurers if they fail.<sup>326</sup> This program is realised in its further draft Bill<sup>327</sup> in consumer insurance presented to the Parliament. The draft Bill received Royal Assent and was enacted as the new Consumer Insurance (Disclosure and Representations) Act 2012. Section 10(1) of this Act prevents insurers from contracting out of the provisions of the Act to the detriment of the consumer (pre-contractual information and remedies for qualifying misrepresentations).<sup>328</sup> Therefore, the 2012 Act is confirmed to be a set of mandatory

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provisions of the ICOBS are available at <http://fshandbook.info/FS/html/FCA/ICOBS>, accessed in August 2013.

<sup>323</sup> ABI Code of Practice, 'Managing Claims for Individual and Group Life, Critical Illness and Income Protection Insurance Products', January 2009.

<sup>324</sup> The Law Commission and the Scottish Law Commission, *A Joint Consultation Paper, Misrepresentation, Non-disclosure and Breach of Warranty by the Insured (CP 1)*, p. X

<sup>325</sup> The Law Commission and the Scottish Law Commission, *Consumer Insurance Law: Pre-contract Disclosure and Misrepresentation (Joint Report with Draft Bill)*, p. 25.

<sup>326</sup> The Law Commission and the Scottish Law Commission, *A Joint Consultation Paper, Misrepresentation, Non-disclosure and Breach of Warranty by the Insured (CP 1)*, p. 71.

<sup>327</sup> The Law Commission and the Scottish Law Commission, *Consumer Insurance Law: Pre-contract Disclosure and Misrepresentation (Joint Report with Draft Bill)*.

<sup>328</sup> Section 10(1) stipulates that '[a] term of a consumer insurance contract, or of any other contract, which would put the consumer in a worse position as respects the matters mentioned in subsection (2) than the consumer would be in by virtue of the provisions of this Act is to that extent of no effect'. In the same section, subsection (3) clarifies that this section 'does not apply in relation to a contract for the settlement of a claim arising under a consumer insurance contract'. Also see the Law Commission and the Scottish Law Commission, *Consumer Insurance Law: Pre-contract Disclosure and Misrepresentation (Joint Report with Draft Bill)*, Appendix 1, Draft Bill and Explanatory Notes, p. 165.

rules in consumer insurance, which in the view of this author, are mandated to protect weaker positioned average consumers.

Furthermore, the vast majority of the responses to Law Commission's review (CP 1) expressly called for a statutory reform of MIA 1906 relating to utmost good faith, for both consumer and business insurance law.<sup>329</sup> The areas of insurance contract law which could cause concern will be explained and discussed further below. However, the arguments concentrate on the consistent defective issues including the duty of disclosure (since it becomes the obvious problem that most consumers are unaware that they are required to volunteer information)<sup>330</sup> and the materiality test.<sup>331</sup> Additionally, the duty not to misrepresent (the MIA 1906's fairness is questioned for denying claims even when the policyholders act honestly and reasonably, but not accurately or completely)<sup>332</sup> and remedies for insurers (the disproportionate remedies for unintentional utmost good faith breach especially for innocent misrepresentations) are addressed as well.

### 3.2.3. Consistent problematic issues in the business context

The CP 1 found six areas of insurance contract law which could cause concern:

- '(1). The current duty of disclosure can operate as a trap;
- 2). Policyholders may be denied claims even when they act honestly and

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<sup>329</sup> The Law Commission and Scottish Law Commission, *Reforming Insurance Contract Law: A summary of Responses to Consultation on Consumer Issues* (May 2008), available at [http://lawcommission.justice.gov.uk/docs/ICL\\_summary\\_of\\_responses.pdf](http://lawcommission.justice.gov.uk/docs/ICL_summary_of_responses.pdf), accessed in January 2013; *Reforming Insurance Contract Law: A summary of Responses to Consultation on Business Issues* (October 2008).

Among the 105 responses which were received from buyers, insurers, brokers, lawyers and representative groups by the Law Commission, between 60 and 70 respondents made comments on substantial problems in the area of consumer insurance, while around 60 respondents addressed business insurance issues. For details, see the Law Commission and Scottish Law Commission *Reforming Insurance Contract Law: A summary of Responses to Consultation on Business Issues* (October 2008).

<sup>330</sup> The Law Commission and the Scottish Law Commission, *Consumer Insurance Law: Pre-contract Disclosure and Misrepresentation (Joint Report with Draft Bill)*, p. 12.

<sup>331</sup> *Ibid*, p.13.

<sup>332</sup> *Ibid*, p.14.

reasonably.

3). The law on warranties of past or present facts can also lead to harsh results.

4). Basis of the contract clauses can be used to convert all statements on a proposal into warranties.

5). In the case of warranties of future conduct, the law states that the policy is also discharged even if the breach of warranty is later remedied or had nothing to do with the loss suffered.

6). An intermediary can introduce inaccuracies into the disclosures made by a policyholder by failing to pass on accurately the information it has been given by the policyholder.<sup>333</sup>

After analysis, it is found that in business insurance, these six areas of questions concentrate mainly on two consistent disputes: the prudent insurer test, and the all or nothing nature of the avoidance remedy.<sup>334</sup> Currently, the test of materiality is twofold: actual inducement and the prudent insurer test. The actual inducement test was established in the *Pan Atlantic* case.<sup>335</sup> Whether the non-disclosed/misrepresented information has actually induced the conclusion of insurance would be taken into account. This pillar is considered as the most appropriate standard till now. As a matter of fact, the vast majority of the criticism centres on the prudent insurer test, which is used nowadays as the second limb of the materiality test. For example, every circumstance which would influence the judgment of a prudent insurer in fixing the premium, or determining whether he will take the risk is material.<sup>336</sup> This limb of test is criticised because it does not take account of the knowledge of an individual/actual insured.<sup>337</sup> This problem causes certain unfavourable effects on the insured, particularly consumers and small or medium size businesses. For example,

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<sup>333</sup> *Ibid*, p. 3.

<sup>334</sup> Bakes, 'Pre-contractual information duties and the Law Commission's review', in Soyer, et al., *Reforming Marine and Commercial Insurance Law*, p. 33.

<sup>335</sup> Lord Mustill stated that 'if the misrepresentation or non-disclosure of a material fact did not in fact induce the contract (in the sense in which that expression is used in the general law of misrepresentation) the underwriter is not entitled to rely on it as a ground for avoiding the contract'. See *Pan Atlantic* [1994] 2 Lloyd's Rep. 427, p. 452.

<sup>336</sup> Bakes, 'Pre-contractual information duties and the Law Commission's review', in Soyer, et al., *Reforming Marine and Commercial Insurance Law*.

<sup>337</sup> The Law Commission and the Scottish Law Commission, *Consumer Insurance Law: Pre-contract Disclosure and Misrepresentation (Joint Report with Draft Bill)*.

see *Lambert v Co-operative Insurance Society Ltd.*<sup>338</sup> Since the vulnerability of consumers has been addressed repeatedly,<sup>339</sup> the Consumer Insurance (Disclosure and Representations) Act 2012 abolishes the voluntary pre-contractual information duty of the customer insured.<sup>340</sup> The existence of different sizes of businesses also becomes an obstacle during the process of constructing a universal and default regime for the business insurance market.<sup>341</sup> Taking into account the difficulties and the reality being confronted with, the law therefore is expected to start from a default position based on generally accepted standards within the industry, so as to meet the reasonable expectations of the parties. Automatically, it is deemed to be more objective to the business insured's reasonable expectations than the current law.<sup>342</sup> This would be a radical change to the materiality test and the adoption of this new test would give rise to quite different judgments compared to the current one. However, the reasonable assured test seems to correspond more closely to the principle of common law.<sup>343</sup>

The demands for alterations also come from criticisms on the avoidance remedies for insurers in cases where they have been induced to conclude the insurance contracts based on the ground of concealments and misrepresentations. The avoidance remedy is criticized because it is alleged to be overly harsh to the innocent insured who acts honestly and reasonably, as a tiny mistake could lead to the rescission of the contract. As a result, distinguishing between dishonest and

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<sup>338</sup> [1975] 2 Lloyd's Rep. 485.

<sup>339</sup> *Ibid.*

<sup>340</sup> Section 2(2), Consumer Insurance (Disclosure and Representations) Act 2012.

<sup>341</sup> The market covers a wide range of parties and risks: some small businesses are in a similar position to consumers; some major businesses may be extremely knowledgeable about insurance. See British Insurance Law Association, *Insurance Contract Law Reform: Recommendations to the Law Commission – A Report of the Sub-Committee of the British Insurance Law Association*, (1<sup>st</sup> September, 2002), part 5, p. 120.

<sup>342</sup> *Ibid.*, p.121.

<sup>343</sup> Since the objective reasonable man test is a typical standard used to measure an individual's conduct at common law.

negligent conduct is becoming necessary. The Law Commission therefore recommends that the consequences of non-disclosure/misrepresentation should depend on the policyholder's state of mind, or the reasonable assured's state of mind.<sup>344</sup> The CP 1 put forward three categories: innocent conduct, negligent conduct, deliberate or reckless conduct.<sup>345</sup> However, according to paragraph 4 and Schedule 1, Consumer Insurance (Disclosure and Representations) Act 2012, the qualifying misrepresentations for which the insurer has a remedy against the consumer include deliberate/reckless misrepresentations and careless misrepresentations.<sup>346</sup> Judging from the definitions provided by the new Act, innocent and negligent misrepresentations are under the general name of 'careless misrepresentation'.

Different from consumer insurance, with regard to the remedies to marine insurers in cases of entirely innocent behaviour, 60% of the authorities agreed, in their responses to the Law Commission, to introduce the proportionate remedy.<sup>347</sup> With regard to careless behaviour, some authorities support retaining avoidance for negligent conduct, but the majority (59%) support a proportionate remedy for negligent conduct, but not the traditional 'all or nothing' remedy.<sup>348</sup>

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<sup>344</sup> The Law Commission and the Scottish Law Commission, *Consumer Insurance Law: Pre-contract Disclosure and Misrepresentation (Joint Report with Draft Bill)*.

<sup>345</sup> The Law Commission and the Scottish Law Commission, *A Joint Consultation Paper, Misrepresentation, Non-disclosure and Breach of Warranty by the Insured (CP 1)*, pp. 72-73.

<sup>346</sup> Section 5 of the Consumer Insurance (Disclosure and Representations) Act 2012 provides that:

- '(2) 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.
- (3) A qualifying misrepresentation is careless if it is not deliberate or reckless.'

<sup>347</sup> These authorities include the British Insurance Law Association (BILA) and Lloyd's. See the Law Commission and Scottish Law Commission *Reforming Insurance Contract Law: A summary of Responses to Consultation on Business Issues* (October 2008), pp. 16-17.

<sup>348</sup> *Ibid.*

### 3.3. Milestones for insurance law reform – pre-contract information

Reform has been considered in 1957<sup>349</sup> and in 1980.<sup>350</sup> With regard to the doctrine of pre-contractual utmost good faith, both the 1957 and 1980 reports proposed that there should be a duty of disclosure of material facts provided that the fact was one which a reasonable insured would disclose. Secondly, they proposed that the ‘reasonable insured’ test should replace the current ‘prudent insurer’ test. However, despite the criticism concerning excessive harshness of remedies for honest and reasonable assureds, these two reports did not make any recommendations for a change regarding remedies, which left people the impression that they are quite modest reports.

However, the Law Reform Committee was finally persuaded that there was no practical necessity for reform in 1957.<sup>351</sup> The Commission gave careful consideration to the 1980 report which made recommendations including a Draft Insurance Law Reform Bill.<sup>352</sup> Nevertheless, the 1980 report was also rejected, and thus no related legislation was enacted afterwards<sup>353</sup> because it was proved to be too controversial for the insurance industry and government.<sup>354</sup>

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<sup>349</sup> The Law Reform Committee, *Fifth Report: Conditions and Exceptions in Insurance Policies* (1957, Cmd. 62, H.M.S.O.).

<sup>350</sup> The Law Commission, *Insurance Law: Non-disclosure and Breach of Warranty* (1980, Report No. 104, Cmd. 8064), available at <http://www.bailii.org/ew/other/EWLC/1980/104.pdf>, accessed in January 2013.

<sup>351</sup> On the basis of submissions by the insurers that ‘... no reputable insurer would rely on a technical defence to defeat an honest claim’; see Bakes, ‘Pre-contractual information duties and the Law Commission’s review’, in Soyer, et al., *Reforming Marine and Commercial Insurance Law*, p. 27.

<sup>352</sup> Longmore, ‘An Insurance Contracts Act for a new Century?’, in *LMCLQ*, pp. 356-368, at p. 357.

<sup>353</sup> The Law Commission, *Law Commission Recommendations: Implementation Log [Last updated: 24/03/10]*, available at [http://www.lawcom.gov.uk/lc\\_reports.htm](http://www.lawcom.gov.uk/lc_reports.htm), assessed in January 2013. It seems that this report is the only one which was rejected in 1980, the other three topics are relating to Family Law (two reports) and Criminal Law (one report).

<sup>354</sup> Bakes, ‘Pre-contractual information duties and the Law Commission’s review’, in Soyer, et al., *Reforming Marine and Commercial Insurance Law*, p. 27.

Another reason why the Law Commission decided to consider reform again, is the report published by the BILA Recommendations to the Law Commission in 2002.<sup>355</sup> In the *Letter to the Law Commission* appended in this report, the BILA stated that they strongly recommended the implementation of reforms on the lines underlying the report, and hoped that the delays in the implementation of the Law Commission's 1980 recommendations would not be repeated.<sup>356</sup> The Sub-Committee also stated that the starting point for reform should be the implementation of this Report, and the enactment of the draft Bill, with possible alternations.<sup>357</sup>

In Longmore LJ's Saxton Lecture material appended to the 2002 report, there were six topics suggested for the Law Commission to consider for law reform. These included: whether a doctrine of utmost good faith should be retained and if so, what its content should be; the appropriate test for an insurer or reinsurer who wishes to defend a claim on the basis of non-disclosure/misrepresentation before formation of the contract; the remedies which should be open to an insurer or reinsurer if he wishes to defend a claim on the ground of non-disclosure/misrepresentation; the right approach to breach of warranty by the insured; the right approach to proposal forms and answers given being declared to be the basis of the contract; the question whether damages should be payable for insurers' refusal to pay a valid claim.<sup>358</sup> This lecture has also been deemed to be one of the remarkable efforts made to trigger insurance law reform.

The BILA report adopted the same basic points as Longmore LJ. In particular, it was recorded that the Statements of Practice by the HM (Her Majesty's) Revenue

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<sup>355</sup> British Insurance Law Association, *Insurance Contract Law Reform: Recommendations to the Law Commission – A Report of the Sub-Committee of the British Insurance Law Association*, (1<sup>st</sup> September, 2002).

<sup>356</sup> *Ibid.*, p. 31.

<sup>357</sup> *Ibid.*, p. 3.

<sup>358</sup> Bakes, 'Pre-contractual information duties and the Law Commission's review', in Soyer, et al., *Reforming Marine and Commercial Insurance Law*, p. 20.

and Customs were insufficient, and that the role of the Ombudsman did not deal satisfactorily with any deficiency in the law. It further stated that ‘the appropriate course is to remove unfairness in the law, not simply to alleviate the unfairness’.<sup>359</sup> Thus, the Law Commission launched the insurance contract project through publishing a Scoping Paper.<sup>360</sup> Furthermore, the Law Commission issued the first Consultation Paper,<sup>361</sup> which concentrates on misrepresentation, non-disclosure and breach of warranty by the insured (this covers the extracts from Issues Papers 1-3). In addition to the pre-contract phase, the Law Commission also published Issues Papers regarding insurable interest,<sup>362</sup> micro-businesses,<sup>363</sup> damages for late payment and the insurer’s duty of good faith,<sup>364</sup> post-contract duty of good faith,<sup>365</sup> broker’s liability for premiums,<sup>366</sup> requirements for a formal marine policy,<sup>367</sup> and Responses for Consultation Paper re both consumer and business insurance.<sup>368</sup> The issue of a draft Bill<sup>369</sup> and the enactment of Consumer Insurance (Disclosure and Representations) Act 2012 regarding pre-contract disclosure and misrepresentation becomes the prominent product of this project till now.

In addition to the actions aforesaid, another noteworthy point is the Law Commission’s argument for reforming both consumer and business insurance.<sup>370</sup> In

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<sup>359</sup> *Ibid*, p. 31.

<sup>360</sup> The Law Commission and the Scottish Law Commission, *Insurance Contract Law: A Joint Scoping Paper*.

<sup>361</sup> The Law Commission and the Scottish Law Commission, *A Joint Consultation Paper, Misrepresentation, Non-disclosure and Breach of Warranty by the Insured (CP 1)*.

<sup>362</sup> Issues Paper 4: *Insurable Interest*.

<sup>363</sup> Issues Paper 5: *Micro-businesses – should micro-businesses be treated like consumers for the purposes of pre-contractual information and unfair terms?*

<sup>364</sup> Issues Paper 6: *Damages for Late Payment and the Insurer’s Duty of Good Faith*.

<sup>365</sup> Issues Paper 7: *The Insured’s Post-contract Duty of Good Faith*.

<sup>366</sup> Issues Paper 8: *The Broker’s Liability for Premiums (Section 53)*.

<sup>367</sup> Issues Paper 9: *The Requirements for a Formal Marine Policy (Section 22)*.

<sup>368</sup> The Law Commission and Scottish Law Commission, *Reforming Insurance Contract Law: A summary of Responses to Consultation on Consumer Issues* (May 2008).

<sup>369</sup> The Law Commission and the Scottish Law Commission, *Consumer Insurance Law: Pre-contract Disclosure and Misrepresentation (Joint Report with Draft Bill)*.

<sup>370</sup> It is provided that the consumer regime should apply where an individual enters into a contract of insurance wholly or mainly for purposes unrelated to his business. See also the Law Commission and



the MIA 1906, purchasers of insurance, whether businesses or consumers, are obliged to disclose or represent to insurers any information which would affect the judgement of a 'prudent underwriter' when considering the risk.<sup>371</sup> If such duties are not fulfilled, the insurer is entitled to avoid the policy *ab initio* and to refuse to pay the claim. It can be said that, for consumers, the Act was effectively bypassed by industry codes of practice and guidance notes, the FOS and [original] FSA regulations.<sup>372</sup> Conversely, the MIA 1906 remains the governing law for business insurance, including small/medium size enterprise. However, it is noticeable that some of the impetus for law reform flows from understandable concern about the vulnerability of consumers.<sup>373</sup>

The question of whether marine insurance should be included in the law reform, was answered by the Commission's 1980 report which stipulated that many of the reforms proposed applied to both consumer and business insurance, with the exception of reinsurance and MAT (marine, aviation and transport insurance) because of their unique characteristics.<sup>374</sup> Nevertheless, the Law Commission's Consultation Paper (CP 1) provisionally proposed that the reform proposals for business insurance should be equally extended to MAT<sup>375</sup> and reinsurance because they do not want to set more boundaries to new legislation.<sup>376</sup> Therefore, the following analysis concerning marine insurance law reform will be mainly completed with reference to business insurance.

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the Scottish Law Commission, *A Joint Consultation Paper, Misrepresentation, Non-disclosure and Breach of Warranty by the Insured (CP 1)*, 4.11.

<sup>371</sup> Hertzell, 'Insurance contract law reform in England/Wales and Scotland', in Soyer, et al., *Reforming Marine and Commercial Insurance Law*, p. 3.

<sup>372</sup> *Ibid.*

<sup>373</sup> Bakes, 'Pre-contractual information duties and the Law Commission's review', in Soyer, et al., *Reforming Marine and Commercial Insurance Law*, p. 28.

<sup>374</sup> The Law Commission, *Insurance Law: Non-disclosure and Breach of Warranty*, p. 14.

<sup>375</sup> The Law Commission and the Scottish Law Commission, *A Joint Consultation Paper, Misrepresentation, Non-disclosure and Breach of Warranty by the Insured (CP 1)*, 5.152.

<sup>376</sup> *Ibid.*, 5.156. It is interesting that the new Consumer Insurance (Disclosure and Representations) Act 2012 is confirmed to be not applicable to reinsurance.

### **3.4. Law Commissions' proposals for reform and accomplishments – pre-contract information**

It seems that there have been various reports about insurance contract law reform since 2006; thus, the Law Commission provides readers a flow diagram, pictured in figure 3.1 (on page 87 of this thesis), illustrating the current status of the insurance project.

It can be concluded from the diagram that the reform of insurance contract law regarding consumer insurance was successful, as the submission of the final report included a draft Bill which received Royal Assent, and was finally approved as the new Consumer Insurance (Disclosure and Representations) Act 2012. There is still a long-term task remaining for business insurance, in addition to the Consultation Papers (CP 1, CP 2 and CP 3), since the Law Commission still needs to complete the final report for business insurance and submit a draft Bill on business insurance to Parliament.

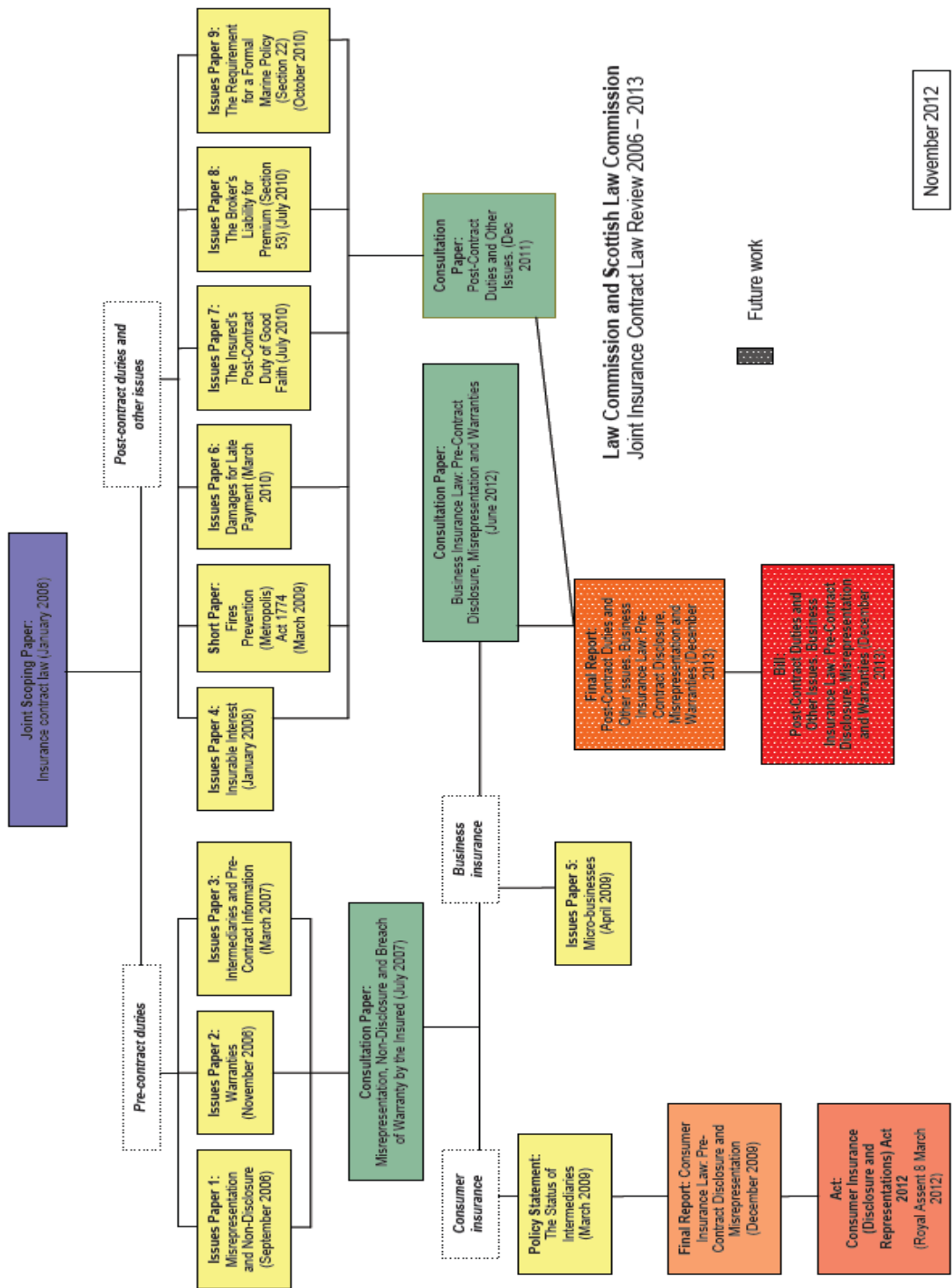


Figure 3.1. Diagram showing the current status of the insurance project. (Courtesy of the Law Commission)<sup>377</sup>

<sup>377</sup> Available at <http://lawcommission.justice.gov.uk/areas/insurance-contract-law.htm>, accessed in January 2013.

### 3.4.1. Proposed reform and alterations of law for consumer insurance

Although the duty of utmost good faith concerns both contractual parties, it applies differently in relation to the different contracting parties, and raises different issues of policy. The CP 1, therefore, does not cover the insurer's duty of good faith,<sup>378</sup> but it is considered in the CP 2. Meanwhile, the duty of good faith imposed by section 17 applies not only at the pre-contractual stage but throughout the life of the contract. However, its application at the post-contractual stage raises distinct issues, which were considered in CP 2 and examined below.<sup>379</sup>

The Law Commission made several proposals regarding consumer insurance in part 4 of the CP 1.<sup>380</sup> After a three-year consultation process since the Law Commission and Scottish Law Commission set up a joint review of insurance law in 2006, the Law Commissions drafted a 'short, targeted bill'<sup>381</sup> and presented it to Parliament. It was approved by both Houses and received Royal Assent in 2012. The Consumer Insurance (Disclosure and Representations) Act 2012 was mandated to fix the deficiency of the FOS, codify confusing rules, re-proposition the inappropriate roles of the FOS, and also to catch up with European developments.<sup>382</sup> Under the new Act, the consumer's duty to volunteer material facts is going to be abolished, as the manner previously adopted by the FOS.<sup>383</sup> Instead, consumers must take reasonable care to answer their insurer's questions fully and accurately. As a result

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<sup>378</sup> The Law Commission and the Scottish Law Commission, *A Joint Consultation Paper, Misrepresentation, Non-disclosure and Breach of Warranty by the Insured (CP 1)*, p. 24.

<sup>379</sup> *Ibid.*

<sup>380</sup> The proposed reform includes: abolishing consumers' duty to volunteer information; adopting a duty to answer questions honestly and reasonably; avoiding the whole insurance policy for deliberate or reckless act; protecting honestly and reasonably acting policy holder; introducing a compensatory remedy for negligent act; extending good faith to renewals; and abolishing 'fact warranties' and 'basis of the contract' sections. *Ibid.*, part 4.

<sup>381</sup> *Ibid.*, p. 4.

<sup>382</sup> *Ibid.*, part 3.

<sup>383</sup> The FOS has effectively abolished the duty of disclosure. The 1986 Statement required insurers to ask clear questions about matters which are generally found to be material. The FOS has interpreted this to mean that if an insurer fails to ask a question, it cannot complain that information was not disclosed.

of abolishing the duty of disclosure for consumers, inevitably, more issues are raised relating to misrepresentation. Therefore, the Consumer Insurance (Disclosure and Representations) Act 2012 introduced different remedies for each type of misrepresentation. This is the method used by the FOS.<sup>384</sup> Although the 2012 Act only applies to consumer insurance, an assessment of the selected alterations still have value in reference to business insurance cases.

#### **3.4.1.1. Abolishing the consumer's duty to volunteer information and application**

Considering the defects of the MIA 1906 for consumer insurance mentioned above, the average consumer's duty of voluntary information is abolished.<sup>385</sup> Thus, the coming into force of the new Act will repeal previous legislation regarding consumer's duties in a consumer insurance contract. However, this is also said to provide legislative confirmation for the practices adopted by the FOS before the reform, although these decisions have never been published. Yet, it is impossible to say how closely the proposals resemble existing practices.<sup>386</sup>

It is not the case that all marine insurance contracts will be excluded from the Consumer Insurance (Disclosure and Representations) Act 2012. As section 2(5) provides, a contract of marine insurance, which is a consumer insurance contract, is subject to the provisions of this Act. The remaining marine insurance policies are still governed by the MIA 1906. In order to distinguish a consumer insurance contract

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<sup>384</sup> The FOS effectively divides misrepresentations into three types:  
'(1). Where the consumer acted reasonably (or "innocently"), the FOS requires that the insurer pays the claim;  
(2). Where the consumer was careless (variously referred to as "negligent" or "inadvertent"), the FOS will provide a proportionate remedy; and  
(3). Where the consumer acted deliberately or recklessly, the insurer is entitled to avoid the policy.'

<sup>385</sup> Section 2, Consumer Insurance (Disclosure and Representations) Act 2012.

<sup>386</sup> Johann Hjalmarsson, 'The Law Commissions' draft bill on consumer insurance', *ILM*, 19<sup>th</sup> May 2010, available at <http://www.i-law.com/ilaw/doc/view.htm?id=247111>, accessed in January 2013.

from a business insurance contract, the Law Commission defines the former concept as a contract of insurance between –

‘(a) an individual who enters into the contract wholly or mainly 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.’<sup>387</sup>

It can be concluded that there are no substantial alterations of legislation in non-consumer marine insurance, since the 2012 Act only covers contracts of insurance entered into by individual policyholders for purposes wholly or mainly unrelated to their businesses.<sup>388</sup> This includes mixed-use insurance policies (such as an individual insuring a home with home office under a consumer insurance),<sup>389</sup> rather than those policies by a company or other corporate body.<sup>390</sup> Meanwhile, the MIA 1906 still applies to most business insurance events, and specifically marine insurance. The most authoritative definition of a marine insurance contract is provided by Section 1, MIA 1906, which states, it ‘is a contract whereby the insurer undertakes to indemnify the assured, in manner and to the extent thereby agreed, against marine losses, that is to say, the losses incident to marine adventure.’ It can be said that both the MIA 1906 and Consumer Insurance (Disclosure and Representations) Act 2012 have the jurisdictions of marine insurance, with the former applying to business marine insurance contracts, and the latter to consumer marine

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<sup>387</sup> Section 1, Consumer Insurance (Disclosure and Representations) Act 2012.

<sup>388</sup> *Ibid.*

<sup>389</sup> The Law Commission and the Scottish Law Commission, *Consumer Insurance Law: Pre-contract Disclosure and Misrepresentation (Joint Report with Draft Bill)*, Draft Bill and Explanatory Notes, A. 5, p. 147.

<sup>390</sup> *Ibid.*, A.4, p. 147.

insurance contracts (such as insuring a private yacht or small boat).<sup>391</sup> Again, because of the uniqueness of mixed-use contracts, the main purpose of the marine insurance should be considered when it is bought.

#### **3.4.1.2. The duty to take reasonable care not to misrepresent**

The Consumer Insurance (Disclosure and Representations) Act 2012 imposes an alternative duty on the consumer to take reasonable care not to misrepresent instead of disclosing information voluntarily. Section 2 stipulates that it is the duty of the consumer to take reasonable care not to make a misrepresentation to the insurer, and a failure by the consumer to comply with the insurer's request to confirm or amend particulars previously given is capable of being a misrepresentation for the purposes of the Act.<sup>392</sup> Section 3(1) further provides that '[w]hether or not a consumer has taken reasonable care not to make a misrepresentation is to be determined in the light of all the relevant circumstances'. This vague provision raises another possible issue, such as the extent to which the judges can exercise their discretion. Sections 3(3)-(5) give a standard of 'reasonable care'. Section 3(3) provides that '[i]f the insurer was, or ought to have been, aware of any particular characteristics or circumstances of the actual customer, those are to be taken into account'. Section 3(5) also takes into account that some consumers, with greater knowledge, may make a misrepresentation by acting dishonestly given his/her better knowledge. Effectively, this provides a higher standard for professionals, and in this circumstance, dishonesty is always to be taken as showing lack of reasonable care.

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<sup>391</sup> Section 2(5), Consumer Insurance (Disclosure and Representations) Act 2012. All see *Ibid*, A. 12 and A.13, p. 149.

<sup>392</sup> Sections 2(2) and (3), Consumer Insurance (Disclosure and Representations) Act 2012. For the Law Commissions' explanations, see *Ibid*, Appendix A, Draft Bill and Explanatory Notes, clause 2, pp. 148-149.

### 3.4.1.3. Two-part classification of misrepresentations and remedies

Section 5(1) of the Consumer Insurance (Disclosure and Representations) Act 2012 qualifies misrepresentations as being either (a) deliberate or reckless, or (b) careless.<sup>393</sup> Although 'fraud' is not mentioned in the Act, the Law Commission decided to include fraud within 'deliberateness or recklessness', because they wanted to distinguish this term from criminal fraud.<sup>394</sup>

The subsequent sections also give definitions of deliberate and reckless misrepresentations. Section 5(2) provides:

'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.'

In other words, consumers act deliberately if they act with knowledge and dishonestly, and act recklessly if they act 'without care'.<sup>395</sup> Additionally, section 5(3) and the Explanatory Notes attached to the draft Bill give the definition of a careless misrepresentation: a misrepresentation is careless if it is a qualifying misrepresentation according to section 2(2) to take reasonable care, but is not deliberate or reckless.<sup>396</sup>

Sections 5(3) and (4) stipulate that a qualifying misrepresentation is careless only if it is not deliberate or reckless, and the burden of proof is on the insurers. The insurers are obliged to prove that the qualifying misrepresentation is deliberate or

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<sup>393</sup> The FOS takes a different approach. It effectively divides misrepresentations into three types: (1) where the consumer acted reasonably (or 'innocently'), the FOS requires that the insurer pays the claim; (2) where the consumer was careless (variously referred to as 'negligent' or 'inadvertent'), the FOS will provide a proportionate remedy; and (3) where the consumer acted deliberately or recklessly, the insurer is entitled to avoid the policy. See the Law Commission and the Scottish Law Commission, *Consumer Insurance Law: Pre-contract Disclosure and Misrepresentation (Joint Report with Draft Bill)*.

<sup>394</sup> *Ibid*, note 28, p. 68.

<sup>395</sup> Some consumers act without caring about the consequences.

<sup>396</sup> *Ibid*, Appendix A, Draft Bill and Explanatory Notes, p. 155.



reckless, otherwise, it is considered as careless, which would invoke a different remedy. Therefore, distinguishing a 'deliberate or reckless misrepresentation' from a 'careless misrepresentation' is essential to entitle the insurer to claim the appropriate remedy. According to Schedule 1, paragraph 2, of the Consumer Insurance (Disclosure and Representations) Act 2012, the insurer is entitled to avoid the contract if it is proved that the information misrepresented is deliberate or reckless, and the insurer can keep the premium as long as fairness is maintained. Although the qualification for a careless misrepresentation is not specific, a proportionate remedy can be adopted.<sup>397</sup> The reports of the Law Commission reveal that the term 'careless' corresponds to 'negligent'. The proportionate remedy approach therefore is said to resemble the remedy for a negligent misrepresentation currently used by the FOS, and that has been the case so far.<sup>398</sup> The Appendices attempt to give more technical guidance for proportionate remedies which should be applied in the more complex cases.<sup>399</sup>

Schedule 1, paragraphs 3-8, of the Consumer Insurance (Disclosure and Representations) Act 2012, introduce the appropriate remedy in relation to a qualifying careless misrepresentation in consumer insurance. As the Act suggests, the 'all nor nothing' remedy is abolished and different remedies are provided: if the insurer would not have entered into the consumer insurance contract on any terms, the insurer may avoid the contract and refuse all claims, but must return the premiums paid; if the insurer would have entered into the consumer insurance contract, but on different terms (excluding terms relating to the premium), the

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<sup>397</sup> Bakes, 'Pre-contractual information duties and the Law Commission's review', in Soyer, et al., *Reforming Marine and Commercial Insurance Law*, Schedule 1, p. 170.

<sup>398</sup> The reports reads: '[m]ost of those we consulted felt that the FOS was right to impose proportionate remedies in this way. The FOS approach was considered workable and just', see Bakes, 'Pre-contractual information duties and the Law Commission's review', in Soyer, et al., *Reforming Marine and Commercial Insurance Law*, p. 22.

<sup>399</sup> *Ibid.*

contract is to be treated as if it had been entered into on those different terms if the insurer so requires; and, 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.<sup>400</sup> In terms of the calculation of a proportionate reduction of the claim, paragraph 8 provides an equation, illustrating that:

[T]he insurer needs to pay on the claim only X% of what it would otherwise have been under an obligation to pay under the terms of the contract (or, if applicable, under the different terms provided for by virtue of paragraph 6), where –

$$X = \frac{\text{Premium actually charged}}{\text{Higher premium}} \times 100'$$

#### 3.4.1.4. Mandatory rules

The Consumer Insurance (Disclosure and Representations) Act 2012 is said to favour the assured, not the insurer, since apart from the fact that the burden of proof is imposed on the insurer, it is forbidden that the contract be concluded outside the parameters of this Act, unless the alternative rights give the consumer greater rights than the sections of the Act.<sup>401</sup>

This Act covers several pressing consumer insurance issues, but it still seems far from the comprehensive statutory stage. However, one tendency which we can confirm is that the Law Commissions have entirely abandoned the plans for legislation providing comprehensive codification and is pursuing a step-by-step journey for better insurance contract law.<sup>402</sup> Although the uncertainties in business

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<sup>400</sup> Paragraphs 4-7, Schedule 1, Consumer Insurance (Disclosure and Representations) Act 2012.

<sup>401</sup> Hjalmarsson, 'The Law Commissions' draft bill on consumer insurance', in *ILM*.

<sup>402</sup> *Ibid.*

insurance cannot be finally clarified until the next publication of the draft Bill for business insurance, we can still reasonably expect similar proposals in this respect.

### **3.4.2. Proposed reform for business insurance**

Compared to the achievements obtained in consumer insurance, the business insurance division is moving in a slow but orderly fashion. After the publication of Issues Papers 1 to 9 and the Responses, the Law Commission launched another Consultation Paper 2 (CP 2) in 2011. The CP 2 is mandated at proposing various reforms apart from the pre-contractual duties in business insurance. In the CP 1 several core changes for business insurance legislation are proposed:

#### **3.4.2.1. No separate rules for shipping**

In the CP 1, the Law Commission firstly clarified that they are looking for a default regime, which would apply to all business insurance, unlike the 1980 Law Commission's report. They do not suggest separate rules for marine, aviation or transport insurance, or for reinsurance,<sup>403</sup> since they do not wish to create artificial and complex boundaries unless it is strictly necessary to do so.<sup>404</sup> However, it is interesting to find that the Consumer Insurance (Disclosure and Representations) Act

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<sup>403</sup> The Law Commission and the Scottish Law Commission, *A Joint Consultation Paper, Misrepresentation, Non-disclosure and Breach of Warranty by the Insured (CP 1)*, pp. 10-11. They list out three main reasons for this decision:

- (1). It would be unduly complex to have one law for major construction projects (for example) and another law for ships.
- (2). We wish to avoid arbitrary distinctions where possible.
- (3). Our scheme permits the parties to contract out of the default regime. If sophisticated businesses wish to come to other arrangements to suit their needs, they will be free to do so.'

<sup>404</sup> *Ibid*, p. 124.

2012 is unlikely to apply to reinsurance issues,<sup>405</sup> which is understandable as reinsurance is unlikely to be agreed between common consumers.

### **3.4.2.2. Retaining the duty of disclosure in business insurance contracts and protecting wholly innocent insureds**

Based on the operational routine of the UK market, the CP 1 insists that a duty of disclosure should be retained in business insurance contracts.<sup>406</sup> Meanwhile, the Law Commissioners are considering providing more protection to the innocent insured, which has been reflected through the proportionate remedy in the Consumer Insurance (Disclosure and Representations) Act 2012.<sup>407</sup> In order to remove the penalties imposed on an innocent insured, the Law Commission requires two changes to the default rules: modifying the duty to disclose; and, the application of similar protections to honest and reasonable misrepresentations.<sup>408</sup>

#### **3.4.2.2.1. Modifying the materiality test**

Nowadays, the insured is required to disclose anything that he/she knows, or should know in the ordinary course of business, if it 'would influence the judgment of a prudent insurer in fixing the premium, or determining whether he will take the risk'.<sup>409</sup> This test has suffered serious criticisms for a long time since many complaints allege that this duty is too onerous on the assured. This defect leads to the possibility that an insurer could abuse this duty as a trap for the small/medium

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<sup>405</sup> The Law Commission and the Scottish Law Commission, *Consumer Insurance Law: Pre-contract Disclosure and Misrepresentation (Joint Report with Draft Bill)*.

<sup>406</sup> *Ibid*, p.125.

<sup>407</sup> *Ibid*. Also see Schedule 1, Consumer Insurance (Disclosure and Representations) Act 2012.

<sup>408</sup> The Law Commission and the Scottish Law Commission, *Consumer Insurance Law: Pre-contract Disclosure and Misrepresentation (Joint Report with Draft Bill)*, p. 123.

<sup>409</sup> Bakes, 'Pre-contractual information duties and the Law Commission's review', in Soyer, et al., *Reforming Marine and Commercial Insurance Law*.

sized business which is in a similar position to consumers. The Law Commission, therefore, provisionally proposes to simplify the test in section 18(1) of the MIA 1906 (the prudent insurer test), and alternatively, the duty of disclosure should be limited to facts which the business insured knew, or ought to have known (the reasonable assured test).<sup>410</sup> As a result, in cases of non-disclosure, the burden of proving that a business insured should have known a particular fact should be on the insurer.<sup>411</sup>

Firstly, the reasonable insured test is construed to fit with the business insured's reasonable expectations. The proposal of a reasonable insured test seems to provisionally relieve the pressure from the disagreements which question why current law is unaware of what a reasonable policyholder thinks, only of what would influence a hypothetical prudent insurer and what his particular insurer would have done had it known the full facts.<sup>412</sup> Secondly, the Law Commission states that this new test is sufficiently flexible to adapt to the many different circumstances in which insurance is used and sold to a variety of policyholders,<sup>413</sup> particularly the insured with professional advisers. Apparently, the actual or individual situation would be of considerable importance in individual cases and the practical standard would be visualised by the judiciary. Thirdly, the scope of the pre-contract duty is proposed to be limited to facts which the business insured knew or which it ought to have known. This method is alleged by the Law Commission to be one in which the over-disclosure phenomenon would be cut down.<sup>414</sup>

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<sup>410</sup> The Law Commission and the Scottish Law Commission, *A Joint Consultation Paper, Misrepresentation, Non-disclosure and Breach of Warranty by the Insured (CP 1)*, p. 128.

<sup>411</sup> *Ibid*, p. 129.

<sup>412</sup> Bakes, 'Pre-contractual information duties and the Law Commission's review', in Soyer, et al., *Reforming Marine and Commercial Insurance Law*, p. 12.

<sup>413</sup> The Law Commission and the Scottish Law Commission, *A Joint Consultation Paper, Misrepresentation, Non-disclosure and Breach of Warranty by the Insured (CP 1)*, p. 133.

<sup>414</sup> *Ibid*, p. 134.

### 3.4.2.2.2. Protecting the honest and careful insureds

Additionally, the Law Commission proposes that the insurer should have no right to reject to pay a claim to the innocent insured who gives information incorrectly, but without negligence; this is an approach adopted by many of the continental systems.<sup>415</sup> However, this default rule is rebuttable by agreements to the contrary.<sup>416</sup> The reason is that the Law Commission hopes this would bring the law into line with good market practice and with what they believe business insureds reasonably expect.<sup>417</sup> The burden of showing that the insured did not have reasonable grounds for believing what it said was true, is proposed to be imposed on the insurer.<sup>418</sup>

Currently, the two-fold test of materiality adopted by the UK is 'actual inducement' and 'prudent insurer', which have been challenged in the Law Commission's 1957 and 1980 reports.<sup>419</sup> It seems that the Law Commission has quite a lot of objections for this test. In Issues Paper 1, a two-part test was presented which was based on inducement and that of a reasonable person.<sup>420</sup> However, the latter pillar has been modified slightly during the Consultation Paper (CP 1).<sup>421</sup> The reasonable insured test is proposed by the Law Commission to replace the prudent insurer test. They question why current law does not care what a reasonable insured should have realised was relevant, but asks what a prudent insurer would want to know, which

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<sup>415</sup> For example, Norwegian Marine Insurance Plan 1996, version 2010, arts 4.4. and 4.7; General Swedish Marine Insurance Plan 2006, art 4.6; Swedish Insurance Contracts Act 2005 (SFS 2005:104) chapter 8:9 (remedies only where insured acted intentionally or negligently), also see 'Swedish Insurance Contracts Act 2005', *ILM*, 1 February 2007, available at <http://www.i-law.com/ilaw/doc/view.htm?id=37599>, accessed in January 2013.

<sup>416</sup> The Law Commission and the Scottish Law Commission, *A Joint Consultation Paper, Misrepresentation, Non-disclosure and Breach of Warranty by the Insured (CP 1)*, pp. 126, 130.

<sup>417</sup> The Law Commission and the Scottish Law Commission, *Consumer Insurance Law: Pre-contract Disclosure and Misrepresentation (Joint Report with Draft Bill)*, p. 129.

<sup>418</sup> *Ibid*, p. 131.

<sup>419</sup> In the Law Commission's 1980 report, it is said that: '[a]n honest and reasonable insured may be quite unaware of the existence and extent of this duty, and even if he is aware of it, he may have great difficulty in forming any view as to what facts a prudent underwriter would consider material'. See the Law Commission, *Insurance Law: Non-disclosure and Breach of Warranty*, para. 9.3.

<sup>420</sup> The Law Commission, Issues Paper 1, *Misrepresentation and Non-disclosure*.

<sup>421</sup> The Law Commission and the Scottish Law Commission, *A Joint Consultation Paper, Misrepresentation, Non-disclosure and Breach of Warranty by the Insured (CP 1)*, p. 132.

they think does not fit with the reasonable expectations of the business insured.<sup>422</sup> They also recommend the same test should apply to alleged misrepresentations.

The reasons why they proposed this test included the flexibility of the market, to weaken the expert witness anxious to beat the claim,<sup>423</sup> and to discourage the present tendency to inundate the insurer with information.<sup>424</sup> The Law Commission has therefore concluded that the test of materiality needs to be modified.<sup>425</sup> This point has been altered in consumer insurance by the Consumer Insurance (Disclosure and Representations) Act 2012.

### 3.4.2.3. Distinguishing between dishonest and negligent conduct?

One might urge making a distinction between behaviour that is dishonest and that which is merely negligent in order to distinguish awarded remedies. The Law Commissioners are considering if the Business Insurance Bill should follow the proposals for consumer insurance by distinguishing these two types of conduct.<sup>426</sup> After a closer observation of the Consumer Insurance (Disclosure and Representations) Act 2012, it can be said that there are only two types of conduct: dishonest (including deliberate/reckless and fraudulent conduct) and honest conduct (including careless/negligent and innocent conduct). Accordingly, the compensatory

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<sup>422</sup> *Ibid*, p.132.

<sup>423</sup> This used to arise judicial criticisms for insurers' evidence. See *Roselodge Ltd v Castle* [1966] 2 Lloyd's Rep. 113, p. 132.

<sup>424</sup> The Law Commission and the Scottish Law Commission, *A Joint Consultation Paper, Misrepresentation, Non-disclosure and Breach of Warranty by the Insured (CP 1)*, pp. 133-135.

<sup>425</sup> They provisionally propose that, in order to be entitled to a remedy for the insured's non-disclosure or misrepresentation, the insurer must show that:

- '(1) had it known the fact in question it would not have entered into the same contract on the same terms or at all; and
- (2) it must also show either:
  - (a) that a reasonable insured in the circumstances would have appreciated that the fact in question would be one that the insurer would want to know about; or
  - (b) that the proposer actually knew that the fact was one that the insurer would want to know about.'

See the Law Commission and the Scottish Law Commission, *A Joint Consultation Paper, Misrepresentation, Non-disclosure and Breach of Warranty by the Insured (CP 1)*, p. 137.

remedy to insurers in cases of negligent conduct is developed, which means the remedy would be based on what the insurer would have done had it known the information when it applied to negligent conduct in business insurance.<sup>427</sup> After consideration, it is found by the Law Commissioners that the continental systems examined, all apply a proportional approach to claims that have arisen before it is discovered that the insured made a non-fraudulent misrepresentation, in business as well as consumer insurance.<sup>428</sup> If the proposed law wants to adopt the compensatory or proportional approach in business insurance, distinguishing dishonest from negligent conduct is inevitable.

However, several main disagreements are put forward by some respondents against changing current law. Firstly, it would be difficult for the insurer to prove that an insured acted dishonestly. Secondly, it would be difficult to show what an insurer would have done if it had known the true position. The changes would lead to both insurers and insureds spending large sums on expert witnesses, who simply contradict each other. Finally, there should be strong incentives to encourage an insured to act carefully.<sup>429</sup> The final decision is still being considered by the Law Commission.

### **3.5. Conclusion**

This chapter briefly introduced the pre-contract information (disclosure and representation) in current marine insurance law, historical and practical reasons for reform, milestones of insurance law reform since the first documentation, and the proposals presented by the Law Commissions and provisional achievements in both

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<sup>427</sup> *Ibid*, p.137. See also paragraphs 3-8, Schedule 1, Consumer Insurance (Disclosure and Representations) Act 2012.

<sup>428</sup> *Ibid*, note 24.

<sup>429</sup> *Ibid*, p. 138.



consumer and business insurance reform. It has been found that the tendency of new legislation is to provide more protection to an innocent insured and a compensatory and proportionate remedy to insurers in cases of negligent non-disclosure/misrepresentation. Additionally, the duty of disclosing information before the conclusion of the insurance contract is retained in business insurance. The Law Commission also proposes to modify the materiality test and a reasonable insured test is recommended to replace the current prudent insurer test.

With a one hundred year old statute, and a leading position in the worldwide shipping industry, the UK is competent to pioneer the reform of insurance, especially within the marine insurance industry. Although there are still some voices against reform and huge changes in practice, the government expresses a determination in reforming since the first launch of the Scoping Paper in 2006. Without any doubts, this is a distant and tough task for both legislators and insurance practitioners. However, people must not underestimate the powers of both judicial precedent and the insurance market in the context of post-legislative revision. A revolution in marine insurance law seems inevitable.

## CHAPTER 4

# PRE-CONTRACT UTMOST GOOD FAITH IN CHINESE MARINE INSURANCE LAW AND PRACTICE IN THE LIGHT OF DEVELOPMENTS AND PRACTICE IN ENGLISH LAW

### 4.1. Introduction

The origin of Chinese legal system can be dated back to customary law in Xia and Shang Dynasty. It was further developed in the Western Zhou Dynasty, the Spring and Autumn Period, the Qin Dynasty, the Han Dynasty, the Three Kingdoms, the Two Jins and Northern and Southern Dynasties, Sui and the Tang Dynasty, the Song, Liao, Jin and Yuan Dynasties, the Ming Dynasty, the Qing Dynasty, and the Chinese People's Democratic Temporary Regime.<sup>430</sup> The early format of the new Chinese legal philosophy was not formed until the founding of the People's Republic of China in 1949.<sup>431</sup> Scholars with consensus consider China as a civil law country.<sup>432</sup> However, after a closer observation of the political and social factors in China, it can be concluded that the current Chinese law is one type of Socialist law.<sup>433</sup> But, all in all then, Chinese law is still considered to be in the civil law system, which is mainly

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<sup>430</sup> For details, see Xianyi Zeng, et al., *History of Legal System* (2<sup>nd</sup> ed., Beijing University Press, 2009) (Chinese version); Limin Wang, et al., *History of Legal System* (2<sup>nd</sup> ed., Shanghai People's Press, 2007) (Chinese version).

<sup>431</sup> For details, see Jinquan Chen, et al., *History of the New Chinese Legal Philosophy* (People's Press, 2011) (Chinese version).

<sup>432</sup> Xianyi Zeng, et al., *History of Legal System* (2<sup>nd</sup> ed., Beijing University Press, 2009) (Chinese version).

<sup>433</sup> *Ibid*, chapter 15.

influenced by Roman law, and this also leads to the main divergences between the legal systems in the UK and China.<sup>434</sup>

In China, the insurance industry was not really opened to the international market till 1992, with the return of foreign investments.<sup>435</sup> Especially after the entry into the World Trade Organization in 2001, there was a dramatic increase in the number of foreign investment insurance companies emerging in the Chinese market, which shaped the national competition market. Accordingly, a systematic and comprehensive insurance legislation with international standards (including international conventions and practice) is desired. In the modern history of Chinese maritime law, with the promulgation of the Maritime Code of the People's Republic of China in 1992,<sup>436</sup> Chinese marine insurance law was finalized as one special chapter.<sup>437</sup>

On the basis of the marine insurance articles of CMC and relevant general laws, it is revealed that the duty of 'utmost good faith' has never been recognized by statutes or judicial interpretations. However, the duty of 'good faith' is statutorily

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<sup>434</sup> The main characteristic of English common law decides that it is relying on judicial decisions and the doctrine of binding precedent, rather than scholarly literature, In contrast, a civil law country, China for example, is more reliant on codes, rather than judicial decisions, and the decisions in a civil law country are persuasive only, which is further explained under the heading of 'Should the English study of utmost good faith be adopted by Chinese marine insurance law at once or incrementally?' in this thesis.

Article 2 of the Organic Law of the People's Courts of the People's Republic of China pictures the main court structure in China, by providing that '(t)he judicial authority of the People's Republic of China is exercised by the following people's courts:

- (1) local people's courts at various levels;
- (2) military courts and other special people's courts (revised on September 2, 1983); and
- (3) the Supreme People's Courts.'

In China, therefore, without any powerful judicial assistance from judicial decisions, another resource of Chinese law is the judicial interpretations issued by authorized institutions, for example, the Supreme People's Courts and the Supreme People's Procuratorate.

<sup>435</sup> Including the American International Assurance Company in 1992, Sedgwick Group in 1993, Japan Tokiomarine Holdings Incorporation in 1994, and the Canadian Manulife Insurance Company in 1995. See Pengnan Wang, *The Law of Marine Insurance* (2<sup>nd</sup> ed., Dalian Maritime University Press, 1996) (Chinese version), p. 22.

<sup>436</sup> Maritime Code of the People's Republic of China 1992. Hereinafter referred as CMC.

<sup>437</sup> Chapter XII, Contract of Marine Insurance, CMC.

recognised.<sup>438</sup> Despite this, the leading academic still states that there is no substantial difference between these two terms.<sup>439</sup> Meanwhile, other academics are affirmatively trying to transplant this doctrine from English common law to Chinese law. This is embodied by the Recommendations, Statutes and Explanations on the Amendments of Chinese Maritime Code of the People's Republic of China (Recommendations), published by the project team under the Ministry of Communications of the PRC in 2003.<sup>440</sup> Under this documentation, section 17 of the MIA 1906 is suggested to be respected and followed by Chinese marine insurance law in the future, which raises debates on the practicability of a common law model in a civil country, and also of the English model's inherent defects.

Firstly, this chapter introduces the current situation of the duty of (utmost) good faith in Chinese law by detailing its main contents as implied by leading codes. Secondly, it examines the pre-contractual duty of disclosure imposed on the insurer, including the insurer's duty of lawful operation, pre-contract disclosure and explanation. Thirdly, it examines the assured's pre-contract duty of disclosure and application in practice. Fourthly, it examines legal consequences and remedies of good faith breach in Chinese law. All these issues are observed against the backdrop of English law, although a comprehensive comparative study is provided in the concluding chapter. Additionally, for the sake of providing a more comprehensive analysis of the duty of utmost good faith in Chinese law, several notable common law and Chinese maritime law cases will be referred to where appropriate.

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<sup>438</sup> For example, article 5 of Insurance Law of the PRC 2009, articles 42 and 60 of the Contract Law of the PRC, and article 4 of the General Principles of Civil Law of the PRC 1986.

<sup>439</sup> Wang, *The Law of Marine Insurance*, p. 43; Pengnan Wang, 'Utmost good faith in marine insurance – 35<sup>th</sup> International Conference of the Comité Maritime International (CMI)', (1995) issue 1, *CMT*, p. 40.

<sup>440</sup> The Project of Amendments on Chinese Maritime Code was approved by the Ministry of Communications of the PRC in 2000. In September 2003, the project team published its product with the issue of Recommendations, Legislations Samples and Explanations on the Amendments of Chinese Maritime Code. Detailed analysis is provided in the conclusive chapter.

## **4.2. Duty of utmost good faith in Chinese law**

### **4.2.1. Chinese maritime law – leading codes**

In China, marine insurance contracts are mainly governed by Chapter XII of CMC. Chapter XII, titled as the Contract of Marine Insurance, is one essential component of the CMC, which was drafted with reference to relevant international legislation, especially the MIA 1906 in the UK and a combination of international and Chinese marine insurance practices. Chapter XII of CMC consists of 41 articles in 6 sections, including the General Provisions; Conclusion, Termination and Assignment of Contract; Obligation of the Insured; Liability of the Insurer; Loss of or Damage to the Subject Matter Insured and Abandonment; and Limitation Period for claims.

Apart from the CMC, the other statutory legislation, such as the Insurance Law of the PRC 2009 (CIL 2009),<sup>441</sup> the Contract Law of the PRC (Chinese Contract Law),<sup>442</sup> and the General Principles of Civil Law of the PRC 1986 (General Principles of Civil Law) shall be applied in marine insurance disputes in cases where there is no such provision in the CMC.<sup>443</sup> Since there is no individual branch of marine insurance law, the superiority order of the statutes can be questioned. Originally, scholars could only find traces through some particular pieces of legislations and make deductions on the basis of legal science. In practice, the legal effect of CMC, CIL 2009, Chinese Contract Law, and the General Principles of Civil law is in a descending order.

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<sup>441</sup> The first Insurance Law of the PRC was passed in June 1995 and then was amended in 2002 and 2009 respectively. The current Chinese Insurance Law was amended in 2009 and effective since October, 2009.

<sup>442</sup> Adopted and Promulgated by the Second Session of the Ninth National People's Congress on March 15, 1999.

<sup>443</sup> In addition to these four main sources of marine insurance legislation, before the enactment of the CMC and CIL 1995, China adopted the Regulations of the PRC on Contracts of Property Insurance (repealed by the Insurance Law of the PRC in 1995), the Economic Contract Law of the PRC, (repealed by the Chinese Contract Law 1999) and Law of the PRC on Economic Contracts involving Foreign Interest (repealed by the Chinese Contract Law 1999) to adjust marine insurance disputes.

Firstly, according to article 147 of the CIL 1995 (article 184 of the CIL 2009), marine insurance contracts should be governed by the relevant provisions of CMC. The matters which are not provided by the CMC shall be governed by the relevant provision of the CIL 2009. Secondly, compared to the other statutes, the CMC is construed as a special law in cases of marine issues, and therefore CMC has primacy. Nevertheless, the CMC and CIL 2009 were passed to resolve special issues in insurance, but are not sufficient to deal with general issues in contract law and civil law. Thus, Chinese Contract Law and the General Principles of Civil Law shall be invoked as a further resort. Despite the lack of legislation to regulate the enforcement of these main statutes in marine insurance area, it has been widely recognized that the legal effect of CMC, CIL, Chinese Contract Law, and General Principles of Civil law is in a descending order.

Superiority was finally clarified with a promulgation of the Provisions of the Supreme People's Court on Several Issues about the Trial of Cases Concerning Marine Insurance Disputes in 2006 (Supreme People's Court Provisions 2006),<sup>444</sup> which stipulates that the trial of cases involving the disputes regarding marine insurance contracts shall be governed by the Maritime Law. If there is no such provision in the Maritime Law, the Insurance Law shall apply. Furthermore, if there is no such provision in the previous two statutes, the Contract Law and the other relevant laws shall apply.<sup>445</sup> As a matter of fact, article 1 of the Supreme Court's Provisions is legalizing the practice adopted in China through further statutory legislation. However, the announcement of these Provisions is still deemed to occupy a decisive position during the reforming process of marine insurance legislation.

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<sup>444</sup> These provisions have been adopted at the 1405<sup>th</sup> meeting of the Judicial Committee of the Supreme People's Court on November 13, 2006, and effective since January 1, 2007 (Chinese version).

<sup>445</sup> Article 1, Provisions of the Supreme People's Court on Several Issues about the Trial of Cases Concerning Marine Insurance Disputes, 2006 (Chinese version).

Subsequently, the revised CIL 2009 reaffirms the enforcement order of these leading laws.<sup>446</sup>

Nevertheless, some commentators have expressed their concerns regarding the enforcement of these statutes in practice.<sup>447</sup> Most issues revolve around the issue as to whether it is appropriate to extend the general law to special matters. In particular, uncertainty in law lies in whether general Chinese insurance law can deal with the special marine insurance disputes sufficiently in cases where the latter involves more international and foreign elements.

#### **4.2.2. Duty of utmost good faith in Chinese law**

Distinguished from the MIA 1906, there is no principal provision expressed about the duty of utmost good faith in the CMC or the other leading laws in China. However, traces of 'good faith' can be found in the provisions of CIL (both 1985 and 2009), Chinese Contract Law, and the General Principles of Civil Law. Article 5 of CIL 2009 stipulates that the principle of 'good faith' must be observed by the parties to an insurance contract. Additionally, articles 42 and 60 of the Chinese Contract Law also clarify this principle. On the basis of article 42, a party shall be liable for damages caused by bad faith under the pretext of concluding a contract during the negotiation; concealing a material fact relating to the conclusion of the contract, or supplying false information intentionally; or, any other conduct which violates the principle of good faith. Article 60 of the same law further provides that the parties shall observe the duty of good faith during the performance of their obligations which primarily include notification, assistance, and confidentiality. Moreover, article 4 of the General

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<sup>446</sup> Article 184, CIL 2009, stipulates that marine insurance contracts shall be governed by the CMC; if there is no such provision in the CMC, Chinese Insurance Law shall apply.

<sup>447</sup> For example, Huaijiang Wang, 'Consideration of Improving Marine Insurance Law of China' (Chinese version), (Dalian Maritime University Press, 1998) *ACML*, p. 128.

Principles of Civil Law also notes that in civil activities, the principles of voluntariness, fairness, making compensation for equal value, honesty and credibility shall be observed.

Despite the absence of statutory evidence, for providing the legal position of the doctrine of utmost good faith in China, it is still widely recognized by some Chinese scholars and judiciary that it is one of the basic principles of insurance contracts, and one of the important distinctions between insurance contracts and other general contracts.<sup>448</sup> One seminal Chinese case referring to the concept of utmost good faith duty is *The Tony Best*,<sup>449</sup> in which the Guangzhou Maritime Court expressed its confirmation of the said principle.

This is a case concerning the renewal of an insurance contract. In this case, the assured failed to disclose vital defects of the insured vessel (*Tony Best*): it lacked spare facilities; the ballast system was so heavily rusted that it could not release water; only one generator was working in the engine room; and, the remaining facilities were heavily worn since the commencement of the first insurance contract covering 1992. All these defects had been reported to the ship manager before the negotiation of the first contract covering 1992. Because of this undisclosed information, *Tony Best* grounded five times during her voyages, and finally sank because the engine room flooded with sea water. All these losses occurred under the renewed contract covering 1993. The judgement held that the assured definitely breached the duty of utmost good faith, and the insurance company had the right to

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<sup>448</sup> For example, Pengnan Wang, 'The duty of disclosure and the legal consequences of its breach' (Chinese version), (1993) 4 *ACML*, p. 159; Xin Wang, 'Application of utmost good faith in the performance of Marine Insurance Contract' (Chinese version), (2002) 13 *ACML*, p. 202; Xianglan Zhang, *The law of marine insurance* (Beijing: The Publishing House of Law, 1997) (Chinese version), pp. 405-406.

<sup>449</sup> *Hong Kong Sanlian Shipping Company Limited v People's Insurance Company of China Shenzhen Branch, 'The Tony Best'*, 1999, *CMT*, p. 447, cited by Pengnan Wang, in *Chinese marine insurance: case digests and comments I* (China: Dalian Maritime University Press, 2003) (Chinese version), p. 19.



avoid this contract and deny the liability under the insurance contract. Nevertheless, this case occurred before the enforcement of the CMC 1992. The judgement was made, therefore, to a large extent based on the contractual clauses which stated that the disputes concerning this contract should be governed by English law, including the MIA 1906. This judgment has also been considered to have been made according to article 7 of the Regulations of the PRC on Contracts of Property Insurance, which stipulates that any non-disclosure, concealment or misrepresentation by the insured of the material circumstances would cause the insurer to be entitled to rescind the contract of insurance or disclaim liability.

This statement is subsequently supported by the Recommendations. Clause 313 of the Recommendations proposes that ‘if either party does not observe the duty of utmost good faith, the contract may be avoided by the other party’, which is much identical to section 17 of the MIA 1906. One reason why there is a tendency to introduce this doctrine to China is the massive influence of English maritime law on the global marine industry. However, some other scholars question whether the English utmost good faith doctrine is compatible with the Chinese legal system.<sup>450</sup> This is analysed in the concluding chapter.

In short, the duty of utmost good faith has no legal position in Chinese law unless it is recognized by judicial interpretations issued by the People’s Supreme Court of the PRC, or by new law.

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<sup>450</sup> Zuoxian Zhu and Dong Li, ‘Should the Principle of Utmost Good Faith be adopted in CMC?—Theoretical Recommendations on the Principle of Utmost Good Faith in the Marine Insurance Law’ (Chinese version), (2003) 14 *ACML*, pp. 55-68.

#### **4.2.3. Duty of disclosure in Chinese law – both marine and non-marine insurance**

In accordance with the articles under Chinese law analysed previously, the duty of disclosure is imposed on both parties to an insurance contract in China. Considering its reciprocal and continuing nature, one might ask whether it is voluntary or not in both marine and non-marine insurance areas as well.

The nature of the duty of disclosure in Chinese law can vary. In marine insurance, article 222 of the CMC adopts a similar clause to section 18 of the MIA 1906, stipulating that all the material circumstances should be disclosed to the insurer before the contract is concluded.<sup>451</sup> The similarities between these two provisions contribute the first reasoning to deduce that the duty of disclosure is also an unlimited voluntary obligation in Chinese insurance law. Further, the second paragraph of article 222 confirms this assumption listing certain exceptions in which some information does not need to be disclosed in the absence of inquiry.<sup>452</sup> One might have the view that the exceptions only exist logically with the precondition that the duty of disclosure is one unlimited voluntary duty; otherwise, they would become redundant under the circumstance of an inquiring duty mechanism.<sup>453</sup>

As to the nature of this duty in general insurance law, article 16(1) of CIL 2009 provides a clear and certain answer to this question. In accordance with the language in this clause, an insurer may raise questions concerning relevant details of the insured subject matter, or of the assured, and the proposer shall truthfully inform

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<sup>451</sup> Paragraph 1, article 222 of CMC stipulates that before the contract is concluded, the insured shall truthfully inform the insurer of the material circumstances which the insured has knowledge or ought to have knowledge of in his ordinary business practice and which may have a bearing on the insurer in deciding the premium or whether he agrees to insure or not.

<sup>452</sup> Paragraph 2, article 222 of CMC notes that the insured need not inform the insurer of the facts which the insurer has known of or the insurer ought to have knowledge of in his ordinary business practice about which the insurer made no inquiry.

<sup>453</sup> The inquiring duty of disclosure in general Chinese insurance law is also supported by Jing Zhen, 'Insured's duty of disclosure and test of materiality in marine and non-marine insurance laws in China', (2006) Oct *JBL*, pp. 681-704, at p. 688.

the insurer of such details. On this basis, in general insurance law in China, the insured is required to observe an inquiring duty of disclosure.<sup>454</sup> This can be said to be quite similar to the current circumstance after the statutory reform achieved from the Consumer Insurance (Disclosure and Representations) Act 2012 in English law.<sup>455</sup>

#### **4.2.4. Relationship between the duty of disclosure and good faith in Chinese marine insurance law**

Under Chinese law, the duty of utmost good faith seems to have been formulated by the statements of some courts and scholars with the absence of legislative support. Despite this essential difference between the duty of good faith and utmost good faith in two countries, the relationship between the duty of disclosure and utmost good faith seems to be identical as well.

In the current English law, and specifically in terms of sections 17-20 under the MIA 1906, the doctrine of utmost good faith consists of voluntary disclosure and truthful representation. As a result, the subsequent discussions and theories regarding this doctrine are based on this premise.<sup>456</sup> However, the duty of representation is not separated from the duty of disclosure clearly in Chinese law. One obvious factor that contributes to the distinctions between English law and Chinese law concerning this dispute is the statutory language itself. All the previously discussed Chinese statutes are drafted and enacted in Chinese, which leads to the

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<sup>454</sup> Zhen, 'Insured's duty of disclosure and test of materiality in marine and non-marine insurance laws in China' in *JBL*, p. 682.

<sup>455</sup> Section 2, Consumer Insurance (Disclosure and Representations) Act 2012. In terms of the detailed comparisons between these two jurisdictions, see the General Conclusion chapter below.

<sup>456</sup> However, at common law or in equity, disclosure duty has never been recognized as a matter of general contract law. Also see Bennett, *The Law of Marine Insurance*. After the full coming into force of the Consumer Insurance (Disclosure and Representations) Act 2012, the assured's duty of disclosure will be applied to business insurance but abolished in consumer insurance. For details, see chapters 3 and 4.

shortage of an official or authorised English version. This also raises difficulties in the matter of comparative research. However, one leading Chinese scholar states that in relation to the manner adopted by the MIA 1906, the duty of disclosure in the CMC actually covers both the duties of disclosure and representation in English law.<sup>457</sup>

### 4.3. Pre-contractual duty of disclosure in Chinese maritime law

Currently, articles 222 and 223 of CMC address the duty of disclosure in China, detailing its main contents.<sup>458</sup> As mentioned earlier, in addition to the CMC, article 5 in CIL 2009, articles 42 and 60 in Chinese Contract Law, and also article 4 in the General Principles of Civil Law, can be invoked in a descending order in cases where there are no such provisions in CMC. In order to provide a more comprehensive analysis of the disclosure regime in China, the following paragraphs are divided into topics. These are, the duration and legal nature of pre-contractual disclosure, information requiring disclosure and limits imposed, consequences and remedies for non-disclosure.

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<sup>457</sup> Wang, *The Law of Marine Insurance*, p. 81.

<sup>458</sup> Article 222 of CMC stipulates that:

‘Before the contract is concluded, the insured shall truthfully inform the insurer of the material circumstances which the insured has knowledge or ought to have knowledge of in his ordinary business practice and which may have a bearing on the insurer in deciding the premium or whether he agrees to insure or not.

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

Article 223 of CMC stipulates that:

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

If, not due to the insured’s intentional act, the insured did not truthfully inform the insurer of the material circumstances set out in paragraph 1 of Article 222 of this Code, the insurer has the right to terminate the contract or to demand a corresponding increase in the premium;

In case the contract is terminated by the insurer, the insurer shall be liable for the loss arising from the perils insured against which occurred prior to the termination of the contract, except where the material circumstances uninformed or wrongly informed of have an impact on the occurrence of such perils.’

#### 4.3.1. Duration of the pre-contractual duty of disclosure

In accordance with article 222 of CMC, before the contract is concluded, the insured shall voluntarily truthfully inform the insurer of the material circumstances which the insured has knowledge of or ought to have knowledge of in his ordinary business practice. This may have a bearing on the insurer's decision regarding the premium, or whether he agrees to insure or not. First of all, the end of the duty of pre-contractual disclosure in Chinese law is analogous to the manner adopted in English law. For English marine insurance law, section 18(1) of the MIA 1906 provides that all the material circumstance must be disclosed before the conclusion of the contract. Section 20(1) of the same statute echoes that all the material representations must be made by the insured or his agent, during the negotiations for the contract, and before the contract is concluded. The duty of pre-contractual disclosure therefore ceases on the conclusion of the contract in both Chinese law and English law unless the contract otherwise provides.

Secondly, apart from the analogous phrases adopted by both provisions, the implied practices concerning the duty of disclosure in two countries are similar as well. In English law, it is an essential condition of the policy of insurance that the insurers shall be treated by the insured with utmost good faith during the steps taken from the beginning of the negotiation to the conclusion of the insurance contract.<sup>459</sup> In Chinese law, it seems that CMC has no such express provision clarifying the duration of the duty of disclosure, but it is recognized that this duty should be observed during the whole negotiation process.<sup>460</sup> To sum up, in both English and

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<sup>459</sup> Sections 18-20, MIA 1906.

<sup>460</sup> Wang, *The Law of Marine Insurance*, p. 79.

Chinese law, the duty of disclosure can be considered in two stages: the pre- and post-contractual duty of disclosure.<sup>461</sup>

Therefore, increasing practical disputes lie in applying the duty of disclosure to some post-contractual areas, for instance, whether the material and fundamental changes should be informed to the insurer before accepting an offer of renewal. But in practice, the additional duty of disclosing significant changes to the subject matter of the contract is written into the contract itself, to warn the policyholder of the need to protect their positions by keeping the insurer informed.<sup>462</sup> Apart from applying the renewal of insurance, the post-contractual duty of disclosure is also applied when considering cover for reinsurance, when a vessel intends to enter an additional premium area under a trading warranty, when tendering a change of voyage endorsement, and when required by a held covered clause and, possibly, a cancellation clause.<sup>463</sup> The application of the duty of disclosure especially the post-contractual duty to the aforesaid specific issues is elaborated on below.

#### **4.3.2. Legal nature – mutuality**

Again, exactly as in section 18 in the MIA 1906, the duty of disclosure appears to be imposed on the insureds, solely based on the literal meaning of articles 221 and 222 of CMC.

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<sup>461</sup> For English law, see the following cases regarding the continuing duty discussion: *Black King Shipping Corporation v Massie (The Litsion Pride)* [1985] 1 Lloyd's Rep. 437; *Bank of Nova Scotia v Hellenic Mutual War Risks Association (The Good Luck)* [1988] 1 Lloyd's Rep. 514; [1989] 2 Lloyd's Rep. 238; [1991] 2 Lloyd's Rep. 191, HL.

<sup>462</sup> Rob Thoyts, *Insurance Theory and Practice* (Routledge, 2010), p. 37. In English law, the Explanatory Notes of the Draft Bill for the Consumer Insurance (Disclosure and Representations) Act 2012 confirms that although there is no explicit reference to renewals, renewals are covered as in law these are regarded as new contracts, see the Law Commission and the Scottish Law Commission, *Consumer Insurance Law: Pre-contract Disclosure and Misrepresentation (Joint Report with Draft Bill)*, p. 149.

<sup>463</sup> Hodges, *Cases and Materials on Marine Insurance Law*, p. 218.

However, in English law, section 17 of the MIA 1906 and the subsequent cases are used as an aid to fix the defects left by the codification.<sup>464</sup> In addition to the Act itself, some precedents also reaffirm the mutual legal nature of this duty.<sup>465</sup> In Chinese law, there is no such provision concerning the duty of disclosure's mutual nature in CMC itself. One Chinese judge thus alleges that in marine insurance law, the duty of disclosure is unilateral and only the insured is obliged to disclose material information.<sup>466</sup> But, its mutuality is confirmed in some other Codes regarding general insurance contracts and general contracts, such as, article 5 of CIL 2009.<sup>467</sup> Additionally, article 6 of Chinese Contract Law provides that the parties shall observe the principle of honesty and good faith in exercising their rights and performing their obligations. Article 60 of Chinese Contract Law and article 4 of the General Principles of Civil law also impose a general good faith requirement for the performance of a contract.<sup>468</sup> All these provisions abovementioned provide powerful statutory evidence that the duty of disclosure and even good faith is also mutual in Chinese law.

Apart from the statutory evidence, in the practice of admiralty trials in China, it has been held that the insurer should abide by the duty of disclosure as well.<sup>469</sup> In *Ying Zhilong v China Pacific Insurance Company Hangzhou Branch*,<sup>470</sup> the first instance court stated that because the insurer did not disclose the exclusion clauses to the insured before the conclusion of the insurance contract, the insurer was judged to be

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<sup>464</sup> Section 17 of MIA 1906 stipulates that the duty of utmost good faith needs to be observed by either party otherwise the contract is avoidable, confirming the mutuality of this duty.

<sup>465</sup> For example, *Carter v Boehm* (1766) 3 Burr 1905, p. 1910, per Lord Mansfield; *Banque Keyser Ullmann v Scandia* [1987] 1 Lloyd's Rep. 69, p. 93, per Steyn J. See chapter one above for detailed discussions.

<sup>466</sup> Zhangjun Li, 'Comparative Study on the Duty of Disclosure between China and England' (Chinese version), (Beijing: China University of Political Science and Law, 2003) issue 5 *JCL*, p. 18.

<sup>467</sup> See § 4.2.2 above.

<sup>468</sup> Li, 'Comparative Study on the Duty of Disclosure between China and England' in *JCL*, p. 18.

<sup>469</sup> *Ibid.*

<sup>470</sup> *Ibid.*

in breach of the duty of explanation,<sup>471</sup> and therefore should be responsible for the indemnification of the damages caused.<sup>472</sup>

#### **4.3.3. Contents of insurer's duty of disclosure and recommendations**

Compared to the regime of duty of utmost good faith in English law, the insurer's duty in Chinese law is distinctive. Firstly, in Chinese law, the insurer's duty of good faith introduces the duty of lawful operation, which is not specified as such by the MIA 1906. In doing this, the legislator provided the maximum protection to the assured during the insurance transactions. In other words, the insurer's duty of good faith in Chinese law can be divided into the duty of lawful operation and disclosure, among which the latter is mainly embodied by the duty of pre-contractual duty of disclosure, duty of explanation and post-contractual duty of disclosure. Secondly, according to articles 222 and 223 of the CMC, the duty of disclosure is only imposed on the assured. Inevitably, these two provisions transfer a false image that this duty is not applicable to the insurer. Given this, other general provisions referring to the insurer's obligation of good faith and disclosure should be introduced in this part, especially the provisions under CIL 2009 and Chinese Contract Law.

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<sup>471</sup> The duty of explanation is specified as one aspect of the insurer's duty of disclosure, which is discussed below.

<sup>472</sup> Although this judgment was withdrawn by the High People's Court of Zhejiang later in the appellate case on other grounds, it still can be concluded that the reciprocity of the duty of disclosure is not challengeable in Chinese law.

In the High People's Court judgment, the legal reasoning for rejecting the first instance court judgment is that the insured had known that the Vessel was unseaworthy at the commencement of the voyage but failed to perform contractual obligations. This led to the loss caused by the preventable incident afterwards, and the insured used unseaworthiness as a defence to claim that the exclusion clauses were not foreseeable. The High People's Court judges' stated that the insured breached the duty of utmost good faith and thus should not be awarded the damages caused.



### **4.3.3.1. Duty of lawful operation**

#### **4.3.3.1.1. Legal management in Chinese law**

The status of the duty of lawful operation is not stipulated by any clause in the CMC but implied by provisions of CIL 2009 as a principal provision applicable to the insurance industry in the entirety of China.

In the CIL 2009, the general duty of lawful operation by the insurer is dispersed in most chapters.<sup>473</sup> Firstly, the general provisions require that the contractual parties should conduct insurance activities complying with laws, administrative regulations, social moralities, public interests,<sup>474</sup> and the duty of good faith.<sup>475</sup> The insurance industry should be supervised by the insurance regulatory department under the State Council of the PRC.<sup>476</sup> In addition to the general concept of this duty, subsequent subsections provide further demands for the insurance company, detailing its establishment and registration, legal structure,<sup>477</sup> management and supervision,<sup>478</sup> and legal obligations.<sup>479</sup>

#### **4.3.3.1.2. Statutory and regulatory management in English insurance industry**

In English law, section 41 of the MIA 1906 only imposes a statutory obligation to perform the implied warranty of legality on the assured in order to ensure the insured adventure is carried out in a lawful manner. At common law certain types of contracts are considered to be illegal or void because they are against public policy,<sup>480</sup>

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<sup>473</sup> Chinese Insurance Law 2009 consists of eight chapters, chapters 1, 3, 4, 6-8 all refer to the insurer's duty of lawful operation.

<sup>474</sup> Articles 4, 6, CIL 2009.

<sup>475</sup> Article 5, CIL 2009.

<sup>476</sup> Article 9, CIL 2009.

<sup>477</sup> Chapter 3, CIL 2009.

<sup>478</sup> Chapters 3, 4 and 6, CIL 2009.

<sup>479</sup> Chapter 7, CIL 2009.

<sup>480</sup> MacIntyre, *Business Law*, pp. 168-169.

although there is no express specialized provision regarding the lawful management of an insurance company. In doing this, it seems that the insured is put in a disadvantageous position in statutes.

Apart from the MIA 1906, in English business and insurance industry, some other self-regulations are established to scrutinize the management of general business and enable customers to settle disputes without going to court, such as, the Statements of Practice, the original FSA Rules,<sup>481</sup> the FCA Handbook,<sup>482</sup> FOS scheme, and ABI Code of Practice. Actually, the inappropriate role of this soft-law scheme is still a controversial issue, since the Law Commission has strongly criticized the use of self-regulation rather than statutory reform. This is because the former's voluntary nature (especially the Statements of Practice), would lead them to be ignored.<sup>483</sup> However, another authoritative institution, the ABI, alleged that the greater degree of flexibility provided by the original FSA solutions and FOS statements should not be stifled by reform by way of primary legislation.<sup>484</sup>

The Statement of General Insurance Practice was issued by the British Insurance Association (BIA, predecessor to the ABI) and Lloyd's in 1977. This was followed later in the same year by the Statement of Long-Term Insurance Practice. They were then amended and strengthened in 1986. In the year of 2005, the 1986 General

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<sup>481</sup> For example, the original FSA Handbook: the Perimeter Guidance Manual, Statements of Principle and Code of Practice for Approved Persons, Fit and proper Test for Approved Persons, Threshold conditions, Principles for Businesses, Senior Management Arrangements Systems and Controls, Supervision Manual, New Insurance Conduct of Business Sourcebook, Prudential Sourcebooks relevant to insurers, General Prudential Sourcebook, Prudential Sourcebook for Insurers, Interim Prudential Sourcebook for Insurers, Decision Procedure and Penalties Manual, the Fee Manual.

<sup>482</sup> The FCA Rules include: the Glossary, High Level Standards, Prudential Standards, Business Standards (especially the ICOBS), Regulatory Processes, Redress, Specialist sourcebooks, Listing, Prospectus and Disclosure, Handbook Guides, and Regulatory Guides.

<sup>483</sup> The Law Commission, *Insurance Law: Non-disclosure and Breach of Warranty*, pp. 27-29, cited by the Law Commission and the Scottish Law Commission, *Consumer Insurance Law: Pre-contract Disclosure and Misrepresentation (Joint Report with Draft Bill)*, p. 19.

<sup>484</sup> ABI's Response to the English and Scottish Law Commission's Issues Paper on Micro-Businesses (July 2009), cited by the Law Commission and the Scottish Law Commission, *Consumer Insurance Law: Pre-contract Disclosure and Misrepresentation (Joint Report with Draft Bill)*.

Insurance Practice was withdrawn.<sup>485</sup> Nevertheless, it is still an influential document because the FOS has created its own approach based on it. On the basis of the text of both Statements,<sup>486</sup> it is found that they are silent in respect to the lawful management of an insurance company. However, the clauses regarding non-disclosure and misrepresentation are discussed below.

The FOS was established by Part 16 and Schedule 17 of the Financial Services and Market Act 2000 (FisMA 2000) and section 59 of the Consumer Credit Act 2006 to replace eight existing dispute-resolution mechanisms as a single complaints-handling body. The FOS is considered by the Law Commission to offer the only realistic method and a free opportunity of redress to most consumers.<sup>487</sup> Otherwise, according to the Law Commission's report, the courts would be forced to apply the unfair law to deal with referred disputes.<sup>488</sup> Additionally, the FOS approach to non-disclosure and misrepresentation is described to go further than the other regulations (the original FSA rules and Statements of Practice) because it abolishes the duty to disclose and invokes proportionate remedies for acts for negligent misrepresentation, which is discussed in chapters concerning the duty of disclosure and correct representation.<sup>489</sup> The rules setting out how the FOS should handle complaints were published in a part of the FSA's book, in the section called Dispute resolution: complaints.<sup>490</sup> Since these rules are created to guide the FOS's resolutions to

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<sup>485</sup> For a history of the Statements of Practice, see the Law Commission and the Scottish Law Commission (July 2007), *A Joint Consultation Paper, Misrepresentation, Non-disclosure and Breach of Warranty by the Insured (CP 1)*, Appendix A.

<sup>486</sup> Full text can be found in Appendices B and C of the Issues Paper 1, the Law Commission and the Scottish Law Commission, Issues Paper 1, *Misrepresentation and Non-disclosure*.

<sup>487</sup> The Law Commission and the Scottish Law Commission, *Consumer Insurance Law: Pre-contract Disclosure and Misrepresentation (Joint Report with Draft Bill)*, p. 21.

<sup>488</sup> *Ibid.*

<sup>489</sup> It is found that the approach adopted by the FOS in consumer insurance is finally strengthened by the Consumer Insurance (Disclosure and Representations) Act 2012, which is expounded in chapter 3.

<sup>490</sup> Available at <http://fsahandbook.info/FSA/html/handbook>, accessed in January 2013. This site is no longer updated.

referred disputes against the insurer and intermediary, it is not worth outlining its main provisions in this chapter.

Principally, FISMA 2000, the Financial Services Act 2012 and related regulations are trying to modify the whole operation of an insurance company from the authorisation phase, its ownership and management, to scrutinise the performance of controlled activities. In order to carry on insurance business in the UK, authorisation is required. First of all, based on Parts 1 and 2 of the Financial Services Act 2012 and Parts III and IV of FISMA 2000, there are two main routes for authorisation to carry on a regulated activity.<sup>491</sup> These are, applying through the regulated persons (FCA, PRA and a European Economic Area operator) to get a permission;<sup>492</sup> besides, the applicant must satisfy certain threshold conditions.<sup>493</sup> Otherwise, a person who contravenes the general prohibition could be guilty of, and liable on a criminal offence, which is discussed below. In addition to the general authorisation requirement, the original FSA rules, Financial Services Act 2012, FISMA 2000, FCA's online resources and FCA Handbook also provide detailed application and authorisation process.<sup>494</sup>

Originally, the 'approved persons' regime was developed by FISMA 2000 to regulate the ownership and management of insurance companies. This Act

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<sup>491</sup> The list of regulated activities requiring authorisation is contained in Chapter III of The Financial Services and Markets Act 2000 (Regulated Activities) Order 2001. Based on article 10, effecting and carrying out a contract of insurance are specified as regulated activities. Besides, Chapter XIII lays down three kinds of activities in relation to Lloyd's, including advice on syndicate participation at Lloyd's (section 56), managing the underwriting capacity of a Lloyd's syndicate (section 57), and arranging deals in contracts of insurance written at Lloyd's (section 58).

<sup>492</sup> For the current FCA Handbook, see section 9H, Part 1A, Part 1 of the Financial Services Act 2012. For the original FSA Handbook, see James Bateson, 'Authorisation of UK, EEA and Overseas Insurance Companies', in John Young, et al., *A Practitioner's Guide to the FSA Regulation of Insurance* (3<sup>rd</sup> ed., City & Finance Publishing, 2008), p. 46.

<sup>493</sup> See section 55B, Chapter 3, Part 4A, Part 2, and Schedule 6 of the Financial Services Act 2012. For the original FSA rules, see Bateson, 'Authorisation of UK, EEA and Overseas Insurance Companies', in Young, et al., *A Practitioner's Guide to the FSA Regulation of Insurance*, p. 47.

<sup>494</sup> For example, Chapter 1H(8)b, and section 55K, Chapter 3, Part 4A, Part 2 of the Financial Services Act 2012; section 51(3) of FISMA 2000; and Appendix 2.12 of Supervision (SUP) of the FSA Handbook.

introduced an entirely new system compared with the previous regime under the Insurance Companies Act 1982. According to FiSMA 2000 and the original FSA Handbook, those who want to carry on regulated activities must be approved by the authority individually (initially this is FSA).<sup>495</sup> Besides, section 13, Chapter 3, Part 4A, Part 2 of the Financial Services Act 2012 and Part V of FiSMA 2000 regulate the performance of regulated activities, which include the issue of a prohibition order to prohibit the individual from performing a specified function by the regulators if it appears that this individual is not a fit and proper person to perform this controlled function,<sup>496</sup> and the approval details of authorisation.<sup>497</sup> Additionally, some circumstances are stated which an authorised person could be sued by the injured

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<sup>495</sup> For details of the original FSA rules, see Katherine Coates and Hilary Evenett, 'Ownership and Management of Insurance Companies', in Young, et al., *A Practitioner's Guide to the FSA Regulation of Insurance*, p. 111.

<sup>496</sup> According to section 13, Chapter 3, Part 4A, Part 2 of the Financial Services Act 2012, (f) or subsection (1) substitute –

'(1) The FCA may make a prohibition order if it appears to it that an individual is not a fit and proper person to perform functions in relation to a regulated activity carried on by –

- (a) an authorised person,
- (b) a person who is an exempt person in relation to that activity, or
- (c) a person to whom, as a result of Part 20, the general prohibition does not apply in relation to that activity.

(1A) The PRA may make a prohibition order if it appears to it that an individual is not a fit and proper person to perform functions in relation to a regulated activity carried on by –

- (a) a PRA-authorised person, or
- (b) a person who is an exempt person in relation to a PRA-regulated activity carried on by the person.'

Section 56 of FiSMA 2000 stipulates that:

'(1). Subsection (2) applies if it appears to the Authority that an individual is not a fit and proper person to perform functions in relation to a regulated activity carried on by an authorised person.

(2). The Authority may make an order ("a prohibition order") prohibiting the individual from performing a specified function, any function falling within a specified description or any function.

(3) A prohibition order may relate to –

- (a) a specified regulated activity, any regulated activity falling within a specified description or all regulated activities;
- (b) authorised persons generally or any person within a specified class of authorised person.'

<sup>497</sup> Based on section 14, Chapter 3, Part 4A, Part 2 of the Financial Services Act 2012, and sections 59(1) and (2) of FiSMA 2000, an authorised person must take reasonable care to ensure that no person performs a controlled function under an agreement entered into by this authorised person (or a contractor of the authorised person) unless the appropriate regulator approves.

party who suffers loss caused by this individual's misconduct,<sup>498</sup> which will be discussed below.

In respect to the supervision of insurance companies, Part 2 of the Financial Services Act 2012 first of all confirms the regulatory position of the FCA and PRA,<sup>499</sup> listing their general duties,<sup>500</sup> objectives,<sup>501</sup> corporate governance,<sup>502</sup> arrangements for consulting practitioners and consumers,<sup>503</sup> reviews<sup>504</sup> and right to obtain documents and information.<sup>505</sup> The Financial Services Act 2012 lists out FCA's objectives as being the protection of consumers, integrity, competition, strategy,<sup>506</sup> combined with the overall principles applying to general business and insurance industry set out by the FCA Handbook.

After being nominated as the single rule-maker of the financial services industry, the FSA issued the FSA Handbook to guide and regulate firms. Afterwards, the FSA stated its intention to shift its Handbook towards principles-based regulation. Firstly, PRIN set out the high-level principles with which all authorised firms must comply.<sup>507</sup> A couple of them can be discussed combining with the duty of good faith and lawful management, for example, principle 2 required the firm to conduct its business with due skill, care and diligence. Principle 3 requested the firm to take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems. High-level principles 6 and 8 demanded that the authorised firms must pay due regards to the interests of its customer and treat them fairly, and

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<sup>498</sup> See sections 13 and 14 of Chapter 3, Part 4A, Part 2 of the Financial Services Act 2012 and sections 56(6), 59(1) or (2), 71, FiSMA 2000.

<sup>499</sup> Section 1A, Chapter 1 and section 2A, Chapter 2, Part 1A, Part 2, Financial Services Act 2012.

<sup>500</sup> Sections 1B; 1M, Chapter 1; 2H, Chapter 2, Part 1A, Part 2, Financial Services Act 2012.

<sup>501</sup> Sections 1C-F, Chapter 1; sections 2B-D, Chapter 2, Part 1A, Part 2, Financial Services Act 2012.

<sup>502</sup> Section 3C, Chapter 3, of Part 1A, Part 2, Financial Services Act 2012.

<sup>503</sup> Section 2I, Chapter 2, of Part 1A, Part 2, Financial Services Act 2012.

<sup>504</sup> Section 2O, Chapter 2, of Part 1A, Part 2, Financial Services Act 2012.

<sup>505</sup> Section 2P, Chapter 2, of Part 1A, Part 2, Financial Services Act 2012.

<sup>506</sup> Sections 1C-F, Chapter 1, Part 1A, Part 2, Financial Services Act 2012.

<sup>507</sup> Available at <http://fsahandbook.info/FSA/html/handbook>, accessed in January 2013. This site is no longer updated.

manage the conflicts between different parties. Principle 11 required the firm to deal with its regulators in an open and cooperative way, and disclose to the FSA appropriately anything relating to the firm of which the FSA would reasonably expect notice.

In addition to the high-level principles in PRIN applied to all authorised firms, the FSA Handbook also set out some detailed rules for high-risk products, such as, the Insurance Conduct of Business Sourcebook (ICOBS) which was designed for all general insurance business, for example, car insurance. The ICOBS is continued by the FCA handbook subject to some corrections. Currently, ICOBS 2.2.2R requires the insurance firms to communicate information to a customer or other policyholder in a clear, fair and not misleading way. Besides, chapter 4 of ICOBS deals with the communication of the information about the firm, its services and remuneration. For example, firms are required to provide the customer with at least its status disclosure (including its name and address), scope of service, and fee disclosure. In respect to a general insurance contract, the firms are expected to disclose the law applicable to the contract, the arrangements for handling policyholders' complaints concerning contracts prior to the conclusion of an insurance contract,<sup>508</sup> and the right to cancel a policy.<sup>509</sup> Chapter 8 also stipulates that the insurer must handle claims promptly and fairly and not unreasonably reject a claim.<sup>510</sup>

The ICOBS of the FCA Handbook is mainly dealing with non-investment insurance.<sup>511</sup> ICOBS 1 Annex 1 modifies its general application rule according to the

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<sup>508</sup> ICOBS 6.2.

<sup>509</sup> ICOBS 6.2.5R.

<sup>510</sup> ICOBS 8.1.1R.

<sup>511</sup> According to the Glossary in the FCA Handbook, a 'non-investment insurance contract' is defined to be a contract of insurance which is a general insurance contract or a pure protection contract but which is not a long-term care insurance contract. A 'long-term insurance contract' is defined as a contract:

'(a) which provides, would provide at the policyholder's option, or is sold or held out as providing, benefits that are payable or provided if the long-term care insurance contract

type of firm, its activities and its location.<sup>512</sup> Additionally, special circumstances such as large risks,<sup>513</sup> reinsurance contracts,<sup>514</sup> and pure protection contracts<sup>515</sup> are limited and exempted from the general application rule.

Combining with FISMA 2000 (especially section 21), ICOBS regulates the insurer and intermediary's behaviour in effecting and carrying on an insurance contract.<sup>516</sup> For instance, ICOBS 2.2 requires a firm to communicate information and approved financial promotion to a customer or other policyholder in reasonable steps, and to communicate it in a clear, fair and not misleading way.<sup>517</sup> Echoing the High-level principle 8, ICOBS 2.3 requires a firm to manage conflicts of interest fairly between different parties.<sup>518</sup>

In addition to the abovementioned sections requiring the firm to be managed with good faith and in a lawful manner, ICOBS imposes further requirements of duty of good faith on the insurers and insurance intermediaries. Chapter 4 of ICOBS is dealing with the disputes with respect to information about the firm, its services and remuneration.<sup>519</sup> Nevertheless, this chapter only applies to insurance intermediaries but not insurers. ICOBS 5 requests the firm to take reasonable steps to ensure that

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policyholder's health deteriorates to the extent that he cannot live independently without assistance and that is not expected to change; and  
(b) under which the benefits are capable of being paid for periodically for all or part of the period that the policyholder cannot live without assistance;  
where 'benefits' are services, accommodation or goods necessary or desirable for the continuing care of the policyholder because he cannot live independently without assistance.'

<sup>512</sup> *Ibid*, p. 300.

<sup>513</sup> ICOBS 1 Annex 1, Part 2, para 2.1R.

<sup>514</sup> *Ibid*, para 1.1R. Reinsurance contracts are excluded from ICOBS.

<sup>515</sup> *Ibid*, para 3. ICOBS applies unless the firm elects to comply with COBS.

<sup>516</sup> Application, Chapter 1, in ICOBS.

<sup>517</sup> Check ICOBS 2.2.4G for guidance provided on the application of a clear, fair and not misleading rule.

<sup>518</sup> Including between a firm itself and its customers and between a customer and another client. See ICOBS 2.3.1(1)G.

<sup>519</sup> This chapter stipulates that prior to the conclusion of an initial contract of insurance, the firm must disclose its status, scope of service on paper or any other durable medium available and accessible to the customer, in a clear and accurate manner, comprehensible to the customer, or orally if the customer requests. See ICOBS 4.



the customer only buys a policy under which he is eligible to claim benefits,<sup>520</sup> and explain the material circumstances and the effects of breaching the duty of disclosure to the customers.<sup>521</sup> Furthermore, chapter 6 obliges the insurers to produce, and an insurance intermediary to provide, required information (such as price and cancellation right) to a customer. In doing this, the customer can make an informed decision. ICOBS 8 finally requires the insurer to handle claims promptly and fairly, provide reasonable guidance and appropriate information to help a policyholder make a claim, to not unreasonably reject a claim, and to settle claims promptly once settlement terms are agreed.

#### **4.3.3.1.3. Lawful operation and warranty of legality**

Combined with the implied warranty of legality obliged by section 41 under MIA 1906, the duty of lawful operation and warranty of legality mean two different things. The former is applicable to general insurance, and stipulates that the establishment, registration and management of an insurance company must be legal from the root, while the latter only exists in marine insurance.<sup>522</sup>

The duty of lawful operation embodies one aspect of the insurer's duty of good faith. Furthermore, this is also a typical substantive obligation imposed by law in order to protect the insured's legal benefits. In contrast, if the insurance companies are formed and managed without sufficient administrative or legal supervision, for instance, if founded on illegal purpose or if they deny the indemnification without any

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<sup>520</sup> ICOBS 5.1.2 R (1).

<sup>521</sup> ICOBS 5.1.4 G.

<sup>522</sup> The reason for this is that the policy in non-marine insurance is one on property and nothing more. Baris Soyer, *Warranties in Marine Insurance* (2<sup>nd</sup> ed., Cavendish Publishing Limited, 2005), p. 132. Also see *Euro-Diam Ltd v Bathurst* [1987] 1 Lloyd's Rep. 178, p. 186.

rational reasoning, the insured's economic benefits would be threatened and subsequently, the whole insurance market would suffer.<sup>523</sup>

#### **4.3.3.2. Insurer's duty of pre-contractual disclosure**

As stated earlier, the false impression transferred by article 222 of CMC that the duty of disclosure is imposed on the assured only misleads both parties to neglect the insurer's duty, which further causes this duty to give unprincipled support to the insurer.<sup>524</sup> Therefore, the provisions in general law must be invoked so as to provide more control on the insurers.

Firstly, article 42(2) of Chinese Contract Law stipulates that the party shall be liable for damages if he deliberately conceals important facts relating to the conclusion of the contract, or if he provides false information during the conclusion of a contract, thus causing losses to the other party. As one provision clarified by a general Chinese Contract Law, it undoubtedly applies to the specialized insurance area. However, Chinese Contract Law only covers the fraudulent concealment but not the non-fraudulent non-disclosure situation. Until now, the ambiguity with regard to the certain scope and contents of material information needed to be disclosed by the insurer persists in Chinese law, and we await further judicial interpretation in this issue. In the view of this author, since the shipping industry is becoming more world-wide in China, international trading custom and practice should be taken into account. Although there is no binding precedent doctrine within the Chinese legal system, judgments still contribute a lot to law reform.

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<sup>523</sup> Tao Jiang, 'Duty of utmost good faith in marine insurance law' (Chinese version), (2001) 10 *CL*.

<sup>524</sup> In practice, the assureds are found rarely to invoke the avoidance or termination remedy after suffering loss, and normally the insurers are the alleged injured party. Relieving the duty of disclosure from the insurers but obliging it to the assured solely makes the situation undoubtedly worse.

Secondly, articles 116 and 131 of CIL 2009 also impose the duty of disclosure on the insurance company and its employees. Based on article 116, an insurance company and its employees shall not conceal any material information relating to the marine insurance contract from the applicant. Article 131(1) and (2) of the same law also specify that the insurance broker, agent and some other employees shall not conceal any material information relating to the contract from the applicant or beneficiary. Furthermore, they must not hinder or deceive the applicant or beneficiary from performing the duty of disclosure stipulated in this law. Otherwise, the wrongdoer would be responsible for administrative or criminal liabilities.<sup>525</sup>

#### **4.3.3.3. Duty of explanation and recommendations**

##### **4.3.3.3.1. Duty of explanation**

In addition to the general requirement of disclosing material information to the applicant and beneficiary before the conclusion of a marine insurance contract, one extra duty is imposed on the insurer in Chinese law, which is known as the duty of explanation. Due to the loophole left by CMC regarding the insurer's duty of explanation, the following articles also theoretically apply to specialized marine insurance contracts.

Article 17 of CIL 2009 makes the point that in cases where the insurer decides to adopt the standard form, the insurer shall attach the standard form to the policy, and explain the contract terms and conditions to the applicant. The same article further states that if there are any exclusion clauses imposed by the insurer, then the insurer shall provide sufficient notice of the existence of such exclusion clauses in the

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<sup>525</sup> Articles 162 and 166, CIL 2009.

proposal form, insurance policy or the other insurance documentations and give specific and clear explanations of this exclusion clause written or orally to the applicant when concluding the insurance contract. Otherwise, such clauses shall not be enforceable.

Article 17 of CIL 2009 further imposes the insurer to fulfil the voluntary duty of explanation to the applicant. This is deemed as a remarkable advantage compared to the former legislation.

In addition to specialized legislation in insurance, article 39 in Chinese Contract Law also requires the insurer to perform the duty of explanation under general contracts. This point is also the second element that distinguishes the insurer's duty of disclosure in Chinese law from the statutory legislation in English law, especially MIA 1906. This article states that where standard terms are adopted at the time of concluding a contract, the party supplying the standard terms shall define the rights and obligations between the parties abiding by the principle of fairness. According to the same article, meanwhile, the clause proposer shall inform the other party to note the exclusion or restriction of its liabilities in a reasonable way and explain the standard terms upon request by the other party. The insurer's duty to explain the standard form contract is not as strict as that in insurance law, at least, it is not a voluntary explanation now, but an inquiry duty. Even if the parties have any disputes over the understanding of any clause of the contract, the true meaning shall be determined according to the language, relevant provision, purpose, and transaction practices of the contract, as well as the principle of good faith.<sup>526</sup>

In the view of this author, the duty of explanation should not be a mandatory rule in business marine insurance, but should only apply in cases where there are some

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<sup>526</sup> Article 125, Chinese Contract Law.

particularly problematic clauses or consumer insurance contracts. The reason for not setting the insurer's duty of explanation as a mandatory rule in general marine insurance is that the majority of marine insurance applicants are experienced or supported by specialists. This renders them more knowledgeable when compared to the other individual customers who plan to buy their first life or property insurance. More importantly, the high efficiency and massive volume of information transferred during the marine transactions do not permit the insurer to explain everything to the applicants. In this situation, a duty of explanation seems to be generally redundant in marine insurance and it should not be required in all events. This opinion is also supported by some British leading scholars<sup>527</sup> who express their reasons that in English law, in the absence of constraints violating contracts,<sup>528</sup> the law treats parties to a contract as equals who deal with each other at arm's length, disregarding differences in economic, social or political standing and strength.<sup>529</sup> Therefore, in English law the insurer is generally not required to explain to the assured the terms of the insurance contract<sup>530</sup> since the assured is assumed to appreciate the consequences of dealing with an insurer. Under the second circumstance where the individual customer wants to procure a boat insurance for himself, the duty of explanation should be welcomed.<sup>531</sup> Actually in current English law, the marine insurance contract which is bought by an individual unrelated to business, mainly or wholly, is defined as consumer insurance.<sup>532</sup>

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<sup>527</sup> For example, Eggers, et al., *Good Faith and Insurance Contract*, paras. 12.34-8.

<sup>528</sup> For example, duress, undue influence, misrepresentation and lack of capacity.

<sup>529</sup> See *Bawden v London, Edinburgh and Glasgow Assurance Co* [1892] 2 QB 534 (where the assured was illiterate and blind); *Stone v Reliance Mutual Insurance Society Ltd* [1972] 1 Lloyd's Rep. 469, p. 474 (per Lord Denning, MR), cited by Eggers, et al., *Good Faith and Insurance Contract*, paras. 12.34-8.

<sup>530</sup> *Ibid.*

<sup>531</sup> The reasons are discussed below.

<sup>532</sup> For details, see chapter 3 above.

Yet, there is no absolute model answer for this issue because of the complexity and globalization of the marine industry. For instance, if one shipowner in China decides to effect an insurance policy at Lloyd's in London, apart from the first obstacle in language, the differences between shipping practices in China and UK become the other barrier. In this situation, explaining the Lloyd's standard form terms and exclusion clauses to the international client turns out to be necessary and crucial, otherwise, the misunderstanding would turn into a huge problem as long as disputes emerge.

#### **4.3.3.3.2. Recommendations**

Inevitably, the vexed question has been raised in China regarding the duty of explanation and its enforcement in the general insurance area. Most enquiries have questioned certain criteria of 'clear explanation' and insufficient sanction imposed on the wrongdoers. Actually, these insufficiencies are understandable. In the view of this author, one possible excuse might be the future burden left on the alleged applicant to prove that the explanation made by the insurer is not clear enough, and that the unclear part influences the applicant's final decision.<sup>533</sup>

The first obstacle is the ambiguity left regarding the exact meaning of 'clear explanation'. In the view of this author, an objective 'reasonable insured' test can be introduced in this respect. In other words, insurer's explanation can be considered to be clear enough for the applicant if a reasonable applicant in this individual situation can understand the contract terms.

Furthermore, Chinese statutes' silence and weakness as to the legal consequences of the insurer's breach of duty of explanation may indicate that the

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<sup>533</sup> Such as, reject this offer or choose another insurance company.

legislator intends to force the assured to bear a heavier burden than the insurer. On the basis of CIL 2009, the insurer's failure of explaining the standard form contracts seems to have no legal consequence, and the failure of explaining the exclusion clauses only leads to them being avoided.<sup>534</sup> This needs future judicial interpretation issued by the Supreme People's Court of the PRC.

One might have the view that the duty of explanation imposed on the insurer in both general insurance area and consumer contract in marine insurance, before the conclusion of the insurance contract, is a reasonable requirement. There are several reasons. Firstly, the wide range of would-be insureds results in irregularity in the basic knowledge levels. This fundamental concern happens to the individual insured in consumer insurance contracts. Most of the individual applicants do not buy insurance with sufficient specialized advice from their brokers or agents. As a result, the understanding of contractual terms is connected to their background and inevitably, including education levels, experiences, incomes, and so on. In this irregular situation, it is unrealistic to anticipate each applicant to understand, or potentially understand, the specialized contract terms and conditions. Although in practice, the contractual insurance parties generally are taken to understand the language of insurance, and the respective rights and obligations which the relationship entails,<sup>535</sup> requesting the insurer to explain the contractual terms especially the exclusion clauses to the applicant should be a welcome mechanism to reduce any potential disputes.

Secondly, in contrast to the duty of explanation of the insurer, it is inordinate to overload the duty of understanding to the individual assured impliedly under the circumstances abovementioned. The reasons have been discussed partially in

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<sup>534</sup> Article 17, CIL 2009.

<sup>535</sup> Eggers, et al., *Good Faith and Insurance Contract*, para. 12.34.

previous paragraphs. In addition to the irregularity of applicants, the duty of equality is also another reason. There is no doubt that the doctrine of utmost good faith in the MIA 1906 was founded initially on the imbalance of information between the insurer and insured because of the lack of communication and the incipient level of science and technology. However, in reality the situation is radically different at present. In this situation, imposing a stricter duty of disclosure on the insureds solely is obviously unfair because it imposes them, in particular the individual applicants (both marine and non-marine) and small/ medium size businesses, in a disadvantageous position compared to the professional insurance companies. In performing the duty of explanation, the insurer would take more responsibilities during the negotiation of an insurance contract, so as to reach an agreement with more transparency and confidence.

Thirdly, in the view of this author, a certain legal statute would reduce the disputes between the involved parties. It is easier for both parties to check their rights and obligations during a transaction. Some people may express their concerns about the disadvantages of codification, one of which is its limitations and rigidity. However, it is still better than nothing. Additionally, a common law country should not be concerned with the legislative approach in a civil law system since the precedent system still can conclusively clarify the law afterwards. In contrast, the adoption of the duty of explanation imposed on the insurer would protect the insured's basic right to sufficiently understand the contractual terms and conditions, particularly the insurance contract, which is considered as one contract of unique specialized knowledge.

Finally, in accordance with the long history of the Lloyd's market, it can be seen that a marine insurance contract is usually based upon standard form contracts, and



the insurance clauses in the contract are generally drafted by insurers unilaterally.<sup>536</sup> In actuality, this phenomenon is not unique but quite common in business transactions, for example, landlord and tenant agreements. The standard form contract is mainly used because of its fast speed and low cost. On the other hand, it has to be admitted that the use of a standard form contract may encourage the draftsman to abuse this convenience and injure the other party. Unfortunately, English contract law pays inadequate attention to the efficacy of standard form contracts. Although, the fact that ICOBS<sup>537</sup> requires the insurer to explain the duty of disclosure to the customer may be deemed as a great concession to the individual assured compared to the traditional view held by English law (which states that the insurance contractual parties should be treated equally), this paragraph in ICOBS is inadequate. In explaining the contractual terms and exclusion clauses to the applicants, specifically to common consumer assureds, it is not hard to anticipate that more applicants would be attracted by increasing transparency and confidence in this industry.

#### **4.3.4. Insured's duty of disclosure**

Article 222 in the CMC first provides that the insured shall truthfully disclose the material circumstances to the insurer. On the basis of article 222(1) in CMC, the circumstances which are known or ought to be known to the insured in the ordinary course of business, and which would influence the judgement of an insurer in deciding the premium, or determining whether he will take the risk, are defined to be material. The fact is that, apart from this principal provision regarding 'material

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<sup>536</sup> Geoffrey Hudson, *The Institute Clauses* (3<sup>rd</sup> ed., London: LLP, 1999), p. 1.

<sup>537</sup> See 4.3.3.1.2.

circumstances', there is currently no other statute or judicial interpretation clarifying the legal position in respect of the materiality test in Chinese marine insurance law. Nevertheless, there is no doubt that this topic could be extended through the reasonable insured test, decisive influence test, and inducement.

#### **4.3.4.1. Prudent insurer test**

The test of materiality is always a controversial issue in different countries because the difficulty lies in balancing the rights and obligations of both parties to the insurance contract. On the one hand, the legislation should oblige the insured to truthfully disclose the information of the insured subject, providing sufficient protection and guarantee to the insurer. But on the other hand, the legislation also should prevent the insurer from taking advantage of the duty of disclosure as a technical defence in order to escape from liable indemnification.

In China, some scholars<sup>538</sup> suggest that since the key term relating to the test is, 'would influence the insurer's decision' (which to a large extent, is a copy of section 18(2) of the MIA 1906 with slight differences), the test of materiality could be determined as a 'prudent insurer' test, which is the same as the test adopted by English law particular to marine insurance. Actually this statement is confirmed by the announcement of the Reply to the questions of Commercial and Admiralty Trial Practice involving foreign elements by the Supreme People's Court in 2004.<sup>539</sup> Article 158 in this document states that every circumstance is material if it would influence a prudent insurer's decision, and the material circumstances should be disclosed to the insurer before the conclusion of an insurance contract.

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<sup>538</sup> For example, Zhen, 'Insured's duty of disclosure and test of materiality in marine and non-marine insurance laws in China' in *JBL*, p. 696; Wei Gao, 'On the principle of *Uberrimae Fidei* in Marine Insurance Law' (Chinese version), (1997) *ACML*, p. 339.

<sup>539</sup> Issued by Civil Trial IV, the Supreme People's Court of the PRC, 2004 (Chinese version).

As a matter of fact, at present, the pressure for reforming insurance law is continuing to mount in the UK.<sup>540</sup> In the view of this author, this enquiry is forceful. The proposal of these queries and some other factors triggered the starting of revision and reforming of insurance law in the UK, which is likely to cause further changes in insurance in the near future.<sup>541</sup> In the reports, Draft Bill and the Consumer Insurance (Disclosure and Representations) Act 2012<sup>542</sup> for consumer insurance released by the Law Commission, the famous hypothetical 'prudent insurer' test is proposed to be replaced by a 'reasonable insured' test from start to finish, which echoes the voice of the insurance industry.<sup>543</sup> One reason provided by the Law Commissioners is, that the 'reasonable insured' test is deemed to be more objective to the business insured's reasonable expectations than the current law.<sup>544</sup>

At the same time, some Chinese authorities recommend a 'reasonable insurer' test instead.<sup>545</sup> In the view of this thesis, the 'reasonable insurer' test is ideal. There are two main reasons. Firstly, the 'reasonable insurer' test is more objective than the 'prudent insurer' test adopted by English law. For English commercial marine insurance, the definition of 'prudent insurer' test was raised by section 18(2) in the MIA 1906, which is interpreted as a circumspect or judicious insurer in his

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<sup>540</sup> See chapter 3.

<sup>541</sup> The Law Commission proposed a Draft Bill for Consumer Insurance, which received Royal Assent in March 2012. The Law Commission plans to release the Draft Bill for Business Insurance soon.

<sup>542</sup> In 2006, the Law Commission (England and Wales) and Scottish Law Commission set up a joint review of insurance law, after this three-year consultation, the Law Commissions drafted a 'short, targeted bill' and presented it to the Parliament, which received Royal Assent in 2012. The Consumer Insurance (Disclosure and Representations) Act 2012 is mandated to fix the insufficiency of current insurance legislations in the UK, for consumer insurance area to be specific, codifying the confusing rules, and also catching up with the European developments.

<sup>543</sup> The vast majority of the responses to Law Commission's review (CP 1) expressly called for reform relating to utmost good faith for both consumer and business insurance law. The Law Commission and Scottish Law Commission, *Reforming Insurance Contract Law: A summary of Responses to Consultation on Consumer Issues* (May 2008); *Reforming Insurance Contract Law: A summary of Responses to Consultation on Business Issues* (October 2008).

<sup>544</sup> The Law Commission and the Scottish Law Commission, *A Joint Consultation Paper, Misrepresentation, Non-disclosure and Breach of Warranty by the Insured* (CP 1), p. 121.

<sup>545</sup> For example, see Wang, *The Law of Marine Insurance*, p. 80; Wang, 'The duty of disclosure and the legal consequences of its breach' in *ACML*, p. 163; Li, 'Comparative Study on the Duty of Disclosure between China and England' in *JCL*, p. 19.

dealings.<sup>546</sup> This stated 'objective' criterion has been heavily criticised because of its irrationality for an insured.<sup>547</sup> It seems that this strict test overestimates the insured's capability of thinking over what would influence a hypothetical prudent insurer and even what his particular insurer would have done had it known the full facts.

Secondly, these two test criteria are not basically opposed to one another. Underlying a 'prudent insurer' test or a 'reasonable insurer' test, one common feature is that they have an objective standard. This opinion is supported by some Chinese academics as well.<sup>548</sup> Strictly speaking, the 'reasonable insurer' test in Chinese law is suggested to be enforced by reference to the insurer's average level of insurance knowledge, career experiences and abilities, but not a particular situation.<sup>549</sup> According to the leading law dictionary, there seems no substantial difference between the explanation of a 'prudent person' and a 'reasonable person'.<sup>550</sup>

#### 4.3.4.2. Decisive influence test

The other pillar of the materiality test in Chinese law is the degree of influence to the final decision caused by non-disclosed information. Chinese law adopts a 'decisive influence' test, to the effect that only the circumstance which would influence the decision of the prudent insurer decisively is material. This point is also

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<sup>546</sup> The term of 'prudent' is defined to be 'circumspect or judicious in one's dealings' by the *Black's Law Dictionary*, see Garner, et al., *Black's Law Dictionary*.

<sup>547</sup> The Law Commission and the Scottish Law Commission, *Reforming Insurance Contract Law: A summary of Responses to Consultation on Consumer Issues* (May 2008).

<sup>548</sup> For example, Li, 'Comparative Study on the Duty of Disclosure between China and England' in *JCL*, p. 19; Wang, *The Law of Marine Insurance*, p. 80.

<sup>549</sup> *Ibid.*

<sup>550</sup> The term 'prudent' is defined to be 'circumspect or judicious in one's dealings'. The 'reasonable person' is defined to be a hypothetical person used as a legal standard, especially to determine whether someone acted with negligence; specifically, a person who exercises the degree of attention, knowledge, intelligence, and judgment that society requires of its members for the protection of their own and of others' interests. The reasonable person acts sensibly, does things without serious delay, and takes proper but not excessive precautions. Also termed reasonable man; prudent person; ordinarily prudent person; reasonably prudent person; highly prudent person. Garner, et al., *Black's Law Dictionary*.

the standard used by the courts to rule if the avoidance remedy can be awarded to the injured party.

In English law, the history of the 'decisive influence' test can be dated back to the *CTI* case<sup>551</sup> in which Justice Lloyd held that, on the true construction of section 18(2) of the MIA 1906, a non-disclosed circumstance was material only if its disclosure would have led a prudent underwriter either to decline the risk altogether or to charge a higher level of premium. The non-disclosure must, therefore, have exerted a 'decisive influence' on the judgment of the prudent insurer by inducing a 'different decision' with respect to the risk.<sup>552</sup> However, the 'decisive influence' test was overruled by the Court of Appeal in the same case.<sup>553</sup> The decision of the Court of Appeal regarding this aspect was upheld by the House of Lords in *Pan Atlantic*.<sup>554</sup>

In Chinese law, according to the language of article 222 of the CMC, there is nothing to provide for a detailed test of materiality in marine insurance law. What worsens the situation is the lack of an authoritative judicial interpretation of this part. In spite of the ambiguity in statutory legislation, many Chinese academics favour the 'decisive influence' test.<sup>555</sup> In the view of this author, there are several considerations

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<sup>551</sup> [1982] 2 Lloyd's Rep. 178.

<sup>552</sup> *Ibid*, p. 187, QBD, Lloyd J reasoned that:

'It seems to me that this should be the general rule, if only because the defence under s. 18 is capable of working such great hardship on the assured. Take a case where the fact is known to the assured, but not the materiality of the fact. Suppose that the prudent insurer, if he had known the fact, would have accepted the risk, but charged a small additional premium; suppose further that there is a substantial claim under the policy. In other jurisdictions, the assured could enforce the claim, by tendering the additional premium. But not so in England. The fairness of the English rule is not at once obvious and hardly seems to reflect the duty of utmost good faith under s. 17 which, be it noted, is owed both ways. Why, if the insurer would have accepted the risk in any event, albeit at an increased premium, should he be able to avoid the claim altogether? Since the English law is so favourable to the underwriter in this respect, the least that should normally be expected of the underwriter is to show that a prudent insurer would have charged an increased rate.'

Also see Bennett, *The Law of Marine Insurance*, p. 111.

<sup>553</sup> [1984] 1 Lloyd's Rep. 476, CA.

<sup>554</sup> [1994] 2 Lloyd's Rep. 427. For more details regarding the 'decisive influence test' in English law, check chapter one for details.

<sup>555</sup> For example, Shaochun Yuan, 'The Scope of the duty of disclosure of the assured in marine insurance' (Chinese version), in Guangzhou Maritime Court, et al., (1998) 3 *CMT*, p. 15; Xiaogang Chen, 'The duty of disclosure of the assured in marine insurance law' (Chinese version), (1991) 2

worthy of discussion here. Firstly, it is indisputable that the 'decisive influence' test is objective, but it tends to favour the insurer. This test was held to be purely objective without any consideration of the situation if the assured appreciated the materiality of the fact, or whether the underwriter in question was actually influenced by it. The only relevant point is whether a prudent underwriter would have been interested in the information.<sup>556</sup> In other words, according to Lord Goff, the decisive influence test ignores the fact that it is the duty of the assured to disclose every material circumstance which is known to him, with the result that the question of materiality has to be considered by the assured before he enters into the contract.<sup>557</sup>

The second consideration is that the adoption of the 'decisive influence' test leads to the insured to undertake a heavy burden to decide the elements which would affect the result of a hypothetical prudent insurer's decision. It appears that a full disclosure is the safest option for the insured, but this may be an extreme imposition. This opinion is supported by the Court of Appeal in *CTI*.<sup>558</sup> According to Stephenson LJ, there were 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

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ACML, pp. 188-190; Feng Li, 'On the duty of disclosure' (Chinese version), in Guangzhou Maritime Court, et al., (1998) 3, *CMT*, p. 12, cited by Xin Wang, *Legal Aspects of Chinese Marine Insurance against the Background of English Law* (September, 2000) Thesis (MPhil) The Hong Kong Polytechnic University, p. 59.

<sup>556</sup> Merkin, *Marine Insurance Legislation*.

<sup>557</sup> *Pan Atlantic* [1994] 2 Lloyd's Rep. 427, p. 431.

<sup>558</sup> [1984] 1 Lloyd's Rep. 476, CA.

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?<sup>559</sup>

The concern about overloading the assured to make full disclosure of everything which might influence the mind of an underwriter was also expressed by Justice Blackburn in *Ionides and Another v Pender*,<sup>560</sup> where it is stated that it is too much to put on the assured the duty of disclosing everything which might influence the insurer's decision and in doing so, business could hardly be carried on if this was required. The over-disclosure phenomenon caused by uncertainties of the range of information requiring disclosure has been laid on the table by the English Law Commission and the Scottish Law Commission in their first Consultation Paper,<sup>561</sup> on the grounds that applicants often provide insurers with more information than they are able to process. Just as one experienced insurance lawyer put it, the commercial brokers are tending to walk into underwriters with three CDs and tell them, 'it's all in there'.<sup>562</sup>

Additionally, some other factors could influence the conclusion of a contract decisively as well, such as, the market fluctuations, economic aims and political elements. In practice, it is doubted that the insurer would rather lose a key account, but not make an option to continue this transaction with the knowledge that the insured has non-disclosed or misrepresented some information. To this regard, the standard of a 'decisive influence' is radically different and the universal standard does not apply any more.

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<sup>559</sup> *Ibid*, pp. 526-527.

<sup>560</sup> (1874) LR 9 QB 531, p. 539.

<sup>561</sup> The Law Commission and the Scottish Law Commission, *A Joint Consultation Paper, Misrepresentation, Non-disclosure and Breach of Warranty by the Insured (CP 1)*.

<sup>562</sup> The Law Commission and the Scottish Law Commission, *Consumer Insurance Law: Pre-contract Disclosure and Misrepresentation (Joint Report with Draft Bill)*, p. 134.

#### 4.3.4.3. Actual inducement

In English law, the 'actual inducement' test is known as the second layer of the test of materiality in marine insurance, which entitles the injured party to declare the avoidance of an insurance contract. This test was finally laid down by the famous *Pan Atlantic* case,<sup>563</sup> which required the insurer to prove that the non-disclosed or misrepresented information has actually induced the conclusion of the insurance contract. In Chinese marine insurance law, there is no such provision clarifying whether the insurer must prove this reality. However, the other general statutes provide a brief concept, thus, it is still an attractive topic.

First and foremost, the 'actual inducement' factor is not adopted by Chinese marine insurance law as an element of materiality. Alternatively, a causal link is built up impliedly between the non-disclosure and the conclusion of contracts by the establishment of a 'decisive influence' test. In fact, the 'decisive influence' test already covers causation between the concealment or misrepresentation and the prudent insurer's decision. On this basis, a circumstance is material if it would influence the mind of a prudent insurer decisively in his final decision, and if this be proved, it is superfluous to establish that the mind of the particular insurer has been induced. This opinion was put forward by MacKinnon LJ in his judgement in the early case of *Zurich General Accident and Liability Insurance Co. Ltd. v Morrison*,<sup>564</sup> where it is clearly pointed out that:

'Under the general law of insurance an insurer can avoid a policy if he proves that there has been misrepresentation or concealment of a material fact by the assured. What is material is that which would influence the mind of a prudent insurer in deciding whether to accept the risk or fix the premium, and if this be proved it is not necessary to prove that the mind of the actual

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<sup>563</sup> *Pan Atlantic Insurance Co Ltd and Another v Pine Top Insurance Co Ltd (Pan Atlantic)* [1992] 1 Lloyd's Rep. 101, QBD; (1993) 2 Re LR 119, CA; [1994] 2 Lloyd's Rep. 427, HL.

<sup>564</sup> (1942) 72 Ll.L.Rep.167; [1942] 2 K.B. 53.



insurer was so affected...<sup>565</sup>

The 'decisive influence' test has been overruled by both the Court of Appeal in *CTI*<sup>566</sup> and the House of Lords in *Pan Atlantic*.<sup>567</sup> In the view of this author, these judgments provide a convincing explanation of the redundant status of the actual inducement factor with the 'decisive test' given before *Pan Atlantic*, which is analogous to the present situation in Chinese law.

In spite of that, as a general law compared to the special CMC, article 54 of the Chinese Contract Law deals with the inducement between fraud, coercion, or exploitation of the other party's unfavourable position and the conclusion of contracts, by referring to the revocation of contracts.<sup>568</sup> This article empowers the injured party to petition the court or arbitral institution to modify or rescind the contract in cases where the contract is concluded opposing to his true intention because of the defaulting party's fraud, duress or taking advantage of his vulnerability. This article is also construed to be able to apply to marine insurance law as a provision concerning the 'actual inducement' test. The first possible reason is that, from the wide sense of legal science, if there is no contrary provision in a special law (CMC) referring to a special issue (marine insurance contracts), the provision in a general law (Contract Law of the PRC) can apply to it. But, inevitably, one should be concerned about its blind application from the general area to insurance specialist works.

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<sup>565</sup> *Ibid*, [1942] 2 K.B. 53, pp.172 and 60. Cited by Kerr LJ in his judgment of *CTI* [1984] 1 Lloyd's Rep. 476, p. 495.

Although this judgment is made in connection with the Road Traffic Act, 1934 referring to a policy of insurance having been 'obtained by' the non-disclosure of a material fact, it defined 'material' in the same way as section 18(2) of the MIA 1906.

<sup>566</sup> [1984] 1 Lloyd's Rep. 476.

<sup>567</sup> [1994] 2 Lloyd's Rep. 427.

<sup>568</sup> Paragraph 2, article 54, Chinese Contract Law. In article 54, it is laid down that a party shall have the right to request the People's court or an arbitration institution to modify or revoke the contract if it is concluded by one party against the other party's true intentions through the use of fraud, coercion, or exploitation of the other party's unfavourable position. Paragraph 2, article 54, Chinese Contract Law.

The second reason should be founded on the origins of the duty of disclosure (unequal positions of the insurer and assured). The situation that there are inequalities of knowledge between insurer and insured has been changed and this is also why the English Law Commission and Scottish Law Commission successfully abandoned the consumer assured's duty of disclosure.<sup>569</sup> Although the Draft Bill for commercial insurance has not been released yet, and the duty of disclosure in marine insurance has been expressively announced to be retained,<sup>570</sup> academics are still glad to see that the insurer is not considered to be vulnerable. In the view of this author, the duty of disclosure in most marine insurance transactions should be abolished as well, since currently most insurance companies have their independent databases.

In conclusion, in Chinese marine insurance area, the non-disclosed information is material if it would influence a prudent insurer's decision decisively, and has actually induced the conclusion of the insurance contract, which is different from the tests established by *Pan Atlantic* in English law.<sup>571</sup>

#### **4.3.4.4. Information requiring disclosure – actual knowledge and deemed knowledge**

As stated by article 222 of CMC,<sup>572</sup> sections 18(1) and 19(2) of the MIA 1906, the marine insured or his agent is required to disclose the material information within the scope of his actual knowledge, or knowledge deemed to have been known in the ordinary course of business. Therefore, in respect of the material information

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<sup>569</sup> Section 2, Consumer Insurance (Disclosure and Representations) Act 2012. For the Law Commissions' proposal, see the Law Commission and the Scottish Law Commission, *Reforming Insurance Contract Law: A summary of Responses to Consultation on Consumer Issues*.

<sup>570</sup> The Law Commission and the Scottish Law Commission, *Consumer Insurance Law: Pre-contract Disclosure and Misrepresentation (Joint Report with Draft Bill)*, p. 125

<sup>571</sup> The prudent insurer and actual inducement test.

<sup>572</sup> Article 222, CMC.

requiring disclosure before the conclusion of an insurance contract, the scope of information in Chinese law is the same as the one in MIA 1906.

In English law, combined with sections 18(3),<sup>573</sup> the insured's actual knowledge must be disclosed regardless of whether the insurer could have expected the assured to have such knowledge and what the source of the knowledge is.<sup>574</sup> For instance, if the assured has arranged an investigation in respect of the subject-matter insured, the results of that investigation must be made known to the insurer, whether or not the insurer could have expected the assured to make the investigation. This approach is adopted by Chinese law as well. In Chinese law, the actual knowledge must be disclosed regardless of its source.<sup>575</sup> As to the knowledge deemed to have been known by the assured, some Chinese scholars state that if it is established that under certain situations a reasonable assured (who carries on the same kind of business as the actual assured does) will make inquiry and know the material circumstance thereby, the actual assured is deemed to know it as well.<sup>576</sup>

#### **4.3.5. Limits on disclosure**

In both English law and Chinese marine insurance law, the insured's duty of disclosure is not absolutely unlimited, otherwise, the insurer would become too passive to make reasonable investigations during the negotiation process. At the

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<sup>573</sup> As provided by section 18(3) in MIA 1906, in the absence of inquiry the following circumstances need not be disclosed, namely:

- 'a. Any circumstance which diminishes the risk;
- b. Any circumstance which is known or presumed to be known to the insurer. The insurer is presumed to know matters of common notoriety or knowledge, and matters which an insurer in the ordinary course of his business, as such, ought to know;
- c. Any circumstance as to which information is waived by the insurer;
- d. Any circumstance which it is superfluous to disclose by reason of any express or implied warranty.'

<sup>574</sup> Eggers, et al., *Good Faith and Insurance Contract*, para. 7.105.

<sup>575</sup> Wang, *The Law of Marine Insurance*, p. 81.

<sup>576</sup> Wang, 'The duty of disclosure and the legal consequences of its breach' in *ACML*; Chen, 'The duty of disclosure of the assured in marine insurance law' in *ACML*, p. 186.

same time, the assured would be overloaded with an infinite duty to make full disclosure of every information he knows or he is deemed to know. The occurrence of over-disclosure would be caused subsequently without any doubt.<sup>577</sup>

In Chinese law, the one principal provision which mentions the exception where the insured does not need to perform the duty of disclosure is where the insurer has known of the information, or ought to have knowledge of in his ordinary business practice, and made no inquiry.<sup>578</sup> Apart from this, there is no more detailed legislation with respect to the interpretation of the exceptional circumstances. However, according to the ordinary meaning of this clause, one objective criterion introduced is the insurer's reasonable enquiry test, which has been adopted by section 18(3) of the MIA 1906. Thus, it can be concluded that the premise for this exception for disclosure applies in the absence of the insurer's inquiry. In cases where the insurer does inquire, the limits cannot be relied on anymore.

In the view of this author, the situations exemplified by sections 18 MIA 1906 are worth being referred to in future Chinese marine insurance law reform. As provided by sections 18(3) in MIA 1906, the assured is released from four particular cases in the absence of inquiry, including diminution of the risk, the insurer's actual and presumed knowledge, waiver by the insurer, and warranties. It appears that the CMC only covers the case of the insured's actual and presumed knowledge.

#### **4.3.6. Consequences and remedies for non-disclosure**

The following paragraphs are aimed at elaborating on the legal consequences caused by the insurer and assured's breach of the duty of disclosure. In the

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<sup>577</sup> The Law Commission and the Scottish Law Commission, *Consumer Insurance Law: Pre-contract Disclosure and Misrepresentation (Joint Report with Draft Bill)*, p. 134.

<sup>578</sup> Article 222, CMC.

meanwhile, relevant Chinese codes are introduced, in the light of developments and practice in English law.

#### **4.3.6.1. Insurer's breach of duty**

In Chinese law, as indicated in earlier paragraphs, the legal consequences caused by the insurer's non-disclosure can be mainly divided into two aspects, for example, the insurer's duty of lawful operation and the duty of explanation. Therefore, logically, the following paragraphs are expounded depending on these two topics.

##### **4.3.6.1.1. Consequences and remedies for the breach of lawful operation**

###### **4.3.6.1.1.1. Chinese law**

As pointed out earlier, in Chinese law, the insurance contract is required to be performed according to the doctrine of good faith. Meanwhile, the insurance company is required to operate legally. First of all, anyone who violates the provisions of this law by establishing an insurance company, an insurance asset management company or agency without approval, or conducts insurance transactions illegally, would be banned by the insurance regulatory department. If there are any illegal gains obtained, they will be confiscated and a fine shall be imposed of not less than one, nor more than five times of the illegal gains.<sup>579</sup> In cases where serious violations or failure of correcting within time limits, the insurance

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<sup>579</sup> Articles 159-161, CIL 2009.

company would be ordered to cease operating or would have its licence withdrawn.<sup>580</sup>

Furthermore, anyone who changes information and details without the insurance regulatory department's permission would be ordered to make rectification and improvement, and fined between RMB 10,000<sup>581</sup> and RMB 100,000.<sup>582</sup>

Articles 164-166 and 175 of CIL 2009<sup>583</sup> also exemplify several circumstances under which the insurer company would be ordered by the insurance regulatory department to make rectification and improvement. In the meantime, it would be imposed with a fine between RMB 50,000 and RMB 300,000. In cases of severe

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<sup>580</sup> Article 161, CIL 2009.

<sup>581</sup> Ren Min Bi, Chinese currency.

<sup>582</sup> Article 84 of CIL 2009 stipulates that any insurance company who commits any following acts should obtain the insurance regulatory department's permission: (1) Change of the name of the insurance company; (2) change in the amount of the registered capital; (3) change of business premises of the company or its branch offices; (4) disbandment of divisions (5) division or merger of the insurance company; (6) amendment to its Constitution; (7) change of investors or shareholder who hold more than five percent of the company's shares; or (8) other amendments as specified by the financial supervision and regulation department.

<sup>583</sup> According to article 164, CIL 2009, the insurance company who violates this law and commits the following acts, shall be subject to the insurance regulatory department's decision to make rectification and improvement, and imposed with a fine between RMB 50,000 and RMB 300,000: (1) retaining for its own account excessive insurance exposures which is regarded as having committed a serious breach; or (2) undertaking to provide life insurance where death is the prerequisite for the payment of the insurance benefits, for those who have no civil legal capacity.

Article 165 of the same law further stipulates that the following commitments would lead the committed insurance company to be ordered to make correction and a fine of not less than RMB 50,000 nor more than RMB 300,000; where the circumstances are severe, the insurance regulatory department may restrict the scope of business, direct the company to cease accepting new business or revoke the insurance business license: (1) failing to set up a guarantee fund or violating the stipulations regarding the application of the guarantee fund; (2) failing to set aside or carry forward a reserve for future claims, or set aside an outstanding loss reserve, as required; (3) failing to contribute to the insurance guarantee fund or the accumulated reserve fund as required; (4) failing to effect outward reinsurance as required; (5) violating the regulations governing the application of the funds of the insurance company; (6) establishing branches or representative offices without approval; or (7) carrying out a division or a merger of the company without approval.

As to the insurance agencies' and brokers' duty of disclosure, article 166 reads: if material information was concealed by these parties abovementioned, the agencies or brokers would be ordered to make correction and imposed with a fine between RMB 50,000 and RMB 300,000; where the circumstances are severe, the insurance regulatory department may revoke their licenses.

Article 175 of CIL 2009 regulates that if any foreign insurance institution establishes representative organizations without the approval of the regulatory department under the State Council of the PRC, would be eliminated by this institution and fined between RMB 50,000 and RMB 300,000.

violations of law, the insurance company would be ordered to restrict its scope of business and cease accepting new business, or have its licence withdrawn.<sup>584</sup>

During the management of business, the insurance company also needs to follow articles 170-172 in CIL 2009, to make sure that the insurance transactions are legal. According to articles 170 and 171, any insurance company that endorses, leases, or lends its business licence, or non-discloses information required by the provisions of this law, shall be ordered to cease business and/or be fined between RMB 10,000 and RMB 100,000.<sup>585</sup> In addition to this, article 172 in the same law further provides that anyone who submits false reports, statements, documents and information, or refuses to accept or hinders lawful examination and supervision, or fails to adopt approved insurance clauses and premium rates as required, shall be ordered to make correction, and fined not less than RMB 100,000 nor more than RMB 500,000. In case of severe violations the regulatory department can restrict its scope of business, order it to cease business, or revoke its business license.

In conclusion, anyone who violates the duty of lawful operation under the CIL 2009 in China would be responsible for the civil liability,<sup>586</sup> administrative liability,<sup>587</sup> and/or even criminal liability where severe violations constitute a crime.<sup>588</sup>

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<sup>584</sup> Articles 165, 166 and 167 of CIL 2009.

<sup>585</sup> Article 171 of CIL 2009 lists several circumstances under which the insurance company shall be ordered to make corrections; where it fails to do so within time limits it shall be fined not less than RMB 10,000 nor more than RMB 300,000: (1) failing to submit relevant reports, statements, documents and information in accordance with laws or the regulations; or (2) failing to file the insurance clauses and premium rates for its proposed insurance products as required; or (3) non-discloses information legally.

<sup>586</sup> Article 177, CIL 2009.

<sup>587</sup> Article 178, CIL 2009.

<sup>588</sup> Article 181, CIL 2009.

#### 4.3.6.1.1.2. English law

To highlight distinctions from Chinese Law, English law and some other general business regulations in relation to its authorisation, management and supervision of an insurance company are worth being referred to.

First of all, if a person contravenes paragraph 3, Schedule 9 of the Financial Services Act 2012 which requires him to be authorised to carry on a credit-related regulated activity, such as, insurance, according to the this Act, the authorised person could be guilty of and liable on a summary conviction, to imprisonment for a term not exceeding the applicable maximum term or a fine not exceeding the statutory maximum; or on conviction on indictment, to imprisonment for a term not exceeding two years and/or a fine.<sup>589</sup> Apart from the commission of a criminal offence, paragraph 5, Schedule 9 of the Financial Services Act 2012 and section 26 of the FiSMA 2000 provide that an agreement concluded by an authorised person in the course of carrying on a credit-related regulated activity in contravention of the general prohibition is unenforceable against the other party, who is entitled to recover any money or property paid or transferred by him under the agreement, and have compensation for any loss sustained by him as a result of having parted with it.

Secondly, the 'approved persons' regime<sup>590</sup> is developed and adopted by FiSMA 2000, the Financial Services Act 2012, the original FSA Handbook, and the FCA Handbook to control the performance of regulated activities. If an individual appears to be an unfit or inappropriate person to perform regulated activities, both the FCA

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<sup>589</sup> Paragraph 3(2), Schedule 9, Financial Services Act 2012. Paragraph 3(2)(1G) further explains that '(t)he 'applicable maximum term' is –

- (a) in England and Wales, 12 months (or 6 months, if the offence was committed before the commencement of section 154(1) of the Criminal Justice Act 2003);
- (b) in Scotland, 12 months;
- (c) in Northern Ireland, 6 months.'

<sup>590</sup> For example, paragraph 12, Schedule 5 of the Financial Services Act 2012, and section 64, FiSMA 2000.



and PRA can issue a prohibition order to prohibit this individual from performing a specified function.<sup>591</sup> Additionally, according to section 13, Chapter 3, Part 4A, Part 2 of the Financial Services Act 2012, and section 71 of FiSMA 2000, if a person contravenes section 56(6) which requires a person falling within in subsection (3A) to take reasonable care to ensure that no function of his, in relation to the carrying on of a regulated activity, is performed by a person who is prohibited from performing that function by a prohibition order, or section 59(1) or (2),<sup>592</sup> this misconduct is actionable at the suit of the injured party who suffers loss caused by this contravention.

#### **4.3.6.1.2. Consequences and remedies for the breach of pre-contractual disclosure**

Article 116 of CIL 2009 provides that an insurance company and its employees shall not commit any of the acts in the course of its business operation, including

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<sup>591</sup> See section 13, Chapter 3, Part 4A, Part 2, Financial Services Act 2012, and section 56 of FiSMA 2000, it is stipulated that:

‘(1). The FCA may make a prohibition order if it appears to it that an individual is not a fit and proper person to perform functions in relation to a regulated activity carried on by –  
(a) an authorised person,  
(b) a person who is an exempt person in relation to that activity, or  
(c) a person to whom, as a result of Part 20, the general prohibition does not apply in relation to that activity.

(1A). The PRA may make a prohibition order if it appears to it that an individual is not a fit and proper person to perform functions in relation to a regulated activity carried on by –  
(a) a PRA-authorised person, or  
(b) a person who is an exempt person in relation to a PRA-regulated activity carried on by the person.

(2). The Authority may make a prohibition order prohibiting the individual from performing a specified function, any function falling within a specified description or any function.

(3) A prohibition order may relate to –

(a) a specified regulated activity, any regulated activity falling within a specified description or all regulated activities;

(b) all persons falling within section (3A) or a particular paragraph of that subsection or all persons within a specified class of person falling within a particular paragraph of that subsection.’

<sup>592</sup> Based on section 14, Chapter 3, Part 4A, Part 2 of the Financial Services Act 2012 and sections 59(1) and (2) of FiSMA 2000, an authorised person must take reasonable care to ensure that no person performs a controlled function under an agreement entered into by this authorised person (or a contractor of the authorised person) unless the appropriate regulator approves.

deceiving the insured or beneficiary, concealing material information, preventing or inducing the insured from fulfilling a duty of disclosure, and faking and altering the insurance contract without any approval.<sup>593</sup> Subsequently, based on article 162 of the same law, the defaulting insurer is subject to the insurance regulatory department's discretion and fined between RMB 100,000 and RMB 300,000. In cases of a serious breach, the insurance company's licence would be withdrawn.<sup>594</sup>

Furthermore, any insurer or insurance company concealing information shall be subject to the insurance regulatory department's discretion for correction, or imposed with a fine between RMB 10,000 and RMB 100,000.<sup>595</sup> Despite the typical examples abovementioned and some other articles in chapter 3 of CIL 2009,<sup>596</sup> articles 179 and 181 of the same law further provide that any practitioner who severely breaches laws or administrative regulations shall be barred from entering insurance transactions. Furthermore, any illegal conduct constitutes a crime and shall be subject to criminal proceedings. In short, disobeying the duty of disclosure would lead the defaulting parties to be imposed with not only civil sanctions, but also administrative and/or criminal sanctions.

Nevertheless, the CIL 2009 is also silent regarding the remedies awarded to the innocent insured in cases where the insurer is in a breach of the duty of disclosure. The integrity of remedies mechanism is finally completed by articles 42 and 54 in

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<sup>593</sup> The remaining acts include, refusing to pay the indemnities agreed or insurance money; making false indemnities and cheating for insurance money or any other illegal benefits; misappropriating, intercepting or peculating premium; committing unqualified institutions or individuals with insurance activities; seeking unjust enrichment for any other institutions or individuals; benefiting through the conduct of making up reality; competing unfairly; disclosing customers' trade secrets; and some other conducts which disobey law, administrative regulations, and the rules of the insurance regulatory department under the State Council of the PRC.

<sup>594</sup> Article 162, CIL 2009.

<sup>595</sup> Article 171, CIL 2009; the other two stipulated illegal conducts in this article are failing to submit or keep the reports, report forms, documents or data according to the relevant provisions, or failing to provide relevant information and data; rejecting or impeding lawful supervision and examination according to the relevant provisions.

<sup>596</sup> Articles 163-170, 172-178, 180, CIL 2009.

Chinese Contract Law. Combining these articles, it is found that the rescission or alteration remedy, and damages, are all available for an injured assured in Chinese law, which is different from the provisions in English marine insurance law.<sup>597</sup> In accordance with article 42(2) of Chinese Contract Law, the party shall be liable for damages if he deliberately conceals important facts relating to the conclusion of the contract, or provides false information thus causing losses to the other party.<sup>598</sup> Besides, the contract may be avoided or altered if it is proved that it is concluded against the injured party's intention.<sup>599</sup> However, the alteration or rescission remedy is not automatic and its awarding is totally based on the injured party's petition sent to the court or arbitration institution.

In conclusion, the alteration, rescission and/or damages remedies are all available in Chinese law for the injured assured in cases of breach of the duty of disclosure. In the view of this author, the system adopted by Chinese law is practical and feasible. It is not difficult to imagine that if the insurer's concealment of material information is found before the occurrence of the accident, the assured can choose to alter or rescind the insurance contract. If the injured assured suffers losses because of the

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<sup>597</sup> On the basis of section 17 of MIA 1906 and *Banque Financiere de la Cite SA v Westgate Insurance Co Ltd*. [1988] 2 Lloyd's Rep. 513, the remedy for breach of the duty of utmost good faith is the statutorily provided rescission *ab initio* of the contract only; damages based upon breach of contract is not available. However, damages based upon tort of deceit become available in cases of fraudulent breach of duty of utmost good faith. The remedies regime for consumer insurance is amended by the Consumer Insurance (Disclosure and Representations) Act 2012, including the 'reasonable insured' test and 'proportionate remedy' for innocent misconducts, see chapters 2 and 3 above.

<sup>598</sup> Article 41 of Chinese Contract Law lists three circumstances in which the party shall be liable for damage during the conclusion of a contract and thus causing losses to the other party: (1) pretending to conclude a contract, and negotiating in bad faith; (2) deliberately concealing important facts relating to the conclusion of the contract or providing false information; (3) performing other acts which violate the principle of good faith.

<sup>599</sup> Article 54 of Chinese Contract Law exemplifies several cases in which a party has the right to request the people's court or an arbitration institution to modify or revoke the following contracts: (1) those concluded as a result of significant misconception; (2) those that are obviously unfair at the time when concluding the contract. Also, paragraph 2 says that if a contract is concluded by one party against the other party's true intentions through the use of fraud, coercion, or exploitation of the other party's unfavourable position, the injured party shall have the right to request the people's court or an arbitration institution to modify or revoke it.

insurer's breach he shall be awarded damages as well. In this situation, it is not hard for the insured to make a decision to declare the insurance contract rescinded since there is no loss for him except for loss of time, if he can reclaim the paid premium. However, if the insurer's breach of duty of disclosure was found after the occurrence of accident, thus causing losses to the insured subject, declaring this insurance contract rescinded should be the last resort the policyholder wishes to do because such declaration would discharge the insurance company from further liability to pay the claim. Additionally, based on the MIA 1906 only, the injured marine assured can have this contract rescinded from the beginning. Alternatively, the injured assured has to bear this unfair insurance contract with some alterations. In providing the third additional or alternative damage remedy for the assured, under Chinese law the insurance company would not be able to take advantage of the insured's vulnerability on this point.

#### **4.3.6.1.3. Legal consequences and remedies for the breach of duty of explanation**

As to the enforcement of the insurer's duty of explanation in marine insurance, there is no clear answer in Chinese law. As stated earlier, principally this doctrine can be extended to the specialized areas. However, till now, there is no sufficient judicial support to confirm its application and this needs clarification by further legal interpretations.

Despite this, analysing the consequences and remedies for the breach of this duty in general insurance law is still essential. According to article 17 of CIL 2009, if an insurer fails to explain the standard form clauses of the contract to the insured, no effects ensue. However, in accordance with article 54 of Chinese Contract Law, if the

injured insured can prove that the contract is concluded as a result of significant misconception, or obvious unfairness because the insurer did not explain the terms clearly enough, he can petition the court or arbitration institution to have this contract rescinded or altered. But, in the meantime, it has to be admitted that the burden of proof is substantially heavier for the alleged insured. On one hand, the assured has to prove that, at the conclusion of the contract, the insurer failed to explain the terms to him, and in cases where he wants to have damages recoverable he has to prove that the losses he suffered are caused by the insurer's failure in explanation. On the other hand, if applied in marine insurance, an area in which the assured is assumed to have known the meanings of special rules and terminology, this regime seems unable to work appropriately since the marine insurance parties are assumed to understand the standard form contracts in practice.

In summary, the remedies available in Chinese law for the injured marine insured, in cases where there is breach of duty of explanation (of standard form contracts), are alteration and rescission of the contract. Therefore, the alleged injured insured can request the courts or arbitration institutions to have it modified if he chooses to continue with the insurance contract. If there is irreconcilable conflict between the insurer and insured, the injured party can choose to request relevant institutions to have the contract rescinded, which in accordance with article 58 of the same law means that the contract would be confirmed to be null and void or revoked, and the paid premium is returnable. If it is proved that the assured has suffered loss because of the insurer's breach of this duty, then he can claim damages.<sup>600</sup>

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<sup>600</sup> Article 58, Chinese Contract Law, stipulates that property acquired as a result of a contract shall be returned after the contract is confirmed to be null and void or has been revoked; where the property cannot be returned or the return is unnecessary, it shall be reimbursed at its estimated price. The party at fault shall compensate the other party for losses incurred as a result thereof. If both parties are at fault, each party shall respectively be liable.

By contrast, failure to explain exclusion clauses to the assured before the conclusion of the insurance contract would only render these clauses unenforceable.<sup>601</sup> Thus, the insurer is required to provide sufficient notice or clear explanation to the assured in concluding the insurance contract, either written or orally; otherwise, the exemption clauses have no effects when the contractual parties have a dispute. The unenforceability would not vitiate the force of the whole contract, which means the assured can still recover damages caused by the insured accident, based on the other insurance contract terms.

#### **4.3.6.2. Insured's breach of duty**

As specified by the CMC, in cases where the material information is non-disclosed intentionally, the insurer has the right to terminate the contract without refunding the premium. In cases where there is non-disclosed material information which was not due to an intentional act, the insurer has the right to terminate the contract or raise the premium. However, the factor that non-disclosed or misrepresented material circumstance must have an impact on the occurrence of such perils is excluded from the second case.<sup>602</sup> The two types of the insured's breaches of the duty of disclosure in Chinese law are intentional breach and unintentional breach, which correspond to two different legal consequences.<sup>603</sup> Compared to the harsh English 'all or nothing remedy' applicable to both fraudulent and non-fraudulent concealment or misrepresentation in marine insurance,<sup>604</sup> one might have the view that the manner adopted by the CMC is flexible and fairer for the marine insured.

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<sup>601</sup> Paragraph 2, article 17, CIL 2009.

<sup>602</sup> Paragraph 2, article 223, CMC.

<sup>603</sup> These two types of misconducts are also corresponding to the categorisations finalized by the Consumer Insurance (Disclosure and Representations) Act 2012.

<sup>604</sup> Sections 17-20, MIA 1906.

#### 4.3.6.2.1. Consequences and remedies for intentional non-disclosure<sup>605</sup>

According to article 223(1) of CMC, if the insured breaches the duty of disclosure intentionally, the insurer is entitled to the right to rescind the contract without paying back the premium. Meanwhile, the insurer is discharged from the duty of paying indemnifications for loss caused by the insured perils before the termination of the insurance. Of course, the termination remedy is optional, so the insurer has the option either to continue the insurance or end it immediately.

On the subject of remedies granted to the insurer in cases of the insured's fraudulent non-disclosure or misrepresentation, MIA 1906 is adopting the same manner as the CMC with only slight differences in the statutory language. According to the MIA 1906, an insurance contract is avoidable if the defaulting party breaches the duty of utmost good faith.<sup>606</sup> In general contract law at English common law, the term of avoidance can be understood as putting both parties back to the positions where they were before they entered into the contract.<sup>607</sup> Therefore, in this situation, the paid premium is returnable to the insured and the insurer does not need to pay the indemnifications for the loss caused by the accident. One has to be mindful here that this sanction is not sufficient for a fraudulent breach of duty, these sections (sections 17-20, MIA 1906) aforementioned only apply with an absence of fraud or

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<sup>605</sup> The exact meaning of 'intentional misconduct' is not available from CMC or relevant legislations, however, in the view of this thesis, the construction of 'deliberate/reckless conduct' in consumer insurance in English law could be referred to. According to section 5 of the Consumer Insurance (Disclosure and Representations) Act 2012, '[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'. Similarly, section 5(3) of the same Act defines that '[a] qualifying misrepresentation is careless if it is not deliberate or reckless', which could be lessons for the interpretation of 'unintentional misconduct' in Chinese law.

<sup>606</sup> Sections 17, 28 and 20, MIA 1906.

<sup>607</sup> However, extending the concepts of rescission and avoidance from general contract law to special insurance law is still a controversial issue because the avoidance in insurance area is doubted for its different practical meaning compared to the common law meaning. For instance, in insurance, if the injured party decided to rescind the contract after the occurrence of accidents, actually most of the damaged insured subjects cannot be restored.

illegality. Section 84 of the same Act further points out that the premium is not returnable providing there is fraud or illegality on the assured.<sup>608</sup> Hence, it can be said that in both English and Chinese law, specifically for business marine insurance, in cases where the duty of disclosure is breached fraudulently by the assured, the insurer is empowered to avoid the contract without paying back the premium, and is discharged from paying indemnity for loss suffered by the insured.<sup>609</sup>

Nevertheless, CMC does not apply to whether the insurer can rescue the insurance contract with extra requirements in cases of the assured's fraudulent breach of this duty. Most Chinese scholars claim that, on the basis that article 223(2) of CMC entitles the insurer to demand a higher premium if some material information is non-disclosed unintentionally, there is no reason why a fraudulently cheated insurer cannot charge a higher premium.<sup>610</sup> The increasing subsequent premium remedy is supported by article 54 of Chinese Contract Law, which stipulates that if a contract is concluded because of the other party's fault, the injured party can request relevant institutions to have the contract altered or rescinded. Therefore, the retrospective rescission and alteration remedies are both available for the injured insurer in cases of the insured's fraudulent non-disclosure in Chinese law.

#### **4.3.6.2.2. Consequences and remedies for unintentional non-disclosure**

Article 223(2) of CMC stipulates that the insurer has the right to terminate an insurance contract or require a higher premium if the assured conceals some material information unintentionally. As distinct from the retrospective rescission remedy awarded to the insurer in cases where there is a fraudulent breach of this

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<sup>608</sup> Section 84, MIA 1906.

<sup>609</sup> In this fraudulent situation, the termination of contract in Chinese law is equal to the retrospective rescission in English law, and unreturnable premium can be deemed as a sanction to punish the wrongdoer.

<sup>610</sup> Li, 'Comparative Study on the Duty of Disclosure between China and England' in *JCL*, p. 21.



duty, the insurer still needs to cover the loss caused by the insured accident before the termination of this contract. However, the loss is not recoverable if the non-disclosed or misrepresented information has an impact on the occurrence of such perils.

It can firstly be seen that there are radical differences between the legal consequences of unintentional breach of the duty of disclosure in English and Chinese law. In English marine insurance law, the duty of utmost good faith is required to be performed strictly and faultlessly, and the avoidance remedy can be invoked by the injured party in cases of any degree of breach of this duty, from trivial to serious. For instance, if the material misrepresentation/non-disclosure before the conclusion of the contract would have caused the prudent insurer to increase the premium by 2%, then the rescission of the contract can be chosen by the insurer since there is a breach of duty of disclosure here. However, in this situation, the remedy awarded is very harsh. Thus, based on the MIA 1906, a marine insured's fate is purely controlled by the insurer under the ceiling of the avoidance remedy.

Section 2, Misrepresentation Act 1967 in English law further divides the unintentional act into the negligent and wholly innocent act.<sup>611</sup> Although article 2 of the Misrepresentation Act 1967 suggests that the non-fraudulent act should be differentiated from the fraudulent act, and an alternative damages remedy can be awarded according to the judges' discretion in lieu of a restrict rescission remedy, it is not clear if this approach adopted by general contract law can be extended to a special insurance contract.<sup>612</sup> Compared to the rigid uniformity of the rescission

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<sup>611</sup> Section 2, Misrepresentation Act 1967. However, as section 5 of the Consumer Insurance (Disclosure and Representations) Act 2012 provides, there are only two types of misrepresentations falling within the scope of qualifying misrepresentations, namely, deliberate/reckless and careless misrepresentations, which can be considered to be corresponding to the categorisation in CMC (intentional and unintentional misconducts).

<sup>612</sup> Gilman, et al., *Arnould's Law of Marine Insurance and Average*, pp. 742-3.

remedy in English marine insurance law, the termination remedy in Chinese law is considered to be fairer, reasonable and more flexible, particularly in cases of the assured's wholly innocent breach.<sup>613</sup>

Nevertheless, there are still some limits put on the awarding of the termination remedy in Chinese law. Therefore, if the non-disclosed or misrepresented information has an impact on the occurrence of such perils, the insurer can terminate this contract and in the meantime the loss caused by the perils previously is not recoverable.<sup>614</sup> Paragraph 5 of article 16 in CIL 2009 also stipulates that if an applicant fails to perform his obligation of making a full and accurate disclosure because of gross negligence, and this materially affects the occurrence of an insured event before the termination of the contract, the insurer shall bear no obligation for making any indemnity or payment of the insurance benefits but should return the premiums paid. Unfortunately, there is some lack of clarification about the exact requirements of 'impact' and 'gross negligence' in Chinese law. However, it is submitted by one leading academic in China that the 'impact' does not mean legal causation, but only certain attribution.<sup>615</sup>

Combining the literal meaning of 'impact' and the leading Chinese academic's 'attribution' theory, the consideration should take account of the cases in which the non-disclosed information causes the occurrence of accident solely or partially as one reason. For instance, in *The Tony Best*,<sup>616</sup> although the assured could prove that his non-disclosure was made unintentionally, the insurance company could be

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In the view of this author, since the remedies regime for the breach of utmost good faith is mirrored to the misrepresentation theory at common law, the application from general law to specialized law should not become an obstacle here.

<sup>613</sup> In this context, the effect of terminating the contract is to bring the contract to an end only from the date of termination. See *Johnson v Agnew* [1980] AC 367, 393, per Lord Wilberforce, cited by Eggers, et al., *Good Faith and Insurance Contract*, para. 16.72.

<sup>614</sup> Article 222, CMC.

<sup>615</sup> Wang, *The Law of Marine Insurance*, p. 80.

<sup>616</sup> Recommendations, Statutes and Explanations on the Amendments of Chinese Maritime Code of the PRC (Recommendations).

discharged from the responsibility to pay for the claims if the insurer could prove that the non-disclosed circumstance had impact on the occurrence of such perils, solely or partially.

Another existing ambiguity in CMC lies in identifying whether the premium is returnable to the insured in cases of the assured's non-fraudulent/unintentional non-disclosure. In the view of this thesis, the answer could vary. If the negligently/carelessly non-disclosed information has a certain attribution on the occurrence of insured perils, the insurer is entitled to demand a higher premium, or termination of contract. In the termination situation, combined with article 16 of CIL 2009, the paid premium shall be returned to the assured in the absence of fraud or illegality. Under the second circumstance where the insurer is guilty of a wholly innocent non-disclosure, the injured insurer is entitled to have the contract altered or terminated, but the insured is not discharged from paying compensation for the loss caused before the termination of contract. In the second case, the paid premium shall not be returnable fully but proportionally since the insurer would perform its liabilities anyway.

#### **4. 4. Conclusion**

Chapter 4 analysed the status and contents of the duty of good faith with specific reference to the pre-contractual duty of disclosure in Chinese law. After a comparative study regarding its duration, legal nature, scope, limits, and the legal consequences of the breach of duty in both Chinese law and English law, the following points have been concluded. Firstly, the duty of utmost good faith has never been formally recognized by the Chinese Maritime Code and other related legislation but accepted impliedly, which tends to encourage some Chinese academics to

introduce the whole of section 17 from the MIA 1906 to Chinese marine insurance area. In addition to the awkward situation of utmost good faith in Chinese law, it is found that the statutory contents of the duty of disclosure mainly consists of a pre-contractual duty of disclosure, the duty of explanation, a post-contractual duty of disclosure, which is substantially different from that in English statutes. Thirdly, unlike the test established by English law,<sup>617</sup> the standard in Chinese marine insurance adopts a three-fold test which includes prudent insurer, decisive influence, and actual inducement test. Fourthly, compared to the harsh English remedies available to the breach of this duty, the remedies in Chinese law seem to favour the unprofessional assureds by providing them with the termination,<sup>618</sup> alteration and/or damages options for remedies.

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<sup>617</sup> The two-limb prudent insurer actual inducement test.

<sup>618</sup> Both retrospective termination like rescission and common termination.

## CHAPTER 5

### THE POST-CONTRACT GOOD FAITH AND FRAUDULENT CLAIMS IN ENGLISH MARINE INSURANCE LAW

#### 5.1. Overview

It has been pointed out that the duty of utmost good faith is most controversial at the post-formation stage, especially its harsh effect of a post-contractual breach, namely, avoidance *ab initio*.<sup>619</sup> In the view of this author, the remedy issue is just the tip of the iceberg, reflecting a series of concerns with respect to the post-contract events, which is divided into the general post-formation events and a special issue, namely, fraudulent claims. The first two sections of this chapter, therefore, focus on the post-contract stage to elaborate its legal basis and functions, characteristics and information needed to be post-contractually disclosed, the elusive tests for different types of general post-information duties and its practical application to specific issues, and finally, the legal consequences of non-compliance.

With regard to fraudulent claims, the research begins with its first principles, including the origins, legal basis, meanings, and different types of fraudulent claims. Then the attention is diverted to the map of remedies for fraudulent claims. Subsequently, the issue of insurer's late payment and good faith is addressed to strengthen the integrity of this topic. Apart from the above issues, the insurance contract law reform undergoing in the Law Commissions is considered as another section. Finally, in order to identify the exact degree of good faith for the post-

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<sup>619</sup> Gilman, et al., *Arnould's Law of Marine Insurance and Average*, chapter 18.

contract stage, the normal level of good faith or utmost good faith, the elusive tests are summarized and evaluated in the conclusive section.

### **5.1.1. General ground of the post-contractual duty of good faith and concerned situations**

As stated earlier, both scholars and the judiciary used to be occupied with issues concerning the legal basis of the post-contractual duty of utmost good faith, which is actually linked to remedies available for a breach. On the one hand, this duty is suggested to be implied by contractual terms.<sup>620</sup> However, this proposition is doubted because, based on section 17 of the MIA 1906, the breach of utmost good faith should not lead to a claim for contractual damages, but only the statutory avoidance remedy is available. Some authorities,<sup>621</sup> on the other hand, state that this duty is founded on a separate rule of law, which is likely to be accepted as the overwhelming trend. Despite these arguments revolving around the origins of the post-contract duty of good faith, in the opinion of this author, there is no doubt that it is a continuing duty, which starts from the beginning of the contemplation of an

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<sup>620</sup> *Black King Shipping Corporation v Massie (The Litsion Pride)* [1985] 1 Lloyd's Rep. 437, p. 518, per Hirst J (at the claims stage); *Continental Illinois National Bank & Trust Co of Chicago v Alliance Assurance Co Ltd (The Captain Panagos D.P.)* [1986] 2 Lloyd's Rep. 511 (Evans J held that any breach of the post-contractual duty of utmost good faith in relation to the making of claims also breaks an implied term of the contract); *Bank of Nova Scotia v Hellenic Mutual War Risks Association (Bermuda) Ltd (The Good Luck)* [1988] 1 Lloyd's Rep. 514 (Hobhouse J treated the continuing duty of utmost good faith as arising from an implied term of the contract); *Banque Financiere de la Cite SA (formerly Banque Keyser Ullmann SA) v Westgate Insurance Co (formerly Hodge General & Mercantile Co Ltd)* [1987] 1 Lloyd's Rep. 69, QB (Com. Ct.); *Bonner v Cox* [2005] Lloyd's Rep. IR, 569, para. 255 (on appeal, the point appears to have been common ground ([2006] 2 Lloyd's Rep. 152, Para. 86) and hence the analysis in the judgment is contractual).

<sup>621</sup> For judicial support, see *Merchants & Manufacturers' Insurance Company Limited v Hunt and Others* [1941] 1 KB 295 (CA); *Banque Financiere de la Cite SA (formerly Banque Keyser Ullmann SA) v Westgate Insurance Co (formerly Hodge General & Mercantile Co Ltd)* [1988] 2 Lloyd's Rep. 513, CA, pp. 549-551; [1990] 2 Lloyd's Rep. 377, p. 388; *Bank of Nova Scotia v Hellenic Mutual War Risks Association (Bermuda) Ltd (The Good Luck)* [1989] 2 Lloyd's Rep. 238, p. 263; the Court of Appeal in *The Good Luck* [1990] 1 A.B. 818, p. 888; *Orakpo v Barclays* [1995] L.R.L.R. 443; [2001] 1 Lloyd's Rep. 389, HL, per Lord Hobhouse; *Agapitos v Agnew (The Aegeon) (No. 1)* [2002] 2 Lloyd's Rep. 42, CA.

For academic support, see Eggers, et al., *Good Faith and Insurance Contract*; Gilman, et al., *Arnould's Law of Marine Insurance and Average*; Andre Naidoo and David Oughton, 'The Confused post-formation duty of good faith in insurance law: from refinement to fragmentation to elimination?', (2005) *JBL*, pp. 346-371.

insurance contract (pre-contract duty), and continues during the currency of the contract (post-contract duty).<sup>622</sup>

This doctrine's mutuality is confirmed by section 17 of the MIA 1906, which imposes this duty on both parties, as a preamble section of the following sections 18-20, which is further confirmed by the judiciary.<sup>623</sup> Some authorities<sup>624</sup> maintain that the reciprocity of this duty also applies to the post-formation stage. This opinion is embodied in insurance practice, requiring the insurer to handle claims in good faith and make a payment in a timely fashion, whilst also requiring the assured to perform the duty of post-contractual disclosure and good faith in the context of claims.

The confirmation of the purpose of the duty of good faith can be dated back to *Carter v Boehm*,<sup>625</sup> in which its existence is specified to prevent fraud and to encourage good faith. Therefore, the purpose of preventing fraud requires the assured and its agent to disclose all material circumstances and refrain from misrepresentation during the negotiations leading up to and including the conclusion of the insurance contract.<sup>626</sup> Susan Hodges suggests,<sup>627</sup> in order to comprise utmost good faith's position as a fountain-head where its other duties flow from, it must be

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<sup>622</sup> For example, *Black King Shipping Corporation v Massie (The Litsion Pride)* [1985] 1 Lloyd's Rep. 437, pp. 507-512, per Hirst J; *Cory v Patton* [1872]; [2001] 1 Lloyd's Rep. 389, HL, paras. 6, 48, 51-57, 110-111; *Lishman v Northern Maritime Ins. Co.* (1875) Lloyd's Rep. 10 CP 179; *Overseas Commodities Ltd. v Style* [1958] 1 Lloyd's Rep. 546, p. 559; *Liberian Insurance Agency v Mosse* [1977] 2 Lloyd's Rep. 560; *Orakpo v Barclays Insurance Services* [1995] LRLR 443; *New Hampshire Insurance Company v MGN Limited* [1997], 48, per Potter, LJ, 61, per Staughton LJ; *K/S Merc-Scandia XXXXII v Certain Lloyd's Underwriters (The Mercandian Continent)* [2001] 2 Lloyd's Rep. 563, CA, paras. 34, 39-40, per Longmore LJ.

<sup>623</sup> For example, *Banque Financiere de la Cite SA (formerly Banque Keyser Ullmann SA) v Westgate Insurance Co (formerly Hodge General & Mercantile Co Ltd)* [1988] 2 Lloyd's Rep. 513, CA, p. 544, per Slade LJ. It is remarked by LJ Slade that 'the obligation to disclose material facts is a mutual one imposing reciprocal duties on insurer and insured. In the case of marine insurance contract, section 17 in effect so provides'.

<sup>624</sup> For example, Eggers, et al., *Good Faith and Insurance Contract*, para 10.20. It is pointed out by the authors that the assured will seldom wish to set aside his insurance contract in case a breach of the insurer's: *Manifest Shipping Insurance Co Ltd v Uni-Polaris Shipping Co Ltd (The Star Sea)* [2001] 1 Lloyd's Rep. 389, HL, para. 27, per Lord Hobhouse.

<sup>625</sup> (1766) 3 Burr. 1905, para. 1911.

<sup>626</sup> *Black King Shipping Corporation v Massie (The Litsion Pride)* [1985] 1 Lloyd's Rep. 437, p. 512.

<sup>627</sup> Hodges, *Law of Marine Insurance*, p. 88.

performed before and after the conclusion of the contract. However, it does not mean that it is an endless duty, otherwise, it is an obvious imposition for contractual parties, especially for the assured. Some authorities prefer to state that the duty of good faith continues throughout the contractual relationship at a level appropriate to the moment.<sup>628</sup>

The uniqueness of the post-contractual duty of good faith also lies in its distinction from the general doctrine underlying section 17 of the MIA 1906. In exceptional circumstances, utmost good faith is required to be performed post-contractually, for instance, the assured is required to disclose all material information relating to variations or renewals to an insurance policy to the insurer in order to make its amendments or renewals valid. Conversely, there is no general obligation on the assured to disclose facts material to the risk after the contract has been concluded as a result of the general doctrine of alteration of risks and section 21 of the MIA 1906. Judging from the wider sense, it has to be admitted that the conclusion of an insurance contract does not exclude the duty of utmost good faith, but it does bring about a concern regarding the relationship between the duty and the contract.<sup>629</sup> The duration of the duty of utmost good faith is still unclear in section 17 of the MIA 1906. However, it is described that as long as the contract of insurance remains in existence, the duty therefore continues, to the extent that it is required, until there is

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<sup>628</sup> Clarke, *Law of Insurance Contracts*; in Thomas Schoenbaum, 'The duty of utmost good faith in marine insurance law: a comparative analysis of American and English law' (January, 1998) 29 *JMLC*, p. 31, Schoenbaum described it as a duty which will arise at 'specific decision points'. Tuckey J, at first instance in *Manifest Shipping Co Ltd v Uni-Polaris Shipping Co Ltd (The Star Sea)* [1995] 1 Lloyd's Rep. 651, p. 667, was aptly to define it as a continuing duty which is 'moulded to the moment'. Lord Hobhouse, in *The Good Luck* [1988] 1 Lloyd's Rep. 514, p. 545, stated that 'there can be situations which arise subsequently where the duty of utmost good faith makes it necessary that there should be further disclosure because the relevant facts are relevant to the later stages of the contract'. Also see Hodges, *Cases and Materials on Marine Insurance Law*, p. 226.

<sup>629</sup> Rhidian Thomas, 'Held Covered Clauses in Marine Insurance' in Rhidian Thomas, *The Modern Law of Marine Insurance*, Vol. 2, (London: LLP, 2002), p. 48.



no further use for the duty.<sup>630</sup> In other words, the duty of utmost good faith ceases once the rationale for the duty is at an end. For example, the pre-contractual duty of disclosure and not to misrepresent ceases at the conclusion of the insurance contract, but simultaneously, the post-formation duty of disclosure before the variation of contract will be invoked if there are some adjustments of the contractual obligations. However, the contractual duties cease when the contract is avoided or rescinded, including the duty of utmost good faith.<sup>631</sup> An alternative election for the parties of the marine insurance contract to terminate utmost good faith is the commencement of litigation procedures,<sup>632</sup> which is elaborated below.

### 5.1.2. Elusive standards and principles

Some authorities<sup>633</sup> state that as one part of the duty of utmost good faith ruled by section 17 of the MIA 1906, there is no reason to adopt a different system to post-contractual events. In *The Litsion Pride*,<sup>634</sup> it was held by Justice Hirst that 'avoidance' in section 17 was avoidance *ab initio*, and he saw no reason for putting a different meaning on the word in relation to post-contractual issues. The Court of Appeal, in *The Good Luck*, stated that there was 'no reason why the source in law of the obligation, or the remedy for its breach, should be different after the contract is made, from what it is at the pre-contract stage'.<sup>635</sup> In *The Star Sea*,<sup>636</sup> Leggatt LJ in

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<sup>630</sup> Eggers, et al., *Good Faith and Insurance Contract*, para. 10.03.

<sup>631</sup> *Ibid*, para. 10.64.

<sup>632</sup> *Manifest Shipping Co Ltd v Uni-Polaris Shipping Co Ltd (The Star Sea)* [2001] 1 Lloyd's Rep. 389, HL, per Lord Hobhouse of Woodborough, Lord Clyde and Lord Scott; *Agapitos v Agnew (The Aegeon) (No. 1)* [2002] 2 Lloyd's Rep. 42, CA, per Mance LJ.

<sup>633</sup> *Black King Shipping Corporation v Massie (The Litsion Pride)* [1985] 1 Lloyd's Rep. 437, p. 515, per Hirst J; *Manifest Shipping Co Ltd v Uni-Polaris Shipping Co Ltd (The Star Sea)* [1997] 1 Lloyd's Rep. 360, CA, p. 370; *Fraser Shipping Ltd v Colton and Others* [1997] 1 Lloyd's Rep. 586; *K/S Mercandian XXXII v Certain Lloyd's Underwriters (The Mercandian Continent)* [2001] 2 Lloyd's Rep. 563, CA.

<sup>634</sup> *Black King Shipping Corporation v Massie (The Litsion Pride)* [1985] 1 Lloyd's Rep. 437, p. 515, per Hirst J.

<sup>635</sup> [1990] 1 QB 818, para. 888.

the Court of Appeal, summarised that there should be no difference in principle as to the extent of disclosure required between entering into a policy and the renewal of it. In both cases, the scope of the duty of disclosure should be the same. According to Leggatt LJ's statement, the 'materiality' and 'actual inducement' test should apply in the post-formation issues as well. In *Fraser Shipping Ltd v Colton and Others*,<sup>637</sup> the judge was found to adopt the rules on 'materiality' in the case of pre-contractual non-disclosure to what was effectively a breach of the duty of disclosure under section 17.<sup>638</sup> Therefore in this case, the judge aptly applied the same test of the pre-contractual event to the post-contractual stage. Recently, in *The Mercandian Continent*,<sup>639</sup> Lord Justice Longmore, in the Court of Appeal, considered the breach of the post-contractual duty of utmost good faith. He held that an insurer could only have the right to avoid for a post-contractual breach of the duty of utmost good faith, where the insurer would otherwise be justified in accepting the insured's conduct as a repudiatory breach of the policy. It was stated that the rationale behind this conclusion was that it must have been intended that avoidance for post-contractual matters should be subject to at least the same requirements as avoidance for pre-contractual matters. Hence, the concepts of materiality and inducement, adapted to the post-contractual context, should exist before an insurer can avoid the policy for a post-contractual breach of the duty.<sup>640</sup>

On the contrary, some authorities pointed out that it was crucial to require the assured to make full disclosure and accurate representation with his greatest honesty in the negotiation of an insurance contract. Therefore, even a trivial fault

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<sup>636</sup> *Manifest Shipping Co Ltd v Uni-Polaris Shipping Co Ltd (The Star Sea)* [1997] 1 Lloyd's Rep. 360, CA, p. 370.

<sup>637</sup> [1997] 1 Lloyd's Rep. 586.

<sup>638</sup> *Ibid*, per Potter LJ. Also see Hodges, *Law of Marine Insurance*, p. 229.

<sup>639</sup> *K/S Merc-Scandia XXXXII v Certain Lloyd's Underwriters (The Mercandian Continent)* [2001] 2 Lloyd's Rep. 563, CA, cited by Gilman, et al., *Arnould's Law of Marine Insurance and Average*, p. 754.

<sup>640</sup> Gilman, et al., *Arnould's Law of Marine Insurance and Average*, p. 754.

would cause the contract to be avoided by the injured party. However, after concluding the contract, it has been claimed that there was no justification to require the same high degree of openness post contractually as an insured is obliged to show pre-contractually.<sup>641</sup> In this view, a flexible construction of the duty of utmost good faith is recommended to be adopted.<sup>642</sup> In the same judgment, Lord Hobhouse criticized the remedy of avoidance for a post-contractual breach of the duty of utmost good faith as ‘anomalous and disproportionate’ and said that ‘the result is effectively penal’.<sup>643</sup>

At the present time in English law, it has been suggested that in consideration of identifying any post-contractual events of utmost good faith, some factors should be borne in mind. The first factor is the harsh effect of the breach of the duty, namely avoidance of the contract according to section 17 of MIA 1906. Secondly, the insurer can still be protected against the bad faith of the assured by the contractual stipulations or other legal principles like the doctrine of alteration of risk.<sup>644</sup>

It becomes more complex when the post-formation duty applies to specific issues, including the adjustments or renewals of contractual obligations, held covered clauses, and alteration of risk. Consequently, the search for elusive principles for the post-contractual duty issues becomes the main trend. In the view of this author, it is unrealistic to create only one unified test, or adopt the pre-contract system to control the post-contractual events, or even a unified system within the post-contract mechanism for individual issues. Some academics allege that the uncertainty concerning the juristic basis is a result of the attempt to fashion a multi-faceted,

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<sup>641</sup> *Manifest Shipping Co Ltd v Uni-Polaris Shipping Co Ltd (The Star Sea)* [2001] 1 Lloyd's Rep. 389, HL, paras.6 and 7, per Lord Clyde; the Court of Appeal in *The Good Luck* [1990] 1 QB 818, para. 888.

<sup>642</sup> *Manifest Shipping Co Ltd v Uni-Polaris Shipping Co Ltd (The Star Sea)* [2001] 1 Lloyd's Rep. 389, HL, paras. 6 and 7, per Lord Clyde.

<sup>643</sup> [2001] Lloyd's Rep. IR 247, para. 51.

<sup>644</sup> Bennett, *The Law of Marine Insurance*, p. 308.

singular post-formation duty that applies in many different factual circumstances.<sup>645</sup>

David Foxton QC even criticized the attempt to treat all post-contractual duties of good faith in terms of the general duty enshrined in section 17 as hindering the development of marine insurance law and insurer's reciprocal duties.<sup>646</sup> This opinion is facilitated by an influential comment committed by Bennett:

'It is both preferable and more accurate to refer to a doctrine of utmost good faith that gives rise to a number of distinct features, ..., differences in scope, standard of required behaviour and remedies for breach demand flexibility from the post-formation doctrine.'<sup>647</sup>

Connected with the above authorities and the practical application of good faith or utmost good faith in specific issues, this chapter analyses the principles of the duty of post-contractual good faith (including both the normal good faith and utmost good faith), and the duty to abstain from fraud in respect of the parties' dealings.<sup>648</sup> In order to strengthen the research on the first principle, elusive requirements of good faith are compared at the end of this chapter.

## 5.2. Post-contractual duty of good faith

### 5.2.1. General ground

The purpose of the post-contractual duty is to permit either party, who is about to make a decision for the continuance or performance of the contract, or in connection

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<sup>645</sup> Naidoo and Oughton, 'The Confused post-formation duty of good faith in insurance law: from refinement to fragmentation to elimination?', in *JBL*, p. 352.

<sup>646</sup> David Foxton, 'The post-contractual duties of good faith in marine insurance policies: the search for elusive principles', in Rhidian Thomas, *Marine Insurance: The Law in Transition* (1<sup>st</sup> ed., London: Informa, 2006), chapter 4.

<sup>647</sup> Bennett, 'Mapping the doctrine of utmost good faith in insurance contract law', in *LMCLQ*, pp. 166, 219.

<sup>648</sup> At the first instance in *K/S Merc-Scandia XXXXII v Lloyd's Underwriters (The Mercandian Continent)* [2000] 2 Lloyd's Rep. 357, QB, Aikens J concluded that the post-contractual duty was limited to two categories of cases, namely variations (a species of pre-contractual situation) and fraudulent claims, which was rejected by the Court of Appeal later (*The Mercandian Continent* [2001] 2 Lloyd's Rep. 563, CA, p. 576.).

with a claim, to consider his position with the benefit of all the information known to the other party and act accordingly.<sup>649</sup> Without this crucial doctrine, no duty will be observed after the conclusion of a contract. Nevertheless, the status of post-formation duty is still uncertain in the context of particular cases, for instance, the scope of information needed to be disclosed varies in different circumstances. The situation becomes severer in the context of fraudulent claims. This raises questions of whether the pre-contract system can be extended to post-contract events or fraudulent claims, and how the drawbacks of the pre-contract system can be overcome. Furthermore, the issue of whether the actual inducement and materiality test is suited for the post-formation stage is examined. Finally, it is questioned whether a retrospective or prospective remedy is recommended.

### 5.2.2. Post-contractual duty of disclosure and specific issues

After the observation of recent developments in creating a post-contractual duty of the utmost good faith system in a systematic manner, it is found that three judgments in the first two years of the new millennium have played a significant role in determining the scope of this duty, providing some guidelines for the future of this concept.<sup>650</sup> However, the nature and scope of this duty are still left unresolved.

Some authorities<sup>651</sup> investigated the duration of the post-contractual disclosure duty and exemplified its extension to some specific issues. For instance, after having

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<sup>649</sup> Eggers, et al., *Good Faith and Insurance Contract*, Peter Eggers, 'Utmost good faith and the presentation and handling of claims', in Baris Soyer, et al., *Reforming Marine and Commercial Insurance Law* (London: Informa, 2008), chapter 9, at pp. 230-231.

<sup>650</sup> *Manifest Shipping Co Ltd v Uni-Polaris Shipping Co Ltd (The Star Sea)* [2001] 1 Lloyd's Rep. 389, HL; *K/S Merc-Scandia XXXXII v Certain Lloyd's Underwriters (The Mercandian Continent)* [2001] 2 Lloyd's Rep. 563, CA; *Agapitos v Agnew (The Aegeon) (No. 1)* [2002] 2 Lloyd's Rep. 42, CA. Also see Baris Soyer, 'Continuing duty of utmost good faith in insurance contracts: still alive?', (2003) *LMCLQ*, pp. 39-79 and British Insurance Law Association, *Recommendations to the Law Commission: A Report of the Sub-Committee of the British Insurance Law Association*, (1 September 2002), p. 6.

<sup>651</sup> Clarke, *Law of Insurance Contracts; Black King Shipping Corporation v Massie (The Litsion Pride)* [1985] 1 Lloyd's Rep. 437. See Hodges, *Cases and Materials on Marine Insurance Law*, p. 227.

examined that the duty of good faith continues throughout the contractual relationship at a level appropriate to the moment, Professor Malcolm Clarke extended the duration of this duty to the cover extension and renewal, and also when the insured claims insurance money.<sup>652</sup> Consequently, Justice Hirst in *The Litsion Pride* added more circumstances which would appropriately trigger the 'appropriate moment' contemplated by Clarke, including reinsurance and cancellation clauses.<sup>653</sup> Obviously, difficulties in this area lie in its duration in individual cases and the extensive scope of information needed to be disclosed after the conclusion of an insurance contract. Therefore, attention will be directed to the developments regarding circumstances where the duty might attach. Orders for ship's papers, held covered clauses and fraudulent claims jurisdiction were considered to be three pillars of general post-contractual duty of utmost good faith under section 17 of the MIA 1906.<sup>654</sup> Although this statement is doubted for its potential difficulties,<sup>655</sup> its contribution to mapping the main components in a general post-contract system still cannot be disregarded. This difficult question has been partially answered by the Consumer Insurance (Disclosure and Representations) Act 2012. According to this Act, it is suggested that in consumer insurance, this new legislation of pre-contract information also extends to contract variations.<sup>656</sup> Also, according to the Explanatory

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<sup>652</sup> Clarke, *Law of Insurance Contracts*.

<sup>653</sup> *Black King Shipping Corporation v Massie (The Litsion Pride)* [1985] 1 Lloyd's Rep. 437. See Hodges, *Cases and Materials on Marine Insurance Law*, p. 227.

<sup>654</sup> *Black King Shipping Corporation v Massie (The Litsion Pride)* [1985] 1 Lloyd's Rep. 437, per Hirst J.

<sup>655</sup> The potential difficulties caused by this division are discussed below. Also see Bennett, 'Mapping the doctrine of utmost good faith in insurance contract law', in *LMCLQ*, pp. 165-222, for an authoritative evaluation at this point.

<sup>656</sup> Section 2, Consumer Insurance (Disclosure and Representations) Act 2012. Also see the Law Commission and the Scottish Law Commission, *Consumer Insurance Law: Pre-contract Disclosure and Misrepresentation (Joint Report with Draft Bill)*, p. 149.

Note, it was pointed out that at the practical level, the renewal of insurance is considered as a new contract.<sup>657</sup>

### 5.2.2.1. Alteration of risk and held covered clauses

In practice, due to high risks attached to the insurance industry, it is in the interest of both insurers and assureds to restrict the scope of marine insurance contracts.<sup>658</sup> However, because of its unpredictability, both parties are aware that the policy may not apply to all the circumstances which may arise during a marine adventure, and the assured may want to provide so far as possible that his insurance cover is uninterrupted.<sup>659</sup> For instance, during the currency of an insurance contract, the agreed ports are altered,<sup>660</sup> or there may be a change of voyage,<sup>661</sup> deviation,<sup>662</sup> an absence of specifying several ports of discharge,<sup>663</sup> or a delay in a voyage.<sup>664</sup> According to sections 43-48 of the MIA 1906, unless agreed by both parties, all the aforesaid cases of alteration of risk can discharge the insurer from the liability under the contract. As this doctrine suggests, the alteration of risk during the performance of an insurance contract does not need to be disclosed, unless the alteration is so great that it would change the nature of an insurance policy.<sup>665</sup> For instance, material events listed in sections 43-48, and any other substantial changes could allow the insurer to reassess the risk and premium. On the contrary, if the event does not cause any material alteration of the risk, no further premium may be payable.<sup>666</sup>

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<sup>657</sup> The Law Commission and the Scottish Law Commission, *Consumer Insurance Law: Pre-contract Disclosure and Misrepresentation (Joint Report with Draft Bill)*, p. 149.

<sup>658</sup> Rose, *Marine Insurance: Law and Practice*, para. 12.1.

<sup>659</sup> *Ibid*, para. 12.1.

<sup>660</sup> Sections 43 and 44, MIA 1906.

<sup>661</sup> Section 45, MIA 1906.

<sup>662</sup> Section 46, MIA 1906.

<sup>663</sup> Section 47, MIA 1906.

<sup>664</sup> Section 48, MIA 1906.

<sup>665</sup> *Kausar v Eagle Star* [1998] CLC 129, pp. 131-132, per Saville LJ.

<sup>666</sup> *Hewitt v London General Ins Co Ltd* (1925) 23 LI L Rep. 243, p. 247.

Hence, this event is not great enough to change the nature of primary risk and it is therefore unnecessary to be disclosed. Apparently, this doctrine only applies in the absence of an express term, and it becomes common to contain an 'alteration of risk' clause. This subsequently obliges the assured to advise the insurers of circumstances which increase the risk of an insured loss occurring, failing which the assured will not be insured, or the insurer will be entitled to avoid.<sup>667</sup> In *Ansari v New India Assurance*,<sup>668</sup> it was clarified by the insurance policy that any material alteration to the insured subjects (Premises or Business in this case), or any material change in the facts stated in the Proposal Form, or other facts supplied to the insurer, would have the insurance policy ceded unless the insurer agrees to continue in writing. Judging from English case law and the MIA 1906, it can be concluded that the remedies available for the assured's failure in the duty of alteration of risks notification are always prospective, but not retrospective. In other words, in cases where the assured did not disclose any significant change of risks insured against, the insurer could be discharged from the indemnification for losses caused by the concealed information, as sections 45, 46 and 48 of the MIA 1906 suggest.<sup>669</sup>

On the one hand, the general alteration of the risk doctrine in MIA 1906 empowers the insurer to confine his exposure to protect his interests from being prejudiced by

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<sup>667</sup> In practice, it is common to contain provisions in relation to the alteration of risks in policies, clarifying that fraud renders the contract void. For example, *Insurance Corp. of the Channel Island Ltd v McHugh* [1997] LRLR 94, 135; *Kausar v Eagle Star* [1998] CLC 129, pp. 131-132, per Saville LJ. Also see Eggers, et al., *Good Faith and Insurance Contract*, para. 10.31.

<sup>668</sup> (2009) EWCA Civ 93.

<sup>669</sup> For example, according to section 45(2) of MIA 1906, '[u]nless the policy otherwise provides, where there is a change of voyage, the insurer is discharged from liability as from the time of change, that is to say, as from the time when the determination to change it is manifested; and it is immaterial that the ship may not in fact have left the course of voyage contemplated by the policy when the loss occurs'. Also as section 46(1) of MIA 1906 stipulates, '[w]here a ship, without lawful excuse, deviates from the voyage contemplated by the policy, the insurer is discharged from liability as from the time of deviation, and it is immaterial that the ship may have regained her route before any loss occurs'. Similarly, section 48 of MIA 1906 builds another example in terms of a delay in voyage, noting that '[i]n the case of a voyage policy, the adventure insured must be prosecuted throughout its course with reasonable dispatch, and, if without lawful excuse it is not so prosecuted, the insurer is discharged from liability as from the time when the delay became unreasonable'.



the assured's act after concluding an insurance contract. Nevertheless, this doctrine imposes more options on the assured to have unpredictable circumstances insured by a wider-ranging cover with extra conditions, for example, payment of an additional premium with agreed terms. There are various possible solutions suggested to smooth the conflicts of two opposite standings (maintenance and flexibility), including an automatic renewal of its cover, negotiation of an effective variation of existing contract, and a contemplation of a fresh cover.<sup>670</sup> A 'held covered' clause thus, is invoked as a practical solution to extend the scope of cover, with invocation preserving the negotiated cover from the threat of being lost.<sup>671</sup> The primary function of the held covered provision, therefore, was considered to inject a note of flexibility into the concluded bargain and mitigate the hard insurance contract law regarding the general doctrine of alteration of risk.<sup>672</sup>

A 'held covered' clause is defined to be a provision often found in marine (and other) insurance policies under which the coverage can be extended for an additional premium and/or on terms to be agreed, if notice is given to the underwriter.<sup>673</sup> Unquestionably, this clause is still playing an influential role in the context of utmost good faith, since it has been suggested to spread the latter to the renewals and variations of contracts.<sup>674</sup> In contemporary practice, the legal validity of a held covered clause is partially embodied by section 31(2) of the MIA 1906,<sup>675</sup> stating

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<sup>670</sup> Rose, *Marine Insurance: Law and Practice*, para. 12.1. However, the last two possibilities are rejected by Rose in the same writing because of their unfeasibility in practice.

<sup>671</sup> Thomas, 'Held Covered Clauses in Marine Insurance' in Thomas, *The Modern Law of Marine Insurance*, Vol. 2, chapter 1, p. 2. Also see *Liberian Insurance Agency Inc v Mosse* [1977] 2 Lloyd's Rep. 560, p. 567, per Donaldson J.

<sup>672</sup> Bennett, 'Mapping the doctrine of utmost good faith in insurance contract law', in *LMCLQ*, p. 204.

<sup>673</sup> Thomas, 'Held Covered Clauses in Marine Insurance' in Thomas, *The Modern Law of Marine Insurance*, Vol. 2, chapter 1.

<sup>674</sup> *Ibid*, para. 1.136.

<sup>675</sup> According to section 31(2) of the MIA 1906, where an insurance is effected on the terms that an additional premium is to be arranged in a given event, and that event happens but no arrangement is made, then a reasonable additional premium is payable.

additional premium as one situation where the extended cover applies as binding contracts.<sup>676</sup>

Normally, this traditional clause is like an exclusion clause inserted in the policy specifying that the existing policy is 'held covered in case of any breach of warranty or agreed terms, provided notice be given to the underwriters immediately after receipt of advices and any amended terms of cover and any additional premium required by them be agreed'.<sup>677</sup> The practical Institute Clauses provide typical traditional instances, for example, Institute Time Clauses Hulls (2009), Breach of Warranty (clause 3); International Hull Clauses (2003), Breach of Navigation Provision (clause 11); Institute Cargo Clauses (1982),<sup>678</sup> Change of Voyage (clause 10). The recently revised Institute Cargo Clauses abandoned the traditional formula of a held covered clause, and instead, the same effect is achieved with a view to making the position more readily understandable to potential assureds.<sup>679</sup> For example, the revised Institute Cargo Clauses (2009), Change of Voyage (clause 10) and Termination of the Contract of Carriage (clause 9).<sup>680</sup> Differing from the wording of clause 10 in the 1982 version, the revised clause 10 stipulates that:

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<sup>676</sup> Thomas, 'Held Covered Clauses in Marine Insurance' in Thomas, *The Modern Law of Marine Insurance*, Vol. 2, chapter 1, p. 3.

<sup>677</sup> Institute Time Clauses Hulls (2009), clause 3, breach of warranty; International Hull Clauses, clause 11, breach of navigation provision. The operation of held covered clause has been analysed deeply by Thomas, see *Ibid*, pp. 1-55.

<sup>678</sup> Institute Cargo Clauses (1982), Change of Voyage (clause 10) stipulates that '[w]here, after attachment of this insurance, the destination is changed by the Assured, held covered at a premium and on conditions to be arranged subject to prompt notice being given to the Underwriters'.

<sup>679</sup> Jonathan Gilman QC and Robert Merkin, *Arnould's Law of Marine Insurance and Average* (17<sup>th</sup> ed., 1<sup>st</sup> Supplement, Sweet & Maxwell, 2010), p. 91.

<sup>680</sup> Institute Cargo Clauses (2009), Termination of Contract of Carriage (clause 9), notes that:

'If owing to circumstances beyond the control of the Assured either the contract of carriage is terminated at a port or place other than the destination named therein or the transit is otherwise terminated before unloading of the subject-matter insured as provided for in Clause 8 above, then this insurance shall also terminate unless prompt notice is given to the Insurers and continuation of cover is requested when this insurance shall remain in force, subject to an additional premium if required by the Insurers, either

9.1 until the subject-matter insured is sold and delivered at such port or place, or, unless otherwise specially agreed, until the expiry of 60 days after arrival of the subject-matter insured at such port or place, whichever shall first occur, or

‘10.1 Where, after attachment of this insurance, the destination is changed by the Assured, this must be notified promptly to Insurers for rates and terms to be agreed. Should a loss occur prior to such agreement being obtained cover may be provided but only if cover would have been available at a reasonable commercial market rate on reasonable market terms.

10.2 Where the subject-matter insured commences the transit contemplated by this insurance (in accordance with Clause 8.1), but, without the knowledge of the Assured or their employees the ship sails for another destination, this insurance will nevertheless be deemed to have attached at commencement of such transit.’

Based on the revised clause 10.2 of the Institute Cargo Clauses (2009) regarding change of voyage, the risk is deemed to have attached, and no question of the assured being required to give notice or of an additional premium being required will arise. Meanwhile, clause 10.2 is not considered to be a held covered clause by some leading marine insurance academics.<sup>681</sup> Nevertheless, in the view of this author, the held covered clause has never been abandoned, but replaced by the modified clause as a new automatic held covered clause formula, which is also preferred by some lawyers.<sup>682</sup> Apparently, the automatic extended cover case simplifies the relationship between itself and utmost good faith. The following work below, therefore, is addressed in the context of traditional formula of held covered clauses with notice given in advance.

Utmost good faith is suggested to be tightly connected to the held covered clauses. The judicial support so far offered to this question, confirms that utmost good faith is the condition for the assured to invoke the held covered clauses successfully. For instance, the judgment of Justice McNair in *Overseas Commodities Ltd v Style*<sup>683</sup> held that ‘to obtain the protection of the held covered clause, the assured must act

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9.2 if the subject-matter insured is forwarded within the said period of 60 days (or any agreed extension thereof) to the destination named in the contract of insurance or to any other destination, until terminated in accordance with the provisions of Clause 8 above.’

<sup>681</sup> For example, Gilman and Merkin, *Arnould’s Law of Marine Insurance and Average*, p. 91.

<sup>682</sup> *Ibid*, p. 91.

<sup>683</sup> [1958] 1 Lloyd’s Rep. 546, p. 559.

with the utmost good faith towards the underwriters...'. Similarly, it was observed by Justice Donaldson in *Liberian Insurance Agency Inc. v Mosse*<sup>684</sup> that utmost good faith was indispensable for an assured who seeks to invoke a held covered clause. Analogous statements have been provided by Lord Hobhouse in the House of Lords in *The Star Sea*,<sup>685</sup> and Lord Justice Longmore in *The Mercandian Continent*.<sup>686</sup> To sum up, the assured should disclose all circumstances material to the fixing of premium in held covered clause cases. The assured is entitled to rely on the held covered clause only upon reasonable notice being provided to the insurer.<sup>687</sup>

Some questions may arise with respect to the application of utmost good faith in the held covered clause cases. Foremost, does it fall within the scope of the pre-contract system or post-contract system? This question used to cause lively debate among the judiciary and academics. If this clause arises in connection with the post-contract application of the duty of utmost good faith, consequently, section 17 of the MIA 1906 turns to be its only resource. Therefore, the avoidance *ab initio* remedy in section 17 should logically spread to the held covered clause cases. In the view of this author, this post-contract statement appears to be accurate in terms of the timing requirement in the context of the post-formation system, since the held covered clause is invoked for a further protection to the assured after the conclusion of an insurance contract. Despite this, there is still a need to discuss relevant difficulties. Firstly, utmost good faith in section 17 of MIA 1906 is a mutual obligation imposed on both insurance parties. But, the held covered clause gives rise to a unilateral offer by

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<sup>684</sup> [1977] 2 Lloyd's Rep. 560, p. 568, per Donaldson J, it is commented that 'the assured cannot take advantage of the clause if he has not acted in the utmost good faith'.

<sup>685</sup> [2001] 1 Lloyd's Rep. 389, para. 72.

<sup>686</sup> [2001] 2 Lloyd's Rep. 563, para. 22.

<sup>687</sup> *Liberian Insurance Agency Inc. v Mosse* [1977] 2 Lloyd's Rep. 560, p. 568, per Donaldson J.

the insurer to provide extended cover on the terms of the clause.<sup>688</sup> In practice, the assured has no obligation to adopt an extended cover, but as long as he invokes this clause in an utmost good faith context (the traditional formula of held covered clause) or with agreed terms (the automatic extended cover or modern formula of held covered clause), the insurer is obliged to indemnify the loss caused by additional risks out of the primary policy. Apparently, its unilateral nature in practice is not a match to the mutual nature of general utmost good faith specified by section 17, which is deemed as the principal provision generating a post-contractual duty of utmost good faith. Secondly, if the held covered clause is considered to be attached to the primary insurance and governed by the doctrine of post-contractual utmost good faith, the avoidance remedy should be extended to the held covered clause cases and become the only eligible remedy according to section 17 of the MIA 1906. Given these conditions, whilst the assured in question acts with his extreme good faith for the main body of the original contract, but fraudulently or negligently in terms of the material information in relation to the risks held covered, the whole insurance contract could be denied. This is blatant unfairness for the assured, since at common law, punishment is not the purpose of contractual remedies. Consequently, its irrationality also fails to comply with the requirement for inducement. It is found that early authorities did not deliver any statement regarding the requirement for inducement to avoid the entire contract or variations at the moment of making the decisions.<sup>689</sup> Although the later *Pan Atlantic*<sup>690</sup> case created the actual inducement requirement for utmost good faith, it is still difficult to find the final judicial decision. However, in the view of this author, the materiality and inducement requirement

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<sup>688</sup> Soyer, 'Continuing duty of utmost good faith in insurance contracts: still alive?', in *LMCLQ*, pp. 39-79, at p. 40.

<sup>689</sup> *Overseas Commodities Ltd v Style* [1958] 1 Lloyd's Rep. 546; *Liberian Insurance Agency Inc. v Mosse* [1977] 2 Lloyd's Rep. 560.

<sup>690</sup> [1994] 2 Lloyd's Rep. 427, HL.

should be limited to the alterations attached to the held covered clause. In other words, the party who wants to challenge the altered terms or additional premium provisions must prove that non-disclosure or misrepresentation is material to the variations only.<sup>691</sup> Fourthly, admitting the variation alluded to the held covered clause as one part of the original policy gives rise to incompatibility between this clause and the principle of utmost good faith, with respect to the test and scope of material information needed to be disclosed. As to the principle of utmost good faith in sections 18-20, MIA 1906, the material circumstances which influence a prudent insurer's decision and have actually induced the conclusion of a marine insurance contract must be disclosed before concluding this contract. This general test of materiality is too wide for the held covered clause issue, which could be an extreme imposition for the assured by requiring him to make full disclosure of material information even after the conclusion of the said contract. Therefore, the information which is material in terms of the held covered clause needs to be disclosed by the assured before its application, but not that of importance for the whole contract.

Keeping this in mind, most authorities suggest categorizing this clause into the scope of the pre-contract stage,<sup>692</sup> or alternatively, under sections 18-20 concerning pre-contract utmost good faith in MIA 1906 (this blind application suggestion is criticized for its veracity below). One reason is that since the held covered clause is to be invoked for covering forward risks out of the primary policy, the risks held covered, thus, constitute a distinct contract theoretically.<sup>693</sup> According to Thomas, the held covered clause gives rise to a unilateral offer by the insurer to provide an

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<sup>691</sup> This view has been expressed by Bennett, 'Mapping the doctrine of utmost good faith in insurance contract law', in *LMCLQ*, p. 205, suggesting that 'circumstances... that induce the actual insurer into agreeing to that alteration'.

<sup>692</sup> Soyer, 'Continuing duty of utmost good faith in insurance contracts: still alive?', in *LMCLQ*, pp. 39-79.

<sup>693</sup> The distinct contract theory is confirmed by *Fraser Shipping Ltd v N.J. Colton & Others* [1997] 1 Lloyd's Rep. 586, per Potter LJ, see *Ibid*, p. 40.

extended cover on the terms of the clause, and with notice given, a reasonable premium and reasonable terms agreed, the assured is both accepting and giving consideration for the unilateral offer.<sup>694</sup> The procedures summarized by Thomas just reflect on all elements for a separate valid contract, including, offer, acceptance, consideration and an intention to create legal relations.<sup>695</sup>

Treating the amendment alluded to the held covered clause as a separate new contract is getting more support, from both the judiciary and academia. The judicial evidence lies in the judgment of Lord Justice Potter in *Fraser Shipping Ltd v N.J. Colton & Others*,<sup>696</sup> in which section 18 of the MIA 1906 was referred to in order to assess whether the disclosed information is material. This is assumed to be an indirect confirmation of excluding a held covered clause event from the post-contract scope by importing it to the pre-contract system,<sup>697</sup> since it is widely known that sections 18-20 of the MIA 1906 are applied to the contemplation of an insurance contract. Another authoritative judgment, delivered by Lord Hobhouse, in *Iron Trades Mutual Insurance Co. Ltd v Companhia de Seguros Imperio*,<sup>698</sup> expressed a further need to tailor the duty to its context. In his judgment, it was articulated that:

'Where there is an addition to a contract, as where it is varied, there can be a further duty of disclosure but only to the extent that it is material to the variation being proposed. If the addition does not alter the contractual rights there will be no fact that it is material to disclose and the same will apply if a variation is favourable to the insurer. It will only be when the insurer is being asked to take on some additional risk and/or needing of reassess the premium or terms of cover that disclosure of further facts could be material

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<sup>694</sup> Rhidian Thomas, 'Cargo Insurance: Issues Arising from the Standard Cover Provided by the London Institute Cargo Clauses', in Marc Huybrechts, et al., *Marine Insurance at the turn of the Millennium*, Vol. 1, (Intersentia, 1999), pp. 325, 332.

<sup>695</sup> At common law, it is assumed that, principally, contracting parties of a commercial agreement have serious intentions to create a legal relationship. Additionally, additional premium just meets the 'additional consideration for an additional contract' requirement at common law. For more details of the elements of a valid contract in contract law, see MacIntyre, *Business Law*.

<sup>696</sup> [1997] 1 Lloyd's Rep. 586, pp. 594-597, per Potter, LJ.

<sup>697</sup> This view is expressed by Soyer, 'Continuing duty of utmost good faith in insurance contracts: still alive?', in *LMCLQ*, pp. 39-79, at p. 65.

<sup>698</sup> (1992) 1 Re LR 213, cited by Bennett, 'Mapping the doctrine of utmost good faith in insurance contract law', in *LMCLQ*, note. 220.

and, even then, the facts to be disclosed are only those which are material to what the insurer is being asked to do...Any other conclusion would lead to an absurdity; the duty of the utmost good faith does not include giving the insurer an opportunity, after he has accepted the risk and become bound, to escape from his commitment.<sup>699</sup>

As Lord Hobhouse's judgment suggests, the duty of utmost good faith is confined to the risks accepted by the assured and ceases at the conclusion of the contract, otherwise, the insurer would be awarded with an opportunity to escape from his commitment. Indirectly, Lord Hobhouse's judgment implies that the injection of additional risks or variations of contracts should be treated like a new contract, or at least trigger a new pre-contract duty of utmost good faith out of the original policy. As a matter of fact, this judgment can be considered to be of significance to link utmost good faith for the held covered clauses to contract variations and also renewals.<sup>700</sup>

The second concern, which is linked to the first, is the scope of information which needs to be disclosed before invoking the held covered clause successfully. Regarding Lord Hobhouse's judgment, under the circumstance of an additional risk to a contract, the further duty of disclosure was limited to material information to the variation.<sup>701</sup> One condition precedent to invoke this test, as Lord Hobhouse observed, was whether the variation being proposed would lead the premium to be reassessed or additional terms of cover agreed, for example, when the insurer is asked to take account of some additional risks.<sup>702</sup> In an analogous position, treating contract variations resulting from a held covered clause as a separate new contract simplifies and minimises a series of issues raised, including those with regard to the variation of an insurance contract which is addressed below. Followed by *The Mercandian*

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<sup>699</sup> (1992) 1 Re LR 213, p. 224.

<sup>700</sup> Soyer, 'Continuing duty of utmost good faith in insurance contracts: still alive?', in *LMCLQ*, pp. 39-79, p. 67.

<sup>701</sup> *Iron Trades Mutual Insurance Co. Ltd v Companhia de Seguros Imperio* (1992) 1 Re LR 213, p. 216.

<sup>702</sup> *Ibid.*



*Continent*,<sup>703</sup> Longmore LJ stated that it had never been suggested that a breach of the duty in those situations may avoid the whole of the contract of insurance, although it is clear that avoidance is the only statutory remedy available. The separate new contract theory therefore, on the other hand, states that the information is not needed to be disclosed unless it is material to the risks held covered, or it is material to the variation and renewal of the insurance contract.<sup>704</sup> It is suggested in *Arnould's Law of Marine Insurance and Average*, that cases in held covered clauses can be distinguished by those in which the insurer has a decision to make, and those in which the insurer does not.<sup>705</sup> Following this suggestion, it is observed by its present editors that in the former case, disclosure should be made of those matters which are material to the decision the insurer has to make. Furthermore, since this duty of disclosure in held covered clause cases is also a voluntary duty suggested to be attached to section 17 of MIA 1906, it is analogous to require the assured to reveal all material information positively on the basis of a prudent insurer's mind but not on the assured's assumption. For example, in *Moore Large & Co Ltd v HERMES Credit & Guarantee Plc*,<sup>706</sup> it was observed that where specific information was requested under the terms of a policy endorsement and the information provided may serve purposes other than those related to the assessment of risks, the assured should not be led to the inference that no further information should be disclosed.<sup>707</sup>

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<sup>703</sup> [2001] 2 Lloyd's Rep. 563, para.22(4).

<sup>704</sup> Gilman, et al., *Arnould's Law of Marine Insurance and Average*, p. 757; Bennett, 'Mapping the doctrine of utmost good faith in insurance contract law', in *LMCLQ*, p. 204; Soyer, 'Continuing duty of utmost good faith in insurance contracts: still alive?', in *LMCLQ*, pp. 39-79, at pp. 66-67.

<sup>705</sup> Gilman, et al., *Arnould's Law of Marine Insurance and Average*, p. 757.

<sup>706</sup> [2003] 1 Lloyd's Rep 163, p. 156, per Colman J.

<sup>707</sup> Naidoo and Oughton, 'The Confused post-formation duty of good faith in insurance law: from refinement to fragmentation to elimination?', in *JBL*, note 66.

### 5.2.2.2. Variations to insurance contracts

In the context of contract variations, the materiality and actual inducement test apply, but not with the same standard created in the principal duty of utmost good faith underlying section 17 of the MIA 1906. *Sawtell v Loudon*<sup>708</sup> can be cited as one of the earliest cases regarding the variation of contract. In this case, a broker was instructed to effect a policy on goods, but by mistake he effected it on a ship. This policy was afterwards rectified by the underwriter subscribing a memorandum in the margin and his initials. The broker failed to communicate some information he acquired about the insured ship, the *Sofia*, in the interim. Therefore it was argued by the underwriters that this non-disclosure vitiated the whole policy. One point held by Heath J is that the information disclosed was a material fact and ought to have been disclosed.<sup>709</sup> In spite of this, it is observed that the facts of this case offered no guidance on the general effect of lack of good faith in a variation to an insurance contract since the original policy became spoiled as a result of an error in communication.<sup>710</sup>

As a result, before the parties proceed to make any changes to the original policy, the circumstances which are material to the variations must be disclosed.<sup>711</sup> Baron Blackwell set one fictitious example in his judgment of *Lishman v Northern Maritime Insurance Co*, demonstrating why the position of materiality (and inducement) would be different:

‘If the parties, after making the original agreement, were dissatisfied with the terms of it, and altered it in drawing up the final terms of the insurance, so as substantially to alter the nature of the bargain as affecting both sides,...., it might well be that the obligation to communicate material facts

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<sup>708</sup> (1814) 5 Taunt. 359.

<sup>709</sup> *Ibid*, p. 364.

<sup>710</sup> Foxton, ‘The post-contractual duties of good faith in marine insurance policies: the search for elusive principles’, in Thomas, *Marine Insurance: The Law in Transition*, chapter 4.

<sup>711</sup> *Lishman v Northern Maritime Insurance Co*(1874-75) L.R. 10 C.P. 179, Court of Exchequer Chamber.

would continue until the time of the execution of the policy, at any rate with respect to all matters material to the alteration of the terms.<sup>712</sup>

This view was cited by Lord Hobhouse afterwards in *The Star Sea*,<sup>713</sup> reaffirming that the duty of disclosure would apply to a variation, but only facts material to the additional risk falling within the variation need to be disclosed.<sup>714</sup> As a matter of fact, Lord Hobhouse expressed a clear view in *The Star Sea*, clarifying that where the contract is being varied, facts must be disclosed which are material to the additional risk being accepted by the variation, and meanwhile, after the conclusion of the original policy, there is no need to disclose facts occurring or discovered material to the acceptance and rating of that risk afterwards.<sup>715</sup> Although Blackwell J did not consider whether avoidance would be limited to the variation or extended to the original contract in *Lishman v Northern Maritime Insurance Co*, one might have the view that apparently, this limitation should apply to the avoidance remedy. Discussion is continued in some recent cases in marine insurance.<sup>716</sup> Especially in Justice Hirst's judgment in *The Litsion Pride*, it is agreed that 'a circumstance is material if it would influence the judgment of a prudent underwriter in making the relevant decision on the topic to which the misrepresentation or non-disclosure relates'. It was held that the information was material because it would possibly change the underwriter's decision as to the rate of additional premium, the facultative reinsurance, and even the execution of the cancellation clause.<sup>717</sup>

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<sup>712</sup> *Ibid*, p. 181, per Baron Blackwell.

<sup>713</sup> [2001] 1 Lloyd's Rep. 389, para. 54.

<sup>714</sup> *Ibid*, Lord Hobhouse of Woodborough cited the judgment of Blackburn J in *Lishman v Northern Maritime Insurance Co* (1874-75) L.R. 10 C.P. 179, at p. 182.

<sup>715</sup> *Manifest Shipping Co Ltd v Uni-Polaris Shipping Co Ltd (The Star Sea)* [2001] 1 Lloyd's Rep. 389, HL, p. 187.

<sup>716</sup> For example, *Black King Shipping Corporation v Massie (The Litsion Pride)* [1985] 1 Lloyd's Rep. 437; *Iron Trades Mutual Insurance Co. Ltd v Companhia de Seguros Imperio*(1992) 1 Re LR 213.

<sup>717</sup> *Black King Shipping Corporation v Massie (The Litsion Pride)* [1985] 1 Lloyd's Rep. 437, p. 511.

The judicial evidence does not only confirm the materiality test in the context of contract amendments, but also follows the test adopted in the pre-contract system, namely, circumstances are material which would influence the judgment of a prudent insurer in fixing the additional premium, or determining whether he will accept that variation.<sup>718</sup>

As another element at the core of utmost good faith, the mutuality nature cannot be ignored. In the principal duty of utmost good faith in section 17 of the MIA 1906, either party must observe this duty, although the avoidance remedy of the contract is much likely to be one-sided in practice. By analogy, its unitary inclination in the post-contract situation was confirmed by the judiciary in *The Star Sea*, stating that ‘an inevitable consequence in the post-contract situation is that the remedy of avoidance of the contract is, in practical terms, wholly one-sided’.<sup>719</sup> However, its unitary inclination of avoidance remedy cannot deny the mutuality nature of utmost good faith itself. It is not difficult to imagine that both the insurance company and assured have the right to propose variations to the insurance policy and before the variations being agreed the proposer needs to disclose every material circumstance relating to the variations.

### **5.2.2.3. Renewals to insurance contracts**

In most non-life insurance,<sup>720</sup> the duration is specified by an insurance policy, which is normally for one year. A renewable insurance contract is providing a window for both insurance parties to have the existing policy renewed without complicated

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<sup>718</sup> Some of these case examples are analysed below, see § 5.3.

<sup>719</sup> *Manifest Shipping Co Ltd v Uni-Polaris Shipping Co Ltd (The Star Sea)* [2001] 1 Lloyd's Rep. 389, HL, para.57, per Lord Hobhouse.

<sup>720</sup> According to Garner, et al., *Black's Law Dictionary*, ‘a life insurance policy requires lifetime annual fixed premiums and that becomes payable only on the death of the insured’, distinguishing it from the non-life insurance which is renewed periodically, for example, normally 12 months is limited for an insurance.

procedures undergone during the negotiation of the original insurance policy, but probably with a higher premium or extra terms. In practice, a 'days of grace' provision would be contained in a renewable insurance, granting the assured a short additional time for payment and the renewal would lapse if the assured fails to pay the renewal premium.<sup>721</sup> On the other hand, the right to renew an insurance contract is not an automatic right, but qualified upon the acceptance of such an extension or renewal by the insurers.<sup>722</sup> With a valid offer, an acceptance, additional considerations from both parties and the serious intentions to continue a legal relation, it is logical and legally acceptable to treat the renewed insurance like a separate contract.<sup>723</sup> Meanwhile, it is also reasonable to suggest sections 17-20 of the MIA 1906 governing the utmost good faith issues with respect to the renewal of insurance as being applicable.

Materiality is judged by analogy with the pre-contractual position, which means that every material circumstance must be disclosed or represented during the negotiation of renewing insurance. Similarly, the circumstance is not material unless it would influence the prudent insurer to accept the extension of the original policy, and the insurer would not have accepted the extension with the information discussed. In the non-disclosure context, the party who intends to challenge the renewed contract is obliged to prove that the non-disclosed or misrepresented information is material, or continues to be material for the renewals, otherwise, the materiality requirement specified for the renewed part is not satisfied and the

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<sup>721</sup> Angus Rodger, 'An introduction to insurance and insurance law', in Robert Merkin, et al., *Insurance Law – An Introduction* (1<sup>st</sup> ed., London: Informa, 2007), chapter 1.

<sup>722</sup> *Weldon v GRE* [2000] 2 All E.R. (Comm) 914, also see *Ibid.*

<sup>723</sup> The fresh contract theory is also favoured by Eggers, et al., *Good Faith and Insurance Contract*, para.10.38; Soyer, 'Continuing duty of utmost good faith in insurance contracts: still alive?', in *LMCLQ*, pp. 39-79, at p. 44.

information is, in discussion, immaterial.<sup>724</sup> In the view of this author, the materiality test here is also prospective compared to the entire contract. Additionally, the information is material for the renewals only if it is crucial at the time of the renewal of the insurance contract but irrelevant to the nature in the previous policy.

#### **5.2.2.4. Orders for ship's papers and litigation procedures**

The order for ship's papers was deemed as an exceptional pre-defence discovery procedure, unique to actions on marine insurance policies.<sup>725</sup> Therefore, pursuant to the Civil Procedure Rules 1998, rule 31.12 and rule 58.14, the insurer applies for a discovery order of ship's papers, the court may make an order for specific disclosure, or specific inspection, and subsequently one party must disclose documents specified in the order and/or any documents located as a result of that research. Alternatively, the assured must provide a convincing explanation on why disclosure is unsuccessful or denied to be submitted. The reason to create this exceptional discovery procedure for marine insurers is that the underwriters have no means of knowing how a loss was caused if it occurs when the ship is entirely under the control of the assured.<sup>726</sup> Consequently, the information imbalance will be redressed

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<sup>724</sup> *Pan Atlantic Insurance Co Ltd v Pine Top Insurance Co Ltd (Pan Atlantic)* [1992] 1 Lloyd's Rep. 101, p. 104, per Waller, LJ; *Sharp v Sphere Drake Insurance Plc (The Moonacre)* [1992] 2 Lloyd's Rep. 501, pp. 521-522, per Mr Colman QC; *Hill v Citadel Insurance Co Ltd* [1995] LRLR 218, p. 232, per Cresswell, J; [1997] LRLR 167, p. 170, per Saville LJ. Also see Eggers, et al., *Good Faith and Insurance Contract*.

<sup>725</sup> Bennett, 'Mapping the doctrine of utmost good faith in insurance contract law', in *LMCLQ*, p. 165.

<sup>726</sup> Additionally, according to rule 58.14, Civil Procedure Rules 1998,

'(1) If, in proceedings relating to a marine insurance policy, the underwriters apply for specific disclosure under rule 31.12, the court may—

(a) order a party to produce all the ships papers; and

(b) require that party to use his best endeavours to obtain and disclose documents which are not or have not been in his control.

(2) An order under this rule may be made at any stage of the proceedings and on such terms, if any, as to staying the proceedings or otherwise, as the court thinks fit.'

and the quality of claims and allegations will be improved.<sup>727</sup> The timing of disclosure of ship's papers, therefore, is after the commencement of litigation procedures.<sup>728</sup>

The heart of this issue is the relationship between the post-contractual duty of utmost good faith in section 17 of the MIA 1906 and disclosure of ship's papers. It is understandable why some early authorities<sup>729</sup> treated the origin of the power of the court to require disclosure of ship's papers as one duty lying in utmost good faith, since then, according to this order and the rules in Civil Procedure Rules 1998, the assured must disclose the information of any document specified by this order, or is relevant to this search. It cannot be neglected that even the draftsman of this Act, Sir Mackenzie Chalmers, noted that the order for disclosure of ship's papers was a species of utmost good faith, instancing the former as an example of the operation of post-contract good faith,<sup>730</sup> and this statement has existed for a considerable amount of time. However, some current authorities favour the opposite opinion,<sup>731</sup> claiming that this order is independent of the doctrine of utmost good faith. To deal with this question, investigations need to be firstly addressed to the following issues.

The first concern is the scope of papers that must be disclosed pursuant to the order. Literally, based on rule 31.12 of the Civil Procedure Rules 1998, all the documents specified by the order and/or related to the search must be produced.

According to *Black's Law Dictionary*, the 'ship's papers' is defined to be 'the papers

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<sup>727</sup> Bennett, 'Mapping the doctrine of utmost good faith in insurance contract law', in *LMCLQ*, p. 200.

<sup>728</sup> Eggers, et al., *Good Faith and Insurance Contract*, para. 10.06.

<sup>729</sup> For judicial support, see *Boulton v Houlder Bros Co.* [1904] 1 K.B. 784, pp. 791-2, per Matthew J; *Raynor v Ritson* (1865) 6 B & S, 888, p. 891; *China Trader's Insurance Co. Ltd v Royal Exchange Assurance Corp.* [1898] 2 QB 187, pp. 193-4; *Harding v Bussell* [1905] 2 K.B. 83, p. 85; *Leon v Casey* [1932] 2 K.B. 576, pp. 579-80.

For academic support, see *Ibid*; Bennett, 'Mapping the doctrine of utmost good faith in insurance contract law', in *LMCLQ*; and Soyer, 'Continuing duty of utmost good faith in insurance contracts: still alive?', in *LMCLQ*, pp. 39-79.

<sup>730</sup> *K/S Merc-Scandia XXXXII v Certain Lloyd's Underwriters (The Mercandian Continent)* [2001] 2 Lloyd's Rep. 563, CA, para. 22(8), per Longmore LJ.

<sup>731</sup> *Manifest Shipping Co Ltd v Uni-Polaris Shipping Co Ltd (The Star Sea)* [1997] 1 Lloyd's Rep 360, CA, p. 371; [2001] 1 Lloyd's Rep. 389, HL, para. 60; also see Bennett, *The Law of Marine Insurance*, p. 179; Bennett, 'Mapping the doctrine of utmost good faith in insurance contract law', in *LMCLQ*, p. 201; Gilman, et al., *Arnould's Law of Marine Insurance and Average*, p. 748.

that a vessel is required to provide as the primary evidence of the ship's national character, ownership, nature and destination of cargo, and compliance with navigation laws'.<sup>732</sup> In practice, the ship's papers include certificates of health, charter-party, muster-rolls, licenses, bills of lading, insurance documents, and any other documents to prove the vessel's status. Besides, the scope of this duty is considerably wide because the insurer can apply for every document he thinks is linked to the claims to be produced. As a consequence of admitting the disclosure of ship's papers as a species of utmost good faith under section 17 of the MIA 1906, the pre-stage system should also apply to the post-formation system and extensively to the disclosure of ship's papers for the insurer. But, the extensive scope of ship's papers which the insurer can apply to be disclosed would require a radically different test compared with the prudent insurer, materiality and actual inducement test, in the pre-contract phase. This is because, under present circumstances the particular and individual insurer's requirements should be taken into consideration, but not those of a hypothetical prudent insurer's.

The second concern is whether the utmost good faith duty plays any role in the litigation stage.<sup>733</sup> It has also been suggested that the duty of utmost good faith exists in the conduct of litigation.<sup>734</sup> Sir MacKenzie Chalmers suggested in his 1907 commentary on section 17 that 'even in litigation both sides must play with their cards on the table; hence the full discovery allowed as to ship's papers and other material documents'.<sup>735</sup> In *The Mercandian Continent*, Longmore LJ expressed his

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<sup>732</sup> Garner, et al., *Black's Law Dictionary*.

<sup>733</sup> *Manifest Shipping Co Ltd v Uni-Polaris Shipping Co Ltd (The Star Sea)* [2001] 1 Lloyd's Rep. 389, HL.

<sup>734</sup> MacKenzie Chalmers and Douglas Owen, *The Marine Insurance Act, 1906* (London: W. Clowes, 1907); *K/S Merc-Scandia XXXXII v Certain Lloyd's Underwriters (The Mercandian Continent)* [2001] 2 Lloyd's Rep. 563, CA, para. 23, per Longmore LJ; *Manifest Shipping Co Ltd v Uni-Polaris Insurance Co Ltd (The Star Sea)* [1995] 1 Lloyd's Rep. 651, QB, pp. 667 et seq, per Tuckey J.

<sup>735</sup> Chalmers and Owen, *The Marine Insurance Act, 1906*.



statement citing *Cox v Bankside Agency Ltd.*<sup>736</sup> He appeared to support the view that there was a duty of good faith in the conduct of litigation, but noted that the avoidance *ab initio* remedy attached to its non-compliance was inappropriate.<sup>737</sup> The duty of utmost good faith, therefore, based on these authorities, appeared to survive the commencement of proceedings. In contrast, some authorities held that the duty of utmost good faith came to an end when the litigation started.<sup>738</sup> In *The Star Sea*, Tuckey J suggested that the duty came to an end once legal proceedings had commenced.<sup>739</sup> Consistent with this opinion, Lord Hobhouse reflected that once proceedings had commenced, important changes came about in the parties' relationships.<sup>740</sup> Clearly, it is not appropriate to require the assured to act to the same standard of good faith to be observed in the pre-contract system, since the external environment and internal elements have been changed once the litigation procedure commences. In the opinion of this author, the assured indeed must produce the specified ship's papers by the order in good faith, based on the obligation attached to the procedural order, but not an implied contractual obligation. Actually, one might have the view that this concern is irrelevant to the status of disclosing ship's papers in the conduct of litigation, since rule 58.14 of the Civil Procedure Rules 1998 empowers the Courts to issue the order to require the assured to disclose specified ship's papers 'at any stage of the proceedings and on such terms, if any, as to staying the proceedings or otherwise, as the court thinks fit'. This concern can then be addressed, as this is a procedural duty in association with the order issued but not

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<sup>736</sup> [1995] 2 Lloyd's Rep. 437, p. 462, per Bingham MR.

<sup>737</sup> [2001] 2 Lloyd's Rep. 563, para. 23.

<sup>738</sup> For example, Eggers, et al., *Good Faith and Insurance Contract*, para 11.92-8; Soyer, 'Continuing duty of utmost good faith in insurance contracts: still alive?', in *LMCLQ*, pp. 39-79, at p. 57; *Manifest Shipping Co Ltd v Uni-Polaris Insurance Co Ltd (The Star Sea)* [1995] 1 Lloyd's Rep. 651, QB, pp. 667 et seq.

<sup>739</sup> [1995] 1 LR 651, pp. 667 et seq.

<sup>740</sup> *Rego v Connecticut Insurance Placement Facility* 593 A.2d. 491, 495 (Conn. 1991), p. 497, cited by Eggers, et al., *Good Faith and Insurance Contract*, para. 11.100.

one aspect of the complicated utmost good faith doctrine. In practice, one statutory example of drawing a line between the general duty of good faith and litigation procedure is the International Hull Clauses 2003, clause 45.<sup>741</sup>

The third concern regarding this statement is the incompatibility between English case law and section 17 of the MIA 1906 with respect to the scope of the order for ship's papers and the remedies for a breach.<sup>742</sup> The negative influences of dividing this aspect into the duty of utmost good faith in section 17 include, first of all, the incompatibility between the application of an order for ship's papers and section 17. From the history of this order,<sup>743</sup> it is found that it was rooted in equity and unique in marine insurance actions. The judiciary reaffirmed their views that they did not want to extend this order to actions other than marine insurance actions.<sup>744</sup> However, section 17 of the MIA 1906 applies to both marine and non-marine insurance, and categorizing the pre-defence discovery of ship's papers into section 17 would require the former duty to be extended to both marine and non-marine insurance. This ultimately conflicts with the fundamentals of establishing the order for ship's papers<sup>745</sup> and subsequent case law creating limitations on its application. Secondly, an incompatibility is also created between case law and its avoidance remedy attached to section 17. According to Bennett, there is no record either of early discoveries having been awarded against an insurer or of an insurer being held

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<sup>741</sup> Clause 45.3, International Hull Clauses 2003, stipulates that 'it shall be a condition precedent to the liability of Underwriters that the Assured shall not' commit any fraud 'at any stage prior to the commencement of legal proceedings...'

<sup>742</sup> Bennett, 'Mapping the doctrine of utmost good faith in insurance contract law', in *LMCLQ*, p. 201.

<sup>743</sup> For details see *Ibid*, pp. 200-1; and Eggers, et al., *Good Faith and Insurance Contract*, para. 11.96.

<sup>744</sup> *Twizell v Allen* (1839) 3 M. & W. 337; *Village Main Reef Gold Mining Co. Ltd. v Stearns* (1900) 5 Com. Cas. 246; *Leon v Casey* [1932] 2 J.B. 576, p. 582, per Scrutton LJ.

<sup>745</sup> It is suggested that the pre-defence discovery of ship's papers was designed to redress the information imbalance and enable insurers to formulate an informed response to a claim and to avoid allegations in the defence that might rapidly be proved spurious. See Bennett, 'Mapping the doctrine of utmost good faith in insurance contract law', in *LMCLQ*, p. 200.

entitled to avoid a policy for non-compliance with an order for ship's papers.<sup>746</sup> On the basis of judicial attitudes, it can be concluded that it has never been suggested that the non-compliance with disclosure of ship's papers would entitle underwriters to avoid the policy,<sup>747</sup> since 'whatever it was, it was not the obligation referred to in s.17'.<sup>748</sup> Stay of proceedings, therefore, is the only remedy available for its non-compliance.

It can be concluded that the duty of utmost good faith has no relationship with the assured's duty to discover ship's papers. It is unrealistic to have the assured's duty to discover ship's papers covered by the duty of utmost good faith in section 17, since in doing this, more difficulties and potential incompatibilities would be caused. One might have the view that since the timing of delivering this order is after the conclusion of the referred insurance contract and at the commencement of litigation procedures, then requiring the assured to continue the duty of utmost good faith is, apparently, against the general principle that this duty ends when litigation starts. Furthermore, the obligation imposed on the assured is a procedural response derived from the order issued by the court, but not attached to the marine insurance policy itself. This is upheld by the authoritative judgments delivered by Leggatt LJ<sup>749</sup> and Lord Hobhouse<sup>750</sup> in *The Star Sea*, stating that such orders constituted no more than examples of the Court's procedure for handling cases of this kind, and the breach of which attracted procedural remedies rather than the remedy of avoidance. Additionally, it is suggested by some authorities that the order for ship's papers is

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<sup>746</sup> *Ibid*, p. 201

<sup>747</sup> *Manifest Shipping Co Ltd v Uni-Polaris Insurance Co Ltd (The Star Sea)* [1997] 1 Lloyd's Rep. 360, CA, p. 371, per Leggatt LJ, it is also well made by Leggatt LJ in the Court of Appeal that this order was never made against underwriters; Foxton, 'The post-contractual duties of good faith in marine insurance policies: the search for elusive principles', in Thomas, *Marine Insurance: The Law in Transition*, chapter 4, para.4.8.

<sup>748</sup> *The Star Sea* [1997] 1 Lloyd's Rep. 360, para.60, per Lord Hobhouse.

<sup>749</sup> [1997] 1 Lloyd's Rep. 360, CA, p. 371.

<sup>750</sup> [2001] 1 Lloyd's Rep. 389, HL.

better viewed as a purely procedural response to the lack of appropriate common law discovery procedures.<sup>751</sup> Apart from its exclusive character in marine insurance policies, its increasing discretionary nature<sup>752</sup> appears to conflict with the mandatory requirement to observe utmost good faith under an insurance contract in section 17. Finally, the above factors (including its unilateral character and limitations during the enforcement, incompatibilities with section 17 and case law, a radical different remedy available for a breach compared to the principal utmost good faith system) demonstrate that the assured's duty to disclose vessel's papers is of little weight in utmost good faith.

#### **5.2.2.5. Other situations**

##### **5.2.2.5.1. Cancellation clauses**

A cancellation clause is defined to be a contractual provision allowing one or both parties to avoid their obligations under certain conditions.<sup>753</sup> Under a continuous insurance cover, with a notice given by the assured in advance, the insurer has a right to make a decision to terminate or continue the current policy. If the insurer decides to terminate the policy upon the information revealed afterwards, the insurer or reinsurer would give notice of cancellation, and arrange consequential discussions on terms or contract renewals during the notice period. On the contrary, if the insurer

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<sup>751</sup> Rhidian Thomas, 'Fraudulent insurance claims: definition, consequences and limitations', (2006) *LMCLQ*, pp. 485-516, it is held by Thomas that a fraudulent claim made in litigation (or arbitration) is to be responded to by reference to the procedural rules governing the conduct of litigation; Bennett, 'Mapping the doctrine of utmost good faith in insurance contract law', in *LMCLQ*, p. 201; Soyer, 'Continuing duty of utmost good faith in insurance contracts: still alive?', in *LMCLQ*, pp. 39-79, at p. 74; Eggers, et al., *Good Faith and Insurance Contract*, chapter 11; Foxtan, 'The post-contractual duties of good faith in marine insurance policies: the search for elusive principles', in Thomas, *Marine Insurance: The Law in Transition*, chapter 4, para.4.7.; David Foxtan, 'Fraudulent claims: the law in eight principles' (unpublished, one paper prepared for a Symposium at Swansea University in 2005).

<sup>752</sup> *North British Rubber Co v Cheetham* (1938) 61 L1 LR 337; *Keevil and Keevil Ltd v Boag* (1940) 67 L1 LR 263; *Probatina Shipping Co Ltd v Sun Insurance Office Ltd (The Sageorge)* [1974] QB 635.

<sup>753</sup> Garner, et al., *Black's Law Dictionary*.

accepts the information revealed by the assured and decides to continue the existing policy, the cancellation clause becomes one part of the original policy.<sup>754</sup>

As to the duration of a general post-contractual duty of utmost good faith, on the one hand, it is a common practice for the assured to be released from a continuous duty of material circumstances disclosure to the risks insured against after concluding the insurance contract. Otherwise, there would be inexhaustible excuses available for the insurer to avoid himself from taking market risks, for example, terminating the insurance policy because of the increasing risks insured against. On the other hand, the right to cancel gives the insurer an opportunity to repudiate his liability in respect of an accepted risk,<sup>755</sup> especially in a long-term and continuous insurance policy. In order to resolve conflicts between these two views, and avoid the insurer's abuse of utmost good faith, the judiciary suggested treating the right to cancel a cover not as an absolute right but as an option.<sup>756</sup> It was held by both the Court of Appeal and House of Lords in *Commercial Union Assurance Co v Niger Co Ltd* that there was no continuing duty of disclosure to enable the insurers to determine whether or not to terminate the insurance.<sup>757</sup> Lord Sumner expressed his concern in applying the duty of disclosure too extensively, considering that the extensive application 'would turn what is an indispensable shield for the underwriter into an engine of oppression against the insured'.<sup>758</sup> In order to redress further potential disputes, it was suggested by Bankes LJ that in the case of a long-term contract, it would be wise to contain a provision requiring notice to be given to them if

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<sup>754</sup> Eggers, et al., *Good Faith and Insurance Contract*.

<sup>755</sup> *Ibid*, para.10.35; and Mark Mildred, *Product Liability Insurance* (1<sup>st</sup> ed., London: Informa, 2000), chapter 5.

<sup>756</sup> *Commercial Union Assurance Co v Niger Co Ltd* (1921) 6 LI L Rep. 239 (CA), per Bankes LJ.

<sup>757</sup> *Ibid*, p. 245, per Bankes, LJ; (1922) 13 LI L Rep. 75, HL, p. 77, per Lord Buckmaster.

<sup>758</sup> *Commercial Union Assurance Co v Niger Co Ltd* (1922) 13 LI L Rep. 75, HL, p. 82, per Lord Sumner.

the nature of the risk alters appreciably.<sup>759</sup> In the subsequent judgment, it was observed that there should be no fresh voluntary duty of disclosure imposed on the assured during the notice period given, but a duty not to materially misrepresent facts in discussions with insurers.<sup>760</sup> This observation also accords with the initial judicial intention which is reluctant to extend the duty of disclosure endlessly.<sup>761</sup>

#### **5.2.2.5.2. Claims notification clause – a precedent condition or an innominate term?**

In practice, most insurance contracts contain a provision requiring the assured to notify either claims or circumstances which would give rise to a potential loss to the insurer in a specified manner. This is usually in writing within a time limit given, (which is normally contractually clarified, or within a reasonable time which reads like ‘as soon as reasonably practicable’ or ‘immediately in the event of losses occurred’). In an absence of an express provision, the practice is that the insurers need to pay immediately in the event of a loss according to the insurance policy dependent upon notification. However, if the contracting parties involved have disagreements regarding claims afterwards, business efficiency would be referred to by the courts to judge if there is a duty of notification implied in this case.<sup>762</sup>

One of the earliest case examples enshrining the post-formation duty, *The Litsion Pride*,<sup>763</sup> intended to extend good faith to the delivery of notification. In subsequent

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<sup>759</sup> *Commercial Union Assurance Co v Niger Co Ltd* (1921) 6 LI L Rep. 239, CA, p. 245, per Bankes LJ.

<sup>760</sup> *Iron Trades Mutual Insurance v Companhia de Seguros Imperio* (1992) 1 Re LR 213. Also similarly, *New Hampshire Insurance Company v MGN Limited* [1997] LRLR 24.

<sup>761</sup> For example, *New Hampshire Insurance Company v MGN Limited* [1997] LRLR 24, p. 61, per Staughton LJ.

<sup>762</sup> Cameron McKenna, *Insurance Broking Practice and the Law* (1<sup>st</sup> ed., Service issue 10, London: Informa, 2012), chapter 14.

<sup>763</sup> *Black King Shipping Corporation and Wayang (Panama) SA v Mark Ranald Massie (The Litsion Pride)* [1985] 1 Lloyd's Rep. 437.

cases, *The Mercandian Continent*<sup>764</sup> and *Alfred McAlpine Plc v BAI Insurance (Run Off) Ltd*,<sup>765</sup> some remarkable statements in connection with utmost good faith and a claims notification clause were provided. *The Mercandian Continent* case is construed as a landmark in respect to the claims notification clause because it provided a crucial judgment in categorizing terms and the effect of the breach of a claims notification clause. According to the leading judgment delivered by Longmore LJ, the first three categories of terms in English law<sup>766</sup> coexist with the conditions precedent to the insurer's liability for a particular claim constituting a contract. As Longmore LJ held, four types of contractual terms were observed: (1) condition, a term any breach of which entitles the innocent party to terminate the contract and discharge himself from all further liabilities from the breach; (2) warranty, a term any breach of which only entitles the innocent party to damages; (3) innominate terms, in respect of which the consequence of the breach depends on the nature and gravity of the breach;<sup>767</sup> (4) condition precedent, a term the observance of which is a condition precedent before the other party to the contract comes under any liability whatsoever.<sup>768</sup> It was accepted to apply a duty of good faith in connection with both the notification of claims and litigation procedures, but on the basis of some lesser remedy other than the statutory avoidance *ab initio*.<sup>769</sup>

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<sup>764</sup> [2001] 2 Lloyd's Rep. 563.

<sup>765</sup> *BAI* [2000] 1 Lloyd's Rep. 437, CA.

<sup>766</sup> [2001] 2 Lloyd's Rep. 563, p. 569.

<sup>767</sup> If the breach is sufficiently serious or the consequences of the breach deprive the innocent party of his substantial interests, he can accept the breach as repudiatory and terminate the contract.

<sup>768</sup> Also see Alison Padfield, 'Claims', in Robert Merkin, et al., *Insurance Law – An Introduction* (1<sup>st</sup> ed., London: Informa, 2007), chapter 5.

<sup>769</sup> [2001] 2 Lloyd's Rep. 563, p. 568.

Recently, confusion in the terminology used for insurance contracts and ordinary contracts was discussed in academia, by summarizing different types of contractual terms in insurance law and their equivalents in general contract law.<sup>770</sup>

The *BAI* case is another noticeable decision here because it introduced some freshness in categorizing terms and the effect of the breach of a claims notification clause.<sup>771</sup> During the leading judgment delivered by Waller LJ, the traditional attitude treating the claims notification clause as a simple absolute condition precedent to recovery, a term any breach of which entitles the insurer to reject the claim, was suggested to be shifted to the innominate term theory,<sup>772</sup> or a new-type innominate term,<sup>773</sup> which is limited to particular claims rather than the whole contract as with a general innominate term. According to his judgment, the consequences of a breach of the notification duty may be sufficiently serious to entitle the insurer (the BAI Insurance Company in this case) to reject the claim, albeit the breach is not so serious as to amount to a repudiation of the whole contract.<sup>774</sup> The resulting development is that the assured or his agent's failure to notify the insurer of losses or circumstances would not simply lead a claim to be rejected, but would lead to a variable result upon assessed seriousness of the breach for relevant claim. *Hong Kong Fir Shipping Co Ltd v Kawasaki Kisen Kaisha Ltd*<sup>775</sup> was referred to illustrate

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<sup>770</sup> Padfield, 'Claims', in Merkin, et al., *Insurance Law – An Introduction*, chapter 5. It is suggested that a 'warranty' in insurance law is the equivalent of a 'condition' in ordinary contract law; a 'condition' in insurance law is any term of a contract; a 'warranty' in ordinary contract law is a term the breach of which only entitles the innocent party to damages, never to terminate the contract, and for which there is no equivalent label in insurance law. Since this section is addressed to the losses/claims notification clause, the following attention will be directed to explore the real legal position of a notification clause in insurance.

<sup>771</sup> [2000] 1 Lloyd's Rep. 437.

<sup>772</sup> *Ibid*, this opinion was supported by both Peter Gibson and Buxton, LJJ.

<sup>773</sup> Padfield, 'Claims', in Merkin, et al., *Insurance Law – An Introduction*, chapter 5.

<sup>774</sup> [2000] 1 Lloyd's Rep. 437, para. 21. Waller LJ explained in his judgment that negligence in supplying details of a claim cannot sufficiently constitute a breach of the obligation of good faith, but dishonesty would have to be established.

<sup>775</sup> [1962] 2 QB 26.



different effects of breaking the notification duty, upon whether the breach substantially deprives the insurer of his interests.<sup>776</sup>

In the view of this author, the new-type innominate term analysis is indeed an injection of flexibility into the condition precedent theory for recovery. However, its vital weakness lies in the primary surrounding of this theory, as it must firstly be an implied term. As to this point, admittedly, difficulties in the precise quantification of loss, lead to a failure in attempting to persuade courts to accept a notification duty as an implied term without express provisions.<sup>777</sup> Besides, some other concerns are proposed with the arising new-type innominate term statement. Considering the varied consequences of non-compliance with the duty of notification, for example, where the effect of the non-compliance is serious enough to entitle the insurer to reject the particular claim, this is the same result which would be achieved anyway where a notification clause is construed as a condition precedent. However, the result of a breach would distinguish a precedent condition from a notification duty when it is not sufficiently serious to entitle the insurer to reject the claim, by treating a notification clause equally to a new-type innominate term. Furthermore, the new threshold between sufficient and insufficient seriousness for a particular claim is hard to be unified since the degree of gravity is assessed upon individual claims and more uncertainties would be caused.

As to the first concern, if the effect of a breach is serious enough for the insurer's decision on this particular claim, breach of a condition precedent discharges the insurer of liability to pay the particular claim whether or not any prejudice has been suffered.<sup>778</sup> Nevertheless, this does not discharge the insurer from further liability to

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<sup>776</sup> *Alfred McAlpine Plc v BAI Insurance (Run Off) Ltd (BAI)* [2000] 1 Lloyd's Rep. 437, para. 28.

<sup>777</sup> The judiciary do not intend to expressly define this issue but leave it to practice.

<sup>778</sup> *Virk v Gan Life Holdings Plc* [2000] Lloyd's Rep. IR 159, pp. 162-3, para. 13, CA, see Padfield, 'Claims', in Merkin, et al., *Insurance Law – An Introduction*, chapter 5.

pay any subsequent claim notified in accordance with the condition precedent. Breach of a new-type innominate term, the effect of which is serious enough to substantially influence the insurer's decision, discharges the insurer of any further liability associated with particular claims in question. However, there is still the same effect resulting for the particular claim under both circumstances. If the non-compliance does not influence the insurer's decision substantially, the breach of a precedent condition would not trigger a rejection of particular claims, but a lesser remedy.<sup>779</sup> Conversely, the breach of a new-type innominate term in this case would only entitle the injured insurer to contractual damages instead of a partial termination of contract. Nevertheless, the second assumption is founded on the ground that the assured does not have a strict liability during the performance of a notification clause.<sup>780</sup> This echoes another concern regarding the difficulties in building a practical yardstick between sufficient and insufficient seriousness of a breach for a particular claim, since the degree of gravity varies in individual cases. It is suggested by this author that there is no unified resolution to this concern but it is believed that the insurance industry favours to leave this concern to be clarified by practice. Judging from the accomplishment achieved so far, dishonesty must be established for claiming a breach of good faith of notification duty.

In practice, the information notified to the insurer will take into consideration the compensation assessment and evidence collection, the premium revaluation for a renewal contract, and the handling of some other contracts linked to the original insurance policy, for example, a reinsurance contract or a carriage of goods by sea

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<sup>779</sup> Most probably, no further remedy awarded to the slightly influenced insurer since no loss suffered by him.

<sup>780</sup> This view has been expressed by the judiciary in *BAI*, stating that negligence is inadequate to constitute a breach of good faith in association with losses/claims notification clauses.

contract with a time limit for suit given.<sup>781</sup> Although the non-compliance with the requirements in fulfilling the notification clause does not play a crucial role in every aspect of the whole contract, good faith is necessary for the particular claim, especially sometimes where the assured's non-notification of claims causes consequential losses to the insurer. For instance, one 6 month's delay would cause the insurer's failure in recovering a reinsurance claim from the reinsurer. In this hypothetical circumstance, rejecting the particular claim is adequate for the assured's decision, since the so-called injured insurer does not suffer any loss by discharging himself from the liability for this particular claim, and actually he is not allowed to benefit from the reinsurer on the basis of the doctrine of indemnity. In the meantime, good faith is not deemed to be broken where only the assured's negligence is proved in supplying details of information,<sup>782</sup> but contractual damages should be awarded.

### **5.2.2.5.3. Rights of inspection, follow the settlements and incorporation clauses in general claims context other than fraudulent claims**

#### **5.2.2.5.3.1. Rights of inspection**

The contracting parties' rights to information also include the disclosure of documents in an insurance contracting relationship. Discovering the ship's papers upon the insurer's order is recognizable as a procedural duty and the duty of claims/loss notification associated with the notification clause treated like a condition precedent for a particular claim,<sup>783</sup> whilst, these two duties are obliged (mainly to the assured though) to support the substantive rights to information under an insurance

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<sup>781</sup> For example, one year's time limit given in a carriage contract.

<sup>782</sup> [2000] 1 Lloyd's Rep. 437, p. 444, per Waller LJ.

<sup>783</sup> It is suggested to treat the notification duty like a precedent condition from the construction rule, temporally. Further considerations are left to the Courts. See paragraphs above.

contract.<sup>784</sup>

Generally, in a reinsurance contract, it is common for a reinsurer to inspect the records of the reassured. Practically, the right to inspection of records is operated in an express clause form since the insurer is strongly recommended to do so to avoid any further contractual disputes or tensions created between the insurance parties. However, it was submitted to be primarily implied in a reinsurance contract in an absence of an explicit duty. In *Phoenix General Insurance Co. of Greece S.A. v Halvanon Insurance Co. Ltd.*,<sup>785</sup> Lord Hobhouse stated that certain terms relevant to the unique reinsurance relationship have to be implied primarily to make sure the business proceeds in a proper and business-like fashion. Meanwhile, there is also a different voice alleging that since there is no such right to investigate expressly set out in the insurance contract, the reinsurer has no right to get access to his reassured's books.<sup>786</sup>

Apart from confirming the essential position of an inspection clause, either implied or express, another contribution of the *Phoenix* case is that Lord Hobhouse's judgment set out several principal points for good faith in this regard. Firstly, his judgment admitted the relationship between good faith and the reinsurer's right to inspect records. Clearly, Lord Hobhouse believed that the right to inspect was grounded in, and imported by, the duty of good faith by delivering a judgment on discussing the duration of certain duties.<sup>787</sup> Furthermore, the reinsurer's right to inspection of records is not ceded at the conclusion of a reinsurance policy, but was continuing.<sup>788</sup> It is a practical statement since it is exactly what is undergoing in the

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<sup>784</sup> Foxton, 'The post-contractual duties of good faith in marine insurance policies: the search for elusive principles', in Thomas, *Marine Insurance: The Law in Transition*, chapter 4.

<sup>785</sup> [1985] 2 Lloyd's Rep. 599, p. 614, per Hobhouse LJ.

<sup>786</sup> *Société Anonyme d'Intermediaries Luxembourgeois v Farex Cie* [1995] L.R.L.R. 116.

<sup>787</sup> [1985] 2 Lloyd's Rep. 599, p. 614, per Lord Hobhouse.

<sup>788</sup> *Ibid.*

insurance market. The right to inspect is operated throughout the entire contract, from the contemplation and performance stage to the claiming stage.

It is supposed that the right to investigate information relevant to the insurance contract is not unilateral but also entitled to the assured, especially at the contemplation stage before the assured has made a valid offer. This is reasonable if the assured commenced investigation on the insurance company's information, including its satisfaction of claims records, service and premium scales offered. However, a marine assured has no interests on this point, but is more interested in the insurance company's certifications, and whether his potential insurer is being registered in any world or regional insurer association list. The assured's right to inspect becomes extremely vital when the insured object is so valuable that the shipowner is worried that his insurer could not afford any losses and probably announce a bankruptcy to avoid his liabilities. In this typical case, the shipowner's insurance policy is reinsured.

The right to inspection of the assured's documents is suggested to be operated in an efficient and professional manner,<sup>789</sup> usually by an inspector or the insurance company's own in-house team. However, criticisms relate to the insurers' overuse of this right to confidential documents during the inspection,<sup>790</sup> and the insurance companies' underhand tactics to avoid liabilities during the investigation stage.

Because the assured's relevant records and documents are mainly inspected by the experienced inspection team from the insurance company, as long as the assured is willing to open his files to the insurer there is practically no dispute in

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<sup>789</sup> For more details, see Robert Merkin, *A Guide to Reinsurance Law* (1<sup>st</sup> ed., London: Informa, 2007), chapter 7. And *Muttern v Eastern and Midlands Railway Company* (1888) 38 Ch.D. 92.

<sup>790</sup> Merkin, *A Guide to Reinsurance Law*, chapter 7.

respect to utmost good faith.<sup>791</sup> However, difficulties lie in the objective test to evaluate the mental element to establish a breach,<sup>792</sup> for instance, the assured is required to make relevant information reasonably available.<sup>793</sup> Additionally, because of the assured's trivial role in inspection, failing to allow the insurer to approach relevant information only entitles an order issued by a Court to have the inspection enforced, but not any avoidance remedy attached to principal non-compliance with utmost good faith.<sup>794</sup>

#### 5.2.2.5.3.2. Follow the settlements clauses

Many reinsurance policies would contain a 'follow the settlements' clause, intending to ensure that the reinsurer settles claims covered by the primary insurance efficiently and commercially.<sup>795</sup> This applies in relation to the acceptance of liability and the amount of the claim.<sup>796</sup> This clause gives rise to the reassured's good faith during the claims handling under the primary insurance policy and its influence on the consequential reinsurance policies (sometimes it is beyond one layer of reinsurance).

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<sup>791</sup> The assured's concealment of some material documents falls within the scope of a general duty of disclosure, which is mainly governed by section 17-20 of the MIA 1906. The uniqueness of the insurer's right to inspection leads to this particular issue to be excluded from the contents of the principal utmost good faith doctrine.

<sup>792</sup> Foxton, 'The post-contractual duties of good faith in marine insurance policies: the search for elusive principles', in Thomas, *Marine Insurance: The Law in Transition*, chapter 4.

<sup>793</sup> *Phoenix General Insurance Co. of Greece S.A. v Halvanon Insurance Co. Ltd.* [1985] 2 Lloyd's Rep. 599, p. 614, per Lord Hobhouse.

<sup>794</sup> Foxton, 'The post-contractual duties of good faith in marine insurance policies: the search for elusive principles', in Thomas, *Marine Insurance: The Law in Transition*, chapter 4.

<sup>795</sup> Such as, *Insurance Co of Africa v Scor (UK) Reinsurance Co Ltd.* [1985] 1 Lloyd's Rep. 312. In this case, the loss settlement language of the reinsurance policy requires that 'being a Reinsurance of and warranted same ... terms and conditions as and to follow the settlements of the Insurance Company of Africa ...'. For recent cases, see *HIH Casualty & General Insurance Ltd v New Hampshire Insurance Co Independent Insurance Co Ltd* [2001] LLR IR 596; *Eagle Star Insurance Co Ltd v Cresswell* [2004] LLR IR 537; *Faraday Capital Ltd v Copenhagen Reinsurance Co Ltd* [2007] LLR IR 23; *IRB Brasil Resseguros AS v CX Reinsurance Co Ltd* [2010] LLR IR 560.

<sup>796</sup> *Hill v Mercantile and General Reinsurance Co plc* [1996] 1 WLR 1239, HL. Also see Andrew McGee, *The Modern Law of Insurance* (3<sup>rd</sup> ed., London: LexisNexis Butterworths, 2011), chapter 49.

In *Insurance Co of Africa v Scor (UK) Reinsurance Co Ltd.*,<sup>797</sup> ICA effected an insurance contract with the warehouses and their contents in Monrovia and Liberia, against fire. Scor had the primary insurance policy reinsured as a leading reinsurer in the London market. Under the reinsurance policy, the reinsurer was required to 'follow the settlements' of the reinsured. Later on, the warehouse caught fire and unfortunately, the insured warehouse and its contents burned to the ground. As the insurer of the primary insurance cover, ICA sent two loss adjusters to the scene for investigation, and reported that there were no suspicious circumstances. ICA, therefore, claimed on his reinsurance. However, the reinsurer, Scor, received several anonymous letters alleging that the Africa Trading Company (ATC), the operator of the warehouse, had deliberately set fire to the warehouse, and the relevant representatives of ICA had been bribed to defraud members of the Lebanese and Indian business community.<sup>798</sup> Unfortunately, Scor's intervention in investigation caused ICA to quit all co-operation, and Scor eventually denied to indemnify the reassured against its share of loss recovered by the primary policy.

The *ICA v Scor* case appeared to be a case regarding the co-operation clauses in reinsurance. However, the test of the reassured's good faith in settling claims was created at the heart of this judgment. After this case, the effect of a clause binding reinsurers to follow settlements of the insurers was also clarified. According to Robert Goff LJ's judgment, the first requirement to the 'follow the settlements' clause is that the claims settled must have fallen within the scope of risks covered by the reinsurance policy as a matter of law.<sup>799</sup> The other judges also added that the settled claim must have been recognized as falling within the scope of the original

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<sup>797</sup> [1985] 1 Lloyd's Rep. 312.

<sup>798</sup> It emerged that these letters were sent by business rivals of ICA.

<sup>799</sup> *Insurance Co of Africa v Scor (UK) Reinsurance Co Ltd.* [1985] 1 Lloyd's Rep. 312, p. 330.

insurance.<sup>800</sup> Meanwhile, the insurer was further required to settle the claim honestly, and to have taken all proper and businesslike steps.<sup>801</sup> Difficulties lying in the requirements of settling claims with good faith were raised and finally resolved in *Assicurazioni Generali SpA v CGU International Insurance Plc.*<sup>802</sup> In this case, the reinsurer was required to ‘follow without question the settlements of the Reassured...’ and the words ‘out of question’ became arguable. However, it was eventually confirmed by the judiciary that the absence of bad faith was not adequate to qualify the requirements underlying the words ‘out of question’, whilst the insurer was required to adopt a commercial and efficient manner in settling claims, distinguishing the ‘follow the settlement’ clauses from a general utmost good faith context.<sup>803</sup> The Court of Appeal latterly recommended the reinsurance parties to contain an express ‘follow the settlements’ clause, with a clear criteria that ‘in settling the claims the insurer had acted honestly and had taken all proper and business like steps in making the settlement’ attached’.<sup>804</sup>

### 5.2.2.5.3.3. Incorporation Clauses

An ‘incorporation clause’ functions efficiently in reinsurance providing that the assured will assist the insurer in the defence of claims.<sup>805</sup> Operating with the claims clauses, the incorporation clause constitutes a claims-related-clauses blueprint. At

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<sup>800</sup> *Hiscox v Outhwaite (No 3)* [1991] 2 Lloyd’s Rep. 524, p. 530. On the basis of Evan J’s judgment, ‘the reinsurer may well be bound to follow the insurer’s settlement of a claim which arguably, as a matter of law, is within the scope of the original insurance, regardless of whether the Court might hold, if the issue was fully argued before it, that as a matter of law the claim would have failed’.

<sup>801</sup> *Insurance Co of Africa v Scor (UK) Reinsurance Co Ltd.* [1985] 1 Lloyd’s Rep. 312, p. 330.

<sup>802</sup> [2003] Lloyd’s Rep. I.R. 725, QB; [2004] Lloyd’s Rep. I.R. 457, CA.

<sup>803</sup> It is suggested by the present authors of Gilman, et al., *Arnould’s Law of Marine Insurance and Average*, p. 760, that the ‘follow the settlements’ clause is not an expression of utmost good faith.

<sup>804</sup> [2004] Lloyd’s Rep. I.R. 457, CA.

<sup>805</sup> Eggers, et al., *Good Faith and Insurance Contract*, para.10.42. Relevant cases include, for example, *Pine Top Insurance Co Ltd v Unione Italiana Anglo Saxon Reinsurance Co Ltd* [1987] 1 Lloyd’s Rep. 476, per Gatehouse J; *HIH Casualty & General Insurance Ltd v New Hampshire Insurance Co Independent Insurance Co Ltd* [2001] LLR I.R. 596; *Habas Sinai Ve Tibbi Gazlar Isthisal Endustri As v Sometal Sal* [2010] EWHC 29 (Comm).



the claiming stage, both the insurer and assured are required to act in good faith. However, good faith alluded to the claims co-operation clause is not suggested to be an expression of post utmost good faith, since it arises on a purely contractual basis.<sup>806</sup>

### **5.2.3. Remedies for post-formation good faith breaches – is avoidance the universal remedy or are there alternative remedies?**

#### **5.2.3.1. Avoidance remedy for post-contract utmost good faith breach in held covered clauses, variations and renewals to insurance contracts context**

The third concern in the held covered clause context at this stage raises the question: is avoidance the universal remedy, or are there alternatives?<sup>807</sup> In the view of this author, covering the held covered clause cases under the group of new contract is considered to allow a rationalization in terms of remedies available.<sup>808</sup> The harshness and unreasonableness of the avoidance remedy rescinding the whole insurance policy *ab initio* in cases of an utmost good faith breach has been discussed in chapter 3. By analogy, the avoidance remedy becomes a penalty to the party who makes a mistake confined to the risks covered by the held covered clauses, variation and even the renewal of a contract. As stated earlier, the post-contractual utmost good faith theory in the context of held covered clauses would turn section 17 of the MIA 1906 to be the exclusive origin of this issue. Therefore, avoidance, as the only available remedy, would become the unified solution for principal utmost good faith issues and specific decision points, which is apparently

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<sup>806</sup> *Gan Insurance Co Ltd v Tai Ping Insurance Co Ltd (Nos 2 and 3)* [2001] Lloyd's Rep I.R. 667, para. 68. Also see Gilman, et al., *Arnould's Law of Marine Insurance and Average*, p. 760; and McGee, *The Modern Law of Insurance*, chapter 19, p. 280.

<sup>807</sup> The first two concerns are expounded in 5.2.2.2 of this chapter.

<sup>808</sup> This is supported by Soyer, 'Continuing duty of utmost good faith in insurance contracts: still alive?', in *LMCLQ*, pp. 39-79, p. 67.

disproportionate. This statement is favoured by Leggatt LJ in his judgment in the Court of Appeal, *The Star Sea*,<sup>809</sup> which held that under the circumstances of amendments, although it was still uncertain whether the remedy is avoidance of the whole contract, or merely of the amendment, taking 'inducement of the actual underwriter' into account was sufficient to conclude that a prospective avoidance of amendment should be the only remedy permitted.

With the opinion that the insurer recreates a new and distinct insurance policy in the held covered clause cases, some opinions<sup>810</sup> confirmed the governing position of sections 18-20 of the MIA 1906, by excluding the feasibility of section 17 into this issue. In the view of this author, this opinion is incorrect because of some latent weaknesses.<sup>811</sup> First of all, according to the statutory language of the MIA 1906, it cannot be denied that sections 18-20 apply to pre-contract utmost good faith, not special issues or post-contract events. Additionally, according to Bennett's influential writing, the held covered clause issue does not fall within section 18 of the MIA 1906 since the latter cannot continue once the contract has been concluded. Therefore, after concluding a new contract based on the amendments attached to held covered clauses, or variations of contract or renewals, denying the application of section 17 actually would cause a gap at this moment. Bennett, thus, suggested another possible solution to avoid any potential complexity and unpredictability regarding

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<sup>809</sup> [1997] 1 Lloyd's Rep. 360, CA, p. 370.

<sup>810</sup> For example, Soyer, 'Continuing duty of utmost good faith in insurance contracts: still alive?', in *LMCLQ*, pp. 39-79, at p. 67. Also, referring to section 18 of the MIA 1906 by Potter LJ in *Fraser Shipping Let v N.J. Colton & Others* [1997] 1 Lloyd's Rep. 586, pp. 594-597, to stipulate how to judge whether the facts not disclosed were material or not in a held covered clause case, is deemed as impliedly confirming the held covered clause should be governed as a pre-contractual issue, by sections 18-20.

<sup>811</sup> This author's opinion is also available from Bennett, 'Mapping the doctrine of utmost good faith in insurance contract law', in *LMCLQ*, pp. 165-222, at pp. 206-207, by suggesting excluding the duty of utmost good faith attached to the amendments of cover under held covered clauses from sections 17-20 of the MIA 1906.

special decision points and even post-contract utmost good faith, namely, a solution moulding itself to its context in terms of scope and remedy.<sup>812</sup>

There used to be some uncertainties on the effect of the breach of utmost good faith in the variation context. Some early authorities had some hesitations in applying avoidance to the original insurance policy.<sup>813</sup> However, others suggested that a material non-disclosure and misrepresentation attached to the contract variation would lead to the entire policy being vitiated.<sup>814</sup> In Blackburn J's judgment in *Lishman v Northen Maritime Insurance Co.*,<sup>815</sup> it was held that:

'[S]uppose the policy were actually executed, and the parties agreed to add a memorandum afterwards, altering the terms: if the alteration were such as to make the contract more burdensome to the underwriters, and a fact known at that time to the assured were concealed which was material to the alteration, I should say the policy would be vitiated.'

Recently, some judicial evidence proves that the right of avoidance only applies to the variation and not to the original insurance contract. For instance, in Lord Hobhouse's judgment of *Iron Trades Mutual Insurance Co. Ltd v Companhia de Seguros Imperio*, it was held that:

'Where there is an addition to a contract, as where it is varied, there can be a further duty of disclosure but only to the extent that is material to the variation being proposed. If the addition does not alter the contractual rights there will be no fact that it is material to disclose and the same will apply if a variation is favourable to the insurer.'<sup>816</sup>

Subsequently, in Leggatt LJ's judgment of *The Star Sea*, he stated that:

'[I]n relation to amendment a duty of disclosure of facts material to the amendment will exist but the law is not, we think, clear as to whether the remedy is avoidance of the whole contract or merely of the amendment. Since inducement of the actual underwriter is necessary, there seems much

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<sup>812</sup> *Ibid*, at p. 222.

<sup>813</sup> For example, Sir Michael Mustill and Jonathan Gilman in *Arnould's Law of Marine Insurance and Average*, 16<sup>th</sup> ed., 1981, vol. 2, para. 621; *Fraser Shipping Limited v N.J. Colton* [1997] 1 Lloyd's Rep. 586, this question is left open by Potter LJ.

<sup>814</sup> *Lishman v Northen Maritime Insurance Co.* (1875) Lloyd's Rep. 10 CP 179, p. 182, per Blackburn J.

<sup>815</sup> (1875) Lloyd's Rep. 10 CP 179, p 182, per Blackburn LJ.

<sup>816</sup> (1992) 1 Re LR 213; p. 224, per Lord Hobhouse

to be said for the point of view that avoidance of the amendment is all that should be permitted...'<sup>817</sup>

Similarly in *The Mercandian Continent*,<sup>818</sup> Longmore LJ expressed the scope of the right of avoidance stating, 'it only applies to the variation not to the original risk', and so it is, if the variation is induced by fraudulent misrepresentation. Based on Longmore LJ's judgment, Mr Siberry QC in *O'Kane v Jones*<sup>819</sup> confirmed that 'non-disclosure [at that point] would give rise to a right to avoid only the variation, not the contract itself'. Longmore LJ's prospective remedy view is also cited in *Groupama Insurance Co Ltd v Overseas Partners Re Ltd*,<sup>820</sup> in which it was held that in cases of any additional subscription, induced by false statements under a reinsurance policy, the avoidance of additional subscription is the only remedy permitted.

After observing Lord Hobhouse's judgment in *The Star Sea*<sup>821</sup> and Longmore LJ's judgment in *The Mercandian Continent*,<sup>822</sup> it can be said that, indirectly, the judiciary also favoured extending the pre-contract system to non-disclosure and misrepresentation issues arising in respect to any renewed insurance.<sup>823</sup> In a later part of his judgment, Longmore LJ reaffirmed that the avoidance should be limited to the variation, renewal or the application of the 'held covered' provision, prospectively.<sup>824</sup>

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<sup>817</sup> [1997] 1 Lloyd's Rep. 360, CA, p. 370.

<sup>818</sup> *K/S Merc-Scandia XXXXII v Certain Lloyd's Underwriters (The Mercandian Continent)* [2001] 2 Lloyd's Rep. 563, CA, para. 22(2), per Longmore LJ.

<sup>819</sup> [2004] 1 Lloyd's Rep. 389, para. 229, per Mr Siberry, QC.

<sup>820</sup> [2003] EWHC 34 (Comm), QB.

<sup>821</sup> [2001] 1 Lloyd's Rep. 389, HL, para. 54.

<sup>822</sup> *K/S Merc-Scandia XXXXII v Certain Lloyd's Underwriters (The Mercandian Continent)* [2001] 2 Lloyd's Rep. 563, CA, p. 571, per Longmore LJ.

<sup>823</sup> According to Longmore LJ's judgment, '[a] duty of good faith exists when the insured seeks to renew the contract of insurance. That is a prospective right and if it is not observed by each party, the other party can avoid the contract. It is never suggested that, although the breach takes place during the currency of the earlier contract, the earlier contract is avoided as well as the renewal'.

<sup>824</sup> *K/S Merc-Scandia XXXXII v Certain Lloyd's Underwriters (The Mercandian Continent)* [2001] 2 Lloyd's Rep. 563, CA, p. 574, per Longmore LJ.

## **5.2.3.2. Remedies available in other post-contract formation situations**

### **5.2.3.2.1. Cancellation clause and claims notification clause**

In terms of the non-compliance with cancellations clauses, it is supported by both leading academics and judicial interpretation that there is no continuing post-contract good faith imposed.<sup>825</sup> Therefore, if an expressed 'cancellation clause' is agreed by insurance parties, any non-compliance with this clause constitutes a contractual breach which causes contractual damages. With the absence of such provisions in insurance, any non-compliance would be considered by the judiciary, referring to business efficiency and commercial practice.

As stated earlier in this chapter, the negligent non-notification of claims does not constitute a breach of good faith in the notification clause context, and dishonesty should be established. Furthermore, it is unfortunate that the effect of a fraudulent notification in insurance is still left open by the judiciary,<sup>826</sup> for example, it is unclear whether the effect of a fraudulent notification would constitute a breach of the continuing post-formation duty of utmost good faith for the whole contract. In order to resolve this problem, there is a need to clarify the position of a notification clause for the whole insurance policy.

In the view of this author, a duty of notification is a continuing duty derived from utmost good faith for the whole contract, but should be distinguished from the latter. It can be said that sometimes non-compliance with this duty is not grave enough to influence the whole contract. It becomes a commercial sense, especially in insurance with professional advice provided. Even the non-experienced assured should have acknowledged that at least he has to notify the insurer of the occurrence of an

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<sup>825</sup> See § 5.2.2.5.1.

<sup>826</sup> *Alfred McAlpine Plc v BAI Insurance (Run Off) Ltd (BAI)* [2000] 1 Lloyd's Rep. 437, p. 444, per Waller LJ.

accident, otherwise, no claims would be recovered. Uncertainties lie in the reasonable time limits given in the absence of an express term requiring claims/loss notification. The reality is that there are only rare cases in practice relating to this issue. It becomes one reason why the attempts to persuade the courts to imply a term that the insurer will act with reasonable speed and efficiency in the negotiation, assessment and payment of claims, are likely to fail.<sup>827</sup>

One might have the view that since the assured's notification duty is suggested to be derived from utmost good faith, a breach of this duty should entitle the injured insurer to avoid the entire contract *ab initio*; the author disagrees with this point. Furthermore, it is clearly stated by the present editors of *Arnould's* that there is no room for a middle concept of avoidance from the date the insurer avoids, which adds complexities to the point whether this duty (of utmost good faith) can attach in connection with a claims notification clause (not a fraudulent act), given that the authorities which support the extent of the duty in those situations are premised on the remedy of avoidance *ab initio* not being available.<sup>828</sup>

This promotes questions about the position of a fraudulent notification. Does it fall within the scope of fraudulent claims, or should it be simply treated as a breach of a normal contractual term, such as, a condition precedent? If it is identified as a fraudulent claim issue in utmost good faith, what remedies are available here? If the avoidance remedy is awarded in a fraudulent notification context, is not it an overly harsh penalty to the assured compared with the prospective forfeiture of claim remedy? And logically, attention is directed to the harshness of the rescission remedy in post-formation utmost good faith. On the other hand, if it is deemed as a breach of a traditional condition precedent, is not it encouraging the incentive of

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<sup>827</sup> Padfield, 'Claims', in Merkin, et al., *Insurance Law – An Introduction*, chapter 5. Also *Insurance Corporation of the Channel Islands v McHugh* [1997] LRLR 94, per Mance LJ.

<sup>828</sup> Gilman, et al., *Arnould's Law of Marine Insurance and Average*, p. 750.

making dishonest notification of claims since no retrospective sanction would be triggered? In the same hypothetical circumstance, would the claimant's dishonest conduct influence the subsequent claims? All these aforesaid concerns need to be clarified by further judgments.

Simultaneously, the application of the new-type innominate term theory needs to be treated with caution, since in *Friends Provident Life & Pensions Ltd. v Sirius International Insurance Corp*,<sup>829</sup> the Court of Appeal rejected Justice Waller's analysis in *BAI*, and insisted that previous decisions on this point were *obiter* only.<sup>830</sup> Apparently, there is still uncertainty as to the real legal position of a notification clause, since the new-type innominate term analysis has no application after the *BAI* decision. As its uniqueness suggests, the claims notifications clause falls outside of the scope of general post-formation utmost good faith.

With the statements given, this author agrees with the opinion in favour of recommending to both parties to set out expressly the notification clause and the effect of breach, but, where they do not do so, it is for the court to infer their intention by construing the contract.<sup>831</sup> In other words, whether the notification clause in question is a precedent condition depends on the business efficacy and the judiciary's discretion in individual cases. If it is confirmed to be a precedent condition, fraudulent breach would entitle the injured insurer to reject the particular claim. It will not influence subsequent claims notified in accordance with this notification clause, whilst negligent notification does not constitute a real breach of this duty. If it is confirmed to be an ordinary term, but not a precedent condition, the breach of a notification clause would entitle the insurer contractual damages only if the insurer

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<sup>829</sup> [2005] 2 Lloyd's Rep. 517, CA.

<sup>830</sup> Both *K/S Merc-Scandia XXXXII v Certain Lloyd's Underwriters (The Mercandian Continent)* [2001] 2 Lloyd's Rep. 563, CA, and *Alfred McAlpine Plc v BAI Insurance (Run Off) Ltd (BAI)* [2000] 1 Lloyd's Rep. 437.

<sup>831</sup> John Birds, 'Innominate Terms in Insurance Contracts (Case Comment)', (2006) *JBL*, pp. 545-8.

can prove that his loss is caused by this breach, or he could reject the claim if this breach seriously prejudiced him.

#### **5.2.3.2.2. Rights to inspection, follow the settlements and incorporation clauses**

Because of the assured's trivial role in inspection, failing to allow the insurer to approach relevant information only entitles an order issued by a Court to have the inspection enforced, but not the avoidance *ab initio* remedy attached to the non-compliance with the principal utmost good faith duty.

The consequence of the insurer's dishonesty in handling claims would constitute a fraudulent claim under the consequential reinsurance contract which the insurer claims on, and obviously this would cause the reinsurance attached to be avoided. Uncertainties lie in whether the avoidance remedy is available for the insurer who settles claims negligently but not dishonestly, for example, lacking of prudence as a professional insurer to dispose the primary claims or the manner adopted is not as efficient or commercial as a business-like manner. The majority of cases dealing with this concern have been resolved by practical trading custom, since business efficiency would be hindered if every claim settled by the primary insurer has to be confirmed and qualified by judicial interventions and arbitrations.<sup>832</sup> It would be wise for the insurance parties to clarify that the insurers should settle the claims reasonably. Moreover, the burden of proof would go to the reinsurer if he intends to challenge either the insurer's honesty or professionalism in settling primary claims.<sup>833</sup> However, in practice, it is really difficult for the reinsurer to prove the original insurer's unprofessionalism although the primary insurer is commonly required to co-operate

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<sup>832</sup> Barlow Lyde and Gilbert, *Reinsurance Practice and the Law* (1<sup>st</sup> ed., London: Informa, 2011), para. 29.31.

<sup>833</sup> For example, *Charman v Guardian Royal Exchange Assurance plc* [1992] 2 Lloyd's Rep. 607.



with his reinsurer. Apart from the practice abovementioned, in the view of this author, there are some possible solutions. First of all, in the absence of fraud and dishonesty, the reinsurer has the option to dispose the claims on reinsurance gently, and send this case back to the original insurer for re-investigation. Secondly, the reinsurer could negotiate with the primary insurer on the amount of indemnity and try to achieve compromise in compensation. Thirdly, if there is no compromise achieved, the courts or arbitration institutions would become the last resort for the reinsurer, and the attention would be directed to the general burden of proof principle in the 'follow the settlements' clause context.

As observed earlier in this chapter, continuing utmost good faith is not suggested to be imposed on the reinsurance parties in the incorporation clause context. On this ground there are two relevant situations: (1) the reassured's cooperation is argued for being a condition precedent or simple condition;<sup>834</sup> and (2) the unified construction of a co-operation clause.<sup>835</sup> For the first consideration, this author is in favour of treating the co-operation clause as a simple condition. Possible reasons for the primary insurer to refuse cooperation with his reinsurer during claims investigation could be that there is nothing more than the reinsurer concealing his fraudulent claims or negligence, or protecting his confidential information. In the view of this author, a confidential agreement between both parties in association with the insurer's duty to inspection can be invoked for the assured's information protection. Moreover, it is suggested that the assured should distinguish confidential from unconfidential information in order to avoid potential tensions caused between insurance parties. If the insurer intends to challenge the assured's honesty and claim

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<sup>834</sup> McGee, *The Modern Law of Insurance*, chapter 17. According to this writing, the division of conditions is unclear. However, the co-operation clause is suggested to be treated like a simple condition.

<sup>835</sup> *Royal & Sun Alliance Insurance Plc v Dornoch Ltd* [2004] Lloyd's Rep. I.R. 826, per Aikens J.

compensation on this insurance, the insurer is obliged to prove that the assured in question has made a fraudulent claim. However, it is still positive that the assured's non-compliance would be influential for the insurer to conduct a loss investigation, and being a condition precedent, any breach would only cause particular claims to be rejected. Therefore, a condition theory is favoured by this author, which means any breach of a co-operation clause would lead to the insurance contract being repudiated, and the injured insurer to be entitled to damages if any loss can be proved.

### 5.3. Fraudulent claims – utmost good faith or good faith?

Currently, fraud is recognized as a severe and expensive global problem in the insurance industry. An insurer is even described to be particularly vulnerable to fraud.<sup>836</sup> According to the figures released by the ABI, insurers detected over 2,500 fraudulent claims worth £18 million every week in 2010, which increased the cost to protect honest customers against fraud up to £2 billion a year. However, the extra expense is paid for by honest policyholders through higher premiums.<sup>837</sup> In addition to the confirmation of its central role in the assured's presentation of claims from practice, the duty to advance claims honestly is clarified to be the only component of

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<sup>836</sup> The Law Commission, Issues Paper 7, *The Insured's Post-contract Duty of Good Faith*.

<sup>837</sup> Association of British Insurers, 'You could not make it up but some did. Insurers detecting more fraudulent claims than ever: over 2500 worth £18 million every week' (Thursday, 28 July 2011, ABI News Release Ref: 31/11), available at [http://www.abi.org.uk/Media/Releases/2011/07/You\\_could\\_not\\_make\\_it\\_up\\_but\\_some\\_did\\_Insurers\\_detecting\\_more\\_fraudulent\\_claims\\_than\\_ever\\_over\\_2500\\_worth\\_18\\_million\\_every\\_week.aspx](http://www.abi.org.uk/Media/Releases/2011/07/You_could_not_make_it_up_but_some_did_Insurers_detecting_more_fraudulent_claims_than_ever_over_2500_worth_18_million_every_week.aspx), accessed in January 2013. Also see Association of British Insurers, *No Hiding Place – Insurance Fraud Exposed*, (September 2012), available at <http://www.abi.org.uk/Publications/63750.pdf>, accessed in January 2013.

According to ABI's observation, it was also observed that from 2005 to 2010 both the number and overall value of insurance frauds detected have risen by over 100%. Also, according to ABI report, the insurance fraud is a serious criminal offence that affects every honest insurance customer, adding extra £50 a year to their premiums.

the assured's duty in his presentation of a claim by judicial statements,<sup>838</sup> which gives people sufficient reason to reconsider fraud issues. Therefore, as the voice of the UK's insurance, the ABI launched the Insurance Fraud Register that will contain details of all known insurance fraudsters,<sup>839</sup> on the basis of one of its fundamental reports.<sup>840</sup>

Uncertainties lie in the issue concerning whether the insurer's remedy is to decline the fraudulent claim, or whether there is a further entitlement to rescind the entire policy for a breach of utmost good faith. Principally, according to section 17 of the MIA 1906, any breach of utmost good faith would cause the whole insurance contract to be avoided. The avoidance remedy including recouping any claims previously paid, therefore, appears to be the exclusive statutory remedy available. However, it has been proved that Courts are reluctant to entitle the insurer with the forfeiture of the whole contract, but only of the fraudulent claim.<sup>841</sup> On the one hand, the divergence between common law and section 17 of the MIA 1906 is considered to cause unnecessary complexities and confusions to post-contractual duties. On the other hand, the disjuncture lends support to most practitioners to express their anxiety for a statutory reform. According to the responses received by the Law Commission regarding its Issues Paper 7, 23 of 25 responses considered that it would be helpful

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<sup>838</sup> For example, *Manifest Shipping Co Ltd v Uni-Polaris Insurance Co Ltd (The Star Sea)* [2001] 1 Lloyd's Rep. 389, HL; *K/S Merc-Scandia XXXXII v Certain Lloyd's Underwriters (The Mercandian Continent)* [2001] 2 Lloyd's Rep. 563, CA; *Direct Line Insurance Plc v Khan* [2001] EWCA Civ 1974; [2002] LLR I.R. 364; *Agapitos v Agnew (The Aegeon) (No.1)*[2002] Lloyd's Rep. I.R. 191, QB; [2002] 2 Lloyd's Rep. 42, CA; and *Axa General Insurance Ltd v Gottlieb* [2005] EWCA Civ 112; [2005] 1 LLR. I.R. 369. Cited by Eggers, et al., *Good Faith and Insurance Contract*, para.11.06.

<sup>839</sup> Association of British Insurers, 'ABI lifts the lid on the £1 billion a year insurance fraud industry as the insurance fraud register is launched' (Thursday, 13 September 2012, ABI News Release Ref: 40\_12), available at [http://www.abi.org.uk/Media/Releases/2012/09/ABI\\_LIFTS\\_THE\\_LID\\_ON\\_THE\\_1\\_BILLION\\_A\\_YEAR\\_INSURANCE\\_FRAUD\\_INDUSTRY\\_AS\\_THE\\_INSURANCE\\_FRAUD\\_REGISTER\\_IS\\_LAUNCHED.aspx](http://www.abi.org.uk/Media/Releases/2012/09/ABI_LIFTS_THE_LID_ON_THE_1_BILLION_A_YEAR_INSURANCE_FRAUD_INDUSTRY_AS_THE_INSURANCE_FRAUD_REGISTER_IS_LAUNCHED.aspx), accessed in January 2013.

<sup>840</sup> Association of British Insurers, *No Hiding Place – Insurance Fraud Exposed*.

<sup>841</sup> For example, *Axa General Insurance Ltd v Gottlieb* [2005] LLR: I.R., 369.

to introduce legislation to clarify the insurer's remedies available in connection with the assured's fraud.<sup>842</sup>

### **5.3.1. Origins and legal basis of the assured's duty to promote claims with honesty**

The Fraud Act 2006 provides a comprehensive criminal sanction mechanism for fraud.<sup>843</sup> At English common law, civil fraud was judicially confirmed 'to be proved when it is shown that a false representation has been made (1) knowingly, or (2) without belief in its truth, or (3) recklessly, careless whether it be true or false'.<sup>844</sup> However, in the insurance context, the legal definition of fraud was considered by Pollock C.B. in *Goulstone v Royal Insurance Company*.<sup>845</sup> In this case, it was held that 'the claim was fraudulent' if 'it was wilfully false in any substantial respect' and the assured 'forfeited all benefit under the policy'.<sup>846</sup> Meanwhile, this decision is generally cited as the genesis of the common law rule that the fraudulent claims

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<sup>842</sup> The Law Commission and the Scottish Law Commission, *A Joint Consultation Paper, Insurance Contract Law: Post Contract Duties and other Issues (CP 2)*, part 7, p. 74.

According to subsequent contents of CP 2, the responses are made by consultees, including the ABI and some law firms.

<sup>843</sup> For example, section 1 of the Fraud Act 2006 stipulates that:

'(1) A person is guilty of fraud if he is in breach of any of the sections listed in subsection (2) (which provide for different ways of committing the offence).

(2) The sections are —

(a) section 2 (fraud by false representation),  
(b) section 3 (fraud by failing to disclose information), and  
(c) section 4 (fraud by abuse of position).

(3) A person who is guilty of fraud is liable —

(a) on summary conviction, to imprisonment for a term not exceeding 12 months or to a fine not exceeding the statutory maximum (or to both);

(b) on conviction on indictment, to imprisonment for a term not exceeding 10 years or to a fine (or to both).'

Available at <http://www.legislation.gov.uk>, accessed in January 2013.

<sup>844</sup> *Derry v Peek* (1889) LR 14 App Cas 337, p. 375.

<sup>845</sup> *Goulstone v Royal Insurance Company* (1858) 1 F & F 276.

<sup>846</sup> *Ibid*, p. 279.

cannot be recovered at all.<sup>847</sup> Nevertheless, most judges did not define the legal basis of fraud or its relationship with the duty of good faith.

Currently, most insurance contracts contain a 'fraud clause' to clarify the insurer's remedies for fraud,<sup>848</sup> which is considered to be a 'contractual solution to the uncertainty of the fraudulent claims rule'.<sup>849</sup> One outstanding example is clause 45.3 of the International Hull Causes (01/11/03), which stipulates that:

'45.3 It shall be a condition precedent to the liability of the Underwriters that the Assured shall not at any stage prior to the commencement of legal proceedings knowingly or recklessly;  
45.3.1 mislead or attempt to mislead the Underwriters in the proper consideration of a claim or the settlement thereof by relying on any evidence which is false;  
45.3.2 conceal any circumstance or matter from the Underwriters material to the proper consideration of a claim or a defence to such a claim.'

The 'fraud clause' is also strongly recommended to commercial contractual parties to protect themselves from damage caused by the fraudulent misconduct, but only becomes effective when it is expressed in unambiguous terms and communicated to the other party.<sup>850</sup> Practice has been revealed to be in connection with fire policies,<sup>851</sup> and commonly found in property policies (such as vehicle and household insurance), and less frequently, liability policies.<sup>852</sup> The fraudulent claims clause is also always found on the very first page of the familiar Lloyd's J Form, noting that 'if the assured

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<sup>847</sup> For example, *Agapitos v Agnew (The Aegeon) (No.1)* [2002] Lloyd's Rep. I.R. 191, QB; [2002] 2 Lloyd's Rep. 42, CA; *K/S Merc-Scandia XXXXII v Certain Lloyd's Underwriters (The Mercandian Continent)* [2001] 2 Lloyd's Rep. 563, CA; *Manifest Shipping Co Ltd v Uni-Polaris Insurance Co Ltd (The Star Sea)* [2001] 1 Lloyd's Rep. 389, HL. Also, see Gilman, et al., *Arnould's Law of Marine Insurance and Average*, p. 747.

<sup>848</sup> For example, Clause 45.3 of the International Hull Causes (01/11/03).

<sup>849</sup> Lynne Skajaa, 'International Hull Causes 2002: a contractual solution to the uncertainty of the fraudulent claims rule?', (2003) *LMCLQ*, pp. 279-288.

<sup>850</sup> The Law Commission and the Scottish Law Commission, *A Joint Consultation Paper, Insurance Contract Law: Post Contract Duties and other Issues (CP 2)*.

For case examples, see *Britton v Royal Insurance Co* (1866) 4 F&F 276, p. 279; *K/S Merc-Scandia XXXXII v Certain Lloyd's Underwriters (The Mercandian Continent)* [2001] 2 Lloyd's Rep. 563, CA, p. 568, etc.

<sup>851</sup> *Harris v Evans* (1924) 19 L1L Rep. 303.

<sup>852</sup> *K/S Merc-Scandia XXXXII v Certain Lloyd's Underwriters (The Mercandian Continent)* [2001] 2 Lloyd's Rep. 563, CA, p. 568, para.10, per Longmore LJ.

shall make any claim knowing the same to be false and fraudulent, as regards amount or otherwise, the policy shall become void and all claims hereunder shall be forfeited'.<sup>853</sup> On the contrary, the situations become uncertain in the absence of an expressed 'fraud clause'. Interestingly, one early case *Britton v Royal Insurance Company* (1866) held that fraudulent claims failed even in the absence of an express fraud clause,<sup>854</sup> which was further affirmed by Longmore LJ in the Court of Appeal in *The Mercandian Continent*.<sup>855</sup> Others suggested that the 'fraud clause' should be considered as an implied term.<sup>856</sup> Therefore, the legal basis of the assured's duty not to make fraudulent claims and its relationship with section 17 of MIA 1906 are still left open.<sup>857</sup> However, as stated earlier, the answer to this issue is relevant to the insurer's remedies for fraudulent claims. If the fraudulent claim issue is proved to be founded on the basis of the duty of utmost good faith and section 17 of the MIA 1906, there would be no doubt that the avoidance *ab initio* remedy must be the exclusive remedy awarded to the injured insurer. However, if it is proved to be founded on the basis of a separate rule of law, then the insurer's remedies could be more flexible.

Some members of the judiciary and commentators favoured the first opinion, stating that the assured's duty not to make fraudulent claims is one aspect of the post-contractual duties of utmost good faith. The former, therefore, should fall within the scope of utmost good faith and section 17.<sup>858</sup> For instance, in *The Litsion Pride*,

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<sup>853</sup> *Ibid.*

<sup>854</sup> *Britton v Royal Insurance Company* (1866) 4 F.& F. 905.

<sup>855</sup> [2001] 2 Lloyd's Rep. 563, CA, p. 568, para.10, per Longmore LJ.

<sup>856</sup> For example, *Black King Shipping Corporation v Massie (The Litsion Pride)* [1985] 1 Lloyd's Rep. 437, p. 438, per Hirst J. He observed that 'the duty not to make fraudulent claims and not to make claims in breach of the duty of utmost good faith was an implied term of the policy'.

<sup>857</sup> For example, Lord Hobhouse and Lord Scott in *Manifest Shipping Co Ltd v Uni-Polaris Insurance Co Ltd (The Star Sea)* [2001] 1 Lloyd's Rep. 389, HL, para. 81; *K/S Merc-Scandia XXXXII v Certain Lloyd's Underwriters (The Mercandian Continent)* [2001] 2 Lloyd's Rep. 563, CA, p. 568, per Longmore LJ.

<sup>858</sup> For common law, see *Dome Mining corporation Ltd v Drysdale* (1931) 41 L1L Rep. 109, pp. 121-122, per Branson J; *Black King Shipping Corporation v Massie (The Litsion Pride)* [1985] 1 Lloyd's Rep. 437, per Hirst J; *Bank of Nova Scotia v Hellenic Mutual War Risks Association (Bermuda) Ltd*

Justice Hirst held that although the post-contract breach was open to the underwriters to simply defend claims without avoiding the policy, the duty not to make fraudulent claims was implied in the insurance contract and logically, section 17 of MIA 1906 could also be extended to the post-contractual stage.<sup>859</sup> In his later judgment, it was held that the duty of utmost good faith was applied with a 'full rigour' in relation to the giving of information of the voyage in question and the presentation of the claim.<sup>860</sup> In *Orakpo v Barclays Insurance Services Co Ltd*,<sup>861</sup> it was held by the majority that deliberately exaggerated claims were substantially fraudulent and the insurers were entitled to demand the forfeiture of the whole policy.

On the contrary, some others favoured the second opinion, claiming that the duty not to promote honest claims does not fall within the scope of utmost good faith,<sup>862</sup> but is based on a separate rule of law.<sup>863</sup> In the view of this author, the logic is simple. Firstly, categorizing the duty not to make fraudulent claims as beyond the origin of utmost good faith would avoid the implications to the insurer's remedies, which are addressed by the straightjacket from section 17 of MIA 1906. Getting rid of the limitations of the avoidance remedy, more remedies could be introduced successfully,

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(*The Good Luck*) [1990] 1 QB 818 (CA), pp. 885-890, per May LJ; *Bucks Printing Press Ltd v Prudential Assurance Co* [1994] 3 Re LR 219, p. 223, per Saville LJ; *Orakpo v Barclays* [1995] L.R.L.R. 443; *Manifest Shipping Co Ltd v Uni-Polaris Insurance Co Ltd (The Star Sea)* [2001] 1 Lloyd's Rep. 389, HL, held by majority.

For academic support, see Thomas, 'Fraudulent insurance claims: definition, consequences and limitations', in *LMCLQ*, pp. 485-516, at p. 511; Peter MacDonald Eggers, 'Remedies for the failure to observe the utmost good faith', (2003) *LMCLQ*, pp. 249-278; Eggers, et al., *Good Faith and Insurance Contract*.

<sup>859</sup> *Black King Shipping Corporation v Massie (The Litsion Pride)* [1985] 1 Lloyd's Rep. 437, pp. 438, 515, per Hirst J.

<sup>860</sup> [1985] 1 Lloyd's Rep. 437, p. 512.

<sup>861</sup> [1995] L.R.L.R. 443.

<sup>862</sup> *Agapitos v Agnew (The Aegeon) (No.1)* [2002] 2 Lloyd's Rep. 42, CA, per Mance LJ.

<sup>863</sup> *Manifest Shipping Co Ltd v Uni-Polaris Insurance Co Ltd (The Star Sea)* [2001] 1 Lloyd's Rep. 389, HL, para. 62, per Lord Hobhouse; *K/S Merc-Scandia XXXXII v Certain Lloyd's Underwriters (The Mercandian Continent)* [2001] 2 Lloyd's Rep. 563, CA, pp. 568, 574, paras. 11, 31, per Longmore LJ.

For textual support, see Gilman, et al., *Arnould's Law of Marine Insurance and Average*; Bennett, 'Mapping the doctrine of utmost good faith in insurance contract law', in *LMCLQ*, pp. 165-222; Thomas, 'Fraudulent insurance claims: definition, consequences and limitations', in *LMCLQ*, pp. 485-516, at p. 514.

for example, forfeiting the particular fraudulent claims, but not the genuine claims, which may have been paid previously.

Secondly, it was suggested that not treating the assured's duty to promote honest claims as one aspect of utmost good faith, could make it easier to release the whole doctrine from being criticized for its extremely punitive remedy at the post-contract stage. Without the limitations created by the statutory avoidance remedy from section 17 of the MIA 1906, some alternatives could be introduced and adopted in the case where the assured makes dishonest claims. For instance, one could mention the proportionality remedy adopted by Australian insurance law,<sup>864</sup> Misrepresentation Act 1967,<sup>865</sup> and the Consumer Insurance (Disclosure and Representations) Act 2012.<sup>866</sup> Meanwhile, judicial support is found for supporting the injection of flexibility to the insurer's remedies for fraudulent claims.

In *Direct Line Insurance v Khan*,<sup>867</sup> it was held that the fraudulent claims for rent tainted the whole of the defendant's claims, and all benefits under that policy were forfeited. In this case, the joint policy-holders, husband and wife, took out a policy on their home, against risks including fire. The insured house was burned afterwards and the husband made fraudulent claims for rent without the knowledge of his wife (the alternative accommodation was revealed to be owned by the husband). The other claims included sums for reinstatement of building and replacement of contents, which were covered by the insurance company. In the end, it was held by the Court of Appeal that although it was disproportionate to punish Mrs Khan as an innocent joint policy-holder because of her husband's fraud, all benefits should be forfeited

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<sup>864</sup> Section 56(2), Australian Insurance Contracts Act 1984.

<sup>865</sup> Sections 2 and 3, Misrepresentation Act 1967.

<sup>866</sup> However, it should be noted that in the Consumer Insurance (Disclosure and Representations) Act 2012, the proportionate remedy is limited to negligent misrepresentations, but not reckless/careless misconducts with dishonesty. Despite its application to pre-contractual utmost good faith, it could be a lesson relevant to the analysis of the post-contract event.

<sup>867</sup> [2002] Lloyd's Rep. I.R. 364.



since this couple owned the same interest and the husband was acting partly on behalf of both himself and his wife as an agent. Undoubtedly, the whole policy was avoided.

This issue has since been extended to whether earlier claims made before a fraud and subsequent claims made after a fraud are tainted. Not until recently have judges made a statement on this point. In *Axa General Insurance Ltd v Gottlieb*,<sup>868</sup> it was held by the Court of Appeal that separate claims which were made without fraud were not tainted by another individual fraudulent claim, which just strengthened the judicial opinion regarding the insurer's remedies for fraudulent claims. The avoidance *ab initio* remedy is not available, as a fraud would not lead to a forfeiture of all claims, but only to contaminated claims under the insurance policy.<sup>869</sup>

Attached to the separate rule of law theory, an implied contract theory is raised by some commentators.<sup>870</sup> The discussions undertaken relate to whether the assured's duty to make truthful claims is based on a separate rule of law derived from an implied term in the contract?<sup>871</sup> The implied contract theory is quite appealing because more contractual remedies would be dragged into the cases of fraudulent claims, since this misconduct is simply treated as a breach of contract. This proposition appears to avoid the restricted and debatable avoidance *ab initio* remedy for fraudulent claims in utmost good faith framed by section 17 of MIA 1906. In reality, this statement is still lacking of a strong basis,<sup>872</sup> so the attempts to rely on 'business

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<sup>868</sup> [2005] LLR: I.R., 369, p. 369.

<sup>869</sup> *Ibid*, p. 370.

<sup>870</sup> For example, Bennett, 'Mapping the doctrine of utmost good faith in insurance contract law', in *LMCLQ*, pp. 165-222, at p. 211; Eggers, et al., *Good Faith and Insurance Contract*; Clarke, *Law of Insurance Contracts*, para. 27-2C3.

<sup>871</sup> Richard Aikens, 'The post-contract duty of good faith in insurance contracts: is there a problem that needs a solution?', (2010) 5 *JBL*, pp. 379-393, at pp. 383-384.

<sup>872</sup> The strongest basis for supporting an implied term theory would be public policy, see Thomas, 'Fraudulent insurance claims: definition, consequences and limitations', in *LMCLQ*, pp. 485-516, at p. 510.

efficacy' or 'necessary implication' would be factually contentious.<sup>873</sup> That is also why a contractual implied term for fraudulent claims is commented to be 'unnecessary and superfluous'.<sup>874</sup> However, in the view of this author, putting the pitfalls aside, the implied term statement turns the restricted and bald rescission remedy to be elastic, by introducing more contractual remedies.

### 5.3.2. Meanings and degrees of fraud

#### 5.3.2.1. Meanings of fraudulent claim - must materiality be satisfied?

In addition to the fraud defined in *Derry v Peek*,<sup>875</sup> Viscount Sumner delivered his judgment on the construction of false claims in another influential case, *Lek v Mathews*,<sup>876</sup> defining that:

'[A] claim is false not only if it is deliberately invented but also if it is made recklessly, not caring whether it is true or false but only seeking to succeed in the claim.'

A combined test of dishonesty was further provided by *Twinsectra Ltd v Yardley and Others*.<sup>877</sup> In this case, Lord Hutton termed a 'combined test' of 'dishonesty', providing that 'it must be established that the defendant's conduct was dishonest by

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<sup>873</sup> *The Moorcock* (1889) 14 PD 64, cited by Thomas, see *Ibid*, at p. 510. For common law, see *Banque Financiere de la Cite SA (formerly Banque Keyser Ullmann SA) v Westgate Insurance Co (formerly Hodge General & Mercantile Co Ltd)* [1990] 2 Lloyd's Rep. 377, HL. In this case, the possibility of applying contractual remedies for damages was fully rejected.

<sup>874</sup> Thomas, 'Fraudulent insurance claims: definition, consequences and limitations', in *LMCLQ*, pp. 485-516, at p. 510. According to Thomas, the development of the common law rule of forfeiture turns the contractual implied term proposition to be unnecessary and superfluous. According to Aikens, 'The post-contract duty of good faith in insurance contracts: is there a problem that needs a solution?', in *JBL*, pp. 379-393, the principle that an insured and an insurer must act in good faith is of universal application in common law, not depending on an implied terms of a contract. In Foxton, 'Fraudulent claims: the law in eight principles', the separate rule generated from general law theory is listed as the first principle in law for fraudulent claims.

<sup>875</sup> (1889) L.R. 14 App. Cas 337, p. 337. As a matter of fact, the basis of the 'fraud' concept was grounded in some earlier cases. Such as *Goulstone v Royal Insurance Company* (1858) 1 F & F 276, p. 279, which was analysed earlier, and *Chapman v Pole* (1870) 22 LT 306, p. 307, per Cockburn CJ. But Viscount Sumner's statement later is deemed as a relatively comprehensive definition providing a judicial ambit of fraud.

<sup>876</sup> (1927) 29 LLR, 141, p. 145, per Viscount Sumner.

<sup>877</sup> [2002] UKHL 12, para. 27.

the ordinary standards of reasonable and honest people and that he himself realised that by those standards his conduct was dishonest', which is defined to be a comprehensive definition embracing an objective test and a subjective test.<sup>878</sup>

The scope and meaning of fraudulent claims abovementioned are widely recognized in both judicial and leading academic writings.<sup>879</sup> Despite this, the meaning and scope of fraudulent claims in insurance is well developed by *The Litsion Pride*,<sup>880</sup> in which the traditional situations of fraud were extended.<sup>881</sup> In this case, by comparing with *Style*<sup>882</sup> and *Liberian*,<sup>883</sup> the duty in the claims sphere was extended from the traditional confines to fraud in the circumstances of the casualty, or the quantification of the loss to culpable misrepresentation,<sup>884</sup> or non-disclosure.<sup>885</sup> However, Justice Hirst's 'culpability' theory in *The Litsion Pride* was rejected by the House of Lords thereafter.<sup>886</sup>

Apart from the extension of the ambit of fraudulent claims, in Justice Hirst's judgment, a materiality test was adapted from section 18(2) of the MIA 1906.<sup>887</sup> His judgment can be described to be 'curious' because of the incompatibility with another judgment delivered in the same case, noting that materiality does not need to be

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<sup>878</sup> *Ibid*, at para. 70, cited in John Lowry and Philip Rawlings, 'Fraudulent claims: framing the appropriate remedy', (2006) *JBL*, pp. 339-345. This two-limb test was further cited by Justice Eder in the High Court of Justice, in *Aviva Insurance Ltd v Brown* [2011] EWHC 362 (QB).

<sup>879</sup> For example, Gilman, et al., *Arnould's Law of Marine Insurance and Average*, p. 767; Bennett, 'Mapping the doctrine of utmost good faith in insurance contract law', in *LMCLQ*, pp. 165-222, p. 208, note 234; Foxton, 'Fraudulent claims: the law in eight principles'.

<sup>880</sup> [1985] 1 Lloyd's Rep. 437.

<sup>881</sup> Bennett, 'Mapping the doctrine of utmost good faith in insurance contract law', in *LMCLQ*, pp. 165-222, at p. 168.

<sup>882</sup> *Overseas Commodities Ltd. v Style* [1958] 1 Lloyd's Rep. 546.

<sup>883</sup> *Liberian Insurance Agency Inc. v Mosse* [1977] 2 Lloyd's Rep. 560.

<sup>884</sup> Bennett, 'Mapping the doctrine of utmost good faith in insurance contract law', in *LMCLQ*, pp.165-222, at p.168. However, what is culpability is still unclear.

<sup>885</sup> [1985] 1 Lloyd's Rep. 437, p. 512, per Hirst J.

<sup>886</sup> Hirst J's decision was rejected by Lord Hobhouse in the House of Lords in *Manifest Shipping Co Ltd v Uni-Polaris Insurance Co Ltd (The Star Sea)* [2001] 1 Lloyd's Rep. 389, HL, para. 71. This was also rejected by *Royal Boskalis Westminster NV v Mountain* [1997] LRLR 523, pp. 598-599, per Rix LJ.

<sup>887</sup> [1985] 1 Lloyd's Rep. 437, p. 513, per Hirst J. According to section 18(2) of the MIA 1906, it was stated that 'any fraudulent statement which would influence a prudent underwriter's decision to accept, reject or compromise the claim, is material'.

approved in fraud cases.<sup>888</sup> Similarly, some authorities identify three elements to a fraudulent claim in insurance: substantiality, wilfulness and materiality,<sup>889</sup> which in the view of this author, co-operate as a comprehensive compact. In a later case, *The Mercandian Continent*,<sup>890</sup> Longmore LJ further developed the test of 'materiality' in fraud by indicating the situations where the remedy of avoidance was appropriate in a post-contractual context. In the judgment of Longmore LJ, two considerations were put forward. Firstly, the avoidance remedy is appropriate in the post-formation stage in situations analogous to situations where the insurer has a right to terminate for breach. Secondly, in order to meet the requirements to this purpose, the fraud must be (A) material in the sense that the fraud would have an effect on underwriters' ultimate liability; and (B) the gravity of the fraud or its consequences must be such as would enable the underwriters, if they wished to do so, to terminate for breach of contract.<sup>891</sup>

Distinguished from Justice Hirst's controversial efforts to transplant the 'materiality' test in section 18 in MIA 1906 during *The Litsion Pride*, an authoritative and certain explanation of 'materiality' in fraudulent claims was framed. This provided that a material fraud must be influential to the insurer's handling of claims, such as the obtainment of a settlement or a better settlement, or winning at trial.<sup>892</sup> A fraud is thus judged to be material if truth would make some difference to the insurer's final decision of claims handling. *The Aegeon*<sup>893</sup> is a watermark of the cases of fraudulent

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<sup>888</sup> [1985] 1 Lloyd's Rep. 437, p. 510, per Hirst J.

<sup>889</sup> Clarke, *Law of Insurance Contracts*, para. 27-2B., cited by the Law Commission, Issues Paper 7, *The Insured's Post-contract Duty of Good Faith*, July 2010. In Nicholas Legh-Jones, et al., *Macgillivray on Insurance Law: Relating to All Risks Other Than Marine* (Sweet & Maxwell: Thomson Reuters, 2008), para. 19-061, the editors also agreed with the materiality requirement in fraud. However, it is believed that the 'materiality' test in fraud does not equal to that in MIA 1906.

<sup>890</sup> [2001] 2 Lloyd's Rep. 563, CA.

<sup>891</sup> *Ibid*, para. 35.

<sup>892</sup> *Agapitos and Another v Agnew and Others (No 1) (The Aegeon)* [2003] QB 556, para. 45. Also see Legh-Jones, et al., *Macgillivray on Insurance Law: Relating to All Risks Other Than Marine*.

<sup>893</sup> *Agapitos v Agnew (The Aegeon) (No.1)* [2002] Lloyd's Rep. I.R. 191, QB.

devices, but it is also cited by the Law Commission's Issues Paper 7 as a case example of material fraud. For this reason, some authorities argued that 'materiality' was not needed in fraud, but is demanded in the cases of fraudulent devices only.<sup>894</sup>

### **5.3.2.2. Substantiality, degree of fraud and concerns**

Unquestionably, any fraud in making claims goes to the root of the contract and entitles the insurers to be discharged from his liabilities.<sup>895</sup> Nevertheless, considerations are left by most judges regarding the nature of the insurer's remedies available, whether retrospective or prospective. This issue could also be described as the second pillar of the rationale underlying the insurer's remedies for fraudulent claims.<sup>896</sup> Meanwhile, another relevant concept, the substantiality of fraud, was introduced in *Orakpo v Barclays Insurance Services*.<sup>897</sup>

In this case, Mr Orakpo's benefits under the insurance policy were totally forfeited on the grounds of misrepresentation in the proposal form by reason of the condition of the property at inception and on renewals, and a gross exaggeration of the claims on loss of rent. The 'substantiality' concept in fraud was firstly mentioned by Hoffmann LJ in his judgment regarding the ground on which the insurer's claim failed.<sup>898</sup> Firstly, Hoffmann LJ confirmed that there was no reason to discontinue the duty of good faith on the part of the assured when the contract has been made, which was followed by his further observations in this case. On the contrary, Hoffmann LJ did not make any further explanation on how 'substantiality' was defined in fraud, but described the facts found by the previous judge by citing that

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<sup>894</sup> *Ibid*, paras. 37-38, per Mance LJ.

<sup>895</sup> *Orakpo v Barclays Insurance Services* [1995] 1 LLR 443, per Hoffmann LJ, Sir Roger Parker, and Staughton LJ.

<sup>896</sup> The first principle in this part is the discussion of the judicial basis of the assured's duty not to make fraudulent claims. The insurer's remedies issue is addressed in 5.3.4. of this chapter.

<sup>897</sup> [1995] 1 LLR 443.

<sup>898</sup> *Orakpo v Barclays Insurance Services* [1995] 1 LLR 443, p. 451.

'the plaintiff [Mr Orakpo] had knowingly put forward a claim which he knew to be largely false and had pursued in this claim at the trial'.<sup>899</sup> Finally, in Sir Roger Parker's judgment, it was also upheld that the claim pursued by Mr Orakpo was 'fraudulent to a substantial extent' and consequently, the assured's benefit under this policy should be forfeited. The criteria of being a substantial fraudulent claim is uncertain according to the main judgments delivered in this case, yet, some clues are still available. The total sums of claim was £265,000 and it was discovered by the judge that the loss for rent was grossly exaggerated since it was pursued that 'all 13 bedrooms would have been fully occupied for the ensuing two years and nine months after the first casualty, notwithstanding that there were only three occupants when that casualty occurred'.<sup>900</sup> Also based on this ground, three judges seated in the Court of Appeal delivered the judgments, dismissed the plaintiff's appeal and upheld the First Instance Court's judgment to forfeit not only the part for rent loss but the whole claim under this policy. Therefore, in the case where the claim is made in part genuine and in part fraudulent, whether or not the whole claim can be treated as fraudulent depends on whether or not the fraud is substantial<sup>901</sup> in the promotion of a claim.

The concept of 'substantiality' in fraudulent claims was further addressed in later cases after *Orakpo*.<sup>902</sup> HHJ Peter Coulson QC stated in *Tonkin v UK Insurance Ltd*<sup>903</sup> that, 'it would be absurd if an entirely insubstantial element of a large claim, which is found to be fraudulent, could taint the entirety of that claim'. As stated earlier, in

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<sup>899</sup> *Ibid.*

<sup>900</sup> *Ibid.*, p. 450.

<sup>901</sup> Eggers, et al., *Good Faith and Insurance Contract*, para. 11.38.

<sup>902</sup> For example, in *Nsubuga v Commercial Union Assurance* [1998] 2 LLR 682, Thomas J stated that 'it would not generally in those circumstances be right to conclude readily that someone had behaved fraudulently merely because he put forward an amount greater than that which he reasonably believed he would recover'; also see *Galloway v Guardian Royal Exchange (UK) Ltd* [1999] LLR I.R. 209; *Bhagbhadrani v Commercial Union Assurance Co Plc* [2000] LLR I.R. 94, p. 111.

<sup>903</sup> *Tonkin v UK Insurance Ltd* [2007] LLR I.R. 283, pp. 284, 311.

theory, any breach of utmost good faith according to section 17 of the MIA 1906 would cause the whole insurance contract to be rescinded. At the same time, after the investigations of the relationship between the duty to promote honest claims and utmost good faith in previous paragraphs of this chapter, it is observed that this duty is suggested to be excluded from the scope of the duty of utmost good faith, but is based on a separate rule of law. On the one hand, this point injects elasticity into the strict avoidance *ab initio* remedy system underlying section 17 of the MIA 1906, which is evaluated below. More significantly, it gives enough reasons for further debates on whether or not the fraudulent part is sufficiently substantial to cause the whole related claim to be forfeited.<sup>904</sup>

Obviously, difficulties lie in how to define the range within which fraudulent claims are substantial to contaminate related claims as a whole. Despite this, some authorities still demonstrate a rough degree of latitude allowed by the courts in relation to the allegations of fraud in insurance cases.<sup>905</sup> A claim for £18,000 was denied in *Galloway v Guardian Royal Exchange (UK) Ltd*<sup>906</sup> because it included a claim for an item worth over £2,000 (representing around 11% of the total claim) which had not been lost but was invented by the assured.<sup>907</sup> On the contrary, in *Tonkin v UK Insurance Ltd*,<sup>908</sup> the claim was not entirely disallowed because of another £2,000 fraudulent claim component, representing no more than 0.3% of the total claim.<sup>909</sup> In accordance with the judicial support, HHJ Peter Coulson QC, summarized a rough range of latitude within which the claim could be announced to

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<sup>904</sup> However, this approach is more efficient in cases where there is one particular claim. In cases where separate claims are promoted, the remedy is different.

<sup>905</sup> For example, *Tonkin v UK Insurance Ltd* [2007] LLR I.R. 283; *Orakpo v Barclays Insurance Services* [1995] LRLR 443; *Galloway v Guardian Royal Exchange (UK) Ltd* [1999] Lloyd's Rep IR 209; *Direct Line Insurance v Khan* [2002] Lloyd's Rep IR 364.

<sup>906</sup> *Galloway v Guardian Royal Exchange (UK) Ltd* [1999] LLR I.R. 209.

<sup>907</sup> For a similar case, see *Direct Line Insurance v Khan* [2002] LLR I.R. 364.

<sup>908</sup> [2007] LLR I.R. 283.

<sup>909</sup> *Ibid*, p. 284.

be insubstantial fraud; the latitude did not extend to 12% in *Galloway*<sup>910</sup> or 11% in *Direct Line*.<sup>911</sup>

However, in contrast to Coulson's conclusion in *Tonkin*, it was observed by some academics that a substantial fraud could not be concluded merely upon the greater amount put forward (for example, £2,000 was considered to be substantial in the *Galloway*, but insignificant in the *Tonkin*) or the proportions of the genuine and the fraudulent parts of the claim (although this may be a relevant consideration to take into account).<sup>912</sup> It is suggested by Eggers that one must consider the fraudulent part of the claim on its own and ask whether or not the claim is itself fraudulent, in the sense of being more than merely trivial.<sup>913</sup> The same logic will apply to a claim which is wholly fraudulent, especially the small fraudulent claims.

Several concerns are addressed to the substantiality test as follows. First of all, assuming the assured's duty not to promote fraudulent claims to be outside of the post-formation doctrine of utmost good faith or section 17 of the MIA 1906 injects flexibility into the overly harsh avoidance *ab initio* remedy for fraudulent claims, particularly in the cases where the claims are partly genuine and partly fraudulent. Also based on this ground, the avoidance *ab initio* remedy is not going to be the exclusive remedy, but negotiable for some other issues relating to fraudulent claims, especially in cases where there are trivial frauds. Nevertheless, the adoption of a substantiality test in fraudulent claims will face the uncertainty of a qualified criterion. Although as precedents demonstrate so far, the degree of latitude of insubstantial

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<sup>910</sup> *Galloway v Guardian Royal Exchange (UK) Ltd* [1999] LLR I.R. 209.

<sup>911</sup> *Direct Line Insurance v Khan* [2002] Lloyd's Rep IR 364; *Tonkin v UK Insurance Ltd* [2007] LLR I.R. 283, p. 311.

<sup>912</sup> Eggers, et al., *Good Faith and Insurance Contract*, para. 11.38. Also see *Micro Design Group Ltd v Norwich Union Insurance Ltd* [2006] LLR I.R.235, in which the entire claim was disallowed because burglary claims (£7,900) representing 2% of the total £400,000 claim.

<sup>913</sup> Eggers, et al., *Good Faith and Insurance Contract*, para. 11.38.



fraud is no more than 12% of the total claim in *Galloway*,<sup>914</sup> whether it is substantial or not is, in each case, a question of fact. In conclusion, whether a fraud is substantial or not cannot be concluded merely upon the amount of exaggeration put forward, or its proportion of the whole claim, but combined with the facts in individual cases, commercial good sense and sound practice. Hence, it is also suggested by some commentators and judiciary that there is no reason to wipe out the whole of the claimants' claim just because of a trivial fraud. The main reason of this opinion, in the view of this author, is that commercial law mainly aims to honour an agreement and encourage the business transactions rather than deny it to the inception.

A consequential concern following the adoption of a substantially fraudulent claim theory is that the introduction of partial avoidance of a tainted claim would remove the assured's incentive to honesty since the fraudster would not be penalized nor deprived of his genuine benefits under the insurance policy once fraud is discovered. As Willes J commented, 'it would be most dangerous to permit parties to practise such frauds and... notwithstanding their falsehood and fraud, to recover the real value of the goods consumed'.<sup>915</sup>

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<sup>914</sup> *Galloway v Guardian Royal Exchange (UK) Ltd* [1999] LLR I.R. 209.

<sup>915</sup> *Britton v Royal Insurance Company* (1866) 4 F.& F. 905, p. 909.

### 5.3.3. Types of fraudulent claims

#### 5.3.3.1. General fraudulent claims

According to authorities, the assureds' claims are declined because the assured fraudulently invented a loss which had not taken place, recklessly let it happen, deliberately caused the loss, or concealed relevant information.<sup>916</sup>

In *Britton v Royal Insurance Company*,<sup>917</sup> a fire insurance case, the assured who was suspected of arson took advantage of the fire to make a fraudulent claim. Because of this reason, the assured's benefits were forfeited. In a later case, *Broughton Park Textiles (Salford) Ltd v Commercial Union Assurance Co. Ltd.*,<sup>918</sup> underwriters alleged that the fire was deliberately caused by the assured. Similarly, in *James v CGU Insurance Plc*,<sup>919</sup> the assured's claim was declined because it was alleged by the insurer that he ignited the fire himself, or failed to take steps to extinguish it before it caused damage. Connected with some other examples of the assured's wilful misconduct and claims based on this, one type of fraud is summarized to be the assured's 'pure fraud' by some leading scholars.<sup>920</sup>

Sometimes, in order to conceal the fact that would entitle the insurer with a genuine defence to the claim, the assured misrepresents or non-discloses certain aspects of claims. In *Direct Line Insurance Plc v Khan*,<sup>921</sup> one of the assureds cloaked the fact that he did not pay any rent for the alternative accommodation when the assured house was burned.<sup>922</sup> When his fraud was discovered, not only his, but

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<sup>916</sup> Especially, see Eggers, et al., *Good Faith and Insurance Contract*, para. 11.43. Similarly, Baris Soyer applies the definition of fraud to the insurance context dividing it into three forms, see Soyer, 'Continuing duty of utmost good faith in insurance contracts: still alive?', in *LMCLQ*, pp. 39-79, at p. 44.

<sup>917</sup> (1866) 4 F. & F. 905.

<sup>918</sup> [1987] 1 LLR 194.

<sup>919</sup> [2002] LLR I.R. 206.

<sup>920</sup> For example, Eggers, et al., *Good Faith and Insurance Contract*, para. 11.45.

<sup>921</sup> [2002] Lloyd's Rep. I.R. 364.

<sup>922</sup> The couple is joint policy-holder, and the fraudster is the husband. The alternative accommodation was revealed to be owned by the husband.

also his wife's benefits were forfeited under that policy. Another case example is *Orakpo v Barclays Insurance Services*,<sup>923</sup> in which the assured misrepresented the rent claim.<sup>924</sup> In the end, the judges upheld the insurer's defence that there was a substantial fraud committed by the assured and as a consequence, his benefit should be totally forfeited. In the outstanding case *Agapitos v Agnew (The Aegeon) (No.1)*, it was held by the Court of Appeal that 'if there was a known defence to a claim which the assured deliberately suppressed, his conduct would fall within the fraudulent claim rule'.<sup>925</sup>

### 5.3.3.2. Exaggeration of a genuine claim

Based on ABI's report, bogus or exaggerated claims play a large proportion in insurance, especially in home insurance.<sup>926</sup> As a matter of fact, it is not difficult to reveal that some overlaps exist between instances of general fraudulent claims and fraudulent exaggerations. For example, fabricating loss which has not been suffered is described as an extremely fraudulent exaggeration (from null to a greater amount).<sup>927</sup> A claim is definitely fraudulently exaggerated when the assured forges documents to support his claim which is more than his due under the insurance policy.<sup>928</sup> At the same time, people cannot neglect claims which are insignificantly exaggerated for a start of negotiation, or by haggling over the final amount of indemnity. Thus, regardless of the nature and degree of fraud (substantial or

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<sup>923</sup> [1995] 1 LLR 443.

<sup>924</sup> *Ibid*, p. 450. The assured misrepresented the rent claim by claiming that 'all 13 bedrooms would have been fully occupied for the ensuing two years and nine months after the first casualty, notwithstanding that, there were only three occupants when that casualty occurred'.

<sup>925</sup> [2002] Lloyd's Rep. I.R. 191, QB, p. 574.

<sup>926</sup> Association of British Insurers, *No Hiding Place – Insurance Fraud Exposed*, p. 5.

<sup>927</sup> For example, *Orakpo v Barclays Insurance Services* [1995] 1 LLR 443. In this case, one of the assureds claimed the rent loss which had never been suffered.

<sup>928</sup> See *Ibid*, one of the assureds forged documents to support his claim of rent loss for alternative accommodation, which has never taken place.

insubstantial), exaggeration of claims can be discussed through the angles of an exaggeration for negotiation and a fraudulent exaggeration individually.

#### **5.3.3.2.1. Exaggeration for 'horse-trading'**

Not all exaggeration amounts to fraud. Sometime, a genuine claim is exaggerated by the assured for the purpose of negotiation, 'knowing that they will be cut down by an adjuster',<sup>929</sup> which was confirmed by Staughton LJ as a common issue in practice in *Orakpo*.<sup>930</sup> Based on Hoffmann LJ's judgment, with the absence of misrepresentation or concealment, 'the loss adjuster is in as good a position to form a view of the validity or value of the claim as the insurer, it will be a legitimate reason that the assured was merely putting forward a starting figure for negotiation'.<sup>931</sup> In a later case, *Nsubuga v Commercial Union Assurance*,<sup>932</sup> Thomas J utilized the term of 'horse trading' to expound the situations in which the assured put forward a greater amount of claim than they believed that they will recover, expecting to engage in some form of negotiations. The statement of 'horse-trading' and his explanation was further deemed as the 'most explicit discussion of this point'.<sup>933</sup>

In the view of this author, the statements foresaid could be considered as a desire which is supported by both authorities and principles, on the basis of a general commercial sense and practice in good faith. Meanwhile, the judiciary still cannot overlook the desire of setting a certain standard to have the genuine claims inflated for the purpose of negotiation distinguished from an exaggeration committed for the purpose of deceiving the insurer. Judging from the judicial opinion in *Orakpo*, at least

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<sup>929</sup> *Ibid*, p. 450, per Staughton LJ.

<sup>930</sup> It was observed that 'if one examine a sample of insurance claims on household contents, I doubt if one would find many which stated the loss with absolute truth', *Ibid*.

<sup>931</sup> *Ibid*, p. 451, per Lord Hoffmann.

<sup>932</sup> [1998] 2 Lloyd's Rep. 682.

<sup>933</sup> James Davey, 'Unpicking the fraudulent claims jurisdiction in insurance contract law: sympathy for the devil?', (2006) *LMCLQ*, pp. 223-241, at p. 225.

the exaggerated £77,233 claim cannot be condoned compared to the total sums of £265,321. Additionally, the logic of substantiality in a fraudulent claim can apply in exaggeration as well, since it was observed that there is overlap between these two issues. The nature of exaggeration, therefore, cannot be readily concluded merely upon its greater amount or proportions compared to the total sums of claims, but whether the exaggeration itself is for the purpose of negotiation within a reasonable range, or not.

#### **5.3.3.2.2. Exaggeration and fraudulent claims**

Also in *Orakpo*, according to the leading judgment delivered by Staughton LJ, in the cases where the falsity of what is stated is readily apparent, the gross exaggeration was considered to go beyond what can be condoned or overlooked.<sup>934</sup> This opinion echoes the general requirement of there being a substantially fraudulent claim as stated in earlier paragraphs. Logically, one might say that a substantial exaggeration would amount to a fraudulent one, whereas, an insignificant exaggeration which can be condoned or overlooked would not amount to a wilful one, but a reasonable exaggeration for negotiation instead.

In *Baghbadrani v Commercial Union Assurance Co. Plc*,<sup>935</sup> Justice Gibbs described the fictitious VAT amounting to over £3,000 as material, 'either in itself or in comparison with the total material damage claim'. On the contrary, in a recent case *Danepoint Ltd v Underwriting Insurance Ltd*,<sup>936</sup> HHJ Peter Coulson QC expressed his statement on the error in the calculation of interim payments in the construction industry, concluding that 'there is always a relatively wide margin for error' here which is 'capable of adjustment'. Thus, the judge empathized that it would

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<sup>934</sup> *Orakpo v Barclays Insurance Services* [1995] 1 LLR 443, p. 450, per Staughton LJ.

<sup>935</sup> [2000] Lloyd's Rep. I.R. 94, p. 111.

<sup>936</sup> [2006] Lloyd's Rep. I.R. 429, p. 440.

be wrong to find that claims for interim payments were made fraudulently 'without compelling evidence', since the valuations are mostly dependent on someone's opinion. It is discovered that the Courts have distinguished the mere exaggeration of the overall loss and invention of items to improve the claim. It is observed by the Law Commission in the Issues Paper 7 that the former is treated more 'leniently' than the latter, since there is an obvious intention to deceive in invention, but not in an exaggeration.<sup>937</sup> Nevertheless, in practice, the precise boundary between the honest exaggeration for horse-trading and dishonest claim exaggeration is still difficult to draw.

### 5.3.3.3. Fraudulent devices

To amount to a fraudulent claim, it does not need to be fraudulent from its inception, and an initially honest claim amounts to a fraudulent claim if it is maintained dishonestly thereafter.<sup>938</sup> At the present, the MIA 1906 is silent on this point, but judicial support is discovered in case law.<sup>939</sup> *The Aegeon*<sup>940</sup> is an outstanding case example in fraudulent claims. It not only expressed a judicial

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<sup>937</sup> The Law Commission, Issues Paper 7, *The Insured's Post-contract Duty of Good Faith*, p. 16.

<sup>938</sup> Thomas, 'Fraudulent insurance claims: definition, consequences and limitations', in *LMCLQ*, pp. 485-516, at p. 490.

For judicial support, see *Yeganeh v Zurich plc* [2010] EWHC 1185 (QB), in which the assured was proved to have ignited the fire by himself, which destroyed the insured property, and exaggerated the claim for clothes by providing bank statements, and *Eagle Star Insurance Co Ltd v Games Video Co SA and Others (The Game Boy)* [2004] 1 LLR 238, in which the assureds used fraudulent documentations in order to advance their claim with the intention that the insurance company would be deceived to pay the claim.

<sup>939</sup> By contrast, one example of clear legislations can be found in Norwegian law. It was found that paragraph 1, § 5-1 under the Norwegian Marine Insurance Plan 1996, 2010 version, is wide enough to embrace the use of a fraudulent device in connection with a genuine claim.

Paragraphs 1 and 2 of § 5-1 Duty of the assured to provide particulars and documents reads that:

'The assured shall provide the insurer with such information and documents as are available to him and are required by the insurer for the purpose of settling the claim.

If the assured, intentionally or through gross negligence, fails to fulfil his duties according to paragraph 1, the insurer is only liable to the extent he would have been liable if the assured had fulfilled his duty.'

<sup>940</sup> *Agapitos v Agnew (The Aegeon) (No. 1)* [2002] Lloyd's Rep. I.R. 191, QB; [2002] 2 Lloyd's Rep. 42, CA.

position on the insurer's remedies for fraudulent claims and duties under section 17 of MIA 1906 after the commencement of litigation, but also pointed out a new pattern in which fraudulent manners were used to promote claims. In this case, a passenger ferry *Aegeon* was insured against hull and machinery port risks whilst undergoing maintenance work. The assured warranted that their salvage association certificate would be updated and they would comply with all recommendations prior to the commencement of hot works. A fire subsequently occurred on the *Aegeon* and caused damages while hot works were being carried out. The insurer declined to indemnify the assured on the basis of a breach of warranty relating to the failure to satisfy the requirement to update the salvage association certificate. After the commencement of litigation, it was discovered that the assured disclosed two sworn statements attesting that hot works of a substantial nature had been performed on an earlier date, but not the one maintained by the assured. The insurer therefore, asserted to avoid this policy for fraud. In Lord Justice Mance's judgment, the use of fraudulent devices was held to be 'a sub-species of making fraudulent claims', which led to 'the claim itself in relation to which the fraudulent device or means is used' being forfeited'.<sup>941</sup> In his later judgment, Mance LJ also distinguished the cases of a fraudulent device being used from those claims committed fraudulently. A fraudulent device is used mostly to improve his claim or 'embellish the facts surrounding the claim by some lie' and significant lies of course would cause the nature of the claim to be advanced.<sup>942</sup>

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<sup>941</sup> [2002] 2 Lloyd's Rep. 42, CA, p. 53.

<sup>942</sup> *Ibid*, p. 49.

*The Aegeon* was deemed to provide a 'tentative view of an acceptable solution' in this area.<sup>943</sup> There are more instances.<sup>944</sup> In *Lek v Mathews*,<sup>945</sup> Mr Lek claimed compensation for his assured stamp collection by submitting a schedule of the lost stamps. However, it was discovered that some of the listed stamps had never been issued and some others were extremely rare which Mr Lek could not prove that he had possession. Finally according to the judgment of the House of Lords, it was clarified that if the assured claimed for the loss of things which he knew he had not got, there is a contradiction in terms to say that he may have honestly believed in his claim.<sup>946</sup> In *Wisenthal v World Auxilliary Insurance Corp Ltd*,<sup>947</sup> it was noted by Roche LJ that 'fraud...was not mere lying' and 'it was seeking to obtain an advantage, generally monetary, or to put someone else at a disadvantage by lies and deceit'.<sup>948</sup> One more recent example of using fraudulent manners to improve the claim is *Galloway v Guardian Royal Exchange (UK) Ltd*.<sup>949</sup> In *Galloway*, the assured fraudulently claimed £2,000 for a computer which did not exist by submitting a claims form which contained a declaration that 'the particulars given on this form are true and complete', presenting about 10% of the whole claim. The Court of Appeal judged that the entire claim was contaminated by fraud and Galloway was deprived of the whole claim. Although, according to this judgment, Galloway's concealment of the

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<sup>943</sup> According to Nick Burgess, 'Post-contractual duty of good faith and the fraudulent claims rule', *MRI*, 01 June 2004, Vol 18, No 6, *The Aegeon* was also described as one of a number of recent cases where the eventual outcome has favoured the insurance market.

<sup>944</sup> For more similar cases regarding the use of fraudulent manners or devices, see *Levy v Baillie* (1831) 7 Bing Rep. 349; *Lek v Mathews* (1927) 29 LIL Rep 141, p. 164; *Wisenthal v World Auxilliary Insurance Corp Ltd* (1930) 38 LIL Rep. 54; *Central Bank of India Ltd v Guardian Assurance Co Ltd and Rustomji* (1936) 54 L1L R 247; *The Captain Panagos DP* [1986] 2 LLR 470, p. 511, per Evan J; *Insurance Corp. of the Channel Islands Ltd v McHugh and Royal Hotel* [1997] LRLR 94; *Galloway v Guardian Royal Exchange (UK) Ltd* [1999] LLR I.R. 209; *Sharon's Bakery (Europe) Ltd v AXA Insurance UK plc and Anr* [2011] EWHC 210 (Comm) (the assured's claim was rejected for pre-contractual non-disclosure and the use of forged documents at the claiming stage).

<sup>945</sup> (1927) 29 LIL Rep. 141, p. 164, per Viscount Sumner.

<sup>946</sup> *Ibid.*

<sup>947</sup> (1930) 38 LIL Rep. 54.

<sup>948</sup> *Ibid*, pp. 61-62.

<sup>949</sup> [1999] LLR I.R. 209.



conviction for obtaining property by deception when filling in the proposal form constituted a breach of utmost good faith at the pre-contract stage which would cause the whole policy to be avoided, whether or not the entire claim was tainted by fraud at the claiming stage was focused on by judges seated in this case.<sup>950</sup> It was judged by the court that the fraudulent component was substantial enough to decline the assured's claim as a whole.

It is found that overlaps also exist between the cases of using fraudulent devices to improve a claim, and the cases of which are generally fraudulent, since a fraudster adopts any possible manner, such as presenting false evidence, or forging statements to falsify or advance his claim. However, the use of fraudulent manners does not definitely equate to fraud (or even substantial fraud) at the claiming stage in insurance.<sup>951</sup> Therefore, a further requirement to fraudulent device cases is needed. In *The Aegeon*,<sup>952</sup> Lord Justice Mance refused the requirement of inducement here, stating that it is irrelevant in the context of a fraudulent claim for non-existent or exaggerated loss.<sup>953</sup> It is observed that there is no logic in requiring the fraudulent manners to be relevant to the fraudulent claim, as the purpose of this doctrine at common law is to prevent the assured from making such claims and not merely the

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<sup>950</sup> *Ibid*, p. 209.

<sup>951</sup> Of course, the discussion of substantial fraud is simplified when being linked with another type of fraudulent claim, namely, exaggeration of claims, as the latter is always treated leniently compared with the former. As stated earlier the cases of exaggerating claims are discussed in the exaggeration for negotiation and fraudulent claims individually, between which the exaggeration for negotiation is always considered to propose a starting figure based on the assureds intention for further haggling in good faith. In addition, even the assured's wrong calculation of the interim payment is not deemed as fraud but a reasonable act (*Danepoin Ltd v Underwriting Insurance Ltd* [2006] LLR I.R. 429, p. 440, per HHJ Peter Coulson QC).

<sup>952</sup> *Agapitos v Agnew (The Aegeon) (No. 1)* [2002] Lloyd's Rep. I.R. 191, QB, para.37.

<sup>953</sup> The rejection of the inducement test to a fraudulent claim got both judicial and academic supports. See footnote 45. Also see Thomas, 'Fraudulent insurance claims: definition, consequences and limitations', in *LMCLQ*, pp. 485-516, at p. 496; Foxtan, 'Fraudulent claims: the law in eight principles'.

prevention of the insurer suffering damage thereby.<sup>954</sup> In Mance LJ's later judgment, it was suggested that:

'[T]he Courts should only apply the fraudulent claim rule to the use of fraudulent devices or means which would, if believed, have tended, objectively but prior to any final determination at trial of the parties' rights, to yield a not insignificant improvement in the insured's prospects - whether they be prospects of obtaining a settlement, or a better settlement, or of winning at trial.<sup>955</sup>

In *Stemson v AMP General Insurance (NZ) Ltd*,<sup>956</sup> Mr Stemson's insured building was partially destroyed by fire and a claim was made on the policy. The false statement issued by Mr Stemson to AMP's adjuster at the investigating stage, which led to AMP declining an indemnity, was held to amount to the use of fraudulent devices to promote the claim.<sup>957</sup> In the concurring judgment by Lord Justice Mance, it was commented that, in this case, the materiality of the fraudulent manners to the insurer's settlement was not challenged and was obvious.<sup>958</sup> Clearly, different from the status of fraud in fraudulent claims, the 'materiality' but not the inducement factor is necessary in order to establish the use of fraudulent devices at the claiming stage.

#### 5.3.4. Framing the appropriate remedies for fraudulent claims

The temporal extent of the duty of utmost good faith in section 17 of MIA 1906 raises the question whether the avoidance *ab initio* remedy applies beyond the

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<sup>954</sup> Eggers, et al., *Good Faith and Insurance Contract*, para. 11.37. For judicial support, see *Stemson v AMP General Insurance (NZ) Ltd* [2006] Lloyd's Rep. I.R. 852, paras. 37-38, per Mance LJ.

<sup>955</sup> *Agapitos v Agnew (The Aegeon) (No. 1)* [2002] Lloyd's Rep. I.R. 191, QB, para.38.

<sup>956</sup> [2006] Lloyd's Rep. I.R. 852, para. 35, per Mance LJ. This is an appellant case in which Mr Stemson appealed against the decision of the New Zealand Court of Appeal rejecting his claim against the defendant insurers, AMP.

<sup>957</sup> Although it was corrected later before the settlement, it was held that the fact that the lie happened to be detected or unravelled before a settlement or during a trial did not make it immaterial at the time when it was told. See *Stemson v AMP General Insurance (NZ) Ltd* [2006] Lloyd's Rep. I.R. 852, in the concurring judgment by Mance LJ.

<sup>958</sup> *Ibid*, p. 859, in the concurring judgment by Mance LJ.

conclusion of the contract.<sup>959</sup> Because the uncertainty lies in its post-contractual application, the remedies available for a post-contract breach of good faith becomes a long-lasting unresolved issue. This is always connected with another periodic hot point, namely, the harshness of the avoidance *ab initio* remedy for a breach of good faith in the post-contract event.<sup>960</sup> In order to map the system of the insurer's remedies available for fraudulent claims, it is necessary to look at the current law, including the statutory rules, English case law, and contractual damage.

#### **5.3.4.1. Statutory Rule**

Currently, the MIA 1906 is the unquestionably statutory resource for not only marine insurance, but also non-marine insurance. Nevertheless, because the ambiguity lies in the scope of its application and the severe avoidance sanction awarded, section 17 of MIA 1906 becomes an overarching barrier which is always hiding in the shadow of a controversial issue regarding the remedies available for post-contract events.<sup>961</sup> The following paragraphs are aimed at analysing its drawbacks in the post-contractual events, especially for fraudulent claims.

Firstly, extending section 17 of the MIA 1906 to fraudulent claims is inconsistent with the recent trend which alleges that the judicial basis of the duty of good faith at the claiming stage is a separate rule of law.<sup>962</sup>

Secondly, applying the traditional avoidance *ab initio* remedy to fraudulent claim events is revealed to be a penal remedy since a trivial fraud would cause all benefits of the insurance policy to be forfeited according to section 17, including both genuine

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<sup>959</sup> Since according to the wordings of sections 17-20 in the MIA 1906, the duty of utmost good faith seems to be only limited to the pre-contractual contemplations.

<sup>960</sup> See § 5.1 and 5.2.

<sup>961</sup> This issue has been addressed in earlier paragraphs, and the pitfalls of this opinion also have been analysed.

<sup>962</sup> See § 5.3.

and fraudulent claims. Although common law is famous for its elasticity in being updated by cases and the English courts maintain this point by creating a halfway avoidance remedy,<sup>963</sup> the partial avoidance was fully rejected by current leading academics.<sup>964</sup> On the one hand, the proportionate remedy is deemed to be encouraging fraud. The logic dictates that the fraudster would be encouraged to have a thirst of speculative interests since the genuine claim would not be deprived of, if a fraud is discovered. On the other hand, this refusal just terminates the possibility of introducing a proportionate remedy to fraudulent claims, which also places this issue back to a vicious circle, namely, the disproportionality of avoidance *ab initio* remedy for fraudulent claims.

Thirdly, in order to maintain the traditional elasticity of the common law, it is ideal to confine the application of section 17 of MIA 1906 to the pre-contract stage. This opinion, as observed previously, is evidenced by the judicial reluctance to extend section 17's application scope. Literally, even based on the ordinary meaning of section 17, it is apparent that the insurance contract is concluded 'on' utmost good faith, which does not clarify whether this duty continues after concluding the contract or not.

Fourthly, to sum up the above legislative defects, much light has also been shed on the incompetence in the current statutes, in disposing of the general post-contract events, which is also unravelled by the Law Commission's official publications.<sup>965</sup>

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<sup>963</sup> Although this proposal was clearly rejected by the current editors of the leading academic writing, *Arnould* (Gilman, et al., *Arnould's Law of Marine Insurance and Average*, p. 750), people still cannot disregard the importance of adapting a partial remedy, namely, proportionality remedy, which is currently adopted by Australian law. This approach is also presented by the Law Commission for the coming statutory reforming consultation, citing practical custom from the insurance market. See the Law Commission and the Scottish Law Commission, *A Joint Consultation Paper, Insurance Contract Law: Post Contract Duties and other Issues (CP 2)*, pp. 75-76.

<sup>964</sup> Gilman, et al., *Arnould's Law of Marine Insurance and Average*.

<sup>965</sup> For example, see the Law Commission, Issues Paper 7, *The Insured's Post-contract Duty of Good Faith*, July 2010; the Law Commission and the Scottish Law Commission, *A Joint Consultation Paper, Insurance Contract Law: Post Contract Duties and other Issues (CP 2)*.

One credible response from practice concerning the application of avoidance to the post-contractual event, especially for fraudulent claims, notes that this would bring the industry into 'disrepute', since 'this does not do the industry any credit'.<sup>966</sup>

In other words, the current statutory avoidance remedy is not good law but outdated for fraudulent claims. This is also the main reason why the Law Commissioners conducted a review, presenting a proposal to adopt a prospective remedy rather than the avoidance remedy at English common law.<sup>967</sup>

#### 5.3.4.2. Common law rule

Apart from the statutory rule underlying section 17 of the MIA 1906, the avoidance *ab initio* remedy is also supported by the judiciary, especially those in *The Star Sea*.<sup>968</sup> The leading judgment by Lord Hobhouse stated that avoidance was the sole remedy and there was no remedy in damages for any want of good faith.<sup>969</sup> However, in the meanwhile, a common law remedy is also embodied by cases regarding fraudulent claims, namely, forfeiture.<sup>970</sup>

In the view of this author, the forfeiture remedies often coexist with the avoidance remedy, as if the insurer is entitled to the avoidance *ab initio* remedy, because of the assured's fraudulent claims, then all of the assured's benefits under that policy would be forfeited. If the insurer is awarded with the avoidance of the tainted claim(s) only,

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<sup>966</sup> The Law Commission and the Scottish Law Commission, *A Joint Consultation Paper, Insurance Contract Law: Post Contract Duties and other Issues (CP 2)*, p. 75. According to a broker's response, 'there is no way the law should permit insurers to avoid a policy back to inception on the basis of a fraud that occurred several years after inception'.

<sup>967</sup> *Ibid.*

<sup>968</sup> *Manifest Shipping Co Ltd v Uni-Polaris Insurance Co Ltd (The Star Sea)* [2001] 1 Lloyd's Rep. 389, HL. For a similar case see *Galloway v Guardian Royal Exchange (UK) Ltd* [1999] LLR IR 209.

<sup>969</sup> *Manifest Shipping Co Ltd v Uni-Polaris Insurance Co Ltd (The Star Sea)* [2001] 1 Lloyd's Rep. 389, HL, p. 262, per Lord Hobhouse. This statement is also favoured by *Banque Financiere de la Cite SA (formerly Banque Keyser Ullmann SA) v Westgate Insurance Co (formerly Hodge General & Mercantile Co Ltd)* [1987] 1 Lloyd's Rep. 69, QB (Com. Ct.); [1988] 2 Lloyd's Rep. 513, CA; [1990] 2 Lloyd's Rep. 377, HL.

<sup>970</sup> *Axa General Insurance Ltd v Gottlieb* [2005] LLR I.R., 369.

then the assured's benefits underlying the tainted claim(s) would be forfeited. Subsequently, the forfeiture remedy partially originates from insurance contracts when the fraud clauses are contained.<sup>971</sup> Briefly, as English case law suggests, there are two possible approaches for insurers which are, claiming for retrospective forfeiture or prospective forfeiture, but the final decision is always debatable.

Interestingly, the retrospective forfeiture remedy for the insurer appears to coexist with the avoidance remedy under section 17 of the MIA 1906. The history of the forfeiture rule can be dated back to *Goulstone v The Royal Insurance Company*<sup>972</sup> and *Britton v The Royal Insurance Company*.<sup>973</sup> However, the scope of forfeited benefit is still arguable and left open. Judging from recent juristic opinions, the judiciary is reluctant to award the avoidance *ab initio* remedy to the injured party or a retrospective forfeiture of all benefits under the insurance policy, but rather adopts a prospective approach. In *Axa General Insurance Ltd v Gottlieb*,<sup>974</sup> it was clarified by the judiciary that 'there is no basis or reason for giving the common law rule relating to fraudulent claims a retrospective effect on prior, separate claims which have already been settled under the same policy before any fraud occurs'. However, there is a crucial condition precedent for the above discussion, namely, the benefits are required to be attached to multiple claims. Unfortunately, under the current law the forfeiture of subsequent claims is still ambiguous, and thus needs further clarifications. In terms of the benefit derived from one particular claim, according to a recent judgment of *Aviva Insurance Ltd v Brown*,<sup>975</sup> it was revealed that a

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<sup>971</sup> In cases where a forfeiture of fraudulent claims is clarified by the insurance contract.

<sup>972</sup> (1858) 1 F & F 276, p. 279. In this case it was held that 'the claim was fraudulent' if 'it was wilfully false in any substantial respect' and the assured 'forfeited all benefit' under the policy.

<sup>973</sup> (1866) 4 F & F 905, p. 909. In this case, it was held that 'if there is wilful falsehood and fraud in the claim, the insured forfeited all claim whatever upon the policy'.

<sup>974</sup> [2005] LLR: I.R., 369, p. 375, per Mance LJ.

<sup>975</sup> [2012] Lloyd's Rep. I.R. 211, in which the assured was requested to repay all payment tainted by fraud, but was entitled to the sum in respect of the damaged skylight, which was a separate claim unaffected by fraud.

retrospective forfeiture remedy was allowed to the injured party of an insurance contract. Under the current state of insurance rules in England and Wales, the prospective forfeiture remedy was considered by two notable cases, *Orakpo v Barclays Insurance Services*<sup>976</sup> and *Galloway v Guardian Royal Exchange (UK) Ltd.*<sup>977</sup>

According to the practice in the UK, the FOS follows ICOBS, entitling a partial forfeiture remedy to the defaulting party.<sup>978</sup> The approach adopted by the FOS can be considered to show mercies to the dishonest assured in cases of minor frauds. However, some concerns are caused for the reconsideration of a prospective approach.

First of all, at its superficial value, a prospective forfeiture remedy would discharge the involved parties from their future liabilities, especially those that belong to the insurance company. In practice, the assured may suffer the pure genuine loss and the fraudulent loss. As stated earlier, the fraudulent loss is affected by fraud and the insurance company is discharged from all liabilities in relation to the contaminated claim. Then, what would happen to the legitimate claim which is made subsequently to the disclosure of fraud, and would the following separate claim be declined by the insurance company? In the view of this author, the logic is simple here, in cases where there is a group of separate claims, trivial fraud should not be deemed as a serious breach of good faith and uncontaminated claims should not be affected. This opinion is also favoured by other legal systems, and one outstanding example is in Australian law. According to section 56 of the Australian Insurance Contracts Act 1984, the statutory remedy is limited to the contaminated claims in cases of minor

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<sup>976</sup> [1995] 1 LLR 443.

<sup>977</sup> [1999] Lloyd's Rep. I.R. 209.

<sup>978</sup> Which was referred to by the Law Commissions in the Law Commission and the Scottish Law Commission, *A Joint Consultation Paper, Insurance Contract Law: Post Contract Duties and other Issues (CP 2)*, p. 77.

frauds.<sup>979</sup> Additionally, it is undoubtedly logical that in cases where there is one particular claim, all subsequent benefits attached to this claim should be forfeited since they are definitely tainted here. In cases of significant fraud, in the view of this author, the method based on Australian law is recommended. As section 56(1), Australian Insurance Contracts Act 1984, states, a retrospective remedy would be applied for fraudulent claims but not a retrospective avoidance remedy. In the meanwhile, one might have the view that the general contract law principle should also be taken into account. As a matter of fact, the approach of adopting a retrospective remedy, or a so-called 'proportionality remedy',<sup>980</sup> for fraudulent claims is not a perfect solution but gives rise to another wave of subsequent concerns, among which the most noticeable topic is its negative impact on the assured. In terms of the dangerousness of the proportionality remedy to the assured's incentive to be honest, this has been addressed above.<sup>981</sup> In the meantime, another concern under this topic is the lack of sufficient support from both the judiciary and academics. On the one hand, the precedent condition attached to the momentous proportionality remedy legislation in Australian law is that the fraud must be insignificant or minimal, which reveals its limitations. The most grievous one is its elusive standards in practice. For a grant of partial relief, the alleged party has to prove that the degree of fraud in an individual case is substantial to the whole claim, but the exact latitude of

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<sup>979</sup> Section 56(2), Australian Insurance Contracts Act 1984 reads that 'in any proceedings in relation to [a fraudulent] claim, the court may, if only a minimal or insignificant part of the claim is made fraudulently and non-payment of the remainder of the claim would be harsh and unfair, order the insurer to pay, in relation to the claim, such amount (if any) as is just and equitable in the circumstances'. See Julie-Anne Tarr, 'Fraudulent insurance claims: recent legal developments', (2008) *JBL*, pp. 139-157.

<sup>980</sup> Robert 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*, available at <http://lawcommission.justice.gov.uk/areas/insurance-contract-law.htm>, accessed in January 2013, p. 58.

<sup>981</sup> See § 5.3.2.2 above.



an insignificant fraud is questionable.<sup>982</sup> Additionally, its application is dependent on broad judicial discretions, which is hard to be absolutely standardized. Despite the uncertainties addressed, the approach in English law is supported by some leading academics.<sup>983</sup>

#### 5.3.4.3. Contractual damage remedies

In addition to the statutory and common law rules, there is always another voice proposing extra remedies for a breach of the post-contractual duty of good faith, namely, contractual damages. Apparently, this opinion follows the argument that the assured's duty not to commit fraudulent claims is an implied term, entitling the insurer to a right to claim compensations for contractual damages.

The origin of contractual remedies is the adoption of a 'fraud clause', which is strongly recommended for commercial contracts.<sup>984</sup> Since a 'fraud clause' is incorporated into the insurance contract, then the remedies stipulated by this clause are considered as contractual remedies. Of course, the detailed consequence attached to each individual expressed 'fraud clause' is totally based on the freedom of contract, including forfeiture of all claims<sup>985</sup> or an 'automatic termination' of insurance.<sup>986</sup> The adoption of 'fraud clauses' appears to be a 'contractual solution to

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<sup>982</sup> In Australian law, the practical evidence itself notes an uncertain range, by ruling that a fraud of A\$100 in a claim of A\$10,000 and a fraud of A\$50 in a claim of \$100,000 are minimal. Interestingly, the examples in English marine insurance law are unlike to the Australian examples, and as summarized earlier, a probable range of insubstantial fraud is not extended to 11%-12% compared with claims under the insurance policy in toto. For details, see 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'*, p. 58.

<sup>983</sup> For example, see *Ibid*, p. 59.

<sup>984</sup> See § 5.3.1 above for a detailed introduction to 'fraud clauses'. It was also pointed out by one academic that another resource of contractual defence is consigned to the shadow of more overwhelming insurance defences like non-disclosure and warranties, and later, latent defences such as repudiatory discharge and innominate techniques, see Hwee Ying Yeo, 'Post-Contractual Good Faith – Change in Judicial Attitude?', (May, 2003) Vol 66, No 3, *MLR*, pp. 425-440, at p. 427.

<sup>985</sup> For example, *K/S Merc-Scandia XXXXII v Certain Lloyd's Underwriters (The Mercandian Continent)* [2001] 2 Lloyd's Rep. 563, CA, p. 568, para. 10, per Longmore LJ.

<sup>986</sup> Johanna Hjalmarsson, 'Fraudulent insurance claims', (01 Sep 2010) S.&T.L.

the uncertainty of the fraudulent claims rule<sup>987</sup> by extending the insurers' remedies. But it is still helpless for cases with an absence of an express term. Additionally, it is commented that awarding contractual remedies by 'fraud clauses' could impose restrictions on the development of case law in insurance.<sup>988</sup> Therefore, some commentators intend to establish the second pillar of proposing contractual damages as the remedies for fraudulent claims, which is founded on the basis of an implied term. Of course, the limitations to the implied terms theory has been stated in earlier paragraphs.<sup>989</sup> However, the implied term theory is worthwhile to be discussed here for adapting possible solutions to appropriate remedies for fraudulent claims.

Under general contract law, the three typical types of contractual terms are the condition, the warranty, and the innominate term.<sup>990</sup> Accordingly, there are varied contractual remedies available for breaches of contracts. In cases of a breach of a conditional term, the injured party is awarded the right to terminate the contract and claim compensation for contractual damages. In cases of a breach of a warranty term, the injured party is awarded with contractual damages only.<sup>991</sup> In cases of a breach of an innominate term, where it may be difficult to tell whether it goes to the root of contracts or not, the injured party would be awarded with the contractual remedies upon the effect of breach.<sup>992</sup> It seems to complicate the remedies mechanism for the contractual breaches by providing more options for fraudulent

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<sup>987</sup> Skajaa, 'International Hull Clauses 2002: a contractual solution to the uncertainty of the fraudulent claims rule?', in *LMCLQ*, pp. 279-288.

<sup>988</sup> Thomas, 'Fraudulent insurance claims: definition, consequences and limitations', in *LMCLQ*, pp. 485-516, at p. 500.

<sup>989</sup> This author is inclined to separate the post-contractual event from section 17 of the MIA 1906.

<sup>990</sup> MacIntyre, *Business Law*.

<sup>991</sup> *Poussard v Spiers* (1876) 1 QBD 410 and *Bettini v Gye* (1876) 1 QBD 183 illustrate conditional and warranties terms and how to distinguish them from each other.

<sup>992</sup> According to the outstanding shipping case regarding innominate terms, *Hong Kong Fir Shipping Co Ltd v Kawaskaki Kisen Kaisha Ltd (The Hong Kong Fir)* [1962] 1 LLR 478, p. 479, the seriousness of a breach of contractual terms is judged on whether it deprives the injured party of substantially the whole of the benefit under that contract and if it does, the injured party is entitled to repudiate the whole contract and claim compensations for contractual damages; if it does not, the injured party would be entitled to claim compensations for contractual damages only. Also see MacIntyre, *Business Law*.

claims compared with the restrictive and exclusive avoidance *ab initio* remedy underlying section 17 of the MIA 1906. However, judging from judicial opinion, the introduction of contractual damages to insurance contracts for fraudulent claims is rejected by the Court of Appeal in *La Banque Financiere de la Cite v Westgate*.<sup>993</sup> In this case, it was clarified that contractual damages were not recoverable in cases where a pre-contract breach of good faith and avoidance is the only remedy available.<sup>994</sup> Therefore, it can be concluded that contractual damages are not recoverable in all good faith events in insurance law on the basis of a breach of an implied term.

Despite the judicial refusal and academic support,<sup>995</sup> limitations and consequential concerns are revealed regarding this judgment provided that the assured's duty to make correct claims is implied by contractual terms. First of all, there is an apparent impossibility for the injured party to sue an assured for damages following a fraudulent claim, but the consequential cost of a claims investigation after fraud is discovered must be questioned. Furthermore, would the defaulting party be responsible for indemnifying contractual damages in that case?<sup>996</sup> Interestingly, the judicial answer is negative, which is reflected in *London Assurance v Clare*.<sup>997</sup> In this case, it was held by the High Court that expenses incurred in the investigation of claims were not recoverable as damages for breach of an implied contractual term requesting the assured not to commit a fraudulent claim. Another issue relating to

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<sup>993</sup> [1988] 2 Lloyd's Rep. 513, CA. Also in *Manifest Shipping Co Ltd v Uni-Polaris Insurance Co Ltd (The Star Sea)* [2001] 1 Lloyd's Rep. 389, HL.

<sup>994</sup> *Banque Financiere de la Cite SA (formerly Banque Keyser Ullmann SA) v Westgate Insurance Co (formerly Hodge General & Mercantile Co Ltd)* [1988] 2 Lloyd's Rep. 513, CA, cited by the Law Commission, Issues Paper 7, *The Insured's Post-contract Duty of Good Faith*, p. 41.

<sup>995</sup> For academic support, see Rhidian Thomas, 'Review of Contemporary Legal Developments', (2001)2/3 *JIML*, pp. 71-76.

<sup>996</sup> The Law Commission, Issues Paper 7, *The Insured's Post-contract Duty of Good Faith*, p. 41.

<sup>997</sup> (1937) 57 Ll. L. Rep. 254.

contractual damages in fraudulent claims is whether the injured party is entitled to claim damages for deceit.<sup>998</sup>

#### **5.4. Insurer's late payment and good faith**

At the claiming stage under an insurance policy, besides the assured's duty not to promote fraudulent claims, the insurer is requested to handle the claims honestly, and indemnify a valid insurance claim as soon as possible.

If the insurer rejected a valid claim or delayed payment, the assured is not awarded any damages for the losses caused by the insurer's late payment. With 'distinguished reluctance', the current English Courts prefer not to approve the assured's claim for damages caused by the insurer's unreasonable delay in payment,<sup>999</sup> which is considered to affect the fairness and competitiveness of English law.<sup>1000</sup>

There are two types of debatable liabilities established in concurrent English law and some regulations in the UK. The liability is incurred on the basis of the insurer's breach of his primary obligation to pay compensation and the insurer's duty of good faith. Unfortunately, both theories are not neat enough to be invoked. In the first place, the Courts created a series of precedents to build up the 'hold harmless' principle, meaning that the insurer's primary obligation is not to hold the assured harmless, but prevent the assured from being injured by risks insured.<sup>1001</sup> The

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<sup>998</sup> Including the Law Commissioners, leading academics such as Eggers, et al., *Good Faith and Insurance Contract*, para. 11.116.

<sup>999</sup> For case examples, see *The President of India v Lips Maritime Corporation (The Lips)* [1988] AC 395; *Ventouris v Mountain (The Italia Express) (No 3)* [1992] 2 Lloyd's Rep. 281; *Sprung v Royal Insurance (UK) Ltd* [1999] 1 Lloyd's Rep. I.R. 111.

<sup>1000</sup> For details, see the Law Commission and the Scottish Law Commission, *A Joint Consultation Paper, Insurance Contract Law: Post Contract Duties and other Issues (CP 2)*, part 4.

<sup>1001</sup> For example, *Ventouris v Mountain (The Italia Express) (No 3)* [1992] 2 Lloyd's Rep. 281; *The President of India v Lips Maritime Corporation (The Lips)* [1988] AC 395; *Sprung v Royal Insurance (UK) Ltd* [1999] 1 Lloyd's Rep. I.R. 111.

second step taken by the Courts was denying the 'implied obligation' theory through judicial interpretations directly. Some commentators have a different opinion, claiming that some other jurisdictions can be considered as a resource of the 'implied term' theory in the UK. In England and Wales, the FOS<sup>1002</sup> and the original FSA<sup>1003</sup> rules, both award the innocent assured with damages for an insurer's unreasonable delay in payment or wrongful rejection of a valid claim.<sup>1004</sup> However, these rules do not apply to either business insurance or businesses of a medium or large size, but are confined to 'consumers' or a 'private person'.<sup>1005</sup> The implications of the above solutions decide that they are definitely inadequate to be treated as a statutory source of the implied obligation theory. In the view of this author, there is another

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The nature of the insurer's liabilities was earlier raised in *Ventouris v Mountain (The Italia Express) (No 3)* [1992] 2 Lloyd's Rep. 281, p. 292. According to Hirst J's judgment in the Commercial Court, it was said that the insurer was 'in breach of contract for having failed to hold the indemnified person harmless against the relevant loss or expense' once 'the loss is suffered or the expense incurred'. In the judgment delivered by Hirst J, Lord Goff's ruling in *Firma C-Trade S.A. v Newcastle P. & I. Association (The Fanti and Padre Island)*, (H.L.) [1990] 2 Lloyd's Rep. 191 was cited to support his statement. However, the 'hold harmless' analysis is targeted as one main defect of the current English case law for the insurer's non-payment cases under the reforms committed by the Law Commission, which is addressed below (see § 5.5 below).

<sup>1002</sup> Rule 8.1.1R, ICOBS.

<sup>1003</sup> Section 150(1) of FISMA 2000.

<sup>1004</sup> Currently, this topic is regulated by section 138D, Chapter 2, Part 9A, Part 2 of the Financial Services Act 2012,

<sup>1005</sup> According to the FOS case examples analysed by the Law Commission in its Consultation Paper 2, it is revealed that a small amount of damage is mostly awarded for distress and inconvenience to consumers and small/medium sized businesses. See the Law Commission and the Scottish Law Commission, *A Joint Consultation Paper, Insurance Contract Law: Post Contract Duties and other Issues (CP 2)*, p. 39.

According to rule 3 of the Financial Services and Markets Act 2000 (Rights of Action) Regulations 2001, 'private person' means an 'individual' or a 'legal person'. Rule 3(1) stipulates that:

'Private persons.

3. – (1) In these Regulations, 'private person' means —

(a) any individual, unless he suffers the loss in question in the course of carrying on —

(i) any regulated activity; or

(ii) any activity which would be a regulated activity apart from any exclusion made by article 72 of the Regulated Activities Order (overseas persons); and

(b) any person who is not an individual, unless he suffers the loss in question in the course of carrying on business of any kind; but does not include a government, a local authority (in the United Kingdom or elsewhere) or an international organisation.

(2) For the purposes of paragraph (1)(a), an individual who suffers loss in the course of effecting or carrying out contracts of insurance (within the meaning of article 10 of the Regulated Activities Order) written at Lloyd's is not to be taken to suffer loss in the course of carrying on a regulated activity.'

Section 138D(6) of the Financial Services Act 2012 provides that "(p)private person' has such meaning as may be prescribed",

possible reason for this objection. Admitting the ‘implied term’ theory for the insurer’s primary obligation to indemnify the assured’s losses, is equivalent to admitting that contractual damages are available for the insurer’s breach of this obligation, which is inconsistent with all precedents in English case law. In order to redress confusion on this issue, the Courts chose to express their view directly in *Sprung*.<sup>1006</sup> In *Sprung*, the insurer’s failure to commit payment under a policy was judged to be a failure to pay damages, and an assured had no cause of action for damages for non-payment of damages. A claimant, therefore, was compensated by the entitlement to interest on the damages only.<sup>1007</sup>

In these cases, the second type of liability applicable to the insurer is based on a breach of good faith. At the claiming stage, the insurer is always demanded to handle the assured’s claims honestly in a timely fashion, which is due to the mutuality nature of good faith.<sup>1008</sup> The establishment of ‘good faith’ explores a concern about the assured’s remedies for the insurer’s late payment or wrongful rejection of valid claims. One might have the view that since the insurer’s obligations are founded on good faith, and section 17 of the MIA 1906 has provided avoidance as the only remedy in cases of a breach of utmost good faith, no damages should be awarded to the assured. This statement is not illogical, but it is indeed inconsistent with the damages doctrine applied to general contracts. According to current English contract law, the injured party is entitled to contractual damages for any loss caused by the defaulting party’s breach, as long as the claims satisfy the requirements of the ‘damage’

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<sup>1006</sup> *Sprung v Royal Insurance (UK) Ltd* [1999] 1 Lloyd’s Rep. I.R. 111.

<sup>1007</sup> This was applied to *Ventouris v Mountain (The Italia Express) (No 3)* [1992] 2 Lloyd’s Rep. 281.

<sup>1008</sup> Since the assured is required to act in good faith during the whole insurance contract, including its performance and claiming stage, it would be unfair if no similar requirements were demanded from the insurer’s side. In insurance practice, currently, the large insurance companies are considered to be insurers with overwhelming skills, experience and power compared with the assureds, which becomes more obvious in terms of consumer insurance. Therefore, in order to protect the assured individual consumer’s interests, the Unfair Contract Terms Act 1977 requires the conclusion of a contract to be fair.

principle created by the fundamental case of *Hadley v Baxendale*.<sup>1009</sup> Later, it was interpreted by the Courts that this ‘damage’ principle was limited to general contract cases, rather than insurance cases.<sup>1010</sup> There are many reasons why an insurance contract is treated so differently, but it is believed that the central one is that it is a contract based on speculation.

In the light of the above approach adopted by the English Courts, no damages would be awarded to the assured for the insurer’s late payment or rejection of a valid claim. However, in terms of consumer insurance, the statutory duties are available from the FOS and FAS rules, which were also supported by the recently released publication of the Law Commissions.<sup>1011</sup>

## 5.5. Reforms undergoing in the English and Scottish Law Commissions

Various pressures from both practice and academia have forced the English and Scottish Law Commissions to consider a statutory reform.<sup>1012</sup> The reforming

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<sup>1009</sup> (1854) 156 ER 145. The ‘remoteness’ doctrine was established in this case for contractual damages in contract law. According to this doctrine, not every loss caused by the defaulting party’s breach is recoverable, unless it falls within either one of the following two rules: (A) damages arise naturally from a breach of contract, or (B) damages are within the contemplation of the parties at the time of contracting. For details, see MacIntyre, *Business Law*, pp. 192-193.

<sup>1010</sup> *Ventouris v Mountair (The Italia Express) (No 3)* [1992] 2 Lloyd’s Rep. 281; *The President of India v Lips Maritime Corporation (The Lips)* [1988] AC 395; *Sprung v Royal Insurance (UK) Ltd* [1999] 1 LLR IR 111.

<sup>1011</sup> See the Law Commission and the Scottish Law Commission, *Summary of Responses to Second Consultation Paper: Post contract Duties and other Issues, Chapter 1 Damages for Late Payment*, available at <http://lawcommission.justice.gov.uk/areas/insurance-contract-law.htm>, accessed in January 2013. See paragraphs below for detail.

<sup>1012</sup> For the Law Commission’s reports, see the Law Commission, *Issues Paper 7, The Insured’s Post-contract Duty of Good Faith*; the Law Commission and the Scottish Law Commission, *A Joint Consultation Paper, Insurance Contract Law: Post Contract Duties and other Issues (CP 2)*. And also the Law Commission and the Scottish Law Commission, *Summary of Responses to Second Consultation Paper: Post contract Duties and other Issues, Chapter 1 Damages for Late Payment; Summary of Responses to Second Consultation Paper: Post contract Duties and Other Issues, Chapter 2 Insurer’s Remedies for Fraudulent Claims*, available at <http://lawcommission.justice.gov.uk/areas/insurance-contract-law.htm>, accessed in January 2013.

accomplishments are discussed in the pre-contractual sections,<sup>1013</sup> and the following paragraphs research the situation in post-contractual events.

There are 4 main Law Commission's publications concerning the assured's post contract duties, the Issues Paper 7 and Joint Consultation Paper 2 (CP 2), and the Summary of Responses to Second Consultation Paper regarding insurer's remedies for fraudulent claims. The Issues Paper 7 analysed the current status of insurance law for fraudulent claims, presented proposals for reform, and finally listed out keying questions for consultations. In December 2011, CP 2 was finally released by the Law Commissions, finalizing a proposal for reforming insurance law on the basis of responses to the topics contained in the Issues Paper 7. The Law Commissions recently published the Summary of Responses to the CP 2 regarding the insurer's late payment and remedies for fraudulent claims in December 2012, reflecting strong support from the conlutees who replied for the above proposals.

According to CP 2, in terms of the insurer's non-payment in business insurance, the Law Commissions proposed to adapt the current Scottish Law provisions and some other regulations(e.g.: FOS and FAS rules) in England and Wales, in order to award damages for the losses caused by the insurer's breach of his reasonable indemnification liabilities. Therefore, the Law Commissions proposed to overthrow the traditional 'hold harmless' principle, but to build up a contractual obligation which requires the insurer to pay valid claims within a reasonable time.<sup>1014</sup> On the basis of the responses regarding whether the 'insurers should be able to add to the statutory remedies for fraudulent claims through express contractual terms', 86% of

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<sup>1013</sup> See chapter 3 above for details.

<sup>1014</sup> The Law Commission and the Scottish Law Commission, *A Joint Consultation Paper, Insurance Contract Law: Post Contract Duties and other Issues (CP 2)*, part 5, p. 51. In order to ensure that the insurer has enough time to carry out a full investigations, the Law Commission proposed to introduce the concept of 'reasonable time' to the statutory reform, and explained that the 'reasonable time' should vary according to each individual case with market practice, different locations, sizes of insurance and complexities considered.



consultees provided strong support.<sup>1015</sup> Subsequently, CP 2 proposed that damages should be available for the insurer's late payment,<sup>1016</sup> which was also agreed by most consultees (87% of consultees).<sup>1017</sup> In the meanwhile, further limits were imposed, which directed that the insurer's indemnification obligation is excludable by an express term, but not the duty of 'good faith'.<sup>1018</sup>

According to the proposal presented by the Law Commissions, four main elements need a statutory reform or restatement for the assured's post-contract breaches of good faith.<sup>1019</sup> Firstly, in order to preserve the current law, a policyholder who commits a fraud in relation to a claim forfeits the whole claim to which the fraud relates, and any interim payments made in respect of the claim must be paid back. Therefore, as this factor suggests, in cases where one claim is involved, forfeiture is preferred rather than avoidance, in order to refrain from being castigated for its unprincipled nature. Secondly, in terms of the subsequent claims which arise after the discovery of fraud, the Law Commissions presented a proposal, in the sense that the coming statutory reform can clarify the prospective nature of forfeiture. This element indicates that the Law Commissions intend to treat the assured's duty of good faith at post-contractual stages as an implied condition of an insurance contract and the consequence of its non-compliance is the termination of the contract.

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<sup>1015</sup> See the Law Commission and the Scottish Law Commission, *Summary of Responses to Second Consultation Paper: Post contract Duties and Other Issues, Chapter 2 Insurer's Remedies for Fraudulent Claims*, part 4.

<sup>1016</sup> *Ibid*, p. 50. According to the proposal, in order to limit the amounts of damages for the insurer's late payment, the *Hadley* case under general contract law was recommended to be adopted in the coming statutory reform combining with the foreseeability test established.

<sup>1017</sup> The Law Commission and the Scottish Law Commission, *Summary of Responses to Second consultation Paper: Post contract Duties and other Issues, Chapter 1 Damages for Late Payment*, part 2.

<sup>1018</sup> *Ibid*, pp. 51-52. According to the proposal, the insurer's indemnification obligation or paying damages for losses caused by delay is allowed to be excluded with an express term, but only on the basis of acting in 'good faith'. Therefore, the excludability nature is proposed to be imposed to the insurer's indemnification duty itself but not extended to the duty of good faith.

<sup>1019</sup> *Ibid*, part 8.

Pursuant to the second element, thirdly, the Law Commissions proposed a further point to reaffirm the prospective nature of the forfeiture remedy for this issue, rather than the draconian avoidance *ab initio* remedy.<sup>1020</sup> Under the current case law, this point is supported by the judiciary, but is inconsistent with section 17 of the MIA 1906. The Law Commissioners, therefore, expected that the statutory reform can have this clarified. Also being relevant to the second element, more options of contractual damages are proposed to be awarded for fraudulent claims by the Law Commissions. According to the fourth element, proposing that ‘the insurer should also have a right to claim the costs reasonably and actually incurred in investigating the claim’,<sup>1021</sup> one gate is open for contractual damages in such cases. However, further limitations are imposed on its application by the Law Commissioners, requesting that the costs of claims investigation would not be available where the ‘savings made from the forfeited claim already offset the costs of investigation’.<sup>1022</sup> Apart from the reasonable claim investigation costs, the Consultation Paper 2 also approved that there was a possibility that the insurer would be able to claim damages for deceit.

All the above elements were proposed for further consultations. Based on the summary of responses from commentators in academia, judiciary and practitioners, the above proposals were supported by most of the consultees replied.<sup>1023</sup> The Law Commissions aim to present a full draft Bill of Business insurance contract law for post contractual duties in 2013. Until now, the proposed proportionality remedy for

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<sup>1020</sup> *Ibid.*

<sup>1021</sup> *Ibid.*

<sup>1022</sup> *Ibid*, p. 87. In this Consultation Paper 2, there are three hypothetical examples exemplified to illustrate how it operates.

<sup>1023</sup> The Law Commission and the Scottish Law Commission, *Summary of Responses to Second Consultation Paper: Post contract Duties and Other Issues, Chapter 2 Insurer’s Remedies for Fraudulent Claims*, parts 1-3.

fraudulent claims is ideal to redress the uncertainties and confusions caused by the current law, by avoiding traditional concerns in this regard.<sup>1024</sup>

## **5.6. Conclusion – Reconsidered levels of requirements: good faith or utmost good faith in post-contractual events?**

The levels of requirements are confusing. What is the exact degree of ‘good faith’ required from insurance parties for the post-contractual stage? Is it an average level of ‘good faith’, or an extremely high degree of ‘good faith’ as required at the pre-contract stage?

As stated above in this chapter, contractual parties’ duties at the post-contractual stage are definitely inconsistent with those at the pre-contractual stage.<sup>1025</sup> Because of its restriction, and the rigidity of the observation of pre-contract utmost good faith, whether there is a breach is judged on the basis of the actual inducement reality, but not the degree of fault or negligence. Therefore, in pre-contract utmost good faith circumstances, both vital and trivial mistakes could be disastrous to the continuity of the insurance policy, as long as the two-limb requirements are satisfied.<sup>1026</sup>

As is suggested in this chapter, good faith continues as a requirement after making an insurance contract. In the meanwhile, under certain circumstances, ‘utmost good faith’ is required. The first reason to distinguish the post-contractual duties from the pre-contractual ones, is that the extent of the post-contractual duty of

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<sup>1024</sup> The avoidance *ab initio* in English common law is not the harshest remedy compared with the statutory provision in Norwegian marine insurance law. According to paragraph 3 of § 5-1 under the Norwegian Marine Insurance Plan 1996, 2010 version, ‘if the assured has acted fraudulently, the insurer is free from liability; the insurer may also cancel any insurance contract he has with the assured by giving fourteen days’ notice’.

<sup>1025</sup> In terms of the difference between utmost good faith and its contents in business and consumer insurance, see chapter 3 above for details.

<sup>1026</sup> Materiality and actual inducement test.

good faith varies according to the stage where it arises. Compared with the relatively simple pre-contractual circumstances (the duty of disclosure and not to misrepresent information), the situation under post-contractual circumstances is much more complex. As this part addresses, the post-contract duties in insurance contracts embrace different issues. It was found that after the conclusion of an insurance contract, only in cases of renewals of the policy, variations to extend the policies, alterations of risks and 'held covered' clauses, the contractual parties are requested to exercise the duty of utmost good faith, but nowhere else.<sup>1027</sup> Apart from these four situations, no other cases were mentioned or sent to the Courts. Since the degree of 'good faith' was described to vary depending on the stage of the parties' relationships,<sup>1028</sup> there are elusive principles, but not a universal requirement of good faith needed for the post-contract stage.

Another reason to treat the post-contract duties differently is its distinctive basis. As discussed before, the majority of leading academics intend to separate them from section 17 of the MIA 1906 which is considered as the fountain of utmost good faith, preferring to categorise the post-contractual duty of good faith based on a separate rule of law.<sup>1029</sup> This statement just opens the gate for the Law Commissions to introduce more alternative options for the defaulting party's breaches of good faith,

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<sup>1027</sup> *K/S Merc-Scandia XXXXII v Lloyd's Underwriters (The Mercandian Continent)* [2000] 2 Lloyd's Rep. 357, QB, p. 570. According to Aikens' judgment, the Courts have clearly held that there are four situations in which the duty of utmost good faith must be exercised by the assured attached after the conclusion of the contract.

Apparently, the insurer's and assured's statuses are exchanged after making an insurance policy and it is unfair to request both parties especially the assured's side to continue a contract with the requirements to utmost good faith required pre-contractually. See *Manifest Shipping Co Ltd v Uni-Polaris Insurance Co Ltd (The Star Sea)* [2001] 1 Lloyd's Rep. 389, HL, paras.6 and 7, per Lord Clyde; the Court of Appeal in *The Good Luck* [1990] 1 Q.B. 818, para. 888.

<sup>1028</sup> Aikens, 'The post-contract duty of good faith in insurance contracts: is there a problem that needs a solution?', in *JBL*, pp. 379-393. In this article, good faith was described as the Cheshire Cat: it never disappears entirely, but at certain times you can only see its smile. This opinion receives huge support from both academia and practice in favour of requiring a different level of requirements to the post-contract duties. See § 5.1.2.

<sup>1029</sup> See § 5.1.2.

especially the prospective and proportionality remedy for fraudulent claims.<sup>1030</sup>

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<sup>1030</sup> The prospective and proportionality remedy is available for fraudulent claims in cases where there is a group of different claims. In cases where one particular claim tainted by fraud, the coming law reform would persevere with the current law, under which the defaulting policyholder should forfeit the whole claim. See the Law Commission and the Scottish Law Commission, *A Joint Consultation Paper, Insurance Contract Law: Post Contract Duties and other Issues (CP 2)*.

## CHAPTER 6

### THE POST-CONTRACT DUTIES AND GOOD FAITH IN CHINESE INSURANCE LAW

#### 6.1. Introduction

As stated in chapter 4 concerning pre-contractual utmost good faith in Chinese law, utmost good faith has never been legally recognized but only practically admitted. Therefore, utmost good faith itself needs further legal clarification to confirm its position in the Chinese legal system. The legislators' reforming intention is finally embodied by the Amendments of the Chinese Maritime Code of the PRC in 2003 by introducing the doctrine of utmost good faith in English law to Chinese law.<sup>1031</sup> In the meanwhile, compared with this highly developed doctrine in English case law, the present leading codes in China are lacking of detailed provisions.

Currently in Chinese law, the concept of post contractual good faith can be traced to article 5 of CIL 2009, article 6 of Contract law and article 4 of the General Principles of Civil law,<sup>1032</sup> which provide a blurry picture of good faith instead of pointing out in a straightforward manner whether this doctrine applies to post-contract information or not. This circumstance of Chinese law is similar to that of English common law, which is lacking a clear and detailed statutory clarification. However, as distinct from Chinese codes, the legislative defects in English law were further redressed through subsequent cases by the imposition of application

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<sup>1031</sup> Clause 313, Amendments of Chinese Maritime Code of the PRC, stipulates that 'if either party does not observe the duty of utmost good faith, the contract may be avoided by the other party', which is exactly the same as section 17, MIA 1906.

<sup>1032</sup> See chapter 4 above.

implications.<sup>1033</sup> Circumstances under Chinese law, therefore, become unpredictable since there are only inadequate existing statutes without a binding precedent doctrine which can have legislative defects adjusted afterwards. This chapter, firstly, introduces the insurance parties' post-contract duties of good faith, corresponding to the contents contained in chapter 5 regarding post-contract good faith at English common law. Secondly, a comparative study of the current leading codes and practical manners in China for each individual specific issue under the topic of post-contract good faith is analysed.<sup>1034</sup> In order to provide a comprehensive study, notable case examples in both English law and Chinese law will be addressed.

## **6.2. Post-contract duty of good faith and special issues**

### **6.2.1. Is good faith mutual and continuing in Chinese law?**

First of all, it is of tremendous importance to confirm the continuing and mutual nature of post-contract good faith in Chinese law. As distinct from the English position, under the MIA 1906, there is no overarching article regulating the duty of good faith and its application at the post-contract stage. Despite this pitfall, other general codes and commercial rules would be invoked to deal with relevant disputes as well.

Article 5 of CIL 2009 stipulates that the principle of 'good faith' must be observed by the parties to an insurance contract. Article 6 of Contract Law expressly provides that the parties shall observe the principle of honesty and good faith in exercising their rights and in performing their obligations. Article 4 of the General Principles of

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<sup>1033</sup> See chapters above regarding English law.

<sup>1034</sup> As stated in chapter 4, leading codes in Chinese law governing marine insurance include the Chinese Maritime Code of the PRC (CMC), Chinese Insurance Law of the PRC 2009 (CIL 2009), Contract Law of the PRC (Chinese Contract Law) and the General Principles of Civil Law of the PRC 1986 (General Principles of Civil Law). All these codes are listed in a descending order of their hierarchy.

Civil Law also notes that in civil activities, the principles of voluntariness, fairness, making compensation for equal value, honesty and credibility shall be observed. As the above statutes suggest, not just at the contemplation, but during the currency of a contract, both contractual parties are required to observe good faith.

According to subsequent provisions, after the making of an insurance contract, variations of contract are allowed based on both parties' agreement. The assured is required to notify the alteration of risks,<sup>1035</sup> and must perform the duty of loss notification and mitigation upon the occurrence of risks insured against.<sup>1036</sup> Additionally, the assured is required to cooperate with the insurance company for claims investigations.<sup>1037</sup> At the claiming stage, both the assured and insurer are obliged to act in good faith. From the insurer's side, in order to maintain a smooth operation of the insurance contract, the insurer is obliged to handle claims with good faith<sup>1038</sup> and make payment within a reasonable time.<sup>1039</sup> Subsequently, the assured shall not have the loss recovered in cases where there is a fraud element involved.<sup>1040</sup>

As all the above codes reflect, the duty of good faith is not confined to the pre-contract stage but is extended to the post-contract stage in Chinese law.

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<sup>1035</sup> Article 52, CIL 2009.

<sup>1036</sup> Article 236, CMC; arts 21 and 57, CIL 2009.

<sup>1037</sup> Article 22, CIL 2009.

<sup>1038</sup> Article 25, CIL 2009.

<sup>1039</sup> Articles 237-240, 243-244, CMC; article 23, CIL 2009.

<sup>1040</sup> Article 242 of CMC; article 27, CIL 2009.



## **6.2.2. Good faith and special issues in Chinese law**

### **6.2.2.1. Amendments and renewals of contract**

Based on article 20 of CIL 2009, the insurer and assured may amend the contents of the insurance contract subject to agreement. Under the same article, amendments after the making of an insurance policy are required to be embodied in a written form, for instance, an endorsement slip or some other type of written agreement. The requirement of a written format is imposed by law to avoid any potential disputes by providing paperwork proof, so as to maintain the insurance contract to be performed and completed successfully.

It is found that as with MIA 1906, statutes in Chinese law are silent on the assured's duty of good faith for the variations and renewals of insurance contract. However, business efficiency in China prefers to treat the amendment of contract as a partial renewal of contract. Therefore, such cases are logically governed by the rules applied at the contemplation of a new contract. Connected with the contents underlying chapter 4, regarding the assured's pre-contract duty of disclosure, it can be concluded that when it applies to the amendments and renewals to insurance contract, articles 222 and 223 of the CMC require the assured to voluntarily and truthfully inform the insurer of the material circumstances which the insured has knowledge of, or ought to have knowledge of, in his ordinary business practice, which may have a bearing on the insurer in deciding whether he agrees to accept the variations or renewals.<sup>1041</sup> In other words, the assured is obliged to disclose material circumstances to the amendments and renewals of insurance contracts, which is also a popular statement accepted by most academics in China.<sup>1042</sup>

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<sup>1041</sup> See § 4.3 above.

<sup>1042</sup> For example, Mingyuan Zhang, 'A study on liability defence of the insurer in a marine insurance contract', (1998) 20 *CCLR*, p. 642.

Compared with the assured's duty of utmost good faith for variations and renewals of insurance contracts in English law, the approach adopted by Chinese law is of a dual character. On the one hand, it is an explicit statutory obligation imposed on the insurance parties that alterations and renewals are only allowed based on written agreements. Subsequently, CIL 2009 lists out several detailed examples of written agreement on alterations and renewals, including an endorsement, or a separate endorsement slip attached to the original insurance policy, or an individual written agreement signed between the insurer and assured. Article 20 of CIL 2009, to a large extent, redresses the wrongs committed by the assured for amending and renewing an insurance contract by providing a guideline including the formality requirement to the variation agreement.

Nevertheless, the assured's duty of good faith for the variations and renewals of insurance contract is not legally clarified. The only feasible solution is treating the variation of insurance contract as a partial renewal of contract, and both parties are obliged to disclose all material circumstances of amendments or renewals with utmost good faith.

#### **6.2.2.2. Alteration of risks during currency of contract**

In English law, once the insurance contract is made, unless the policy provides otherwise, the assured is not obliged to disclose any alterations of risks against under the insurance policy, unless the increasing risks change the nature of the insurance.<sup>1043</sup>

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<sup>1043</sup> According to English law, the alteration of risk during the performance of an insurance contract is unnecessary to be disclosed, unless the alteration is so great to change the nature of insurance policy. Sections 43-48 of the MIA 1906 exemplify some exceptions under the doctrine of alteration of risks which need to be disclosed. Principally, such a duty of good faith is embodied by 'warranties' at common law. See § 5.2.2 above.

In Chinese law, the insurer's right to acknowledgement of changes of risks is reaffirmed by CIL 2009. According to article 52, CIL 2009, after the conclusion of an insurance contract, the assured is obliged to notify the insurer of the increasing risks according to the insurance provisions, and the insurer is entitled to increase the premium or terminate the insurance contract. In cases where the assured fails to perform the above duty of disclosure, the insurer is not responsible for any losses caused by concealing of increasing risks. There are several concerns relating to this article. Firstly, the assured's duty to notify the increasing risks to the insurer is a contractual obligation which is totally based on an express term. Therefore, as distinct from the other aspects of good faith in Chinese law, the duty of notifying increasing risks is not mandatory but founded on the express provisions. Also because of this reason, it is strongly recommended that an express 'increasing risks notification' clause should be contained in insurance policies, in order to mitigate the losses which would be caused by any potential changes of risks.

Secondly, not every degree of risk change is required to be disclosed according to the provisions, but significant increase only. A detailed definition of 'significant increase' is still uncertain in Chinese law, which needs further legal clarifications. However, in the view of this author, it would be beneficial to extend the standard adopted in English case law to Chinese practice.<sup>1044</sup> One reason to introduce English procedure here is, that since good faith is a universal umbrella to guarantee business transactions, its ultimate goal is to maintain a balance between the insurer and assured through the negotiation and currency of insurance policy. Thus, on the one hand, the doctrine of good faith demands definite fairness and equality between the insurer and assured, which logically means that neither party should be overloaded.

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<sup>1044</sup> See § 5.2.2 above.

Therefore, it is unreasonable to require the assured to fulfil the everlasting duty of good faith even where insignificant information appears after the conclusion of the insurance contract. In the view of this author, since the insurer concludes an insurance contract with the assured, and charges an insurance premium, the insurer shall take the risks and be responsible for losses caused by the occurrence of perils insured against. However, at the same time, another balance between the risks insured against and the agreed premium at the beginning is not invariable, but can be easily broken by external elements, including alterations of risks. In order to keep the scales weighing the interests of both sides to be in equilibrium, alterations of risks, especially significant increasing risks, need to be notified. As this paragraph suggests, on the premise that there are provisions of an increased risks notification duty, the assured should notify increasing risks which would change the nature of insurance to the insurer in a timely fashion. Judging from the information provided by this article and business efficiency, the significant increase of risks should be substantial enough to change the nature of insurance, for example, increase the original premium or original risks insured under the insurance policy. Besides, if the concealed increase of risks would cause the insurer not to accept the insurance at the beginning, the insurer could have the insurance contract terminated. Apart from its 'materiality', the inducement factor also came into the sight of the leading experts from Comité Maritime International (CMI),<sup>1045</sup> although in the end it was totally rejected. In the view of this author, the reasoning for this objection is clear, since the

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<sup>1045</sup> According to the CMI's 2004 Yearbook, the International Working Group on Marine Insurance (IWG) was set up to represent underwriters, academics and practitioners from both common law and civilian roots. The IWG resolved to concentrate initially on four issues which were identified as the ones most in need of attentions, including the duty of good faith, the duty of disclosure, alteration of risk, and warranties. See CMI, *Yearbook 2004, Vancouver II*, pp. 249-259.

failures of disclosing alterations of risks with good faith would happen after the conclusion of a contract.<sup>1046</sup>

Furthermore, in the view of this author, another essential contained in this article is that the assured shall perform his provisional duty of risks increase notification in a timely fashion. However, 'timing' here should be understood as 'as soon as possible', depending on individual cases. For instance, article 8(1) of the Hull Insurance of the People's Insurance Company of China (PICC) 2009 clearly stipulates that 'immediately upon receipt of advice of any accident or loss to the insured vessel, it is the duty of the insured to give notice to the insurer within 48 hours, and if the vessel is abroad, to the insurer's nearest agent immediately, and to take all reasonable measures for the purpose of minimizing a loss which would be recoverable under this insurance'. Thus, judging from the above codes and practical insurance clauses, it can be observed that the assured's duty of notifying the alteration of risks to the insurer is not a one-off requirement, but a continuing one including its further development.

Fourthly, in cases where an 'increasing risks notification' clause is contained and the assured performs this obligation correspondingly, the insurer may be entitled to extra premium or a termination of contract. The first option for the insurer is easy to understand, since the insurance premium should be correspondent to the level of perils insured against. More difficulties lie in the termination of insurance contract. In order to clarify the termination issue, directions are firstly diverted to its feasibilities in practice. The termination remedy is available to the insurer according to paragraph 1, article 52 of the CIL 2009. According to this article, in cases where the insurer decides to terminate the insurance contract, the premium paid shall be returned to

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<sup>1046</sup> CMI, International Working Group on Marine Insurance, (Singapore, February, 2001) *Discussion Paper*, available at <http://web.uct.ac.za/depts/shiplaw/cmi/marag.pdf>, accessed in January 2013, p. 9.

the assured with the part of premium from the date when the insurance contract begins, to the date when it is terminated, being deducted. Additionally, the termination of contract is awarded together with a forfeiture of prospective claims caused by concealed significant increased risks.<sup>1047</sup>

### 6.2.2.3. Held covered clause

In English law, the assured is also obliged to practice utmost good faith in relation to the applicability of the held covered clause.<sup>1048</sup>

In Chinese law, the held covered clause is not referred to in any insurance legislation, however, requirements are imposed in practice. The Ocean Marine Cargo Clauses 2009 and Hull Clauses of the PICC 2009 provide two practical examples. Clause 4(3) of the Ocean Marine Cargo Clauses 2009 stipulates that:

'[I]n case of a change of voyage or any omission or error in the description of the interest, the name of the vessel or voyage, this insurance shall remain in force only upon prompt notice to this company when the assured becomes aware of the same and payment of an additional premium if required[.]'

Similarly, clause 6(3) of the Hull Clauses 1/1/1986 provides another example of the held covered clause. According to this clause:

'[I]n case the assured is notified with a noncompliance with the insurance provisions concerning the assured cargo, voyage, navigation area, towing, salvage or the sailing date, this insurance shall remain in force only upon prompt notice being given to the insurer and an agreed amended insurance with a higher premium when required; otherwise, the cover would be terminated automatically.'

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<sup>1047</sup> Paragraph 2, article 52, CIL 2009 stipulates that if the assured fails to perform the obligation provided, the insurer shall bear no obligation for indemnifying the insured in respect of an event which occurs due to the increased risk to the subject matter of the insurance.

<sup>1048</sup> For case examples of English law, see: *Overseas Commodities Ltd v Style* [1958] 1 Lloyd's Rep. 546; *Liberian Insurance Agency Inc. v Mosse* [1977] 2 Lloyd's Rep. 560; and *K/S Merc-Scandia XXXXII v Lloyd's Underwriters (The Mercandian Continent)* [2000] 2 Lloyd's Rep. 357, QB; [2001] 2 Lloyd's Rep. 563, CA. Also see § 5.2.2.1 above.

Judging from the trading custom and clause examples widely adopted in China's insurance market, it can primarily be concluded that, only with the absence of a timely notice given to the insurer and agreed amended terms of cover with an additional premium when required, the automatic termination would be invoked. In English law, the held covered clause is not referred to in statutory legislation either. Also, because of the characteristics of a common law system and uncertainties of the judicial basis of the held covered clause, the remedies available for the assured's breach of utmost good faith in such cases are controversial.<sup>1049</sup> The recent affirmative tendency is treating the alteration alluded to the held covered clause as a brand new contract. The breach of utmost good faith at the present, therefore, would cause the alluded amendments to be rescinded prospectively, but not the previous contract or payment. This is a result achieved after a long debate based on relevant cases. As distinct from the historic development of utmost good faith for the held covered clause in English law, the provisions of the PICC clauses simplify this issue by awarding an automatic termination of this cover for the assured's failure to perform good faith.

#### **6.2.2.4. Duty of loss notification**

At English common law, the assured is obliged to notify to the insurer, either claims or circumstances which would give rise to a potential loss according to the insurance provisions. In case of an absence of an express loss notification clause, business efficacy is referred to by the Courts once the insurance parties have such disputes.<sup>1050</sup>

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<sup>1049</sup> See § 5.2.2 above.

<sup>1050</sup> See § 5.2.2.5.2 above for English law.

In Chinese law, there is an implied obligation imposed on the assured to notify the insurer immediately and to avoid or minimize the loss once the peril insured against occurs; otherwise, the insurer shall not be responsible for the extended loss caused by the assured's breach of this obligation.<sup>1051</sup> Subsequently, article 21 of the CIL 2009 introduces circumstances of breach of good faith. According to this article, in cases where the assured deliberately or recklessly fails to perform the loss notification obligation, and causes uncertainty to the assessment of the nature of, the cause for and the extent of the loss, the insurer shall not be liable for indemnities or insurance benefits for the undetermined portion. However, the above rule does not apply when the insurer has been, or should have been, notified with the occurrence of insured accident timely through some other manner.

As the above contents in Chinese law suggest, firstly, there is a duty of good faith after the making of insurance, requiring the assured to notify the insurer with the occurrence of insured accidents immediately; otherwise, the insurer is not responsible for the indemnity to the beneficiary or assured. Secondly, especially on the basis of the CIL 2009, the assured's breach of this duty is mainly reflected by the assured's deliberateness or recklessness. The assured, thus, cannot have the loss covered by the insurance company if the loss is caused by the assured's deliberateness or recklessness in his breach of loss notification duty.

Furthermore, from the assured's side, the assured is obliged to fulfil this obligation of loss notification. However, on the other hand, the reality that the insurer has the acknowledgement of the occurrence of the insured accident can break the chain of causation and the insurer shall bear the indemnifying duty. Therefore, as long as the insurer is informed by the assured directly or by a third party of the occurrence of the

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<sup>1051</sup> Article 236, CMC.



insured accident, or the insurer should have known this accident through any other manners, such as newspapers, the assured's duty of loss notification is discharged, and the insurer should bear and complete the compensation for the loss caused.

The last concern raised concerning the assured's duty of good faith in notifying loss is the consequence of the assured's failure of performing this obligation. Apparently, this point is tightly linked with the remedies available for the assured's good faith breach, and it is discussed below.

#### **6.2.2.5. Other issues – duty of documents submission and mitigation**

Apart from the main pillars of the assured's post-contractual good faith in Chinese law, some other circumstances are worth being discussed.

Firstly, the assured is imposed with a duty of documents submission after the occurrence of a peril insured against as required. On the basis of article 251 of CMC, after the incurrence of a peril insured against, and before the payment of indemnity, the insurer may demand that the insured submit evidence and material related to the ascertainment of the nature of the peril and the extent of the loss as requested. However, this duty is not mandatory but proposed by the insurer, and according to Chinese law, there is no principal provision regarding the effect of a breach. In the view of this author, this article resolves most potential difficulties underlying insurance regarding the assured's duty of documents submission, especially connected with the cooperation under claims investigations. Foremost, this article turns the assured's duty to be implied by law in the absence of an express clause of insurance contracts. Against the backdrop of article 251, CMC, any rejection of fulfilling the duty of presenting relevant documentations and evidence as requested

by the insurer would constitute a breach of law. And logically, this duty becomes one necessary aspect of the assured's post-contractual good faith in Chinese law.

The second aspect, which can be linked with the assured's post-contract good faith, is the duty of mitigation after the occurrence of risks insured against. This duty is provided by article 236 of CMC and article 57, CIL 2009, stating that upon the occurrence of the peril insured against, the assured shall notify the insurer immediately and shall take necessary and reasonable measures to avoid or mitigate the loss. Under this article, further requirements are provided, by requiring the assured to act according to the insurer's special instructions as long as they are served.<sup>1052</sup>

Therefore, in summary, the assured's duty of mitigation after the occurrence of the insured event is implied as another aspect of good faith in Chinese law.<sup>1053</sup> In order to maintain the assured's loyalty and encourage its performance, the current Chinese law intends to allocate necessary and reasonable expenses caused by the assured's performance of mitigation duty and some other duties to the insurer, which can be described as a fair and viable solution.

### **6.3. Fraudulent claims**

Similarly to section 55 of the MIA 1906, the draftsman of Chinese insurance law provides a separate article specifically for fraud.

CMC makes it clear that fraud is an unforgivable element for insurance. According to article 242, CMC, the insurer shall not bear the indemnification for the loss if the loss is caused by the assured's intention. This is a straightforward and concise

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<sup>1052</sup> Paragraph 1, article 236, CMC.

<sup>1053</sup> At English common law, this aspect is governed by section 78 of the MIA 1906, under the heading of suing and labouring clause.

provision which has clarified the legislators' zero tolerance of fraud in marine insurance. As a matter of fact, further details are extended by article 27, CIL 2009 for general insurance except for life insurance. As the CIL 2009 provides, the assured or beneficiary's fabrication of loss, intentional act, use of fraudulent devices to advance claims and exaggerations of genuine loss are four main aspects of fraud at the claiming stage.

Until now, it is revealed that the discussed codes, CMC and CIL 2009, are silent on the definition of intention. However, some academics realized that a particular guidance was found within the Criminal Law of the PRC.<sup>1054</sup> In accordance with article 14 of Criminal Law of the PRC, 'an intentional crime refers to an act committed by a person who clearly knows that his act will entail harmful consequences to society but who wishes or allows such consequences to occur, thus constituting a crime'. However, some scholars intended to interpret 'intention' as 'a typically culpable state of mind' and deem 'intentional breach of good faith' in Chinese insurance law as a claim committed by 'a proposer [if he] actually knows that what he disclosed is untrue or if he does not care whether or not it is true'.<sup>1055</sup> After a comparison between the definition of 'intention' in Chinese criminal law and English case law,<sup>1056</sup> Chinese academics prefer to extend such guidance to insurance law and this needs confirmation by legal clarification.

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<sup>1054</sup> Zhenqi Wei, *Civil Law* (Beijing: Beijing University Press, 2000) (Chinese version), p. 692; Liming Wang and Lixin Yang, *Tort Law* (Beijing: Law Press, 1996) (Chinese version), p. 71, cited by Hwee Ying Yeo, Yu Zheng and Jianlin Chen, 'Of remedies and non-disclosure in the insurance law of the People's Republic of China', (2011) 6 *JBL*, pp. 556-577.

<sup>1055</sup> Yeo, Zheng and Chen, 'Of remedies and non-disclosure in the insurance law of the People's Republic of China', in *JBL*, pp. 556-577, notes 59 and 60.

<sup>1056</sup> In English case law, the draftsman prefers using 'recklessness or deliberateness' instead of using 'intention'. The Consumer Insurance (Disclosure and Representations) Act 2012 provides a comprehensive definition of a deliberate or reckless act. According to section 5(2), Consumer Insurance (Disclosure and Representations) Act 2012:

'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

As paragraph 1, article 27, CIL 2009 states, at the claiming stage, fraud in claims is created in cases where the assured makes a false claim or fabricates a claim which has not occurred.<sup>1057</sup> Paragraph 2 provides that fraudulent claims could be committed in cases where losses are caused by the applicant or beneficiary's deliberateness.<sup>1058</sup> Paragraph 3 provides that if the assured or beneficiary uses fraudulent manners to advance claims, fraud is established at the claiming stage. Here, the circumstances under which a fraudulent device is used include the use of forged and altered documentations or relevant evidence.<sup>1059</sup> Furthermore, also in paragraph 3, it is provided that exaggerating the genuine claim and falsifying the cause of the occurrence of the insured event is also treated as a fraudulent claim.<sup>1060</sup> Apparently, these aspects are the same as those defined by English case law.<sup>1061</sup> In a civil law country, codes could simplify problems by certain language, but also could complicate problems because of the lack of flexibility. Therefore, according to the current Chinese legislation in insurance, practical examples are codified under article 27, CIL 2009. In the meantime, article 27 differentiates legal effects for fraudulent claims, which is addressed below.

#### **6.4. Insurer's duty of claim handling and payment**

In English law, the insurer's duty of reasonable claim handling and timely payment for compensation is derived from practice. In Chinese law, provisions prefer simplicity

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(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.'

<sup>1057</sup> Paragraph 1, article 27, CIL 2009.

<sup>1058</sup> Paragraph 2, article 27, CIL 2009.

<sup>1059</sup> Paragraph 3, article 27, CIL 2009.

<sup>1060</sup> *Ibid.*

<sup>1061</sup> See § 5.3 above.

and have this point clarified straightforward in legislations as one aspect of the insurer's post-contract good faith.

In chapter 12, CMC, section 4 is created to regulate the liability of the insurer. Among these provisions, selected articles are worthwhile to be addressed. Generally, article 237 of CMC provides that after the loss caused by the occurrence of the event insured against, the insurer is obliged to promptly indemnify the assured. In the meanwhile, exceptional circumstances are exemplified by article 242, exempting the loss caused by the assured's deliberateness from the general scope of the insurer's obligation of prompt indemnification. According to article 243, unless otherwise provided in the insurance contract, the insurer is not liable for the indemnification for the loss or damage caused to the cargo by such circumstances as, a delay in the voyage or delivery of cargo, market fluctuation, natural loss, inherent defects or nature of the cargo, or improper packing. In terms of the hull insurance and freight insurance, the insurer is discharged from the duty of indemnification for the loss and damage caused to the vessel by the following causes, such as, unseaworthiness of the ship at the commencement of the voyage, (except where under a time policy the assured has no knowledge thereof) and where the loss is caused by natural wear or corrosion of the ship.<sup>1062</sup> Therefore, but for the above exceptions, the insurer is generally obliged to handle valid claims and make prompt indemnification in good faith.

Articles in CIL 2009 provide detailed contents of the insurer's duty of reasonable claims handling and timely payment of compensation. Firstly, paragraph 1, article 23 of CIL 2009 provides that after the receipt of a claim for indemnity, or for payment of the insurance benefits from the assured or the beneficiary, the insurer shall ascertain

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<sup>1062</sup> In article 218, CMC, it is specified that the Chinese Maritime Codes apply to both hull and cargo insurance.

and determine whether to make the indemnity or effect the payment of the insurance benefits in a timely manner; unless otherwise provided in the insurance contract, a decision shall be reached within 30 days in respect of complicated cases. This paragraph further requires that the final decision of whether to make the indemnity or effect the payment of the insurance shall be notified to the assured or beneficiary. With respect to the valid claims, the insurer shall fulfil his obligations for such indemnity or payment within 10 days after an agreement is reached with the assured or the beneficiary on the amount of indemnity or payment. Additionally, according to this paragraph, the insurer is required to fulfil his obligation within the time limits given by the insurance contract. Paragraph 2, article 23 of CIL 2009, provides that in cases where the insurer fails to fulfil the obligations specified in the preceding paragraph in time, the insurer shall compensate the assured or the beneficiary for any damage incurred as a remedy in addition to the payment of compensation, which is considered as the remedy available for the insurer's breach of good faith in such cases. Furthermore, based on paragraph 3 of this article, the insurer's obligation for indemnity or payment of the insurance benefits is defined as a legal obligation, and it is illegal for any entity or individual to interfere with the insurer's such obligation, or hinder the assured's right to receive the payment.

Secondly, article 24 stipulates that in cases where invalid claims are made by the assured or beneficiary, the insurer shall issue the notice of rejection with main reasons within three days after the decision reached. Article 25 in the same law further notes that in cases where the amount of indemnity or payment of the insurance benefits cannot be determined within 60 days of the receipt of the claim, and relevant evidence and information thereof, then the insurer shall effect payment of the minimum amount which can be determined by the evidence and information

obtained. Thus, the insurer shall pay the balance after the final amount of indemnity or payment of the insurance benefits is determined.

Finally, the time limits given for the assured's right to claim compensation or payment for insurance benefits is two years.<sup>1063</sup> Therefore, except for life insurance, the assured is entitled within two years to present valid claims from the date when the assured or beneficiary is aware of the occurrence of the insured event.<sup>1064</sup>

## **6.5. Remedies available for post-contract breach of good faith**

### **6.5.1. Amendments and renewals of insurance contracts**

Except for the general requirement of good faith underlying articles 222 and 223, CMC is silent on the assured's good faith for variations and renewals of insurance. However, the general legislation in insurance has this point regulated.

As article 20, CIL 2009 stipulates, an insurance contract could be amended upon the agreement between the assured and insurer. Compared with English law, the draftsman of Chinese insurance law defines a more detailed formality requirement of amendments and renewals of insurance contracts. Article 20 of CIL 2009, further provides that where an insurance contract is amended, the insurer shall endorse or attach an endorsement to the original policy or other insurance documents, or the amendments shall be based on a written agreement between the insurance parties. In addition to CIL 2009, Chinese Contract Law and the General Principles of Civil Law also detail the formality requirements to the variation agreement between contractual parties and the effect of a bilateral amendment or an ambiguous

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<sup>1063</sup> Article 26, CIL 2009.

<sup>1064</sup> Also according to this article, the assured or beneficiary of life insurance is awarded with a period of five years for presenting valid claims.

amendment clause.<sup>1065</sup> It is found that on the basis of articles in CIL 2009, Contract law and General Principles of Civil law, any amendment of insurance contracts must be agreed in writing, otherwise it would be rejected and presumed as not having been altered. In cases where the amendment agreement is ambiguous, the insurance contract shall be presumed as not having been amended.

Nevertheless, the current Chinese law does not deal with the area regarding the assured's remedies for breach of good faith for contract variations and renewals. However, judging from the experience from English law, the leading trend is dividing contract variations and renewals underlying pre-contract events.<sup>1066</sup> In the view of this author, this manner can be introduced to the current Chinese law, to resolve the legislative defects and logically, articles concerning general pre-contract events could be applied. In the meanwhile, any breach of good faith under contract variations and renewals would cause the amendments and new contracts to be avoided, prospectively. As stated in chapter 4 concerning the pre-contract duty of good faith in Chinese law, there are two types of pre-contract breaches of good faith (the intentional and unintentional misconduct) and, therefore, two correspondent remedies are available.<sup>1067</sup> Linked with the above concerns, two types of remedies can be confirmed. In cases where the assured intentionally non-discloses material information at the contemplation of negotiation about insurance contract variations

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<sup>1065</sup> Article 77, Chinese Contract law. Articles 56-59 of the General Principles of Civil Law. CMC and CIL 2009 are silent on the legal effects of amendments to an insurance contract which are not evidenced in a writing form, but orally or by some other types of forms. However, this concern is addressed by the Contract law and General Principles of Civil law indirectly. According to the Chinese Contract law, in cases where the laws or administrative regulations provide, approval and registration procedures to such modification shall be gone through in accordance with such provisions. Additionally, any ambiguous and uncertainties caused by a modification of contract shall be presumed as not having effect. Article 56 of the General Principles of Civil Law also provides that civil acts (including contract) may be committed in a written form, oral form or other forms; in cases where law provides special requirements, civil activities shall be committed according to the provisions. In terms of the bilateral amendments and ambiguous amendment clauses, articles 57-59 of the General Principles of Civil Law address details.

<sup>1066</sup> For example, see chapter 3 above for details regarding the application of the Consumer Insurance (Disclosure and Representations) Act 2012.

<sup>1067</sup> Article 223, CMC.



and renewals, the insurer has the right to terminate the amended part or renewals without refunding the premium. In cases where the material information is non-fraudulently concealed, the insurer is entitled with the right to terminate the contract or raise the premium for amended part or renewals, unless the non-disclosed information at the contemplation of amending and renewing insurance is material.

After a comparison, it is found that based on the statutory remedies available for the assured's pre-contract breach of good faith, the remedies for the assured's breach of good faith for variations and renewals of an insurance contract are relatively prospective with regard to the whole insurance, but not as harsh as being retrospective.

#### **6.5.2. Alteration of risks during the currency of insurance**

Different from the general doctrine of alteration of risks at English case law, the assured's obligation to notify the insurer with significant changes of risks is treated as one aspect of the assured's good faith during the currency of insurance.<sup>1068</sup>

As suggested by article 52, CIL 2009, any significant increased alterations of risks should be disclosed to the insurer on the basis of an express clause in the contract. Upon the receipt of the assured's notice, the insurer is entitled to raise the premium or terminate the insurance contract. Paragraph 2 of this article further provides that in cases where the assured fails to perform the preceding duty, the assured shall not bear the losses caused by the concealed information. Therefore, it can be found that under the current Chinese law, the remedies available for the assured's breach of such obligation is prospective again, which means that the insurer would be

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<sup>1068</sup> See § 5.2.2 above.

discharged from the indemnification for losses caused by the non-disclosed alteration of risk, but not with the avoidance *ab initio*.

### **6.5.3. Held covered clause**

An automatic termination of insurance contract is provided by practical clauses for the assured's good faith breach in relation to the held covered clause.

As stated earlier, clause 4 of the Ocean Marine Cargo Clauses 2009 and clause 6 of the Hull Clauses of the PICC 2009 provide the basics. In clause 4 of the Ocean Marine Cargo Clauses 2009, in cases where there is a change of voyage, or any omission or error in the description of the interest, the insurance shall be continued upon a prompt notice and extra premium as required. As a result, a good faith breach after the making of an insurance contract would cause the contract to be terminated. On the basis of clause 6(3) of the Hull Clauses of the PICC 2009, in case of a timely notice of a noncompliance with the insurance provisions concerning the assured cargo, voyage, navigation area, towing, salvage or the sailing date, the insurance is continued on the basis of an amendment agreement with extra requirements where relevant. Subsequently, without a prompt notice provided, the cover would be terminated automatically.

Judging from the abovementioned insurance clauses provided by one of the biggest insurance companies in China, the PICC, it can be concluded that there is fine distinction between the remedies available for the assured's good faith breach under a held covered clause in Chinese law and English case law, which is addressed in the conclusive chapter.<sup>1069</sup>

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<sup>1069</sup> See § (2).A.i of the general conclusion of this thesis.

#### 6.5.4. Duty of loss notification

Article 236 of CMC and article 21 of CIL 2009 provide that, after the occurrence of insured risks, the assured is imposed with a duty of loss notification. Under this obligation, the assured is required to give a timely notice to the insurer with good faith. In fact, on the basis of CMC, the two components of this loss notification duty are, the duty of prompt notification of loss and the duty of mitigation.

Firstly, if the assured fails to fulfil the duty of loss notification because of his deliberateness/intention and gross negligence, and such failure also creates uncertainties to risk assessments, the insurer would be discharged from the indemnification for the consequential loss caused.<sup>1070</sup> Obviously, the remedy available for the assured's deliberateness and gross negligence is a prospective forfeiture of claim further caused, but not the whole contract. Similarly, 'gross negligence' is not defined in either CMC, CIL 2009, or a general civil law branch (Contract Law or the General Principles of Civil Law). An explanation of 'negligence' in Chinese law can be found from the Criminal Law of the PRC, which stipulates that a negligent act is 'committed by a person who should have foreseen that this act would possibly entail harmful consequences to society but who fails to do so through his negligence or, having foreseen the consequences, readily believes that they can be avoided, so that the consequences do occur'.<sup>1071</sup> Compared with the definition of 'negligence' at English common law,<sup>1072</sup> the extension of criminal negligence to civil law is likely to be confirmed in Chinese law by further clarifications.

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<sup>1070</sup> Article 21, CIL 2009.

<sup>1071</sup> Article 15, Criminal Law of the PRC.

<sup>1072</sup> For example, section 5, Consumer Insurance (Disclosure and Representations) Act 2012.

Secondly, the assured is imposed with the duty of mitigation.<sup>1073</sup> Also in article 236, CMC, after the occurrence of perils insured against, apart from the duty of notification, the assured is required to adopt reasonable manners to avoid or mitigate loss. Once the insurer provides special notification regarding reasonable approaches, the assured is required to act according to the insurer's instructions. Paragraph 2 of article 236 subsequently specifies that in cases where the assured fails to perform the above duties, the insurer is entitled with a prospective right to reject consequential losses caused. To be more specific, if the assured does not adopt necessary approaches to mitigate/avoid further loss, or does not adopt appropriate manners according to the insurer's instructions, the insurer is not liable for any consequential loss caused.

### **6.5.5. Other issues**

#### **6.5.5.1. Assured's duty of documents submission**

The marine assured's duty of documents submission after the occurrence of perils assured against and before the insurer's commitment of payment for indemnification, requires the assured to provide documentations and materials relating to the

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<sup>1073</sup> The assured and his agents' duty of averting or minimizing a loss is also available from section 78 of the MIA 1906 in English law, although it is not covered by the principal doctrine of utmost good faith. According to section 78 in terms of the suing and labouring clause:

'(1) Where the policy contains a suing and labouring clause, the engagement thereby entered into is deemed to be supplementary to the contract of insurance, and the assured may recover from the insurer any expenses properly incurred pursuant to the clause, notwithstanding that the insurer may have paid for a total loss, or that the subject-matter may have been warranted free from particular average, either wholly or under a certain percentage.

(2) General average losses and contributions and salvage charges, as defined by this Act, are not recoverable under the suing and labouring clause.

(3) Expenses incurred for the purpose of averting or diminishing any loss not covered by the policy are not recoverable under the suing and labouring clause.

(4) It is the duty of the assured and his agents, in all cases, to take such measures as may be reasonable for the purpose of averting or minimising a loss.'

assessment of the nature of perils and the extent of loss where requested.<sup>1074</sup> Article 22, CIL 2009, provides a similar requirement, noting that after the occurrence of insured risks, the applicant, assured, or beneficiary shall bear the duty of cooperation and submit relevant documentations and materials regarding the assessment of loss.

After a close observation, it is found that both CMC and CIL 2009 are silent on the legal consequence of the assured's failure of performing the duty of documents submission and presenting important materials regarding risk and loss assessments. However, judging from selected articles in CIL 2009, some clues can be found. Firstly, based on the provisions of the insurance contract, in cases where materials and information provided are inadequate, the insurer shall notify the assured or the beneficiary with a request to provide the insurer with additional evidence or information.<sup>1075</sup>

According to Chinese insurance law, articles 23-25, after the receipt of relevant evidence and information, the insurer is obliged to complete the claim investigation and commit payment for compensation within 60 days. In cases where the indemnification and insured benefits are hard to be determined, the insurance company shall effect the minimum payment which can be confirmed on the basis of relevant information obtained, and pay the balance when it can be confirmed. Apart from the articles requiring the assured to provide relevant information, article 27 in the same law also awards a prospective forfeiture claim remedy to the insurer once the assured commits fraudulent claims. Therefore, a further remedy available for the insurer, in cases where the assured fails to provide sufficient material regarding the assessment of the nature of perils, the cause of accident, and the extent of loss, shall

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<sup>1074</sup> Article 251, CMC.

<sup>1075</sup> Paragraph 2, article 22, CIL 2009.

be a prospective forfeiture of the claim. With an absence of adequate material provided, the insurer can decline the uncertain part, even though it is confirmed that the assured commits a fraud when submitting relevant evidence and information. Thus, the insurer is discharged from his liability of indemnification for the tainted part. It should be noticed that both of the above manners are prospective, and the genuine components of the insurer's compensation liability shall not be effected.<sup>1076</sup>

#### **6.5.5.2. Assured's duty of mitigation<sup>1077</sup>**

The assured's duty of mitigating and avoiding loss in good faith is imposed by article 236, CMC and article 57, CIL 2009. As the current Chinese legislation states, in cases where the assured fails to adopt measures to mitigate/avoid or act according to the special instructions delivered by the insurer's side, any extended loss caused would not be recovered from the insurer.<sup>1078</sup> Therefore, it can be concluded that the remedy available for the assured's good faith breach in mitigating losses is prospective and the innocent component is not contaminated.

In terms of any consequential expenses caused, article 240 of the CMC stipulates that the insurer shall bear necessary and reasonable expenses incurred by the assured for avoiding and mitigating the loss. As the legislators exemplify in this article, such expenses include those necessarily and reasonably caused by the assured's measures for avoiding and mitigating the loss, and those incurred for acting on the special instructions of the insurer, as provided in previous article 236 in the same law. In the meanwhile, the amount of such expenses is suggested to be

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<sup>1076</sup> See § 6.5.6 below.

<sup>1077</sup> As stated earlier, a similar duty is available from the MIA 1906, under the heading of suing and labouring clause, instead of under the classic utmost good faith topic. It is found that the contents of the assured's duty to mitigation are similar in Chinese law and English law; both legislations require the assured and his agent to avert or minimize losses caused by the risks insured against, and any consequential expenses incurred to such measures are recoverable, which is addressed below.

<sup>1078</sup> Paragraph 2, article 236, CMC.

separated from the indemnification to be paid with regard to the subject matter insured, and all the expenses referred to in article 240 shall be limited to the equivalent of the insured amount.<sup>1079</sup> Similarly, the CIL 2009 provides another clear requirement. In accordance with article 57 of the CIL 2009, any expenses necessarily and reasonably caused by the assured's efforts made, to prevent or mitigate further loss or damage of the subject matter of the insurance after the occurrence of the insured event are borne by the insurer. Additionally, the amount of expenses shall be calculated separately from the indemnity for the loss of the subject matter of the insurance and it shall not exceed the sum insured.

#### **6.5.6. Remedies available for fraudulent claims**

Article 242, CMC and article 27, CIL 2009 both intend to ban the assured to propose fraudulent claims by awarding the right of severe sanction to the injured insurer. Several examples of fraudulent claim are found to be exemplified, with correspondent remedies provided, by the current Chinese insurance legislation.

Firstly, as CMC and CIL 2009 provide,<sup>1080</sup> one remarkable example of the assured's fraud at the claiming stage is the assured's deliberateness. It is further clarified that any claims caused by the assured's intention is not recoverable from the insurer.<sup>1081</sup> Apparently, once the assured causes loss to the insured subject

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<sup>1079</sup> In addition to the reasonable expenses caused by the assured's performance of the duty of mitigation, paragraph 1, article 240 of CMC also states the reasonable expenses for survey and assessment of the value, for the purpose of ascertaining the nature and extent of the peril insured against, shall also be borne by the insurer and separately calculated.

<sup>1080</sup> Article 242, CMC and paragraph 2, article 27 of CIL 2009.

<sup>1081</sup> A similar statement is found in English law as well. In English law, specifically the MIA 1906, section 55 is legislated to define losses included and excluded by general marine insurance contracts. As section 55(2) stipulates, 'the insurer is not liable for any loss attributable to the wilful misconduct of the assured, but, unless the policy otherwise provides, he is liable for any loss proximately caused by a peril insured against, even though the loss would not have happened but for the misconduct or negligence of the master or crew'.

intentionally,<sup>1082</sup> but he still submits such claims hoping to have indemnification paid by the insurer, the assured's claim is not valid but forged by himself. The consequence is a prospective forfeiture remedy, discharging the insurer from his indemnification liability regarding the contaminated part. In addition to the forfeiture remedy, the assured would be deprived of the return of premium. It is noticeable that the seizure of the assured's payment of premium does not apply to life insurance, since the latter is really unique in practice.<sup>1083</sup> The second example of the assured's fraud at the claiming stage is fabrication.<sup>1084</sup> In cases where the assured or beneficiary fabricates an accident under the insurance policy, which has not really been incurred, the assured is judged to be committing a fraudulent claim. Consequentially, the insurer is entitled to repudiate the insurance contract without returning payment of premium from the assured. Another factor exemplified by CIL 2009 is the assured's use of fraudulent manners in order to advance claims. As paragraph 3, article 27 stipulates, in cases where the assured adopts fraudulent devices, such as falsified evidence, material, or some other information, to improve genuine claims, the remedy available for the insurer is also the forfeiture of claims which are tainted. Also under this paragraph, the fourth type of fraud is defined as an exaggeration of genuine claims. According to the second sentence of this paragraph, the insurer is discharged from his indemnification liability or insured benefit payment for the exaggerated component. This can be said to be a prospective remedy as well.

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<sup>1082</sup> For instance, the assured sets a fire to insured cargo or vessel intentionally.

<sup>1083</sup> Article 43, CIL 2009. In this article, it is stipulated that:

'In the event that the applicant or the beneficiary has intentionally caused the death, disability or illness of the insured, the insurer shall bear no obligation for payment of the insurance benefits. In the event that the applicant has paid premiums for two years or more, the insurer shall, in accordance with the contract, return the cash value of the policy to other beneficiaries, if any.

If the beneficiary has intentionally caused the death or disability of the insured, or attempted to cause the death of the insured or the beneficiary shall lose his/her right to claim the insurance benefits.'

<sup>1084</sup> Paragraph 1, article 27, CIL 2009.



Finally, paragraph 4, article 27, CIL 2009 concludes that the abovementioned examples of fraud could give rise to the remedy of any influential payment from the defaulting assured.

#### **6.5.7. Remedies for the insurer's failure of handling claims in good faith**

The remedy available for the insurer's failure of handling claims in good faith is clarified by article 23(2), CIL 2009, which provides that once the insurer fails to perform his obligation to handle claims and commit payment for compensation within a reasonable time, the insurer is liable for any losses caused by such failure.

Of course, this legal resort is going to be invoked with an absence of a clarified clause under the insurance policy and becomes a default manner which is implied by law. It is allowed, technically, to cover and specify such issue under an insurance policy in advance, by regulating the insurer's reasonable claims handling obligation and contractual damages attached. However, the assured and insurer are in unequal positions, and the assured, in the majority of cases, has no option but to accept the standard form insurance contract provided by the insurance company, with this issue contained,<sup>1085</sup> also in some cases, without. In that case, the default rule implied by CIL 2009 becomes the last resort awarded to the assured to ensure his benefits. In terms of the legal nature of the above circumstances, the conclusion is quite apparent since the former is implied by law and the latter is contractual damages.

#### **6.6. Conclusion**

After a closer observation, it can be concluded that, firstly, identical to the circumstance of the pre-contractual duty of good faith in Chinese law, the basic

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<sup>1085</sup> For example, clause 8, Hull Insurance Clauses 2009.

principles of marine insurance is well established in English law, although the wordings are slightly different.<sup>1086</sup>

Secondly, compared with the restrictive ‘all to gain’ and ‘nothing to lose’ remedy for any breach of utmost good faith in English law, possible remedies in Chinese law are more flexible and reasonable. As examined previously, in Chinese law, the termination of insurance contract (such as those for intentional non-disclosure of material circumstances), prospective forfeiture of claim (including those for unintentional breach of good faith), and contractual damages (for instance, those clarified by insurance clauses) are provided. Besides, in the absence of any specialized provisions in CMC and CIL 2009, general clauses in Contract Law and General Principles of Civil Law of the PRC are legally recognized to be invoked in an order of priority.<sup>1087</sup>

Thirdly, different from the limited resource regarding utmost good faith provided by section 17, MIA 1906, more case examples of good faith are concisely specified by CMC and CIL 2009, but not in much depth. For instance, the assured’s duty of good faith in cases of the amendments and renewals of insurance,<sup>1088</sup> the duty of notifying significant increased risks,<sup>1089</sup> the duty of loss notification and mitigation,<sup>1090</sup> the duty of documents submission,<sup>1091</sup> the duty to promote honest claims,<sup>1092</sup> the insurer’s duty of handling claims in good faith and paying indemnification timely.<sup>1093</sup> Although it could be argued that all the regarded details are based on the scholars’ wishful thinking which is derived from one fragment of the principal articles, such as article 5

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<sup>1086</sup> L. Li, ‘The Maritime code of the People’s Republic of China’, (1993) *LMCLQ*, p. 215. For statutory examples, articles 222 and 223, CMC and sections 17-20, MIA 1906.

<sup>1087</sup> See chapter 4 above.

<sup>1088</sup> Article 20, CIL 2009.

<sup>1089</sup> Article 52, CIL 2009.

<sup>1090</sup> Article 236, CMC; articles 21 and 57, CIL 2009. Also see section 58, MIA 1906 for English law.

<sup>1091</sup> Article 22, CIL 2009.

<sup>1092</sup> Article 242, CMC; article 27, CIL 2009.

<sup>1093</sup> Articles 237-240, 243, 244, CMC; article 23, CIL 2009.

of CIL 2009, article 6 of Chinese Contract Law and article 4 of the General Principles of Civil Law, the proposed challenge indicates that a statutory reform is expected to be carried out with detailed circumstances expressly specified.

Fourthly, in the light of the fact that the assured is occasionally abused by the insurer in practice, for example, by avoiding the clauses regarding the insurer's obligation to handle claims and commit payment in good faith, a default insurance policy is strongly recommended.

## CHAPTER 7

### THE ASSURED'S BROKER IN ENGLISH LAW: UTMOST GOOD FAITH AND OTHER ISSUES

#### 7.1. Introduction

The intermediary's fraud or negligence in the transmission of pre-contract information to the insurer leads to a significant percentage (13%) of insurance allegations pursued with the FOS.<sup>1094</sup> Judging from the last 100-year-experience, however, no more than 20 reported cases invoked the insurance agent's duty of utmost good faith underlying section 19, MIA 1906.<sup>1095</sup> As a matter of fact, in addition to the MIA 1906, the insurance intermediaries' act is also governed by the general common law and other practical codes. Within the UK, selected legislations regarding the intermediaries include the Insurance Brokers (Registration) Act 1977 (which was repealed by the FiSMA 2000), FiSMA 2000,<sup>1096</sup> and the Financial Services Act 2012.<sup>1097</sup> In the FiSMA 2000, the FSA was confirmed to be the regulator for insurance, investment business and banking; however, this act was further amended by the Financial Services Act 2012, which stipulates that FCA is the

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<sup>1094</sup> The Law Commission, *Reforming Insurance Contract Law – Policy Statement: The Status of Intermediaries (For whom does an intermediary act in transmitting pre-contract information from consumer to insurer?)*, (March 2009), available at <http://lawcommission.justice.gov.uk/>, accessed in January 2013, p. 2. In this statement, up to 2007, 25 out of 190 allegations decided by the Ombudsman were revealed to be about the intermediary's action when effecting the insurance policies.

<sup>1095</sup> The Law Commission and the Scottish Law Commission, *A Joint Consultation Paper, Insurance Contract Law: The Business Insured's Duty of Disclosure and the Law of Warranties (CP 3)*, p. 89.

<sup>1096</sup> Available at <http://www.legislation.gov.uk/ukpga/2000/8/contents>, accessed in January 2013.

<sup>1097</sup> Available at <http://www.legislation.gov.uk/ukpga/2012/21/contents/enacted>, accessed in August 2013.

insurance regulator.<sup>1098</sup> Recently, the publication of the FCA Handbook, ICOBS,<sup>1099</sup> strengthens the FCA's overwhelming 'regulator' position in general insurance within the UK. In addition to the FCA and PRA, the FOS also regulates insurance companies. Another institution, the ABI, also contributes to the supervision and regulation of insurance in the UK with the help of its General Insurance Codes & Guidance Notes.<sup>1100</sup> At the European Union level, the Insurance Mediation Directive enacted by the European Parliament and the Council of European Union provides another example of intermediary legislation.<sup>1101</sup> Such phenomenon illustrates that the current law concerning the intermediary's duty is confusing and there are unconquered obstacles in applying statutory codes to a complex commercial practice.

In order to determine the main differences between the current law in the UK and its application in practice, and to restructure a more efficient legal mechanism to govern the insurance agent's duty of utmost good faith in the UK, this part is extended to several sections below. These include, the intermediary's position in three-party-situations (for instance, whether on the behalf of the insurer or assured), and, the insurance broker's duties in section 19 of the MIA 1906 and its statutory application in practice (for example, the information and agents included).<sup>1102</sup> In order to echo with the reforming act launched by the Law Commission, selected controversial issues are discussed in the second half of this chapter.

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<sup>1098</sup> Available at <http://www.legislation.gov.uk/ukpga/2012/21/contents/enacted>, accessed in August 2013. However, FCA and PRA are obliged to follow the duty of good corporate governance (section 3c, Chapter 3, Part 1A, Part 2 of the Financial Services Act 2012), functioning as appropriate regulators.

<sup>1099</sup> Available at <http://fshandbook.info/FS/html/FCA/ICOBS>, accessed in August 2013.

<sup>1100</sup> Available at [http://www.abi.org.uk/Information/Codes\\_and\\_Guidance\\_Notes/General\\_Insurance\\_Codes\\_and\\_Guidance\\_Notes.aspx](http://www.abi.org.uk/Information/Codes_and_Guidance_Notes/General_Insurance_Codes_and_Guidance_Notes.aspx), accessed in January 2013.

<sup>1101</sup> The European Parliament and the Council of European Union, *Directive 2002/92/EC of the European Parliament and of the Council of 9 December 2002 on insurance mediation*, (15/01/2003 P. 0003 – 0010, Official Journal L 009), available at <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:32002L0092:EN:HTML>, accessed in January 2013.

<sup>1102</sup> Please notice that in the recently enacted Consumer Insurance (Dispute and Representations) Act 2012, the consumer assured's duty of disclosure is abolished.

## 7.2. For whom is the broker acting: the insurer or assured?

An insurance agent may be employed either by the insurer to effect an insurance, or the assured to subscribe to the insurance policy.<sup>1103</sup> For whom the intermediary is acting at the time of effecting insurance, therefore, is crucial for deciding which party shall bear the liability for the broker's negligence or fraud when it is revealed.<sup>1104</sup>

If the broker is acting for the insurer to sell insurance policies, and the insurance is spoiled because of the broker's fault in exercising utmost good faith at the contemplation of a contract, then in accordance with the general agency rules specifying that an intermediary's actions and state of mind are imputed to the principal, the insurer is assumed to know any relevant information which has been known by the intermediary,<sup>1105</sup> and the insurer would be responsible for their poor advice.<sup>1106</sup> Logically, if the broker is acting for the assured when placing the

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<sup>1103</sup> 'Agent' occasionally emerges together with another two confusing terms – broker and intermediary, and sometimes, 'consultant', 'adviser', 'service' emerges as popular descriptions as well. For a detailed discussion, see Right Honourable Lord Mance, et al., *Insurance Disputes* (3<sup>rd</sup> ed., London: Informa, 2011), chapter 8.

In the Glossary of Terms and Main Texts list of the Consultation Paper 3, a broker is defined as 'an individual or firm who arranges the sale or purchase of insurance', an insurance intermediary is defined as 'someone through whom insurance is brought or sold, usually a broker', and the placing broker and producing are defined as 'a broker who places insurance cover on behalf of its client with an underwriter' and 'a broker who introduces a proposal for insurance or reinsurance to its own broking firm or another broking firm' respectively. See the Law Commission and the Scottish Law Commission, *A Joint Consultation Paper, Insurance Contract Law: The Business Insured's Duty of Disclosure and the Law of Warranties* (CP 3), p. xii.

In this thesis, in order to avoid confusion, based on the definitions adopted by the Law Commissions in the Joint Consultation Paper 3, this author intends to consider the agent, broker and intermediary as working on behalf of the assureds.

<sup>1104</sup> The importance of a broker's position in a three-party situation was observed in, the Law Commission, *Reforming Insurance Contract Law – Policy Statement: The Status of Intermediaries (For whom does an intermediary act in transmitting pre-contract information from consumer to insurer?)*; Gilman, et al., *Arnould's Law of Marine Insurance and Average*, chapter 7; Mance, et al., *Insurance Disputes*, chapter 8; the Law Commission and the Scottish Law Commission, *A Joint Consultation Paper, Insurance Contract Law: The Business Insured's Duty of Disclosure and the Law of Warranties* (CP 3).

<sup>1105</sup> The Law Commission, *Reforming Insurance Contract Law – Policy Statement: The Status of Intermediaries (For whom does an intermediary act in transmitting pre-contract information from consumer to insurer?)*, pp. 4-5; *Whitlam v Hazel* [2004] EWCA Civ 160 (CA).

<sup>1106</sup> In practice, in most consumer insurance cases, the intermediary is selling insurance on behalf of insurers. In such cases, the first priority of the assured is making a claim. Subsequently, if the claims are rejected by the insurer for the intermediary's negligence or fraud, the assured can refer his complaint to the FOS.

insurance policy, then the assured is assumed to be responsible for their actions, for example, the broker's misrepresentation and non-disclosure. It has been described by some leading academics to be a danger area to discuss the issue regarding the agent's position in this type of triple-party situation<sup>1107</sup> with an absence of clarification under the insurance policies. This 'danger area' has been analysed by the Law Commission in various reports,<sup>1108</sup> and currently, the Law Commissioners have decided to give up their initial proposal to introduce a bright line test to identify whether the intermediary in question is acting on behalf of the insurer or insured, and have put forward default rules.<sup>1109</sup> In one report, the Law Commission lists three exceptional cases where the intermediary acts for the insurer. These are, (A) the intermediary has authority to bind the insurer to cover, (B) the intermediary is the appointed representative of the insurer, and (C) the intermediary has actual express authority from the insurer to collect pre-contract information on its behalf. Furthermore, they also stated other cases where it is implied that the intermediary is acting for the consumer.<sup>1110</sup>

These principles, however, should be finally attributed to be implied by facts. In the light of the above rules discussed, it is principally established that the agent is the assured's agent. This default rule is extracted not only from statutes<sup>1111</sup> and case

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<sup>1107</sup> Mance, et al., *Insurance Disputes*, chapter 8.

<sup>1108</sup> For example, the Law Commission and the Scottish Law Commission, *A Joint Consultation Paper, Misrepresentation, Non-disclosure and Breach of Warranty by the Insured (CP 1)*; the Law Commission and the Scottish Law Commission, *A Joint Consultation Paper, Insurance Contract Law: The Business Insured's Duty of Disclosure and the Law of Warranties (CP 3)*; and the Law Commission, *Reforming Insurance Contract Law – Policy Statement: The Status of Intermediaries (For whom does an intermediary act in transmitting pre-contract information from consumer to insurer?)*.

<sup>1109</sup> The Law Commission, *Reforming Insurance Contract Law – Policy Statement: The Status of Intermediaries (For whom does an intermediary act in transmitting pre-contract information from consumer to insurer?)*, pp. 25-28.

<sup>1110</sup> *Ibid*, pp. 25-28.

<sup>1111</sup> For statutory examples, see section 19, MIA 1906.

law,<sup>1112</sup> but also authorities, especially in the business insurance industry (such as marine insurance).<sup>1113</sup> Keeping in mind that it is a default rule to impliedly treat an insurance broker, especially a business insurance broker, as acting on behalf of the assured, it is much easier to expound the analysis below concerning section 19, MIA 1906 and its application in practice.

### **7.3. Marine insurance broker: legal liability and section 19, Marine Insurance Act 1906**

The insurance broker's duty of utmost good faith is principally regulated by section 19, MIA 1906. The section which is entitled as 'Disclosure by Agent effecting Insurance' states:

'Subject to the provisions of the preceding section as to circumstances which need not be disclosed, where an insurance is effected for the assured by an agent, the agent must disclose to the insurer –

(a). 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; and

(b). Every material circumstance which the assured is bound to disclose, unless it come to his knowledge too late to communicate it to the agent.'<sup>1114</sup>

Furthermore, section 20 of the MIA 1906, provides regulations regarding the agent's duty of utmost good faith. Section 20(1) states that the assured or his agent is required to make honest representation at the contemplation of the insurance policy, otherwise the whole insurance contract is avoidable. In *Blackburn Low & Co v*

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<sup>1112</sup> For case-law examples; see *Empress Ass Corp Ltd v CT Bowring & Co Ltd* (1904) 11 Com Cas 107; *Rozanes v Bowen* (1928) 32 L1 LR 98, 101; *Anglo-African Merchants Ltd v Bayley* [1970] 1 QB 311; *North & South Trust Co v Berkeley* [1971] 1 WLR 470; *McNealy v The Pennine Insurance Co Ltd* [1978] 2 LLR 18 (CA); *Roberts v Plaisted* [1989] 2 LLR 341; *Winter v Irish Life Assurance plc* [1995] 2 LLR 274, etc.

<sup>1113</sup> For authorities in marine insurance law, see Gilman, et al., *Arnould's Law of Marine Insurance and Average*, chapter 7, para. 7.06; Mance, et al., *Insurance Disputes*, chapter 8, para. 12.23; Rose, *Marine Insurance: Law and Practice*, para. 4.40.

<sup>1114</sup> Section 19, MIA 1906.



*Vigors*,<sup>1115</sup> it was firstly held that ‘neither the plaintiffs nor the agent through whom the policy was effected had any knowledge of the material fact the concealment or non-disclosure of which is relied on as vitiating the policy’. Later in *Blackburn Low v Haslam*,<sup>1116</sup> it was further stated that the policy was void on the ground of concealment of material facts by the agents of the assured.<sup>1117</sup> It is believed that the early form of section 19, MIA 1906 is derived from these two fundamental judgments, especially the former one. In the view of this author, the wording of judicial decision in *Blackburn Low v Haslam* also contributes to the defects currently underlying section 19’s application, since included agents were limited to the ‘effecting agent’, which is addressed below. Based on the statutory codes and English case-law, the following concerns are worthy of investigation.

### **7.3.1. Legal nature of the broker’s duties**

As stated earlier, the status of an insurance agent is flexible and may be changed during the process of insurance. For instance, at the claiming stage, on the one hand, the agent assists with his assured to make claims by providing professional advice, but afterwards, the agent should communicate information to the assessor or investigator from the insurer’s side to complete the claiming investigation, even though some of the information is confidential. There seems to be a conflict of interest<sup>1118</sup> here since the insurance agent is at the time working for both his principal

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<sup>1115</sup> (1887) LR 12 App. Cas 531, (CA).

<sup>1116</sup> (1888) LR 21, QBD 144.

<sup>1117</sup> This case is then mentioned by *Quinn Direct Insurance Ltd v Law Society of England and Wales* [2010] Lloyd’s Rep. I.R. 655; *Group Josi Re Co SA v Walbrook Insurance Co Ltd* [1996] 1 Lloyd’s Rep. 345; *PCW Syndicates v PCW Reinsurers* [1996] 1 Lloyd’s Rep. 241; *Holts Motors Ltd v South-East Lancashire Insurance Co Ltd* (1930) 37 Ll. L. Rep. 1.

<sup>1118</sup> According to the general principles of the law of agency, an agent should not allow himself to be in a position where there is a conflict of interest between the duty to his principal and himself, or the third party. For authority, see Rose, *Marine Insurance: Law and Practice*, chapter 4.

and the underwriter.<sup>1119</sup> Another notable example which can illustrate the subtle position of an insurance broker during the three-party situation, is the case of the *Zephyr*,<sup>1120</sup> in which the brokers were in charge of both the direct insurance contracts (between the assured and primary insurers), and also the reinsurance contracts (between the primary insurers and reinsurers). Thus, in order to avoid the 'danger area', the leading market models in the UK choose to treat the agent as impliedly acting for an assured.<sup>1121</sup> However, the general agency law also applies, especially in terms of the insurance agent's duty of care owed to his employer in both employment law and tort law.

Thus, one aspect is, that according to sections 19 and 20, MIA 1906, an insurance agent is required to make material representation and disclosure to the insurer at the contemplation of the insurance policy. Based on the statutory language of these two sections only, especially the leading section 19, it is revealed that little obligation is added compared with sections 17 and 18 under the same Act. For that reason, section 19 of MIA 1906 is only described as an extension of section 18, since no extra new obligations are created except for the extension of an assured's duties of disclosure and honest representation to his agent.

On the other side, in accordance with the general agency rules, a professional broker owes a duty of care to his assured in tort.<sup>1122</sup> In other words, English case law denotes that the parallel standing of a professional agent leads them to owe tortious

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<sup>1119</sup> This is also the Lloyd's Market usage. See *Ibid*.

<sup>1120</sup> *General Accident Fire and Life Assurance Corporation and Others v Peter William Tanter and Others (The Zephyr)* [1984] 1 Lloyd's Rep. 58; [1985] 2 Lloyd's Rep. 529.

<sup>1121</sup> The Law Commission, *Reforming Insurance Contract Law – Policy Statement: The Status of Intermediaries (For whom does an intermediary act in transmitting pre-contract information from consumer to insurer?)*.

<sup>1122</sup> *Forsikringsaktieselskapet Vesta v Butcher* [1988] 1 LLR 19; *Youell v Bland Welch & Co Ltd (Superhulls Cover Case) (No. 2)* [1992] 1 LLR 7; *Punjab National bank v De Boinville* [1995] 2 AC 145, quoted by Gilman, et al., *Arnould's Law of Marine Insurance and Average*, note 37.

duties to his employer and the assured, as well as fulfilling the duty of care in the negotiation of an insurance policy.

Last but not the least, the relationship between the assured and insurance broker is also embodied by the agency agreements. It is recommended to bind both parties through a written agreement, but the written agreement is not essential.<sup>1123</sup> Of course, clarified clauses in terms of the broker's duties shall be firstly invoked. Nevertheless, in an absence of such expressed clauses, sections 19 and 20 of MIA 1906 and other relevant rules shall apply, such as, FOS rules and some other self-regulations. For that reason, it happens in practice that the broker may be involved in both a contractual breach as well as tortuous liability. In the view of this author, the coexisting contractual and tortuous liabilities raise another issue concerning whether the intermediary should bear any legal liabilities for his fault, which is addressed below.

### **7.3.2. Information included and exceptions**

After clarifying the insurance broker's overwhelming position to act on behalf of the assured, the analysis of information needed to be disclosed and represented in terms of utmost good faith is supplemented on a sound basis below.

According to section 19(a), MIA 1906, the agent is obliged to transmit material information he knows, or ought to know, in the ordinary course of business to the insurer before effecting insurance policies. The following factors are expounded. Firstly, based on the statute law, the extent to which information is obliged to be transmitted to the insurer at the contemplation of an insurance contract is analysed. Judging from the statutory language of sections 19 and 20, MIA 1906, the materiality

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<sup>1123</sup> There is no requirement to the formality of a contract in English case law. Therefore, the contract may be written, oral, or confirmed through contractual parties' conducts.

test applies here as well. Therefore, as section 20(2) states, information which would influence the prudent insurer's determination in fixing the premium or accepting the risk is material to be disclosed and represented to the insurer, for example, with regard to the navigation area and classification of an assured vessel. At English case law, a reasonable agent is required to know what information is material and immaterial.<sup>1124</sup> *Arnould* exemplifies the circumstances which need to be passed on to the insurer by the agent when placing the insurance policies,<sup>1125</sup> for instance, the time of sailing,<sup>1126</sup> the principal's previous insurances and losses which serve as the basis of the contract,<sup>1127</sup> the ownership of insured subject,<sup>1128</sup> and the material information in reinsurance.<sup>1129</sup>

The second factor which is worthwhile to be addressed here is which type of information is material enough to be passed on to the insurer? The answer to this query is available from both primary legislation and English precedents. The statutory answer is in sections 19 and 20, MIA 1906, providing that the 'prudent insurer' test applies in the context of the insurance broker's non-disclosure or misrepresentation during the negotiation of insurance policies.<sup>1130</sup> Apart from the 'prudent insurer' test of materiality, the 'actual inducement' test was subsequently created by English case-law,<sup>1131</sup> which has been elaborated in previous parts regarding assured's utmost good faith in performing his obligations.<sup>1132</sup> On the other hand, the

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<sup>1124</sup> Gilman, et al., *Arnould's Law of Marine Insurance and Average*, paras. 7-10.

<sup>1125</sup> *Ibid*, chapter 7, notes 68 and 69.

<sup>1126</sup> *Seller v Work* (1801) Marshall on Ins. 243, vol2, p.202; see *Ibid*, chapter 7, note 68.

<sup>1127</sup> *Rozanes v Bowen* (1928) Vol.32 L1 LR, 98.

<sup>1128</sup> *Total Graphics Ltd v AGF Insurance Ltd* [1997] 1 LLR 599.

<sup>1129</sup> *Aneco Reinsurance Underwriting Ltd v Johnson & Higgins* [1999] LRIR 565.

<sup>1130</sup> Especially section 20(2), MIA 1906, reads that: '[a] representation is material which would influence the judgment of a prudent insurer in fixing the premium, or determining whether he will take the risk'.

<sup>1131</sup> The same as the 'actual inducement' test of the assured's utmost good faith. As to the insurance broker's utmost good faith, the 'actual inducement' test was repeated by Cresswell J in his judgment of *Aneco Reinsurance Underwriting Ltd v Johnson & Higgins* [1999] LRIR 565.

<sup>1132</sup> See chapters 2-5 above.

'inducement' test in insurance is confirmed to be an extension of the general common law rules concerning actionable misrepresentation in contract law.<sup>1133</sup>

What information a broker 'knows' or 'ought to know' is the third factor which shall be elaborated to crystallize the exact scope of material circumstances included by such obligation.<sup>1134</sup> The wording of section 19, MIA 1906, is apparently inadequate for its enforcement. Therefore, in addition to the events summarized from English case law, the Law Commissioners further supplemented its test based on a theoretical standing.<sup>1135</sup> In accordance with the Law Commission's Consultation Paper, the terms 'knows' or 'ought to know' present a powerful condition that, regardless of the capacity of the insurance broker, any information that is received, or ought to be supplied to the broker in an ordinary course of business, must be disclosed or truly represented to the insurer before the making of insurance contracts. Failure of this indicates that the underwriter is awarded the right to avoid the whole insurance. To be more specific, even though it is the principal's fault, if material information is hidden from both his agent and insurance company, the whole insurance is voidable.<sup>1136</sup> This rule is also confirmed to apply to reinsurance events and renewals/amendments to insurance.<sup>1137</sup> In the end, the Law Commission proposed an interpretation of the current law to be that section 19, MIA 1906, only applies to information which is received or held by agents in their capacity for the particular policyholder, but not for the other clients served.<sup>1138</sup>

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<sup>1133</sup> MacIntyre, *Essentials of Business Law*, according to general common law, 'inducement' is one requirement to 'actionable misrepresentation'.

<sup>1134</sup> Section 19(a), MIA 1906.

<sup>1135</sup> The Law Commission and the Scottish Law Commission, *A Joint Consultation Paper, Insurance Contract Law: The Business Insured's Duty of Disclosure and the Law of Warranties (CP 3)*, pp. 93-95.

<sup>1136</sup> *El Ajou v Dollar Land Holdings Plc* [1994] BCC 143, p. 156, per Hoffmann LJ; *Societe Anonyme d'Intermediaries Luxembourgeois (SAIL) v Farex Gie* [1994] CLC 1094, p. 1111, per Hoffmann LJ, see *Ibid.*

<sup>1137</sup> Gilman, et al., *Arnould's Law of Marine Insurance and Average*, chapter 16.

<sup>1138</sup> The Law Commission and the Scottish Law Commission, *A Joint Consultation Paper, Insurance Contract Law: The Business Insured's Duty of Disclosure and the Law of Warranties (CP 3)*, p. 95.

It can be argued that it is difficult to prove whether or not the material information in question has been communicated to the broker by the assured, and it is unfair to rely on the broker's utmost good faith breach since it is not always his fault. Nevertheless, this issue can be resolved quite promptly. The main reason is that, apart from the avoidance remedy awarded to the injured insurer, the MIA 1906 does not blame the insurance broker for his, or his principal's, concealment or misrepresentation by entitling the assured any right to damages. Therefore, whether the intermediary bears any legal liabilities for his action is not certain immediately, as this would need to be established through tort of negligence. On the one hand, the lack of a damage remedy in the MIA 1906 closes the floodgates. The determination of the broker's knowledge is included regardless of the capacity in which it was received, and this inevitably raises difficulties in the understanding of section 19(b), MIA 1906. At the claiming stage, since the final result of the assured and his agent's post-contract good faith breach would be the same (an avoidance of the whole insurance contract), and the real story between the agent and the principal would be left to the general agency law to deal with, then there is no need to identify the defaulting party among the agent and principal at an early stage.

Section 19(b), MIA 1906, further requires the insurance agent to disclose every material circumstance supplied by the principal, unless it is too late to be communicated. After a close observation, it is revealed not only by this author, but also by the Law Commissioners, that this term is superfluous.<sup>1139</sup> Section 18 firstly obliges the assured to disclose and honestly represent material information in his possession to the underwriter at the contemplation of insurance policies. Sections 19(a) and 20(2) subsequently extend such obligation beyond to the assured's broker.

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<sup>1139</sup> *Ibid.*

As a result, the material information which is held by either the assured or the agent should be passed on to the insurer but this is not rebuttable by an untimely communication (since the principal is obliged to be liable for his agent's conducts).

Finally, the issue as to who are the agents to whom section 19 applies is also considered as a problematic one. Based on the ground of the legislative language of section 19(a), the broker effecting insurance for the assured must disclose material information he knows, or ought to know, in the ordinary course of business to the insurer. The reading of this term was firstly supported by the judiciary seated in *PCW Syndicates v PCW Reinsurers*.<sup>1140</sup> According to Saville LJ's judgment in this case, he agreed with Waller LJ's conclusion from the reading of the words used in section 19, alleging that the agent included by this code only 'encompasses those who actually deal with the insurers concerned and make the contract in question'.<sup>1141</sup> Nevertheless, in the same case, Staughton LJ expressed his disagreement to this point by quoting authority that at times:

'[I]nstead of dealing direct with the underwriter, the agent employed to effect an insurance acts through an intermediate agent or agents, and in such cases the concealment of a material fact within the knowledge of any agent through whose agency, whether mediately or directly, the insurance has been effected, vitiates the policy.'<sup>1142</sup>

Judging from the above insurance practice, one might have the view that there is no need to confine the application of section 19 to agent 'agent to insure', but rather one could include all agents.

In the view of this author, the main reasoning arises partially from the boundary of the broker's knowledge required to be transmitted to the underwriter. As discussed earlier, as long as either the broker or the assured processes material information,

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<sup>1140</sup> [1996] 1 Lloyd's Rep. 241.

<sup>1141</sup> *PCW Syndicates v PCW Reinsurers* [1996] 1 Lloyd's Rep. 241, per Saville LJ, and 1148 D,E, Rose LJ.

<sup>1142</sup> *Ibid*, p. 257, per Staughton LJ.

and regardless whether it has been communicated successfully to the broker or not, the insurance contract can be avoided for the broker's failure of disclosure or dishonest representation to the underwriter. The law of tort will then be used to figure out if the broker is in a breach.<sup>1143</sup> The same logic can apply here, by stating that as long as the material information is held by the assured's side, if any non-disclosure or misrepresentation is revealed, the insurance can be voided because of the assured's or his broker's breach of utmost good faith. Subsequently, the assured can reclaim any damages from the defaulting broker in tort law or contract law. However, if the assured himself is at fault, he will have no remedy. Although these circumstances described above are founded on a theoretical basis, they are fully supported by English case law,<sup>1144</sup> law reformers<sup>1145</sup> and some leading academics.<sup>1146</sup>

Some exceptions from the preceding section 18, MIA 1906, are expressly extended beyond the broker's utmost good faith duty.<sup>1147</sup> For this reason, it can be confirmed that an insurance broker is exempted from disclosing the risk diminution and waiver by the insurer.<sup>1148</sup>

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<sup>1143</sup> For example, *Henderson v Merrett Syndicates Ltd* [1995] 2 AC 145. In this fundamental House of Lords case, it was established that 'the duty of exercising reasonable skill and care exists where a person undertakes to perform professional or quasi professional services for another... [and] the undertaking of such duties, together with a reliance on them is sufficient to give rise to a duty of care in tort, unless this is precluded by contractual agreement between the parties'. It was further cited by *Fashion Brokers Ltd v Clarke Hayes* [2000] Lloyd's Rep. P.N. 398; and followed by *Titan Steel Wheels Ltd v Royal Bank of Scotland Plc* [2010] 2 Lloyd's Rep. 92.

<sup>1144</sup> For instance, in *GMA v Unistorebrand International Insurance* [1995] LRLR 333, it was held that section 19 applies to an intermediate agent as well. In *Baker v Lombard Continental Insurance Plc* (unreported) 24 January 1997, Coleman J believed that the majority of the Court of Appeal in *Group Josi Re v Walbrook Ins Co Ltd* [1996] 1 LR 345 had held that section 19 required an intermediate agent to be included in such situation, cited by the Law Commission and the Scottish Law Commission, *A Joint Consultation Paper, Insurance Contract Law: The Business Insured's Duty of Disclosure and the Law of Warranties (CP 3)*, p. 93.

<sup>1145</sup> *Ibid*, p. 93.

<sup>1146</sup> For example, Gilman, et al., *Arnould's Law of Marine Insurance and Average*, chapter 7; Earl of Halsbury, et al., *Halsbury's Laws of England* (1<sup>st</sup> ed., Butterworths, 1911), vol. 17, p. 407, para. 796, cited by Staughton LJ in *PCW Syndicates v PCW Reinsurers* [1996] 1 WLR.

<sup>1147</sup> Section 19, MIA 1906, 'Subject to the provisions of the preceding section as to circumstances which need not be disclosed, where an insurance is effected for the assured by an agent, the agent must disclose to the insurer - ...'

<sup>1148</sup> Section 18(3), MIA 1906, stipulates that:

'In the absence of inquiry the following circumstances need not be disclosed, namely: -



#### **7.4. Legal consequence of broker's utmost good faith breach: should the intermediary bear any legal liabilities for his fault?**

After a close examination of sections 17-20 of the MIA 1906, it can be said that the insurance is also avoidable if the assured's broker fails to perform his duty of utmost good faith. Some authorities from the insurance industry suggested that in addition to the avoidance remedy available for the insurer, a right to damages against his broker should also be provided to the assured to indemnify his loss caused by the broker's fault.<sup>1149</sup> The Law Commissioners declined this suggestion and gave up proceeding with the reform on this topic.<sup>1150</sup> The decision is understandable, as, in the first place, the avoidance remedy in such circumstance is awarded not because of the broker's negligent or intentional concealment/misrepresentation, but the assured's concealment of material information or inappropriate instructions to his broker. Accordingly, it is unfair to blame the broker and force him to bear liabilities for his employer's utmost good faith breach. Avoiding this problematical issue under insurance legislation makes the whole system concise without being tame and unambiguous.

In the next instance, refraining from touching ambiguous damages for the assured in cases where the insurer defends successfully on the broker's utmost good faith, does not mean that the draftsman is encouraged to ignore this issue, but to leave it to the general agency law with a broader application scope. Up to now, it is explicit to

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- (a) Any circumstance which diminishes the risk;
  - (b) Any circumstance which is known or presumed to be known to the insurer. The insurer is presumed to know matters of common notoriety or knowledge, and matters which an insurer in the ordinary course of his business, as such, ought to know;
  - (c) Any circumstance as to which information is waived by the insurer;
  - (d) Any circumstance which it is superfluous to disclose by reason of any express or implied warranty.'

<sup>1149</sup> The Law Commission and the Scottish Law Commission, *A Joint Consultation Paper, Insurance Contract Law: The Business Insured's Duty of Disclosure and the Law of Warranties (CP 3)*, p. 97.

<sup>1150</sup> This is also the initial plan presented by the Law Commissions after observing responses from insurance professionals; see *ibid.*

point out that principally, an agent owes his principal a duty to exercise reasonable care and skill in fulfilling his duties,<sup>1151</sup> and any loss caused because of the broker's fault can be recovered from the broker according to the law of tort or even through other mechanisms.<sup>1152</sup> Indeed, the reality that there is also a contractual relationship between the assured and his broker, which is protected by contract law, also supplies another possible contractual damage to the innocent assured. The dual-insurance provided by the current law is sufficient to guarantee the assured's interests under an employment contract, and similar legislation in MIA 1906 thereby becomes unhelpful and confusing.

As a result of the two main reasons stated above, the law reformers recently gave up proceeding with any future amendments regarding the right of the assured to claim damages against the broker at fault, based on sections 17-20, MIA 1906, deciding it was currently sufficient to leave it to the present general rules.<sup>1153</sup>

## **7.5. Reform proposal from the Law Commission– a new statutory code**

Keeping all concerns addressed earlier in mind, the Law Commission made proposals in several papers to proceed with reforms concerning the broker's utmost good faith.

The history of reform in the Law Commission can be dated back to March 2007, and the release of its Issues Papers 3 regarding Intermediaries and Pre-contract

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<sup>1151</sup> For example, *Henderson v Merrett Syndicates Ltd* [1995] 2 AC 145; *HIH Casualty and General Insurance Co Ltd v Chase Manhattan Bank* [2003] LR IR 230, etc.

<sup>1152</sup> For example, the Financial Services and Markets Act 2000, the Financial Services Act 2012, the FCA Handbook – Insurance Conduct of Business sourcebook; the rules apply in the Financial Ombudsman Service, the Associations of British Insurers rules, and the Insurance Mediation Directive at the EU level.

<sup>1153</sup> The Law Commission and the Scottish Law Commission, *A Joint Consultation Paper, Insurance Contract Law: The Business Insured's Duty of Disclosure and the Law of Warranties (CP 3)*.

Information.<sup>1154</sup> In this report, the Law Commissioners put forward their reforming suggestions in an early form, including the preservation of section 19, MIA 1906, in consumer business and, subsequently, the Law Commissioners raised enquiries regarding an extended duty under section 19, MIA 1906.<sup>1155</sup> Two years later, the Law Commission issued another document in terms of the legal position of intermediaries and the transmission of pre-contract information to the insurer.<sup>1156</sup> The second landmark that needs to be mentioned here is the Joint Consultation Papers (CP 1 and CP 2) delivered by the Law Commission and the Scottish Law Commission, relating to both pre-contract information<sup>1157</sup> and post contract duties.<sup>1158</sup> However, all the original recommendations for a statutory reform regarding the role of the agent in these papers are finally affirmed by the current Consultation Paper.<sup>1159</sup>

According to the Law Commission's recently launched Consultation Paper (CP 3),<sup>1160</sup> the consultees are invited to reply to the planned proposals. These include, whether there is a need to clarify the scope and nature of section 19(a) of the MIA 1906; whether there is a need to clarify that the amended section 19(a) should apply to all agents and confine the scope of information possessed by that agent in its

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<sup>1154</sup> The Law Commission, Issues Paper 3, *Intermediaries and Pre-contract Information*.

<sup>1155</sup> *Ibid*, pp. 51-52.

In accordance with this Issues Paper 3, the Law Commissioners asked 'whether there are reasons to preserve an extended duty under section 19(a):

- '(1) Should the remedy lie in damages against the intermediary, rather than in avoidance against the insured?
- (2) Should any information given in confidence by a third party be excepted from the scope of the duty?
- (3) Should the duty be curtailed to information received in the course of the relevant transaction?'

<sup>1156</sup> The Law Commission, *Reforming Insurance Contract Law – Policy Statement: The Status of Intermediaries (For whom does an intermediary act in transmitting pre-contract information from consumer to insurer?)*.

<sup>1157</sup> The Law Commission and the Scottish Law Commission, *A Joint Consultation Paper, Misrepresentation, Non-disclosure and Breach of Warranty by the Insured (CP 1)*.

<sup>1158</sup> The Law Commission and the Scottish Law Commission, *A Joint Consultation Paper, Insurance Contract Law: Post Contract Duties and other Issues (CP 2)*.

<sup>1159</sup> The Law Commission and the Scottish Law Commission, *A Joint Consultation Paper, Insurance Contract Law: The Business Insured's Duty of Disclosure and the Law of Warranties (CP 3)*.

<sup>1160</sup> *Ibid*.

capacity as agent for that policyholder, even though the information is avoided intentionally by the broker; whether the insurer should be awarded with any damage against the assured on his misrepresentations if the broker fails to disclose material information; and finally, whether section 19(b) should be retained.<sup>1161</sup> This evidence suggests that the Law Commissioners are proposing a new statutory code in business insurance.

## 7.6. Conclusion

Judging from the conflicts between the current law and its application in practice, in terms of the insurance broker's duties, it has been proved that a new statutory code is the only resort to have them resolved. At present, with new methods introduced to selling insurance, such as the increasingly popular price comparison websites, and a significant reduction in the number of traditional small consumer insurance intermediaries providing advice, traditional intermediaries are not in an unshakable position anymore. Nevertheless, the current law needs to be injected with more flexibility to deal with rapid change and unpredictability, which are promoted by new technologies and changing commercial relationships.<sup>1162</sup>

In relation to business insurance, the MIA 1906 is functioning appropriately with the coverage of general law.<sup>1163</sup> However, some legislative pitfalls still need further clarification to make the current insurance legislation more concise. The Law Commission's proposal is based on the responses received from the consultees,

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<sup>1161</sup> *Ibid.* The author's opinions about the above proposed reform have been expressed in § 7.3.2 above.

See the Law Commission, *Reforming Insurance Contract Law – Policy Statement: The Status of Intermediaries (For whom does an intermediary act in transmitting pre-contract information from consumer to insurer?)*, p. 3.

<sup>1163</sup> Including Agency law, Tort law, Employment law, Contract law and relevant self-regulations addressed.

judiciary, and leading academics, therefore, the proposal is reliable because of its sound basis. However, whether the Proposal Bill will be presented to the Parliament successfully and obtain approval in the end is still a matter of conjecture.

## CHAPTER 8

### INSURANCE AGENCIES AND GOOD FAITH IN CHINESE LAW

#### 8.1. General Remarks

Currently in China, there is no principal article revealed from CMC, regulating a marine insurance agent or broker's good faith during the transaction and currency of insurance. Relevant provisions are indeed available from general insurance law and civil or tort law codes in China, yet, only limited and general resources are found.<sup>1164</sup> Meanwhile, another resort which could be invoked to scrutinize the insurance market in China is provided by the China Insurance Regulatory Commission, functioning as a governmental regulator of insurance practice.<sup>1165</sup> Therefore, the current status of legislation governing insurance agencies in China is similar to that in English law, since the statutory legislation and practical rules coexist to secure the commercial transaction order in both countries.

#### 8.2. Insurance agent and good faith

In China, intermediaries are becoming more and more popular in the insurance market, particularly for average individual consumers. For business insurance, especially marine insurance, the majority of big insurance companies prefer delegating professional agents who are acting on behalf of the insurers themselves

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<sup>1164</sup>CIL 2009, the General Principles of Civil Law, and Tort Liability Law of the People's Republic of China (Chinese Tort Law).

<sup>1165</sup> For more details about the China Insurance Regulatory Commission, see information available at <http://www.circ.gov.cn>, accessed in January 2013.

to transact insurance business. Under these circumstances, the insurance agents are employed by the insurers and collect handling fees therefrom.<sup>1166</sup> In order to facilitate the research underlying chapter 7 and current trading practice,<sup>1167</sup> this chapter is focused on the agent effecting insurance on behalf of the assured, which is defined as, ‘an entity which, based on the interests of the applicant, provides intermediary services between the applicant and the insurer so that they enter into an insurance contract and receive a commission in accordance with laws’.<sup>1168</sup> Its definition is further extended to the professional insurance agencies and branches.<sup>1169</sup>

Although the CMC is silent on the agent’s pre-contractual duty of disclosure, it is covered in the CIL 2009. As stated by article 131 of CIL 2009, during the insurance transactions, the insurance broker, agent and any other personnel must not deceive the assured or beneficiary,<sup>1170</sup> conceal any material information affecting the insurance,<sup>1171</sup> prevent or induce the assured from performing the duty of disclosure as regulated by this law,<sup>1172</sup> forge or amend an insurance contract without the permission of the other parties, provide fraudulent evidence for the insurance parties,<sup>1173</sup> or disclose the assured’s confidential information.<sup>1174</sup> In the general Chinese Contract Law and General Principles of Civil Law, in addition to the principal

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<sup>1166</sup> For a detailed definition of ‘insurance agent’, see article 117, CIL 2009. With respect to the insurance agent acting for the insurance company, both general legislation and the Chinese Insurance Regulatory Commission Regulations provide guidelines. For example, Regulations on Supervision of Professional Insurance Agencies, which was promulgated on 25<sup>th</sup> September 2009, and became effective on 1<sup>st</sup> October 2012.

<sup>1167</sup> See § 7.2 and attached notes above.

<sup>1168</sup> Article 118, CIL 2009.

<sup>1169</sup> Article 2, Regulations on Supervision of Professional Insurance Broker Institutions, which was promulgated on 25<sup>th</sup> September 2009, and became effective on 1<sup>st</sup> October 2012.

<sup>1170</sup> Article 131(2), CIL 2009.

<sup>1171</sup> *Ibid.*

<sup>1172</sup> Article 131(3), CIL 2009.

<sup>1173</sup> Article 131(6), CIL 2009.

<sup>1174</sup> Article 131(10), CIL 2009.

articles of the general good faith requirement, no such provisions for insurance agents are revealed.<sup>1175</sup>

A similar principal article is also provided by the China Insurance Regulatory Commission's Regulations on Supervision of Professional Insurance Agencies (Regulations). According to article 3 of the Regulations, the professional insurance agencies are required to act in good faith and fairness. The examples of prohibitive behaviours, including the insurance broker's non-disclosure and fraud of insurance contained in article 131, CIL 2009, are also adopted by articles 46 and 47 of the Regulations. However, as with English law, the above analysis indicates that the mechanism ruling insurance agencies is confusing and difficult to be invoked.

Besides the inadequate legislation particular to the insurance agent's duty of good faith, another legislative defect revealed is the uncertainty about the scope of information needed to be disclosed by an agent. Nevertheless, further clarification can refer to the scope adopted by the MIA 1906, since marine insurance is a global business governed by international conventions, international trading custom and practice.<sup>1176</sup>

### **8.3. Consequences of noncompliance and extra damages**

Currently, remedies relating to the insurance agent's noncompliance with good faith in Chinese law are observed to be concentrated on civil liabilities, administration and criminal sanctions.

According to article 128, CIL 2009, if the assured or applicant suffers any loss caused by the insurance agent's fault, the defaulting agent shall be liable for

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<sup>1175</sup> Article 6, Chinese Contract Law and article 4, General Principles of Civil Law.

<sup>1176</sup> Recommendations are committed in the thesis conclusive paragraphs below.



damages or losses caused. Unfortunately, the exact extent of the damages entitled is still ambiguous. In particular, it is not clarified whether any extra retrospective avoidance or prospective forfeiture of claims is available. After consultations with some practitioners<sup>1177</sup> from the China shipping market, it is found that in current practice, the only way to deal with the agent's non-disclosure is by terminating the insurance contract, which can be done on the basis of articles 222 and 223 of CMC. Therefore, the insurer has the right to terminate the insurance contract upon the assured, or his agent's intentional non-disclosure of material circumstances without refunding the premium. At the same time, the insurer shall not be liable for any loss arising from the perils insured against before the contract is terminated. Accordingly, the insurer has the right to terminate the contract or to demand a corresponding higher premium upon the assured or his agent's unintentional non-disclosure of material circumstances. If, the insurance contract is terminated by the insurer, the insurer is still liable for the loss arising from the perils insured against which occurred prior to the termination of the contract, except where the material circumstances concealed have an impact on the occurrence of such perils. It can be said that, acting on behalf of the assured, the insurance agent's material non-disclosure has the same legal effect on the insurance contract as the assured's good faith breach, both intentional and unintentional.<sup>1178</sup>

On the basis of the above discussion, regardless of the assured's contribution to his agent's good faith breach, the insurance contract could be avoided, both retrospectively and prospectively. This results in the focus being diverted to distinguish the innocent assured cases from the deliberate assured cases, in order to

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<sup>1177</sup> Personal discussions with one broker, one lawyer, and one manager of the insurance department of the Sinotrans Ship Management Ltd – Hong Kong on 15<sup>th</sup> October 2012.

<sup>1178</sup> In English law, instead of intentional and unintentional misconducts, the deliberate/reckless and careless misconducts are distinguished to indicate the main categories of the assured's misrepresentations. See section 5, Consumer Insurance (Disclosure and Representations) Act 2012.

comprehend the way in which the insurance agent's good faith is regulated. First of all, in addition to the civil liability underlying article 128 of CIL 2009, article 166 in the same law further stipulates the consequence of the insurance agent's good faith breach which is listed in article 131. As this article provides, severe violations of article 131 would cause administrative and criminal sanctions, including rectification upon the insurance regulatory department's discretion and a fine between RMB 50,000 and RMB 300,000. Where the violations are severe, the wrongdoer's licence shall be withdrawn.<sup>1179</sup> Additional manners are provided by Chinese Tort Law and the regulations enacted by the Chinese insurance regulator, the China Insurance Regulatory Commission. Therefore, if the assured has no contribution to the agent's good faith breach, tortious damages could be claimed according to articles 6, 7 and 15, Chinese Tort Law.<sup>1180</sup> At the same time, the innocent assured is also entitled to report to the regulatory department to issue administrative sanctions for the assured. As article 71 of the Regulations on Supervision of Professional Insurance Broker Institutions provides, if the insurance agencies violate the duty of good faith underlying article 46 of the same Regulations (including the duty of disclosure and to

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<sup>1179</sup> Article 166, CIL 2009. In the same law, articles 178, 179, 181 stipulate more sanctions for severe violations, which are limited to the administrative and criminal level.

<sup>1180</sup> Article 6, Chinese Tort Law, notes that:

'If an actor, through his/her/its own fault, infringes upon the civil rights or interests of another, he/she/it shall bear tort liability. If, pursuant to the law, an actor is presumed to be at fault and he/she/it is unable to show that he/she/it was not at fault, he/she/it shall bear tort liability.'

Article 7, Chinese Tort Law, provides that:

'If an actor prejudices the civil rights or interests of another and laws provide that he/she/it is required to bear tort liability, such provisions shall apply regardless of whether or not he/she/it was at fault.'

Article 15, Chinese Tort Law, stipulates that:

'The principal means of bearing tort liability are set forth below:

- (1) cessation of the tort;
- (2) elimination of the obstruction;
- (3) eradication of the danger;
- (4) return of the property;
- (5) restoration to the original state;
- (6) indemnification of the loss;
- (7) apologising; and/or
- (8) elimination of the effect and restoration of reputation.

The aforementioned means of bearing tort liability may be applied singly or in combination.'

provide honest evidence), the China Insurance Regulatory Commission could issue a warning; if there are no illegal gains obtained, a fine shall be imposed of no more than RMB 10,000; if there are any illegal gains obtained, a fine shall be imposed of no more than three times of the illegal gains; additionally, a warning note and a fine of no more than RMB 10,000 would be imposed on the directors and other relevant people who are liable.

Under the second circumstance, if the assured himself contributes to the agent's good faith breach, the former party shall bear the joint liability with the latter. As article 66(1) of the General Principles of the PRC provides, if the principal is aware that a civil act is being executed in his name but fails to repudiate it, his consent shall be deemed to have been given, which cause a joint liability to be undertaken. Similar, joint liability articles are also available in Chinese Tort Law, for example, articles 8 and 26 regarding joint tortious liabilities.<sup>1181</sup>

#### **8.4. Conclusion**

After a comprehensive examination of the current Chinese law, it can be concluded that there is a definite shortage of clear legislation regarding the insurance agent's good faith and the legal effect of its noncompliance (particularly in terms of the civil liability caused), which can be deemed as a vital defect in terms of a civil law country. In practice, with the absence of a statutory remedy available, articles 222 and 223 of CMC, are extended, with additional remedies provided by general codes (including CIL 2009, Chinese Contract Law, General Principles of Civil Law and

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<sup>1181</sup> Article 8, Chinese Tort Law, stipulates that '[i]f two or more persons jointly commit a tortious act, thereby causing injury to another, they shall bear joint and several liability'. In article 26, Chinese Tort Law, it is provided that '[i]f the injured person was also at fault in the occurrence of the injury, the liability of the wrongdoer may be reduced'.

Chinese Tort Law) and regulations (such as Regulations on Supervision of Professional Insurance Broker Institutions). If the assured himself is innocent and has made no contribution to the good faith breach, then he is allowed to claim compensation from the defaulting agent on the basis of articles 128, 131 and 166, CIL 2009, and also relevant articles in the General Principles of Civil Law and Chinese Tort Law. Additionally, the injured assured could have the circumstances dealt with by the China Insurance Regulatory Commission.<sup>1182</sup> If both the assured and his agent have committed misconducts which could be considered as a good faith breach, they shall bear joint liabilities mainly based on Chinese Tort Law. Nevertheless, its enforcement in practice in China is really inadequate, since it is hard to prove whether there is a direct causal link between the agent's good faith breach and the termination of contract, or the innocent assured's sufferings.<sup>1183</sup>

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<sup>1182</sup> Articles 3, 46, 82, Regulations on Supervision of Professional Insurance Broker Institutions.

<sup>1183</sup> Personal discussions with practitioners in shipping industry, on 15<sup>th</sup> October 2012.

## GENERAL CONCLUSION

### Comprehensive Overview

The operation of the doctrine of utmost good faith, in both English and Chinese law, is fundamentally inefficient. This thesis addressed the fact that at English law, sections 17-20 of the MIA 1906 function as an overarching resource of utmost good faith for both marine and non-marine insurance. This includes its nature of reciprocity, its material requirements (the prudent insurer actual inducement test), and the avoidance *ab initio* remedy for its noncompliance, regardless of the assured's degree of fault (which applies to deliberate/reckless and careless/negligent misconducts).<sup>1184</sup> Despite the fact that the duty of utmost good faith is essentially only applied to the assured, the behaviour of the insurer and the insurance agent (acting on behalf of the assured) is scrutinized, and noncompliance with the duty of utmost good faith may give rise to legal effects accordingly.<sup>1185</sup> Judging from the reforming achievements obtained by the Law Commissions in consumer insurance, it is found that the law of pre-contract information has been improved by abolishing the consumer assured's voluntary duty of disclosure, strengthening the duty of honest representation, adopting a 'reasonable assured' test instead of the traditional 'reasonable insurer' test, and, by introducing a proportionate remedy for innocent misrepresentations.<sup>1186</sup> The success achieved in consumer insurance could be a lesson to the coming statutory reform in business insurance, which includes marine insurance. It has been identified that the continuing duty of utmost good faith may be extended to various post-contract events (including post-contract disclosure and

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<sup>1184</sup> See chapters 1 and 2.

<sup>1185</sup> See chapters 1, 2 and 7.

<sup>1186</sup> See chapter 3.

good faith at the claiming stage). Despite the controversial issues regarding its legal basis and elusive degrees of good faith, the insurance parties are required to act with utmost good faith or average good faith at various stages, and accordingly, the difficulties in dealing with the remedy issue.<sup>1187</sup>

In Chinese law, although there is an absence of the term utmost good faith, good faith is provided by leading codes and practicality, meaning that extreme good faith is required. Distinguished from the doctrine of utmost good faith at English law, the pre-contract mechanism in the Chinese marine insurance legal system is confined to a voluntary duty of disclosure. In order to protect the innocent assured, Chinese law distinguishes intentional misconduct from innocent misconduct and provides different remedies accordingly (a retrospective termination of insurance contract for intentional misconducts and a prospective termination insurance contract for innocent misconducts). Additionally, a materiality test (a prudent insurer decisive actual inducement test) is established to judge whether the defaulting party's good faith breach is material or not.<sup>1188</sup> At the claiming stage, Chinese law prefers providing a prospective forfeiture of fraudulent claims, rather than avoidance *ab initio*.<sup>1189</sup> Subsequently, good faith applies to the insurer and insurance agent during the three-party situations since it is a mutual obligation in insurance.<sup>1190</sup> With legislative defects being revealed in Chinese law, leading authorities intend to replicate the utmost good faith doctrine from English law to Chinese marine insurance legislation, by adopting section 17 of the MIA 1906 as a principal article in the statutory reform.<sup>1191</sup>

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<sup>1187</sup> See chapter 5.

<sup>1188</sup> See § 4.3.4.

<sup>1189</sup> See § 6.5.6.

<sup>1190</sup> See chapters 4 and 8.

<sup>1191</sup> This is criticised below under the heading, 'Should the English duty of Utmost Good Faith be adopted by Chinese marine insurance law at once or incrementally?'

## Comparisons and recommendations for marine insurance

### (1). Pre-contract stage

#### A. Nature of the duty of disclosure and not to misrepresent

In English law, it is required that the duty of utmost good faith is observed with full honesty by both parties during insurance transactions.<sup>1192</sup> As one principle derived from the doctrine of utmost good faith, it is demanded that the duty of disclosure achieves the same standard imposed on the duty of utmost good faith, namely, the highly strict 'utmost' standard. Therefore, based on section 18 of MIA 1906 and subject to the Consumer Insurance (Disclosure and Representations) Act 2012, all the material information needs to be fully disclosed to the insurer by the insured, otherwise, the injured insurer could invoke the applicable remedies.<sup>1193</sup> Therefore, this duty requires the insured to disclose all the material circumstances to the insurer voluntarily.<sup>1194</sup> Before the enactment of the Consumer Insurance (Disclosure and Representations) Act 2012, the MIA 1906 applied equally to both marine and non-marine areas. Therefore, it can be concluded that even in general insurance law, it is required that the duty of disclosure is achieved unlimitedly. However, the situation has changed dramatically following the new Act, which governs consumer insurance.<sup>1195</sup> According to the latest statutory reform, the traditional voluntary duty

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<sup>1192</sup> Section 17, MIA 1906.

<sup>1193</sup> Sections 17-19, MIA 1906.

<sup>1194</sup> The commonly cited definition of utmost good faith is 'a positive duty to voluntarily disclose, accurately and fully, all facts material to the risk being proposed, whether asked for them or not', cited by Rob Thoys, *Insurance Theory and Practice* (London: Routledge, 2010), p. 33; Zhen, 'Insured's duty of disclosure and test of materiality in marine and non-marine insurance laws in China', in *JBL*, pp. 681-704.

Section 18(3) of MIA 1906 also lists some exceptions where the insured is not required to disclose all information in the absence of inquiry, including the diminishing of the risks, the knowledge which is known or presumed to be known to the insurer, any circumstances waived by the insurer, and information covered by warranties.

<sup>1195</sup> For detailed alterations, see chapter 3.

of disclosure is going to be abolished in consumer insurance and replaced by the duty not to misrepresent, based on inquiries.<sup>1196</sup>

In Chinese law, the assured's duty of disclosure is specialized in marine insurance, and is distinguished from general insurance. As stated in chapter 4, based on article 222 of CMC, the duty of disclosure is also voluntary and unlimited in marine insurance. However, in general insurance, this duty is inquiries-based, which echoes the nature of the average consumer assured's duty not to misrepresent in the Consumer Insurance (Disclosure and Representations) Act 2012 in English law.<sup>1197</sup>

## **B. The insurer's duty of lawful operation and explanation**

In English law, apart from the implied warranty of legality imposed on the assured,<sup>1198</sup> no statutory obligation of the insurance company's lawful operation is revealed in the MIA 1906 and English case law. However, self-regulation provides other resorts for this issue at the practical level,<sup>1199</sup> which are not preferred by the judiciary. The insurer's duty of explanation is not required by MIA 1906 for insurance, which is supported by some leading academics.<sup>1200</sup> However, self-regulations such as the ICOBS of the FCA Handbook, requires the insurer to explain the duty of

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<sup>1196</sup> Section 2, Consumer Insurance (Disclosure and Representations) Act 2012. For business insurance, see section 20, MIA 1906.

<sup>1197</sup> See § 4.2.3 for details. Also see Zhen, 'Insured's duty of disclosure and test of materiality in marine and non-marine insurance laws in China', in *JBL*, pp. 681-704. In Jing Zhen's article, it is summarized that in Chinese practice, there is no chance for the average consumer to commit voluntary disclosure, and the only practical form of this duty is asking the applicant to fill in the proposal form honestly.

<sup>1198</sup> Section 41, MIA 1906.

<sup>1199</sup> For example, the original FSA Rules, FCA Handbook, FOS scheme, and ABI Code of Practice.

<sup>1200</sup> For example, Eggers, et al., *Good Faith and Insurance Contract*, paras.12.34-8. See § 4.3.3.3 for details.

When it comes to the general contract law, if the exclusion clauses are not communicated to the offeree before the conclusion of a contract, then such clauses shall not be enforceable. However, there are four circumstances in which the exclusion clauses can be incorporated into the contract afterwards, one of which is incorporation through sufficient notice or reference. (In English law, based on old precedents, the exclusion clauses can be incorporated into a contract through signature, notice/reference, previous dealings and trade customs, see MacIntyre, *Business Law*).



disclosure to the customer.<sup>1201</sup> In the view of this author, the insurer's explanation duty should vary in different situations, but not function as a mandatory rule.<sup>1202</sup>

In Chinese law, there is clear statutory legislation providing for the insurer's duty of lawful operation and explanation of standard forms based on inquiries.<sup>1203</sup> However, the model example of a clear explanation and the legal effect of its non-compliance are still uncertain in Chinese law.<sup>1204</sup> In order to deal with such issues, taking relevant general legislation into consideration,<sup>1205</sup> the remedies available in Chinese law for the insurer's failure of explanation include requesting the courts or arbitration institution to have the contract modified or rescinded if there is no compromise achieved in the end. Additionally, if the contract is avoided, the paid premium is returnable. Also, if it is proved that the assured has suffered loss because of the insurer's breach of this duty, then he can claim damages.<sup>1206</sup>

### C. Test of material circumstances

In English law, as early case law established, both parties are required to disclose and represent material circumstances which would influence the prudent insurer's decision and have actually induced the conclusion of an insurance contract, otherwise, the insurance contract may be avoided *ab initio*.<sup>1207</sup> The above operation

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<sup>1201</sup> According to para. 5.1.4G of the ICOBS, a firm should bear in mind the restriction on rejecting claims for non-disclosure (ICOBS 8.1.1R (3)). Ways of ensuring a customer knows what he must disclose include, (1) explaining the duty to disclose all circumstances material to a policy, what needs to be disclosed, and the consequences of any failure to make such a disclosure, or (2) ensuring that the customer is asked clear questions about any matter material to the insurance undertaking.

<sup>1202</sup> See § 4.3.3.3.

<sup>1203</sup> For the insurer's duty of lawful operation, see articles 4, 5, 6, 9 of CIL 2009 for example. For the insurer's duty of explanation, see article 17 of CIL 2009 and article 39 of Chinese Contract Law. See § 4.3 for details. Also see § 4.3.6.1 for legal effects of the insurer's noncompliance with the duty of lawful operation, especially regarding its administrative liabilities.

<sup>1204</sup> See § 4.3.6.1.3.

<sup>1205</sup> Article 17, CIL 2009 and articles 54 and 58 of Chinese Contract Law.

<sup>1206</sup> Article 58, Chinese Contract Law. See § 4.3.6.1.3.

<sup>1207</sup> See chapters 1 and 2. A similar test is adopted by § 3-1, Norwegian Marine Insurance Plan 1996, version 2010. The full text is available at <http://www.norwegianplan.no/eng/index.htm>, accessed in January 2013. As paragraph 1, § 3-1 provides, '[t]he person effecting the insurance shall, at the time

was confirmed to be functioning in both business and consumer insurance. However, after the approval of the Consumer Insurance (Disclosure and Representations) Act 2012, selected influential changes are made to abolish the average consumer assured's voluntary duty of disclosure and to replace the classic prudent insurer test with a reasonable assured test,<sup>1208</sup> which may constitute lessons to business insurance. Therefore, according to the current legislation, marine insurance (both consumer and business insurance) is still governed by MIA 1906. However, after the full enforcement of the Consumer Insurance (Disclosure and Representations) Act 2012, consumer marine insurance will be governed by the new Act, while the MIA 1906 will continue to direct business marine insurance.

The prudent insurer test is continued in Chinese marine insurance law, coexisting with the actual inducement test and decisive test.<sup>1209</sup> This author has addressed concerns in terms of the necessity of a decisive test under these circumstances.<sup>1210</sup>

#### **D. Extent of actual knowledge needs to be disclosed**

In English law, case examples of physical and moral hazard indicate the extent of actual knowledge needed to be disclosed to the insurer.<sup>1211</sup>

On the contrary, without further limitations and adjustments provided by subsequent cases, Chinese law is uncertain as to the boundary of the assured's actual knowledge. In the view of this author, since marine insurance is a globalized industry and the classic maritime legislation in China is founded on a set of

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the contract is concluded, make full and correct disclosure of all circumstances that are material to the insurer when deciding whether and on what conditions he is prepared to accept the insurance'.

<sup>1208</sup> See chapter 3 above.

<sup>1209</sup> See § 4.3.4.

<sup>1210</sup> See § 4.3.4.3.

<sup>1211</sup> See § 1.3.4 for detailed case examples.

international trade customs and practices, practical examples from the English legal system can become lessons for future Chinese legislation.

### **E. Limits on disclosure**

The duty of material circumstances disclosure in both the English and Chinese legal systems is not endless. According to UK legislation, MIA 1906 lists out exceptions which do not need to be disclosed.<sup>1212</sup> In Chinese law, the only exception expressed is that the insurer has known of or ought to have knowledge of in his ordinary business practice if the insurer made no inquiry,<sup>1213</sup> which is contained as one of the exceptions listed in MIA 1906, which is totally inadequate in practice.<sup>1214</sup> In the view of this author, the exceptional cases in English law can be extended to Chinese legislation since they are codified after a detailed observation of authoritative case reports.

### **F. Remedies available for pre-contract good faith breach**

With regard to English marine insurance law, the ‘all or nothing remedy’ is the only statutory provision available for the utmost good faith breach, which is mainly made available to the injured insurer in practice.<sup>1215</sup> The crucial pitfall of the avoidance *ab*

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<sup>1212</sup> Section 18(3), MIA 1906. See § 1.3.5 for detailed exceptions of the duty of disclosure in English law.

<sup>1213</sup> Article 222, CMC.

<sup>1214</sup> See § 4.3.5.

<sup>1215</sup> See chapters 1 and 2 above. A similar manner is adopted by the Norwegian Marine Insurance Plan 1996, version 2010, § 3-2 - § 3-4, by entitling the right to cancel the insurance contract to the insurer, both fraudulent and innocent non-disclosure, with notice given.

Chapter 3 defined the following as:

‘§ 3-2. Fraudulent misrepresentation

If the person effecting the insurance has fraudulently failed to fulfill his duty of disclosure, the contract is not binding on the insurer.

The insurer may also cancel other insurance contracts he has with the person effecting the insurance by giving fourteen days’ notice.

§ 3-3. Other failure to fulfil of the duty of disclosure

*initio* remedy is that it can be invoked by the injured party in consequence of the defaulting party's trivial and vital non-disclosure and misrepresentation, which is not appropriate. Therefore, the Law Commissioners proposed to introduce a proportionate remedy to protect innocent assureds.<sup>1216</sup> The current achievement regarding this issue is embodied by the Consumer Insurance (Disclosure and Representations) Act 2012, which provides that a proportionate remedy is available for careless/negligent misrepresentation,<sup>1217</sup> instead of the classic 'all or nothing' remedy.<sup>1218</sup> However, some leading academics intend to maintain the restrictions in business marine insurance since it is claimed that the adoption of a proportionate remedy may encourage the assured's negligence since no penalties would be made available.<sup>1219</sup>

In Chinese law, despite the use of different terms to describe the clarifications of non-disclosure and misrepresentation, misconducts with honesty are distinguished from those with fraud, namely, intentional and unintentional misconducts.<sup>1220</sup> Accordingly, on the basis of CMC, remedies available for the assured's non-

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If the person effecting the insurance has, at the time the contract is concluded, in any other way failed to fulfil his duty of disclosure, and it must be assumed that the insurer would not have accepted the insurance if the person effecting the insurance had made such disclosure as it was his duty to make, the contract is not binding on the insurer.

If it must be assumed that the insurer would have accepted the insurance, but on other conditions, he shall only be liable to the extent that it is proved that the loss is not attributable to such circumstances as the person effecting the insurance should have disclosed. Liability is limited in the same manner if the person effecting the insurance has been in breach of the duty of disclosure after the contract was concluded, unless it is proved that the loss occurred before the person effecting the insurance was able to correct the information supplied by him.

In the cases referred to in paragraph 2, the insurer may cancel the insurance by giving fourteen days' notice.

§ 3-4. Innocent breach of the duty of disclosure

If the person effecting the insurance has given incorrect or incomplete information without any blame attaching to him, the insurer is liable as if correct information had been given, but he may cancel the insurance by giving fourteen days' notice.'

<sup>1216</sup> See chapter 3.

<sup>1217</sup> Also, according to the Consumer Insurance (Disclosure and Representations) Act 2012, two types of qualifying misrepresentations are provided, namely, deliberate/reckless misrepresentation and careless/negligent misrepresentation. See chapter 3 for details.

<sup>1218</sup> See chapter 3.

<sup>1219</sup> *Ibid.*

<sup>1220</sup> See § 4.3.

disclosure vary in different cases. After a close examination, it can be concluded that the assured's intentional non-disclosure could lead to the insurance contract being terminated retrospectively, but the assured's unintentional non-disclosure only causes a prospective termination.<sup>1221</sup> Under the first circumstance, the defaulting party's dishonesty would also lead to the premium being unrecoverable. Compared to the classic all or nothing remedy in English law, the mechanism in Chinese law injects more flexibility to protect the innocent assured, which is also preferred by the draftsman in English consumer insurance.

## **(2). Post-contract stage**

### **A. Remedies available for post-contract events**

#### **i. Amendments and renewals of insurance contracts and the held covered clauses**

In English law, despite of the hindrances caused by the statutory avoidance *ab initio* remedy provided by MIA 1906 to govern post-contract utmost good faith, the judiciary prefer to limit the avoidance to contract variations/renewals and the alterations made in terms of the held covered clause only.<sup>1222</sup>

In Chinese law, it is found that a detailed format requirement of agreed amendments and renewals is imposed by CIL 2009, which requests a written agreement.<sup>1223</sup> In order to avoid potential disputes in terms of a vague amendment clause, the current Chinese law prefers declining the validity of the alteration in question, with the absence of a written agreement, which logically spreads to

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<sup>1221</sup> Articles 222 and 223, CMC. See § 4.3.6.2.

<sup>1222</sup> For example, *K/S Merc-Scandia XXXXII v Certain Lloyd's Underwriters (The Mercandian Continent)* [2001] 2 Lloyd's Rep. 563, CA, p. 574, per Longmore LJ. See § 5.2.3 for details.

<sup>1223</sup> See § 6.5.1.

contract renewals. Therefore, it can be concluded that in doing this, difficulties of the remedy issue regarding contract amendments and renewals are efficiently resolved by confining its extent to invalid variations and renewals only. In Chinese law, the held covered clause is also popularly adopted by main insurance clauses in practice, and an automatic termination of insurance contract could be awarded with an absence of prompt notice. This means that the insurance contract is repudiated immediately at the breach of the assured's good faith under the held covered clause without affecting the previous effect of the contract.

## **ii. Alteration of risks**

Similarities are recognized between Chinese law and English case law in terms of the assured's failure in the duty of alteration of risk notification. Sections 45, 46 and 48 of MIA 1906 specify the remedies available for the insurer in cases where the assured fails to perform this duty under the circumstances including the change of voyage, deviation and a delay in voyage.<sup>1224</sup> Apart from the abovementioned circumstances, no other continuing duty of disclosure is required since the judiciary are reluctant to impose an endless duty on the assured. Judging from the above English statutory legislation, after the making of an insurance contract, the remedies available for the assured's good faith breach regarding alterations of risks are preferred to be a prospective forfeiture of claims caused by the concealment.

In Chinese law, the assured's duty of disclosing significantly increased risks is embodied by an express term in practice, but this is not a mandatory obligation. On

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<sup>1224</sup> While, in the Norwegian Marine Insurance Plan 1996, version 2010, paragraph 2 of § 3-8 stipulates that '[a] change of the State of registration, the manager of the ship or the company which is responsible for the technical/maritime operation of the ship shall be deemed to be an alteration of the risk as defined by paragraph 1', which applies to 'a change of classification society'.

the basis of an expressed notification clause, the assured's noncompliance with this duty may invoke extra premium and/or an immediate termination of insurance.<sup>1225</sup>

### **iii. Fraudulent claims**

In the UK, Misrepresentation Act 1967, MIA 1906, English case law and other practical codes provide different manners for the assured's fraudulent claims, namely, avoidance *ab initio* and forfeiture of claim(s).<sup>1226</sup>

It is revealed that compared with English case law, Chinese insurance legislation provides a set of flexible remedies available for the assured's fraudulent claims, particularly upon its legal nature. After a deep analysis, it can be concluded that there is zero tolerance of any fraud in insurance. Nevertheless, the remedy or forfeiture awarded to the defaulting insurer is prospectively confined to the contaminated claims only. In order to express their decisions to forbid any fraud in insurance and encourage commercial transactions based on good faith, Chinese legislators allow the insurer to keep any premium paid from the assured, as a sanction.<sup>1227</sup>

## **B. Insurer's late payment**

In Chinese law, paragraph 2, article 23 of CIL 2009, provides that in cases where the insurer fails to fulfil the obligation of making reasonable indemnifications in time, the insurer shall compensate the assured or the beneficiary for any damage incurred as a remedy in addition to the payment of compensation. Furthermore, based on paragraph 3 of this article, the insurer's obligation for indemnity or payment of the

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<sup>1225</sup> See § 6.2.2.2.

<sup>1226</sup> Under the second circumstance, if there are several claims promoted by the assured in total, a forfeiture remedy is applied to the contaminated claim(s) only but not the genuine ones; if there is only one claim promoted by the assured, a forfeiture remedy is applied to the whole fraudulent claim, but not to the insurance contract. See § 5.3.4.

<sup>1227</sup> See § 6.5.6.

insurance benefits is defined as a legal obligation, and it is illegal for any entity or individual to interfere with the insurer's obligation for indemnity or payment of the insurance benefits, or to hinder the assured's right to receive the payment.

In current English case law, the judiciary is extremely reluctant to award any compensation for the marine insurer's rejection of valid claims or unreasonable delay in indemnifying the assured's claims.<sup>1228</sup> However, the Law Commissioners proposed to introduce the existing FOS and the original FAS rules in England and Wales in consumer insurance to business insurance, in order to govern the business insurer's performance of reasonable indemnification liabilities.<sup>1229</sup>

### **(3). Agent's good faith: recommendations**

In English law, the duty of disclosure is also imposed on the insurance agent. On the basis of section 19 of the MIA 1906, an agent must disclose any material circumstance which is known by himself, and that is deemed to be known or that has been communicated to him in the ordinary course of business.<sup>1230</sup> Furthermore, this section also stipulates that every material circumstance which the assured is bound to disclose must be disclosed by the agent to the insurer as well, unless it comes to his knowledge too late.<sup>1231</sup> In fact, extending the agent's duty of disclosure regime from English law to Chinese law is not inappropriate since now the shipping industry has been advanced to a worldwide and flourishing industry.

In Chinese law, the scope of information that needs to be disclosed by the agent is still uncertain. However, the MIA 1906 could be applied to offer a solution by defining that the scope of information that needs to be disclosed by the agent as the

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<sup>1228</sup> But this is not applied to consumer insurance. See § 5.4 for details.

<sup>1229</sup> CP 2. See § 5.5 for details. Of course, the original FSA rules are replaced by the FCA Handbook, which is mainly governing insurance practice in the UK, cooperating with the PRA.

<sup>1230</sup> Section 19(1), MIA 1906.

<sup>1231</sup> Section 19(2), MIA 1906.



knowledge which is known, or ought to be known in the ordinary course of business, and the information which the assured is bound to disclose and has been communicated to the agent in due course. However, one leading scholar asserts that in Chinese law, the agent shall undertake an independent duty to disclose information or knowledge based on himself, but not the information transferred from the insured.<sup>1232</sup> This issue is still left for further clarification through judicial interpretations.

### **Initiatives at the European Union level**

At the European level, the EU Project Group 'Restatement of European Insurance Contract Law' was created to draft a Restatement of European Insurance Contract Law (Restatement), which is functioning as a Model Law in general insurance for the European and other national legislators.<sup>1233</sup> One recent significant achievement is the publication of '*Principles of European Insurance Contract Law (PEICL)*' in 2009,<sup>1234</sup> which was adopted as a fundamental element of an Optional Instrument including Insurance Contract Law in 2011.<sup>1235</sup> Although it is found that there are not special rules for individual branches of insurance law, such as marine insurance, the initiatives relating to good faith from the Restatement could still provide lessons for both English and Chinese marine insurance law reform.<sup>1236</sup>

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<sup>1232</sup> Pengnan Wang, 'The duty of disclosure and the legal consequences of its breach', in *ACML*, p. 161.

<sup>1233</sup> For a brief introduction of this European project, see § 3.2.1.

<sup>1234</sup> Project Group Restatement of European Insurance Contract Law, *Principles of European Insurance Contract Law (PEICL)* (Munich: Sellier European Law Publishers, October 2009).

<sup>1235</sup> European Parliament, *Resolution on policy options for progress towards a European Contract Law for consumers and businesses*, (2011, 2011/2013(INI)).

<sup>1236</sup> See § 3.2.1 for detailed discussion.

## **Should the English duty of utmost good faith be adopted by Chinese marine insurance law at once or incrementally?**

As previously discussed, because of the influences made by the doctrine of binding precedent in English law, and the unchallengeable position of London in the global marine industry, there is a tendency to extend the regime of utmost good faith to Chinese law. The issue of Recommendations by the Project Team is a conspicuous example.<sup>1237</sup>

However, this recommendation has been doubted for its feasibility and scrutiny.<sup>1238</sup> In the view of this author, the adoption of the typical English duty of utmost good faith in China is still a distant task. The fundamental reason for this author's presumption is lying in the characteristics of a civil law system, and specifically in Chinese law.<sup>1239</sup> Apart from the general characters of the civil law system, the uniquenesses of Chinese legislation is worthwhile to be introduced here. In China, law is enacted by the National People's Congress and local governments or authorities. In an absence of adequate legislation, the Supreme People's Courts and the Supreme People's Procuratorate are allowed to issue 'judicial interpretations' on point of law.<sup>1240</sup> Actually, 'judicial interpretations' can be divided into interpretations, regulations, replies and decisions, depending on relevant codes in question.<sup>1241</sup> Of course, High People's Courts, People's Procuratorates and authorized Specialized Courts are endowed with the power to make a proposal, ask for instructions or make suggestions in terms of judicial interpretations, and the Supreme People's

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<sup>1237</sup> See § 4.1.

<sup>1238</sup> For example, Zhu and Li, 'Should the Principle of Utmost Good Faith be adopted in CMC? – Theoretical Recommendations on the Principle of Utmost Good Faith in the Marine Insurance Law', in *ACML*, pp. 55-68.

<sup>1239</sup> For the history of Chinese law, see the beginning of chapter 4.

<sup>1240</sup> Resolution of the Standing Committee of the National People's Congress Providing an Improved Interpretation of the Law.

<sup>1241</sup> Article 6, Provisions of the Supreme People's Court on the Judicial Interpretation Work (No.12 [2007] of the Supreme People's Court March 23<sup>rd</sup>, 2007).

Procuratorate will make the final decision.<sup>1242</sup> Combined with the typical nature of a civil law system relying more on scholarly literatures rather than judicial decisions, it can be concluded that as distinct from English law, case law is not considered as a main resource in the Chinese legal system.

Additionally, there are also some other considerable factors. Firstly, as explained in previous paragraphs, the utmost good faith doctrine would not be legally recognized by Chinese courts until its legal status is confirmed by the issue of a new statute or judicial interpretation by the Supreme People's Court or the Supreme People's Procuratorate of the PRC, or clarified by express contract clauses. In China, as stated earlier, the only remedy for current legislative defects is a new statutory legislation or judicial interpretation issued by the Supreme People's Court and the Supreme People's Procuratorate of the PRC (including local authorities), or alternatively, amendments of existing laws. Even though this recommendation is adopted by China, judging from what has been accomplished so far, there is, as yet, no fast-track solution.

Secondly, inevitable theoretical barriers would put this thought of adopting the whole package of English duty of utmost good faith at the forefront of efforts to enforce the same doctrine in China, in particular the distinct legal natures of civil law and common law systems.<sup>1243</sup> Obviously, the doctrine of good faith is a subjective theory but not a concrete concept, and the concept of utmost good faith seems to be too challenging and intangible to be enforced correctly. Although English courts have established a series of standards to balance and scrutinize its enforcement (for instance, the 'prudent insurer actual inducement' test for materiality and rescission of an insurance contract, and the confirmation of its mutuality during insurance

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<sup>1242</sup> *Ibid*, and Article 6, Provisions of the Supreme People's Procuratorate on the Judicial Interpretation Work (No. 4 [2006] of the Supreme People's Procuratorate).

<sup>1243</sup> *Ibid*, at pp. 60-61.

transactions, and also the mechanism governing post-contract events), it is still one of the most controversial legal topics because of its complexity and controversy. The precedent doctrine is an ideal supporting tool to fix any defects caused by vulnerable or vague legislation, but judicial precedent only works appropriately in a common law system and only has a mere persuasive role in a civil law system. Therefore, 'certainty' becomes a necessary element for civil law legislation, and all of the subsequent limitations and interpretations established by judgements actually have no direct effect for the validity of current Chinese legislation. In the case of a theoretical utmost good faith doctrine, English law proves its flexibility which is a characteristic of a system based on precedent.

Furthermore, some practical difficulties would set a higher threshold for its enforcement, especially in the absence of comprehensive legislation and scrutiny in Chinese law. On the one hand, the complexity of the theoretical doctrine leads to the occurrence of uncertainty, which is not acceptable by China as a civil law country. The inevitable defects, on the other hand, are difficult to be fixed through further judicial cases in China. For instance, how does one avoid that the insurance companies use this as a technical defence to release themselves from further liabilities after the occurrence of an accident?<sup>1244</sup> At common law, further restrictions can be imposed through judicial precedents, but not in a civil law country.

Finally, section 17 of the MIA 1906 itself is in a very difficult situation in English law at present. The duty of utmost good faith has been standing for around two centuries; however, there are increasing calls for reform. One reason is that the MIA 1906 is itself now outdated in view of technological advances. There are several pressing aspects for pre-contract information reform in the England system. Firstly, the range of

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<sup>1244</sup> Wang, *The Law of Marine Insurance*, p. 43.

information needed to be disclosed should be adjusted since the voluntary duty of disclosure is addressed mainly to the assured. Secondly, it needs to be questioned whether the 'prudent insurer' test requires modification. Thirdly, the avoidance remedy is criticized to be too harsh for the defaulting party in breach, especially for the wholly innocent assureds. Finally, the 'proportionality approach' in statute law<sup>1245</sup> can be extended to marine insurance, and also the legal basis of utmost good faith in post-contract events. Apart from the revolutionary and material movements conducted in the UK, some other countries are also interested in the development of their own marine insurance legislation, especially the review of MIA 1909 made by the Australian Law Commission.<sup>1246</sup> All these movements just prove that the status of the MIA 1906 in business insurance is likely to be challenged in the near future, including the duty of utmost good faith. In the view of this author, the proposed changes in English law need to be taken into account.

After evaluating the enforceability and difficulties of adopting section 17 of MIA 1906 in Chinese marine insurance industry, it is found that more issues are revealed. On the one hand, it seems to be challenged on the grounds that social, economic and technical change, and even political change, have reversed the informational asymmetry between the insurer and assured at the beginning of their relationship. This factor also seems to be strong enough to shake the foundation of this doctrine. In addition to the enquiries regarding its fundamentals, this doctrine has been criticised on its detailed application rules. Therefore, in the view of this thesis, it is not right to simply duplicate the whole package of the English utmost good faith doctrine

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<sup>1245</sup> Misrepresentation Act 1967. Also Schedule 1, Consumer Insurance (Disclosure and Representations) Act 2012.

<sup>1246</sup> 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'*.

into Chinese law. Imminent and proposed changes in English law, however, need to be taken into account.

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## Appendix 1

### Marine Insurance Act 1906<sup>1247</sup>

#### 1906 CHAPTER 41 6 Edw 7

An Act to codify the Law relating to Marine Insurance.

#### 1. MARINE INSURANCE DEFINED

A contract of marine insurance is a contract whereby the insurer undertakes to indemnify the assured, in manner and to the extent thereby by agreed, against marine losses, that is to say, the losses incident to marine adventure.

#### 2. MIXED SEA AND LAND RISKS

1. A contract of marine insurance may, by its express terms, or by usage of trade, be extended so as to protect the assured against losses on inland waters or on any land risk which may be incidental to any sea voyage.
2. Where a ship in course of building, or the launch of a ship, or any adventure analogous to a marine adventure, is covered by a policy in the form of a marine policy, the provisions of this Act, in so far as applicable, shall apply thereto; but, except as by this section provided, nothing in this Act shall alter or affect any rule of law applicable to any contract of insurance other than a contract of marine insurance as by this Act defined.

#### 3. MARINE ADVENTURE AND MARITIME PERILS DEFINED

1. Subject to the provisions of this Act, every lawful marine adventure may be the subject of a contract of marine insurance.
2. In particular there is a marine adventure where—
  - a. Any ship, goods or other moveables are exposed to maritime perils. Such property is in this Act referred to as "insurable property";
  - b. The earning or acquisition of any freight, passage money, commission, profit, or other pecuniary benefit, or the security for any advances, loan, or disbursements, is endangered by the exposure of insurable property to maritime perils;
  - c. Any liability to a third party may be incurred by the owner of, or other person interested in or responsible for, insurable property, by reason of maritime perils.

"Maritime perils" means the perils consequent on, or incidental to, the navigation of the sea, that is to say, perils of the sea, fire, war perils, pirates, rovers, thieves,

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<sup>1247</sup> Please note that amendments effected by the Consumer Insurance (Disclosure and Representations) Act 2012 are not included as the thesis reflects position in February 2013.

captures, seizures, restraints, and detentions of princes and peoples, jettisons, barratry, and any other perils, either of the like kind or which may be designated by the policy.

### **Insurable Interest**

#### **4. AVOIDANCE OF WAGERING OR GAMING CONTRACTS**

1. Every contract of marine insurance by way of gaming or wagering is void.
2. A contract of marine insurance is deemed to be a gaming or wagering contract—
  - a. Where the assured has not an insurable interest as defined by this Act, and the contract is entered into with no expectation of acquiring such an interest; or
  - b. Where the policy is made "interest or no interest", or "without further proof of interest than the policy itself", or "without benefit of salvage to the insurer", or subject to any other like term:

Provided that, where there is no possibility of salvage, a policy may be effected without benefit of salvage to the insurer.

#### **5. INSURABLE INTEREST DEFINED**

1. Subject to the provisions of this Act, every person has an insurable interest who is interested in a marine adventure.
2. In particular a person is interested in a marine adventure where he stands in any legal or equitable relation to the adventure or to any insurable property at risk therein, in consequence of which he may benefit by the safety or due arrival of insurable property, or may be prejudiced by its loss, or damage thereto, or by the detention thereof, or may incur liability in respect thereof.

#### **6. WHEN INTEREST MUST ATTACH**

1. The assured must be interested in the subject-matter insured at the time of the loss though he need not be interested when the insurance is effected: Provided that where the subject-matter is insured "lost or not lost", the assured may recover although he may not have acquired his interest until after the loss, unless at the time of effecting the contract of insurance the assured was aware of the loss, and the insurer was not.
2. Where the assured has no interest at the time of the loss, he cannot acquire interest by any act or election after he is aware of the loss.

#### **7. DEFEASIBLE OR CONTINGENT INTEREST**

1. A defeasible interest is insurable, as also is a contingent interest.
2. In particular, where the buyer of goods has insured them, he has an insurable interest, notwithstanding that he might, at his election, have rejected the goods, or have treated them as at the seller's risk, by reason of the latter's delay in making delivery or otherwise.



## **8. PARTIAL INTEREST**

A partial interest of any nature is insurable.

## **9. RE-INSURANCE**

1. The insurer under a contract of marine insurance has an insurable interest in his risk, and may re-insure in respect of it.
2. Unless the policy otherwise provides, the original assured has no right or interest in respect of such re-insurance.

## **10. BOTTOMRY**

The lender of money on bottomry or *respondentia* has an insurable interest in respect of the loan.

## **11. MASTER'S AND SEAMEN'S WAGES**

The master or any member of the crew of a ship has an insurable interest in respect of his wages.

## **12. ADVANCE FREIGHT**

In the case of advance freight, the person advancing the freight has an insurable interest, in so far as such freight is not repayable in case of loss.

## **13. CHARGES OF INSURANCE**

The assured has an insurable interest in the charges of any insurance which he may effect.

## **14. QUANTUM OF INTEREST**

1. Where the subject-matter insured is mortgaged, the mortgagor has an insurable interest in the full value thereof, and the mortgagee has an insurable interest in respect of any sum due or to become due under the mortgage.
2. A mortgagee, consignee, or other person having an interest in the subject-matter insured may insure on behalf and for the benefit of other persons interested as well as for his own benefit.
3. The owner of insurable property has an insurable interest in respect of the full value thereof, notwithstanding that some third person may have agreed, or be liable, to indemnify him in case of loss.

## **15. ASSIGNMENT OF INTEREST**

Where the assured assigns or otherwise parts with his interest in the subject-matter insured, he does not thereby transfer to the assignee his rights under the contract of insurance, unless there be an express or implied agreement with the assignee to that effect.

But the provisions of this section do not affect a transmission of interest by operation of law.

## **Insurable Value**

### **16. MEASURE OF INSURABLE VALUE**

Subject to any express provision or valuation in the policy, the insurable value of the subject-matter insured must be ascertained as follows—

1. In insurance on ship, the insurable value is the value, at the commencement of the risk, of the ship, including her outfit, provisions and stores for the officers and crew, money advanced for seamen's wages, and other disbursements (if any) incurred to make the ship fit for the voyage or adventure contemplated by the policy, plus the charges of insurance upon the whole;  
The insurable value, in the case of a steamship, includes also the machinery, boilers, and coals and engine stores if owned by the assured, and, in the case of a ship engaged in a special trade, the ordinary fittings requisite for that trade;
2. In insurance on freight, whether paid in advance or otherwise, the insurance value is the gross amount of the freight at the risk of the assured, plus the charges of insurance;
3. In insurance on goods or merchandise, the insurable value is the prime cost of the property insured, plus the expenses of and incidental to shipping and the charges of insurance upon the whole;
4. In insurance on any other subject-matter, the insurable value is the amount at the risk of the assured when the policy attaches, plus the charges of insurance.

## **Disclosure And Representations**

### **17. INSURANCE IS *UBERRIMAE FIDEI***

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.

### **18. DISCLOSURE BY ASSURED**

1. Subject to the provisions of this section, 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.
2. Every circumstance is material which would influence the judgment of a prudent insurer in fixing the premium, or determining whether he will take the risk.
3. In the absence of inquiry the following circumstances need not be disclosed, namely:—

- a. Any circumstance which diminishes the risk;
  - b. Any circumstance which is known or presumed to be known to the insurer. The insurer is presumed to know matters of common notoriety or knowledge, and matters which an insurer in the ordinary course of his business, as such, ought to know;
  - c. Any circumstance as to which information is waived by the insurer;
  - d. Any circumstance which it is superfluous to disclose by reason of any express or implied warranty.
4. Whether any particular circumstance, which is not disclosed, be material or not is, in each case, a question of fact.
  5. The term "circumstance" includes any communication made to, or information received by, the assured.

## **19. DISCLOSURE BY AGENT EFFECTING INSURANCE**

Subject to the provisions of the preceding section as to circumstances which need not be disclosed, where an insurance is effected for the assured by an agent, the agent must disclose to the insurer—

- a. 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; and
- b. Every material circumstance which the assured is bound to disclose, unless it come to his knowledge too late to communicate it to the agent.

## **20. REPRESENTATIONS PENDING NEGOTIATION OF CONTRACT**

1. Every material representation made by the assured or his agent to the insurer during the negotiations for the contract, and before the contract is concluded, must be true. If it be untrue the insurer may avoid the contract.
2. A representation is material which would influence the judgment of a prudent insurer in fixing the premium, or determining whether he will take the risk.
3. A representation may be either a representation as to a matter of fact, or as to a matter of expectation or belief.
4. A representation as to matter of fact is true, if it be substantially correct, that is to say, if the difference between what is represented and what is actually correct would not be considered material by a prudent insurer.
5. A representation as to a matter of expectation or belief is true if it be made in good faith.
6. A representation may be withdrawn or corrected before the contract is concluded.
7. Whether a particular representation be material or not is, in each case, a question of fact.

## **21. WHEN CONTRACT IS DEEMED TO BE CONCLUDED**

A contract of marine insurance is deemed to be concluded when the proposal of the assured is accepted by the insurer, whether the policy be then issued or not; and, for the purpose of showing when the proposal was accepted, reference may be made to

the slip or covering note or other customary memorandum of the contract, [*although it be stamped*].

**NOTE:**

*[Words in italics] deleted by the Finance Act 1959, s 37(5), Sch 8, Pt II.*

## **22. CONTRACT MUST BE EMBODIED IN POLICY**

Subject to the provisions of any statute, a contract of marine insurance is inadmissible in evidence unless it is embodied in a marine policy in accordance with this Act. The policy may be executed and issued either at the time when the contract is concluded, or afterwards.

## **23. WHAT POLICY MUST SPECIFY**

A Marine policy must specify—

1. The name of the assured, or of some person who effects the insurance on his behalf;
2. *The subject-matter insured and the risk insured against;*
3. *The voyage, or period of time, or both , as the case may be, covered by the insurance;*
4. *The sum or sums insured;*
5. *The name or names of the insurers.*

**NOTE:**

*Sub-ss (2)–(5): repealed by the Finance Act 1959, ss 30(5), (7), 37(5), Sch 8, Pt II.*

## **24. SIGNATURE OF INSURER**

1. A marine policy must be signed by or on behalf of the insurer, provided that in the case of a corporation the corporate seal may be sufficient, but nothing in this section shall be construed as requiring the subscription of a corporation to be under seal.
2. Where a policy is subscribed by or on behalf of two or more insurers, each subscription, unless the contrary be expressed, constitutes a distinct contract with the assured.

## **25. VOYAGE AND TIME POLICIES**

1. Where the contract is to insure the subject-matter "at and from", or from one place to another or others, the policy is called a "voyage policy", and where the contract is to insure the subject-matter for a definite period of time the policy is called a "time policy". A contract for both voyage and time may be included in the same policy.
2. *Subject to the provisions of s 11 of the Finance Act, 1901, a time policy which is made for any time exceeding 12 months is invalid.*

**NOTE:**

*Sub-s (2): repealed by the Finance Act 1959, ss 30(5), (7), 37(5), Sch 8, Pt II.*

## **26. DESIGNATION OF SUBJECT-MATTER**

1. The subject-matter insured must be designated in a marine policy with reasonable certainty.
2. The nature and extent of the interest of the assured in the subject-matter insured need not be specified in the policy.
3. Where the policy designates the subject-matter insured in general terms, it shall be construed to apply to the interest intended by the assured to be covered.
4. In the application of this section regard shall be had to any usage regulating the designation of the subject-matter insured.

## **27. VALUED POLICY**

1. A policy may be either valued or unvalued.
2. A valued policy is a policy which specifies the agreed value of the subject-matter insured.
3. Subject to the provisions of this Act, and in the absence of fraud, the value fixed by the policy is, as between the insurer and assured, conclusive of the insurable value of the subject intended to be insured, whether the loss be total or partial.
4. Unless the policy otherwise provides, the value fixed by the policy is not conclusive for the purpose of determining whether there has been a constructive total loss.

## **28. UNVALUED POLICY**

An unvalued policy is a policy which does not specify the value of the subject-matter insured, but, subject to the limit of the sum insured, leaves the insurable value to be subsequently ascertained, in the manner hereinbefore specified.

## **29. FLOATING POLICY BY SHIP OR SHIPS**

1. A floating policy is a policy which describes the insurance in general terms, and leaves the name of the ship or ships and other particulars to be defined by subsequent declaration.
2. The subsequent declaration or declarations may be made by indorsement on the policy, or in other customary manner.
3. Unless the policy otherwise provides, the declarations must be made in the order of dispatch or shipment. They must, in the case of goods, comprise all consignments within the terms of the policy, and the value of the goods or other property must be honestly stated, but an omission or erroneous declaration may be rectified even after loss or arrival, provided the omission or declaration was made in good faith.
4. Unless the policy otherwise provides, where a declaration of value is not made until after notice of loss or arrival, the policy must be treated as an unvalued policy as regards the subject-matter of that declaration.

## **30. CONSTRUCTION OF TERMS IN POLICY**

1. A policy may be in the form in the First Schedule of this Act.
2. Subject to the provisions of this Act, and unless the context of the policy otherwise requires, the terms and expressions mentioned in the First Schedule to this Act shall be construed as having the scope and meaning in that schedule assigned to them.

### **31. PREMIUM TO BE ARRANGED**

1. Where an insurance is effected at a premium to be arranged, and no arrangement is made, a reasonable premium is payable.
2. Where an insurance is effected on the terms that an additional premium is to be arranged in a given event, and that event happens but no arrangement is made, then a reasonable additional premium is payable.

### **Double Insurance**

### **32. DOUBLE INSURANCE**

1. Where two or more policies are effected by or on behalf of the assured on the same adventure and interest or any part thereof, and the sums insured exceed the indemnity allowed by this Act, the assured is said to be over-insured by double insurance.
2. Where the assured is over-insured by double insurance—
  - a. The assured, unless the policy otherwise provides, may claim payment from the insurers in such order as he may think fit, provided that he is not entitled to receive any sum in excess of the indemnity allowed by this Act;
  - b. Where the policy under which the assured claims is a valued policy, the assured must give credit as against the valuation for any sum received by him under any other policy without regard to the actual value of the subject-matter insured;
  - c. Where the policy under which the assured claims is an unvalued policy he must give credit, as against the full insurable value, for any sum received by him under any other policy;
  - d. Where the assured receives any sum in excess of the indemnity allowed by this Act, he is deemed to hold such sum in trust for the insurers, according to their right of contribution among themselves.

### **Warranties, Etc.**

### **33. NATURE OF WARRANTY**

1. A warranty, in the following sections relating to warranties, means a promissory warranty, that is to say, a warranty by which the assured undertakes that some particular thing shall or shall not be done, or that some condition shall be fulfilled, or whereby he affirms or negatives the existence of a particular state of facts.
2. A warranty may be express or implied.
3. A warranty, as above defined, is a condition which must be exactly complied with, whether it be material to the risk or not. If it be not so complied with, then,

subject to any express provision in the policy, the insurer is discharged from liability as from the date of the breach of warranty, but without prejudice to any liability incurred by him before that date.

#### **34. WHEN BREACH OF WARRANTY EXCUSED**

1. Non-compliance with a warranty is excused when, by reason of a change of circumstances, the warranty ceases to be applicable to the circumstances of the contract, or when compliance with the warranty is rendered unlawful by any subsequent law.
2. Where a warranty is broken, the assured cannot avail himself of the defence that the breach has been remedied, and the warranty complied with, before loss.
3. A breach of warranty may be waived by the insurer.

#### **35. EXPRESS WARRANTIES**

1. An express warranty may be in any form of words from which the intention to warrant is to be inferred.
2. An express warranty must be included in, or written upon, the policy, or must be contained in some document incorporated by reference into the policy.
3. An express warranty does not exclude an implied warranty, unless it be inconsistent therewith.

#### **36. WARRANTY OF NEUTRALITY**

1. Where insurable property, whether ship or goods, is expressly warranted neutral, there is an implied condition that the property shall have a neutral character at the commencement of the risk, and that, so far as the assured can control the matter, its neutral character shall be preserved during the risk.
2. Where a ship is expressly warranted "neutral" there is also an implied condition that, so far as the assured can control the matter, she shall be properly documented, that is to say, that she shall carry the necessary papers to establish her neutrality, and that she shall not falsify or suppress her papers, or use simulated papers. If any loss occurs through breach of this condition, the insurer may avoid the contract.

#### **37. NO IMPLIED WARRANTY OF NATIONALITY**

There is no implied warranty as to the nationality of a ship, or that her nationality shall not be changed during the risk.

#### **38. WARRANTY OF GOOD SAFETY**

Where the subject-matter insured is warranted "well" or "in good safety" on a particular day, it is sufficient if it be safe at any time during that day.

#### **39. WARRANTY OF SEAWORTHINESS OF SHIP**

1. In a voyage policy there is an implied warranty that at the commencement of the voyage the ship shall be seaworthy for the purpose of the particular adventure insured.
2. Where the policy attaches while the ship is in port, there is also an implied warranty that she shall, at the commencement of the risk, be reasonably fit to encounter the ordinary perils of the port.
3. Where the policy relates to a voyage which is performed in different stages, during which the ship requires different kinds of or further preparation or equipment, there is an implied warranty that at the commencement of each stage the ship is seaworthy in respect of such preparation or equipment for the purposes of that stage.
4. A ship is deemed to be seaworthy when she is reasonably fit in all respects to encounter the ordinary perils of the seas of the adventure insured.
5. In a time policy there is no implied warranty that the ship shall be seaworthy at any stage of the adventure, but where, with the privity of the assured, the ship is sent to sea in an unseaworthy state, the insurer is not liable for any loss attributable to unseaworthiness.

#### **40. NO IMPLIED WARRANTY THAT GOODS ARE SEAWORTHY**

1. In a policy on goods or other moveables there is no implied warranty that the goods or moveables are seaworthy.
2. In a voyage policy on goods or other moveables there is an implied warranty that at the commencement of the voyage the ship is not only seaworthy as a ship, but also that she is reasonably fit to carry the goods or other moveables to the destination contemplated by the policy.

#### **41. WARRANTY OF LEGALITY**

There is an implied warranty that the adventure insured is a lawful one, and that, so far as the assured can control the matter, the adventure shall be carried out in a lawful manner.

#### **The Voyage**

#### **42. IMPLIED CONDITION AS TO COMMENCEMENT OF RISK**

1. Where the subject-matter is insured by a voyage policy "at and from" or "from" a particular place, it is not necessary that the ship should be at that place when the contract is concluded, but there is an implied condition that the adventure shall be commenced within a reasonable time, and that if the adventure be not so commenced the insurer may avoid the contract.
2. The implied condition may be negated by showing that the delay was caused by circumstances known to the insurer before the contract was concluded, or by showing that he waived the condition.

#### **43. ALTERATION OF PORT OF DEPARTURE**

Where the place of departure is specified by the policy, and the ship instead of sailing from that place sails from any other place, the risk does not attach.



#### **44. SAILING FOR DIFFERENT DESTINATION**

Where the destination is specified in the policy, and the ship, instead of sailing for that destination, sails for any other destination, the risk does not attach.

#### **45. CHANGE OF VOYAGE**

1. Where, after the commencement of the risk, the destination of the ship is voluntarily changed from the destination contemplated by the policy, there is said to be a change of voyage.
2. Unless the policy otherwise provides, where there is a change of voyage, the insurer is discharged from liability as from the time of change, that is to say, as from the time when the determination to change it is manifested; and it is immaterial that the ship may not in fact have left the course of voyage contemplated by the policy when the loss occurs.

#### **46. DEVIATION**

1. Where a ship, without lawful excuse, deviates from the voyage contemplated by the policy, the insurer is discharged from liability as from the time of deviation, and it is immaterial that the ship may have regained her route before any loss occurs.
2. There is a deviation from the voyage contemplated by the policy—
  - a. Where the course of the voyage is specifically designated by the policy, and that course is departed from; or
  - b. Where the course of the voyage is not specifically designated by the policy, but the usual and customary course is departed from.
3. The intention to deviate is immaterial; there must be a deviation in fact to discharge the insurer from his liability under the contract.

#### **47. SEVERAL PORTS OF DISCHARGE**

1. Where several ports of discharge are specified by the policy, the ship may proceed to all or any of them, but, in the absence of any usage or sufficient cause to the contrary, she must proceed to them, or such of them as she goes to, in the order designated by the policy. If she does not there is a deviation.
2. Where the policy is to "ports of discharge", within a given area, which are not named, the ship must, in the absence of any usage or sufficient cause to the contrary, proceed to them, or such of them as she goes to, in their geographical order. If she does not there is a deviation.

#### **48. DELAY IN VOYAGE**

In the case of a voyage policy, the adventure insured must be prosecuted throughout its course with reasonable dispatch, and, if without lawful excuse it is not so prosecuted, the insurer is discharged from liability as from the time when the delay became unreasonable.

#### **49. EXCUSES FOR DEVIATION OR DELAY**

1. Deviation or delay in prosecuting the voyage contemplated by the policy is excused—
  - a. Where authorised by any special term in the policy; or
  - b. Where caused by circumstances beyond the control of the master and his employer; or
  - c. Where reasonably necessary in order to comply with an express or implied warranty; or
  - d. Where reasonably necessary for the safety of the ship or subject-matter insured; or
  - e. For the purpose of saving human life, or aiding a ship in distress where human life may be in danger; or
  - f. Where reasonably necessary for the purpose of obtaining medical or surgical aid for any person on board the ship; or
  - g. Where caused by the barratrous conduct of the master or crew, if barratry be one of the perils insured against.
2. When the cause excusing the deviation or delay ceases to operate, the ship must resume her course, and prosecute her voyage, with reasonable dispatch.

### **Assignment of Policy**

#### **50. WHEN AND HOW POLICY IS ASSIGNABLE**

1. A marine policy is assignable unless it contains terms expressly prohibiting assignment. It may be assigned either before or after loss.
2. Where a marine policy has been assigned so as to pass the beneficial interest in such policy, the assignee of the policy is entitled to sue thereon in his own name; and the defendant is entitled to make any defence arising out of the contract which he would have been entitled to make if the action had been brought in the name of the person by or on behalf of whom the policy was effected.
3. A marine policy may be assigned by indorsement thereon or in other customary manner.

#### **51. ASSURED WHO HAS NO INTEREST CANNOT ASSIGN**

Where the assured has parted with or lost his interest in the subject-matter insured, and has not, before or at the time of so doing, expressly or impliedly agreed to assign the policy, any subsequent assignment of the policy is inoperative:

Provided that nothing in this section affects the assignment of a policy after loss.

### **The Premium**

#### **52. WHEN PREMIUM PAYABLE**

Unless otherwise agreed, the duty of the assured or his agent to pay the premium, and the duty of the insurer to issue the policy to the assured or his agent, are concurrent conditions, and the insurer is not bound to issue the policy until payment or tender of the premium.

### **53. POLICY EFFECTED THROUGH BROKER**

1. Unless otherwise agreed, where a marine policy is effected on behalf of the assured by a broker, the broker is directly responsible to the insurer for the premium, and the insurer is directly responsible to the assured for the amount which may be payable in respect of losses, or in respect of returnable premium.
2. Unless otherwise agreed, the broker has, as against the assured, a lien upon the policy for the amount of the premium and his charges in respect of effecting the policy; and, where he has dealt with the person who employs him as a principal, he has also a lien on the policy in respect of any balance on any insurance account which may be due to him from such person, unless when the debt was incurred he had reason to believe that such person was only an agent.

### **54. EFFECT OF RECEIPT ON POLICY**

Where a marine policy effected on behalf of the assured by a broker acknowledges the receipt of the premium, such acknowledgment is, in the absence of fraud, conclusive as between the insurer and the assured, but not as between the insurer and broker.

### **Loss and Abandonment**

### **55. INCLUDED AND EXCLUDED LOSSES**

1. Subject to the provisions of this Act, and unless the policy otherwise provides, the insurer is liable for any loss proximately caused by a peril insured against, but, subject as aforesaid, he is not liable for any loss which is not proximately caused by a peril insured against.
2. In particular—
  - a. The insurer is not liable for any loss attributable to the wilful misconduct of the assured, but unless the policy otherwise provides, he is liable for any loss proximately caused by a peril insured against, even though the loss would not have happened but for the misconduct or negligence of the master or crew;
  - b. Unless the policy otherwise provides, the insurer on ship or goods is not liable for any loss proximately caused by delay, although the delay be caused by a peril insured against;
  - c. Unless the policy otherwise provides, the insurer is not liable for ordinary wear and tear, ordinary leakage and breakage, inherent vice or nature of the subject-matter insured, or for any loss proximately caused by rats or vermin, or for any injury to machinery not proximately caused by maritime perils.

### **56. PARTIAL AND TOTAL LOSS**

1. A loss may be either total or partial. Any loss other than a total loss, as hereinafter defined, is a partial loss.
2. A total loss may be either an actual total loss, or a constructive total loss.

3. Unless a different intention appears from the terms of the policy, an insurance against total loss includes a constructive, as well as an actual, total loss.
4. Where the assured brings an action for a total loss and the evidence proves only a partial loss, he may, unless the policy otherwise provides, recover for a partial loss.
5. Where goods reach their destination in specie, but by reason of obliteration of marks, or otherwise, they are incapable of identification, the loss, if any, is partial, and not total.

## **57. ACTUAL TOTAL LOSS**

1. Where the subject-matter insured is destroyed, or so damaged as to cease to be a thing of the kind insured, or where the assured is irretrievably deprived thereof, there is an actual total loss.
2. In the case of an actual total loss no notice of abandonment need be given.

## **58. MISSING SHIP**

Where the ship concerned in the adventure is missing, and after the lapse of a reasonable time no news of her has been received, an actual total loss may be presumed.

## **59. EFFECT OF TRANSSHIPMENT, ETC.**

Where, by a peril insured against, the voyage is interrupted at an intermediate port or place, under such circumstances as, apart from any special stipulation in the contract of affreightment, to justify the master in landing and re-shipping the goods or other moveables or in transshipping them, and sending them on to their destination, the liability of the insurer continues, notwithstanding the landing or transshipment.

## **60. CONSTRUCTIVE TOTAL LOSS DEFINED**

1. Subject to any express provision in the policy, there is a constructive total loss where the subject-matter insured is reasonably abandoned on account of its actual total loss appearing to be unavoidable, or because it could not be preserved from actual total loss without an expenditure which would exceed its value when the expenditure had been incurred.
2. In particular, there is a constructive total loss—
  - i. Where the assured is deprived of the possession of his ship or goods by a peril insured against, and (a) it is unlikely that he can recover the ship or goods, as the case may be, or (b) the cost of recovering the ship or goods, as the case may be, would exceed their value when recovered; or
  - ii. In the case of damage to a ship, where she is so damaged by a peril insured against that the cost of repairing the damage would exceed the value of the ship when repaired.

In estimating the cost of repairs, no deduction is to be made in respect of general average contributions to those repairs payable by other interests, but account is to be taken of the expense of future salvage

operations and of any future general average contributions to which the ship would be liable if repaired; or

- iii. In the case of damage to goods, where the cost of repairing the damage and forwarding the goods to their destination would exceed their value on arrival.

## **61. EFFECT OF CONSTRUCTIVE TOTAL LOSS**

Where there is a constructive total loss the assured may either treat the loss as a partial loss, or abandon the subject-matter insured to the insurer and treat the loss as if it were an actual total loss.

## **62. NOTICE OF ABANDONMENT**

1. Subject to the provisions of this section, where the assured elects to abandon the subject-matter insured to the insurer, he must give notice of abandonment. If he fails to do so the loss can only be treated as a partial loss.
2. Notice of abandonment may be given in writing, or by word of mouth, or partly in writing and partly by word of mouth, and may be given in terms which indicate the intention of the assured to abandon his insured interest in the subject-matter insured unconditionally to the insurer.
3. Notice of abandonment must be given with reasonable diligence after the receipt of reliable information of the loss, but where the information is of a doubtful character the assured is entitled to a reasonable time to make inquiry.
4. Where notice of abandonment is properly given, the rights of the assured are not prejudiced by the fact that the insurer refuses to accept the abandonment.
5. The acceptance of an abandonment may be either express or implied from the conduct of the insurer. The mere silence of the insurer after notice is not an acceptance.
6. Where a notice of abandonment is accepted the abandonment is irrevocable. The acceptance of the notice conclusively admits liability for the loss and the sufficiency of the notice.
7. Notice of abandonment is unnecessary where, at the time when the assured receives information of the loss, there would be no possibility of benefit to the insurer if notice were given to him.
8. Notice of abandonment may be waived by the insurer.
9. Where an insurer has re-insured his risk, no notice of abandonment need be given by him.

## **63. EFFECT OF ABANDONMENT**

1. Where there is a valid abandonment the insurer is entitled to take over the interest of the assured in whatever may remain of the subject-matter insured, and all proprietary rights incidental thereto.
2. Upon the abandonment of a ship, the insurer thereof is entitled to any freight in course of being earned, and which is earned by her subsequent to the casualty causing the loss, less the expenses of earning it incurred after the casualty; and, where the ship is carrying the owner's goods, the insurer is

entitled to a reasonable remuneration for the carriage of them subsequent to the casualty causing the loss.

**Partial Losses  
(Including Salvage & General Average  
& Particular Charges)**

**64. PARTICULAR AVERAGE LOSS**

1. A particular average loss is a partial loss of the subject-matter insured, caused by a peril insured against, and which is not a general average loss.
2. Expenses incurred by or on behalf of the assured for the safety or preservation of the subject-matter insured, other than general average and salvage charges, are called particular charges. Particular charges are not included in particular average.

**65. SALVAGE CHARGES**

1. Subject to any express provision in the policy, salvage charges incurred in preventing a loss by perils insured against may be recovered as a loss by those perils.
2. "Salvage charges" means the charges recoverable under maritime law by a salvor independently of contract. They do not include the expenses of services in the nature of salvage rendered by the assured or his agents, or any person employed for hire by them, for the purpose of averting a peril insured against. Such expenses, where properly incurred, may be recovered as particular charges or as a general average loss, according to the circumstances under which they were incurred.

**66. GENERAL AVERAGE LOSS**

1. A general average loss is a loss caused by or directly consequential on a general average act. It includes a general average expenditure as well as a general average sacrifice.
2. There is a general average act where any extraordinary sacrifice or expenditure is voluntarily and reasonably made or incurred in time of peril for the purpose of preserving the property imperilled in the common adventure.
3. Where there is a general average loss, the party on whom it falls is entitled, subject to the conditions imposed by maritime law, to a rateable contribution from the other parties interested, and such contribution is called a general average contribution.
4. Subject to any express provision in the policy, where the assured has incurred a general average expenditure, he may recover from the insurer in respect of the proportion of the loss which falls upon him; and, in the case of a general average sacrifice, he may recover from the insurer in respect of the whole loss without having enforced his right of contribution from the other parties liable to contribute.
5. Subject to any express provision in the policy, where the assured has paid, or is liable to pay, a general average contribution in respect of the subject insured, he may recover therefor from the insurer.

6. In the absence of express stipulation, the insurer is not liable for any general average loss or contribution where the loss was not incurred for the purpose of avoiding, or in connection with the avoidance of, a peril insured against.
7. Where ship, freight, and cargo, or any two of those interests, are owned by the same assured, the liability of the insurer in respect of general average losses or contributions is to be determined as if those subjects were owned by different persons.

## **Measure of Indemnity**

### **67. EXTENT OF LIABILITY OF INSURER FOR LOSS**

1. The sum which the assured can recover in respect of a loss on a policy by which he is insured, in the case of an unvalued policy to the full extent of the insurable value, or, in the case of a valued policy to the full extent of the value fixed by the policy, is called the measure of indemnity
2. Where there is a loss recoverable under the policy, the insurer, or each insurer if there be more than one, is liable for such proportion of the measure of indemnity as the amount of his subscription bears to the value fixed by the policy in the case of a valued policy, or to the insurable value in the case of an unvalued policy.

### **68. TOTAL LOSS**

Subject to the provisions of this Act and to any express provision in the policy, where there is a total loss of the subject-matter insured,—

1. If the policy be a valued policy, the measure of indemnity is the sum fixed by the policy;
2. If the policy be an unvalued policy, the measure of indemnity is the insurable value of the subject-matter insured.

### **69. PARTIAL LOSS OF SHIP**

Where a ship is damaged, but is not totally lost, the measure of indemnity, subject to any express provision in the policy, is as follows:—

1. Where the ship has been repaired, the assured is entitled to the reasonable cost of the repairs, less the customary deductions, but not exceeding the sum insured in respect of any one casualty;
2. Where the ship has been only partially repaired, the assured is entitled to the reasonable cost of such repairs, computed as above, and also to be indemnified for the reasonable depreciation, if any, arising from the unrepaired damage, provided that the aggregate amount shall not exceed the cost of repairing the whole damage, computed as above;
3. Where the ship has not been repaired, and has not been sold in her damaged state during the risk, the assured is entitled to be indemnified for the reasonable depreciation arising from the unrepaired damage, but not exceeding the reasonable cost of repairing such damage, computed as above.

## **70. PARTIAL LOSS OF FREIGHT**

Subject to any express provision in the policy, where there is a partial loss of freight, the measure of indemnity is such proportion of the sum fixed by the policy in the case of a valued policy, or of the insurable value in the case of an unvalued policy, as the proportion of freight lost by the assured bears to the whole freight at the risk of the assured under the policy.

## **71. PARTIAL LOSS OF GOODS, MERCHANDISE, ETC.**

Where there is a partial loss of goods, merchandise, or other moveables, the measure of indemnity, subject to any express provision in the policy, is as follows:—

1. Where part of the goods, merchandise or other moveables insured by a valued policy is totally lost, the measure of indemnity is such proportion of the sum fixed by the policy as the insurable value of the part lost bears to the insurable value of the whole, ascertained as in the case of an unvalued policy;
2. Where part of the goods, merchandise, or other moveables insured by an unvalued policy is totally lost, the measure of indemnity is the insurable value of the part lost, ascertained as in case of total loss;
3. Where the whole or any part of the goods or merchandise insured has been delivered damaged at its destination, the measure of indemnity is such proportion of the sum fixed by the policy in the case of a valued policy, or of the insurable value in the case of an unvalued policy, as the difference between the gross sound and damaged values at the place of arrival bears to the gross sound value;
4. "Gross value" means the wholesale price or, if there be no such price, the estimated value, with, in either case, freight, landing charges, and duty paid beforehand; provided that, in the case of goods or merchandise customarily sold in bond, the bonded price is deemed to be the gross value. "Gross proceeds" means the actual price obtained at a sale where all charges on sale are paid by the sellers.

## **72. APPORTIONMENT OF VALUATION**

1. Where different species of property are insured under a single valuation, the valuation must be apportioned over the different species in proportion to their respective insurable values, as in the case of an unvalued policy. The insured value of any part of a species is such proportion of the total insured value of the same as the insurable value of the part bears to the insurable value of the whole, ascertained in both cases as provided by this Act.
2. Where a valuation has to be apportioned, and particulars of the prime cost of each separate species, quality, or description of goods cannot be ascertained, the division of the valuation may be made over the net arrived sound values of the different species, qualities, or descriptions of goods.

## **73. GENERAL AVERAGE CONTRIBUTIONS AND SALVAGE CHARGES**

1. Subject to any express provision in the policy, where the assured has paid, or is liable for, any general average contribution, the measure of indemnity is the



full amount of such contribution, if the subject-matter liable to contribution is insured for its full contributory value; but, if such subject-matter be not insured for its full contributory value, or if only part of it be insured, the indemnity payable by the insurer must be reduced in proportion to the under insurance, and where there has been a particular average loss which constitutes a deduction from the contributory value, and for which the insurer is liable, that amount must be deducted from the insured value in order to ascertain what the insurer is liable to contribute.

2. Where the insurer is liable for salvage charges the extent of his liability must be determined on the like principle.

#### **74. LIABILITIES TO THIRD PARTIES**

Where the assured has effected an insurance in express terms against any liability to a third party, the measure of indemnity, subject to any express provision in the policy, is the amount paid or payable by him to such third party in respect of such liability.

#### **75. GENERAL PROVISIONS AS TO MEASURE OF INDEMNITY**

1. Where there has been a loss in respect of any subject-matter not expressly provided for in the foregoing provisions of this Act, the measure of indemnity shall be ascertained, as nearly as may be, in accordance with those provisions, in so far as applicable to the particular case.
2. Nothing in the provisions of this Act relating to the measure of indemnity shall affect the rules relating to double insurance, or prohibit the insurer from disproving interest wholly or in part, or from showing that at the time of the loss the whole or any part of the subject-matter insured was not at risk under the policy.

#### **76. PARTICULAR AVERAGE WARRANTIES**

1. Where the subject-matter insured is warranted free from particular average, the assured cannot recover for a loss of part, other than a loss incurred by a general average sacrifice, unless the contract contained in the policy be apportionable; but, if the contract be apportionable, the assured may recover for a total loss of any apportionable part.
2. Where the subject-matter insured is warranted free from particular average, either wholly or under a certain percentage, the insurer is nevertheless liable for salvage charges, and for particular charges and other expenses properly incurred pursuant to the provisions of the suing and labouring clause in order to avert a loss insured against.
3. Unless the policy otherwise provides, where the subject-matter insured is warranted free from particular average under a specified percentage, a general average loss cannot be added to a particular average loss to make up the specified percentage.
4. For the purpose of ascertaining whether the specified percentage has been reached, regard shall be had only to the actual loss suffered by the subject-matter insured. Particular charges and the expenses of and incidental to ascertaining and proving the loss must be excluded.

## **77. SUCCESSIVE LOSSES**

1. Unless the policy otherwise provides, and subject to the provisions of this Act, the insurer is liable for successive losses, even though the total amount of such losses may exceed the sum insured.
2. Where, under the same policy, a partial loss, which has not been repaired or otherwise made good, is followed by a total loss, the assured can only recover in respect of the total loss:

Provided that nothing in this section shall affect the liability of the insurer under the suing and labouring clause.

## **78. SUING & LABOURING CLAUSE**

1. Where the policy contains a suing and labouring clause, the engagement thereby entered into is deemed to be supplementary to the contract of insurance, and the assured may recover from the insurer any expenses properly incurred pursuant to the clause, notwithstanding that the insurer may have paid for a total loss, or that the subject-matter may have been warranted free from particular average, either wholly or under a certain percentage.
2. General average losses and contributions and salvage charges, as defined by this Act, are not recoverable under the suing and labouring clause.
3. Expenses incurred for the purpose of averting or diminishing any loss not covered by the policy are not recoverable under the suing and labouring clause.
4. It is the duty of the assured and his agents, in all cases, to take such measures as may be reasonable for the purpose of averting or minimising a loss.

## **Rights of Insurer on Payment**

## **79. RIGHT OF SUBROGATION**

1. Where the insurer pays for a total loss, either of the whole, or in the case of goods of any apportionable part, of the subject-matter insured, he thereupon becomes entitled to take over the interest of the assured in whatever may remain of the subject-matter so paid for, and he is thereby subrogated to all the rights and remedies of the assured in and in respect of that subject-matter as from the time of the casualty causing the loss.
2. Subject to the foregoing provisions, where the insurer pays for a partial loss, he acquires no title to the subject-matter insured, or such part of it as may remain, but he is thereupon subrogated to all rights and remedies of the assured in and in respect of the subject-matter insured as from the time of the casualty causing the loss, in so far as the assured has been indemnified, according to this Act, by such payment for the loss.

## **80. RIGHT OF CONTRIBUTION**

1. Where the assured is over-insured by double insurance, each insurer is bound, as between himself and the other insurers, to contribute rateably to the loss in proportion to the amount for which he is liable under his contract.
2. If any insurer pays more than his proportion of the loss, he is entitled to maintain an action for contribution against the other insurers, and is entitled to the like remedies as a surety who has paid more than his proportion of the debt.

## **81. EFFECT OF UNDER INSURANCE**

Where the assured is insured for an amount less than the insurable value or, in the case of a valued policy, for an amount less than the policy valuation, he is deemed to be his own insurer in respect of the uninsured balance.

### **Return of Premium**

## **82. ENFORCEMENT OF RETURN**

Where the premium or a proportionate part thereof is, by this Act, declared to be returnable,—

- a. If already paid, it may be recovered by the assured from the insurer; and
- b. If unpaid, it may be retained by the assured or his agent.

## **83. RETURN BY AGREEMENT**

Where the policy contains a stipulation for the return of the premium, or a proportionate part thereof, on the happening of a certain event, and that event happens, the premium, or, as the case may be, the proportionate part thereof, is thereupon returnable to the assured.

## **84. RETURN FOR FAILURE OF CONSIDERATION**

1. Where the consideration for the payment of the premium totally fails, and there has been no fraud or illegality on the part of the assured or his agents, the premium is thereupon returnable to the assured.
2. Where the consideration for the payment of the premium is apportionable and there is a total failure of any apportionable part of the consideration, a proportionate part of the premium is, under the like conditions, thereupon returnable to the assured.
3. In particular—
  - a. Where the policy is void, or is avoided by the insurer as from the commencement of the risk, the premium is returnable, provided that there has been no fraud or illegality on the part of the assured; but if the risk is not apportionable, and has once attached, the premium is not returnable;
  - b. Where the subject-matter insured, or part thereof, has never been imperilled, the premium, or, as the case may be, a proportionate part thereof, is returnable:

Provided that where the subject-matter has been insured "lost or not lost" and has arrived in safety at the time when the contract is concluded, the premium is not returnable unless, at such time, the insurer knew of the safe arrival.

- c. Where the assured has no insurable interest throughout the currency of the risk, the premium is returnable, provided that this rule does not apply to a policy effected by way of gaming or wagering;
- d. Where the assured has a defeasible interest which is terminated during the currency of the risk, the premium is not returnable;
- e. Where the assured has over-insured under an unvalued policy, a proportionate part of the premium is returnable;
- f. Subject to the foregoing provisions, where the assured has over-insured by double insurance, a proportionate part of the several premiums is returnable:

Provided that, if the policies are effected at different times, and any earlier policy has at any time borne the entire risk, or if a claim has been paid on the policy in respect of the full sum insured thereby, no premium is returnable in respect of that policy, and when the double insurance is effected knowingly by the assured no premium is returnable.

## **Mutual Insurance**

### **85. MODIFICATION OF ACT IN CASE OF MUTUAL INSURANCE**

1. Where two or more persons mutually agree to insure each other against marine losses there is said to be a mutual insurance.
2. The provisions of this Act relating to the premium do not apply to mutual insurance, but a guarantee, or such other arrangement as may be agreed upon, may be substituted for the premium.
3. The provisions of this Act, in so far as they may be modified by the agreement of the parties, may in the case of mutual insurance be modified by the terms of the policies issued by the association, or by the rules and regulations of the association.
4. Subject to the exceptions mentioned in this section, the provisions of this Act apply to a mutual insurance.

## **Supplemental**

### **86. RATIFICATION BY ASSURED**

Where a contract of marine insurance is in good faith effected by one person on behalf of another, the person on whose behalf it is effected may ratify the contract even after he is aware of a loss.

### **87. IMPLIED OBLIGATIONS VARIED BY AGREEMENT OR USAGE**

1. Where any right, duty, or liability would arise under a contract of marine insurance by implication of law, it may be negated or varied by express agreement, or by usage, if the usage be such as to bind both parties to the contract.
2. The provisions of this section extend to any right, duty, or liability declared by this Act which may be lawfully modified by agreement.

## **88. REASONABLE TIME, ETC., A QUESTION OF FACT**

Where by this Act any reference is made to reasonable time, reasonable premium, or reasonable diligence, the question what is reasonable is a question of fact.

## **89. SLIP AS EVIDENCE**

Where there is a duly stamped policy, reference may be made, as heretofore, to the slip or covering note, in any legal proceeding.

## **90. INTERPRETATION OF TERMS**

In this Act, unless the context or subject-matter otherwise requires,—

"Action" includes counter-claim and set off:

"Freight" includes the profit derivable by a shipowner from the employment of his ship to carry his own goods or moveables, as well as freight payable by a third party, but does not include passage money:

"Moveables" means any moveable tangible property, other than the ship, and includes money, valuable securities, and other documents:

"Policy" means a marine policy.

## **91. Savings**

1. Nothing in this Act, or in any repeal effected thereby, shall affect—
  - a. The provisions of the Stamp Act 1891, or any enactment for the time being in force relating to the revenue;
  - b. The provisions of the Companies Act 1862, or any enactment amending or substituted for the same;
  - c. The provisions of any statute not expressly repealed by this Act.
2. The rules of the common law including the law merchant, save in so far as they are inconsistent with the express provisions of this Act, shall continue to apply to contracts of marine insurance.

## **92. REPEALS**

The enactments mentioned in the Second Schedule to this Act are hereby repealed to the extent specified in that schedule.

**NOTE:**

*Repealed by the Statute Law Revision Act 1927.*

**93. COMMENCEMENT**

This Act shall come into operation on the first day of January, 1907.

**NOTE:**

*Repealed by the Statute Law Revision Act 1927.*

**94. SHORT TITLE**

This Act may be cited as the Marine Insurance Act 1906.

**SCHEDULES**

**FIRST SCHEDULE (s 30)**

**Form of policy**

BE IT KNOWN THAT ... as well in ... own name as for and in the name and names of all and every other person or persons to whom the same doth, may, or shall appertain, in part or in all doth make assurance and cause ... and them, and every one of them, to be insured lost or not lost, at and from ...

Upon any kind of goods and merchandise, and also upon the body, tackle, apparel, ordnance, munition, artillery, boat, and other furniture, of and in the good ship or vessel called the ... whereof is master under God, for this present voyage, ... or whosoever else shall to for master in the said ship, or by whatsoever other name or names the said ship, or the master thereof, is or shall be named or called; beginning the adventure upon the said goods and merchandises from the loading thereof aboard the said ship.

upon the said ship, etc.

and so shall continue and endure, during her abode there,. upon the said ship, etc.

And further, until the said ship, with all her ordnance, tackle, apparel; etc., and goods and merchandises whatsoever shall be arrived at ...

upon the said ship, etc., until she hath moored at anchor twenty-four hours in good safety; and upon the goods and merchandises, until the same be there discharged and safely landed. And it shall be lawful for the said ship, etc., in this voyage to proceed and sail to and touch and stay at any ports or places whatsoever.

without prejudice to this insurance. The said ship, etc., goods and merchandises, etc., for so much as concerns the assured by agreement between the assured and assurers in this policy, are and shall be valued at ...

Touching the adventures and perils which we the assurers are contented to bear and do take upon us in this voyage: they are of the seas, men of war, fire, enemies, pirates, rovers, thieves, jettisons, letters of mart and countermart, surprisals, takings at sea, arrests, restraints, and detentions of all kings, princes, and people, of what nation, condition, or quality soever, barratry of the master and mariners, and of all other perils, losses, and misfortunes, that have or shall come to the hurt, detriment, or damage of the said goods and merchandises, and ship, etc., or any part thereof. And in case of any loss or misfortune it shall be lawful to the assured, their factors, servants and assigns, to sue, labour, and travel for, in and about the defence, safeguards, and recovery of the said goods and merchandises, and ship, etc., or any part thereof, without prejudice to this insurance; to the charges whereof we, the assurers, will contribute each one according to the rate and quantity of his sum herein assured. And it is especially declared and agreed that no acts of the insurer or insured in recovering, saving, or preserving the property insured shall be considered as a waiver, or acceptance of abandonment. And it is agreed by us, the insurers, that this writing or policy of assurance shall be of as much force and effect as the surest writing or policy of assurance heretofore made in Lombard Street, or in the Royal Exchange, or elsewhere in London. And so we, the assurers, are contented, and do hereby promise and bind ourselves, each one for his own part, our heirs, executors, and goods to the assured, their executors, administrators, and assigns, for the true performance of the premises, confessing ourselves paid the consideration due unto us for this assurance by the assured, at and after the rate of ...

IN WITNESS whereof we, the assurers, have subscribed our names and sums assured in London.

N.B. — Corn, fish, salt, fruit, flour, and seed are warranted free from average, unless general, or the ship be stranded — sugar, tobacco, hemp, flax, hides and skins are warranted free from average, under five pounds per cent., and all other goods, also the ship and freight, are warranted free from average, under three pounds per cent. unless general, or the ship be stranded.

### **Rules for construction of policy**

*The following are the rules referred to by this Act for the construction of a policy in the above or other like form, where the context does not otherwise require:—*

1. Where the subject-matter is insured "lost or not lost", and the loss has occurred before the contract is concluded, the risk attaches, unless at such time the assured was aware of the loss, and the insurer was not.
2. Where the subject-matter is insured "from" a particular place, the risk does not attach until the ship starts on the voyage insured.
3.
  - a. Where a ship is insured "at and from" a particular place, and she is at that place in good safety when the contract is concluded, the risk attaches immediately.
  - b. If she be not at that place when the contract is concluded, the risk attaches as soon as she arrives there in good safety, and, unless the policy otherwise provides, it is immaterial that she is covered by another policy for a specified time after arrival.

- c. Where chartered freight is insured "at and from" a particular place, and the ship is at that place in good safety when the contract is concluded the risk attaches immediately. If she be not there when the contract is concluded, the risk attaches as soon as she arrives there in good safety.
  - d. Where freight, other than chartered freight, is payable without special conditions and is insured "at and from" a particular place, the risk attaches pro rata as the goods or merchandise are shipped; provided that if there be cargo in readiness which belongs to the shipowner, or which some other person has contracted with him to ship, the risk attaches as soon as the ship is ready to receive such cargo.
4. Where goods or other moveables are insured "from the loading thereof", the risk does not attach until such goods or moveables are actually on board, and the insurer is not liable for them while in transit from the shore to ship.
  5. Where the risk on goods or other moveables continues until they are "safely landed", they must be landed in the customary manner and within a reasonable time after arrival at the port of discharge, and if they are not so landed the risk ceases.
  6. In the absence of any further licence and usage, the liberty to touch and stay "at any port or place whatsoever" does not authorise the ship to depart from the course of her voyage from the port of departure to the port of destination.
  7. The term "perils of the seas" refers only to fortuitous accidents or casualties of the seas. It does not include the ordinary action of the winds and waves.
  8. The term "pirates" includes passengers who mutiny and rioters who attack the ship from the shore.
  9. The term "thieves" does not cover clandestine theft or a theft committed by any one of the ship's company, whether crew or passengers.
  10. The term "arrests, etc., of kings, princes, and people" refers to political or executive acts, and does not include a loss caused by riot or by ordinary judicial process.
  11. The term "barratry" includes every wrongful act wilfully committed by the master or crew to the prejudice of the owner, or, as the case may be, the charterer.
  12. The term "all other perils" includes only perils similar in kind to the perils specifically mentioned in the policy.
  13. The term "average unless general" means a partial loss of the subject-matter insured other than a general average loss, and does not include "particular charges".
  14. Where the ship has stranded, the insurer is liable for the excepted losses, although the loss is not attributable to the stranding, provided that when the stranding takes place the risk has attached and, if the policy be on goods, that the damaged goods are on board.
  15. The term "ship" includes the hull, materials and outfit, stores and provisions for the officers and crew, and, in the case of vessels engaged in a special trade, the ordinary fittings requisite for the trade, and also, in the case of a steamship, the machinery, boilers, and coals and engine stores, if owned by the assured.
  16. The term "freight" includes the profit derivable by a shipowner from the employment of his ship to carry his own goods or moveables, as well as freight payable by a third party, but does not include passage money.



17. The term "goods" means goods in the nature of merchandise, and does not include personal effects or provisions and stores for use on board. In the absence of any usage to the contrary, deck cargo and living animals must be insured specifically, and not under the general denomination of goods.

## **Appendix 2**

### **List of Interviewees**

1. Dr. Min – Claims Handler, Sinotran Shipping Ltd, Hong Kong, China (interviewing time: 10<sup>th</sup> Sep. 2012)
2. Mr. Li – Founder, Shanghai Logistics Company, Shanghai, China (interviewing time: Oct. 2012)