

## Marine Insurance Warranty: Comparing Common and Civil Law Approaches and their Implications for the Reform of Chinese Law<sup>1</sup>

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### Abstract:

For risk management, ‘warranty’ provisions in common law serve to define the risk insured, whereas civil law countries adopt an ‘alteration of risk’ doctrine. The term ‘warranty’ under Chinese marine insurance law is derived from English law, whereas in its general insurance law China at the same time also adopts an ‘alteration of risk’ doctrine to control risk. The need for a reform of insurance warranty law has prompted much scholarly debate. Following a thorough discussion of the status quo of warranty law in China, this paper further explores the reformed warranty law under the Insurance Act 2015 in England, together with the general ‘alteration of risk’ doctrine in civil law countries. It is argued that blindly importing relevant articles from the Insurance Act 2015 is not a feasible solution, as this will not only create more disputes, but will also create inconsistency with other laws. The paper concludes by suggesting that maybe adopting the ‘alteration of risk’ doctrine is a better way to replace the current warranty law under Chinese marine insurance law.

**Keywords:** risk management; warranty; Chinese Marine Code; Insurance Act 2015; alteration of risk

### A. Introduction

In common law, warranty<sup>5</sup> has long been employed in insurance contracts to circumscribe the risk to which the underwriter subscribed or guarded against possible alteration of the insured risk during the currency of the policy.<sup>6</sup> It was not until the Marine Insurance Act 1906 (MIA 1906) in the UK that a legal framework regulating insurance warranty was codified. The Act contains nine sections and is also supplemented with numerous judicial practice cases. Nevertheless, the law is constantly criticized as being harsh and unfair; of particular note is S33(3) of MIA 1906, which provides that a breach of warranty leads to an automatic discharge of liability as from the date of

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<sup>5</sup> Unless otherwise specified, the warranty referred to in this article means the promissory warranty.

<sup>6</sup> Baris Soyer, *Beginning of a New Era for Insurance Warranties?* [2013] LMCLQ 384.

such breach, which could give the insurer leeway to escape liability for a technical breach that has no causation at all for the losses.<sup>7</sup>

In contrast, the legal provisions on warranty under Chinese maritime law seem to be weak, since only one article explicitly related to warranty can be found in the Chinese Maritime Code (CMC).<sup>8</sup> Therefore, there are endless criticisms from domestic scholars; these are followed by suggestions to reform marine insurance warranty law in the CMC, which mainly benchmark the MIA 1906. Now that the Insurance Act 2015 has been passed in the UK on 12 February 2015, and will enter into force in August 2016,<sup>9</sup> there are once again fierce demands for the adoption of a similar approach to insurance warranty law in the CMC.

This article aims to compare insurance warranty law in common law with the doctrine of ‘alteration of risk’ in civil law, together with their implications for the reform of Chinese law. Thus, it will start first with a discussion of the legal status quo of Chinese law on marine insurance warranty; thereafter, the article will focus on an evaluation of the recent English insurance law reform; this will be followed by a discussion of the civil law approach - the doctrine of alteration of risk during the insurance period. After revealing the nature of Chinese law on the increase of perils, the article will conclude that the civil law approach, i.e., the doctrine of alteration of risk, may be a better choice for marine insurance warranty under Chinese law.

## **B. Legal provisions on warranty in the CMC**

There does not exist a separate law, like the MIA 1906 in the UK, to regulate marine insurance activities in China. The CMC is the law that is dedicated to regulating ‘the relations arising from maritime transport and those pertaining to ships...’,<sup>10</sup> and the marine insurance contract is recognized as one of the important areas to be regulated. Chapter 12, concerning the marine insurance contract, contains 41 articles in total, of which only one article explicitly mentions ‘warranty’. Specifically, Article 235 reads,

‘The insured shall notify the insurer in writing immediately where the insured has not complied with the *warranty clauses* as stipulated in the contract. The insurer may, upon receipt of the notice, terminate the contract or demand an amendment to the terms and conditions of the insurance coverage or an increase in the premium.’

Apparently, this article, on the one hand, imposes the duties of notification upon the insured if there is a breach of warranty; on the other hand, it allows the insurer to enjoy the right to: 1) terminate the contract; 2) demand an amendment to the terms and conditions of the insurance cover;

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<sup>7</sup> Baris Soyer, *Beginning of a New Era for Insurance Warranties?* [2013] LMCLQ 384, 385; see also Zhen Jing, *Warranties and Doctrine of Alteration of Risk during the Insurance Period: A Critical Evaluation of the UK Law Commissions’ Proposal for Reform of the Law of the Warranties*, [2014] Insurance Law Journal Vol.25, 184.

<sup>8</sup> The CMC was adopted by the Standing Committee of the National People’s Congress and entered into effect on 1<sup>st</sup> July 1993. It is labelled as “Special Law” in the Chinese legal system for regulating all marine activities. According to its Article 1, the CMC is to regulate the relations arising from maritime transport and those pertaining to ships, to securing and protecting the legitimate rights and interests of the parties concerned, and to promote the development of transport, economy and trade.

<sup>9</sup> <http://services.parliament.uk/bills/2014-15/insurance.html>, last accessed on 22 December 2015.

<sup>10</sup> The Maritime Code, Article 1.

or 3) an increase in the insurance premium. However, no definition of ‘warranty’ is given in this article, nor can it be found in Chapter 12 or elsewhere in the CMC.

This legal status quo has undoubtedly caused chaos in academic circles. Basically, most scholars vehemently support the existence of the warranty regime in China.<sup>11</sup> Their opinion is grounded on three reasons: Firstly, the use of ‘warranties’ in Article 235 of the CMC is a strong indication that the lawmakers have accepted that the warranty is an essential component of marine insurance law;<sup>12</sup> secondly, in a judicial interpretation issued by the Supreme Court of the PRC in 2007,<sup>13</sup> it made clarification as to certain rights and obligations assumed either by the insured or the insurer on breach of warranty. Lastly, warranty clauses have long been used in policy clauses in the Chinese marine insurance market.<sup>14</sup> Accordingly, in spite of there being some deficiencies, existence of the law on warranty in China cannot be properly denied. Nevertheless, various opinions have since been raised; these mainly claim that the expression ‘warranty’ in the CMC is, by nature, a specially stipulated clause, which is different to a common law warranty, such as the one stipulated in MIA1906.<sup>15</sup>

In addition, two other issues are frequently under debate: The expression in Article 235 conveys a possible interpretation that the insurer is not entitled to terminate the contract unless and until he receives written notification from the insured; and that the insured can easily alleviate such a passive consequence if he delays delivery of the notice or even chooses not to deliver such a notice at all.<sup>16</sup> If that were true, the very *first issue* is, what should the insurer do to protect his rights where the insured deliberately delays delivery of the written notice once the warranty is breached?<sup>17</sup> The *second issue* is about the legal status of the insurance contract in the situation where the insurer chooses not to terminate the contract, but the parties cannot reach any agreement as to the terms or premium to be amended immediately after the breach of warranty. Since the

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<sup>11</sup> Marc A. Huybrechts, *Warranty System in Chinese Maritime Code and Marine Insurance Act 1906*, Annual of China Maritime Law, 2001 Vol.11 146, 147-148; Trine Lisa Wilhelmsen, *Duty of Disclosure, Duty of Good Faith, Alteration of Risk and Warranties*, CMI Yearbook, 2000 281, 386; Yuzhuo Si, *Maritime Law Monograph* (in Chinese), (2<sup>nd</sup> edn, Renmin University of China 2010), 400; Pengnan Wang, *Hai Shang Bao Xian He Tong Fa Xiang Lun* (in Chinese), (Dalian Maritime University Press 3<sup>rd</sup> edn, 2011), p.69; Zhaonan Yang, *Marine Insurance* (in Chinese), (Law Press 2009), p. 109.

<sup>12</sup> Marc A. Huybrechts, *Warranty System in Chinese Maritime Code and Marine Insurance Act 1906*, Annual of China Maritime Law, 2001, Vol.11 146 147-148.

<sup>13</sup> The “Provisions of the Supreme People’s Court on Several Issues about the Trial of Cases Concerning Marine Insurance Disputes”, which was issued by the Trial Committee of the Supreme Court of PRC (effected in 2007).

<sup>14</sup> Take for example, Article 6 (2) (3) of Hull and Machinery Insurance Clause 2009 of PICC Property and Casualty Company Limited. The majority of the scholars believe it is a warranty clause.

<sup>15</sup> In fact it has been argued that the expression ‘specially stipulated clause’ is a corresponding concept in civil law countries as opposed to the warranty in English. See Zhen Li, *China’s Reform and Introduction of Warranty under English Law from a Continental Law Country’s View*, Annual of China Maritime Law, 2007, Vol.1880, 81 (in Chinese).

<sup>16</sup> Xin Wang, *On the Legal Consequence of Breach of Warranty in Marine Insurance*, Annual of China Maritime Law, 2001, Vol. 12 65, 67 (in Chinese).

<sup>17</sup> Zhen Li, *China’s Reform and Introduction of Warranty under English Law from a Continental Law Country’s View*, Annual of China Maritime Law, 2007, Vol.18 80, 84-85 (in Chinese); see also Xin Wang, *On the Legal Consequence of Breach of Warranty in Marine Insurance*, Annual of China Maritime Law, 2001, Vol. 12 65, 72 (in Chinese).

CMC lacks clear rules for these two issues, answers must likely be sought by referring to other laws.

### **C. Other laws and legal documents regulating insurance warranties**

Apart from the CMC, there are laws or legal documents, either directly or indirectly, regulating insurance warranties; the most relevant ones include the Insurance Law of People's Republic of China (Insurance Law), the Contract Law of People's Republic of China (Contract Law), which were passed by China's National People's Congress (NPC), and the related judicial interpretation. Among them, as far as marine insurance activities are concerned, application of the CMC shall prevail over the Insurance Law, and the Insurance Law shall prevail over the Contract Law.<sup>18</sup> Moreover, the Insurance Law and Contract Law also serve as functional supplements where the CMC is silent on certain issues.<sup>19</sup> The judicial interpretation, on the other hand, serves to deal with certain issues where the specific meaning of any provision of law requires further clarification; or deals with any new circumstances appearing after the issuance of a law that require clarification of the basis for the application of such law.<sup>20</sup>

#### **a. Insurance Law**

The Insurance Law in China was first enacted in 1995, and it underwent two amendments in 2009 and 2015 respectively. The Insurance Law (Amendment) 2015<sup>21</sup> was promulgated by the Standing Committee of the NPC on April 24, 2015.

The purpose of the Insurance Law is to regulate insurance activities and to protect the legitimate rights and interests of all parties to the insurance activities.<sup>22</sup> The Insurance Law has a wide application to 'all insurance activities carried out within the territory of the PRC'.<sup>23</sup> In addition, Article 182 clarifies that 'where the Maritime Code of the People's Republic of China is silent, the relevant provisions of this Law shall apply.'

#### **b. Contract Law**

The Contract Law was adopted by the NPC and entered into effect in 1999. The scope of the Contract Law is to govern agreements made between individual persons, legal persons or other

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<sup>18</sup> Article 123 of the Contract Law and Article 182 of the Insurance Law. This is also consistent with the general principles provided in Chinese Legislation Law. Article 123 of the Contract Law reads, 'where there are other provisions in respect of a certain contract in law other than the Contract Law, such provisions shall prevail.' Article 182 of the Insurance law reads, 'Marine insurance shall be governed by the provisions of the Chinese Maritime Code; where the Chinese Maritime Code is silent on certain issues, the relevant provisions of this Law (i.e. the Insurance Law) shall apply.'

<sup>19</sup> Article 123 of the Contract Law and Article 182 of the Insurance Law.

<sup>20</sup> Article 45 of the Legislation Law.

<sup>21</sup> For the sake of simplicity, it will be referred to as the 'Insurance Law', as it makes no difference to the words.

<sup>22</sup> Article 1 of the Insurance Law.

<sup>23</sup> Article 3 of the Insurance Law.

organizations as equal parties, for the establishment, modification and termination of relationships involving the civil rights and obligations of such entities.<sup>24</sup>

The Contract Law explicitly regulates 15 types of contracts, and the marine insurance contract is not listed among those 15 types. However, the Contract Law explicitly clarifies that its general principles shall apply if there lacks provisions in any special laws;<sup>25</sup> thus, the Contract Law shall apply in cases where the CMC cannot answer a particular issue related to a warranty under a marine insurance contract.

### **c. Judicial Interpretation**

Pursuant to the Legislation Law<sup>26</sup>, the NPC has the authority to make or adopt judicial interpretations, and such documents shall have the same legal effect as that of the laws made by the NPC. In addition, the Supreme Court's authority to issue judicial interpretations was also granted by the NPC in 1981 to clarify issues arising from judicial trials;<sup>27</sup> however, there are doubts as to whether interpretations issued by the Supreme Court shall have the same legal effect as those issued by the NPC. The confusion remains in theory; nevertheless, judicial interpretations by the Supreme Court play a significant role in judicial practice.

For the purpose of clarifying certain disputes with regard to marine insurance activities during a judicial trial, the Trial Committee of the Supreme Court passed *'Provisions of the Supreme People's Court on Several Issues about the Trial of Cases Concerning Marine Insurance Disputes'* (the Provision). Three out of 17 articles in the Provision are related to the warranty issue, i.e., Articles 6, 7 and 8.

### **d. Clarifications provided by the Provision for two issues in the CMC**

As mentioned earlier, Article 235 of the CMC seems to convey the message that submission of notice by the insured is a prerequisite for the insurer to exercise his right to terminate the contract; in other words, the insurer does not have such a right until and unless he receives written notice from the insured.<sup>28</sup> Hence, one potential risk may exist where the insured attempts to delay the delivery of such notice; or he may even not notify the insurer of such a fact in order to actually prevent the insurer from exercising the right.<sup>29</sup> This is not a rare phenomenon in insurance practice

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<sup>24</sup> Article 2 of the Contract Law.

<sup>25</sup> Article 123 and 124 of the Contract Law.

<sup>26</sup> The Legislation Law of the People's Republic of China was adopted at the third Session of the Ninth National People's Congress in 2000.

<sup>27</sup> Article 2 of *Decision of Strengthening the Legal Interpretation* issued by the Standing Committee of the NPC in 1981. The Supreme Court's authority to issue "judicial interpretation" is derived from this *Decision* (in Chinese). For the details, see [http://www.npc.gov.cn/wxzl/gongbao/2000-12/06/content\\_5004401.htm](http://www.npc.gov.cn/wxzl/gongbao/2000-12/06/content_5004401.htm), last accessed on 22 December 2015.

<sup>28</sup> Yuquan Li, *Study on the 'Warranty' system in the Marine Insurance Act*, Annual of China Maritime Law, 2004 Vol.15 1, 14 (in Chinese); Xin Wang, *On the Legal Consequence of Breach of Warranty in Marine Insurance*, Annual of China Maritime Law, 2001, Vol. 12 65, 72 (in Chinese).

<sup>29</sup> Xin Wang, *On the Legal Consequence of Breach of Warranty in Marine Insurance*, Annual of China Maritime Law, 2001, Vol. 12 65, 72 (in Chinese).

in China.<sup>30</sup> In order to provide a solution to this awkward situation, Article 6 of the Provision provides:

‘Where the insured does not immediately notify the insurer upon breach of warranty, the insurer may claim to the Court that the insurance contract shall be terminated as from the date of the breach and the Court shall support such petition.’<sup>31</sup>

Apparently, this answers the first inherent issue in Article 235 of the CMC, by clearly stating that the insurer has the right to terminate the contract once the warranty is breached, and that such a right shall not be affected by any delay in receiving a written notice from the insured. This is considered to be reasonable, since it is not appropriate for the judicial interpretation to create any restriction on the insurer’s right of termination, as is clearly stipulated in the CMC.<sup>32</sup>

Article 8 further provides that where there is no agreement as to the terms and conditions made between the parties after a breach of the prescribed warranty, the insurance contract shall be terminated as from the date of the breach,<sup>33</sup> thus providing the answer to the abovementioned second issue in the CMC. At the same time, it prevents the insured from undermining the insurer’s right by deliberately delaying delivery of the required notice. Another point that could be implied is that, once the warranty is breached, the insurer is not liable for any losses during the negotiation period.<sup>34</sup> It is noted that varied opinions were raised over this point during the drafting process of the Provision. One of the proposals was that the insurer shall be held liable for any loss occurring during the negotiation process, provided there is no causation between the breach and the

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<sup>30</sup> Shumei Wang, *Understanding and Application on the <Provisions of the Supreme People’s Court on Several Issues about the Trial of Cases Concerning Marine Insurance Disputes>*, The People’s Judicature, 2006 (12) 14, 16 (in Chinese).

<sup>31</sup> Article 6 of the Provision.

<sup>32</sup> Shumei Wang, *Understanding and Application on the <Provisions of the Supreme People’s Court on Several Issues about the Trial of Cases Concerning Marine Insurance Disputes>*, The People’s Judicature, 2006 (12) 14, 15-16 (in Chinese). However, it is to be noted that there is a similar provision in the Insurance Law that touches upon the notification issue and the consequence laid down in the Insurance Law is different from that in the Provision. This will be discussed in detail later.

<sup>33</sup> In its explanatory paper, the drafters of the Provision make a contradictory statement, in that it repeatedly stresses that the warranty clause in English law is a significant one and that breach of warranty leads to immediate discharge of the liability. Therefore, they come to the conclusion that if there is no agreement reached upon the breach, then the insurance contract shall be terminated as from the date of the breach, which is very much akin to supporting an automatic termination. However, an automatic termination approach is obviously not in compliance with the intention of the CMC, which explicitly gives the insurer the right to choose between two alternatives. Therefore, in the author’s opinion, the CMC offers a retrospective termination. Where the insured fails to notify the insurer of such breach, or where there is no agreement as to the terms and conditions after the breach, if the insurer chooses to terminate the contract then the insurance contract shall be terminated as from the date of the breach.

<sup>34</sup> Shumei Wang, *Understanding and Application on the <Provisions of the Supreme People’s Court on Several Issues about the Trial of Cases Concerning Marine Insurance Disputes>*, The People’s Judicature, 2006 (12) 14, 16 (in Chinese).

subsequent losses; this proposal was however rejected by the Supreme Court.<sup>35</sup> There will be further discussion about this point elsewhere in the article.<sup>36</sup>

In addition, it is worth mentioning Article 7 of the Provision. According to Article 7, if the insurer, upon receipt of the written notice, has indemnified the insured despite the breach of warranty, he shall not claim against the insured on the same ground. This article is quite similar to the insurer's right to waive provided in S 34 (3) of the MIA 1906. However, the waiver in Article 7 is, by nature, a waiver by election, whereas the waiver under MIA 1906 is a waiver by equitable estoppel.<sup>37</sup> The consequence of automatic discharge of breach of warranty in English law gives the insurer no right to elect,<sup>38</sup> while the waiver in CMC clearly enables the insurer to make a choice between the two alternatives.<sup>39</sup> Also, it should be noted that the drafters of the Provision tried to provide a definition of 'warranty', given the frequent disputes in judicial practice that are actually about what constitutes a warranty.<sup>40</sup> But they finally withdrew any proposal related to this matter, and issued the final paper without the definition. It was considered with caution that a judicial interpretation shall only serve to clarify the ambiguity of provisions in the law but not to create a new law.<sup>41</sup>

There is no doubt that the Provision has settled some issues under dispute, and helps to prevent the insureds from undermining the rights enjoyed by the insurers.<sup>42</sup> However, there are still some unsolved or emerging issues both in theory and in practice.

#### **D. Unsolved or unclarified issues on insurance warranty**

##### **a. What is 'warranty'? How is it identified?**

Given that there is no explicit definition in the CMC or in other legislations, identification of warranty has always been a prominent issue in judicial practice, and judicial decisions on what constitutes a warranty varies from court to court.

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<sup>35</sup> Xin Wang, *On the Legal Consequence of Breach of Warranty in Marine Insurance*, Annual of China Maritime Law, 2001, Vol. 1265, 69-71 (in Chinese); Xumei Fu, *Interpretation of the Chinese Maritime Code*, People's Court Press 1995, 435 (in Chinese). This proposal was arrived at after considering that warranty clauses are closely related to the risks insured against, and are thus in compliance with the general rules of the Contract Law.

<sup>36</sup> For more information, see Section D (b): 'Termination: A divergence existing in the Provision and other laws'.

<sup>37</sup> Baris Soyer, *Beginning of a New Era for Insurance Warranties?* [2013] LMCLQ 384, 389.

<sup>38</sup> Howard Bennett, *The Law of Marine Insurance* (Oxford University Press 2<sup>nd</sup> edn, 2006) 551, para.18.95; see also Baris Soyer, *Beginning of a New Era for Insurance Warranties?* [2013] LMCLQ 384, 389.

<sup>39</sup> Baris Soyer, *Beginning of a New Era for Insurance Warranties?* [2013] LMCLQ 384, 389.

<sup>40</sup> Shumei Wang, *Understanding and Application on the <Provisions of the Supreme People's Court on Several Issues about the Trial of Cases Concerning Marine Insurance Disputes>*, The People's Judicature, 2006 (12) 14, 15-16 (in Chinese).

<sup>41</sup> Shumei Wang, *Understanding and Application on the <Provisions of the Supreme People's Court on Several Issues about the Trial of Cases Concerning Marine Insurance Disputes>*, The People's Judicature, 2006 (12) 14, 15-16 (in Chinese); article 45 of legislation law regarding the function of judicial interpretation.

<sup>42</sup> Shumei Wang, *Understanding and Application on the <Provisions of the Supreme People's Court on Several Issues about the Trial of Cases Concerning Marine Insurance Disputes>*, The People's Judicature, 2006 (12) 14, 16 (in Chinese).

For instance, in a case tried by Guangzhou Maritime Court, the Court took it for granted that one clause was a warranty clause.<sup>43</sup> The case involved a cargo policy between the plaintiff, a trading company, and the defendant, an insurance company. In this case, both parties agreed in the policy, *inter alia*, that the insured voyage was from India to Shekou, China. However, the vessel in question arrived at the port of Chiwan, China and discharged the insured cargo there. Later the cargo was found to have deteriorated during the process of discharging. A material fact in this case was that the change in discharging port was submitted by the insured to the insurance company, and an indemnity agreement was subsequently reached between the parties. In the case, the insured claimed against the insurance company to indemnify the losses as agreed.<sup>44</sup> However, the insurer refused to indemnify the insured on the ground that the insured, by discharging the cargo at Chiwan rather than Shekou, was in breach of the warranty clause under the initial insurance contract. So one of the issues in front of the Court was whether the agreement as to the port of discharge in the initial policy should be identified as a ‘warranty’; if yes, the insurer could be discharged from liability once the said warranty was breached. The Court decided that the policy was effectively established based upon the consensus of both parties, and that the agreement as to the port of discharge should thus be treated as a warranty clause; however, the judgment lacked any clear explanation as to why it should be treated as a warranty clause.<sup>45</sup>

By way of contrast, in another marine insurance dispute between the plaintiff, a company in Shanghai (the respondent in this appeal case), and the defendant, the China Continent Property&Casualty Insurance Company (the appellant in this appeal case), the reasoning in the approach adopted by the court involved was different.<sup>46</sup> The policy concerned involved a voyage from Zhangjiangang, China to Yingkou, China for the carriage of some large machinery and equipment. In the policy, the agreed date of commencement was 27 September 2007. Due to a change in the towage arrangement, the voyage did not start until 16 October 2007, and the insurer was informed of this fact. The insured sued the insurance company for the loss of one machine at the port of discharge, but the insurer argued that the insured was in breach of the warranty clause due to the change in the date of commencement. The Court of Appeal reasoned in detail that two requirements shall be met to constitute a warranty clause: Firstly, a warranty clause must be clearly stipulated to be such in the contract; and secondly, there is a requirement that the parties to any ‘promises’, should fully understand, or ought to have understood, the intention of such ‘promises’

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<sup>43</sup> <http://dllawyers.chinalawinfo.com/newlaw2002/slc/slc.asp?db=fnl&gid=117466678> (in Chinese), last accessed on 22 December 2015.

<sup>44</sup> The insured trading company brought a lawsuit against the carrier and later withdrew the claim. After that the insured and the insurer reached an agreement as to the indemnity issue and subrogation right. However, the insurer refused to admit such an agreement on the ground that the insured was in breach of the warranty clause by discharging the cargo at the port of Chiwan. Therefore, the assured brought a claim against the insurance company.

<sup>45</sup> It is noted that, even though the Court decided that the agreement as to the port of discharge was a warranty, and that the assured, by changing the discharging port, was in breach of such warranty, yet the Court did not support the insurer on the ground that the insurer had already agreed to the indemnity agreement, and thus he could not argue against the insured’s breach. Another consideration was that the losses occurred as a result of the listed perils in the policy, and therefore the Court finally delivered the judgment in favor of the insured plaintiff.

<sup>46</sup> Case No. (2010) Hu Gao Min Si (Hai) Zhong Zi No. 41, available at: <http://dllawyers.chinalawinfo.com/newlaw2002/slc/slc.asp?db=fnl&gid=117757274> , last accessed on 22 December 2015.



and the consequences of any breach of warranty. In this case there was a divergence in the understanding between the parties as to the date of commencement in that the insured claimed that the ‘date of commencement’ meant the start of the liability under the policy, while the insurer argued that such stipulation meant the date of the sailing. It was thus considered by the Court that there was no consensus reached between the parties and that the stipulation as to the date of commencement should not be treated as a warranty clause. The approach adopted in this case seems to be more reasonable, although it only applies to express warranty clauses in the contract. Clearly stipulating such a clause into the contract may eliminate any chance for the insurer to avoid his liability by arbitrarily claiming the ‘warranty’ to be breached. Nevertheless, since judges in Chinese courts are not entitled to create law, this approach would not therefore have any significant influence on similar cases tried by other courts.

Under English law, in order to constitute an insurance warranty, no particular form of words is required and, indeed, the word ‘warranty’ or ‘warrantied’ need not even be used. The identification of warranty clauses shall be dependent upon the intention of the parties as revealed by the contract as a whole.<sup>47</sup> This similar principle is actually utilized by the Chinese Courts. For example, in a case tried by the Shanghai Maritime Court,<sup>48</sup> the plaintiff (the insured) and the defendant (the insurer) entered into a voyage insurance for the purpose of towage of the M/V ‘Canadian Harvest’. Among other things, the insurance contract stipulated ‘20 April 1995’ as the sailing date. However, no word of ‘warranty’ actually appeared in the insurance policy. The vessel in question first sailed on 29 May 1995, but the sailing was however suspended due to breakdown of the main engine. After repair work, the vessel in question finally began the insured voyage on 1 December 1995. The vessel suffered a total loss due to bad weather, and the insured claimed against the insurer for indemnification. However, the insurer argued that he was not liable for the loss on various grounds, and one of them was that the insured was in breach of warranty for it did not commence the voyage as agreed in the policy. The Court delivered a judgment in favor of the insurer, on the ground of the insured’s non-disclosure of material information. However, the Court’s reasoning as to the warranty is worth quoting at some length. It was considered by the Court that the duration of the insurance coverage shall start from unmooring at the loading port to the moment of anchoring or mooring at the port of destination. Also, *the agreed date of commencement in the policy does not necessarily mean that the vessel shall commence sailing on that particular date*; instead, it can satisfy the condition if the voyage starts *within a reasonable time from the agreed sailing date*. Nevertheless, it was hardly considered reasonable for the vessel to start her first voyage 40 days after its prescribed sailing date, and then to commence a second voyage several months later after repairing the main engine. Along with a consideration of the characteristics of the voyage policy

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<sup>47</sup> Professor Bennett summarized, “it is a question of construction, and the presence or absence of the word ‘warranty’ is not conclusive”. See Howard Bennett, *The Law of Marine Insurance*, Oxford University Press 2<sup>nd</sup> edn, 2006, 552, para.18.62. See also *HIH Casualty & General Insurance Ltd v New Hampshire Insurance Co.* [2001] 2 Lloyd’s Rep 161, para 101 per Rix LJ; *Toomey v Banco Vitalicio de Espana SA de Seguros y Reaseguros* [2004] EWCA Civ 622, [2005] Lloyd’s Rep IR 423, para 40-42

<sup>48</sup> Xin Wang, *On the Legal Consequence of Breach of Warranty in Marine Insurance*, Annual of China Maritime Law, 2001, Vol. 1265, 71-72 (in Chinese).

and industry practice, the Court held that the insured's failure to commence the insured voyage within a reasonable time was in breach of the warranty as stipulated in Article 235 of CMC.

#### **b. Termination: A divergence existing in the Provision and other laws**

There is some divergence between various related laws as to the legal provisions with regard to the date of termination of the contract. Under the Provision, the insurer has the right to terminate the contract upon a breach of warranty, and such right shall not be affected by whether or not the insured notifies the insurer of such breach, or whether or not any agreement as to new terms and conditions is reached after negotiation. An attempt to understand a 'warranty' can be also made by reference to the general rules of the Contract Law. It is considered that an insurance warranty should be treated as a 'condition' in a contract.<sup>49</sup> A 'condition', according to the Contract Law, is an event agreed on by parties to the contract, upon the achievement of which the contract is deemed to be either effected or terminated.<sup>50</sup> Pursuant to Article 235 of the CMC, a 'warranty' is a clause that both parties agree upon in the contract, one that gives the insurer the right to terminate the contract upon any breach of the warranty by the insured. Hence, it may be concluded that a 'warranty' falls within the category of 'condition' in the Contract Law. In addition, Article 93 of the Contract Law provides the condition that effects termination of the contract;<sup>51</sup> and Article 96 provides that under the circumstances of either contractual termination<sup>52</sup> or statutory termination<sup>53</sup>, the party demanding the termination of the contract shall first notify the other party, and the contract shall be terminated upon receipt of the notice by the other party. Therefore, based upon the above two articles in the Contract Law, once a warranty is breached, the insurer demanding termination of the contract shall notify the insured of such, and the insurance contract shall be terminated upon the receipt of such notice by the insured. That may also mean that the insurer's liability for any loss will continue until 'the receipt of notice by the insured'; in other words, the time of 'the receipt of notice by the insured' is the point at which the insurance contract is legally terminated. As a consequence, one may conclude that the insurer shall still be responsible for any losses occurring before the insurance contract is 'legally' terminated.<sup>54</sup> It is interesting to note that

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<sup>49</sup> Xin Wang, *On the Legal Consequence of Breach of Warranty in Marine Insurance*, Annual of China Maritime Law, 2001, Vol. 12 65, 71-72 (in Chinese).

<sup>50</sup> Article 93 of the Contract Law. See also Guangxin Zhu, *General Rules of the Contract Law*, (People's University of China Press: 2008), 135-136 (in Chinese); Limin Wang, Shaokun Fang and others, *The Contract Law*, (People's University of China Press: 2002), 130-131 (in Chinese). Also, several requirements shall be satisfied as a condition, that is, the event is to occur in the near future; the happening of such event is not a sure thing; and the agreed event shall be in compliance with the law.

<sup>51</sup> Article 93 of the Contract Law reads '...the parties may terminate a contract if they reach a consensus through consultation. The parties may agree upon conditions under which either party may terminate the contract. Upon satisfaction of the conditions, the party who has the right to terminate the contract may terminate the contract.' See also: Xin Wang, *On the Legal Consequence of Breach of Warranty in Marine Insurance*, Annual of China Maritime Law, 2001, Vol. 12 65, 69-71(in Chinese).

<sup>52</sup> Article 93 of the Contract Law.

<sup>53</sup> Article 94 of the Contract Law sets out four particular circumstances with a default clause under which parties to the contract have the right to terminate the contract, which is also treated as 'statutory termination' in theory.

<sup>54</sup> Xin Wang, *On the Legal Consequence of Breach of Warranty in Marine Insurance*, Annual of China Maritime Law, 2001, Vol. 12 69-71 (in Chinese); See also Shumei Wang, *Understanding and Application on the <Provisions of the Supreme People's Court on Several Issues about the Trial of Cases Concerning Marine Insurance Disputes>*, The People's Judicature, 2006 (12) 14, 16 (in Chinese).

Article 52 of the Insurance Law also provides that the insurance contract should be terminated upon the receipt of notice by the insured. Thus, it may follow that the proposal that was objected to by the Supreme Court when drafting the Provision should actually have been accepted, and that the insurer should thus be held liable for any losses occurring during the new negotiation process, provided there is no causation between the breach and the subsequent losses. Nevertheless, if the insurer were deemed to be liable for any losses occurring prior to the insured receiving notification of termination, then it may be fair and reasonable to limit the insurer's liability for losses that are not caused by the prior breach.

It seems that, as far as the rules go regarding termination of an insurance contract in a case where the warranty is breached, the Contract Law and the Insurance Law contain a similar approach, whereas the Provision contains a different one. This divergence may be ascribed to the inherent nature of the ranking of laws in the Chinese legal system. It is clear that if a judicial interpretation of the law is made or adopted by the NPC, then this has the same ranking as the laws made by the NPC.<sup>55</sup> However, the Provision was issued by the Supreme Court and adopted by the Trial Committee of the Supreme Court. It is noted that a majority of their interpretations are issued for the purpose of clarifying certain issues in judicial trials, and consistency issues might not be given enough consideration. Thus, which law shall be given priority when issues arise in this regard? According to the drafters of the Provision, the conclusion in the Provision as to the date of termination of the contract is largely arrived at by taking into consideration the legal regime of warranty in the MIA 1906.<sup>56</sup> However, it is not appropriate to simply refer to English law at the cost of losing legal consistency within the Chinese legislative system.

### **c. The implied insurance warranty**

The MIA 1906 provides two types of implied warranty, i.e., the warranty of seaworthiness of the vessel (in a voyage policy) and the warranty of legality.<sup>57</sup> In contrast to this, Article 235 of the CMC does not show any intention to include an implied warranty. Despite lacking legislative support, there have been legal cases that from time to time have raised this issue of implied warranty. However, it has also been noticed that the court decisions do not seem to be consistent.

#### *Implied warranties of legality*

The implied warranty of legality was considered by the Tianjin Maritime Court in 1994 concerning the M/V 'Fuda' in a marine insurance contract dispute.<sup>58</sup> M/V 'Fuda' was owned by a foreign-owned enterprise, which was a registered non-shipping company in China. For the purpose of ship registration, the foreign company entered into a ship management contract with a shipping company domiciled in Tianjin. As a consequence, M/V 'Fuda' was registered under the name of

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<sup>55</sup> Article 50 of the Legislation Law.

<sup>56</sup> Shumei Wang, *Understanding and Application on the <Provisions of the Supreme People's Court on Several Issues about the Trial of Cases Concerning Marine Insurance Disputes>*, The People's Judicature, 2006 (12) 14, 16 (in Chinese).

<sup>57</sup> S 39 (1) and S 41 of MIA 1906.

<sup>58</sup> For more information, please see Yi Liu, *Study on the Warranty System in Marine Insurance*, Shanghai Maritime University, Master's Dissertation 2006, 41-43 (in Chinese).

the Tianjin shipping company, and was run by this company to engage in ocean transportation. However, the foreign company was listed as the insured in the policy. M/V 'Fuda' was involved in a collision during a voyage and later sank. The foreign company, being the insured, claimed against the insurance company for the total loss of the ship, but the insurance company declined the claim on the ground of the insured's breach of the implied warranty of legality, for the ship insured was not legally registered. Tianjin Maritime Court was in favor of the insurance company on the ground that the foreign-owned ship did not satisfy the requirements set out in the *Regulations on waterway transportation of the People's Republic of China* and the *Regulations on the registration of ships of the People's Republic of China*<sup>59</sup>, and that its registration was in violation of the administrative laws of China. Therefore, the Court held that the foreign company, by not following the registration process, was in breach of the implied warranty of legality, and rejected its claims. The judgment gave no response or guidance as to what extent illegality is needed so as to determine that such implied warranty has been breached. Interestingly, this decision was, however, overruled by the Tianjin High Court for the simple reason that the management arrangement between the foreign company and the domestic shipping company was allowed by the law, and even the breach of certain administrative regulations was not severe enough to allow the insurer to be exempted from his liability under the insurance contract. They also further clarified that not all the illegal acts would render the voyage illegal; the legal purpose of a particular law shall also be taken into consideration so as to prevent the insurer from technically avoiding his liability.

In contrast to this, there was another case tried by the Guangzhou Maritime Court which took a somehow stricter approach when deciding whether it was a violation of implied warranty of legality. It was a cargo insurance case, and the goods insured were subject to the authorization of a restricted importation license. The cargo suffered water damage during the voyage. The case itself was not a simple one; one of the issues was whether the insured, a Chinese buyer, had an insurable interest at the time of the incident. However, the insurer argued that, even if the insured had an insurable interest, the insurer should not be held liable for damage to the goods on the ground that the insured, by failing to get such license, was in breach of the implied warranty of legality. The Court found in favor of the insurer and rejected the insured buyer's claim, and determined that the insured, by violating the relevant regulation as to the import certification policy (failing to get the required license), was in breach of the implied warranty of legality and therefore the damages suffered by the insured could not be covered by the insurance contract.<sup>60</sup>

#### *Implied warranty of seaworthiness in a voyage policy*

Under the MIA 1906, the implied warranty of seaworthiness in a voyage policy is clearly stated in S39(1). In contrast to this, the CMC classifies that unseaworthiness at the time of commencement

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<sup>59</sup> A foreign company is not entitled to engage in the shipping business within the navigational waterways of China without the authorization of the Ministry of Transportation of the People's Republic of China. Also, if the registered capital of a company involves foreign capital, then the registered capital of the Chinese contributors shall be not less than 50% of the whole registered capital. See Article 7 of the *Regulations on the waterway transportation of People's Republic of China* and Article 2 of the *Regulations on the registration of ships of People's Republic of China*.

<sup>60</sup> Legal case citation cannot be found. For more information, please see Pengnan Wang, *Zhong Guo Hai Shang Fa An Li Zhai Yao Ji Ping Lun* (in Chinese), (Dalian Maritime University Press: 2003) 67.

of a voyage shall be incorporated as an exclusion in the policy.<sup>61</sup> This is regarded as a reasonable approach<sup>62</sup> that is largely supported by insurance practice in China<sup>63</sup>. If it were to be considered as a type of implied warranty, it would require strict compliance, and a breach of this implied warranty would result in harsh consequences. In comparison, if it were put into an exclusion clause that was normally drafted in a way that ‘...unless otherwise agreed in the insurance contract, the insurer shall not be liable for the loss of or damage to the insured cargo arising from any of the following causes: (1) unseaworthiness of the ship at the time of the commencement of the voyage, unless where, under a time policy, the insured has no knowledge thereof...’,<sup>64</sup> there apparently requires the existence of causation because of the inclusion of ‘arising from’. If the loss that occurred results from a breach of seaworthiness, then the insured is deprived of his right to claim against the insurer. The causation requirement in the exclusion clause seeks to strike a better balance between the insurer and the insured in that it prevents the insurer from abusing his right to avoid his liability under the insurance contract, and it can protect the insurer’s right by restricting his liabilities to those losses not related to the insured’s breach. Moreover, in a time policy, it precludes the situation where the insured has no knowledge of such unseaworthiness at the commencement of the voyage.<sup>65</sup>

#### **E. Development of the common law approach: the Insurance Act 2015**

The Insurance Act 2015 in the UK finally received Royal Assent in February 2015, and this marked a new milestone for insurance law and practice. As a result of enacting Ss 9, 10 and 11, significant changes have been made in response to long-lasting criticisms over warranty. These three sections apply to both express and implied warranties.<sup>66</sup>

Firstly, following S10(2), the harsh consequence of an automatic discharge has been abolished,<sup>67</sup> and this has been replaced by the suspension approach. The insurer is not liable for any losses occurring, or attributable to something happening, after a breach of warranty, unless and until the breach has been remedied;<sup>68</sup> this means that “... [T]he risk is simply suspended during any period of breach”.<sup>69</sup> This position, as is observed by some scholars, is defensible when taking into account both the rationale for incorporating warranties into insurance contracts, and their function in risk assessment and management.<sup>70</sup> The insurer will not be liable where the agreed cover is altered due

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<sup>61</sup> Article 244 (1) of the CMC.

<sup>62</sup> Pengnan Wang, *Zhong Guo Hai Shang Bao Xian He Tong Fa Xiang Lun* (in Chinese), (Dalian Maritime University Press: 2<sup>nd</sup> edn, 2003), 304.

<sup>63</sup> ‘Article 2(1) unseaworthiness’ is under the title ‘exclusions’ of China PICC Hull and Machinery Clause 2009; ‘Article 2 (1) unseaworthiness’ is also under the title ‘exclusions’ of Hull and Machinery Clause of China Pacific Insurance Company.

<sup>64</sup> Article 244 of CMC.

<sup>65</sup> Article 244 of CMC.

<sup>66</sup> S 10 (1) of the Insurance Act 2015. It is observed that market practice and judicial rulings have rendered the implied warranties of little significance, but where they remain effective the ability of an insurer to reply upon a breach is restricted by the 2015 Act: see Robert Merkin and Özlem Gürses, *The Insurance Act 2015: Rebalancing the Interests of Insurer and Assured*. The Modern Law Review, 2015 Issue 6 1004, 1018-1019.

<sup>67</sup> S 10 (1) (a) of the Insurance Act 2015.

<sup>68</sup> S 10 (2) of the Insurance Act 2015.

<sup>69</sup> Robert Merkin and Özlem Gürses, *Insurance Contracts after the Insurance Act 2015*, Law Quarterly Review 2015.

<sup>70</sup> Baris Soyer, *Beginning of a New Era for Insurance Warranties*, 2013 LMCLQ 384, 387.

to the insured's breach; and when the risk returns to what was originally agreed, his liability resumes. The effect of the suspension approach still requires that the warranty must be strictly complied with, and that any breach of warranty will result in an *automatic suspension* of the insurer's liability.<sup>71</sup> It may thus be concluded that the Insurance Act 2015 offers the solution for only one scenario, i.e., where the breach of warranty can be remedied, since there is no mention of possible remedies where the breach is permanent;<sup>72</sup> for example, where the insured warrants that the lorry will be used for carrying metal materials, but it is later permanently changed to be used for carrying gas cylinders, thus permanently breaching the warranty,<sup>73</sup> for which the ultimate consequence is exactly the same as that under MIA 1906.

Secondly, S11(1) intends to focus on terms designed to reduce specific risks. It delineates a line between specific types of risk, which are classified into three types, and 'a term defining the risk as a whole', which is explicitly excluded. The Law Commission did not provide any guidance as to the differences between these two, and leaves the issue to the courts.<sup>74</sup> Accordingly, debates have arisen over the application of this subsection along with subsections 2 and 3.<sup>75</sup> A real moral dilemma will arise where, for example, the insured attempts to explain a term which is limited to a particular risk; or which defines the risk as a whole, whichever is for his benefit, while the insurer argues the other way round.<sup>76</sup> Undoubtedly, in this respect the law creates more uncertainty and further scope for disputes in practice.<sup>77</sup>

Thirdly, S11(4) adds some complexity to the relation between S10 and S11. It is clear that S10 applies to warranties, and that it also sets out the legal consequence of a breach of warranty. S11 concerns 'terms not relevant to the actual loss' (as shown in the section title); however, by adding its subsection (4), S11 now has the potential to also apply to warranties. Therefore, there are three possible different situations: 1) S10 applies to all warranties; 2) some warranties will be caught by S11—if they are aimed at reducing particular risks; and 3) S10 and S11 may apply together—in which case S10 becomes subject to S11. As a result, if a warranty is relevant to a particular kind of loss, or at a particular time or location, S11 will possibly apply. Therefore, as already noted by

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<sup>71</sup> Zhen Jing, *Warranty and doctrine of alteration of risk during the insurance period: A critical evaluation of the UK Law Commission's proposals for reform of the law of warranties*, Insurance Law Journal, 2014 Vol.25 183, 191.

<sup>72</sup> See The Explanatory Notes to the Bill, <http://www.publications.parliament.uk/pa/bills/cbill/2014-2015/0155/en/15155en.htm>, at para. 89, "It acknowledges, however, that some breaches of warranty cannot be remedied." Last accessed on 2 December 2015.

<sup>73</sup> Zhen Jing, *Warranty and doctrine of alteration of risk during the insurance period: A critical evaluation of the UK Law Commission's proposals for reform of the law of warranties*, Insurance Law Journal, 2014 Vol.25 183, 191.

<sup>74</sup> Insurance Contract Law: Business Disclosure; Warranties; Insurers' Remedies for Fraudulent Claims; and Late payment, Law Com No 353/Scot Law Com No 238, at para.18.44, [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/331733/41872\\_Cm\\_8898\\_WEB.PDF](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/331733/41872_Cm_8898_WEB.PDF). Last accessed on 2 December 2015.

<sup>75</sup> Robert Merkin and Özlem Gürses, *The Insurance Act 2015: Rebalancing the Interests of Insurer and Assured*. The Modern Law Review 2015 Issue 6 1004, 1020-1021.

<sup>76</sup> P. Jaffe, *Reform of the Insurance Law of England and Wales – Separate Laws for Different Needs of Businesses and Consumers*, [2013] 126 BILA 18, 38.

<sup>77</sup> House of Lords Paper 81, 35-37 <http://www.publications.parliament.uk/pa/ld201415/ldselect/ldinsur/81/81.pdf>, last accessed on 22 December 2015.

the LMC<sup>78</sup>, if the scope of the policy cover is narrow, such as for only a specific type of risk, such as fire risk, then S11 would apply; however, if it is of a broad nature (such as an all-risks policy), there is a good chance of the insurer arguing that S10 rather than S11 should be taken into consideration.<sup>79</sup>

Fourthly, the Law Commission claimed that the Insurance Act 2015 adopts a more objective assessment, thus avoiding the causal link.<sup>80</sup> This seems to be true if S10(2) is read alone, as it has the effect that an insurer is not liable for the loss if the term is not complied with by the insured; it is irrelevant whether or not breach of the term actually contributed to the loss that occurred. However, as analyzed above, S11 also has a role to play when the breach of warranty falls within its scope. By scrutinizing section 11(2)-(3), it is clear that the insurer might not simply rely upon the insured's non-compliance to 'exclude, limit or discharge' his liability under the policy if the insured satisfies subsection (3). Subsection (3) sets out three elements to consider when deciding whether the insurer can reasonably 'exclude, limit or discharge' his liability, namely: (1) the insured's non-compliance; (2) the loss that actually occurred; and (3) the specific circumstances in which the loss occurred. If S11(3) merely provided for elements (1) and (2), i.e. 'if the non-compliance with the term could not have increased the risk of the loss which actually occurred', it would be easy to understand how an objective assessment is required. However, when taking into account all three elements, it appears far from clear. For example, where a property has been damaged by flooding, the insured could show that a failure to use the required type of lock on a window (as a warranty in the policy) could not have increased the risk of that loss.<sup>81</sup> Therefore, the importance is not to merely stress the loss that actually occurred, but to emphasize what actually occurred *in the circumstance in which it occurred*. Put another way, unless the specific circumstance would have had some bearing on the risk of loss that actually occurred, the insurer may not rely upon such non-compliance. This, as has been pointed out, is a pure causation.<sup>82</sup>

To better prove the existent causation under S11, it is necessary to compare it with the causation test adopted in S11 of the New Zealand Insurance Law Reform Act 1977 (1977 Act). Following S11 of the 1977 Act, there is a presumption that the event or the existence of certain circumstances is likely to increase the risk of such loss occurring<sup>83</sup> unless the insured can prove that the loss was not caused by and did not contribute to the happening of such events or the existence of such

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<sup>78</sup> The Lloyd's Market Association (LMA) and the International Underwriting Association of London (IUA) were involved intensively for the discussion of the Insurance Bill, and they were together referred to as 'London Market Carriers', or LMC in the House of Lords Paper 81, <http://www.publications.parliament.uk/pa/ld201415/ldselect/ldinsur/81/81.pdf>, last accessed on 22 December 2015.

<sup>79</sup> House of Lords Paper 81, 37, at para. 12, <http://www.publications.parliament.uk/pa/ld201415/ldselect/ldinsur/81/81.pdf>, last accessed on 22 December 2015.

<sup>80</sup> Insurance Contract Law: Business Disclosure; Warranties; Insurers' Remedies for Fraudulent Claims; and Late payment, Law Com No 353/Scot Law Com No 238, at para.14.24 and 18.14, [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/331733/41872\\_Cm\\_8898\\_WEB.PDF](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/331733/41872_Cm_8898_WEB.PDF). Last accessed on 22 December 2015.

<sup>81</sup> Example given in the Explanatory Note, for the detail, see <http://www.publications.parliament.uk/pa/bills/cbill/2014-2015/0155/en/15155en.htm>, last accessed on 22 December 2015.

<sup>82</sup> Robert Merkin and Özlem Gürses, *Insurance Contracts after the Insurance Act 2015*, Law Quarterly Review 2015.

<sup>83</sup> First paragraph of S11(b) of the New Zealand Insurance Law Reform Act 1977.

circumstances.<sup>84</sup> A more detailed illustration of the second part of S11 of the 1977 Act was delivered by Judge Richardson in a case where it was shown that, unless the existence of the relevant circumstances in itself increases the risk of loss, there is no justification for denying the insured the protection of the cover.<sup>85</sup> S11 of the 1977 Act focuses on whether the specific circumstances in which the loss actually occurred has any influence on the actual loss suffered. It is in effect the causation. S11 of the Insurance Act 2015 may have the same effect.

In conclusion, then, the reforms with regard to warranty in the Insurance Act 2015 might not be desirable, and as has been discussed above, the Act has created uncertainty and there may be fertile ground for even more disputes.<sup>86</sup> Therefore, there has even been a voice of support calling for complete abandonment of the warranty.<sup>87</sup>

#### **F. Civil law approach: alteration of risk during the insurance period**

‘Alteration of risk’ is a civil law doctrine that relates to risk management. It is deemed to have a similar function to that of a warranty; and it serves to confine the risk to the scope that the insurer promises to undertake at the time of the contract.<sup>88</sup> The definition of what constitutes an alteration of risk may vary, but the definitions may be based upon four different approaches:<sup>89</sup>

‘The first approach is that the risk must be increased compared to the written or implied conditions of the insurance contract. The second approach is that the risk must be altered or increased in such a way that the insurer would not have accepted the insurance at all, or would not have accepted the insurance on the same conditions if he had known about the increase. A third method is to say that the risk is substantially altered. The last approach is to connect the sanction to circumstances affecting or altering the risk after the contract is concluded without any further definition.’<sup>90</sup>

The Norwegian Marine Insurance Plan 1996 (2010 version) (NMIP 2010) is a good example in this respect. With regard to the duties of both the person effecting the insurance and of the insured,

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<sup>84</sup> Second paragraph of S11(b) of the New Zealand Insurance Law Reform Act 1977.

<sup>85</sup> This is a rephrased sentence of Judge Richardson, for the original judgment, see *New Zealand Insurance v Harris* [1990] 1 NZLR 10, 16.

<sup>86</sup> P. Jaffe, *Reform of the Insurance Law of England and Wales – Separate Laws for Different Needs of Businesses and Consumers*, [2013] 126 BILA 18, 38; Zhen Jing, *Warranty and doctrine of alteration of risk during the insurance period: A critical evaluation of the UK Law Commission’s proposals for reform of the law of warranties*, Insurance Law Journal, 2014 Vol.25 183, 190.

<sup>87</sup> Zhen Jing, *Warranty and doctrine of alteration of risk during the insurance period: A critical evaluation of the UK Law Commission’s proposals for reform of the law of warranties*, Insurance Law Journal, 2014 Vol.25 183; Professor Merkin responded ‘No warranties. Full stop.’ The Law Commission and Scottish Law Commission, *Insurance Contract Law: the business insured’s duty of disclosure and the law of warranties*, a joint Consultation Paper 2012, para. 14.4.

<sup>88</sup> Zhen Jing, *Warranty and doctrine of alteration of risk during the insurance period: A critical evaluation of the UK Law Commission’s proposals for reform of the law of warranties*, Insurance Law Journal, 2014 Vol.25 183, 195.

<sup>89</sup> Trine-Lise Wilhelmsen, *Duty of Disclosure, Duty of Good Faith, Alteration of Risk and Warranties*, CMI Yearbook 2000, 376. For more details, see <http://comitemaritime.org/Uploads/Yearbooks/Yearbook+2000.pdf>, last accessed on 22 December 2015.

<sup>90</sup> Trine-Lise Wilhelmsen, *Duty of Disclosure, Duty of Good Faith, Alteration of Risk and Warranties*, CMI Yearbook 2000, 376-377. For more details, see <http://comitemaritime.org/Uploads/Yearbooks/Yearbook+2000.pdf>, last accessed on 22 December 2015.



Section 2 under Chapter 3 concerns the alteration of risk. Ss3-8 provides the definition of an alteration of risk that occurs where a circumstance that is to form the basis of the insurance changes and where this change is contrary to the implied conditions of the contract. NMIP 2010 takes into account the insured's fault or 'the state of the insured's mind' when dealing with the corresponding remedies for the insurer. Where the insured has intentionally caused or agreed to an alteration of risk, the insurer is free from liability, but he has to satisfy the assumption that he would not have accepted the insurance had he known of such alteration.<sup>91</sup> If the insurer would have accepted the insurance albeit on other conditions, he is only liable for the loss which is not due to such alteration.<sup>92</sup> Otherwise, the insurer has the right to cancel the insurance contract upon the occurrence of an alteration of risk.<sup>93</sup> NMIP 2010 also stipulates the duty of notice assumed by the insured under the circumstances in which an alteration of risk occurs. The insured shall notify the insurer if he becomes aware of the alteration of risk, failing which the insurer is either free of liability or may cancel the insurance contract pursuant to Ss 3-9.<sup>94</sup> NMIP 2010 entitles the insurer to the right to cancel the insurance contract if an alteration of risk happens,<sup>95</sup> but it also sets down requirements as to exercising the right of cancellation. The first requirement is that the insurer shall notify the insured by giving 14 days' notice if he intends to invoke such right.<sup>96</sup> Moreover, it specifies that the insurer's right of cancellation may be forfeited if he fails to perform the duty of notice without undue delay.<sup>97</sup> Further, the right of cancellation is subject to exceptions under which the insurer may not exercise his right of cancellation. If the alteration of the risk has ceased to be material to the insurer, or if the risk alters for the purpose of saving human life or engaging in a salvage operation during the voyage, the insurer may not invoke the alteration of risk.<sup>98</sup>

It seems that this 'alteration of risk' principle tries to strike a balance between the interests of the insurer and the insured. The alternative choice for the insurer upon the insured's intentional act<sup>99</sup> satisfies the insurer's needs in that the cancellation of the contract is not always a good choice, since in practice the insurer must also take into consideration client maintenance and the achievement of his commercial purpose. Offering the insurer an alternative not only meets the insurer's various needs, but also promotes success of the transaction by allowing the insurance contract to continue to be effective. In addition, the requirement for notification by both the insured and the insurer guarantees the certainty of the contract, and the grace period (i.e. the 14 days' notice) is reasonable in that it allows both parties to negotiate or seek alternative cover. Furthermore, to restrict the insurer's right of cancellation for the purpose of saving human life or engaging in a salvage operation is consistent with international conventions and at the same time encourages proper salvage activities and due regard for the safety of human life.

#### **G. 'Alteration of risk' provision under Chinese insurance law**

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<sup>91</sup> S 3-9 (1) of NMIP 2010.

<sup>92</sup> S 3-9 (2) of NMIP 2010.

<sup>93</sup> S 3-10 of NMIP 2010. The insurer's right of cancellation is still subject to his giving 14 days' notice.

<sup>94</sup> S 3-11 of NMIP 2010.

<sup>95</sup> S 3-10 of NMIP 2010.

<sup>96</sup> S 3-10 of NMIP 2010.

<sup>97</sup> S 3-13 of NMIP 2010.

<sup>98</sup> S 3-12 (2) of NMIP 2010.

<sup>99</sup> S 3-9 (2) of NMIP 2010.

It is to note that Insurance Law in China has effectively adopted a similar doctrine of ‘alteration of risk’; this is shown in Article 52, which reads:

‘Where the degree of the perils of the subject matter insured greatly increases during the term of the validity of the contract, the insured shall notify the insurer in a timely manner as agreed upon, and the insurer may accordingly increase the insurance premium or terminate the contract. If the insurer terminates the contract, he shall, after deducting the receivable part from the day of commencement of the liability to the day of the termination, refund the rest of the premium to the insured.

Where the insured fails to perform his obligation of notification specified in the preceding paragraph, the insurer shall not be liable for indemnity in the case of the occurrence of an event insured against which is caused by the material increase in risk.’

Article 52 provides two alternatives under the circumstance where there is *an increase of risk* during the term of validity of the insurance contract, namely, to increase the premium or to terminate the contract. In addition, the insured has the obligation to notify the insurer of such an alteration, the failure of which shall not affect the insurer’s right of termination. Nevertheless, there is no precise interpretation of the phrase ‘in a timely manner as agreed upon’, which may thus require reference to the contract agreement in each particular case.

As to the insurer’s duty of notification, this is also consistent with the provisions in the Contract Law. References can be made to Article 96 of the Contract Law in which the stipulation provides that ‘...either party to the contract demanding a termination of the contract in accordance with the provision of Article 93 (2) and Article 94<sup>100</sup> of this Law, shall notify the other party.’ Consequently, the contract shall be terminated upon receipt of notice by the other party. This means that if the insurer intends to exercise his right to terminate the contract according to Article 52 (statutory termination) of the Insurance Law, he would also obey his legal obligation under Article 96 of the Contract Law. On the other hand, if the insured fails to notify the insurer, then the insurer shall not be liable for the compensation. As a result, once the insured breaches his obligation of notification, the insurer can refuse to indemnify the insured and does not have to refund part of the premium to the insured. This approach definitely precludes the dilemma caused when the insured tries to avoid notifying the insurer of a change in circumstances.

It can be noted that neither the Insurance Law nor the Contract Law place any restriction on the time period for the insurer’s right of giving notice, whereas, for example, NMIP 2010 clearly provides for a 14-days’ prior notice. However, this does not mean that the insurer’s right of termination is without any time limitation under Chinese law. According to Article 95 (2)<sup>101</sup> of the

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<sup>100</sup> Article 93 deals with the termination of contract by agreement. Article 94 is mainly about statutory termination, and contains four specific situations (the failure of the contract purpose; anticipatory breach of the contract; the failure of the contract purpose due to one party’s delay in the performance) and one default clause (any other situation stipulated in the law).

<sup>101</sup> Article 95 reads: ‘Where there is a time duration as to the right of terminating the contract either stipulated by the laws or agreed upon by parties to the contract, if he fails to exercise such right within the specific duration, the right shall be extinguished. Where there is no such duration either stipulated by the law or agreed upon by the parties, the

Contract Law, the insurer must, after receiving the other party's notice, exercise the termination within a reasonable time, failing which the right becomes extinguished. In addition, Article 52, by its nature, is about the alteration of risk; however, unlike in the NMIP 2010, it lacks a precise definition of 'alteration of risk'; thus, it could become difficult in a particular case to decide what actually constitutes a situation where 'the degree of the perils of the subject matter insured *greatly increases*...'

Furthermore, it is to be noted that the law in countries like Germany and Norway differentiates the remedies by taking into account the fault of the insured;<sup>102</sup> however, this is not yet considered at all in either the Insurance Law or the Contract Law in China. Otherwise it would be reasonable and fair, because intentional and innocent non-performance of a duty should not be treated in the same way.<sup>103</sup>

## H. Conclusion

Based upon the doctrine of 'alteration of risk' during the insurance period, the insured, in the event of an increase in the risk, would continue to be covered under the policy if the insurer chooses to charge a higher premium or to change the policy terms or arrange other alternatives. Even if the insurer determines to terminate the contract, he shall first give notice to the insured within either a specific period of time or within a reasonable period of time if there is no prior specific time agreed, thus allowing the insured to seek other insurance cover. This doctrine is suggested to be 'a best way' to replace the age-old practice of warranty.<sup>104</sup> This is true, because on the one hand it has a similar function to a warranty with respect to risk management, but on the other hand it also provides fairer solutions other than legal consequences usually allowed for the breach of a warranty.

Given that there already exists the legal provision embodying the doctrine of 'alteration of risk' in the Insurance Law, could this same approach be considered for adoption into the law covering marine insurance contracts in China? Doing so would lead to a better understanding of risk management, as well as go a long way toward achieving the goal of better harmonization of laws.

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party entitled to such right, after being notified by the other party, shall exercise his right within a reasonable time, failing of which will render the right extinguished.' Accordingly, the insurer's right to terminate the contract is clearly stipulated in the Insurance Law under the circumstance of a greatly increased risk, and given that there is no article which regulates a specific time for the insurer's right, the insurer's right of termination is, therefore, subject to Article 95 (2) of the Contract Law.

<sup>102</sup> The German law also takes into account the insured's intentional fault, negligent fault or unintentional fault. Similar classification can be seen in the Norwegian Marine Insurance Plan 1996, 2010 version.

<sup>103</sup> Zhen Jing, *Warranty and doctrine of alteration of risk during the insurance period: A critical evaluation of the UK Law Commission's proposals for reform of the law of warranties*, Insurance Law Journal, 2014 Vol.25 183, 204.

<sup>104</sup> Zhen Jing, *Warranty and doctrine of alteration of risk during the insurance period: A critical evaluation of the UK law Commissions' proposals for reform of the law of warranties*, Insurance Law Journal, 2014 Vol.25 183, 207-208.