

**Maritime Law & Marine Insurance**  
**CML 625S**

**PAPER ON:** Marine Insurance---CMI Guidelines for the Formulation of  
Marine Insurance Law and China in Particular

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**Marine Insurance---CMI Guidelines for the Formulation of  
Marine Insurance Law and China in Particular**

- ✓ Analysis to the guidelines
1. Art.1 sets out a general principle recognized by most countries on contracts: both parties must act in good faith.
  2. Art.2 gives the basic requirement of good faith: discloses all and not misrepresents any material facts and material alteration of risk that may affect the policy, this requirement covers the whole period of the contract. It extends the requirement in Marine Insurance Act, 1906, which required “the assured must disclose to the issuer, before the contract is concluded, every material circumstance...”<sup>1</sup>.
  3. Art.3 refers to the obligation of strict compliance to essential terms. It entitles the party to cancel the contract when the other party breaches the obligation, particularly to the basic safety requirement.
  4. Art.4 introduces the two-tier test method to assess the materiality. The test of

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<sup>1</sup> Subsection 1 of Section 18, Marine Insurance Act, 1906

materiality should not only base on the reasonable insurer, but also the reasonable assured. It is a change to the requirement of single test---prudent insurer---in English Marine Insurance Act, 1906.

5. Art.5 gives emphasis on the link between the breach and the loss or the claim. This challenges the requirement of warranty in English Marine Insurance Act, 1906 which “gives insurer too much power to avoid liability and is unfairly harsh to the assured”<sup>2</sup>.
6. Art.6 and 7, together, offer the different remedies when different nature of the term breached.

- ✓ Indicate the extent to which they deal with marine insurance issues in international marine practice and in China particular

**Note:** Chinese national rules on marine insurance are incorporated in the Maritime Code of P.R. China (CMC) as Chapter 12 “Contract of Marine Insurance”, which applies both to hull insurance and cargo insurance.<sup>3</sup>

## 1. Good Faith—Disclosure and Misrepresentation

### *Good faith in general*

A contract of marine insurance is a contract based upon the utmost good faith, and, if either party does not observe the utmost good faith, the other party may avoid the contract.<sup>4</sup> This is the requirement of good faith adopted by English law. It is also a widely accepted principle in most countries, which maybe use the different words.

Good faith is a duty owed by both parties to the bargain and it also imposes a similar duty of disclosure on the insurer.<sup>5</sup> It is well established that the duty of the utmost good faith is owed

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<sup>2</sup> *An Analysis to the Reply to CIM Questionnaire* by Trine-Lise Wilhelmsen

<sup>3</sup> Art. 218 of *Chinese Maritime Code*

<sup>4</sup> Sec. 17 of *Marine Insurance Act, 1906*

<sup>5</sup> *The Duty of Good Faith—the Past and the Future* by Kendall Freeman

equally by the insurer as it is owed by the assured.<sup>6</sup>

The main issue concerning the principle of good faith is that it embraces the duty of disclosure and misrepresentation, but reaches further both concerning the scope of the duty of disclosure and concerning the time.<sup>7</sup> As contractual duty, good faith goes far beyond the duty to disclose.<sup>8</sup>

In China, acting in good faith is a general requirement for all contracts; it exists through the whole period of the contract, not only before the contract conclude.

The duty to disclose, or full disclose, has been analysed as two distinct obligations, closely related.<sup>9</sup>

--- Duty to disclose all material information known to him

--- Duty not to misrepresent material facts

### ***Disclosure***

The duty of disclosure as it relates to placing, however defined, will encompass all that the insurer actually knows, all that he is presumed to know and all that is imputed to him from his agents before the contract is made.<sup>10</sup> It is to be emphasized that not only must material circumstances known by the assured be disclosed but also material circumstances that he is deemed to know.<sup>11</sup> In case of “non-disclosure”<sup>12</sup> of materiality, insurer could avoid the contract. It is both a duty to pass material information that is vital or necessary for this evaluation to the insurer, and a duty not to misrepresent it.<sup>13</sup>

The purpose of the duty to disclose is that the law requires the proposer to volunteer all

<sup>6</sup> *Good Faith and Insurance Contract* 2<sup>nd</sup> edition by Peter Macdonald Eggers P384

<sup>7</sup> *An Analysis to the Reply to CIM Questionnaire* by Trine-Lise Wilhelmsen

<sup>8</sup> *Good Faith, Disclosure, Misrepresentation and the Omnipotent Warranty: South Africa Perspective* by John Hare

<sup>9</sup> *Good Faith and Insurance Contract* 2<sup>nd</sup> edition by Peter Macdonald Eggers P125

<sup>10</sup> *ibid* P384

<sup>11</sup> *Marine Insurance* 4<sup>th</sup> edition, by E R Hardy Ivamy P40

<sup>12</sup> If goods are normally carried in wooden cases and the assured, or is broker, did not disclose that on this occasion the goods were to be carried in cardboard cartons this would be non-disclosure.

<sup>13</sup> *An Analysis to the Reply to CIM Questionnaire* by Trine-Lise Wilhelmsen

information material to the assessment of the risk by the prospective insurer, which the proposer knows or ought to have known.<sup>14</sup> It is one of the most effective means of achieving contractual equality between the assured and the insurer<sup>15</sup> and the onus for disclosure must primarily rest on the proposer<sup>16</sup> for it is the assured who has the most intimate knowledge of the nature of the risk.<sup>17</sup>

According to CMC, “before the contract is concluded, the assured must disclose to the insurer every material circumstance that is known to the assured and every circumstance that the assured is deemed to know or ought to be known by him in the ordinary course of business.”<sup>18</sup>

### ***Misrepresentation***

Representation, in the simplest words, is a statement of fact and it should be a truthful statement<sup>19</sup>; If it is untruthful, it will be misrepresentation.<sup>20</sup> A representation is material if it “would influence the judgment of a prudent insurer in fixing the premium or determining whether he will take the risk.”<sup>21</sup> The distinction between misrepresentation and non-disclosure is none too real, as compliance with the duty of disclosure will automatically discharge the duty not to misrepresent.<sup>22</sup>

As to the representation, CMC requires that “the circumstance which is known to the insurer or the insurer is deemed to know in the ordinary of business, if in the absence of inquiry, the assured need not to disclose.”<sup>23</sup>

<sup>14</sup> *Shipping Law and Admiralty Jurisdiction in South Africa* by John Hare Chapter 18, P694

<sup>15</sup> *ibid*

<sup>16</sup> *Marine Insurance Vol.1 Principles & Basic Practice* by Robert H. Brown

<sup>17</sup> *Shipping Law and Admiralty Jurisdiction in South Africa* by John Hare Chapter 18, P694

<sup>18</sup> Subsection (1) of Art.222, *Chinese Maritime Code*

<sup>19</sup> For example, if goods are normally carried in wooden cases and the assured or his broker disclose that the goods were to be carried in cardboard cartons and qualified this by saying they were extra strong export cartons, this would be a representation. See *Marine Insurance Vol.1 Principles & Basic Practice* by Robert H. Brown

<sup>20</sup> The same example as above, if the goods were in fact carried in weaker cardboard cartons, the statement regarding extra strong cartons would be a misrepresentation and the insurer could avoid the contract if the misrepresentation was material. See *Marine Insurance Vol.1 Principles & Basic Practice* by Robert H. Brown

<sup>21</sup> Sub.2 of Sec.20 of *English Marine Insurance Act, 1906*

<sup>22</sup> *Good Faith and Insurance Contract 2<sup>nd</sup> edition* by Peter Macdonald Eggers P125

<sup>23</sup> Subsection(2) of Art.222, *Chinese Maritime Code*

***What is the Criterion to determine the materiality?***

“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.”<sup>24</sup> This is known as the “prudent insurer” test. M.I.A.1906 introduced for the first time in the courts the principle of a prudent (rational) insurer, adopts the test of a prudent insurer.<sup>25</sup>

***How to test the materiality?***

It is submitted that there are 2 tests for determining materiality---a prudent insurer test and a reasonable insured test.<sup>26</sup>

---A prudent insurer test: If a prudent insurer is influenced by the knowledge of the fact undisclosed in deciding whether he will reject the risk or he will accept it only at a higher premium rate, that fact is material.<sup>27</sup>

This test goes too far in favouring the insurer in that the insured is under a strict duty to correctly assess the materiality of particular information in the eyes of another person—a prudent insurer.<sup>28</sup>

---A reasonable insured test: According to this test, the question should be whether a reasonable man in the position of the insured, and with the knowledge of the allegedly material facts, ought to have realized that they were material to the risk.<sup>29</sup> The benefit of this test is that it considers the actual knowledge of the insured.<sup>30</sup>

This test suffered a fatal blow by the Court of Appeal in *Lambert v Co-operative Insurance Society Ltd*<sup>31</sup> and it is now well established that materiality must be assessed by consulting the prudent or reasonable insurer.<sup>32</sup>

<sup>24</sup> Section 18 (2) of *English Marine Insurance Act, 1906*

<sup>25</sup> *The duty of disclosure in insurance contract law*, by Semin Park

<sup>26</sup> *ibid*

<sup>27</sup> *ibid*

<sup>28</sup> *The Marine Insurance Act 1909: Issues Paper*, Page 21, Prepared by International Trade and Environment Law Branch, Commonwealth Attorney-General’s Department

<sup>29</sup> *The duty of disclosure in insurance contract law*, by Semin Park

<sup>30</sup> *The Marine Insurance Act 1909: Issues Paper*, Page 24, Prepared by International Trade and Environment Law Branch, Commonwealth Attorney-General’s Department

<sup>31</sup> *Good Faith and Insurance Contract 2<sup>nd</sup>* edition by Peter Macdonald Eggers P347

<sup>32</sup> *ibid*

Unfortunately, there is no similar requirement about the materiality test in CMC.

*At what time should the information be disclosed?*

It is clear that the duty to disclose persists throughout the pre-contract negotiations until the contract is concluded.<sup>33</sup> The materiality of a fact is determined, using the general practice and opinion of the insurers, at the time that the duty of disclosure has to be performed, in other words, at the time at which the insurance contract becomes binding.<sup>34</sup> The effect of this is that the insured must disclose any material facts at any negotiating stage and before any proposal is accepted by the insurer.<sup>35</sup>

Duty to disclose is a pre-contractual duty that falls away with the conclusion of the insurance contract,<sup>36</sup> there is a duty on both insured and insurer to disclose to each other prior to conclusion of the contract of insurance every fact relative and material to the risk or the assessment of the premium.<sup>37</sup> Where a policy is to be renewed in circumstances where the risk has changed to the knowledge of the assured, the assured would be bound at the time of the renewal to disclose such changed circumstances.<sup>38</sup>

On this point, the regulation in Chinese law is interesting. There is no specific requirement about the time of good faith, but as a general requirement of contract, as I mentioned earlier, it covers the whole period of contract. As to the disclosure, Chinese Maritime Code required that: “the assured should disclose the material facts to insurer before the contract concluded”<sup>39</sup>.

Should we disclose any information after conclude the contract?

There are two different approaches of disclosure: active duty and passive duty. An active duty

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<sup>33</sup> *Shipping Law and Admiralty Jurisdiction in South Africa* by John Hare Chapter 18, P699

<sup>34</sup> *The Duty of Disclosure in Insurance Contract Law*, by Semin Park

<sup>35</sup> *The Duty of Good Faith—the Past and the Future* by Kendall Freeman

<sup>36</sup> *Shipping Law and Admiralty Jurisdiction in South Africa* by John Hare Chapter 18, P694

<sup>37</sup> The Oudtshoorn Municipality decision at 433 E

<sup>38</sup> *Shipping Law and Admiralty Jurisdiction in South Africa* by John Hare Chapter 18, P699

<sup>39</sup> Art.222 of *Chinese Maritime Code*

of disclosure is that the person affecting the insurance has a duty to disclose all (material) facts to the insurer. This is the main solution in all the countries<sup>40</sup> and also in China.<sup>41</sup>

On the other hand, a passive duty of disclosure, or representation in Chinese MC<sup>42</sup>, implies that the insurer will have to define what information is material through a questionnaire<sup>43</sup>, in the absence of inquiry, there is no need to be disclosed.

***Consequences of breach the duty to disclose or in case of misrepresentation:***

Where the contract is voidable in case of the assured's misrepresentation, the insurer repudiates the contract and seeks a return to the *status quo ante*.<sup>44</sup>

China is in a special situation. CMC has divided these issues by distinguishing between innocent and fraudulent misrepresentation.

---In the case of fraudulent of assured, insurer is entitled to avoid the contract and retain the premium. Further, insurer is not liable for the loss before the avoidance of the contract.<sup>45</sup>

---In the case of innocent of assured, insurer is entitled to avoid the contract or additional premium. Insurer is liable for the loss before the avoidance of the contract, except the non-disclosure or misrepresentation has causative link to the loss.<sup>46</sup>

Even if this is the case, it should however be noted that in practice it is difficult to draw a clear line between the two issues.

## **2. Alteration of Risk**

When entering into an insurance contract the insurer will normally base the calculation of the premium and the policy conditions on certain presumptions concerning the risk. When these presumptions are altered, he may therefore either want to terminate the coverage or to change

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<sup>40</sup> *An Analysis to the Reply to CIM Questionnaire* by Trine-Lise Wilhelmsen

<sup>41</sup> Subsection (1), Art.222 of *Chinese Maritime Code*

<sup>42</sup> Subsection (2), Art.222 of *Chinese Maritime Code*

<sup>43</sup> *An Analysis to the Reply to CIM Questionnaire* by Trine-Lise Wilhelmsen

<sup>44</sup> *Shipping Law and Admiralty Jurisdiction in South Africa* by John Hare Chapter 18, P703

<sup>45</sup> Subsection (1) of Art.223, *Chinese Maritime Code*

<sup>46</sup> Subsection (2) of Art.223, *Chinese Maritime Code*

his insurance conditions.<sup>47</sup>

The definitions of what constitutes an alteration of risk vary, but one point is certain: an alteration of risk, especially those increase risks will normally activate a duty to notify the insurer.<sup>48</sup> The insurer shall be wholly or partly without liability for loss caused by the subject matter insured being used outside the trading area or for a purpose other than that stipulated in the policy or the vessel's certificate.<sup>49</sup>

Insurance contract may be altered, with the consent of two parties, because of the alteration of risk. If the assured alone causes the variation of the risk and it is material, insurer may avoid the contract<sup>50</sup> except in regard to those insurers who had signed or initialed the alterations.

CMC does not seem to use the concept of alteration of risk, but do contain certain similar provisions for specific problems.<sup>51</sup> "...the assured should notify the insurer in writing immediately..."<sup>52</sup>. But according to Chinese Insurance Law: "During the period of policy, the assured, according to the requirement of contract, should notify the insured when the risk of subject-matter increased; insured is entitled to avoid the contract or additional premium"<sup>53</sup>, this requirement also applies to marine insurance.

### 3. Essential Terms

Most systems make use of the essential term (clause or condition), breach of which gives rise, in appropriate circumstances, to the right to terminate and claim damages<sup>54</sup> although there is no definite definition about essential terms. In practice, the essential term treated as a material and causative contractual stipulation<sup>55</sup> and assured must be strictly complied with.

<sup>47</sup> *An Analysis to the Reply to CIM Questionnaire* by Trine-Lise Wilhelmsen

<sup>48</sup> *An Analysis to the Reply to CIM Questionnaire* by Trine-Lise Wilhelmsen

<sup>49</sup> Section 2.4 *Marine Insurance Conditions relating to Commercial Vessel Smaller than 15 meters or 25 gross tons, Norway*

<sup>50</sup> *Marine Insurance* 4<sup>th</sup> edition, P278 by E R Hardy Ivamy

<sup>51</sup> *An Analysis to the Reply to CIM Questionnaire* by Trine-Lise Wilhelmsen

<sup>52</sup> Art.235 of *Chinese Maritime Code*

<sup>53</sup> Art. 36 of *Chinese Insurance Law*

<sup>54</sup> *Discussion Paper of International Working Group on Marine Insurance*

<sup>55</sup> *The Omnipotent Warranty: England v the World* ,P6 by John Hare

In continental practice, warranty equates with the essential term, where a contractual term was regarded as a “warranty”, it was automatically treated as an essential term, entitling the insurer to repudiate the contract.<sup>56</sup>

The problem is that the regulation seems to be too hard to the assured. It gives the insurer a tool to avoid liability even if the warranty was not material to the insurer’s decision to accept the risk<sup>57</sup> or to refuse the claims.

In order to protect the assured from the harsh consequences of a breach of warranty, marine policies in many of the countries using this concept contain so-called “held covered” clauses which allow the policy to continue even after a breach of a warranty.<sup>58</sup> An example of a held covered clause is that given “any breach of warranty as to cargo, trade, locality, towage, salvage services, or date of sailing”, the assured shall be held covered “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>59</sup>.

China is in the same position on this point but the approach to establish this condition, however, differs. In China, the provision is placed under the heading “Termination”, which also includes breach of a warranty.<sup>60</sup>

“...where the assured has not complied with the warranties under 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”.<sup>61</sup> A similar clause can also be found in *Chinese Hull and Cargo Clauses*.<sup>62</sup>

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<sup>56</sup> *ibid*

<sup>57</sup> *An Analysis to the Reply to CIM Questionnaire* by Trine-Lise Wilhelmsen

<sup>58</sup> *ibid*

<sup>59</sup> Form 3, *ITCH Hulls 1995*

<sup>60</sup> *An Analysis to the Reply to CIM Questionnaire* by Trine-Lise Wilhelmsen

<sup>61</sup> Art.235 of *Chinese Maritime Code*

<sup>62</sup> *Chinese HC VI No. 3 and CC IV No. 3.*

#### 4. Situation Relates to the compliance of safety requirement

As the party to marine insurance contract, the insurer looks upon safety at sea as a very important issue<sup>63</sup> and most marine assurance policies contain a warranty that the assured shall at all times comply with statutory requirements relating to the safe operation of the ship.<sup>64</sup> Where infringement of safety regulations results in loss, compensation may be reduced or lapse, unless the infringement occurred in the act of saving human life.<sup>65</sup>

Complied with the requirement of ship safety, for example, ISM Code, insurer is entitled to avoid the contract. "The insurer shall be wholly or partly without liability for loss...., the same shall apply if the vessel does not have valid certificates".<sup>66</sup>

According to *International Hull Clause, 2003*, automatic termination for failure to maintain Class, to comply with Class requirements relating to the vessel's seaworthiness and to have in place valid ISM documentation:<sup>67</sup>

---The vessel shall be classed with a Classification Society agreed by Underwriters<sup>68</sup>

---Any recommendations, requirements or restrictions imposed by the vessel's Classification Society which relate to the vessel's seaworthiness or to her maintenance in a seaworthy condition shall be complied with by the dates required by that society.<sup>69</sup> This also applies to ISM and recommendations by Class as to seaworthiness. The remedy remains as automatic termination.

---The vessel shall have in force a valid Safety Management Certificate as required by Chapter IX of the International Convention for the Safety of Life at Sea (SOLAS) 1974 as amended and any modification thereof.<sup>70</sup>

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<sup>63</sup> *An Analysis to the Reply to CIM Questionnaire* by Trine-Lise Wilhelmsen

<sup>64</sup> *Shipping Law and Admiralty Jurisdiction in South Africa* by John Hare Chapter 6, P234

<sup>65</sup> Section 4.1 *Marine Insurance Conditions relating to Commercial Vessel Smaller than 15 meters or 25 gross tons, Norway*

<sup>66</sup> Section 2.4 *Marine Insurance Conditions relating to Commercial Vessel Smaller than 15 meters or 25 gross tons, Norway*

<sup>67</sup> *International Hull Clause, 2003*

<sup>68</sup> Section 13.1.1 of *International Hull Clause, 2003*

<sup>69</sup> *ibid*

<sup>70</sup> *ibid*

In China, if the ship loses its class or changes Classification society without the approval of the insurer, the insurance will automatically terminate.<sup>71</sup>

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<sup>71</sup> *Chinese HC VI No. 2.*