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REMEDIES FOR BREACH OF THE PRE-CONTRACT DUTY OF DISCLOSURE IN CHINESE INSURANCE LAW

ZHEN JING*

Chinese Insurance Law imposes on the insured a duty to disclose material information prior to the formation of the contract. This duty is limited to the scope and extent of the insurer's inquiry and to the insured's actual knowledge. The insurer may rescind the contract if the insured fails to disclose a material fact, either intentionally or by gross negligence. This article considers the remedies for breach of this duty, examines the way in which Chinese courts determine whether a breach occurs intentionally or by gross negligence, and discusses deficiencies of the available remedies. Finally, this article recommends adopting the doctrine of proportionality for insurers' liability for losses.

I. INTRODUCTION

An insurance contract is a contract based on the utmost good faith.¹ In the contract formation period, the principle of utmost good faith creates a well-established duty owed by the insured to the insurer to disclose material facts and to refrain from making untrue statements when negotiating the contract.² Typically, the insurer is not knowledgeable about the specific thing being insured, while on the other hand, the insured often knows everything. Thus, it is the duty of the insured to make a full disclosure to the insurer of all the material facts of the subject to be insured. Based on the information provided by the insured, the insurer can decide whether to accept the risk and, if so, on what terms.

Generally speaking, the insured is obliged to disclose to the insurer all material information prior to the formation of the contract.³ In China,

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¹ Marine Insurance Act 1906, 6 Edw. 7 c. 41 §17. For more on history and development of the doctrine of disclosure in English law, *see generally* ROBERT MERKIN, COLINVAUX'S LAW OF INSURANCE (11th ed., Sweet & Maxwell, 2016).

² *See* J. BIRDS, B. LYNCH & S. MILNES, MACGILLIVRAY ON INSURANCE LAW (12th ed. Sweet & Maxwell, 2012).

³ *See*, Marine Insurance Act 1906, 6 Edw. 7 c. 41 § 18; (UK), *Insurance Contracts Act 1984* s 21 No. 80, 1984 as amended in 2008 (Austl.), *Insurance Contract Act of 23 November 2007* Federal Law Gazette I, at page 2631, No. as

the current law relating to the insured's duty of disclosure or representations is provided in Art. 16 of the Insurance Law 2009 (Insurance Law),⁴ which states, "[w]hen concluding an insurance contract, the insurer may raise questions concerning relevant details of the insured subject matter or of the insured. The proposer shall truthfully disclose such details to the insurer."⁵ Where the proposer (the insured)⁶ fails to comply with the duty of disclosure, the insurer's remedies depend on the degree of the insured's fault and resulting consequences of the breach.⁷

This paper considers the remedies available to insurers when an insured breaches the duty of disclosure in both Chinese Insurance Law and English law. It examines the way in which Chinese courts determine whether a breach occurs intentionally or by gross negligence. Additionally, it considers deficiencies of the law in respect to the available remedies, and makes recommendations regarding the doctrine of proportionality. Specifically, as the doctrine relates to the definitions of intentional and grossly negligent non-disclosure, and how it affects the insurer's exposure in the case of a grossly negligent non-disclosure.

last amended by Article 2 (79) of the Act of 22 December 2011 (Federal Law Gazette I, at page 3044) § 19 (Ger.); Insurance Law of the People's Republic of China, promulgated by Order No. 51 of the President of the People's Republic of China, effective 2009 (China) [hereinafter Insurance Law of the People's Republic of China].

⁴ Insurance Law of the People's Republic of China was enacted by the National People's Congress in 1995, which was the first comprehensive legislation on insurance in China that consists of insurance contract law and insurance regulation. To meet the commitment to the WTO, the Insurance Law 1995 was amended in 2002 mainly on insurance regulation, and insurance contract law was essentially not changed in 2002 version. The Law was again amended in 2009. Both contract law and regulation were amended substantially. Insurance Law of the People's Republic of China, *supra* note 3.

⁵ *Id.*

⁶ The person who makes an application for insurance is called the proposer. When the insurer has agreed to underwrite the risk, the proposer is now called the insured or the policyholder. This article uses the term "the insured" for the proposer or the insured.

⁷ Insurance Law of the People's Republic of China, *supra* note 3, at Art. 16(4) and (5).

II. A BRIEF OVERVIEW OF THE DUTY OF DISCLOSURE

A. INQUIRY DISCLOSURE

Chinese Insurance Law uses inquiry disclosure, i.e. “asking and answering” questions in the proposal form.⁸ According to Art. 16(1) of the Insurance Law, the insured is required to disclose only the information asked by the insurer on the proposal form. Even if the insured fails to disclose material information, the insurer may not rescind the contract when such information is beyond the scope of the questions raised in the proposal form.⁹

When the Supreme People’s Court of China (the SPC) enacted its Second Interpretation on Certain Questions Concerning the Application of the Insurance Law of the Peoples’ Republic of China (the SPC Interpretation II),¹⁰ the SPC made it clear that “[t]he insured’s duty of disclosure is limited to the scope and content of the insurer’s inquiry; where the insurer and the insured dispute on the scope and content of the inquiry, the onus of proof rests upon the insurer.”¹¹ Accordingly, the insured has fulfilled the duty of disclosure if he has truthfully answered the questions in the proposal form. He has no duty to volunteer information to the insurer, even if the information is material.

⁸ *But see* Maritime Code of the People’s Republic of China (promulgated by Order No. 64 of the President of the People’s Republic of China, November 7, 1992, effective July 1, 1993 (“...before the contract is concluded, the insured shall disclose to the insurer material circumstances which the insured has knowledge of or ought to have knowledge of in his ordinary business practice and which would influence the insurer in deciding the premium or whether he agrees to insure or not.”)).

⁹ *See* Z. Jing, *Insured’s duty of disclosure and test of materiality in marine and non-marine insurance laws in China*, JBL 681, 686-687 (2006).

¹⁰ *See* Interpretations of the Supreme People’s Court on Several Issues Concerning the Application of the Insurance Law of the People’s Republic of China (promulgated by Sup. People’s Ct., May 6, 2013, effective June 8, 2013) Document No. fa shi [2013] No. 14, Art. 5 & 6, <http://www.sglaw.cn/en/news.php?id=361> (last visited Feb. 4, 2017) (China) (clarifying ambiguities of the Insurance Law and puts forth detailed rules for the Insurance Law) [hereinafter SPC Interpretations]. The Supreme People’s Court stipulation, judicial explanation or decision has legal force. This means that the Supreme People’s Court stipulation, judicial explanation or decision is one of the legal sources in China.

¹¹ *Id.* at Art. 6(1),

Sometimes a situation may occur where the insured has voluntarily disclosed some information without being inquired by the insurer, but the information is untrue and misleading. Neither the Insurance Law nor the SPC Interpretation II provides any rule for handling this situation. However, the High People's Court (HPC) of Beijing City has stated that if an insured has voluntarily written down information on the proposal form which was not requested by the insurer, it is deemed that the insurer has made inquiry as to that information. Therefore, the insured owes a duty to disclose that information truthfully.¹² This issue has yet to be addressed by the SPC.

Under English law, the Consumer Insurance (Disclosure and Representations) Act 2012 (CIDRA)¹³ does not require consumers to volunteer material facts. Instead, consumers are required to take reasonable care not to make a misrepresentation.¹⁴ This means that the consumers must take reasonable care to answer insurers' questions fully and accurately. If consumers do volunteer information, they must take reasonable care to ensure that the information is not misleading. For non-consumer insurance,¹⁵ the duty of fair presentation is now provided in s.3 of the Insurance Act 2015 (UK).¹⁶ The general effect of fair presentation is that it creates a duty of disclosure. Sections 3(4)(a)-(b) provide two statutory ways of satisfying this duty of (voluntary) disclosure. Section 3(4)(a) effectively replicates the disclosure duty in § 18(1) of the Marine Insurance Act 1906 (UK), its key features are that the insured must disclose "every

¹² Art. 8 of the Guidance of the High People's Court of Beijing City Concerning Questions of How to Deal with Insurance Disputes 2005. It must be noted the guidance enacted by the High People's Court is only to guide the lower courts rather than to bind them. These guiding rules have no legal force.

¹³ Consumer Insurance (Disclosure and Representations) Act 2012 c. 6 (U.K.), <http://www.legislation.gov.uk/ukpga/2012/6/contents/enacted> ("Consumer insurance contract means a contract of insurance between (a) an individual who enters into the contract wholly or mainly for purposes unrelated to the individual's trade, business or profession, and (b) a person who carries on business of insurance and who becomes a party to the contract by way of that business[;] "consumer" means the individual who enters into a consumer insurance contract, or proposes to do so.").

¹⁴ *Id.* at 2(2).

¹⁵ A non-consumer insurance contract means any insurance contract that is not used for consumer purposes. This includes insurance for charities, micro-businesses and small or medium enterprises, as well as large risks, marine insurance and reinsurance.

¹⁶ Insurance Act 2015, c. 4, § 3 (U.K.), <http://www.legislation.gov.uk/ukpga/2015/4/contents/enacted>.

material circumstance” that the insured “knows or ought to know.”¹⁷ If the insured has failed to satisfy the strict duty in § 3(4)(a), it may still satisfy the disclosure duty under § 3(4)(b). Specifically, § 3 (4)(b) is satisfied by disclosing sufficient information to put a prudent insurer on notice that the insurer must make further inquiries that, when answered, would reveal material circumstances that the insured knows or ought to know. Section 3(4)(b) represents the key change to the duty of disclosure. It reflects the trend in case law of accepting the fact that it may not be possible or necessary for every material circumstance to be disclosed.¹⁸

In summary, under English law with respect to consumer insurance, inquiry-based disclosure (i.e. representation) is adopted under CIDRA. In the context of non-consumer insurance, voluntary disclosure has been preserved by the Insurance Act 2015 (U.K.), but the strictness of the duty of voluntary disclosure has been mitigated by § 3(4)(b) of the Insurance Act 2015 (U.K.).

B. INSURED’S ACTUAL KNOWLEDGE

Art. 16(1) of the Chinese Insurance Law requires the insured to disclose material information to the insurer at the time of the contract, but does not give any provision about the insured’s knowledge. The SPC has provided a clear rule with respect to the insured’s knowledge, stating that “[w]hen entering into an insurance contract, circumstances about the subject matter of insurance or of the insured which are to be truthfully disclosed by the insured as required by Art. 16(1) of the Insurance Law are those that the insured actually knows.”¹⁹ The insured is obligated to disclose only what he actually knows, not what he ought to know. Therefore, constructive knowledge is irrelevant.

C. TEST OF MATERIALITY

By virtue of Art. 16(2) of the Insurance Law,²⁰ a material fact is a fact that “shall sufficiently influence the insurer’s decision on whether or

¹⁷ *Id.*

¹⁸ See *CTI v. Oceanus* [1984] 1 Lloyd’s Rep. 476 (U.K.); *Garnat Trading and Shipping v. Baominh Insurance Corporation* [2011] EWCA (Civ) 773 (U.K.).

¹⁹ SPC Interpretations, *supra* note 10, at Art. 5.

²⁰ Insurance Law of the People’s Republic of China, *supra* note 3, at Art. 16(2) (“The insurer shall have the right to rescind the insurance contract where the

not he will accept the insurance or raise the premium rate.”²¹ The term “sufficient influence” can also mean “decisive influence.”²² The term “insurer” mentioned in Art. 16(2) denotes a “prudent insurer” or “reasonable insurer.”²³ The test of materiality under Chinese Insurance Law can be described as a “prudent insurer decisive influence” test, where an insurer would not have entered into the contract or would have raised the premium rate had he known of the fact undisclosed or misrepresented by the insured.²⁴

In contrast, under English law, CIDRA abolishes “the mere influence prudent insurer” test of materiality, but the concept of “inducement”²⁵ has been preserved. Under this standard, the insurer must show that without the misrepresentation he would not have entered into the contract, or would have done so on different terms.²⁶ The inducement approach has also been preserved in § 8(1) of the Insurance Act 2015 (U.K.) for non-consumer insurance.

III. TYPES OF NON-DISCLOSURE AND REMEDIES

A. RESCISSION OF THE CONTRACT

Non-disclosure or misrepresentation can be made intentionally, by gross negligence, negligently or innocently. Chinese Insurance Law provides different remedies for breach of the duty of disclosure depending on the type of breach. The insurer is entitled to rescind the contract where the insured breaches the duty to disclose intentionally or through gross negligence if the insured’s misrepresentation or failure to disclose sufficiently influenced the insurer’s decision to accept the insurance or raise

proposer fails to fulfil the obligation of truthful disclosure ... intentionally or by gross negligence so that the failure of disclosure or misrepresentation shall sufficiently influence the insurer’s decision on whether he will accept the insurance or raise the premium rate.”).

²¹ *Id.*

²² Jing, *supra* note 9, at 695.

²³ *Id.* See also Z.Y. Liu, *Life Insurance Law and Practice*, LAW PRESS CHINA 230 (2012).

²⁴ *Id.*

²⁵ *Pan Atlantic Ins. Co. Ltd v. Pine Top Ins. Co. Ltd* [1995] 1 A.C. 501, [1994] 3 W.L.R. 677; [1994] 3 All E.R. 581 (U.K.).

²⁶ Consumer Insurance (Disclosure and Representations) Act, 2012, c. 6 § 4.1(b) (U.K.), <http://www.legislation.gov.uk/ukpga/2012/6/contents/enacted> [hereinafter *CIDRA*].

the premium rate.²⁷ Art. 16 of the Insurance Law implies that the insurer is not entitled to rescind a contract resulting from the innocent or mere negligent non-disclosure or misrepresentation, even if the undisclosed information is material. The insured's right of rescission shall lapse when the insurer does not exercise it thirty days after learning of the insured's breach, or past two years from the date of formation of the contract.²⁸

Under Chinese law, an insurer is not allowed to rescind the contract, unless the following conditions are met: (i) the insured must have made inquiries about the relevant facts in questions raised in the proposal form prior to the formation of the contract;²⁹ (ii) the insured must actually know the relevant facts;³⁰ (iii) the insured breached this duty intentionally or by gross negligence;³¹ (iv) the undisclosed information is material in that it sufficiently influences a prudent insurer's decision on whether or not he will accept the insurance or raise the premium rate;³² (v) when concluding the contract, the insurer did not know that the insured had failed to provide truthful information;³³ and (vi) the insurer's right of rescission of the

²⁷ Insurance Law of the People's Republic of China, *supra* note 3, at Art. 16(2).

²⁸ *Id.* at Art.16(3) ("The right of rescission provided in the preceding paragraph shall lapse where the insurer does not exercise it thirty days after he knows that there is the cause for rescission. Where over two years have passed from the date of formation of the contract, the insurer may not rescind the contract; where an insured event occurs, the insurer shall be liable for making indemnity payment or paying insurance benefits."). See Z. Jing, *Incontestability provisions in insurance law and policies*, J. OF BUS. L. 253-288 (2016) (discussing the time limits for the insurer's right of rescission of the contract).

²⁹ Insurance Law of the People's Republic of China, *supra* note 3, at Art. 16(1). See also Art. 6.1, Interpretations of the Supreme People's Court on Several Issues Concerning the Application of the Insurance Law of the People's Republic of China (promulgated by Sup. People's Ct., May 6th, 2013, effective June 8th, 2013) Document No. fa shi [2013] No.14, <http://www.sglaw.cn/en/news.php?id=361> (last visited Feb. 4th, 2017)(China).

³⁰ SPC Interpretations, *supra* note 10, at Art. 5.

³¹ Insurance Law of the People's Republic of China, *supra* note 3, at Art.16(2).

³² *Id.*

³³ Insurance Law of the People's Republic of China, *supra* note 3, at Art.16(6) ("Where the insurer knows that the proposer fails to make a truthful disclosure at the time of entering into a contract, the insurer may not rescind the contract; where an insured event occurs, the insurer shall be liable for making indemnity payment or paying insurance benefits.").

contract must be exercised within thirty days after learning of the insured's breach of the duty, or within two years from the date of formation of the contract.³⁴

Similarly, under English law, CIDRA provides that if a consumer breaches the duty to take reasonable care not to make a misrepresentation,³⁵ and this misrepresentation induces the insurer to enter into the contract, the insurer will have a remedy. The nature of the insurer's remedy depends on the nature of the consumer's misrepresentation and, in particular, the consumer's state of mind.

For a deliberate or reckless misrepresentation,³⁶ the insurer is entitled to void the contract, refuse all claims, and treat the contract as if it never existed. The insurer may also retain the premium unless it would be unfair to do so.³⁷ In contrast, for an honest and reasonable misrepresentation, the insurer is not entitled to rescind the contract and must pay the claim.

For a careless misrepresentation,³⁸ the insurer's remedies are based on what he would have done if the consumer had complied with the duty to take reasonable care not to make a misrepresentation. If the insurer would not have entered into the contract on any terms, the insurer may void the contract and refuse all claims, but must return the premium paid. If the insurer would have entered into the contract on different terms, the contract may be read to include those different terms. If the premium would have been higher, the insurer must proportionately reduce the amount to be paid on a claim.³⁹ In situations where the insurer would have contracted on different terms or for a higher premium (or both), available remedies will be determined by the specific line of insurance. For example, in non-life insurance, either side is entitled to terminate future coverage with reasonable notice. Whereas, in life insurance, the insurer is not allowed to

³⁴ Insurance Law of the People's Republic of China, *supra* note 3, at Art.16(3).

³⁵ *CIDRA*, *supra* note 26, at c. 6 § 2.2.

³⁶ *Id.* at § 5.2 ("A misrepresentation is deliberate or reckless if the consumer (a) knew that it was untrue or misleading, or did not care whether or not it was untrue or misleading, and (b) knew that the matter to which the misrepresentation related was relevant to the insurer, or did not care whether or not it was relevant to the insurer.").

³⁷ *CIDRA*, *supra* note 26, at sch 1.

³⁸ *Id.* at § 5.3 ("A qualifying misrepresentation is careless if it is not deliberate or reckless.").

³⁹ *Id.* at 7.

terminate the contract and must continue the policy either on the existing terms or on amended terms.⁴⁰

Under the Insurance Act 2015 (U.K.), for non-consumer insurance, the insurer has a remedy for a breach of fair presentation if the insurer can show that but for the breach, it would not have entered into the contract at all, or would have done so only on different terms.⁴¹ The insurer may void the contract for deliberate, reckless, or even innocent breach of this duty if the insurer can show inducement.

B. REMEDIES IN RELATION TO PRE-RESCISSION LOSSES AND PREMIUM PAID

The legal consequences with respect to losses that occurred prior to the rescission of the contract and with respect to the premium paid by the insured depend on whether the breach occurred intentionally or through gross negligence.

For intentional non-disclosure or misrepresentation, the insurer is not liable for losses that occurred prior to the rescission of the contract whether or not the loss is caused by the undisclosed facts, and shall not refund the premium.⁴² The insurer may rescind the contract *ab initio*, as if the insurer had never been at risk under the policy. The retroactive effect of a rescinded contract seems to be unilateral to the insurer in the sense that only the insurer is entitled to demand restoration of *status quo ante*, but the insured is not entitled to a recovery of premium paid. The retention of the premium by the insurer can be regarded as a penalty to the insured for his intentional breach of the duty of disclosure.

In the case of non-disclosure or misrepresentation by gross negligence, depending on whether or not the fact undisclosed or misrepresented has a material impact on the occurrence of the insured events, there are two possible remedies. The insurer is not liable for losses that occurred prior to the rescission of the contract if the fact undisclosed or misrepresented has a material impact on the occurrence of the insured events, but the insurer must refund the premium.⁴³ In this case, the rescission of the

⁴⁰ J. BIRDS, B. LYNCH & S. MILNES, *supra* note 2, at 582.

⁴¹ Insurance Act, 2015, c. 4, § 8(1) (U.K.).

⁴² Insurance Law of the People's Republic of China, *supra* note 3, at Art. 16(4).

⁴³ Insurance Law of the People's Republic of China, *supra* note 3, at Art. 16(5).

contract is retroactive. If there is no causal connection between the occurrence of the insured event and the undisclosed fact, the insurer is liable for losses that occurred prior to the rescission of the contract. In this case, the rescission of the contract is not retroactive, but prospective, i.e. from the moment of rescission.

The question of whether or not the rescission of the contract is retroactive is important in some circumstances. If, for example, the insured is paid for a loss under a health policy, and then, on the occasion of a second loss, the insurer discovers that there has been an intentional or a grossly negligent non-disclosure or misrepresentation by the insured, it is material to know the moment in time from which the policy is deemed to be rescinded. If the contract is rescinded only from the moment of rescission, the insured would keep the money paid to him for his earlier claim. This is so in the case of a grossly negligent non-disclosure which has no material impact on the occurrence of the insured events. If the contract is rescinded *ab initio*, and not merely for the future, the insurer should be deemed to have never been at risk, the insured should repay the money to the insurer. This is so for the case of an intentional non-disclosure, and also for the case of a grossly negligent non-disclosure which has a material impact on the occurrence of the insured event.

C. DETERMINATION OF INTENTIONAL OR GROSSLY NEGLIGENT BREACH OF THE DUTY

The legal consequences for an intentional or grossly negligent breach of the duty of disclosure are different with respect to liability for losses which occurred prior to rescission of the contract and for return of premium paid by the insured. There is a continuum that runs from simple negligence through gross negligence to intentional misconduct. Recklessness, or reckless disregard, lies between gross negligence and intentional harm.⁴⁴ It is not easy to clearly draw a line between mere negligence and gross negligence, but it is necessary and important to distinguish intentional acts from grossly negligent acts, and mere negligent acts from grossly negligent acts, since different remedies are available depending on the type of breach.

The Chinese Insurance Law does not define the term “intentional.” The definition of the term “intentional” is provided by the Criminal Law of

⁴⁴ *Saba v. Compagnie Nationale Air Fr.*, 78 F.3d 664, 667 (D.C. Cir. 1996).

China.⁴⁵ There, an intentional crime refers to an act committed by a person who clearly knows that his act will entail harmful consequences to society but who wishes or allows such consequences to occur.⁴⁶ By analogy, a non-disclosure or misrepresentation can be deemed intentional if the insured has knowledge of a fact or information but does not disclose it to the insurer. The same would be true if an insured provides an untrue answer to the insurer's question, knowing that the insurer would act on the fact or information and enter into the contract which the insured would otherwise not have been able to enter into.

Intention is subjective, and unless the insured admits his intent, his culpability can only be reflected and judged by the facts of the case. Courts usually treat a breach of the duty of disclosure as an intentional breach if the insured: (i) knew the existence of the fact in question;⁴⁷ (ii) knew that the fact was relevant to the insurer;⁴⁸ and (iii) knew that his answer to the question was untrue or misleading, with the purpose of inducing the insurer to enter into the proposed contract. For example, in *Mr. Guo v. the Life Insurance Company Beijing Branch*,⁴⁹ Mr. Guo purchased a critical illness policy in his name on November 16, 2008. Mr. Guo was diagnosed with acute myocardial infarction on May 24, 2009, and incurred related medical costs of ¥80,000. Upon investigation, the insurer discovered that the insured was diagnosed with coronary heart disease and treated at the same hospital before the formation of the insurance contract, but the insured gave a negative answer to the question in the proposal form which asked "Have the life insured been diagnosed with any heart disease?" The court held that the insured knew the fact that he suffered from heart disease and concealed that fact, so the failure to comply with the duty of disclosure was

⁴⁵ Criminal Law of the People's Republic of China was adopted by the Second Session of the Fifth National People's Congress on July 1, 1979, amended by the Fifth Session of the Eighth National People's Congress on March 14, 1997, promulgated by Order No. 83 of the President of the People's Republic of China on March 14, 1997, and effective on October 1, 1997 [hereinafter *Criminal Law*].

⁴⁶ *Id.* at Art. 14.

⁴⁷ SPC Interpretations, *supra* note 10, at Art. 5 (The insured's knowledge refers to actual knowledge. The insured's constructive knowledge is irrelevant).

⁴⁸ *Id.*; Insurance Law of the People's Republic of China, *supra* note 3, at Art. 16.

⁴⁹ *Mr. Guo v. The Life Ins. Co. Beijing Branch*, (Interm. People's Ct. 2012) (China), reported in 5 Annual Report of the Typical Insurance Cases, LAW PRESS CHINA, 2013; see also, ZHEN JING, CHINESE INSURANCE CONTRACTS: LAW AND PRACTICE, n. 433 (2016).

intentional. The insurer would not have entered into the contract had the insurer known of the undisclosed fact, thus the insurer was not liable for the medical costs.

The Chinese Insurance Law provides no definition of “gross negligence.” The definition of “negligent crime” is provided under Chinese Criminal Law. There, a negligent crime refers to an act committed by a person who should have foreseen that his actions would possibly entail harmful consequences to society.⁵⁰ The standard of negligence is what conduct one expects from the proverbial “reasonable person.” Gross negligence connotes a significantly higher degree of culpability. Gross negligence is a severe degree of negligence taken as reckless disregard. Blatant indifference to one’s legal duty, other’s safety, or their rights are examples.⁵¹ It is also described as a lack of care that even a careless person would use.⁵²

In *Conway v. O’Brien*,⁵³ the United States Supreme Court described gross negligence as being, “substantially and appreciably higher in magnitude and more culpable than ordinary negligence. Gross negligence is equivalent to the failure to exercise even a slight degree of care.... It is very great negligence, or the absence of slight diligence, or the want of even scant care.”⁵⁴ Similarly, in *Grill v. General Iron Screw Collier Co.*,⁵⁵ Justice Willes famously observed that gross negligence is ordinary negligence with a “vituperative epithet.”⁵⁶

Though the Chinese Insurance Law provides no definition of “gross negligence,” Chinese courts have found non-disclosure of material facts to be grossly negligent in the following situations.⁵⁷

⁵⁰ *Criminal Law*, *supra* note 45, at Art. 15.

⁵¹ *Gross Negligence*, BLACK’S LAW DICTIONARY (10th ed. 2014).

⁵² ZHAN HAO, THE NEW INSURANCE LAW: INTERPRETATION ON PRACTICE HIGHLIGHTS AND CASE ANALYSIS 83 (2009).

⁵³ *Conway v. O’Brien*, 312 U.S. 492, 495 (1941).

⁵⁴ *Id.* at 495. The definition was the accepted Vermont definition of gross negligence found in *Shaw v. Moore*, 104 Vt 529, 529 (1932).

⁵⁵ *Grill v. Gen. Iron Screw Collier Co.*, L.R. 1 C. P. 600 (1866).

⁵⁶ *Id.* at 612.

⁵⁷ X.M. XI, UNDERSTANDING AND APPLICATION OF THE SUPREME PEOPLE’S COURT SECOND INTERPRETATION ON CERTAIN QUESTIONS CONCERNING THE APPLICATION OF THE INSURANCE LAW OF THE PEOPLES’ REPUBLIC OF CHINA 156 (2014), *cited in* Jing, *supra* note 49.

- (1) The insured failed to know the materiality of the relevant facts due to his gross negligence. The Insurance Law adopts inquiry-based disclosure; the insured is obliged to disclose only the facts which are inquired by the insurer in questions in proposal form. The insured has no duty to volunteer information to the insurer.⁵⁸ Sometimes, even if the insurer puts questions in the proposal form, the insured failed to understand the meaning of the question due to his gross negligence, and therefore failed to disclose the material facts to the insurer, this constitutes gross negligent non-disclosure.

- (2) In some situations, although the insured knew the relevant facts and also knew that the facts are material, he failed to disclose the material facts to the insurer due to his gross negligence. Sometimes the insurer's agents sell insurance products in an inappropriate manner. The agent fills in the proposal form and answers the questions raised in the proposal form, and then, asks the insured to sign the completed proposal. According to Art. 3 of the SPC Interpretation II, in the situation where the insurer or his agent completes the proposal form, the insured then signs the proposal, the content provided by the insured or the agent is treated as the real representations by the insured himself. If the insured does not read the completed proposal form but simply signs it, he may not be able to find any inconsistency between what was put in the form and what was true in reality. Thus, the insured is deemed to fail by gross negligence to disclose the true facts which he knew, but not intentionally, as the insured has no subjective intention to mislead the insurer to make a wrong judgement and decision regarding the proposed contract.

The following cases explain how courts find gross negligence. In *Mrs. Zhang v. the Life Insurance Company Beijing Branch*,⁵⁹ Mrs. Zhang

⁵⁸ Insurance Law of the People's Republic of China, *supra* note 3, at Art. 16(1).

⁵⁹ *Mrs. Zhang v. The Life Ins. Co. Beijing Branch*, cited in J.X LIU, TYPICAL CASES AND ADJUDGEMENT CONSIDERATION OF INSURANCE LAW 269 (2012); J.X

effected a life insurance policy on the life of her uncle in September 2010.⁶⁰ In the proposal form, a number of questions about the state of the life insured's health were raised. Specifically the insurer asked: (1) "In the last three years, has the life insured been found to have any physical abnormality by medical examination?" and (2) "In the last year, has the life insured visited any hospital for medical tests, received any treatments and taken any medicine?"⁶¹ The insured answered the questions in the negative. The life insured died from carbon monoxide poisoning in March 2011. After the life insured's death and upon inquiry by the insurer, Mrs. Zhang told the insurer that she took the life insured for a medical examination in July 2010 and there was no abnormality of the life insured's health. Based on the information provided by Mrs. Zhang, the insurer further investigated the case and found in the medical examination report from the hospital that the life insured's blood cells number decreased and the doctor advised him to have a further test. The insurer refused the claim by reason of the insured's failure to disclose the material fact. According to the normal practice of underwriting, the insurer would not issue a life insurance policy if the life insured was found to have any abnormalities in a blood test. Mrs. Zhang said that the proposal form was filled by the insurer's agent. She was asked by the agent to sign the proposal. She did not read the proposal but signed it. The court noted that the insurer would not have discovered the insured's blood test abnormality had Mrs. Zhang not told the insurer after the death of the life insured the fact that the life insured had taken a medical examination and the details of the hospital where the medical examination was carried out.⁶²

This led the Court to believe that Mrs. Zhang did not intend to conceal the material fact in order to mislead the insurer intentionally, and her statement that the insurer's agent filled the proposal form and that she did not read the proposal form should be accepted as true. Thus, the court held that the insured's failure to disclose the material fact was not intentional, but grossly negligent.⁶³ The "gross" negligence in this case is reflected by the fact that if the insured had taken a little care to read the

LIU, TYPICAL CASES AND ADJUDGEMENT CONSIDERATION OF INSURANCE LAW (2012).

⁶⁰ She had an insurable interest on her uncle. For more on insurable interest, see Z. Jing, *Insurable Interest in Life Insurance: a Chinese Perspective*, J. OF BUS. L. 337 (2014).

⁶¹ Mrs. Zhang v. The Life Ins. Co. Beijing Branch, *supra* note 59.

⁶² *Id.*

⁶³ *Id.*

proposal, she should have found the misrepresentation made by the agent. The court also held that according to Art. 16(5) of the Insurance Law, in the case of gross negligence, if the undisclosed fact has a material impact on the occurrence of the insured events, the insurer is not liable for paying insurance benefits related to the insured events occurring prior to the rescission of the contract. In this case, the life insured died of gas poisoning and there was no causal connection between the undisclosed fact (decrease of blood cell number) and the death of the life insured, so the insurer was liable for paying the insurance proceeds.

In *Mrs. Zhou v. the Insurance Company*,⁶⁴ Mrs. Zhou effected a life policy with coverage of hospital expenses on the life of her husband in January 2005. In the proposal form the insurer asked: (1) “[h]ave you had any blood tests within the last two years?” and (2) “[h]ave you had any blood disease, or suspected blood disease?”⁶⁵ The answers to the questions were negative. In March 2005, the life insured visited a hospital. He was suspected to have blood disease which was not confirmed. The insured paid for the hospital expenses. On another occasion in May 2005, the life insured visited the hospital again for treatment and was diagnosed with myelodysplastic syndrome. The insured paid for the costs of treatment. In August 2005, the life insured died of leukaemia. It was discovered after the death of the life insured that before the contract was entered into, the life insured visited hospital in March 2003 and was diagnosed with pneumonia and suspected aplastic anaemia.

The court held that the insured must have been aware of the blood disease but failed to disclose it to the insurer. As to the question of whether the non-disclosure was intentional or grossly negligent, the court found that on the proposal form, in the box regarding how to contact the life insured’s son and/or daughter, it said, “the same as the proposer.” The term “proposer” is a technical term. Mrs. Zhou lacked insurance knowledge and she should not have known how to use the term “proposer.” Moreover, some details about the life insured, such as his height and weight, were incorrect. The evidence showed that the proposal form was completed by the insurer’s agent not the insured. The insured failed to read the proposal form before signing it. Therefore, her failure to disclose was held to be grossly negligent. The court considered whether there was any causal connection between the undisclosed fact and the occurrence of the insured event. In this case, the insured died of leukaemia and the undisclosed

⁶⁴ XI, *supra* note 57, at 157.

⁶⁵ *Id.*

disease was suspected aplastic anaemia. There was an apparent causal connection between the death of the life insured and the undisclosed disease. Thus, the court found that the insurer was not liable but should return the premium to the insured.

In a more recent case,⁶⁶ the insured purchased life insurance with coverage of critical illness on her aunt's life in June 2013. The proposal form asked: "[d]oes the life insured drink alcohol? If yes, how much do you drink daily?" The insured gave a negative response to both questions. In August 2013, the life insured was diagnosed with cirrhosis and chronic liver failure. While being treated, she told the doctor that she drank alcohol for 20 years with a daily volume of about 500ml (equivalent to half a litre of whisky every day), but about 50ml in the last two months. The insured filed a claim for critical illness. The insurer denied the claim on the ground that the insured intentionally failed to disclose her heavy alcohol consumption. The insured provided evidence of a recorded telephone conversation with the insurer's agent who sold the life policy to the insured. In this conversation the agent said that "you told me that the life insured has a habit of drinking but you did not tell me she drank 500ml every day, I passed your message to the Insurance Company."

The main issue before the court was whether the non-disclosure was intentional, grossly negligent or merely negligent. Although the insured gave a negative response to the question about the life insured's drinking habit on the proposal form, she told the agent that the life insured had a habit of drinking, so she did not intentionally conceal this material fact. The life insured is the insured's aunt, not mother, the insured should not be expected to know the amount of alcohol consumed by her aunt every day, so it would be reasonable to hold that the insured did not intentionally withhold the material fact in respect of the amount of alcohol consumed by her aunt. On the other hand, if the insured had asked her aunt about the fact of her drinking habit and amount of alcohol consumed daily, she would easily know that fact. The court held that the insured's non-compliance with her duty of disclosure of the material fact was grossly negligent. The insurer was not liable for critical illness payment as there was a causal connection between the life insured's heavy drinking habit and her liver failure. However, the insurer returned the premium to the insured.

⁶⁶ Feng v. the Life Ins. Co. Beijing Branch, reported in Wan Jun Yuan, *The Insured Does Not Truthfully Inform the Insurance Company Has the Right to Terminate the Insurance Contract*, CHINA INS. NEWS (Mar. 15, 2016), http://chsh.sinoins.com/2016-03/15/content_188025.htm.

The aforementioned cases demonstrate how Chinese courts analyze the insured's duty to disclose. First, courts consider whether the insured has intentionally concealed a material fact. If a court fails to find the insured's non-disclosure was intentional, it will then examine the extent of the insured's negligence. Differentiating between gross negligence and mere negligence requires a fact specific inquiry. Courts have great discretionary power, as there is no clear definition of gross negligence under Chinese Insurance Law.

D. CAUSATION

Liability for an intentional non-disclosure does not require proof of any connection between the insurer's loss and the undisclosed fact.⁶⁷ However, in the context of a grossly negligent non-disclosure, a causal link must be established before the insurer can be discharged from liability for pre-rescission loss.⁶⁸

As discussed earlier, Chinese courts interpret the term "material impact" to mean "causal connection." The People's Courts will not uphold an insurer's repudiation of liability for pre-rescission loss if there is no causal connection between the undisclosed fact and the occurrence of an insured event.⁶⁹ However, the extent of the causal connection varies

⁶⁷ Insurance Law of the People's Republic of China, *supra* note 3, at Art. 16(4) (The insurer is allowed to rescind the contract where there is an intentional breach of the duty).

⁶⁸ *Id.* at Art. 16(5).

⁶⁹ Guiding Opinions of the Higher People's Court of Guangdong Province on Several Issues Concerning the Trial of Insurance Contract Disputes (promulgated by Guangdong Province Higher People's Court, effective Sept. 2, 2011) at Art. 6(2) (China), http://blog.sina.com.cn/s/blog_9fad4650101fbnt.html; Notice of the Higher People's Court of Shandong Province on Printing and Distribution of the Opinions on Several Issues Concerning the Trial of Insurance Contract Disputes (Trial) (promulgated by Shandong Province Higher People's Court, effective Mar. 17, 2011) at Art. 7 (China) [hereinafter *Notice of the Higher People's Court of Shandong Province*], <https://wenku.baidu.com/view/41faa4b9453610661fd9f475.html>; Higher People's Court of Zhejiang Province on Trial of Property Insurance Contract Disputes Guiding Opinions on Several Issues in Dispute Cases (promulgated by Zhejiang Province Higher People's Court, effective Sept. 8, 2009) at Art. 7 (China), <http://wenku.baidu.com/view/e6c9c806cc1755270722083c.html?re=view>. It must be noted the guidance enacted by the High People's Courts is only to guide the lower courts rather than to bind them. These guiding rules have no legal force.

according to the guiding rules for handling insurance disputes provided by different courts. For example, the High People's Court (HPC) of Shandong Province seeks a "causal connection";⁷⁰ the HPC of Guangdong Province demands a "direct causal connection";⁷¹ while the HPC of Zhejiang Province looks for "the proximate causal connection."⁷² It is submitted that, "direct causal connection" and "proximate causal connection" have the same meaning, that is, the loss is caused by the event. As for "simple causal connection," some commentators argue correlation is sufficient and does not require strict causality. For example, a "simple causal connection" could be made between smoking and lung cancer, hypertension and heart-attack, anaemia and leukaemia, and hepatitis and liver cancer.⁷³ The issue of causal connection is complex and needs further clarification by the SPC.

IV. DEFICIENCIES OF THE LAW WITH RESPECT TO GROSSLY NEGLIGENT NON-DISCLOSURE

Under the current framework, the insurer's refusal of liability for loss by reason of a grossly negligent non-disclosure requires a causal connection between the loss and the undisclosed fact. The law seems reasonable, but there is a major flaw. In some situations, the insurer would

⁷⁰ Notice of the Higher People's Court of Shandong Province, *supra* note 69 ("People's Courts shall not uphold the insurer's repudiation of liability for losses which occurred prior to rescission of the contract on the ground of non-disclosure or misrepresentation where there is no causal connection between the fact undisclosed by the insured's gross negligence and the occurrence of the insured event").

⁷¹ Guiding Opinions of the Higher People's Court of Guangdong Province on Several Issues Concerning the Trial of Insurance Contract Disputes, Art. 6(2) ("Where the insured failed to comply with the duty of disclosure by gross negligence as stipulated in Art. 16(5) of the Insurance Law, and there is no direct causal connection between the undisclosed fact and the occurrence of the insured event, People's Courts shall not uphold the insurer's repudiation of liability on the ground of the insured's failure to disclose the fact.").

⁷² See The Guidance of Zhejiang Province High People's Court Concerning Questions of How to Deal with Property Insurance Disputes 2011, Art. 7 ("Where the fact undisclosed by the insured's gross negligence was not the proximate cause to the occurrence of the insured event, and there was not decisive causal connection to the insurer's liability, the insurer's refusal of liability on the ground of non-disclosure will not be upheld.").

⁷³ X.M. XI, UNDERSTANDING AND APPLICATION OF THE INSURANCE LAW OF THE PEOPLES' REPUBLIC OF CHINA 90 (2010); Liu, *supra* note 59, at 274.

not have entered into the contract, or would have entered into the contract with a higher premium, had he known of the undisclosed fact at the time of the contract. However, the insurer is nevertheless liable for the loss if there is no causal connection between the undisclosed fact and the occurrence of the insured event. Thus, the insurer may receive a lower premium but bear a higher risk.

For example, an insured pays a £1000 annual premium for a death policy in the amount of £40,000. The insured did not inform the insurer of the fact that he had high blood pressure at the time of the contract. Had the insurer known of the insured's hypertension, the insurer would still have issued the policy but would have charged a higher premium of £1,300. The insured then dies of liver cancer. The insurer is liable for the loss, as no causal connection can be established between the death and hypertension. In this situation, the insurer received £1000 premium and paid £40,000 for the loss. The insurer would have received £1300 premium and paid £40,000 for the loss had the insured disclosed his hypertension.

This unfair and unreasonable outcome demonstrates why the doctrine of proportionality should be adopted. The insurer should be able to reduce the amount of benefit paid proportionately to the ratio of premium he received and the premium he should have received had he known of the undisclosed fact. Accordingly, if the doctrine of proportionality applied, the insurer would pay £30,769⁷⁴ instead of £40,000.

England and Australia have adopted the doctrine of proportionality. Under CIDRA, for careless misrepresentations, if the insurer would have entered into the consumer insurance contract, but would have charged a higher premium, the insurer may proportionately reduce the amount to be paid on a claim.⁷⁵ This is also the approach for neither deliberate nor reckless non-disclosures for non-consumer insurance in the Insurance Act 2015 (U.K.).⁷⁶

Under the Insurance Contracts Act 1984 (Australia), if an insured fails to comply with its duty of disclosure before the contract is entered into, the insurer's claim-based liability is reduced to the amount that would place the insurer in the position in which it would have been if the failure to disclose had not occurred or the misrepresentation had not been made (as

⁷⁴ (£40,000 × £1000/£1300 = £30,769)

⁷⁵ Consumer Insurance Disclosure and Representations Act 2012, *supra* note 13, at ¶ 7(1).

⁷⁶ Insurance Act 2015, *supra* note 16, at ¶ 6(1).

long as the insurer is not entitled to avoid the contract or being entitled to avoid the contract has not done so).⁷⁷

V. RECOMMENDATIONS FOR AMENDMENT OF THE LAW

This article has discussed the shortcomings of the current law with respect to remedies for grossly negligent breach of the duty of disclosure at the time of the contract. Recommendations for the definitions of the terms below have been put forward with reference to the judicial practice in China and to the English approach under CIDRA and the Insurance Act 2015 (U.K.).

The following recommendations address these shortcomings, specifically:

- (1) For a grossly negligent breach of the duty of disclosure by the insured:
 - a. Where the insurer can show a causal connection between the occurrence of the insured event and the material fact undisclosed or misrepresented, the insurer shall not be liable for the insured events which occurred prior to the rescission of the contract, but shall refund the premium paid.
 - b. Where there is no causal connection between the occurrence of the insured event and the material fact undisclosed or misrepresented,
 - i. if the insurer would not have entered into the contract had he been informed by the insured of the material fact, the insurer shall not be liable for the insured events which occurred prior to the rescission of the contract, but shall refund the premium paid;
 - ii. if the insurer would have entered into the contract, but would have charged a higher premium had he been informed by the insured of the material fact, the insurer may reduce the amount to be paid proportionately to the ratio of

⁷⁷ Insurance Contracts Act 1984, s. 28 (Austl.).

premium he received and the premium he should have received.

- (2) It is also suggested that Chinese Insurance Law provide definitions for the terms of intentional and grossly negligent non-disclosure or misrepresentation. Recommendations for these definitions are as follows:
- a. A non-disclosure or misrepresentation is intentional if the insured: (a) knew the existence of the fact in question,⁷⁸ (b) knew that the fact was relevant to the insurer, and (c) knew that his answer to the question was untrue or misleading, with the intention that the insurer act on it in the sense that it would induce the insurer to enter into the proposed contract.
 - b. A non-disclosure or misrepresentation is grossly negligent⁷⁹ if the insured: (a) did not care whether or not it was untrue or misleading, (b) did not care whether or not it was relevant to the insurer, but (c) had no intention that the insurer act on it in the sense that it would induce the insurer to enter into the proposed contract.⁸⁰

VI. CONCLUSION

This article has considered the insured's duty of disclosure and the remedies for the breach of this duty under Chinese Insurance Law as compared to other jurisdictions. By comparing Chinese law and English law with respect to remedies for breach of the duty of disclosure or representation, we find the same approach has been applied, specifically with regard to intentional breach. This approach allows both Chinese and English insurers to rescind the contract and retain the premium paid. CIDRA and the Insurance Act 2015 (U.K.) further entitles the insurer to avoid the contract and retain premium paid for a reckless breach of the duty, while Chinese law provides milder remedies for the same grossly negligent breach. the insurer is entitled to rescind the contract but must refund the

⁷⁸ SPC Interpretations, *supra* note 10, at Art. 5.

⁷⁹ This refers to the definition of reckless misrepresentation in section 5(2) of the CIDRA.

⁸⁰ Liu, *supra* note 59, at 274.

premium paid, and he is liable for losses which occurred prior to the rescission of the contract if there is no causal connection between the occurrence of the insured event and the undisclosed fact. Remedies under Chinese law appear to be more protective of the insured who has less bargaining power in an insurance negotiation. However, there are shortcomings and omissions with respect to remedies for breach of the duty under Chinese law.

As discussed earlier, the remedies for pre-rescission losses in the case of a grossly negligent non-disclosure, which has no material impact on the occurrence of the insured event, are flawed. In this situation, the insurer may receive a lower premium, but bears a higher risk, if the insurer would not have entered into the contract or would have done so but charged a higher premium. In order to strike a balance between protecting the insured and being fair to the insurer, the doctrine of proportionality should be applied.

Lastly, Chinese law is flawed in that it does not provide definitions for the terms “intentional” or “grossly negligent” non-disclosure or misrepresentation. This has created uncertainty and judicial difficulties. Courts give different decisions for similar factual cases. It is necessary to introduce a provision into the Insurance Law to define the terms “intentional” and “grossly negligent” non-disclosures.