

CHAPTER 3: SHIP MORTGAGE, MARITIME LIEN AND POSSESSORY LIEN

Ship Mortgage.....	¶13-010
Overview.....	¶13-011
Mortgage on ships under construction.....	¶13-012
Basic rights and obligations of ship mortgagor and mortgagee.....	¶13-013
Rank of claims secured by ship mortgages.....	¶13-014
Enforcement.....	¶13-015
Extinction.....	¶13-016
Maritime Lien.....	¶13-020
Overview.....	¶13-021
Characteristics.....	¶13-022
Preferential claims.....	¶13-023
Rank of preferential claims.....	¶13-024
Acquisition, transference, enforcement and extinction.....	¶13-025
Possessory Lien on Ships.....	¶13-030
Overview.....	¶13-031
Acquisition.....	¶13-032
Enforcement and extinction.....	¶13-033
Other liens against ships.....	¶13-034
Cross-cutting Issues.....	¶13-040

In this chapter, three essential types of security interests in ships – ship mortgage, possessory lien on ships, and maritime lien – are discussed.

¶3-010 Ship Mortgage

Under civil law, mortgages are typically effectuated on immovable properties. Nonetheless, it can be established on valuable movable properties – such as ships – so long as is explicitly prescribed by the law.

¶3-011 Overview

Under the Maritime Code of the People's Republic of China ("PRC") ("Chinese Maritime Code" or "CMC"), the mortgage effectuated on a ship should be registered with the ship registry jointly by the mortgagee and the mortgagor; no mortgage may act against a third party unless registered.¹ The effect of ship mortgages may also extend to freight and charter hire earned by the ship, attached interest to the ship, insurance indemnity for the loss of the ship, and proceeds of judicial sale of the ship. The CMC is the first legislation in China that treats insurance indemnity for the loss of a mortgaged property as property subrogation thereof.² Ship mortgagees are entitled to priority in compensation from insurance indemnity for the loss of the mortgaged ship.³ This approach was then followed by the Guaranty Law of the People's Republic of China ("Guaranty Law") and the Property Law of the People's Republic of China ("Property Law").⁴ It is suggested that the accountability of the above CMC provisions be enhanced by expanding the scope of property

1 Maritime Code (PRC) (adopted at the 28th Session of the Standing Committee of the 7th National People's Congress, 7 November 1992; promulgated by Order No. 64 [1992] of the President of the PRC, 7 November 1992; effectively 1 July 1993) ("CMC"), Art 13. See also, discussions in Chapter 2 ¶2-046, *supra*.

2 Wang Pengnan, *Ship Mortgage and Marine Insurance*, Annual of China Maritime Law (1994), Vol. 5, 160; Chen Haibo, *On the Enforcement of Maritime Liens*, Annual of China Maritime Law (1999), Vol. 10, 76.

3 CMC, Art 20.

4 Guaranty Law (PRC) (adopted at the 14th Session of the Standing Committee of the 8th National People's Congress, 30 June 1995; promulgated by Order No. 50 [1995], 30 June 1995; effectively 1 October 1995), Art 58; Property Law (PRC) (adopted at the 5th Session of the 10th National People's Congress, 16 March 2007; promulgated by Order No. 62 [2007] of the President of the PRC, 16 March 2007; effectively 1 October 2007), Art 174.

subrogation to cover all "indemnity" for the loss of the mortgaged property, as Article 58 of the Guaranty Law does.⁵

At the National Symposium of the Presidents of Chinese Maritime Courts held in July 2001, a consensus was reached among the presidents of Chinese Maritime Courts that, "a ship mortgagee may request the court to auction the mortgaged ship for the purpose of the repayment of the credits secured by the ship mortgage, in accordance with an effective but unregistered mortgage deed between the mortgagee and the mortgagor. Nonetheless, the mortgagee's claims or defence acting against a third party based on the unregistered mortgage should not be supported by the courts. Therefore, where other creditors claim for the repayment from the sale proceeds of the ship auctioned, the repayment of the credits secured by an unregistered mortgage may not rank higher than those secured by a registered mortgage or those arising from other maritime claims."⁶

¶3-012 Mortgage on ships under construction

Mortgages may be established on a ship under construction.⁷ Documents for the registration of a mortgage on a ship under construction, as set in the Working Procedure of Ship Registration enacted by the Maritime Safety Administration ("MSA") of the PRC, mainly include the follows: (i) an application form; (ii) the written consent from the joint owners who hold at least two-thirds (or agreed proportionate) shares in the ship, where applicable; (iii) identity documents of the mortgagor and the mortgagee; (iv) evidence of the ship ownership enjoyed by the mortgagor; (v) a ship mortgage deed and the principal contract collateralised; (vi) a document ascertaining the value of the ship mortgaged as agreed upon between the mortgagor and the mortgagee; (vii) no less than five photographs to demonstrate the building process of the ship and a document issued by a qualified ship surveyor for the purpose of testifying the building process

5 Qiu Jing, *Three Topics on Ship Mortgagee's Right of Subrogation*, Annual of China Maritime Law (1998), Vol. 9, 92.

6 SPC, Minutes of the Symposium of the Presidents of Chinese Maritime Courts (July 2001), Part II.

7 CMC, Art 14 para 1. See also, discussions in Chapter 2 Section 2-032, *supra*.

of the ship; and (viii) joint verdict of the mortgagor and the mortgagee about the effectuation of other mortgages on the ship.⁸

¶3-013 Basic rights and obligations of ship mortgagor and mortgagee

A mortgaged ship should be insured by the mortgagor unless the mortgage deed provides otherwise.⁹ In case the mortgagor fails to insure the ship, the mortgagee has the right to place the ship under insurance and the mortgagor should pay for the premium thereof.¹⁰ The establishment of a mortgage by joint owners of a ship should, unless otherwise agreed upon among the joint owners, be subject to the consent of those that hold at least two thirds of the shares in the ship.¹¹ The ownership of a mortgaged ship should not be transferred without the consent of the mortgagee.¹² In *Li and others v Jiesheng Waterway Engineering Co., Ltd.*,¹³ the High People's Court of Zhejiang Province held that, where a mortgage was effectuated on a ship which was registered as being solely owned by an enterprise, the sales and purchase of the shares in the ship among the shareholders of the enterprises, which did not affect the interests of the mortgagee, should be valid, even though no consent of the mortgagee had been acquired beforehand. In *Hezhong Shipping Co., Ltd. and others v Hu*,¹⁴ the High People's Court of Hubei Province held that, Article 191 paragraph 2 of the Property Law – which lays down that prior consent from the mortgagee to the transference of the mortgaged property is not required in the situation where the transferee undertakes to repay the credits secured by the mortgage to the mortgagee – applies also to maritime cases involving ship mortgages. In the present case where the transferee of the mortgaged ship had agreed to repay the credits

8 Working Procedure of Ship Registration (Decree No. 9 [2015] of the Maritime Safety Administration; effectively 4 January 2015), Art 63.

9 CMC, Art 15.

10 Ibid.

11 Ibid, Art 16.

12 Ibid, Art 17.

13 High People's Court of Zhejiang Province, Civil Chamber, second instance, Civil Judgment [2014] No. 73 ([2014] Zhe Hai Zhong Zi No. 73).

14 High People's Court of Hubei Province, Civil Chamber No. 4, second instance, Civil Judgment [2014] No. 86 ([2014] E Min Si Zhong Zi No. 86).

on behalf of the transferor (the mortgagor) to the mortgagee, the court found the mortgagee not empowered to repudiate the transference of the ship between the mortgagor and the transferee.

In case the mortgagee has assigned all or part of its credits secured by ship mortgage to another party, the rights relating to the ship mortgage should be assigned accordingly.¹⁵ Even though the assignment of the credits secured by ship mortgage does not enlist consent from the mortgagor, the changes in the identity of the mortgagee arising accordingly should nevertheless be registered with the ship registry.

As the rights relating to ship mortgage are not a typical kind of insurable interests under the CMC, it has been recommended since the 1990s that a system of insurance of the interests of ship mortgagees be established in the Chinese legal regime.¹⁶ However, the Insurance Law of the People's Republic of China ("Insurance Law") which erects the fundamental mechanisms and principles for marine insurance does not spare any attention to insurance of mortgage interests in its latest amendment of 2015.¹⁷

The right of joint owners to effectuate mortgages on their ship should be exercised in a manner that conforms to the provisions of Article 97 of the Property Law, which provides that, "[d]isposing of or making major repairs to the co-owned immovables or movables shall be subject to agreement reached by the co-owners who possess two-thirds or more of the total shares or by all of the joint owners, except where the owners agree otherwise." The application of these provisions to ship mortgages, however, does not affect the enforcement of the CMC provisions relating to the legal effect of unregistered co-ownership of ships against third parties.¹⁸ In *Chongqing Rural Commercial Bank Wanzhou Branch v Jinyuan Shipping Co.*,¹⁹ one of the two co-owners of the ship concerned was

15 CMC, Art 18.

16 Qiu Jing, *On Insurance Protection for Ship Finance by Mortgage Lending*, Annual of China Maritime Law (1996), Vol. 7, pp160 – 165.

17 Insurance Law (PRC) (adopted at 14th Session of the Standing Committee of the 8th National People's Congress, 30 June 1995; amended in 2002, 2009, 2014 and 2015).

18 CMC, Art 10.

19 High People's Court of Hubei Province, Trial Supervision Chamber, re-trial procedure, Civil Judgment [2013] No. 9 ([2013] E Min Jian San Zai Zi No. 9).

registered as the sole owner thereof. A mortgage was then effectuated on the ship by the registered owner – without any consent from the other co-owner – to secure its own debts owed to the ship mortgagee. The ship mortgage was jointly registered by the registered owner and the ship mortgagee with the ship registry. One of the issues for the High People's Court of Hubei Province to decide was whether the ship mortgage had been effectively established. As unregistered co-ownership may not act against a third party under the CMC and the Ship Registration Regulations of the People's Republic of China ("Ship Registration Regulations"),²⁰ the court found that the unregistered co-ownership enjoyed by the other co-owner may not act against a *bona fide* third party in the present case – viz., the ship mortgagee, and that the ship mortgagee may enforce its right against the entire value of the ship mortgaged.

¶3-014 Rank of claims secured by ship mortgages

Two or more mortgages may be established on a same ship.²¹ The ranking of the claims secured by the mortgages should be determined according to the dates of their registration.²² The mortgages registered on the same date rank equally in respect of compensation.²³

¶3-015 Enforcement

As indicated by the definition of ship mortgage under the CMC, the fundamental rights of the ship mortgagee is to enjoy a prioritised rank in compensation from the proceeds of judicial sale of the mortgaged ship where the mortgagor fails to pay its debt secured by ship mortgage to the mortgagee.²⁴ The mortgagee is not entitled to detain or sell the mortgaged ship by itself – that is, it has to enforce the ship mortgage through the court. In *Yinggao Shipping Co. Ltd. v Guangzhou Rural Commercial Bank*

20 Ship Registration Regulations of the People's Republic of China (Order No. 155 [1994] of the State Council; effectively 1 January 1995; amended by Order No. 653 [2014] of the State Council, 29 July 2014) ("Ship Registration Regulations").

21 CMC, Art 19 para 1.

22 Ibid.

23 Ibid, Art 19 para 2.

24 CMC, Art 11.

Huangpu Branch,²⁵ the High People's Court of Guangdong Province held that, where a ship mortgage and a surety provide security to a same credit, the creditor may enforce its claims against the ship mortgage and the surety simultaneously.

The Civil Procedure Law of the People's Republic of China ("CPL") as amended in 2012 erects non-litigation proceedings for the enforcement of security interests in property.²⁶ Under Chapter 15 Section 7 of the amended CPL, the holder of security interests or any other party entitled to enforce the security interests may file an application with the basic people's court at the place where the collateral property is located or at the place of registration of the security interests.²⁷ If the application complies with legal requirements, the people's court should rule to auction or sell the collateral property, and the parties may, based on the ruling, apply to the people's court for execution; if the application does not comply with legal requirements, the people's court should rule to dismiss the application, and the party may initiate litigation proceedings before a people's court.²⁸ The applicability of those CPL provisions in maritime cases is addressed in the Provisions on Several Issues Concerning the Application of Law in the Arrest and Auction of Ships enacted by the Supreme People's Court ("SPC") ("SPC Provisions on the Arrest and Auction of Ships").²⁹ Where any party applies for the auction of a ship to enforce the security interests of the arrested ship in accordance with the provisions of Chapter 15 Section 7 of the Civil Procedure Law, the application should be filed with the maritime court at the place where

25 High People's Court of Guangdong Province, Civil Chamber No. 4, second instance, Civil Judgment [2014] No. 21 ([2014] Yue Gao Fa Min Si Zhong Zi No. 21).

26 Civil Procedure Law (PRC) (adopted at the 4th Session of the 7th National People's Congress, 9 April 1991; amended at the 30th Session of the 10th Standing Committee of the National People's Congress, 28 October 2007; amended at the 28th Session of the 11th Standing Committee of the National People's Congress, 31 August 2012; promulgated by Order No. 59 [2012] of the President of the PRC; effectively 1 January 2013) ("CPL").

27 CPL, Art 196.

28 Ibid, Art 197.

29 Supreme People's Court ("SPC"), Provisions on Several Issues Concerning the Application of Law in the Arrest and Auction of Ships (passed at the 1631st meeting of the Judicial Committee of the SPC, 8 December 2014; Judicial Interpretation No. 6 [2015]; effectively 1 March 2015) ("SPC Provisions on the Arrest and Auction of Ships").

the ship is located or at the place where the ship's port of registry is located, and should be handled in accordance with the Special Maritime Procedure Law of the People's Republic of China ("SMPL")³⁰ and the SPC Provisions on the Arrest and Auction of Ships regarding the procedure for the repayment of debts in the auction of the ship.³¹

¶3-016 Extinction

A ship mortgage may be extinguished by virtue of various reasons, such as (i) the loss of the mortgaged ship;³² (ii) the extinction of the secured credits; (iii) the enforcement of ship mortgage by the mortgagee; and (iv) judicial sale of the mortgaged ship. Under the Property Law, the time limitation for the mortgagee to exercise its rights is the same as that for the enforcement of its credits to which the mortgage is collateral.³³ Such a provision supersedes its predecessor under the Provisions on Several Issues Concerning the Application of the Guaranty Law of the People's Republic of China enacted by the SPC ("SPC Provisions on the Guaranty Law") which acknowledges the validity of a mortgage within two years since the elapse of the time limitation for an action based on the claims secured by the mortgage.³⁴

In *BE Bank v FT Co.*,³⁵ Tianjin Maritime Court accentuated that judicial auction of a ship induced the extinction of ship mortgage effectuated on the ship prior to the auction, because, by virtue of the application of the Provisions on the Auction of Arrested Ships by Maritime Courts for Debt Liquidation enacted by the SPC, a ship purchaser in judicial

30 Special Maritime Procedure Law (PRC) (adopted by the 13th Session of the Standing Committee of the 9th National People's Congress, 25 December 1999; promulgated by Order No. 28 [1999] of the President of the PRC, 25 December 1999; effectively 1 July 2000) ("SMPL").

31 SPC Provisions on the Arrest and Auction of Ships, Art 23.

32 CMC, Art 20.

33 Property Law, Art 202.

34 SPC, Provisions on Several Issues Concerning the Application of the Guaranty Law of the People's Republic of China (passed at the 1133rd meeting of the Judicial Committee of the SPC, 29 September 2000; Judicial Interpretation No.44 [2000]; effectively 13 December 2000) ("SPC Provisions on the Guaranty Law"), Art 12 para 1.

35 Tianjin Maritime Court, Maritime Chamber, first instance, Civil Judgment [2005] No. 401 ([2005] *Jin Hai Fa Shang Chu Zi No. 401*).

auction acquires the ownership of the ship through original obtainment and, thus, should not be held liable for any claim arising against the ship prior to the auction.³⁶ The successors of the aforementioned Provisions – that is, the SPC Provisions on the Arrest and Auction of Ships – also clarify that, after a ship is auctioned or sold by the maritime court, the effect of any preservative measures which were effectuated on the ship prior to the auction or selling should extinguish.³⁷

¶3-020 Maritime Lien

¶3-021 Overview

Maritime lien, which is unique to the maritime regime, is defined by the CMC as "the right of the claimant, subject to [the pertinent provisions of the CMC], to take priority in compensation against shipowners, bareboat charterers or ship operators with respect to the ship which gave rise to the [pertinent] claim."³⁸ In this section, the issues as to characteristics of, claims secured by, and acquisition and extinction of, maritime liens are discussed.

¶3-022 Characteristics

Maritime liens are characterised under the Chinese regime as security interests in the ship which gave rise to the legally-prescribed maritime claims secured by maritime liens against parties including shipowners, bareboat charterers, or ship managers.³⁹ Maritime liens are not maritime claims in nature; they serve to secure the enforcement of certain types of maritime claims as delineated by the law.⁴⁰

36 SPC, Provisions on the Auction of Arrested Ships by Maritime Courts for Debt Liquidation (Document No. 14 [1994] of the SPC; effectively 6 July 1994) [repealed and replaced by the SPC Provisions on the Arrest and Auction of Ships], Art 1 para 15.

37 SPC Provisions on the Arrest and Auction of Ships, Art 15.

38 CMC, Art 21.

39 *Ibid.*

40 The nature of maritime liens as security interests is also discussed in Xiao Sili, *The Nature of Maritime Lien*, Annual of China Maritime Law (1992), Vol. 3, p72.

the premature termination of contract can be determined in accordance with the provisions of Article 107 of the Contract Law, which dedicate to remedies for breach of contract.¹³⁰ Where specific legal provisions are still insufficient to determine the rights and obligations of the parties, the fundamental principles in contract law should apply. For instance, the principle of fairness applies where there is a need to decide whether the stipulated amount of liquidated damages is excessively high,¹³¹ the principle of privity of contract applies where the default performance of the sub-charter party is caused by the default performance of the head charter party,¹³² the principle of proportionality applies where both parties to the charter party have defaulted in performing the same.¹³³ The courts have also acknowledged the validity of the termination¹³⁴ or alteration¹³⁵ of contract, as agreed upon by the parties through their actions, rather than written words.

130 *Li v Yuanhan Shipping Co.*, Ningbo Maritime Court, Maritime Chamber, first instance, Civil Judgment [2014] No. 232 ([2014] *Yong Hai Fa Shang Chu Zi No. 232*).

131 *WXZH v Fujian GH Shipping Co.*, High People's Court of Tianjin Municipality, Civil Chamber No. 4, second instance, Civil Judgment [2014] No. 83 ([2014] *Jin Gao Min Si Zhong Zi No. 83*).

132 *He v Zhou*, High People's Court of Zhejiang Province, Civil Chamber No. 4, second instance, Civil Judgment [2008] No. 43 ([2008] *Zhe Min Si Zhong Zi No. 43*), where the court confirmed that the obligations of the parties under the sub-charter party to perform the contract cannot be exempted by the default performance of the head charter party.

133 *Cai and others v Zhuhai JL Development Co.*, High People's Court of Shandong Province, Civil Chamber No. 4, second instance, Civil Judgment [2004] No. 266 ([2004] *Lu Gao Fa Min Si Zhong Zi No. 266*), where both the shipowner and the charterer were negligent in properly documenting the ship for the purpose of performing the services under the charter party.

134 *NS Container Lines v HA Shipping Co.*, High People's Court of Shanghai Municipality, Civil Chamber No. 4, second instance, Civil Judgment [2013] No. 79 ([2013] *Hu Gao Min Si (Hai) Zhong Zi No. 79*).

135 *Shanghai HX Logistics Co. v HR (Hong Kong) Shipping Co.*, High People's Court of Shanghai Municipality, Civil Chamber No. 4, second instance, Civil Judgment [2009] No. 124 ([2009] *Hu Gao Min Si (Hai) Zhong Zi No. 124*).

CHAPTER 6: MARINE INSURANCE

Introduction	¶16-010
Contract of Marine Insurance.....	¶16-020
Subject Matters of Insurance.....	¶16-030
Main Obligations of the Insured	¶16-040
Material facts	¶16-041
Insurance premium	¶16-042
Warranties	¶16-043
Mitigation of loss	¶16-044
Upgrade of risks	¶16-045
Main Obligations of Insurer	¶16-050
Indemnification	¶16-051
Exemptions	¶16-052
Termination of Insurance Contract	¶16-060
Loss of Subject Matter Insured	¶16-070
Actual total loss	¶16-071
Constructive total loss.....	¶16-072
Partial loss.....	¶16-073
Subrogation and Abandonment	¶16-080
Subrogation	¶16-081
Abandonment	¶16-082

¶16-010 Introduction

According to Article 1 of the Provisions on Several Issues Concerning the Trial of Cases over Marine Insurance issued by the Supreme People's Court ("SPC") of the People's Republic of China ("PRC") in 2006 ("SPC

Provisions on Marine Insurance”),¹ the court may adjudicate marine insurance disputes in accordance with the provisions of the Maritime Code of the People’s Republic of China (“Chinese Maritime Code” or “CMC”),² the Insurance Law of the People’s Republic of China (“Insurance Law”),³ and the Contract Law of the People’s Republic of China (“Contract Law”).⁴ It is further clarified in Article 2 of those Provisions that, for damages to piers or port facilities, if they are caused by marine accidents, the CMC should apply; if they are caused by non-marine accidents, the Insurance Law should apply.

In addition to the traditional forms of insurance services provided by commercial insurance practitioners, mutual assurance between the shipowners is also a common instrument that the shipowners rely upon to insure against risks that may arise from their operation of the ships at the sea. The associations of the shipowners for that purpose are usually referred to as Protection and Indemnity (“P&I”) Clubs. Mutuality is the characteristics of the P&I contracts – in the general sense, the shipowners (*viz.*, the Club members) function as both insurer and insured. The China Shipowners Mutual Assurance Association (also known as “China P&I Club” or “CPI”), established in 1984 in Beijing, covers its Members from third party liabilities in respect of loss of and damage to cargo, injury, illness or loss of life of crew or passengers, pollution damage, collision liability, fines, wreck removals and etc.⁵ Although CPI is still not a member of Pool Clubs, the coverage provided by CPI is, in principle, identical to that provided by a Pool Club in respect of both scope and

1 Supreme People’s Court (“SPC”), Provisions on Several Issues Concerning the Trial of Cases over Marine Insurance (passed at the 1405th meeting of the Judicial Committee of the SPC, 13 November 2006; Judicial Interpretation No. 10 [2006]; effectively 1 January 2007) (“SPC Provisions on Marine Insurance”).

2 Maritime Code (PRC) (adopted at the 28th Session of the Standing Committee of the 7th National People’s Congress, 7 November 1992; promulgated by Order No. 64 [1992] of the President of the PRC, 7 November 1992; effectively 1 July 1993) (“CMC”).

3 Insurance Law (PRC) (adopted at 14th Session of the Standing Committee of the 8th National People’s Congress, 30 June 1995; amended in 2002, 2009, 2014 and 2015).

4 Contract Law (PRC) (adopted at the 2nd Session of the 9th National People’s Congress, 15 March 1999; promulgated by Order No.15 [1999] of the President of the PRC, 15 March 1999; effectively 1 October 1999).

5 CPI, Profile (http://www.cpiweb.org/xiehuijigou/en_aboutus.jsp).

limits.⁶ “The Rules” of the CPI entered into effect on 1 January 2014, containing general terms and conditions of the assurance – including protection and indemnity risks covered, hull and machinery risks covered, special cover, exceptions and limitations, period of insurance, variation of contract, termination of insurance, etc.⁷ The provisions of Chapter XII of the CMC, “Contract of Marine Insurance”, lay down the fundamental principles and rules of marine insurance, which cannot be derogated from by voluntary stipulations in the contracts of marine insurance.

¶ 6-020 Contract of Marine Insurance

Under the CMC, a contract of marine insurance is a contract whereby the insurer undertakes, as agreed, to indemnify the loss to the subject matter insured and the liability of the insured caused by perils covered by the insurance against the payment of an insurance premium by the insured.⁸ The covered perils referred to in this definition encompass “any maritime perils agreed upon between the insurer and the insured, including perils occurring in inland rivers or on land which is related to a maritime adventure”.⁹ A contract of marine insurance include mainly the following terms: (i) name of the insurer; (ii) name of the insured; (iii) subject matter insured; (iv) insured value; (v) insured amount; (vi) perils insured against and perils excepted; (vii) duration of insurance coverage; and (viii) insurance premium.¹⁰

The High People’s Court of Shanghai Municipality affirmed in *Zhu v HA Property Insurance Co. Shanghai Branch*¹¹ that, the time of the conclusion of an insurance contract is the time when the two parties reached upon consensus – the fact as to whether an insurance policy has been issued, whether insurance premium has been paid, or whether the insurance

6 Ibid.

7 Full text of *The Rules* is available at http://www.cpiweb.org/en_baoxiantiaokuan/1.jsp.

8 CMC, Art 216 para 1.

9 Ibid, Art 216 para 2.

10 Ibid, Art 217.

11 High People’s Court of Shanghai Municipality, Civil Chamber No. 4, second instance, Civil Judgment [2014] No. 117 ([2014] *Hu Gao Min Si (Hai) Zhong Zi No. 117*).

period has commenced, is not decisive for the valid conclusion of the contract. In addition, the insurance period should be determined in accordance with the contract; where there is no agreement in the contract, the insurance period commences after the day on which the insurer receives insurance premium from the insured.

The insured may conclude an open cover with the insurer for the goods to be shipped or received in batches within a given period; the open cover should be evidenced by an open policy to be issued by the insurer.¹² The insured under the open cover assumes, under the CMC, the obligation to notify immediately the insurer the name of the carrying ship and the voyage, upon learning that the cargo insured thereunder has been shipped or has arrived.¹³ Despite the fact that legal consequences of a default in the required notification are unclear under the CMC, it is submitted nevertheless that, advance declaration of each batch of cargo under the open cover is not a preceding condition for the commencement of the insurance period in respect of each batch of cargo.¹⁴

Where the insured was aware or ought to be aware that the subject matter insured had suffered a loss due to the incidence of a peril insured against when the contract was concluded, the insurer should not be liable for indemnification but should have the right to the premium; where the insurer was aware or ought to be aware that the occurrence of a loss to the subject matter insured due to a peril insured against was impossible, the insured should have the right to recover the premium paid.¹⁵ As to the legal effect of an anti-dated insurance policy on which the commencement date of the insurance period is recorded as earlier than the date of contract conclusion or issuance of insurance policy, it is argued that the validity of the insurance contract should be sustained so long as the above situations occur, which may exempt the obligations of the insurer or the insured, the issuance of an anti-dated insurance policy *per se* represents the reaching of an agreement between the insured and the insurer in respect of the anti-dating, which, in addition, does not

¹² CMC, Art 231.

¹³ *Ibid*, Art 233.

¹⁴ Yuan Shaochun, *On the Legal Issues of Open Cover*, Annual of China Maritime Law (2002), Vol. 13, p237.

¹⁵ CMC, Art 224.

impair any interests of a third party.¹⁶ Consequently, where the insured, at the time of the issuance of an anti-dated insurance policy, did not, or did not ought to, know that damages caused by any insured accident had already occurred before the issuance of the anti-dated insurance policy but within the indicated insurance period thereon, the anti-dated insurance policy should be valid, and the insurer should assume the liability for indemnity according thereto.¹⁷ It is further maintained that the legal effect of an anti-dated insurance policy should be the same as that of any other kinds of valid insurance policy.¹⁸ In *China Pacific Property Insurance Co. Shanghai Branch v Shanghai MZ Import & Export Co.*,¹⁹ the insurance policy was issued on 7 August 2009, on which the insurance period commenced from 1 August 2009. Afterwards, the insured was notified about a marine accident involving its cargo. Evidence showed that the accident occurred on 7 August. Given that no further evidence before the court showed that, when the insurance policy was issued, the insured knew, or ought to know, about the occurrence of the insured accident, the High People's Court of Shanghai Municipality held the policy effective between the two parties.

Where an insurance contract is entered into on standard clauses provided by the insurer, the insurer should provide an insurance policy with the standard clauses attached and explain the contents of the contract to the insurance applicant.²⁰ For those clauses exempting the insurer from liability in the insurance contract, the insurer should sufficiently warn the insured of those clauses, and expressly explain the contents of those clauses to the insured in writing or verbally. If the insurer fails to make a warning or express explanation thereof, those clauses should not be effective.²¹ To sum up, the above provisions impose obligations on the insurer to (i) give appropriate reminder to the insured about the standard

¹⁶ Li Zhaoliang, *An Analysis on the Legal Issues of Back-Dated Marine Cargo Insurance Policy*, Annual of China Maritime Law (2008), Vol. 19, p249.

¹⁷ *Ibid*, pp252 – 253.

¹⁸ *Ibid*, p255.

¹⁹ High People's Court of Shanghai Municipality, Civil Chamber No. 4, second instance, Civil Judgment [2011] No. 186 ([2011] Hu Gao Min Si (Hai) Zhong Zi No. 186).

²⁰ Insurance Law, Art 17 para 1.

²¹ *Ibid.*, Art 17 para 2.

clauses that may exempt the insurer from liability for indemnity; and (ii) to provide explicit explanations of those standard clauses. The insurer is not obliged to underscore or explain standard clauses which do not exempt its liability for indemnify. In *Qinzhou ZYS Shipping Co. v PICC Beihai Branch*,²² Clause 8 of the insurance contract concerned stipulated that, where damages are caused by the insured accidents, the insured should consult with the insurer before repairing the vessel or paying any fees; otherwise, the insurer is entitled to inspect the reasonability of the payment of any fees. The High People's Court of Guangxi Zhuang Autonomous Region held that such a clause did not exempt the insurer from liability, and that therefore the insurer was not obliged to give special reminder, or express explanation, of it to the insured.

It is argued, however, that the aforementioned obligations of the insurer to underscore and explain the exemptions in standard clauses need not be strictly applied in marine insurance. Given the fact that most of the insured in marine insurance are business entities, instead of individual consumers who need to be provided with particular protection by the Insurance Law, the obligations to explain needs to be assumed in maritime insurance only where the insured so requests, unless legal consequences of the pertinent clauses are grave and go beyond the apprehension of a reasonable insured.²³

In *PA Property Insurance Co. Shanghai Branch v Shanghai HR Ship Engineering Co.*,²⁴ the ship builder insured with the insurer against liability arising from the quality of a ship it built. Upon the receipt of a compensation claim from the ship purchaser for damages caused by the defective quality of oil paint on the ship concerned, which manifested itself after the delivery of the ship, the ship builder raised an indemnity claim against the insurer, who, afterwards, rejected the

22 High People's Court of Guangxi Zhuang Autonomous Region, Civil Chamber No. 4, second instance, Civil Judgment [2013] No. 45 ([2013] *Gui Min Si Zhong Zi No. 45*).

23 See generally, Liu Yitong and Wang Xin, Application of Insurers' Obligation of Interpretation of Clauses to Marine Insurance, *Chinese Journal of Maritime Law* (2014) Vol. 25, 4, pp31 – 32.

24 High People's Court of Shanghai Municipality, Civil Chamber No. 4, second instance, Civil Judgment [2014] No. 78 ([2014] *Hu Gao Min Si (Hai) Zhong Zi No. 78*).

indemnity claim, contending that the insured liability for "damages to ships caused by the work of the ship builder" as prescribed in Clause 6 of the insurance contract concerned referred only to "physical damages" to ships during the ship construction, not including potential defects that would manifest themselves after the completion of the construction work. The insurer's contention was rebutted by the High People's Court of Shanghai Municipality, which held that, the general meaning of the term "damages" should include both "physical damages" and "potential defects" that would manifest themselves after the delivery of the ship. If the insurer adopted the meaning of the term other than the ordinary one, it should explain this to the insured expressly. In the present case where the insurer's interpretation of the term "damages" would further relieve its own indemnity liability, the insurer should, in accordance with Article 30 of the Insurance Law,²⁵ highlight the clause containing the term and provide explicit explanations of the term to the insured. As no evidence showed that the insured had discharged the obligation of explanation, the insurer's interpretation of the term, which favoured itself, was not admitted by the court. In *PA Property Insurance Co. Zhejiang Branch v Ningbo XY Import & Export Co.*,²⁶ the insurance period as indicated in the standard clauses on the insurance policy concerned was "warehouse to warehouse" ("W/W"). Simultaneously, it was incorporated into the insurance contract that the insurance period commenced on 16 August 2011, by which date the cargo had already been on its route of transportation. The High People's Court of Zhejiang Province maintained that, where the clauses in the contract contravened with each other and the contract itself did not provide any resolution in such a situation, the pertinent clauses should be interpreted in a way that favoured the insured, in accordance with Article 30 of the Insurance Law. Therefore, the insurance period in the present case should be "W/W", which was longer than the one commencing on 16 August 2011. In *China*

25 Insurance Law, Art 30, according to which, where there is any dispute between the insurer and the insured over any clause of an insurance contract entered into by using the standard clauses of the insurer, the clause should be interpreted as commonly understood. If there are two or more different interpretations of the clause, the people's court or the arbitral tribunal should interpret the clause in favor of the insured.

26 High People's Court of Zhejiang Province, Civil Chamber, second instance, Civil Judgment [2012] No. 116 ([2012] *Zhe Hai Zhong Zi No. 116*).

Pacific Property Insurance Co. Shenzhen Branch v Zhenzhen XL Mariculture Co.,²⁷ the parties stipulated in the insurance contract concerned, on the one hand, that the deductible franchise for each accident was 20%; and, on the other hand, that there would be no deductible franchise for indemnity for total loss. When addressing the conflicts between those stipulations, the High People's Court of Guangdong Province maintained that, in the present case where total loss arose, no deductible franchise should be made by the insurer, because those inconsistent stipulations should be interpreted in a manner that favoured the insured in accordance with the law.

¶6-030 Subject Matters of Insurance

Subject matters of marine insurance, under the CMC mainly include (i) ship; (ii) cargo; (iii) income from the operation of the ship including freight, charter hire and passenger's fare; (iv) expected profit on cargo; (v) crew's wages and other remuneration; (vi) liabilities to a third party; and (vii) other property which may sustain loss from a maritime peril and the liability and expenses arising therefrom.²⁸ In addition, the insurer may reinsure the insurance of the subject matter aforementioned; unless otherwise agreed in the contract, the insured under the original insurance should not be entitled to the benefit of the reinsurance.²⁹ It is a general rule under the Insurance Law that where the subject matter insured is assigned, the assignee succeeds to the rights and obligations of the assignor (*viz.*, the insured).³⁰ Where the subject matter insured is assigned, the assignor or the assignee should notify the insurer in a timely manner, unless it is a cargo-carriage insurance contract or it is otherwise provided for by the contract.³¹

In the absence of stipulations between the insured and the insurer, the insurable value of subject matters should be determined in accordance with the CMC, which provides for the following rules:

²⁷ High People's Court of Guangdong Province, Civil Chamber No. 4, second instance, Civil Judgment [2004] No. 16 ([2004] Yue Gao Fa Min Si Zhong Zi No. 16).

²⁸ CMC, Art 218 para 1.

²⁹ *Ibid*, Art 218 para 2.

³⁰ Insurance Law, Art 49 para 1.

³¹ *Ibid*, Art 49 para 2.

- (i) The insurable value of the ship is the value of the ship at the time when the insurance liability commences, being the total value of the ship's hull, machinery, equipment, fuel, stores, gear, provisions and fresh water on board as well as the insurance premium.
- (ii) The insurable value of the cargo is the aggregate of the invoice value of the cargo or the actual value of the non-trade commodity at the place of shipment, plus freight and insurance premium when the insurance liability commences.
- (iii) The insurable value of the freight is the aggregate of the total amount of freight payable to the carrier and the insurance premium when the insurance liability commences.
- (iv) The insurable value of other subject matter insured is the aggregate of the actual value of the subject matter insured and the insurance premium when the insurance liability commences.³²

The insured amount of subject matters should be agreed upon between the insurer and the insured, but not exceed the insured value. Where the insured amount exceeds the insured value; the portion in excess is null and void.³³ No efforts are spared by the provisions of the CMC to define insurable interest in subject matters of insurance, which is construed, under the Insurance Law, as "a legally recognised interest owned by an insurance applicant or insurant in the subject matter insured."³⁴ According to the Insurance Law, the insured in property insurance is the party which has an insurable interest in the subject matter insured at the time an insured incident occurs to the subject matter.³⁵

Insurable interest in cargo under sea carriage may be transferred during the carriage. A contract of marine insurance for the carriage of goods by sea may be, under the CMC, assigned by the insured via endorsement or otherwise, and the rights and obligations under the contract are assigned accordingly; the insured and the assignee should be jointly and severally liable for the payment of the premium if such premium

³² CMC, Art 219.

³³ *Ibid*, Art 220.

³⁴ Insurance Law, Art 12 para 6.

³⁵ *Ibid*, Art 12 para 2.

remains unpaid up to the time of the assignment of the contract.³⁶ Different types of insurable interest in cargo under sea carriage mainly include, but are not limited to, (i) cargo ownership; (ii) possessory lien on cargo; and (iii) insured liability and risks arising from cargo carriage.³⁷ Thus, depending on the circumstances, the seller or buyer of the cargo, the carrier of the cargo, the cargo insurer, or the pledgee of the Bill of Lading (“B/L”) containing the cargo may possess insurable interest in the pertinent cargo.³⁸ In April 2004, the SPC clarified in its Replies to the Enquiries Arising from Foreign-Related Commercial and Maritime Adjudication (I) that insurable interest in marine insurance refers to the legally-recognised interest held by the insured in the subject matter – in other words, the insured holds legally-recognised economic stakes in the subject matter.³⁹ Shipowners, ship mortgagees, ship insurers, sellers or buyers of the cargo under marine shipping, cargo carriers, cargo insurers, pledgees of B/L concerning the cargo, etc., can hold insurable interest in the subject matter of marine insurance.⁴⁰

It is advocated that economic interest in the cargo, even though being held by a party which seemingly does not legally possess interest, be decisive for insurable interest in the cargo.⁴¹ Accordingly, despite the fact that the ownership or risks relating to the cargo under marine shipping have been passed from the seller to the buyer during the transportation, provided damages to or loss of the cargo are in effect borne by the seller by virtue of an agreement between the seller and the buyer or any other reasons, the seller should be held as possessing insurable interest in the cargo. Such a practice does not derogate from the definition of contract

36 CMC, Art 229. Similar provisions can be found in Article 49 of the Insurance Law.

37 Huang Weiqing, *On the Insurable Interest of International Marine Cargo*, Annual of China Maritime Law (2001), Vol. 12, p30.

38 Ibid.

39 SPC, Replies to the Enquiries Arising from Foreign-Related Commercial and Maritime Adjudication (I) (publicised by the Civil Chamber No. 4 of the SPC, December 2008), Questions No. 157 “How to define insurable interest in marine insurance?”.

40 Ibid.

41 See generally, Wang Darong, *Principle of Economic Interest Should Be Applied in Marine Insurance in China*, Annual of China Maritime Law (2001), Vol. 12, p32.

of marine insurance under the CMC.⁴² In *A Co. v B Co. Jining Branch*,⁴³ the High People’s Court of Shandong Province found that, the allocation of risks between the seller and the buyer in an international sales transaction which involved the use of the standard trade term – “Free on Board” (FOB) in the present case – can be changed by the following-up actions of the two parties. Given the fact that, in the present case, the seller agreed to reduce the price of the cargo when cargo damages occurring in the carriage were uncovered after the delivery of cargo, the court held that the seller (which was also the insured under the insurance contract) had insurable interest in the cargo, because it assumed actual losses arising from cargo damages.

In *PICC Jiujiang Branch v Hainan Huyu Transportation Co.*,⁴⁴ one of the issues for the High People’s Court of Hainan Province to decide was whether the ship operator concerned had insurable interest in the ship it operated. Given the fact that, in the present case, the ship operator assumed the risks arising from ship operation and paid insurance premium, the court found it having insurable interest in the ship concerned. In *China Pacific Property Insurance Co. Shenzhen Branch v Douma Creative Co. Ltd.*,⁴⁵ the shipper under the contract of carriage of goods by sea (also the seller under the international sales contract) insured the cargo with the insurer and paid the insurance premium, and

42 Wang Ailing, *The Conflict Between the ‘Warehouse to Warehouse’ Clause of Marine Insurance and the Definition Principle of Insurable Interest in China and the Countermeasures*, Annual of China Maritime Law (2011), Vol. 22, 3, pp90 – 91. A similar opinion that economic interest should be decisive for the determination of insurable interest can also be found in Wang, supra note 41. Under Article 216 of the CMC, a contract of marine insurance is a contract whereby the insurer undertakes, as agreed, to indemnify the loss to the subject matter insured and the liability of the insured caused by perils covered by the insurance against the payment of an insurance premium by the insured. The covered perils referred to in the preceding paragraph mean any maritime perils agreed upon between the insurer and the insured, including perils occurring in inland rivers or on land which is related to a maritime adventure.

43 High People’s Court of Shandong Province, Civil Chamber No. 4, second instance, Civil Judgment [2012] No. 7 ([2012] Lu Min Si Zhong Zi No. 7).

44 High People’s Court of Hainan Province, Civil Chamber No. 3, second instance, Civil Judgment [2013] No. 7 ([2013] Qiong Min San Zhong Zi No. 7).

45 High People’s Court of Guangdong Province, Civil Chamber No. 4, second instance, Civil Judgment [2010] No. 176 ([2010] Yue Gao Fa Min Si Zhong Zi No. 176).

the insurer issued the insurance policy to the shipper. After the cargo was lost in the voyage, the shipper, as the insured, tendered indemnity claims to the insurer, which nonetheless rejected such claims on the ground that the shipper did not have insurable interest in the cargo as the shipper did not present the original B/L or the sales contract relating to the cargo. The High People's Court of Guangdong Province rebutted the insurer's contention, holding that, since the insurer failed to prove to the court that either (i) when the marine accident causing the loss of cargo occurred, the shipper had received payment for the cargo and thus, transferred insurable interest to the payer; or (ii) any party other than the shipper had tendered indemnity claims to the insurer, it was justifiable to admit the insurable interest held by the shipper; and such an insurable interests held by the shipper did not need to be evinced by the sales contract or the B/L. Similarly, the High People's Court of Zhejiang Province in *Zhao and others v PICC Wenzhou Branch*⁴⁶ found that, notwithstanding the fact that the insured was the registered owner of the ship concerned, as the insurer was aware of the existence of the actual owner as well as the affiliation agreement between the actual owner and the registered owner, the actual owner should be regarded as the actual insured who had insurable interest in the ship and was entitled to insurance indemnity.

¶6-040 Main Obligations of the Insured

¶6-041 Material facts

Prior to the conclusion of the insurance contract, the insured should truthfully inform the insurer of the material circumstances which the insured has knowledge of or ought to have knowledge of in its ordinary business practice and which may have a bearing on the insurer in deciding the premium or whether he agrees to insure or not.⁴⁷ The insured need not inform the insurer of the facts which the insurer has known of or the insurer ought to have knowledge of in its ordinary business

⁴⁶ High People's Court of Zhejiang Province, Civil Chamber No. 3, second instance, Civil Judgment [2007] No. 110 ([2007] *Zhe Min San Zhong Zi No. 110*).

⁴⁷ CMC, Art 222 para 1.

practice if about which the insurer made no inquiry.⁴⁸ That obligation of the insured is typically characterised as "duty of disclosure". Briefly, the duty of disclosure entails the insured to truthfully uncover, prior to the conclusion of the contract, material facts about the subject matter that may impact on the decision to be made by the insurer, unless the insurer is, or ought to be, aware of the facts in its ordinary business.

Remedies of the insurer for breach of the duty of disclosure by the insured include mainly the insurer's right to terminate the insurance contract or to increase the insurance premium. Where the insurer decides to terminate the contract, it is still liable for indemnity for damages caused by the insured accidents which occur prior to the termination of contract, unless the occurrence of the insured accidents relate to the uncovered information.⁴⁹

The above provisions under the CMC are criticised for being insufficiently clear in the following respects: (a) where the insurer decides to terminate the contract, whether the insurer is entitled to keep the insurance premium paid by the insured? (b) Where the insurer decides to terminate the contract, whether the insurer is entitled to due insurance premium before the termination of the contract? (c) Where the insurer decides to increase insurance premium, in which way can the amount of additional insurance premium be determined? (d) How can the impacts of the uncovered information on the occurrence of an insured accident be determined?⁵⁰ It is also argued that, the criterion for the successful discharge of the duty to disclose should be the principle of "good faith", rather than the principle of "utmost good faith" which is adopted typically in the common law systems, because (i) the meaning of the term "good faith" is more flexible than that of the term "utmost good faith", and therefore can be applied in different circumstances or stages of marine insurance; and (ii) the Insurance Law, which sets out the legal background of the provisions of the CMC, establishes the principle

⁴⁸ Ibid, Art 222 para 2.

⁴⁹ Ibid, Art 223.

⁵⁰ Wang Pengnan, *The Duty of Disclose and Legal Consequences of Breaching the Duty*, Annual of China Maritime Law (1993), Vol. 4, p167.

of good faith, rather than the principle of utmost good faith, as one of the fundamental values in the Chinese legal regime.⁵¹

Under the Insurance Law, the insurer is entitled to terminate the contract only when the insured breaches the duty of disclosure due to deliberation or gross negligence.⁵² Such a right to terminate the contract should be exercised within 30 days from the day when the insurer knows the cause of termination; in no case should the insurer possess the right to terminate the contract on that basis upon the lapse of two years or more from the day when an insurance contract is entered into. The insurer should nonetheless be liable for indemnity claims if the insured incidents occur before the termination of the contract.⁵³ The principle of estoppel was introduced into the latest amendment to the Insurance Law in 2009 – that is, where the insurer has knowledge of any material facts that are not covered by the insured when it concludes the insurance contract with the insured, the insurer should not be entitled to terminate the contract based on the above provisions, and should be liable for indemnity claims.⁵⁴

¶6-042 Insurance premium

Unless otherwise agreed in the insurance contract, the insured should, under the CMC, pay the premium immediately upon the conclusion of the contract; the insurer may refuse to issue the insurance policy or other insurance certificate before the premium is paid by the insured.⁵⁵ Where the insured was aware or ought to be aware, at the time of the conclusion of the contract, that the subject matter insured had suffered a loss due to an insured peril, the insurer should not be liable for indemnity but should be entitled to the insurance premium. Where the insurer was aware or ought to be aware, at the time of the conclusion of the contract,

51 This principle has been adopted by the Insurance Law in its 2003, 2009, and 2015 amendments. Insurance Law, Art 5. Zhu Zuoxian and Li Dong, *Should the Principle of Utmost Good Faith Be Adopted in CMC? – Theoretical Reconsideration on the Principle of Utmost Good Faith in the Marine Insurance Law*, Annual of China Maritime Law (2003), Vol. 14, p67.

52 Insurance Law, Art 16 para 2.

53 Ibid, Art 16 para 3.

54 Ibid, Art 16 para 6.

55 CMC, Art 234.

that the occurrence of an insured peril would be impossible, the insured should be entitled to the refund of the insurance premium it has paid to the insurer.⁵⁶

¶6-043 Warranties

After the entry into force of the insurance contract, the insured should notify the insurer in writing immediately where the insured has failed to comply with the warranties 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.⁵⁷

Against the backdrop that Chinese contract law does not employ the taxonomy of “condition” and “warranty” in the common law systems, the above provisions of the CMC are the only ones in the Chinese legal regime that introduce express warranties of the insured in the insurance contract.⁵⁸ It is also noticeable that implied warranties are not covered by those provisions.⁵⁹ Generally, where the insurer decides to terminate the contract based on breach of warranties by the insured, such termination of the contract should be effective proactively, rather than retroactively – that is, the rights and obligations of the two parties before the termination of the contract should not be affected.⁶⁰ It is further argued that, unless otherwise stipulated in the contract, where the insurer decides to terminate the contract based on breach of warranties by the insured, the insurer’s liability for indemnity arising prior to the termination of the contract may be exempted if the damages are caused by the breach of warranties.⁶¹

It is underscored that the right to terminate the contract based on breach of warranties under the CMC should be distinguished from the right

56 Ibid.

57 Ibid, Art 235.

58 Wang Xin, *On the Legal Consequence of Breach of Warranty in Marine Insurance*, Annual of China Maritime Law (2001), Vol. 12, p65.

59 Li Yuquan, *Study on the ‘Warranty’ System in the Marine Insurance Act*, Annual of China Maritime Law (2004), Vol. 15, p14.

60 Wang, supra note 58, p69.

61 Ibid, p72.

to terminate the contract based on the satisfaction of certain legally-prescribed conditions in Article 45 of the Contract Law,⁶² in particular given the consideration that, under the CMC, the insurer needs to take further actions where it decides to terminate the contract – such as notifying the insured about its decision; whereas, under the Contract Law, the contract terminates automatically from the time the agreed condition is satisfied.⁶³ A default on the typical warranty of the insured under ship insurance to remain the ship seaworthy may not only bring the insured into breaching both its warranties and the principle of good faith, but also empower the insurer to invoke the exemptions for indemnity liability as prescribed under the CMC.⁶⁴

¶6-044 Mitigation of loss

The insured assumes the obligation to mitigate the loss when the insured accidents occur – upon the occurrence of the insured peril, the insured should notify the insurer immediately and should take necessary and reasonable measures to avoid or mitigate the loss; where special instructions for the adoption of reasonable measures to avoid or mitigate the loss are given by the insurer, the insured should act according to such instructions.⁶⁵ The insurer's liability for indemnity may not be exempted

⁶² Under Article 45 of the Contract Law, the parties may agree to attach conditions on the validity of the contract; a contract with collateral conditions on its entry into effect shall become effective upon the fulfillment of the conditions; a contract with collateral conditions on its dissolution shall lose its validity upon the fulfillment of the conditions. Where either party, for the sake of its own interests, unjustifiably prevents the fulfillment of the aforesaid conditions, the conditions shall be deemed as fulfilled; where either party unjustifiably hastens the fulfillment of the conditions, the conditions shall be deemed as not fulfilled.

⁶³ Wang, *supra* note 58, p72.

⁶⁴ CMC, Art 244 para 1. Cai Fujun and Yu Jianlin, *Application of Law Regarding Warranties in Marine Insurance*, Annual of China Maritime Law (2011), Vol. 22, 1, p99. Under Article 244 paragraph 1 of the CMC, unless otherwise agreed in the insurance contract, the insurer shall not be liable for the loss of or damage to the insured ship 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; (2) wear and tear or corrosion of the ship.

⁶⁵ CMC, Art 236.

even if the measures adopted by the insured to avoid or mitigate the loss or damage bring about no effect.⁶⁶

¶6-045 Upgrade of risks

Under the Insurance Law, where the degree of peril of the subject matter insured greatly increases during the term of validity of the contract, the insured should notify the insurer in a timely manner as agreed upon in the contract, and the insurer may, as agreed upon in the contract, increase the insurance premium or terminate the contract. If the insurer terminates the contract, it should refund the insurance premium to the insured after deducting, as agreed upon in the contract, the receivable part from the day of commencement of insurance liability to the day of contract rescission. Where the insured fails to perform that obligation of notification, the insurer should not be liable for indemnification provided an insured incident occurs for the reason that the degree of peril the subject matter insured confronts greatly increases.⁶⁷

Despite the fact that the CMC does not attend to the insured's obligation to notify the increase of risks, the Insurance Law can apply as legal basis for pertinent stipulations in the marine insurance contract. In *China DD Property Insurance Co. v Shanghai GJ Engineering Co.*,⁶⁸ the High People's Court of Shanghai Municipality accentuated that the insured's obligation of notification arose only when the degree of risks upgraded. In addition, where the insurer complained about the insured's default in discharging that obligation, it should assume the burden of proof that the event which should have been notified by the insured had resulted in the upgrade of the degree of risks.

⁶⁶ SPC Provisions on Marine Insurance, Art 12.

⁶⁷ Insurance Law, Art 52.

⁶⁸ High People's Court of Shanghai Municipality, Civil Chamber No. 4, second instance, Civil Judgment [2010] No. 41 ([2010] Hu Gao Min Si (Hai) Zhong Zi No. 41).