INSURANCE LAW BETWEEN COMMERCIAL LAW AND CONSUMER LAW: CAN THE UNITED STATES INSPIRE CHINA IN INSURANCE MISREPRESENTATION

QIHAO HE[*] & CHUN-YUAN CHEN[**]

The theoretical argument behind the "pro-insured" or "pro-insurer" debate contains elements of contract law, business law, and consumer law. This article reexamines the insurance misrepresentation rule under the RLLI, ands compares it to insurance law in China. This comparison demonstrates the struggle between preference for insured or insurer. We have reconsidered the subtopics of misrepresentation, including innocent misrepresentation, materiality, reliance, remedy, contribute-to-the-loss approach and others, from not only the perspective of either party of the insurance contract, but also the overall efficiency of the insurance market and society. For the structure and remedy of insurance misrepresentation, we recommend a reasonable rule, which allows rescission for any kind of misrepresentation, but this is not equivalent to a rule that an insurer can rescind contract for any mistake of a policyholder. Rather than presetting remedies for misrepresentations, this rule asks a court to decide the proper remedy according to any important circumstances of the case, including severity of misrepresentation, accountability of policyholder, factual causation and so on.

I. INTRODUCTION

---

[*] Associate Professor of Law, China University of Political Science and Law, College of Comparative Law. Beijing, China. S.J.D., LL.M (Honors) in Insurance Law, University of Connecticut School of Law.

[**] Corresponding author. Associate Professor, Department of Risk Management and Insurance, College of Commerce, National Cheng-Chi University, Taiwan. J. S. D., LL.M., University of Illinois at Urbana-Champaign. Ph.D. in Law, China University of Political Science and Law. Ph.D. in Law, M.S., LL.B., National Cheng-Chi University. E-mail: cyc@mail2.nccu.tw.

The authors would like to thank the participants in the symposium of Was the World Turned Upside Down? The ALI Restatement of the Law, Liability Insurance held at the University of Connecticut School of Law & Rutgers Law School. Qihao He acknowledges the financial support of Ministry of Education Research Program on Catastrophe Insurance (No. 18YJC820024), and China University of Political Science and Law Research Program on Climate Change Insurance (No. 10818433), and Comparative Private Law Innovation Project of CUPL(No.18CXTD05).

This research aims to analyze and compare the development of the Restatement of the Law of Liability Insurance ("RLLI") in the United States and the Insurance Act in China, with a focus on misrepresentation. By exploring their theoretical bases, especially the consideration of consumer protection, we will examine their uniformity and then provide recommendations. In recent years, many countries have significantly modified their insurance laws. In 2008, Germany, the United Kingdom, and the United States all modified their respective insurance contract law[1] with the intention of enhancing the protection of insurance consumers. Additionally, the U.K. enacted a new Consumer Insurance (Disclosure and Representations) Act in 2012 and Insurance Act in 2015, significantly modifying the preexisting regulation structure of Marine Insurance Act 1906 ("MIA") and demonstrating different treatment for consumer insurance law and commercial insurance law.[2] In the U.S., the most recent and important innovation is the publishing of the Restatement of the Law of Liability Insurance, which includes many critical rules of insurance law. Similarly, the Principles of the Law of Liability Insurance ("PLLI"), an earlier version of the RLLI, contained relevant discussions reflecting concerns about the "pro-insurer rule" and the "pro-insured rule." These developments demonstrate the continuing struggle for balancing the interests of policyholders and insurers.

The RLLI was recently published and is still developing and attracting discussion from scholars and practitioners. This is in contrast to Germany and the U.K., which have both finished revolutionizing their insurance law. Despite its recent publication, the RLLI continues to attract criticism.[3] More importantly, the current RLLI does not use a pro-insured approach for all of its rules,[4] and thus provides a valuable opportunity to reconsider and reexamine the current and popular pro-insured rule.

China is another important and interesting jurisdiction. It is

---

[1] Versicherungsvertragsgesetz [VVG] [Insurance Contract Act 2008], Nov. 23, 2007, BGBL I at 2631, last amended by BGBL I at 3214 (Ger.), https://www.gesetze-im-internet.de/englisch_vvg/englisch_vvg.html#p0111.

[2] Paul Jaffe, *Reform of the Insurance Law of England and Wales-Separate Laws for the Different Needs of Businesses and Consumers*, 87 TUL. L. REV. 1075, 1078 (2013); Chun-Yuan Chen, *Reassessing Accountability and Sophistication of Insured in Insurance Misrepresentation: Lessons and Implications for Taiwan*, 9 ASIAN J.L. & ECON. 1, 3 (2018).

[3] George L. Priest, *A Principled Approach Toward Insurance Law: The Economics of Insurance and the Current Restatement Project*, 24 GEO. MASON L. REV. 635, 662 (2017).

[4] *E.g.*, Tom Baker & Kyle D. Logue, *In Defense of the Restatement of Liability Insurance Law*, 24 GEO. MASON L. REV. 767, 783 (2017).

now the second largest insurance market in the world, and remains on track to become the biggest by the mid-2030s.[5] China has had a long-term debate about the position of insurance law in relation to commercial law. In other words, is insurance law a part of commercial law, which requires less preference for the insured in legislation, or a part of consumer protection law, which implies more protection mechanisms for consumers? More importantly, this argument in China substantially originates from another fundamental controversy: separation or integration of the civil code and the commercial code. This issue is highly controversial when considered with the General Principles of Commercial Law, which consists of general provisions of commercial code, and the General Rules of the Civil Law. Relevant debates did not stop after the General Rules of the Civil Law of the People's Republic of China was promulgated in 2017.[6] Based on such similarity, they are a possible reference for each other.

Since misrepresentation is one of the most important and controversial issues in insurance law, this study will reexamine the consumer protection preference in the subtopic of misrepresentation, including innocent misrepresentation, materiality, reliance, remedy, contribute-to-the-loss approach and so on. In sum, this study will explore the continuing debates about the pro-insurer rule and pro-insured rule in the RLLI in the U.S., as well as substantive issues of insurance law in China, and try to find an optimal model for the rules of misrepresentation.

II. THE ALI RESTATEMENT OF THE LAW, LIABILITY INSURANCE ON THE RULE OF MISREPRESENTATION

A. DEVELOPMENT OF THE RLLI: PRO-INSURED OR PRO-INSURER RULE

Since insurance products usually involve consumers with less sophistication and bargaining power than insurers, standardized forms are generally used. Additionally, legal mechanisms for improving the status of the consumer are common in insurance law, such as *contra proferentem* and the reasonable expectation rule.[7] However, the mentioned rules may have

---

[5] *World Insurance: The Great Pivot East Continues*¸ SWISS RE INST. (2019), https://www.swissre.com/dam/jcr:b8010432-3697-4a97-ad8b-6cb6c0aece33/sigma3_2019_en.pdf.

[6] Siyi Lin, *Looking Back and Thinking Forward: The Current Round of Civil Law Codification in China*, 52 INT'L LAW. 439, 440 (2019).

[7] James M. Fischer, *Why Are Insurance Contracts Subject to Special Rules of Interpretation?: Text Versus Context*, 24 ARIZ. ST. L.J. 995, 1017 (1992). *But see* Hazel Glenn Beh, *Reassessing the Sophisticated Insured Exception*, 39 TORT TRIAL & INS. PRAC. L.J. 85, 86 (2003).

the issue of "pro-insured bias."[8] A similar situation happens in the substantial rules of insurance law. The American Law Institute ("ALI") began drafting Principles of the Law of Liability Insurance in 2010. In 2014, the ALI converted an existing PLLI into a Restatement of the Law of Liability Insurance, which "restates" rules from existing case law.[9] Substantial parts of the first three chapters were approved in the 2016 annual meeting. The final version of the RLLI was approved in 2018,[10] the contents of which are still subject to considerable debate, especially whether the proposed rules are excessively "pro-insured" or "pro-insurer."[11] Most of the concern is that the PLLI or RLLI are more improperly preferable towards insureds. They may be too strict on insurers, disrupt the fairness and efficiency of insurance contracts, and, in the end, let insurers raise insurance premiums to pass the cost to policyholders.[12] This also implies that the specific rules proposed in the RLLI may be a result of policy considerations, either for insureds, insurers, or both. Thus, it is worthy of more attention to clarify the "pro-insured" or "pro-insurer" ideas behind the RLLI, before attempting to justify them or exploring any other balancing alternatives.

---

[8] *E.g.*, Peter Nash Swisher, *A Realistic Consensus Approach to the Insurance Law Doctrine of Reasonable Expectations*, 35 TORT & INS. L.J. 729, 758 n.128 (2000) ("Even if insurance contracts involve standardized agreements provided in the proverbial 'take it or leave it' fashion, the pro-insured bias may amount to excessive correction if courts fail to accurately and precisely identify the danger that standardized agreements present."); Fischer, *supra* note 7, at 996-97.

[9] Victor E. Schwartz & Christopher E. Appel, *Encouraging Constructive Conduct by Policyholders in the Restatement of the Law of Liability Insurance*, 68 RUTGERS U. L. REV. 455, 456 (2015).

[10] Press Release, Am. Law. Inst., The American Law Institute Approves Restatement of the Law, Liability Insurance (May 22, 2018), https://www.ali.org/news/articles/american-law-institute-approves-liability-insurance/; *see also* Kenneth S. Abraham, *Plain Meaning, Extrinsic Evidence, and Ambiguity: Myth and Reality in Insurance Policy Interpretation*, 25 CONN. INS. L.J. 329, 331 (2018); Michael Menapace, *Going Beyond the Four Corners to Deny a Defense: A Critique of Section 13(3) of the Restatement of Liability Insurance*, 53 TORT TRIAL & INS. PRAC. L.J. 795, 799 (2018).

[11] Scott E. Harrington & Alan B. Miller, *Economic Perspectives on the Restatement of the Law on Liability Insurance Project* 2-3 (2017), https://ssrn.com/abstract=2941892; Jay M. Feinman, *The Restatement of the Law of Liability Insurance As A Restatement: An Introduction to the Issue*, 68 RUTGERS U. L. REV. 1, 19 (2015). As for the example of duty to settle, see Leo P. Martinez, *The Restatement of the Law of Liability Insurance and the Duty to Settle*, 68 RUTGERS U. L. REV. 155, 167 (2015).

[12] Schwartz & Appel, *supra* note 9, at 457–58. For more discussions, see Priest, *supra* note 3, at 662; Baker & Logue, *supra* note 4, at 783.

B. STRUCTURE AND REMEDY OF MISREPRESENTATION

Many of the proposed rules of misrepresentation are highly correlated to the theme of "pro-insured" or "pro-insurer." The first critical issue is the framework of misrepresentation, which relates to the subjective element, remedy issues, and the status of innocent misrepresentation. In the general rules of common law, an insurer may void an insurance contract if a policyholder supplies false and material information to the insurer.[13] However, in the earlier version of the PLLI, the draft had an innovation for misrepresentation rules.[14] First, the insurer could only rescind the policy when the misrepresentation was either intentional or reckless. Also, the misrepresentation had to satisfy the elements of materiality and reliance, and the insurer had to return all paid premiums.[15] In this way, for the policyholder's negligent or innocent misrepresentation, the insurer has no right to rescind the policy. Furthermore, if the policyholder satisfies the definition of large commercial policyholder, then the mentioned rule is not mandatory.[16]

The PLLI provides another novel remedy, quasi-reformation, for misrepresentation with no intention or recklessness:[17]

> If the insurer would have issued the same policy but at a higher premium if the correct information had been supplied at the time of the application or renewal, the insurer must pay the claim at issue but may collect from the policyholder or deduct from the claim payment the additional premium that would have been charged.[18]

If the insurer would not have issued the policy for any premium if the correct information had been supplied at the time of the application or renewal, the insurer must pay the claim at issue but may collect from the

---

[13] Schwartz & Appel, *supra* note 9, at 460.

[14] PRINCIPLES OF THE LAW OF LIAB. INS. § 7 cmt. b (AM. LAW. INST., Tentative Draft No. 1, 2013).

[15] *Id*. § 7(2) ("an insurer may decline to pay a claim on the basis of a false or misleading representation made by a policyholder during the application or renewal process for the insurance policy and may, after returning all premiums paid by the policyholder, rescind the policy only if all of the following conditions are met: (a) The misrepresentation was either intentional or reckless as defined in § 8; (b) The insurer reasonably relied on the misrepresentation in issuing or renewing the policy as specified in § 9; and (c) The misrepresentation was material as defined in § 10.").

[16] *Id*. § 7(5).

[17] *Id*. § 11 cmt. a.

[18] *Id*. § 11(1).

policyholder or deduct from the claim payment a reasonable additional premium for the increased risk.[19]

Thus, in the event that misrepresentation is neither intentional nor reckless, instead of rescission of the policy, the policyholder has the right to receive the proceeds minus the additional premiums. The mentioned rules are arguably more preferable for the policyholder.

However, such special rules for misrepresentation about the policyholder's intent and quasi-reformation remedy are both removed in the following RLLI, because there is no legal support in common law.[20] Also, the RLLI disregards the distinction between small and large commercial policyholders. In the current RLLI, rescission of the insurance contract is not limited to intentional or reckless misrepresentation,[21] and no special rule like quasi-reformation remedy is available for innocent misrepresentation. The remedy will not be different because of the sophistication of the policyholder either.[22] In the end, there is no obvious classification of misrepresentation which leads to a different remedy.[23] Insurers may rescind the policy even for innocent misrepresentation. The reporter in the RLLI justifies that the misrepresentation rule in many common law jurisdictions is substantially one of strict liability.[24] Thus, this rule is obviously more preferable for insurers, in contrast to the rule in the PLLI, which is preferable for policyholders.

Essentially, the rules in the PLLI (intentional and reckless misrepresentation rule) and the RLLI (strict liability misrepresentation rule) have opposing pros and cons. The PLLI's rule is more lenient for policyholders because one can still get coverage in the case of innocent or negligent misrepresentation. In contrast to the RLLI, under this rule, the insurer assumes the substantial risk of compensating innocent misrepresentations and this thereby encourages better underwriting.[25]

---

[19] *Id*. § 11(2).

[20] Baker & Logue, *supra* note 4, at 784.

[21] RESTATEMENT OF THE LAW LIAB. INS. § 7(1) (AM. LAW INST., Proposed Final Draft No. 2, 2018).

[22] *See* Caroline Wood, *A Reformation Remedy for Educators Professional Liability Insurance Policies*, 65 EMORY L.J. 1411, 1416 (2016).

[23] RESTATEMENT OF THE LAW LIAB. INS. § 7(2) (AM. LAW INST., Proposed Final Draft No. 2, 2018) ("Subject to the rules governing defense obligations, an insurer may deny a claim or rescind the applicable liability insurance policy on the basis of an incorrect representation made by a policyholder in an application for an insurance policy only if the following requirements are met: (a) The misrepresentation was material as defined in § 8; and (b) The insurer reasonably relied on the misrepresentation in issuing or renewing the policy as specified in § 9.").

[24] *Id*. § 7 cmt. j

[25] Lorelie S. Masters, Amy R. Bach & Daniel R. Wade, *The American Law Institute Principles/Restatement of the Law of Liability Insurance: Part*

However, criticisms are that the policyholder is in the better position to avoid innocent misrepresentation[26] because of his knowledge of his own experience and facts about the loss.[27] The PLLI shifts the burden of the investigation of the history of the insurance applicant from himself to the insurer, ignoring cost effectiveness.[28] Furthermore, misrepresentation may influence the insurer's assessment, and the estimation of the reasonable premium for increased risk in quasi-reformation remedy may be difficult.[29]

As for the RLLI rule, innocent misrepresentation is still subject to the remedy of rescission. The powerful remedy of rescinding the contract may provide a stronger incentive for the policyholder to comply with the duty of disclosure.[30] But there are fairness concerns because a mere innocent misrepresentation will make a policy voidable. Such result may be too harsh and unfair for the policyholder.[31] Some jurisdictions have other mechanisms to alleviate fairness issues, such as requiring the insurer to introduce evidence that it would not have approved the application if accurate information had been supplied.[32] Also, innocent misrepresentation is one of the risks that risk-averse policyholders prefer to shift to insurers, and thus this rule may not be efficient.[33]

Theoretically, the intentional and reckless misrepresentation rule in the PLLI is more pro-insured, whereas the strict liability misrepresentation rule in the RLLI is pro-insurer. Even though the intentional and reckless misrepresentation rule was present in an earlier version of the PLLI, it has been abandoned in the RLLI. Some parts of the RLLI keep the intentional and reckless misrepresentation rule, but it is just an option for courts instead of a proposed rule. For example, to defend Professor Priest's criticism that the intentional and reckless misrepresentation rule has concerns of efficiency, Professor Tom Baker and Professor Kyle Logue clarify that this rule is not applied in the RLLI, and it is retained as a possible alternative to the contribute-to-the-loss approach.[34] In other words, since the RLLI rejects the contribute-to-the-loss approach, if a court would like to alleviate the issue that can be addressed by such rule, it is better off considering the intentional

---

III Selected Comments from a Policyholder Perspective 35 (LexisNexis July 2015).

[26] Schwartz & Appel, *supra* note 9, at 464-65; Chen, *supra* note 2, at 8.

[27] Priest, *supra* note 3, at 654.

[28] *Id.* at 655.

[29] Schwartz & Appel, *supra* note 9, at 465.

[30] *Id*. at 464.

[31] RESTATEMENT OF THE LAW LIAB. INS. § 7 cmt. j (AM. LAW INST., Proposed Final Draft No. 2 2018).

[32] Masters, Bach & Wade, *supra* note 25, at 33.

[33] RESTATEMENT OF THE LAW LIAB. INS. § 7 cmt. j (AM. LAW INST., Proposed Final Draft No. 2 2018).

[34] Baker & Logue, *supra* note 4, at 786-87.

and reckless misrepresentation rule.[35] Regardless of the argument of efficiency, the development from PLLI to RLLI shows a shift from pro-insured rule to pro-insurer.

C. MATERIALITY

The RLLI defines the Materiality Requirement as: "but for the misrepresentation, a reasonable insurer in this insurer's position would not have issued the policy or would have issued the policy only under substantially different terms."[36] In order to distinguish the reliance element, the RLLI emphasizes that materiality is a purely objective inquiry in that the insurer needs to demonstrate that there is an objectively reasonable basis for the judgment in regular underwriting.[37] The criteria of that judgment is a "reasonable insurer" instead of a particular or "ordinary or average" insurer, because this rule may better cover the scenario where an innovative insurer asks the questions that ordinary insurers would not.[38] In such a case, the question asked by an innovative insurer is generally not asked by an ordinary or average insurer. In this sense, an ordinary insurer is less likely to satisfy the reasonableness standard. Thus, it seems that the reasonable insurer standard is stricter for an insurer and more preferable for a policyholder.

D. RELIANCE

The RLLI defines the reasonable reliance requirement as: "[t]he reliance requirement of § 7(2)(b) is met only if: (1) but for the misrepresentation, the insurer would not have issued the policy or would have issued the policy only with substantially different terms; and (2) Such actions would have been reasonable under the circumstances."[39] In contrast to materiality, reliance in the RLLI is primarily defined as a subjective element, identifying "the impact of misrepresentation on the particular insurer."[40] The reasonableness element in reliance, an objective element, focuses on "whether the insurer reasonably failed to discover or act upon the truth." An insurer must prove that an objectively reasonable insurer in the insurer's position would not discover the misrepresentation.[41] Similar to the objective materiality issue, an insurer needs to prove reliance to the degree of a reasonable insurer. This may urge an insurer to conduct further and more

---

[35] RESTATEMENT OF THE LAW LIAB. INS. § 9 cmt. b. (AM. LAW. INST., Proposed Final Draft 2018).

[36] *Id.* § 8.

[37] *Id.* § 8 cmt. c.

[38] *Id*. § 8 cmt. d.

[39] *Id*. § 9.

[40] *Id*. § 9 cmt. a.

[41] *Id*. § 9 cmt. d.

serious investigation to satisfy this element.[42] Overall, it is harsher for an insurer and more advantageous for a policyholder.

As mentioned above, the RLLI clarifies objective elements in materiality and reliance. The insurer has the responsibility to prove that and assumes risk if he fails to do so. This also attracts some criticisms, such as: "these rules … will have the economic effect of reducing insurance availability to the society by increasing the costs and reducing the predictability of the underwriting process."[43] Generally, rules for materiality and reliance are more preferable for a policyholder than an insurer.

E. CONTRIBUTE-TO-THE-LOSS APPROACH

Another important issue is that, unlike some jurisdictions, the RLLI rejects the contribute-to-the-loss rule, which is also referred to as the causal relation doctrine.[44] Under this rule, an insurer cannot reject a claim from a policyholder if there is no causal relation between the accident and the fact misrepresented. The RLLI does not follow this approach for the following reasons: first, the current RLLI rule is better off than the contribute-to-the-loss rule, because all kinds of misrepresentation will be penalized rather than only misrepresentations which contribute to the loss;[45] second, when the precise relationship between cause of loss and misrepresentation is hard to prove, an insurer will substantially suffer the cost. Unfair cross-subsidies occur here since a high-risk policyholder who has misrepresented without precise evidence of causation may be subsidized by a low-risk policyholder who does not misrepresent at all.[46] There is no sufficient common law authority to support this rule.[47] Finally, as mentioned above, the RLLI suggests that the benefit of the contribute-to-the-loss rule can be better addressed by applying the intentional/reckless approach, which limits rescission to the case where the policyholder misrepresentation is intentional or reckless.[48]

The current approach applies the increased-risk standard in materiality instead of the contribute-to-the-loss approach. However, this is still subject to some criticisms, such as the fact that the proposed rule and reason are lacking sufficient support and explanation. Also, as a suggested

---

[42] *Id.*

[43] Priest, *supra* note 3, at 655.

[44] *Compare* RESTATEMENT OF THE LAW LIAB. INS. § 9 cmt. b (AM. LAW INST., Proposed Final Draft No. 2, 2018), *with* Henrik Lando, *Optimal Rules of Negligent Misrepresentation in Insurance Contract Law*, 46 INT'L. REV. L. & ECON. 70, 71 (2016).

[45] RESTATEMENT OF THE LAW LIAB. INS. § 9 cmt. b (AM. LAW INST., Proposed Final Draft No. 2, 2018).

[46] *Id.*

[47] *Id.*

[48] *Id.*

alternative for the intentional/reckless approach, it may fail to clarify the insurer's burden of proof.[49] Generally, the RLLI rejects the contribute-to-the-loss rule, and thus an insurer can rescind the policy as long as misrepresentation occurs regardless of the relationship between cause of loss and misrepresentation. Across the spectrum of pro-insurer and pro-insured, the RLLI rule is obviously more pro-insurer.[50]

III. CHINESE INSURANCE LAW ON THE RULE OF MISREPRESENTATION

One of the greatest achievements or efforts of the RLLI is conceptualizing insurance law as a unique field.[51] The Sino-American comparative research is motivated by the debate whether the particular proposed rules of both the RLLI in the U.S. and the Insurance Act in China (as well as the Supreme People's Court Judicial Interpretations on Certain Questions Concerning the Application of the Insurance Act)[52] might be construed as either "pro-insured" or "pro-insurer" when facing legal action.[53] The theoretical argument behind the "pro-insured" or "pro-insurer" debate is the controversy that exists between insurance contract law, business law, and consumer law. Comparative thinking is, therefore, best informed by highlighting a few of the distinctions between American and Chinese insurance law and litigation. We explore and argue that the proposed insurance rules, whether "pro-insured" or "pro-insurer," should be "in the long-term interest of policyholders with respect to maximizing the availability of insurance to society."[54] And we will apply this benchmark to test Chinese rules in the area of misrepresentation.

---

[49] Masters, Bach & Wade, *supra* note 25, at 34.

[50] Baker & Logue, *supra* note 4, at 782-83.

[51] *Tom Baker works to define the field of liability insurance law*, PENN LAW (June 20, 2016), https://www.law.upenn.edu/live/news/6274-tom-baker-works-to-define-the-field-of-liability#.V2lC3qIsAwd.

[52] According to the Stipulation of the Supreme People's Court on the Judicial Explanation (2007 No. 12), the Supreme People's Court judicial interpretation has legal effect. And it is worth to state the role of the Supreme People's Court and its Judicial Interpretation. Since China is not the case law system, it means that insurance law principles are largely uniform law developments built up from predominantly the Judicial Interpretations (not all the decisions) of Supreme People's Court of China that are binding on the entire country. *See The Stipulation of the Supreme People's Court on the Judicial Explanation*, 13 New Laws and Regulations 45, 45-48 (2007).

[53] Harrington & Miller, *supra* note 11.

[54] Priest, *supra* note 3, at 653

A. A BRIEF OVERVIEW OF CHINESE INSURANCE LEGISLATION AND ITS GUIDING PRINCIPLES

The first statute on insurance was enacted in 1995 and included provisions on both insurance contracts and insurance regulation.[55] The Insurance Act of 1995 was then amended in 2002, 2009, and 2015. The Insurance Act of 1995 adopted de facto more pro-insurer rules than its amendments in order to enhance the development of insurance business, and thus provided more incentives for insurers while paying less attention to consumer protection.[56] The good thing is that China's insurance industry has developed dramatically since 1995. The data shows that in less than 20 years, the annual premium income has risen *2800%* through 2017, making China the second largest insurance market in the world.[57] Unfortunately, the insurance business earned a bad reputation due to the difficulty of getting compensation for the insured.[58] And that is why the consumers often view the insurers as liars. Over time, the fast growth of the insurance market and an increasing number of consumers created a demand for more regulation to protect consumers.[59]

The long-awaited 2009 amendment expressly expanded consumer rights and provided more protection provisions for the insured by replacing major articles of the original act. This transition reflects the legislator's shift in attitude from emphasizing the development of the insurance industry to embracing consumer protection, and from emphasizing freedom of contract to accepting contractual justice.[60] In addition, since 2009, the Supreme People's Courts ("SPC") has published four judicial interpretations of the Insurance Act: in 2009 (the SPC Interpretation I), 2013 (the SPC Interpretation II), 2015 (the SPC Interpretation III) and 2018 (the SPC

---

[55] ZHEN JING, CHINESE INSURANCE CONTRACTS LAW AND PRACTICE 32-43 (2017).

[56] WEI ZHENG, GAIGE KAIFANG SISHINIAN DE BAOXIAN JIANGUAG [THE 40 YEARS INSURANCE REGULATION IN THE AFTERMATH OF REFORM AND OPENING UP] 73-77 (China Acad. Journal Elec. Publ'g House 2019).

[57] Editorial, *China's Awakening Sends Shockwaves Around the World*, ATLAS MAG., 1 (Oct. 2018), https://www.atlas-mag.net/en/issue/china-s-awakening-sends-shockwaves-around-the-world.

[58] CHRISTIAN NOTHHAFT, MADE FOR CHINA: SUCCESS STRATEGIES FROM CHINA'S BUSINESS ICONS 151 (Springer Int'l Publ'g 2018).

[59] Kaun-Chun Chang, *Commentaries on the Recent Amendment of the Insurance Law of the People's Republic of China Regarding Insurance Contracts from the Perspective of Comparative Law*, 10 WASH. U. GLOBAL STUD. L. REV. 749, 752-53 (2011).

[60] XU CHONGMIAO & LI LI, ZUI XIN BAO XIAN FA SHI YONG YU AN LI [NEWLY AMENDED INSURANCE LAW—APPLICATION & CASES] 14 (2009).

Interpretation IV),[61] and aims to clarify the ambiguous articles of the Insurance Act in order to strengthen the protection of the insured.

In contrast, in the U.S., the transition of the Principles Project to a Restatement raised vigorous opposition from the insurance industry concerning many pro-insured provisions, with the rule of misrepresentation being one of the most contentious provisions.[62] China made major modifications regarding insurance misrepresentation, and the guiding principle of the 2009 Amendment, the subsequent Amendments, and the SPC Interpretations is to enhance consumer protection and mitigate the insured's responsibility.[63]

B. STRUCTURE AND REMEDY OF MISREPRESENTATION

In the RLLI, misrepresentation is defined as an incorrect statement of fact made by a policyholder in an application for an insurance policy, and there are two requirements (materiality and reasonable-reliance) for which an insurer may deny a claim or rescind the applicable insurance policy.[64] In Chinese insurance law, misrepresentation falls under the insured's duty of disclosure, since it was originally introduced to protect the interest of insurers due to information asymmetry.[65] The general rule of the insured's misrepresentation is Article 16 of the Insurance Act (2015). This rule has been modified several times, especially by the Insurance Act (2009) and SPC Interpretation II (2013), focusing on the protection for insurance consumers. It provides that:

> Article 16
>
> (1) Where the insurer makes any inquiry about the subject matter insured or about the insurant when entering into an insurance contract, the insurance applicant shall tell the truth.
>
> (2) The insurance applicant fails to perform the obligation of telling the truth as prescribed in the preceding paragraph intentionally or for gross negligence, which is enough to affect the insurer's decision on whether to underwrite the insurance or raise the insurance premium, and thus the insurer shall have the right to rescind the contract.

---

[61] The Interpretation I 2009 focuses on the application of the Insurance Act 2009 amendment. The Interpretation II 2013 is mainly on general rules of insurance contracts. The Interpretation III 2015 focuses on life insurance, while the Interpretation IV 2018 focuses on property and liability insurance.

[62] Schwartz & Appel, *supra* note 9, at 460-65.

[63] Chang, *supra* note 59, at 767.

[64] RESTATEMENT OF THE LAW LIAB. INS. §§ 7-9 (AM. LAW INST. 2019).

[65] HAILIN ZOU, INSURANCE LAW 126 (2017).

> (3) The right to rescind as stated in the preceding paragraph shall be extinguished if not exercised within 30 days of the time the insurer knows of the cause for rescission. Once 2 years have elapsed after the contract is entered into, the contract may not be rescinded even if cause for rescission exists; where an insured incident occurs, the insurer shall be liable for paying indemnity or insurance benefit.
>
> (4) Where the insurance applicant intentionally fails to perform the obligation of telling the truth, the insurer shall not be liable for paying indemnity or insurance money for an insured incident that occurs before the contract is rescinded, and shall not refund the insurance premium.
>
> (5) Where an assured in gross negligence fails to make truthful disclosure so as to contribute materially to the occurrence of an insured event, the insurer shall not be liable for paying indemnity or insurance money for an insured incident which occurs before the contract is rescinded, but shall refund the insurance premium.
>
> (6) Where the insurer knowing the truth which the insurance applicant fails to tell enters into an insurance contract with the insurance applicant, the insurer shall not rescind the contract and, if an insured incident occurs, shall be liable for paying indemnity or insurance money.[66]

Section 1 proclaims the insured's duty of disclosure. Section 2 defines the meaning and elements of failure to meet the duty of disclosure. That includes: (a) subject fault ("intentionally or gross negligence"); (b) materiality ("affect the insurer's decision on whether to underwrite the insurance or raise the insurance premium"); and (c) remedy for breach of the duty ("the insurer shall have the right to rescind the contract"). Section 3 and 6 stipulate the limitations of the insurer's remedies, which is also called the incontestability clause and the waiver clause. Section 4 and 5 discuss the consequences due to the insured's intentional failure to disclose a material fact or by gross negligence respectively.

The Insurance Act provides different legal remedies depending on the type of breach. If the insured intentionally misrepresents material facts in applying for insurance, the insurer is entitled to rescind the contract, is not responsible for the loss, and does not have to refund the premium. If the insured misrepresents material facts by gross negligence, the insurer is entitled to rescind the contract, is not responsible for the loss, but has to

[66] Insurance Law of the People's Republic of China (promulgated by the Standing Comm. Nat'l People's Congr., June 30, 1995, effective April 24, 2015), art. 16.

refund the premium.[67] If the insured only negligently or innocently misrepresents material facts, the insurer is not entitled to rescind the contract, and is liable for the loss caused by the insured occurrence.[68] Unlike the RLLI rule, where innocent misrepresentation is still subject to the remedy of rescission, China has adopted and maintained a pro-insured rule since its 2009 Amendment.

For intentional misrepresentation there is little debate, but not for gross negligence. It could be justified to punish the policyholder for intentionally violating the duty of disclosure. It might not be justified for instances of gross negligence considering the non-sophistication of the insured in risk assessment. The insured could only get the refund premium due to gross negligence, however, he or she has no right to ask for insurance compensation. This "all-or-nothing" legal consequence seems too harsh for the insured, since it is the same result if he or she intentionally breaches the duty. As for the alternative and more pro-insured choice, it is suggested that the insurer may reduce the compensation amount "to be paid proportionately to the ratio of premium he received and the premium he should have received."[69]

As remedies for the insurer, he enjoys the right of contract rescission (Rücktritt) and the right of nonpayment of claims. In order to protect the insured, the insurer shall rescind the contract at first and then declare for the right of nonpayment of claims.[70] In other words, the insurer could not refuse to pay the claims directly without contract rescission.

C. THE SCOPE OF THE DUTY OF DISCLOSURE: INQUIRY-BASED DISCLOSURE

There are two types of disclosure: inquiry-based disclosure and voluntary disclosure. Originally, the insured voluntarily disclosed the material information to assist the insurer in risk assessment, since the

---

[67] *Id.*

[68] Insurance Law of the People's Republic of China (promulgated by the Standing Comm. Nat'l People's Congr., June 30, 1995, effective Oct. 1, 2009), art. 16; Insurance Law of the People's Republic of China (promulgated by the Standing Comm. Nat'l People's Congr., June 30, 1995, effective Oct. 28, 2002), art. 17.

[69] Zhen Jing, *Remedies for Breach of the Pre-Contract Duty of Disclosure in Chinese Insurance Law*, 23 CONN. INS. L.J. 327, 346-47 (2017).

[70] Zuìgāo Rénmín Fǎyuàn Guānyú Shìyòng "Zhōnghuá Rénmín Gònghé guó Bǎoxiǎnfǎ" Ruògān Wèntí De Jiěshì (Er) (最高人民法院关于适用《中华人民共和国保险法》若干问题的解释 (二)) [Interpretation of the Supreme People's Court on Several Issues Concerning the Application of the Insurance Law of the People's Republic of China (2)] (Sup. People's Ct. 2013).

insurance contract is traditionally regarded as the utmost good faith contract.[71] The Maritime Code of China includes the provisions on marine insurance that adopts voluntary disclosure.[72] It reads in pertinent part:

> Article 222
>
> [B]efore 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.[73]

However, the voluntary disclosure approach means that the insured's duty of disclosure is not limited to the scope of the insurer's inquiry, and the adverse consequences that the insured fails to inform will be imposed on the insured.[74] It puts a pretty heavy burden on the insured, and seems neither reasonable nor fair for the unsophisticated insured. Therefore, the Insurance Act of 1995 disregarded voluntary disclosure and directly adopted the inquiry-based disclosure. Article 16 (1) of the Insurance Law, as amended in 2009 and 2015 follows the same approach. This approach is clearly the pro-insured rule, which encourages the regulatory and constructive conduct of the insurer. The regulatory function of the insurer, which reflects the socioeconomic role of insurance, is a valuable lens for supporting the pro insured rules and adjudicating the insurers' operation.[75]

From voluntary and active disclosure to inquiry-based passive notification, the insured will only provide information to the extent that the insurer asks. It raises two disputed questions. The first question is whether the insured should inform the insurer of the information outside the scope of the insurer's inquiry, if the information is material. The China Insurance Regulatory Commission (CIRC) once affirmed the recognition that if the insurer does not ask, the insured need not inform.[76] However, one year later,

---

[71] Chang, *supra* note 59, at 764.

[72] *See* Maritime Code of the People's Republic of China (promulgated by the Standing Comm. People's Cong., Nov. 7, 1992, effective Nov. 7, 1992), art. 222, http://www.ilo.org/dyn/natlex/natlex4.detail?p_lang=en&p_isn=31944&p_country=CHN&p_count=1097 (China).

[73] *Id.*

[74] ZOU, *supra* note 65, at 125.

[75] Jeffrey W. Stempel, *Enhancing the Socially Instrumental Role of Insurance: The Opportunity and Challenge Presented by the ALI Restatement Position on Breach of the Duty to Defend*, 5 U.C. IRVINE L. REV. 587, 590 (2015).

[76] Notice on Problems in Rectifying Life Insurance Clauses (promulgated by the China Ins. Regulatory Comm'n, 2006, effective 2006),

the CIRC restated that if the insured knows or should know that certain material matters involve the determination of the insurability, which affects the insurer's decision whether to underwrite or increase the insurance premium, even if the insurer has not made a clear inquiry, the insured should inform the insurer of the information.[77] To restrict the insured's obligation, the SPC Interpretation clarified that for the information outside the inquiry form, the insured is obligated to disclose only what he actually knows, not what he should know.[78]

The second question is whether all the questions the insurer asked fall into the scope that the insured has to answer, especially for the general clauses listed in the insurance policy inquiry form. This question is not addressed in the Insurance Act, but the SPC Interpretation II clarifies that not all the questions asked by the insurer should be truthfully informed.[79] If the insurer is not asking about important facts, the insured does not breach the duty even by concealing or misrepresenting.[80] In other words, the insurer's inquiry needs to be material facts which could restrict the insured. The next issue is to explore how to decide the materiality of the facts, which is also one element of the breach of the duty of disclosure.

D. MATERIALITY

Among the questions asked by the insurer, the facts that involve the assessment of the underwritten risks should be material facts. A material fact is defined as one "[which] is enough to affect the insurer's decision on whether to underwrite the insurance or raise the insurance premium."[81] There are two questions left to be addressed for the definition. First, it is still unsettled that the term "insurer" mentioned in Art. 16(2) should be understood as either the insurer in the specific case ("the subjective standard") or a reasonable insurer ("the objective standard"). Considering the protection

---

no. 318 (This Notice has been abolished).

[77] Reply on Issues Related to Insurance Contract Disputes (promulgated by the China Ins. Regulatory Comm'n, Feb. 21, 2006, effective Feb. 21, 2006).

[78] Interpretation of Supreme People's Court on Several Issues pertaining to Application of the Insurance Law of the People's Republic of China (II) (promulgated by the Sup. People's Ct., May 31, 2013), art. 5; *see also* Jing, *supra* note 69, at 331.

[79] Interpretation of Supreme People's Court on Several Issues pertaining to Application of the Insurance Law of the People's Republic of China (II) (promulgated by the Sup. People's Ct., May 31, 2013), art. 6.

[80] Min Chang, *Study on Insurance Contract Incontestability System*, 2 GLOBAL L. REV. 76-91 (2012).

[81] Insurance Law of the People's Republic of China (promulgated by the Standing Comm. Nat'l People's Cong., June 30, 1995, effective Apr. 24, 2015), art. 16.

of the insured, especially the non-sophistication and reasonable expectations of the insured, many courts have adopted the "objective standards" and treated the insurer as the prudent insurer.[82]

Second, in contrast to the RLLI, Chinese insurance law has not proscribed what approach could be used to evaluate materiality. In judicial practices, different courts adopted different judgment standards, which ultimately led to far-reaching judgment results. Previously, as a general rule, all the questions specifically asked by the insurer are important facts.[83] However, the SPC Interpretation denied this approach, but adopted a more pro-insured attitude: "not all the questions asked by the insurer should be truthfully informed."[84] It indicates that if the question asked by the insurer is not a material fact, the insured could reject information or misrepresent without adverse consequence.

For this issue, the RLLI adopts the pro-insurer rule "increased-risk standard in materiality" and rejects the "contribute-to-the-loss" approach.[85] However, following the central philosophy of consumer protection, China adopts the pro-insured "contribute-to-the-loss" approach, and puts the burden on the insurer in misrepresentation, at least for misrepresentation made by the "gross negligence" of the insured.[86]

E. SUBJECT FAULT: INTENTIONALLY OR GROSS NEGLIGENCE

The subject fault of the duty of disclosure matters not only in evaluating materiality, as discussed above, but also causes different legal consequences which we will discuss in the next section. The subjective fault in the Insurance Act 2009 Amendment was changed from "negligence" to "gross negligence," and thus it only distinguishes misrepresentation that can

---

[82] Zhen Jing, *Insured's Duty of Disclosure and Test of Materiality in Marine and Non-Marine Insurance Laws in China*, J. BUS. L. 681, 686-87 (2006).

[83] XIN CHEN, INSURANCE LAW 64 (2010).

[84] Interpretation of Supreme People's Court on Several Issues pertaining to Application of the Insurance Law of the People's Republic of China (II) (promulgated by the Sup. People's Ct., May 31, 2013), art. 6.

[85] Baker & Logue, *supra* note 4, at 782-83. For a discussion of the contribution to the loss rule in relation to materiality, see generally Kathryn H. Vratil & Stacy M. Andreas, *The Misrepresentation Defense in Causal Relation States: A Primer*, 26 TORT & INS. L.J. 832, 835 (1990).

[86] Insurance Law of the People's Republic of China (promulgated by the Standing Comm. Nat'l People's Cong., June 30, 1995, effective Apr. 24, 2015), art. 16 ("Where a policyholder failed to perform the obligation to provide truthful information due to gross negligence which has a serious impact on the occurrence of an insured event, the insurer shall not be liable to make compensation or payment . . .").

be made intentionally or by gross negligence.[87] In other words, the subjective fault of the insured is limited to "intentionally or [through] gross negligence," and thus increases the protection for the insured. The significance of China's insurance law adopting the "gross negligence" instead of "negligence" of the policyholder as the subject fault, may not only expand the degree of insured's fault, but also provide a more operational path to limit the insurer's right of rescission of the contract.[88] However, the problem is that there is no definition of "gross negligence" in the Act, and this creates confusion in deciding to what extent the insured's misrepresentation can be attributed to "gross negligence" rather than "negligence."[89]

The Insurance Act of 1995 provided a similar rule to that of the RLLI, "[i]f the assured fails to make such a disclosure as provided in the preceding paragraph in negligence, and such breach of disclosure duty is material for an insured event, insurer could rescind the contract and return the premium."[90] However, the Insurance Act of 2009 Amendment protects "innocent misrepresentation" only if the insured made the misrepresentation with intent to deceive or gross negligence. In those instances, the insurer could rescind the contract.[91] The Insurance Act of 2009 Amendment adopts a similar pro-insured rule to that in the PLLI.[92]

F. A SHORT SUMMARY

As for the nature of insurance law, in the U.S., it "is neither a branch of private contract law nor of public commercial law, but is its own field that

---

[87] *Id.*

[88] ZOU, *supra* note 65, at 130.

[89] *See, e.g.*, Ergang Chen v. China Life Luliang County Branch, YunNan Luniang District People's Court, No. 1233 (2018); Yingchun Huo v. China Pingan Insurance Chifeng Branc, Inner Mongolia Hongshan District People's Court, No. 474 (2015).

[90] Insurance Law of the People's Republic of China (promulgated by the Standing Comm. Nat'l People's Cong., June 30, 1995, effective June 30, 1995), art. 16.

[91] Changyin Han, *A Comparative Review on Mainland and Taiwan Insurance Contract Law: Focus on Mainland Insurance Act 2009 Amendment*, 7 INS. STUD. 3, 7-8 (2009).

[92] Schwartz & Appel, *supra* note 9, at 462-63 ("Where a policyholder negligently provided information to obtain an insurance policy, the Principles project established a novel 'quasi-reformation remedy.'"). Under this approach, the insurer was required to pay the claim of the negligent policyholder in full but could recoup some higher premium for the increased risk the insurer would have undertaken had the policyholder supplied the correct information when asked. *See* PRINCIPLES OF THE LAW OF LIAB. INS. § 7 cmt. b (AM. LAW INST., Tentative Draft No. 1, 2013).

includes aspects of both public and private law."[93] In China, under the background of the drafting Civil Code, insurance law is not seriously governed by the forthcoming Civil Code. There are only a few articles related to auto compulsory liability insurance (with Traffic Accident Social Assistance Fund) in the section of tort liabilities, for the purpose of providing compensation to the insureds and the third-party victims.[94] Insurance contracts were originally considered to be commercial contracts since their oldest form is marine insurance. From this perspective, insurance law should be regarded as part of commercial law. However, there is no General Principles of Commercial Law, let alone the Commercial Code in China. Insurance law constitutes the subject of special legislation as its own field in China.

Similar to the RLLI, China has no special rules or acts excluding the application of insurance law to business insurance. Thus, the current laws regarding the duty of disclosure shall be applied for all insureds. Moreover, China does not distinguish "sophisticated commercial insureds"[95] from "individual insureds," which resembles the difference between "business insurance" and "consumer insurance."

It is also worth using the developments in behavioral science to determine what consumers understand and why pro-insured rules are credited.[96] In addition, insurance technologies have enabled the insurer to better evaluate risk and underwrite the policy. On the contrary, behavioral economists explain consumers' anomalies as intuitive thinking bias in risk assessment.[97] What's more, the insured may conduct myopic loss aversion.[98] He or she may simply ignore the adverse consequences of misrepresentation and will not disclose all information voluntarily in fear of a higher premium,

---

[93] Jeffrey E. Thomas, *Insurance Law Between Business Law and Consumer Law*, 58 AM. J. COMP. L., 353, 353 (2010).

[94] Zhōnghuá Rénmín Gònghéguó Mínfǎ Diǎn Caoan (中华人民共和国民法典草案)[Civil Code of the People's Republic of China (draft)] (promulgated by Nat'l People's Cong., March 2020), art. 1213, 1215, 1216, https://npcobserver.files.wordpress.com/2019/12/civil-code-draft.pdf, 232-33, *translated in* google translate.

[95] The sophisticated insured doctrine is often regarded as one pro-insured rule since it is a common law rule that distinguishes (to some extent) between commercial and individual insurance consumers in the U.S. Since there is no uniform definition as to what constitutes a sophisticated insured, and it has not gained universal acceptance, this doctrine is not adopted in the RLLI. *See* Thomas, *supra* note 93, at 362-63.

[96] James Davey, *Fracturing and Bundling Risks: The Coverage Expectations of the "Real" Reasonable Policyholder*, 11 RUTGERS J. L. & PUB. POL'Y 118, 167 (2013).

[97] DANIEL KAHNEMAN, THINKING, FAST AND SLOW 20–21 (2011).

[98] *See* Shlomo Benartzi & Richard H. Thaler, *Myopic Loss Aversion and the Equity Premium Puzzle*, 110 Q.J. ECON. 73 (1995).

and this attitude makes consumers underestimate the risks of being exposed to harsh consequences.

IV. COMPARATIVE COMMENTS AND IMPLICATIONS

A. STRUCTURE AND REMEDY OF MISREPRESENTATION

1. Clarification of the RLLI

The RLLI in the U.S. and insurance law in China share important differences as well as similarities. One of the most critical differences will be the structure and remedy of misrepresentation. China differentiates rescission of contract according to the accountability of the policyholder. Insurers may rescind an insurance contract for a policyholder's intentional and reckless misrepresentation, but not for an innocent one. This model is similar to the rules in the United Kingdom, Germany, and the intentional/reckless approach in the PLLI. In the U.S., the RLLI changes the rule in the PLLI and does not categorize misrepresentation according to the accountability of the policyholder. Any misrepresentation may cause rescission of the insurance contract by the insurer, and this is in fact a strict liability rule. The structure and remedy of misrepresentation in the RLLI and China are likely in different positions on the spectrum, but their development may have implications for each other.

Even though the current rule in the RLLI is the strict liability misrepresentation rule, it is worth scrutinizing the reason why it abandons the intentional and reckless misrepresentation rule and its justification for doing so.[99] In the early version, the PLLI adopted an intentional and reckless misrepresentation rule as an "innovation," because the strict liability misrepresentation rule is unfair and inefficient. The loss caused by an unintentional mistake shall be one of the risks that the policyholder purchases liability insurance for.[100] Policyholders also purchase liability insurance for the purpose of "shifting the financial risks of their negligent conduct to insurers."[101] In other words, it is more likely justified to punish intentional misrepresentation, since this is correlated to adverse selection from policyholder. This will let the honest members of the insurance pool cross-subsidize dishonest members. However, an honest mistake would be less likely to cause this concern, and to cover such loss is generally the purpose of purchasing liability insurance.[102] Thus, "the strict liability version of the misrepresentation defense is also inefficient, insofar as it

---

[99] Baker & Logue, *supra* note 4, at 786.

[100] PRINCIPLES OF THE LAW OF LIAB. INS. § 7 cmt. b (AM. LAW INST., Tentative Draft No. 1 2013).

[101] *Id.*

[102] Baker & Logue, *supra* note 4, at 784.

results in a misallocation of risk."[103]

Interestingly, the later version of the RLLI abandons the intentional and reckless misrepresentation rule and replaces it with the strict liability misrepresentation rule. However, it seems that there are no further and theoretical reasons for this change, except the explanation that there is no sufficient common law authority to support the intentional and reckless misrepresentation rule.[104] In later debates between the Reporters and Professor Priest at Yale Law School, they emphasize and clarify that the intentional and reckless misrepresentation rule is no longer adopted in the RLLI, but they still once again explain the possible unfairness and inefficiency of the strict liability misrepresentation rule.[105] But for the reason that the restatement is to "restate the common law governing all such liability insurance contracts" rather than create a new rule,[106] Reporters do not theoretically reject the intentional and reckless misrepresentation rule. More likely, the Reporters reluctantly accepted the strict liability misrepresentation rule for the RLLI. Regardless of the nature of the restatement and policy considerations, it should be fair to say that the RLLI does not theoretically reject the intentional and reckless misrepresentation rule. In this sense, it may be too quick to say the RLLI prefers the current strict liability misrepresentation rule and negates the intentional and reckless misrepresentation rule.

2. Efficiency issue

As discussed, the U.S. changed from the more pro-insured PLLI to the more pro-insurer RLLI. Conversely, China changed the Insurance Act from preferring insurers to preferring policyholders. It is also worth considering other possible justifications for the current or alternative rule for misrepresentation, including efficiency of society. Even though the policyholder's risk of innocent misrepresentations would be better off transferred to the insurer, the insurer is substantially less likely to prevent such misrepresentations. In contrast, the policyholder is more likely to possess the necessary information for the insurance application and better control the possibility of mistake.[107] In the intentional and reckless misrepresentation rule, the policyholder may have less incentive to prevent innocent misrepresentation, because the insurer has to pay for insurance proceeds. From this viewpoint, the strict liability misrepresentation rule,

---

[103] PRINCIPLES OF THE LAW OF LIAB. INS. § 7 cmt. b (AM. LAW INST., Tentative Draft No. 1 2013); *See also* Lando, *supra* note 44, at 77.

[104] RESTATEMENT OF THE LAW LIAB. INS. § 9 cmt. b (AM. LAW INST., Proposed Final Draft 2018).

[105] Baker & Logue, *supra* note 4, at 784.

[106] *Id.* at 767.

[107] Chen, *supra* note 2, at 8; Priest, *supra* note 3, at 655.

while perhaps harsher for the policyholder, alternatively provides more incentive to decrease misrepresentation. This would possibly be better for society, if the harshness of the strict liability misrepresentation rule can be clarified to a certain extent. This will be further discussed in the summary and recommendation.

Second, for the intentional and reckless misrepresentation rule, the determination and benchmark for applying the rule may not be as easy as it appears. All categories may have the issue of over-inclusion or under-inclusion. The intentional and reckless misrepresentation rule constrains the rescission of a contract to intentional and reckless misrepresentation, but it is not always that critical for an insurer to satisfy the element of materiality. In contrast, an insurer is not allowed to rescind an insurance contract for innocent misrepresentation, even though such a mistake could be very critical for underwriting.[108] Why do we use the accountability of the policyholder as a threshold for rescission of contract, rather than the other elements of misrepresentation? This may require more justification.

3. Benchmark issue

The determination of the misrepresentation issue is also happening in China. Even though China applies the intentional and reckless misrepresentation rule, it is highly controversial to define the intentional, gross negligent, and innocent conduct of misrepresentation. As aforementioned, China modified the Insurance Act from "negligence" to "gross negligence" in rules of misrepresentation, but the definitions are unclear and thus many controversies appear. Actually, there are no definitions for the terms "intentional" or "gross negligence" which has created judicial uncertainty.[109]

The earlier version of the PLLI not only adopted the intentional and reckless misrepresentation rule but also provided definitions for them.[110] However, similar to the rejection of the intentional and reckless misrepresentation rule because there is not sufficient common law to support such a rule, there are few cases to support the determination of the categories of misrepresentation. Even if there were definitions of intentional and reckless misrepresentation, there would be problems in application and more time would be necessary to accumulate relevant case law and rules.[111] Since

[108] Chen, *supra* note 2, at 16.

[109] Jing, *supra* note 69, at 348.

[110] A misrepresentation by a policyholder is intentional if at the time it is made the policyholder knows or believes that the statement is false. For reckless, it means that the policyholder is willfully indifferent to whether the statement is true or false. PRINCIPLES OF THE LAW OF LIAB. INS. § 8 (AM. LAW INST., Tentative Draft No. 1 2013).

[111] However, the rule in PLLI at least provides some clues and possible benchmark for determining the categories of misrepresentation. Thus, if

the category of misrepresentation is a critical determining element for remedy, this issue will inevitably be hotly contested in misrepresentation litigation. The possible increase in litigation cost should be considered for the intentional and reckless misrepresentation rule.

B. REFORMATION

Apart from the aforementioned structure and remedy of misrepresentation, China and the RLLI have more similarity for the reformation of contract in innocent misrepresentation. Like the struggle between the PLLI and the RLLI, the common law general rule of strict liability in misrepresentation has been argued for a long time. In the case of innocent misrepresentation, the strict liability rule is usually criticized for problems such as harshness for insureds, market-distorting subsidy for non-misrepresenting insureds, over-compensation for insurers, and causing an incentive to engage in bad-faith underwriting.[112] Instead of the extreme consequence of rescission, reformation of a contract is usually the suggested remedy for innocent misrepresentation to avoid the mentioned problems of the strict liability rule.[113] The earlier version of the PLLI adopted reformation as a remedy for innocent misrepresentation to replace rescission. But this was abandoned for the traditional strict liability rule, because there were not sufficient common law cases to support it. In China, the current Insurance Act has no specific reformation remedy for innocent misrepresentation. Thus, even though reformation of contract is usually recommended and applied in other jurisdictions, China and the RLLI have not yet adopted this rule.

Even with the legal and economic justifications for reformation of contract, the approach still has some issues to be addressed. Like the German Insurance Contract Act in 2008, it uses the rule of proportionality to replace the old all-or-nothing principle.[114] However, the new proportionality rule is

---

China would like to keep the intentional and reckless misrepresentation rule, some definitions like the PLLI are necessary.

[112] Brian Barnes, *Against Insurance Rescission*, 120 YALE L.J. 328, 338-42 (2010); *See also* Genia Lindsey, *Why the Rescission of Health Insurance Policies Is Not an "Equitable" Remedy*, 40 N.M. L. REV. 363, 385 (2010).

[113] Barnes, *supra* note 112, at 358-65; Wood, *supra* note 22, at 1418.

[114] *See* Versicherungsvertragsgesetz [VVG] [Insurance Contract Act 2008], Nov. 23 2007, BGBL I at 2631, last amended by BGBL I at 3214 (Ger.), https://www.gesetze-im-internet.de/englisch_vvg/englisch_vvg.html#p0160 ("(4) … in accordance with subsection (3), second sentence, shall be ruled out if he would also have concluded the contract in the knowledge of the facts which were not disclosed, albeit with other conditions. The other conditions shall become an integral part of the contract with retroactive effect upon the request of the insurer; in the case of a breach of duty for which the policyholder does not

subject to many criticisms. For example, the proportionality rule is more lenient for policyholders than the strict liability rule, and reversely deters the effects of sanctions. Also, the new rule gives more privilege to the careless policyholder at the cost of the careful policyholder. And apparently, the new system may be too complex, flexible, and uncertain.[115] Such legal uncertainty makes the application even more difficult and may increase disputes and cost. For the U.S., the uncertainty issues may remain. For example, according to the PLLI, if the insurer would not have issued the policy for any premium if the correct information had been supplied at the time of the application or renewal, the insurer must pay the claim at issue but may collect from the policyholder or deduct from the claim payment a reasonable additional premium for the increased risk.[116] But it may need more specific rules and experience to decide a "reasonable additional premium" for the case where the insurer would not approve the insurance application if he had received the correct information.

Also, like the development of the intentional and reckless misrepresentation rule, the RLLI does not keep the reformation remedy of the PLLI because this is not a general common law rule. If we consider the cost of the reformation remedy, such as its uncertainty and the corresponding litigation cost, it may be even higher because the U.S. lacks the experience of applying this rule. The U.S. may need more time and cost to clarify the application and benchmark of this rule in specific cases. All such concerns can justify why the RLLI does not keep this rule at this moment. For China, the current law has no mechanism like reformation of contract for misrepresentation. Even though this approach looks less lenient for the policyholder, it may not be necessary to change it if China can fix the concerns of the RLLI.

---

bear responsibility they shall become an integral part of the contract as of the current period of insurance. (5) The insurer shall only be entitled to the rights under subsections (2) to (4) if he has instructed the policyholder in writing in separate correspondence of the consequences of any breach of the duty of disclosure. These rights shall not exist if the insurer was aware of the disclosed risk factors or the incorrectness of the disclosure. (6) In the case of subsection (4), second sentence, leading to an increase in the insurance premium of more than 10 per cent on account of an alteration of the contract, or if the insurer refuses to cover the risk for the undisclosed circumstance, the policyholder may terminate the contract without prior notice within one month of receipt of the insurer's communication. The insurer shall notify the policyholder of this right in the communication.").

[115] Helmut Heiss, *Proportionality in the New German Insurance Contract Act 2008*, 5 ERASMUS L. REV. 105, 107 (2012).

[116] PRINCIPLES OF THE LAW OF LIAB. INS. § 11(2) (AM. LAW INST., Tentative Draft No. 1, 2013).

C. MATERIALITY, RELIANCE, AND CONTRIBUTE-TO-THE-LOSS APPROACH

The PLLI and RLLI use materiality and reliance to capture the significance and influence of misrepresentation. They are approximately equivalent to materiality in China's Insurance Act. The RLLI adopts the "objective standards" and treats the insurer as the prudent insurer. Even though some cases and literature also adopt this approach in China, it is worth clarifying this issue in the Insurance Act. Furthermore, the RLLI adopts the "increased-risk standard" in materiality but rejects the "contribute-to-the-loss" approach. This is believed to be more pro-insurer rather than pro-insured. However, the causation or contribute-to-the-loss approach, which requires causation between misrepresentation and loss, is more pro-insured. As mentioned before, China at least applies this rule for misrepresentations made by the "gross negligence" of the insured. Even though the contribute-to-the-loss approach is more favorable for the insured, it lacks theoretical and economic justification. This approach stints the remedy of an insurer according to an unexpected and uncertain causation issue. This may decrease the incentive for policyholders to present correct information, and thus deter the efficiency of the market. Therefore, it is better off for China to follow the approach of the RLLI and reject the contribute-to-the-loss approach.

D. A SHORT SUMMARY

The U.S. and China share differences and similarities in their development of misrepresentation rules. This also demonstrates both countries' consideration and struggle between preference for insurer or insured. We now realize that the final and current rules do not justify themselves. More understanding about their background is necessary. Also, in addition to the perspective on either party of the insurance contract, the overall efficiency of the insurance market and society needs to be considered. Regarding the structure and remedy of insurance misrepresentation, which are the most fundamental issues, the rules in the RLLI are worth more merit, if with one more clarification.

Generally, the strength of the strict liability rule is flexibility. A court has more room to decide the proper remedy for misrepresentation without any preset constraint. On the opposing side, one of the weaknesses of the strict liability rule is its harshness for the policyholder. This implies that the insurer is allowed to rescind the contract for a misrepresentation which is material but not deserving rescission. As long as a court is able to properly assess the severity of the misrepresentation and find a reasonable remedy, it may not be necessary to preset the remedy for a specific misrepresentation in statue or restatement. In order words, we recommend a reasonable rule, which allows rescission for any kind of misrepresentation, but this is not the equivalent to a rule that an insurer can rescind a contract for any mistake of

the policyholder. Rather than presetting remedies for misrepresentations, this rule asks a court to decide the proper remedy according to any important circumstances of the case, including the severity of the misrepresentation, the accountability of the policyholder, factual causation and so on.[117] Considering all possible costs of the preset intentional and reckless misrepresentation rule, including efficiency issues, benchmark issues, and relevant litigation costs, it would be another alternative worth considering, to allow a court to make decisions on a case-by-case basis and thus accumulate experience and rules.

V. CONCLUSION

This article has reconsidered the insurance misrepresentation rule under the RLLI as compared to China which is stated as the insured's duty of disclosure. By comparing Chinese law and American law, we find some similarities but differences as well. After the 2008 financial crisis, China joined the world trend to enhance the protection of insurance consumers. The 2009 Amendment and the following SPC Interpretations are vivid examples and have replaced many provisions of the Insurance Act of 1995 that were more pro-insurer. In the U.S., the PLLI adopts many innovations but is criticized as pro-insured without common law justification. And thus, the current RLLI does not exhibit a pro-insured approach.

Since there will be continuing debates over pro-insurer and pro-insured rules, we have tried to assess the insurance misrepresentation rules from the perspective of societal efficiency rather than the perspective of any one individual party to an insurance contract. Thus, we apply an agreed upon benchmark which is "in the long-term interest of policyholders with respect to maximizing the availability of insurance to the society."[118]

For the structure and remedy of misrepresentation, China and the U.S. are in different positions. China moved to the pro-insured rule, allowing the insurer to rescind an insurance contract only for the policyholder's intentional and reckless misrepresentation. In the U.S., the RLLI adopts a strict liability rule allowing the insurer to rescind the policy for all kinds of misrepresentations. The strict liability rule seems to be harsher for policyholders than the intentional and reckless misrepresentation rules, but it provides more incentive to decrease misrepresentation, and would possibly be better for society.

Even though reformation of contract is usually recommended and applied in other jurisdictions, China and the RLLI are similar for not adopting reformation of contract in cases of innocent misrepresentation yet. We disagree with applying the rule of proportionality to replace the old all-or-nothing principle, which is subject to many criticisms, especially from the law and economic

---

[117] Chen, *supra* note 2, at 16-17.
[118] Priest, *supra* note 3, at 653.

perspective of reformation of contract.

For the materiality issue, if we follow the above benchmark, it is suggested that China should reject the contribute-to-the-loss approach, which requires causation between misrepresentation and loss, since it decreases the incentive of the policyholder to present correct information, and thus deters the efficiency of the market.

Based on the above benchmark and analysis, the RLLI does provide several inspirations for China in insurance misrepresentation and indicates how to protect the long-term interest of policyholders and enhance the efficiency of the whole society. Of course, a determination of whether China's insurance misrepresentation rules function well or not might require further empirical studies.