Non-disclosure and Fraudulent Disclosure under Japanese Insurance Law and Practice*

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Japanese Commercial Code has provisions with respect to non-marine insurance (Articles 629 to 683) and marine insurance (Articles 815 to 841). In my topic here is no special provision for the latter, and thus most of the provisions I will refer to are those with respect to non-marine insurance, which shall be applied to marine insurance as well (Article 815(2)). Relevant Articles of Commercial Code and Japanese H&M policy are attached in the end for the reference.

A. Disclosure at time of contract

Articles 644 (1) provides, *inter alia,* that if the person effecting insurance, with intent or gross negligence, at the time of insurance contract, did not disclose material facts or circumstances or did disclose false material facts or circumstances, the insurer is entitled to terminate the insurance contract, unless the insurer knew, or did not know with his fault, such material facts or circumstances.

1. Who owes duties?

The person effecting insurance shall be found as having committed gross negligence, not a simple fault. The insurer has burden of proof for gross negligence of the person effecting insurance. Article 644 does not impose the duty to disclose the material circumstances to the assured. However, in most of cases, if the assured is at gross negligence or with intent, the person effecting insurance would be considered at gross negligence.

The prevailing Japanese Hull Insurance Policy Form (hereinafter, 'Japanese H&M Policy') in its Clause 17 imposes both the party effecting insurance and the assured the duties to disclose material circumstances. Also, Japanese H&M Policy in the same Clause excludes cases where the party effecting insurance or the assured at gross negligence did not know the material circumstances or knew it without accuracy, by

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providing, "did not disclose the circumstances in spite of his knowledge or did disclose the circumstances falsely.

Japanese laws do not have the misrepresentation as the cause of action, in which I understand, the assured's intent or fault is not necessary but need only three factors; (i) the representation must usually be one of fact; (ii) the representation must be false; and (iii) the representation must have induced the resulting transaction. Japanese laws has the cause of action based on collateral mistake or fraud, but it would be the same as English law, very rare in practice.

MIA s. 17 provides: A contract of marine insurance is a contract based upon utmost good faith and, if the utmost good faith be not observed by either party, the contract may be avoided by the other party. We do not have such general provision, which would affect interpretation of each of other provisions with respect to the insurance.

2. Materiality

The insurer also has burden of proof as to 'material circumstances.' Whether a certain fact or circumstance is 'material' shall be found based on objective review as to if such fact or circumstance would have affected the insurer's decision to take a risk to be covered under the policy. I understand, MIA s.18 could be construed that in order to avoid the policy non-disclosure had induced the insurer, on the mind as a prudent insurer, to enter into the policy. I do not think if there would be any significant difference between these objective and subjective way of observation even when they are applied in practice.

Japanese H&M Policy defines this 'material circumstances' as those to be filled in the application form for insurance and other material circumstances, which should affect the insurer's determination to enter into the policy or to fix the terms of the policy. See clause 17 (1) (iii) and (iv). Japanese H&M Policy has not restricted material circumstances to the items listed in their application form, unlike some of non-marine insurance policy. The form and its listed items may narrow the interpretation of the 'materiality' in each case. However, their application form is very simple, same as the H&M policy form, not including specific or detailed facts or circumstances. Among Japanese H&M underwriters, some have set up their internal manual to list the matters to be checked or are setting up such manual. Before the application, all discussions are not necessarily made with the insurer. The policy terms or the application form does not always define 'material facts or circumstances.' Thus, there may remain unclearness in

the materiality of certain facts or circumstances.

At present, Japanese government is reviewing the provisions of Commercial Code with respect to the insurance contract from the aspect if those provisions are corresponding to the modern insurance market and its present situations and if they are fair to the parties. The Legal System Council of the Ministry of Justice set up the Insurance Law Committee in November 2006, in order to pursue the said review. The Committee submitted its intermediate draft for proposal to revise the insurance law in August 2007 (hereinafter 'Intermediate Draft'), and collected the public comments. Intermediate Draft suggests that the above Article 644 should be amended to the effect that the assured shall disclose only the material circumstances, which the insurer has requested to disclose. Article 644 (1) at present demands the assured to judge himself if certain facts or circumstances are material for his disclosure. The above proposal tries to avoid it, and to shift the risk to the insurer. Many of the public comments have accepted this line of amendment.

3. Insurer's knowledge

If the insurer knew, or did not know with his fault, such material circumstances, the insurer cannot terminate the insurance contract. See provisos of Article 644(1).

4. Effect of termination

Article 645 (1) provides that the termination based on non-disclosure or false-disclosure shall have its effect from the termination, but Article 645 (2) provides that the insurer does not need to make payment even if the termination is made after the accident occurred. In the latter case, Article 645(2) continues to say, if there is no causative link between the material circumstances to be disclosed by the assured and the accident covered under the policy, the insurer could not reject the payment under the policy. I understand that there may be three kinds of system in this respect; (i) causation is necessary for the insurer's exemption; (ii) causation is not necessary for the insurer's exemption; and (iii) the amount of insurance payment is prorated. Japanese law adopted (i) It is not certain whether Japanese H&M Policy changed it by its clause 17(2), which provides that the termination shall have a retrospective effect, or if clause 17 (2) still keeps the treatment under Japanese law. Intermediate Draft has proposed (i) and (iii) as alternative, but (iii) was not well accepted by the public comments.

B. Disclosure during contract – Significant change of risk

1. Change of risk by assured's conduct

Article 656 provides that the insurance contract shall become null and void when the risk covered by the policy has significantly been changed or increased by the assured's culpable conduct. At least, it is submitted that the culpable conduct shall not include the assured faulty conduct. The assured shall not be construed to include a wide range of people on the side of the assured. The court seeks whether a person to conduct to increase a risk has the authority to enter into an insurance contract, but the scholars objected against it and submitted that the court should look who can control the subject of insurance, the ship in H&M policy case. While Article 656 makes the insurance contract invalid, it is submitted that the Article shall be amended to protect the assured. Intermediate Draft suggests to stop this different treatment in case the assured's culpable conduct changed or increase the risk, and even in such case the insurance contract should go to the same destiny provided in Article 657 as provided for cases where the risk has been changed or increased significantly without the assured culpable conduct.

2. Change of risk not by assured's conduct

Article 657 provides, *inter alia*, that if a risk is significantly increased not by the assured culpable conduct, the insurer could terminate the contract with its effect thereafter. The assured has to inform a significant increase of risk to the insurer, and in case of his failure, the insurance contract shall be deemed void from the time of the risk increase. In order to make the insurance contract void, we do not need the causation.

3. Significancy

The issue of significancy leaves uncertainty in actual cases. Japanese H&M policy in its Clause 14 (1) lists the circumstances as shown below by which the Policy becomes invalid, though the other insurance often define what is a significant change of risk by listing up such risks.

(i) the ship did not have the inspection of the authority, the class or the insurer
(ii) the class was changed or deleted without the insurer's approval
(iii) the vessel violated trade restriction under law or insurance contract
(iv) the vessel was used for the purpose of violating the law or conventions
(v) the vessel's owner or bareboat charterer was changed without the insurer's

acceptance

(vi) the vessel's structure or use of purpose was significantly changed without the insurer's acceptance thereafter

(vii) and a risk to be insured under the policy was significantly changed by the assured's conduct, for which he shall be liable, without the insurer's acceptance thereafter

Clause 14 (2) provides that the insurer's discretion to terminate the insurance contract even if the assured seeks the insurer's acceptance, in case (i) to (iv) happens, but such circumstances ceased and in case (vi) to (vii) occurred.

Clause 14 (3) amended Article 657 to the effect that the insurer shall be exempted only when the assured failed to inform the circumstance (vii) with intent or gross negligence. Clause 14 (4) provides that if the insurer knew the circumstances (iii) with or without the assured's notice, the insurer could terminate the insurance contract by 10 days' advance notice and the termination will effect only thereafter, and the insurer shall exercise their right to terminate the insurance contract within 30 days after they knew the said circumstances.

Intermediate Draft suggests the provision to request the assured to inform without delay the insurer of the circumstances that the risk has been increased due to the change of the material circumstances which are demanded by the insurer to inform at the time of insurance contract. If the assured fails to make a notice as demanded with intent or with gross negligence, the insurer is entitled to terminate the insurance contract. As to the treatment in case where the accident occurred before termination, Intermediate Draft suggests two patterns of solution. (A) The insurer shall be exempted unless the assured establishes no-causation between the uninformed material circumstance and the accident, and (B) (i) If the assured did not inform such circumstances with intent, the insurer shall be exempted unless the assured establishes no-causation between the uninformed material circumstance and the accident, and (ii) If the assured did not inform such circumstances with gross negligence, the insurer shall be exempted unless the assured establishes no-causation between the uninformed material circumstance and the accident and that the insurer would have terminated the contract if he had known such uninformed circumstances. In case where, assuming the same situation, the insurer only would have raised the premium if he had known such uninformed circumstances, the insurer will not be exempted at all but will have to pay the insurance proceed proportionally deducted. It is my personal opinion that the solution (B) would not be adopted finally, since the terms are so complicated that the parties to the insurance contract could not foresee a result. The public comments are not leaning to either (A) or (B).

C. Features and recent trend of Japanese H&M market

Before 1996, there was no restriction under the anti-trust law against H&M underwriters' collaboration to make the insurance contract terms. H&M underwriters set up the H&M insurance contract form through the Japan Federation of the Hull & Machinery Underwriters, and used the form in their businesses to undertake H&M risks. Under the united H&M insurance terms, Japanese H&M underwriters offered to the customers the same level of the premium, and thus there was substantially no competition in respect of the insurance terms and the premium.

At present, collaboration in the terms and/or premiums of H&M policy among H&M underwriters shall be regarded as violation of the anti-trust law, and the Japan Federation of the Hull & Machinery Underwriters was resolved. By this system change, H&M insurance market has been totally freed, and it is said that at present H&M insurance premium in Japan is one of the lowest over the world. The Unfair Trade Committee sometimes says that H&M insurance market freedom since 1996 is one of the typical successful cases.

Further to the above, as you know, Japanese companies including the underwriters are employing their staff normally for their life long up to the age of 55 to 60, sometimes further. Of course, there is a new trend where some employees move from company to company more often but it is still not usual among Japanese insurance companies. As to H&M businesses, most of H&M staff would not move to the other section of the same company. It is not often that a person in non-marine section is coming to H&M sections. H&M staff will be divided into the business, underwriting and claim departments, among which close communications are kept. For instance, the business department staff is visiting the ship owner's office very often, and the claim department staff in case of casualty or other insurance claims will closely communicate with the ship owner, involving business department people as well. When they leave the position at 4-5 year interval, they will pass all information of that ship owner to a person who will take over his position. Of course, during his term of the office, he will report what he knew through his contact with the ship owner. The information about the ship owner, their fleet and business plan is commonly retained among H&M staff. They even know a divorce or potential divorce of the ship owner's president's nephew. They also visit the dockyard and other companies relevant to the shipping circle, and thus know what kind of ship the ship owner will build or plan to build and whom she would be chartered out.

Also here, it shall be pointed out the influence of 4/4th collision liability clause

Japanese H&M policy has adopted since long time ago. By that clause, H&M underwriters are compelled to handle the collision cases in addition to pure p.a./g.a. case, which is significantly different from the situation overseas. Through those cases, they become to know more about the ship owner and their fleet. Japanese underwriters are sometimes using 3/4th collision liability clause with Japanese form of English H&M policy, which adopts most of ITC Hulls policy, or ITC Hull policy itself, but still 4/4th collision liability clause is prevailing in Japanese market.

Recent mergers among H&M underwriters may well contribute such well-informed position H&M underwriters have enjoyed to keep. By those recent mergers, nearly 90 percent of Japanese H&M insurance market is occupied by three major H&M underwriters. It would rarely happen that H&M underwriters would undertake H&M insurance without having full details of the assured company and their ship. It could be said that most of uncertainty under the provisions of Commercial Code regarding insurance and Japanese H&M policy with respect to the disclosure has overcome by those close relationship between the underwriter and the ship owner and by their business promotion and underwriting practice in Japan. Review and amendment of the insurance law, now under work, would make legal relationship between the underwriter and the ship owner more stable with respect to the disclosure, and would reasonably protect the assured, which is one of the targets if insurance shall support the society.

A story of 'Kakkontoh':

Kakkontoh (葛根湯) is a traditional and long-used herbal medicine in Japan, consisting of arrowroot gruel, adding crude drugs like tree's wigs, grass roots, etc. Old and junk doctors were giving patients Kakkontoh, every occation. A patient has a headache, give Kakkontoh. He/she is catching a cold, Kakkontoh. Hangover, Kakkontoh! Ohhh, you are pregnant.. Congraturation! Have Kakkontoh! Who are you? A hasband? waiting for your wife? You must be bored. Have Kakkontoh... My grandma once fell from the stair from 2nd to 1st floor. Doc. gave her 'Kakkontoh', and my grandpa said to grandma, "why you did not take Kakkontoh before fell-down!" Insurance shall never be Kakkontoh like this. Depending on what and how you mix up crude drugs, Kakkontoh will be a good medicine, so be the insurance.

Commercial Code

Article 644

(1) If the party effecting insurance, with intent or gross negligence at the time of insurance contract, did not disclose material circumstances or did make false disclosure as to material circumstances, the insurer is entitled to terminate the insurance contract, unless the insurer knew, or did not know with his fault, such material circumstances.

(2) The insurer's right to terminate the insurance contract as provided in the preceding paragraph shall be extinguished, unless the insurer exercises the said right within one month after he knew the said cause for termination or within five years after the execution of the contract

Article 645

(1) The termination made by the insurer in accordance with the preceding Article shall have the effect only after the termination.

(2) Even if the insurer terminates the contract after the risk occurred, the insurer shall be exempted, and in case the insurer made payment of the insurance proceed, the insurer is entitled to claim the return of the said insurance proceed, unless the party effecting insurance proves that the risk occurred has not caused by the circumstances which he did not disclose or did disclose as true.

Article 656

The insurance contract shall become null and void when during the term of the contract the risk is significantly changed or increased due to the circumstances for which the assured shall be liable.

Article 657

(1) The insurer is entitled to terminate the insurance contract when during the term of the contract the risk is significantly changed or increased due to the circumstances for which the party who effected insurance or the assured shall not be liable, but the said termination shall have effect only after the termination.

(2) In the preceding paragraph, when the party who effected insurance or the assured knew the facts that the risk has been significantly changed or increased, they without delay shall notify the insurer of such facts, and if they fails to make such notice, the insurer shall regard the insurance contract as null and void from the time when the change or increase of such risk.

(3) In case the insurer fails to terminate the contract without delay after he received the notice as provided in the preceding paragraph or knew the said change or increase of the

risk, the insurer shall be deemed as having approved the said contract.

Article 825

In case the assured fails to commence or continue the voyage, changes the navigation route, or otherwise makes significant change or increase of risk involved, the insurer shall be exempted for the accident after the said change or increase, unless the said change or increase did not cause the accident or unless the accident arose from the force majeure or the justifiable reason, for which the insurer shall be liable.

Japanese H&M Policy

Clause 14

(1) The company shall be exempted from indemnifying the damage or loss arisen after the occurrence of the circumstances listed below, provided that the company shall indemnify the same if the company approved it in writing after the circumstance listed below had ceased: -

(i) the ship did not have the inspection of the authority or the class or the inspection designated by the insurer in order to pursue the voyage safely,

(ii) the ship's class was changed or deleted without the insurer's approval,

(iii) in the term policy, the vessel went out of the trade limit designated in this policy or was engaged in navigating the place out of usual navigation route; and in voyage policy, the ship failed to leave the port within a period described in this policy, was engaged in navigating the place out of usual navigation route, or deviated from the route designated in this policy or changed the port of destination, except in case where such actions was taken in order to avoid an imminent danger or for life salvage or medical treatment of the person on board or in case where the insurer approved such actions in writing,

(iv) the ship was used for the purpose of violating the law or conventions,

(v) the ship went into a place of war or warlike operation or was used for the matter in connection with war or warlike operation, except in case where the insurer approved such actions in writing,

(vi) the ship owner or bareboat charterer was changed, except in case where the insurer approved such change in writing,

(vii) the ship's structure or use of purpose was significantly changed, except in case where the insurer approved it in writing, or

(viii) except the circumstances listed above, a risk to be insured under the policy was

significantly changed by the assured's conduct, for which he shall be liable, except in case where the insurer approved it in writing.

(2) Even if the party who effected insurance or the assured requests the Company in writing to continue the coverage with the Company's approval in the circumstance set out below, the Company shall have discretion to terminate the insurance contract as at the time of the request for the Company's approval. The said termination shall have the effect only after the termination.

(i) in case where the circumstances listed as above (i) or (iv) of the preceding paragraph, or

(ii) in case where the circumstance listed (vi) to (viii) of the preceding paragraph

(3) Except the circumstances listed in (i) to (vii) of the first paragraph hereof, in case where the risk to be covered by the Company was significantly changed or increased due to the circumstances for which the party who effected insurance or the assured shall not be liable, the party who effected insurance or the assured shall notify the Company of the circumstances without delay after he knew the circumstances. The party who effected insurance or the assured with intent or at gross negligence fails to notify the Company of such circumstances without delay, the Company shall not be liable to indemnify the damage or loss arisen after the circumstances to be notified occurred.

(4) In the preceding paragraph, if the Company knew the circumstances (iii) with or without notice from the party who effected insurance or the assured, the Company shall be entitled to terminate the insurance contract by 10 days' advance notice, and the termination will have its effect only thereafter.

(5) The Company's right to terminate the insurance contract shall become invalid, unless the Company shall exercise it within 30 days after he knew the said circumstances for the termination.

Clause 17

(1) The party effecting insurance or the assured, at the time of contract with intent or at gross negligence, did not disclose the circumstances set out below or made false disclosure of such circumstances, notwithstanding he knew them, the Company shall be entitled to terminate the insurance contract, except in case where at the time of contract the Company knew the circumstances which the party effecting insurance or the assured did not disclose or failed to know them at fault.

(i) The other insurance contract has been executed as to a part or all of the insured interests, the risk to be covered and the period of insurance as doubled.

(ii) This insurance contract is for a third party as the assured

(iii) The items to be filled in the insurance application form

(iv) Except the above, the material circumstances which would affect the Company's

acceptance for underwriting the insurance or its determination of the terms of the insurance.

(2) In case the Company terminates this insurance contract in accordance with the preceding paragraph, the termination will have retroactive effect back to the time when the insurance contract was executed.

(3) The right to terminate the insurance contract as provided in the first paragraph shall become invalid, unless the Company shall exercise it within 30 days after the Company knows the said circumstances for the termination.