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WORLD MARITIME UNIVERSITY

Shanghai, China

The Application of Insurable Interest in Marine Transportation

By

LI JUN SHI

China

A dissertation submitted to the World Maritime University in partial
fulfillment of the requirements for the award of the Degree of

MASTER OF SCIENCE

In

INTERNATIONAL TRANSPORT AND LOGISTICS

2007

DECLARATION

I certify that all the material in this research paper that is not my own work has been identified, and that no material is included for which a degree has previously been conferred on me.

The contents of this research paper reflect my own personal views, and are not necessarily endorsed by the University.

.....

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.....

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ACKNOWLEDGEMENT

The two-year period for study in the master course is the most treasure memories in my life. I took the lectures by the most famous professors in maritime field both from Shanghai Maritime University and World Maritime University. And the professional acknowledge offered by the professors widened my horizon not only to the industry of transportation and logistics but also to the world overseas.

I really appreciate Prof. Xu Da Zhen, my Chinese supervisor who gave me very helpful suggestions in my academic work and offered me the opportunity to attend the BIMCO seminar as to be his assistant during my study.

Many Professors who come from World Maritime University gave me very helpful suggestions after class, and they initiated me to be a “better lady” not only in academy but also in life.

I appreciate all the fellows who work for this master program, the diligent work by them helps my classmates and me to hold the master degree successfully.

I should say thank you to my dear Paul. You evidenced the changes and growth of me since two years ago when I entered into this program. Your words which encouraged and supported me will be the most shinning marks in the navigation of my life.

Finally I inscribe the dissertation to my beloved parents, who have supported me in every possible way since I applied for this program. The promising future of your daughter is always because of you.

ABSTRACT

Title of Dissertation: **Study on the Application of Insurable Interest in Marine Transportation**

Degree: **Master of Science in International Transport and Logistics**

Since marine business is regarded as an “adventure” and the carrier can be exempted from or limited to duties under international convention such as Visby Rules when the carrier had due diligence during the voyage, any party who has an insurable interest in a shipment has a need for pursuing an ocean cargo policy. The insurance policy indemnifies the seller or buyer in the event of loss or damage to goods due to a peril insured against risk while the insurable interest is one of the fundamental principles to determine whether one insurance contract is valid or not. The assured should prove that he got the insurable interest when the damage arrived and that is also the pre-condition for sue.

This dissertation is to make a deliberate and systemic study on the insurable interest and its application in marine transportation. By comparing the two standard of insurable interest determination, author holds the conclusion that the “economic interest” should clarify the controversial problems and provide theoretic suggestion for legislation and practice. And the issues of disputes in this dissertation about insurable interest make out its applications in practice of international trade.

Hopefully, this dissertation can make traders in mainland China who purchases marine cargo insurance to better know the principle of insurable interest and its

application trend of the domestic and foreign market so as to formulate the right insurance strategies for their business.

Keywords: insurable interest, marine insurance, INCOTERMS 2000, MIA 1906

TABLE OF CONTENTS

DECLARATION	I
ACKNOWLEDGEMENT	II
ABSTRACT	III
LIST OF FIGURES	VII
LIST OF ABBREVIATIONS	VIII
1. INTRODUCTION	1
1.1 THE PURPOSE OF THIS STUDY	1
1.2 THE METHODOLOGY OF THE RESEARCH	2
1.3 THE STRUCTURE OF THE PAPER	2
1.4 THE LIMITATION OF THE PAPER	4
2. LITERATURE REVIEW	5
2.1 FORMER RESEARCH ABROAD	5
2.2 CURRENT RESEARCH ABROAD	5
2.3 CURRENT RESEARCH DOMESTIC	7
2.4 SHORTAGES IN CURRENT RESEARCH DOMESTIC	7
3. THE EVOLUTION OF INSURABLE INTEREST	8
3.1 THE HISTORY AND CHARACTERISTICS OF INSURABLE INTEREST	8
3.1.1 <i>The stem of insurable interest</i>	8
3.1.2 <i>Lucena V. Cranfurd</i>	8
3.1.3 <i>The transferred cargo policy in international trade</i>	9
3.1.4 <i>The transferred characteristic of insurable interest</i>	10
3.2 THE STANDARD OF INSURABLE INTEREST DETERMINATION	10
3.2.1 <i>The legal interest</i>	10
3.2.2 <i>The economic interest</i>	11
3.3 THE REFORMS TO MIA 1906	15

4. THE INSURABLE INTEREST IN INTERNATIONAL TRADE	18
4.1 INTRODUCTION	18
4.1.1 <i>The dilemma to the traders</i>	18
4.1.2 <i>INCOTERMS</i>	18
4.2 THE INSURABLE INTEREST IN TERMS OF INCOTERMS 2000	19
4.2.1 <i>EXW terms</i>	19
4.2.2 <i>DES, DEQ, DDU, DAF, DDP terms</i>	20
4.2.3 <i>FAS terms</i>	20
4.2.4 <i>FOB, C&F and CIF terms</i>	20
4.3 THE INSURABLE INTEREST OF CARGO OWNER	20
4.4 THE INSURABLE INTEREST TO CARGO PROFIT	22
4.4.1 <i>The insurable interest of seller to cargo profit</i>	22
4.4.2 <i>The insurable interest of buyer to cargo profit</i>	22
4.5 THE SITUATION WHEN CONTRACT IS BREACHED	22
4.5.1 <i>The situation one party breaches the contract</i>	23
4.5.2 <i>The seller takes right of stoppage in transit</i>	23
5. THE DICUSS ON SOME CONSIDERABLE ISSUES – FROM TRADERS’ POINT OF VIEW	25
5.1 THE ISSUE OF “TRANSIT TIME”	25
5.2 THE ITEM OF “WAREHOUSE TO WAREHOUSE”	25
5.3 THE PROVISION OF “LOST OR NOT LOST”	26
5.4 SELLER’S INTEREST CONTINGENCY INSURANCE	27
5.5 THE INSURABLE INTEREST OF MORTGAGE	29
5.6 THE INSURABLE INTEREST OF LIEN	29
5.7 THE SUGGESTION TO THE TRADERS	29
5.7.1 <i>The suggestion to the seller</i>	30
5.7.2 <i>The suggestions to the buyer</i>	31
6 CONCLUSION AND RECOMMENDATIONS	32
6.1 CONCLUSIONS	32
6. 2 RECOMMENDATIONS--THE SUGGESTIONS TO THE LEGISLATION OF CHINA	32
REFERENCE	36

LIST OF FIGURES

Figure 2.2 Swiss Re Statistics	5
Figure 5.7 The National Economy Maintained a Steady and Fast Growth in 2006	29
Figure 5.7 China Insurance Sector Analyses (2006)	29

LIST OF ABBREVIATIONS

MIA	Marine Insurance Act
INCOTERMS	International Commercial Terms
UNCL	United Nations Convention on Contracts for the International Sale of Goods
EXW	EX Works
DES	Delivered Ex Ship
DEQ	Delivered Ex Quay
DDU	Delivered Duty Unpaid
DAF	Delivered at Frontier
DDP	Delivered Duty Paid
CIF	Cost, Insurance, Freight
C&F	Cost and Freight
FOB	Free on Board
FCA	Free by Carrier
ALRC	Australian Law Reform Commission
ICA	Insurance Contracts Act
IAC	Insurance Association of China
IIC	Insurance Institute of China

1. INTRODUCTION

1.1 The purpose of this study

An interesting phenomena the author found when browsing the materials of briefing by some organizations such as SITPRO Ltd.¹, which is the UK's Trade Facilitation Agency supported by the Department of Trade and Industry, and American Institute of Marine Underwriters². All of the organizations encourage the traders to purchase the policies whenever he is the seller or buyer. It is an advertisement and business strategy that make the traders to recognize the advantages of underwrite a policy in their own countries, not only for enhancing protection of the traders' cargo interests and improving the international trade administration, but also to flourish the insurance market in the countries.

The Chinese insurance market has shown a steady growth in the recent past,³ the author writes the dissertation that it aims to make out the importance of cargo marine insurance to the international trade with reference of international rules such as INCOTERMS 2000. It emphasis the status of the insurable interest principle in marine insurance and explains how to ensure appropriate insurance in place and that traders don't assume another party has made the necessary arrangements, leaving their liable in the event of a claim. The dissertation looks at the different clauses stated in insurance acts, insurance contracts and practice which contain details of insurable interest as to find the right provision in policy for Chinese local insured.

¹ Trading Advice: Exporting Goods from the UK <http://www.sitpro.org.uk>

² Cargo Insurance Restrictions (in United States and in Foreign Countries)
<http://www.aimu.org>

³ China Insurance Sector Analysis (2006) - Market Research Reports
<http://www.bharatbook.com>

1.2 The methodology of the research

In the dissertation, the author does the detailed work on the historical evaluation of cases from United Kingdom, U.S.A and Australia. Compared by the cases of different two views which define the insurable interest, the author does the further research on the implementation of the principle of insurable interest in legislation of China. And all through the research, case study and combined with related practice are the primary research methods. The case study research excels at bringing us to an understanding of a complex issue or object and can extend experience or add strength to what is already known through previous research such as the explanation of some act and clauses. Additionally, the practices of modern international trade are the touchstones of helping the author to make suggestions to the traders in China.

1.3 The structure of the paper

On the basis of the cases, clauses and practices cited in this paper, the author wants to give some useful suggestions to the traders who involve in international insurance business. Before going straight to the conclusions, there will be three main questions to be examined step by step. First, a journey will be taken to explore the standard of insurable interest determination by virtue of the history and characteristics of insurable interest with the equivocal statement of MIA 1906. Second, the practice of insurance business highlights the importance of insurable interest under trade terms of INCOTERMS. The third question is concerned with the provisions and different situations when insurable interest applied in and to clarify the disputed issues to the readers. When giving suggestions to the traders, the author also holds constructive suggestions on legislation of China which has an increased trading volume every year and a growth of the insurance market.

The paper is divided into SIX chapters.

Chapter one is the introduction, including the purpose of the paper, scope and key of research and the structure of the paper.

Chapter two is the literature review which includes the development of definitions and applications of insurable interest.

In Chapter three the author expatiates the history and characteristics of insurable interest, and the core of dispute is the standard of insurable interest determination. Two different views- the “legal interest” and the “economic interest” are discussed with some classic cases and legislation of many countries. The reforms of MIA 1906 by some countries have influenced the status of insurable interest in academic field and practice.

In Chapter four, the author emphasizes on the requirements of insurable interest in marine insurance and elaborates the provisions and details in practice including some disputes. Afterwards the author gives suggestions to the traders both seller and buyer who involve in international business.

The last Chapter is the conclusion and recommendation, in which the author summarizes the most important viewpoints of the paper, and puts forward some constructive suggestions regarding modification of marine legislation of China, namely: (1) Principle of economic interest should be applied in marine insurance in China. (2) Add a provision concerning marine insurable interest in Maritime Code. (3) Add a provision stipulates the insurable interest to be attached at the time

of loss. (4) Add a provision which could protect the interest of the buyer who has paid for the goods in FOB or CFR sale.

1.4 The limitation of the paper

Due to the limitation of time, the author prepares the cases in details as more as possible, but in the issue of “the insurable interest in lien” there is no typical case be found during the study. The author tries to discuss and give suggestions to the traders in China who always are confused by different international rules in insurance procedures, somehow lack of practice of case study.

2. LITERATURE REVIEW

2.1 Former Research Abroad

The U.K. Marine Insurance Act 1906 (MIA 1906) is regarded as “the mother of all marine insurance statutes” when came into force on 1st January, 1907. It is a very touchstone of the conception of insurable interest.

The sections 4-15 of MIA 1906 shows: the insured must contain: (1) financial loss, (2) the loss was caused by the peril insured against; (3) the subject matter was covered by the peril, (4) insurable interest. The function of insurable interest is to avoid gaming or wagering by contracts. And the definition of insurable interest stems from *Lucena v. Crauford*¹. The restricted view is that legal relationship adds economic interest. The *Moonacre*² was the relationship between the insured and the subject matter of the insurance efficiently close to justifies his being paid in the event of its loss or damage. The commercial cases of the Lloyd’s Rep which be cited in the dissertation has an important influence on the definition of insurable interest in former times.

2.2 Current Research Abroad

Through the statistics provided by Swiss Re we can conclude the importance of insurance in world trading volume as follows:

World insurance in 2005: the worldwide insurance industry wrote premiums to the tune of USD 3426 billion. According to the Swiss Re sigma study, non-life increased by 0.6%. The 2003/04 trend towards improved capitalization and profitability continued in 2005 in insurance.

¹ *Lucena v. Crauford* 2 B & PNR 269 (1806)

² *Moonacre* Lloyd's Rep. 501 (1992)

Figure 2.2 - World Insurance in 2005: moderate premium growth, attractive profitability, Swiss Re, No 5/2006.

John Dobbyn¹ gives the resource of the insurable interest which comes from the Life Assurance Act 1744. And Cordon C. A. Dickson and John T. Steel held the opinion of economic interest in insurance parties.

Until now there has been no international convention on marine insurance. Much of the world's marine insurance business is transacted in London and is governed expressly or impliedly by English law. ²There are standard clauses in this industry such as the Institute Clauses and reflect an international model. The reforms to MIA 1906 by legislation of many countries nowadays carry out the challenges to the necessities of insurable interest in one country's judgment.

The notes of INCOTERMS identify the insurable Interest. In many cases either the buyer or the seller is not obligated to provide insurance. In a number of cases neither party is obligated to provide insurance. However, both the seller and buyer should be aware that they may have insurable interest in the goods and the preparation for purchasing the insurance coverage.

Walter M. Mellert gives the first line of insurance business. He explains what marine is all about, what can go wrong, how to remedy those situations and where insurance comes in the publication "Marine Insurance".³

¹ John Dobbyn, Insurance Law, Law Press Co. 2001 p.77 -79

² Professor Dr. Marko Pavliha "Lectures on Marine Insurance Law" (2004)

³ Walter M. Mellert, "Marine Insurance" <http://www.swissre.com>

The “Guide to U.S. Cargo Insurance” prepared by the American Institute of Marine Underwriters as a service to international traders, actual and potential, upon whose venturing into the world market our own fortunes depend. And its also one of the resources to initiate the author write this dissertation

2.3 Current Research Domestic

Prof. Jiang Zhaoguo made the conclusion that the determinations of insurable interest in history have developed for 3 phases.¹

In Chaoan Co. v. Zhongbao Property Insurance Co.², the court stated that the assured did not have insurable interest because he is lack of the imported admission to the cargo. It holds the dispute that whether the determination of insurable interest is standard by “legal interest” or “economic interest”.

The Maritime Code and the Insurance Law of China is the legal reference which be cited in this dissertation.

2.4 Shortages in Current Research Domestic

- (1) There is no definition of insurable interest in Maritime Code of China
- (2) The explanation to the principle of insurable interest in the Insurance Law of China is not very clear.
- (3) No article about how to guide the domestic traders purchasing insurance policy in details of insurable interest has been declared.

¹ Jiang Zhaoguo, The basic concepts of insurance Law, Law Press Co. 2002, p.47-69

² The Case of Chaoan Co. v. Zhongbao Property Insurance Co.
<http://www.chinalawbook.com>

3. THE EVOLUTION OF INSURABLE INTEREST

3.1 The history and characteristics of insurable interest

There have been many definitions of insurable interest in academic research of history; the key part is which the standard of determination is. This chapter helps the reader have a clear understand of the words “insurable interest” with some examples of typical cases and more related clauses the traders attempt to learn will be discussed later.

3.1.1 The stem of insurable interest

It was recorded that the earliest legislation which concerns the insurable interest can be stemmed from 1746 by the parliament of United Kingdom, and the Life Assurance Act is the modern law of insurance in 1744.¹ In Life Assurance Act: “From and after the passing of this Act no insurance shall be made have no interest, or by way of gaming or wagering.” Some scholars regard it as the derivation of the insurable interest which influences the academic field.²

3.1.2 Lucena V. Cranford³

The statement of Lord Lawence in the judgment of Lucena vs. Cranford has often been cited as a powerful heritage of the “factual expectations doctrine” which came from the “Prize Act” to the captain and seafarers cited by Lord Mansfield in the

¹ John Dobbyn, Insurance Law, Law Press Co. 2001 p.77 -79

² Andrew McGee, The Modern Law of Insurance, Butterworth UK, 2001, p. 35
John Birds, Birds’ Modern Insurance Law, Sweet & Maxwell, 5th Ed 5., 2001,
p.35-37

Kenneth Cannar, Essential Cases in Insurance Law, Woodhead-Faulker, 1985 1st
Ed pp4

³ Lucena v. Crauford 2 B & PNR 269 (1806)

decision of *le Cras V. Hughes*¹, a Spanish ship was navigated by a British captain and crew in the war with Spain. The explanation of insurable interest by Lord Lawence has been the powerful source and influenced the insurance industry for centuries in the views of many scholars and writers. The *Macaura V. Northern Assurance Co. Ltd*² has been a further result in the strengthening of the position of principle of insurable interest.³

3.1.3 The transferred cargo policy in international trade

The performance of international trade has been done by the transference of the documents which are the proof of the right of ownership. In the modern world, a merchant will not wait a length of long time until the cargo arrives at destination. The value of cargo on policy is equivalent to the value of insured goods. In some forms of international trading such as L/C condition, the bank requires the seller showing documents including policy to prove that the seller has fulfilled the performances agreed in the contract. Furthermore, the documentary nature of an insurance policy lends itself readily to the introduction of the agents of parties and other intermediaries such as bankers, insurers, carriers and their brokers, not only to construct the economic basis for negotiations, but also to represent their legal interests before the goods arrive.

¹ *Le Cras V. Hughes* 99 Eng.Rep. 549 KB (1782),

² *Macaura v Northern Assurance Co Ltd* AC 619 (1925)

³ Rober Merkin, *Calinvaux's Law of Insurance*, 7th Ed, Sweet and Maxwell, 1997, p.62

E.R. Hardy Ivamy, *General Principle of Insurance Law*, 5th Ed., London Butterworths, 1986, p.20

3.1.4. The transferred characteristic of insurable interest

One difference between marine insurance and non-marine insurance is that the contract can be transferred by endorsement without the agreement of insurer.¹ According to the available changes of assured, the judgment of whether the assured has the insurable interest is more complicated and therefore many issues and cases should be discussed in this field.

Another issue is that the ownership of transported cargo is always be transferred by several transactions. During the voyage, it will be transferred from the seller to the buyer or to the third party with the endorsements of the bill of lading. And we always connect insurable interest with the insured property when transferred. Since there has been no uniform rule to determine the time when property is transferred in the academic field until now, to deal with the problem, the international convention makes property and risk issues of the cargo separately. As UNCL and INCOTERMS stipulate revert of risk to be determined by different terms when two parties make the trading contract agreement. Therefore the insurable interest could be determined by analysis of the terms by allowing the rules. But the party who should take the risk will also be indistinct when the buyer refuses to accept the cargo or the seller takes right of stoppage in transit. The author will discuss these issues later.

3.2 The standard of insurable interest determination

3.2.1 The legal interest

Some scholars think that the evolution of insurable interest has been three phases.²

1) The initial insurable interest, which differs the insurance contract to the gambling

¹ Professor Dr. Marko Pavliha, Lectures on Marine Insurance Law (2004)

² Jiang Zhaoguo, The basic concepts of insurance Law, Law Press Co. 2002, p. 47-69

or wagering.

2) The technical insurable interest. The insured subject is not only limited to the property but the insurable interest as well.

3) The economic interest. It was held that the insurable interest is not only determined by the “legal interest” but also consider the assured who resumes financial loss when the subject arrives damage.

The legal interest which is the initial one comes from the definition by Lord Eldon¹. But nowadays the third phase has been mostly accepted by academic field. The scholars of insurance Cordon C. A. Dickson and John T. Steel held that the insurable interest constitute legally protected right which relates to economic relationship between assured and insurer.²

3.2.2 The economic interest

Since the issue on standard of insurable interest appeared, the United States was not on the side of United Kingdom’s. When in *Hooper V. Robinson* the Lord states that the ownerships of goods is not always along with the insurable interest necessarily. When the assured lost or gain the interests from the loss or saved insured property, this undetermined relationship could be regarded as the subject of the insurance contract.³ The judgment is the strong position to repeat the Lord Lawrence’s words in the *Lucena V. Crauford*. And the confirmation of stake holder who got insurable interest on the vessel in *Seaman V. Enterprise Fire & Marine Insurance Co.*⁴ and

¹ *Lucena v. Crauford* 2 B & PNR 269 (1806)

² Men Xin Guo, *The principles and practice of insurance*, The Finance Press Co. 1992, p3

³ *Hooper V. Robinson* AC 619. (1925)

⁴ *Seaman V. Enterprise Fire & Marine Insurance Co.* C.C. 21 Fed 778 (1884)

Hayes V. Milford Mutual Fire Insurance Co.¹ announced the economic interest has been the standard of determination of insurable interest in academic and practice way in most states of the United States.

New York is one of the states which accepted the third phase of insurable interest very earlier in U.S.A. It supported the view of “lawful and substantial interest” which furthers the limitation of “legal interest” by legislation in 1966.²

Some insurance companies in western countries are not willing to argue against the reason that the assured is lack of insurable interest. On one hand the appeal will be seemed to be a technical way to ruin the companies’ reputation on contrary in this industry. On another hand the courts always regard it as an unreasonable appeal so they will be inclined to protect the assured by confirming the available of insurable interest in the judgments.³

The author thinks that the economic interest is much more complied with the development of modern insurance industry. Since the frequency to pass the ownerships by different parties, these kinds of changes are much harder to be caught up by legislation. The assured expect that without other complicated legal relationship, to have an economic interest could be the proof for their protection to the loss. It is apparent that the insurable interest is not only a “mere expectation” but also an expectation subject to the fact.

¹ Hayes V. Milford Mutual Fire Insurance Co. 49 NE 754 (1898).

² John F. Dobbyn, Insurance Law, Law Press Co. 2001, p.92

³ Robert Merkin, Colinviaux’s Law of Insurance, 7th Ed, Sweet and Maxwell, 1997, p.69.

For example, the assured who gets the insurable interest could be the party who has the ownership of the subject. That is the most original and basic pattern in cases. But some parties who get the expected interest in the insured property such as the buyer under CIF term in international trade should be confirmed that they own the “economic interest”. It is the premise that we could do the later discussion. If the “legal interest” is only be concerned, it is far from the insurance practice today.

In the developed insurance market, people get more sophisticate understand to the principle of insurable interest, especially to the insurable interest in property.

And the conservative concept of the legal insurance interest by past centuries has been criticized by scholars.¹ In modern insurance theories and practice, the concept of economic interest is widely accepted.²

Generally, as a fundamental principle, the principle of insurable interest is not only to determine the establishment of insurance contract but also constitutes the valid of the contract. It is clear in the statement of *Sadlers’Co. V. Badcock*, 2 Atk³. that the assured should take the responsibility of assuming insurable interest when arranging the insurance contract and during the insurance period also.

In China, the trader who deals oversea business with foreign parties must have the license of oversea trade which limits the traders’ business aboard.⁴ Many productions should be transported by the arrangements through nominated trade agents who do

¹ Edwin W. Patterson , *Essentials of Insurance Law* , pp. 1302133; John F. Dobby , *Insurance Law* , West Publishing Co. , 1981 , pp. 55256.

² *American Jurisprudence , Insurance* , 2nd Edition ,Lawyers Cooperative Publishing Co.

³ *Sadlers’Co. V. Badcock* , 2 Atk. 554(1743) .

⁴ *The limits of traders in China* <http://sinochem-yancheng.com/>

the process professionally. But one problem involved in the process is that some production merchants sign the import contract without applying for the import license by agents ahead. When the imported goods arrives damage during the voyage, the assured will not be allowed to indemnify his loss since he did not get the insurance interest. In *Chaoan Co. v. Zhongbao Property Insurance Co.*¹, the Court stated that the assured did not have the imported admission to the cargo, so the insurance contract is void because of lack of insurable interest which based on the imported right even the assured has assumed the risk of cargo according to the agreement of trade contract.

The assured can not settle a claim for loss to the subject even he signed the insurance contract, for the reason that he does not gain the “legal admitted” insurable interest in this case. The author thinks that it is on the contrary to the function of the principle of insurable interest and to the development of national economics. Generally, besides the case mentioned above the author can hold other assumptions as follows under situations if we put too much emphasis on the “legal interest”:

- 1) The creditor will not have the insurable interest even the debt property is the only wealth the debtor owns. The loss of debts such as bankruptcy will influence the capability for the debtor to turn back the debts.
- 2) The stake holders will not have the insurable interest in the property of company. Even they will be totally lost since the stocks are their own wealth.
- 3) To be a forwarder, the third party will not have the insurable interest when arranges the insurance contract in name of his for his client.

¹ The Case of *Chaoan Co. v. Zhongbao Property Insurance Co.*
<http://www.Chinalawbook.com>

It is by no means a unanimous belief that the explanation of economic interest is the way to compensate the defects when legal interest can not give the assured a reasonable premise to appeal.

3. 3. The Reforms to MIA 1906

Throughout the twentieth century, marine insurance was practiced in most parts of the world under the influence of the MIA 1906. Many countries inherited most clauses from MIA 1906 directly or indirectly, but some regional initiatives still have reacted to review and reform their laws of marine insurance.

The most notable have been the Scandinavians, in an initiative driven by the marine insurance industry and the Scandinavian Institute of Maritime Law in Oslo. The Norwegian Marine Insurance Plan 3 is a primary example of a successful a voluntary NGO initiative that now sets the parameters for marine underwriting in much of Scandinavia, and indeed elsewhere in the world.¹

Australian marine insurance practice is also very similar to practice in the London market, but Australia also has another piece of important insurance legislation, namely the Insurance Contracts Act (ICA). The ICA does not apply to insurance contracts governed by the MIA. The ICA is more pro-insured than the MIA.

<Insurance Contracts Act 1984>, SECT 17: Where the insured under a contract of general insurance has suffered a pecuniary or economic loss by reason that property the subject-matter of the contract has been damaged or destroyed, the assured is not relieved of liability under the contract by reason

¹John Harel, 248 CMI Yearbook 2004/ Marine Insurance
The CMI Review of Marine Insurance, Report to the 38th Conference of the CMI
Vancouver, 2004

only that, at the time of the loss, the insured did not have an interest at law or in equity in the property.

<Insurance Contracts Act 1984>, SECT 18: (1) Where the insured under-
(a) a contract of life insurance; or (b) a contract that provides for the payment of money on the death of a person by sickness or accident, did not, at the time when the contract was entered into, have an insurable interest in the life of the life insured or of each life insured, the contract is void.

The ARLC has followed the ICA and abolished altogether the concept of insurable interest. This is a radical departure from MIA. Some scholars think it necessitates a repeal of many time-honored provisions in the MIA. In this challenge, any party who suffers an economic loss as a consequence of damage to insured property will be entitled to claim. It will no longer be necessary to demonstrate that they had an insurable interest at the time of the loss. In many respects it introduces concepts which are inconsistent with well-accepted practices in the international trading community such as the provisions of INCOTERMS and many Institute clauses.

It is clear that the abolition of the concept will make it theoretically possible for more than one party to claim indemnity under a cargo policy. The changes also seem to suggest that it is acceptable for a party to have a claim for indemnity, even if the time of the loss and the nature of the loss had nothing to do with the perils insured under the policy. The author thinks that since the underwriters will draft their policies more carefully with regard to these considerations. The debate does not end and China will also examine domestic marine insurance laws. Although MIA 1906 is most influential the evaluation, a reexamination will also begin for whether or not the 1906 Act will continue to serve the industry in the changed times and market circumstances of the approaching twenty-first century.

As mentioned above, some countries have abandoned the concept of legal or equitable interest and have accepted the notion of economic interest in their insurance laws. However, this practice gives rise to several new problems, including especially how to define the boundary of the economic interest. The author suggests the rules of economic insurance interest should be applied comprehensively in order to judgment in China. Moreover, some challenges to insurance business brought by the new concepts and the steps the insurance business should take on the basis of that the difficulties should not baffle the establishment of the economic interest.

4. THE INSURABLE INTEREST IN INTERNATIONAL TRADE

4.1 Introduction

In this chapter the author wants to give details of exactly what cover is given by each situation during the transportation process involving the insurable interest, to enable insurers to choose the most appropriate for their business and trading patterns by making out the importance of insurable interest in international trade..

4.1.1 The dilemma to the traders

Marine insurance covers physical damage to, or loss of the goods whilst in transit by land, sea and air, and offers considerable opportunities and cost advantages if managed correctly. But in Chinese practice, many traders do not want to arrange the type of insurance because they feel they have insufficient knowledge. Some sellers regard them as unnecessary expenses with extra administration cost, so they prefer to do the trading contract under FOB term which they think it is no necessary to arrange the insurance for cargo and make the mistake of allowing other suppliers or customers to control this vital area of business, on another hand they often complain the profit to the business is not high. ¹In the author's opinion, the loss of control increases the difficulties of implementing an effective trade risk management strategy, but can also have far reaching effects on the traders' profitability and the insurance market in China.

4.1.2 INCOTERMS

In international trade, "One of the many important questions that must be decided in every transaction involving a sale of goods is 'Which party to the contract of sale is

¹ Dr. Xin Hai Bao < Study on the economic interest> the legal department of Peking University <http://www.civillaw.com.cn>

obligated to arrange marine and war risk insurance protection?’ A reference relative to the obligations of buyer and seller under the various terms of sale is the INCOTERMS.”¹

It was noted at the beginning that it is the person who bears the risk of loss who has an insurable interest in the goods. In international sales of goods, the contract of sale will, or at least should, stipulate clearly when the risk passes from the seller to the buyer. Often this is done in a standardized manner by reference to a specific term in the standard international commercial terms, elaborated and published by the International Chamber of Commerce, called the INCOTERMS.²

INCOTERMS is an excellent reference to decide which party to the contract of sale is obligated to arrange marine insurance protection. The basic function of the INCOTERMS is to define the obligations of buyer and seller under the various terms of sale. The terms of sale must be accepted as part of the total contract to become legally binding upon all parties.

Most of the international trades take the rules that the property and risk are separated. When they are assumed by different two parties, the party who takes the risk has the insurable interest, instead of the cargo owner. This rule has been widely used in marine transportation according to different terms to determine the insurable interest.

4.2 The insurable interest in terms of INCOTERMS 2000

4.2.1 EXW terms

The seller assumes the risk before delivery. After that the risk and also the insurable

¹ Trading Advice: Exporting Goods from the UK <http://www.sitpro.org.uk>

² Professor Dr. Patrick Donner made “Lectures on Commercial Law” (2005)

interest will be transferred to the buyer. An EXW term represents the minimum obligation for the seller, who has merely to make the goods available at his premises for collection by the buyer's designated carriers.

4.2.2 DES, DEQ, DDU, DAF, DDP terms

The seller assumes the risk and payment before the goods arrive destination. During the voyage, the seller has the insurable interest until the buyer takes the risk under his control. The demarcation of insurable interest under "E" and "D" terms are comparably easier than the later ones.

4.2.3 FAS terms

The seller takes the responsibility to transport the goods along side the nominated vessel and he gets the defeasible interests until the buyer takes the risk. If the vessel which nominated by buyer fails to anchor, the seller has to arrange the barge to take the cargo along side the vessel. In this situation the risk should be assumed by the seller, and assumes the insurable interest.

4.2.4 FOB, C&F and CIF terms

The demarcation of risk is the rail of loading. After that, the buyer assumes the risk even he hasn't got the ownership of goods. Some of the most frequently employed terms in international trade are FOB, C&F and CIF. The terms relate the policy clause "Shipper's Contingency Interest" and "Warehouse to Warehouse" which we will discuss later.

4.3 The insurable interest of cargo owner

When the right of ownership and risk is not separated during the marine transportation, the cargo owner who gets the ownership has the insurable interest. But it is too

complex to demarcate who gets the ownership between two parties, and many countries have different illustrations to make the judgment according to their legal systems. The author makes the conclusion that there are three main rules used internationally to determine the time when ownership transfers,

- 1) When the contract has been agreed.
- 2) According to the parties' agreement
- 3) At the delivery time

To analyze the words in agreement of the contract is very helpful to make clear that which party owns the cargo during the transportation, with the point of view who owns the insurable interest can be concluded.

When the cargo owner pays for the freight and insurance cost before the voyage, such as CIF term, he can not be refund the freight from the carrier when the risk insured happens according to general transportation contracts such as a bill of lading, the cargo owner who paid the freight gets the insurable interest. So does the buyer who pays seller including the insurance cost.¹

In *Reinhart Co. V. Joshua Holy and Sons Ltd*², two parties agreed that the seller exported the textile to United Kingdom C&F Mexico. Unfortunately the goods were damaged before loading. The Lord took the appeal by Article 2 of MIA 1906 and confirmed that in this case, to be the assured, the buyer had right to claim for the

¹ As stipulated in the Article 12 of MIA 1906 and the Article 219 of Maritime Code of China

² Dr. Fu Yan Zhong , The application of insurable interest in transportation, World Shipping Vol.27 No.3

insured goods which were damaged before he got the insurable interest according to the trade term.¹

4.4 The insurable interest to cargo profit

4.4.1 The insurable interest of seller to cargo profit

The cargo profit is between the costs of cargo and its selling price. The seller can have the reasonable expectation to the profit according to the property of cargo which he owns. When the cargo has arrived damage or loss due to the insured risk, the buyer refuses to pay for the cargo so that it made the seller lost his profit. In practice, the Court of United Kingdom exempted the profit cargo profit from the insurable interest but Chinese Court calculate the cargo price in contract or in invoice as one part of the insurable interest. Besides, many countries determine the amount of claim as the market value of cargo at destination port.²

4.4.2 The insurable interest of buyer to cargo profit

Since the buyer will sell the cargo to other parties by endorsement of bill of lading and market is often fluctuated, how to calculate the profit the buyer lost? There has been no related judgment found in cases. The author suggests the amount for claim should be limited as the expected profit adding the original value of cargo which can be reasonable calculated from the market.

4.5 The situation when contract is breached

The special situation such as,

¹ Dr. Fu Yan Zhong , The application of insurable interest in transportation, World Shipping Vol.27 No.3

² Malcolm A. Clarke, The Law of Insurance Contract, 4th Ed, LLP, 1999, p.127

- 1) The buyer refuses to accept the cargo - the contract has been fundamentally breached.
- 2) Right of stoppage in transit

As the situations above, the cargo can not arrive to the buyer's control and the risk will be still reverted to the seller in a contrary way.

4.5.1 The situation one party breaches the contract

The buyer refuses to accept the cargo:

There are three different views,

- 1) The breach by seller does not affect the transferred risk, and the seller still assumes it.
- 2) The breach by seller is the reason that buyer refuses to accept the cargo, so the risk has never been transferred.
- 3) The risk transfers to the seller when the buyer declares that he will not accept the cargo.

4.5.2 The seller takes right of stoppage in transit

The seller takes the right when the buyer breaches the contract. The right of stoppage is one legal concept under common law and has no clear stipulation in Chinese law. In the academic field we can find that:

There are three different views in legal disputes,

- 1) The breach didn't affect the transfer of risk, so the buyer still takes the risk.
- 2) The seller denied to delivery the cargo to the buyer as the risk has never been transferred.
- 3) The risk transferred to the seller after he has taken the right of stoppage in transit.

We find in practice that the risk has never been transferred from seller to buyer when the buyer doesn't refuse to accept the cargo, and when the seller takes the right of stoppage in transit, the risk will be transferred to seller himself.

Some scholars state that the stoppage should be at the premise that the seller lost his ownership of insured goods. The problem is that whether the insurable interest has its retroactivity even before the notice of stoppage when seller didn't get the insurable interest, in the situation such as under FOB term when seller hasn't received the payment by L/C. There is no case be found in Lloyd's which can proof that until now. But it is clear that the buyer will not lose his insurable interest when the stoppage is in used of by seller.

5. THE DISCUSSION ON SOME CONSIDERABLE ISSUES – FROM TRADERS' POINT OF VIEW

5.1 The issue of “transit time”

“Transit time” should be regarded as during the voyage by carrier who is the independent third party with no relation to the trade contract. The seller is not allowed to take the right of stoppage unless

- 1) The FOB loading port in contract is regarded as the destination port, after that the transportation is a new one.
- 2) The carrier delegates the seller's interests and also takes over the cargo. For example, the seller is the real carrier or he demises the vessel for transportation.

From the above we can conclude that if the seller has been separated from both the ownership and possessor right he has no insurable interest at all.

5.2 The item of “Warehouse to Warehouse”

In international trading, the transportation of cargo is not only the marine voyage but also include inland waterway and land transportation. The insured often take the policy with the clause of “Warehouse to Warehouse”. In the terms of FOB and CFR, the buyer always arrange the insurance issue, but the risk of damage or loss will be reverted to buyer when the cargo across the rail of vessel. But in practice, whether the loss happen before crossing the rail is not very clear especially to the container cargo which are sealed before. So the insurable interest under terms of FOB and CFR can be discussed by using the definition of economic insurable interest.

5.3 The provision of “Lost or Not Lost”

According to the provision of Article 6(1) of MIA 1906, the time of insurable interest differs from the older stipulation. Since many unstable factors during the marine voyage in old times, the ocean cargo could be arrived damages before the arrangement of sales contract especially in the cases when the technology of telecomm was not advanced. The assured who faced the situation could not setting the claim for indemnity because lack of insurable interest. The provision of “Lost or Not Lost” has its new function which can protect the assureds’ rights for claim. For example, under CFR term, the seller notices the buyer after the departure of vessel by omission, may be the goods have been lost.¹ It is further stated in one famous case of *Australia NSW Leather Co Pty Ltd V. Vanguard Insurance Co Ltd.*². The provision “Lost or Not Lost” has been cooperated in “Warehouse to Warehouse” but the goods had been stolen before loading on board. The insurer argued against the buyer for the reason that he has no insurable interest when the goods arrives loss. The Lord cited for the two conclusions,

- 1) The “Lost or Not Lost” provision entitled the buyer to get his insurable interest after the damages had happened.
- 2) By the determination of economic insurance interest, the buyer under FOB term had insurable interest of the expected profit when the goods arrive destination safely.

Nowadays, The Institute Cargo Clause of United Kingdom keeps the spirit of “Lost or Not Lost” provision, but it stipulates the additional clause that the assured must has the

¹ Yang Liang Yi, Wang Peng Nan, MIA 1906 Clause, Dalian Maritime University Press Co. 1996, p. 314

² *NSW Leather Co Pty Ltd V. Vanguard Insurance Co Ltd.* 105 FLR 381 (1991)

insurable interest when the goods arrive damages. The author thinks that it is in conformity of the principle of insurable interest. In the Ocean Marine Cargo Clause of China no provision similar as “Lost or Not Lost” is found. But the Article 224 of Maritime Code has the related clause. Accordingly, it is regarded valid when the provision of “Lost or Not Lost” appears in the marine insurance contract.¹

5.4 Seller’s Interest Contingency Insurance

The insurable interest must attach “at the time of the loss”. The exception is “lost or not lost” to deal with the problem of the FOB contracts. And the contingent interest is insurable. The person who advances the freight has an insurable interest and the insured has an insurable interest in the charges. The rule prevents a mere sale of the insured subject matter from transferring the policy unless there is agreement to that effect between seller and buyer. This principle is different from the non-marine insurance when the seller can ask the buyer to transfer the insurance contract by endorsement. But even the buyer is willing to do that, the transfer maybe not valid. Because the insured transfers the contract explicitly or impliedly at or before he lost the insurable interest. For example, when the buyer refuses to accept the goods and the seller always holds the risk, so the insurance contract insured by seller has been invalid because of lack of insurable interest from the beginning.

In *Anderson V. Morice*², the vessel sunk after loading of cargo which has been total loss during the accident. The Lord agreed to the point of view that the assured who was the buyer under C&F term didn’t have the insurable interest before loading since he hadn’t got the ownerships and did not assume the risk of goods. The assured only

¹ Wang Peng Nan, *The Theory and Practice in Modern Marine Insurance*, Dalian University Press, 2004, p.103

² *Anderson v. Morice* 3 Asp MLC 290 (1876)

had got the “contingency interest” when the cargo had been loaded on the vessel by carrier.

Seller’s interest contingency insurance is usually purchased as part of an open cover policy and is not normally available either as a separate policy or for individual shipments. Seller’s interest applies to goods where he is not responsible for arranging cargo insurance, such as sales under FOB and C&F terms. The risk for the seller is that, if goods arrive damaged at destination, the buyer may refuse to accept them. In these cases the risk reverts to the seller with uninsured, damaged goods in a foreign location.

Seller’s Interest operates in a number of situations where the insured:

- 1) Fails or refuses to accept shipping documents or the goods;
- 2) Fails or refuses to accept the goods because of a mistake the insured have made in the contract of sale;
- 3) Fails to obtain a license or authority to import the goods;
- 4) Where the insured interrupt the shipment or suspend the sale whilst the goods are in transit to protect their own best interests.¹

In any of these cases seller’s interest insurance would automatically come into effect and is retroactive to the start of the shipment. Most sellers’ Interest insurance policies contain a clause with a warranty that the existence of the cover should not be disclosed to the buyer. As a seller, the party should realize that seller’s interest insurance only provides cover against physical loss or damage to the goods. But one thing is that the cover does not extend to the financial loss where insured fails to pay for the goods.

¹American Institute of Marine Underwriters, Guide to U.S. Cargo Insurance

5.5 The insurable interest of Mortgage

Sometimes the cargo which be transported by sea is in lien. In this situation, both the mortgager and mortgagee have the insurable interest. If the value of the cargo has been increased according to the market, the limitation of insurable interest will also be expanded.

5.6 The insurable interest of Lien

When in some marine transportation law and contract stipulated, the carrier has lien on cargo when the shipper or consignee doesn't pay the freight or other fees. So the party who owns lien rights has the insurable interest as stipulated in the Article 14(1) of MIA 1906.

5.7 The suggestion to the traders

The total volume of imports and exports of China for the whole year reached 1,760.7 billion US dollars, a year-on-year growth of 23.8 percent.

Figure-5.7 The National Economy Maintained a Steady and Fast Growth in 2006, National Bureau of Statistics of China, <http://www.ccpit.org>

With the prosperous trading market, the insurance business increases the volume as follows:

The total insurance market in China is expected to grow at the rate of more than 13% to reach the level of more than US\$ 100 Billion from the year 2006 onwards.

Figure- 5.7 China Insurance Sector Analysis (2006) <http://www.bharatbook.com>

As many insurance organizations of countries encourage the local traders to be better to control the risk of business and purchase the policy in domestic market, the author

suggests traders in China to gain the knowledge of open cover policy which could be underwritten under different trade terms to ensure the cargo be insured all over the voyage.

5.7.1 The suggestion to the seller

In 2006, the value of exports of China was 969.1 billion US dollars, up 27.2 percent.¹

When the exporters and trading companies sell on CIF term, which allows them to arrange marine cargo insurance, an open cover policy is recommended. Because this insurance cost is legitimately passed on to the customer, who also gets the benefit of the insurance, this virtually amounts to free insurance which the sellers control. Many foreign buyers see this as essential service provided by the sellers, given that cargo insurance rates are often cheaper than those available to the overseas customer in his local market. Indeed, sellers who do not provide a “package” which includes insurance can lose business to competitors who do. The other side of the coin is that the sellers allow their customers to arrange the insurance. This can range from selling on EXW terms to exporting on FOB or C&F terms.

However, what tends to be overlooked is that the seller is totally reliant on the buyer arranging adequate insurance on goods which has probably not been paid for. If the goods arrive damaged or if the buyer’s insurance does not cover the loss, the exporter may not receive payment. Additionally, if the goods or shipping documents are rejected on arrival at destination, the insurance risk can often revert to the exporter who may not have taken out any cover.

¹ National Bureau of Statistics of China, The National Economy Maintained a Steady and Fast Growth in 2006, <http://www.ccpit.org>

5.7.2 The suggestions to the buyer

Of the total the value of the imports in China of 2006 was 791.6 billion US dollars, up 20.0 percent. ¹

Many buyers assume that the sellers are including the marine cargo insurance at no charge when the cost is included in the purchase price as a Chinese trader prefer a CIF contract when imports goods. The reason is that,

- 1) Obtaining information from sellers about these costs and whether they are being loaded can prove difficult.
- 2) The type of cover being provided. Without this information, buyers may not realize they are paying too much for insurance which does not meet their needs, and may leave them with uninsured exposure.

Some countries such as U.S.A. and United Kingdom encourage their insurance industry because they think the security of some overseas insurers may not compare favorably with the security of insurers in their own highly regulated market.

The author think that if the buyer takes control of cargo insurance they can arrange the necessary cover in the market, which is often more comprehensive and price competitive than in overseas markets. In practice, China Insurance Company offers the “Marine Open Policy” to the local importers when the assured is obliged to declare the loading notice of the cargo.² The policy applies to all the shipments made by an exporter over a specific time period rather than to one shipment only. As long as every shipment is covered by the open cover, it is automatically insured.

¹ National Bureau of Statistics of China, The National Economy Maintained a Steady and Fast Growth in 2006, <http://www.ccpit.org>

² Marine Open Policy in China, <http://www.iic.org.cn/> “

6 CONCLUSION AND RECOMMENDATIONS

6.1 Conclusions

According to the history record, marine insurance is the oldest form of insurance. This dissertation defines the insurable interest by referring the different views from countries, and concludes the principle of “economic interest” should be applied in domestic legislation. The dissertation also demonstrates the application of insurable interest in marine transportation, the provisions such as “Lost or Not Lost” and definition as “Seller’s Contingency Interest” help the trading parties involve in the international trades adapt to and serve the needs of modern international business. The author encourages the domestic traders to control the management of insurance because it relates the profits of business but also the growth of insurance market in China.

As the suggestions to the legislation of China to enhance the development speed of insurance industry in mainland China, it is certain that the sellers or buyers who purchase insurance policies in China can be proud of a strong and growing market standing ready with its capacity, stability and innovation which lends support to growth in international trade.

6. 2 Recommendations--the suggestions to the legislation of China

In the study work, the author notices some defects on the legislation related marine insurance in China. The suggestions aim to be the reference to rectify the laws in future and ensure the stability of insurance market in practice.

- 1) Principle of economic interest should be applied in marine insurance in China.

Some countries have abandoned the concept of legal or equitable interest and have accepted the notion of economic interest in their insurance laws. However, this practice gives rise to several new problems, including especially how to define the boundary of the economic interest. The author suggests the rules of economic insurance interest should be applied comprehensively in order to judgment in China.

It can be proof that the principle of economic interest insurable can be practiced in the legislation of many countries. The fixed insurable interest is one new version according to the developed principle.¹ However, based on the analysis of the real intention of parties in a trade contract, it can be concluded that in its historic, legal and economic context, the economic interest is much approach to the litigation.

As the reason has been discussed in Chapter 3, the author suggests that the Maritime Code of China is better to be revised by using the principle of economic interest and stipulates “The insurable interest is the ‘legally economic interest’ which assumed by the assured to the insured subject.” Moreover, some challenges to insurance business brought by the new concepts and the steps the insurance business should take on the basis of that the difficulties should not baffle the establishment of the economic interest.

2) Add a provision concerning marine insurable interest

As one basic principle to the maritime insurance, the principle of insurable interest makes its profound and historical influence to the subject. Compare to other countries’ marine legislation, the legislation of China has its disadvantage that it has no stipulation of insurable interest in Maritime Code, only one stipulation appears in the Insurance Law of China. But its definition can not be explained in marine

¹ Wilson v. Jones LR2 Ex 139 (1867)

insurance completely. The author suggests that the standard of single economic interest should be incorporated in Maritime Code of China.

The Article 12(1) of Insurance Law of China stipulates: “The assured should has insurable interest to the subject.” According to this standard, we could conclude that the assured should get the insurable interest but not the insured in this article. In maritime insurance, the application of insurable interest is to avoid gambling and to limit the subject of claims. The assured is the signer of the contract to pay for the premium. He has no loss until he has the ownership of the goods when the accident happens. It is clear that when the contract is agreed, the insured gets the insurable interest and he has the right to claim for his compensation.

In the Article 12(3) of Insurance Law of China stipulates: “The legal interest be admitted”. It is the same meaning as “legal interest” in common law that means law can protect and carry out the ownership and the contract right compulsory. But this definition ignores the economic relationship between the insured and the subject. Because when the insured has no economic loss during the accident, he has no cause to get the compensation even he gets the “legally admitted interest” on the goods. So the author’s suggestion is that we should reconsider the definition of insurable interest in legislation of China.

For example under the trade term of CIF, the seller takes the responsibility to buy the insurance. When the goods have been transferred across the rail of vessel, the risk of damaged goods has been transferred to the buyer, so the seller never has insurable interest again. If the assured should have insurable interest as stipulation in legislation, the insured can not get the compensation because the assured doesn’t have insurable interest. In these situations, a lot of goods can not be protected in international trade.

- 3) Add a provision which stipulates that the insurable interest must have been attached at the time of loss.

Besides to stipulate the definition and standard of insurable interest, the time of loss related insurable interest is also the key part of consideration.

The time when insured gets the insurable interest stipulated in MIA 1906 is that “when loss happens”, many countries also have the similar clauses as MIA 1906. That’s one of the characteristics of maritime insurance which differ others. A lot of insurance contracts will be invalid if the requirement is that the insured should have insurable interest during the whole insurance period. So the legislation of maritime insurance of China should clarify the time is the lost time when insured has insurable interest.

Above all, the author suggest to add one clause “The insured should has insurable interest when the subject at loss, otherwise he has no right to claim.”

- 4) Add a provision which could protect the interest of the buyer who has paid for the goods in FOB or CFR sale.

It is the special requirement under FOB and CIF terms. The buyer could not get the insurable interest in the insured property, and according to the principle of insurable interest, he may not claim for the loss. As the transportation is much modern and turns to the “containerized time”, the buyer often pays for the goods first before receiving them. As he has no idea how to prove which part the damage happens, he put himself into the miserable situation that can not get the compensation back. The author suggests that the legislation of maritime insurance should consider the risk of the buyer and protect his right to claim for indemnity.

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