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Background

The liability insurance is in a slow development in China. In the 1980s, it was at first widely-introduced into import/export industry, and now developed many categories mainly including public liability insurance, product liability insurance, professional liability insurance, employer's liability insurance. In 2000, the liability insurance market was quite small, with premium income 2.1 billion yuan, counting 3.2% of the property insurance premium.[1] After 15 years, it harvested 30.5 billion yuan in the year of 2015, yet still counting less than 4% of the non-life insurance premium[2] when the world average is over 10% and some developed countries come to around 15%.[3] Specifically, the participation of product liability insurance has been lower than 4% in China,[4] while some developed countries, such as the US, UK and France are over 30%. [5]

As for the legislation, there is far from a well-developed and integral mechanism for liability insurance. Regulations scatter in tort law, product liability law, insurance law and some other administrative laws, where terms and provisions remain general and vague. Detailed clarifications would only be referred to the template of liability insurance contract provided by insurance giants online.

1. Product Liability Insurance

According to Art. 65 and 66 of PRC insurance law, when the defects of insured products cause personal and/or property damage to a third party, the insurer may, as the suffered third party claim, compensate the damages of the injured for the insured. The manufacture, importer & exporter and the seller, who might be liable for the product defects and direct/consequential damage, often invest the liability insurance for their products. Should the industrial risk occur, the insurance company would indemnify the injured as contracted in the insurance agreement.

Product liability insurance could be a win-win situation for both the insured and the injured. On one hand, the insured - no matter a producer, a supplier or a manufacture - is able to transfer certain industrial risks through product liability insurance, thus it would be less vulnerable; on the other hand, the injured -no matter the consumer, the user or other third party - would be able to approach to another remedy if the insured was reluctant to compensate. In addition, insured companies are much encouraged to devote more efforts to develop new products while without such insurance, producers would rather be conservative than creative, in order to avoid defects.

2. "Product", "Defect", "Liability"

The "product" is defined by PRC product quality law, referring to "products processed or manufactured for sale[6]" and the "defect" is defined as "the unreasonable dangers existing in the products that threaten the personal safety or safety of the property of others or nonconformity of the standard" [7]. Theoretically, it can be categorized into design defects, manufacture defects or indication defect.

Different from product quality insurance[8] that only compensate the cost of repairing, replacements or withdraw of the products due to inherent defects, product liability insurance indemnify the damage caused by the defects where strict liability principle shall apply[9]. In the event of industrial risks, the injured could establish *prima facie* case by proving that the damage was caused by the defects of the insured products.

3. Criteria for Indemnification

The indemnification can be based on occurrence of insured events or based on claims. The former means the insurer agreed to indemnify against any loss which allegedly "occurred" as a result of a defect of the insured product during the policy period, while the latter, practiced in a form of claims-made-and-reported policy, only covers claims that are first made against the insured and reported to the insurer during the policy period. Traditionally, occurrence basis[10] is usual but later on it brings "long tail" risk, in which the insurer may face the claim by the insured even years after policy period as long as the insured event was indeed occurred within the policy period. Claim-based policy is more adopted now. it is more affordable and also motivates the insured to care about risk management in case of their "long tail" liability.

Another limit is the insured territory. The insurer would only indemnify the loss which caused by product events occurred within certain insured territory. Moreover, the indemnification of the damage would subject to the amount or insured percentage agreed in the contract. Damage less than certain amount or within certain proportion would be deductible for indemnification calculation.

The indemnification would only cover the insured legal civil (tortious) compensation agreed between the insured and the injured with confirmation of the insurer, or compensation supported by the judicial decisions, arbitral awards. Administrative or criminal punishment is excluded as it is not insurable interest of the insured; It is more generally advisable to act very cautiously in any judicial or administrative action whose decision could translate any fraudulent practice or manoeuvre, even if not sanctioned by a criminal court, which may not be covered by the Insurance company.

4. Compensation in Practice

The compensation calculation would be based on tortious damage, liability identification/sharing and franchise clauses. Tortious damage will cover property loss and personal damage compensation. In the cases where the injured have also contributed to the damage, the court will decide liability sharing between the insured and the injured and accordingly, the compensation the insured would bear. Once compensation is decided, the insurer will bear amount subject to the compensation limit for each event/contract, with deductible percentage or absolute non-compensation amount. For example,[11], if there is a fire accident in cotton factory caused by self-lit motor engine, and the court finds that the factory has to bear 30% liability as its safety management guidance requires equipping flash hider for every vehicle, yet it failed to do so. The 2 motor riders shall bear 70% liability jointly and the compensation limit in the insurance policy for the motor is 550,000 with 15% deductible franchise. If total loss of the factory is 1 million, so the insurance company would have had to compensate 1,000,000*70%*(1-15%) =595,000. Subject to the compensation limit by the insurance policy, the insurance company will be obliged to pay 550,000 and the motor riders shall bear 1,000,000*70%*15%+(595,000-550,000) =150,000, and the factory shall bear the loss of 300,000 itself.

In practice, the Product Liability Litigation in China brings difficulties that should not be underestimated by the companies that also would be protected through the implementation of a Product Liability Insurance. First of all, any insured company should avoid facing a judicial or administrative decision mentioning some notion of fraud or fraudulent manoeuvre, which could render ineffective any insurance contract. In addition, and at the very beginning of a process following an incident or accident, the insured must actively participate in the often-ordered expertise procedure; challenging the conclusions of the expert(s) will be still more difficult to weigh in on the due process of the expertise procedure. At last, we should not underestimate the peculiarities of Chinese civil procedure which will make sometimes difficult or impossible the involvement of the Insurance Company during the pending judicial procedure; Thus, the insured firm will not systematically be relieved from a risk that it thought transferred.

5. Chinese Market *status quo*

Pursuant to Art.2 of PRC insurance law[12], compulsory insurance shall be explicitly regulated by laws and administrative laws, such as Motor Vehicle Third Party Liability Insurance regulated in Road traffic Safety Law, and Accidental Injury Insurance for Coal Miners in Coal Law. "Compulsory" means the service providers / products supplier are legally obliged to buy liability insurance while the compensation amount, franchise clause etc. are subject to the market. In many cases the authority would regulate the minimum amount for events where death occurs, e.g. the minimum compensation shall no less than 200,000 for death in travel liability insurance contract. [13]

As for compulsory liability insurance, such legislation is rare, and product liability insurance is not compulsory. Even for food products, where public concerns are flooded after the Sanlu milk powder incident, calling for compulsory insurance legislation, Food Safety Law defined liability insurance as "encouraged" instead of "compulsory" as drafted, indicating its non-compulsory nature. That contributes most to little participation in product liability insurance by Chinese producers.

Another complaint for the product liability insurance from the enterprises is the high premium with complicated restrictive indemnification calculation, such as the deductible franchise, insurance coverage and standard clauses notification, rendering the product liability insurance little trusted. Poor knowledge on product liability exposes Chinese companies to risky loads of compensation claims.

6. Policy trends

In 2014, the State Council issued a guidance opinion to boost the insurance industry, where it specifically emphasized the task to promote the liability insurance, defining it as a quick fix for dispute reconciliation.[14] Later on, the insurance industry regulator- China Insurance Regulatory Commission (the "CIRC" or "CIRBC"[15]) announced a number of directions to carry out pilot project in some priority areas including food safety, environmental protection and medical liability.

As for food safety liability insurance, the pilot projects had been initiated in 4 provinces and was expanded to the national level in 2015.[16] The producers of meat products, dairy products, alcohol and drinks and health food, meal distribution entities, school canteens and online food transaction platforms et. are strongly encouraged to invest liability insurance. As for Medical liability insurance, all the tertiary public hospitals and over 90% of secondary public hospitals have been insured.[17] Compulsory liability insurance for environmental pollution has been undertaken in trial in several cities, and relevant administrative regulations have been reviewed and approved in principle.[18] Starting from pilot projects in several cities, the State goes further to expand the application territory supplemented with legislation process.

In 2017, The state council also listed insurance industry as one of the key industries where opening-up and reforms would be furthered.[19] In fact, compared with domestic insurance company, liability insurance contributes more to the premium of foreign invested insurer in China.[20] According to the updated Catalog of Industries for Foreign Investment, the equity limit for foreign investment in life insurance has been amended from 50% to 51% and will be removed in 2021.[21] Recently, CBIRC also issued a circular, stating that insurance agency and assessment business are open to foreign investment since June 28, 2018.

ASIALLIANS has a long experience of litigation related to product liability in China before civil, administrative, criminal and arbitration courts. In addition to our team of Chinese lawyers empowered to assist you, whether you are insured, insurer or victim, ASIALLIANS has set up a team of experts to support its Partners and Associates, composed of insurance brokers, of experts before the insurance companies, medical experts, and engineers.

(1) The Chinese insurance year book (2001)

(2) The Chinese insurance year book (2016)

(3) Chen Dongmei, Li Lei .et: International Experience on Product-related Insurance Promoting Product Quality*, shanghai Insurance Monthly.* Nov 2017

(4) See the news available at http://finance.sina.com.cn/money/insurance/bxsd/20070802/05133844877.shtml

(5) *Ibid* footnote 3

(6) See Art. 2 of PRC Product Quality Law

(7) *Ibid*, Art.46.

(8) *Ibid*, Art.40

(9) PRC Tort Law Art. 41" Producers shall bear tortious liability for damage caused to others by their defective products." and Art.42 "Sellers shall bear tortious liability for damage caused to others by DEFECTIVE products where the seller is at fault. Where the seller is unable to identify either the producer or the supplier of defective products, the seller shall bear tortious liability."

(10) Occurrence basis means that the insurer agreed to defend and indemnify against any loss which allegedly "occurred" as a result of an act or omission of the insured during the policy period

(11) This example is adapted by a real case, the find of which is available at http://wenshu.court.gov.cn/content/content?DocID=eb2ade96-ecd2-4291-9aa8-b479ebb0ca22

(12) Art. 2 of PRC Insurance Law

(13) Regulations on Travel Agency Liability Insurance, Art.18

(14) Several Opinions of the State Council on Accelerating the Development of the Modern Insurance Service Industry

(15) Due to the reform of the State Council in April 2018, the insurance industry regulator would be China Bank and Insurance Regulatory Commission(the "CBIRC").

(16) The Guiding Opinion on product liability insurance pilot project, jointly issued by the Food Safety Office of State Council, General Administration of Food and Drug Administration and the China Insurance Regulatory Commission on January 21, 2015

(17) Opinions on promoting medical liability insurance, jointly issued by National Health and Family Planning Commission, Ministry of Justice, China Insurance Regulatory Commission and State Administration of Traditional Chinese Medicine on July 9, 2014

(18) See also at http://www.zhb.gov.cn/gkml/sthjbgw/qt/201805/t20180507_437465_wap.shtml

(19) Circular of the State Council on Several Measures to Boost the Growth of Foreign Investment

(20) This is concluded by comparing the contribution liability insurance premium to the total premium based on the statistics of each insurer submitted to CBIRC in2017. Such contribution in domestic-invested insurance company is around 4%, while in foreign invested insurer, the figure is about 30% on average.

(21) Special Administrative Measures on Access of Foreign Investment (Negative List) (2018 Edition), available at http://www.ndrc.gov.cn/zcfb/zcfbl/201806/t20180628_890730.html