Law Council
OF AUSTRALIA

Unfair Contract Terms – Insurance Contracts

(Supplementary Submission)

The Treasury

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About the Law Council of Australia

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The Law Council advises governments, courts and federal agencies on ways in which the law and the justice system can be improved for the benefit of the community. The Law Council also represents the Australian legal profession overseas, and maintains close relationships with legal professional bodies throughout the world.

The Law Council was established in 1933, and represents 16 Australian State and Territory law societies and bar associations and the Law Firms Australia, which are known collectively as the Council's Constituent Bodies. The Law Council's Constituent Bodies are:

- Australian Capital Territory Bar Association
- Australian Capital Territory Law Society
- Bar Association of Queensland Inc
- Law Institute of Victoria
- Law Society of New South Wales
- Law Society of South Australia
- Law Society of Tasmania
- Law Society Northern Territory
- Law Society of Western Australia
- New South Wales Bar Association
- Northern Territory Bar Association
- Queensland Law Society
- South Australian Bar Association
- Tasmanian Bar
- Law Firms Australia
- The Victorian Bar Inc
- Western Australian Bar Association

Through this representation, the Law Council effectively acts on behalf of more than 60,000 lawyers across Australia.

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- Ms Pauline Wright, Executive Member
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The Secretariat serves the Law Council nationally and is based in Canberra.

About the Section

Legal Practice Section

The Legal Practice Section of the Law Council of Australia was established in March 1980, initially as the 'Legal Practice Management Section', with a focus principally on legal practice management issues. In September 1986 the Section's name was changed to the 'General Practice Section', and its focus broadened to include areas of specialist practices including Superannuation, Property Law, and Consumer Law.

On 7 December 2002 the Section's name was again changed, to 'Legal Practice Section', to reflect the Section's focus on a broad range of areas of specialist legal practices, as well as practice management.

The Section's objectives are to:

- Contribute to the development of the legal profession;
- Maintain high standards in the legal profession;
- Offer assistance in the development of legal and management expertise in its members through training, conferences, publications, meetings, and other activities; and
- Provide policy advice to the Law Council, and prepare submissions on behalf of the Law Council, in the areas relating to its specialist committees.

Members of the Section Executive are:

- Mr Philip Jackson SC, Chair;
- Ms Maureen Peatman, Deputy Chair; and
- Mr Michael James, Treasurer.

Acknowledgement

An initial submission including input from the Small and Medium Enterprise Committee of the Business Law Section (Part A) and Consumer Law Committee of the Legal Practice Section (Part B) was provided to the Treasury on 27 August 2018.

In addition to this submission, the Law Council now provides the submission of the National Insurance Lawyers Group of the Legal Practice Section (Part C).

Part C – National Insurance Lawyers Group

Introduction

1. The Law Council of Australia wishes to make the following supplementary submission to the Treasury on the *Unfair contract terms – insurance contracts* Position Paper.

2. On the 27 August 2018, the Law Council provided a submission to the Treasury covering a range of matters falling within this inquiry. The Law Council now seeks the opportunity to add additional comments, from the National Insurance Lawyers Group of the Legal Practice Section (**the Committee**), which the Law Council considers important to the inquiry.

3. The Committee welcomes the opportunity to provide comments on the Position Paper.

4. The Committee makes submissions on the following Key Elements of the Proposed Model set out below. The Committee otherwise considers that the remainder of the proposals, which raise practical/operational issues, should be the subject of further consultation with the insurance industry.

Application of Unfair Contract Terms regime to Insurance Contracts

5. The Committee supports the introduction of a form of legislation based upon the existing Unfair Contract Terms (**UCT**) legislation to insurance contracts.

6. UCT legislation has worked well in contexts other than insurance to:

   (a) address the imbalance in bargaining power between businesses which issue standard form contracts (**Profferor**) and consumers/small businesses;

   (b) assist in the identification of contractual terms which operate in manner which are inherently unfair; and

   (c) allow the courts to declare such terms to be 'unfair' with the remedial effect that such terms are rendered void.

7. The key features of the existing UCT legislation central to its success are:

   (a) the concept of inherent unfairness:

   A term in a standard form contract will be relevantly unfair where the rights reserved to the drafter go beyond those which are reasonably necessary to protect such party's legitimate interest to the detriment of the consumer/small business. That is, the UCT regime is not aimed at terms which may operate unfairly in some factual circumstances or as against a particular consumer or small business but rather such unfairness must be found in the inherent nature of the term itself.

   (b) the exclusion of each of the main subject matter of the contract and the upfront price:

   A term which forms part of the identification of the subject matter of the contract is not a term capable of being systematically unfair for these terms for the very subject, core or essence of the bargain between the parties;

(c) the remedy of declaring the term to be unfair and, therefore void, as against all consumers/small businesses:

This is a remedy which effectively removes the burden from consumers/ small businesses from having to independently take action against the Profferor.

8. Indeed, the greatest impact of the current UCT legislation is that it creates a significant incentive for the proponents of standard form contracts to review those contracts to ensure that the contracts do not contain contract terms which seek to reserve to themselves rights which go beyond their legitimate rights.

9. The Committee supports the introduction of a form of legislation based upon the existing UCT legislation to insurance contracts so as to provide an efficient form of redress to consumer/small business insureds against terms found in insurance policies which are inherently unfair in the above sense.

10. That support is subject to the following key principles:

(a) the UCT laws applicable to insurance should form a consistent part of the remedial legislation currently governing consumer/ small business policies. To achieve that consistency, they should be integrated into the *Insurance Contracts Act 1984* (Cth) (**IC Act**);

(b) the main subject matter of any insurance contract is a promise to indemnify the insured against specific contingent risks, formed by those terms which define the scope of coverage. Treasury should follow the European Union (**EU**) example and exclude from the UCT laws terms which define the scope cover. While such terms may have the capacity to operate unfairly in specific factual circumstances, such terms are not capable of being inherently unfair;

(c) the 'upfront price' should be defined to include the premium paid or to be paid and any excess or deductible payable by the insured in the event of a claim;

(d) in the event that (contrary to subparagraph (b) above) the main subject matter of the contract is narrowly defined as per the existing Treasury proposal, then greater clarity to the operation of the 'unfairness' test is required to clarify the meaning of the phrase;

(e) the remedies available should be limited to the making of a declaration that a term is unfair, together with (where appropriate) a consequential order that the term is void or cannot be relied upon by the insurer. So as to prevent inconsistency with the remedial regime set out in the IC Act, the UCT laws should not create a broad remedial discretion; and

(f) consistently with the rationale behind the UCT laws, namely the need to address any imbalance in negotiating power as between parties to contracts, the UCT laws should be available for the benefit of such contracting parties only. Third party beneficiaries should be limited to the existing remedies available under the IC Act.

11. In summary:

(a) The proposed changes create a harsher regime for insurers than that which applies to other industries.

(b) A key practical concern with the current proposals as drafted is that insurers may not be able to rely on contractual terms that legitimately define the scope

of the risk agreed to be shared between the insurer and insured. Such a position is inconsistent with the EU, United Kingdom (**UK**) and New Zealand (**NZ**) regimes.

(c) The result is that an insurer (and reinsurer) is exposed to a risk it may not have priced for. This may result in significant cost increases or adverse coverage changes, neither of which will be to the benefit of the consumer the UCT regime is trying to protect.

There is no obvious evidence in support of such significant changes.

(d) Inconsistencies with the legislation currently in place to support consumers/ small businesses in relation to the effect of terms in an insurance policy will create uncertainty that will not be in the interests of consumers/small businesses.

Objectives

12. The Committee has considered the objectives of the proposals and have identified where we believe issues arise in relation to each as noted below.

(a) Ensure that consumers and small businesses who purchase insurance have the same access to protection from unfair terms in insurance contracts as they do for other contracts for financial products and services

As special rules are applied to insurers that are more restrictive than for other industries this is not achieved.

(b) Increase incentives for insurers to improve the clarity and transparency of contract terms, and remove potentially unfair terms from their contracts

This will be the case. However, given certain identified issues with the clarity of the proposals the result could be a poor one for consumers if, to avoid uncertainty, insurers restrict coverage or increase prices. The Committee notes that the proposals do not discuss the Government's standard terms proposals.

(c) Provide appropriate remedies for consumers and enforcement powers for the Australian Securities and Investments Commission (**ASIC**).

There are significant remedies provided, but the Committee's concern is that if there is a lack of certainty regarding the operation of the provisions, there will be more disputes and price increases may result to cover this risk.

(d) Extending the UCT laws to insurance contracts will also bring Australia into line with comparable jurisdictions, including the EU, UK and NZ, where insurance contracts are not excluded from those jurisdictions' UCT laws

This does not appear to be the case. The EU, UK and NZ all apply different rules designed to reduce uncertainty in the insurance context. The Treasury proposal would result in UCT laws significantly out of line with the approach taken in each of these jurisdictions and could lessen competition by discouraging international insurers from participating in the Australian market.

Key Element 1 – Applying the ASIC Act to insurance Contracts

Amending section 15 of the IC Act to allow the current UCT regime in the ASIC Act to apply to insurance contracts regulated by the IC Act

Relevant questions addressed:

Question 1: Do you support the proposal to amend section 15 of the IC Act to allow the current UCT laws in the ASIC Act to apply to insurance contracts regulated by the IC Act?

Question 2: What are the advantages and disadvantages of this proposal?

Question 4: Do you support either of the other options for extending UCT protections to insurance contracts?

Question 5: What are the advantages and disadvantages of this proposal?

Question 6: [Not Addressed]

13. The Committee does not support this method of implementation.

14. Unlike most other contract types, insurance contracts are already subject to comprehensive legislation in the IC Act which governs rights as between insurers and insureds.

15. The intention of the legislation was to comprehensively govern the rights, obligations and remedies available to parties under an insurance contract. Central to the regime (and to the insurance relationship itself) is the duty of utmost good faith. This intention is evidenced from:

    (a) section 12;

    (b) section 15 (which is, notably, contained in Part II of the IC Act in respect of the duty of utmost good faith);

    (c) section 33; and

    (d) section 55.

16. In the event that the UCT Laws proposed by Treasury sit in the *Australian Securities and Investments Commission Act 2001* (Cth) (**ASIC Act**) (or otherwise sit outside the IC Act) there is scope for inconsistency between those laws and the IC Act which is not addressed by the Treasury proposal.

17. Moreover, the retention of the IC Act as the sole Federal legislation affecting the contractual rights and obligations of insurers and insured, has the advantage of clarity and ease of understanding for insureds which can relevantly find information as to their rights and obligations in one place.

18. By way of example, section 54 provides that an Insurer may not refuse to pay claims in certain circumstances. The courts have decided that section 54 will not apply in relation to 'a restriction or limitation which must necessarily be acknowledged in the making of a claim, having regard to the type of insurance contract under which that

claim is made'. The UCT laws, to the extent that they apply to terms defining or circumscribing the risk insured by reference to an act of the insured or some other person happening after the contract was entered into, may create an inconsistency between those laws and the remedial provisions as specifically crafted to achieve a fair balance between the insurer and the insured and as applied by the High Court.

19. The only argument against the UCT Laws being located within the IC Act appears to be a desire for 'consistency of application' across all financial service providers. With respect, the fact that the Treasury proposal includes different provisions in relation to numerous fundamental aspects of the existing UCT laws (including the main subject matter of the contract, the unfairness test and the appropriate remedy) recognises the need for different approaches to the application of the UCT laws.

20. Enhancing existing IC Act remedies will also reduce confusion as to applicable legislation and simplify training and the risk of any inconsistency of laws.

Key Element 2 – Main subject matter definition

Relevant questions addressed:

Question 7: Do you consider that a tailored 'main subject matter' exclusion is necessary?

Question 8: If yes, do you support this proposal or should an alternative definition be considered?

Question 9: Should tailoring specific to either general or life insurance contracts also be considered?

21. The Committee considers that it is important to tailor the definition of 'main subject matter of the contract' because the nature of insurance is such that, in the absence of such definition, there would undoubtedly be significant uncertainty in the industry and among consumers and small businesses (and their lawyers) as to the identification of the main subject matter on an insurance contract.

22. In the absence of a specific provision, clarity as to what constitutes the main subject matter of an insurance contract would not emerge until the question had been considered by the High Court.

23. The Committee does not support the proposed 'main subject matter' exclusion contained within the Treasury proposal because that definition does not reflect an accurate appreciation of the nature of insurance contracts.

24. The Treasury proposal initially defines the 'main subject matter' of the contract as being '*those terms which describe what is being insured*'.[1] However, it then proceeds to give the following example:

> *For example, under a home and contents policy, terms excluded from review would include those which detail the insured property, such as the location and type of dwelling.*

[1] Proposal Paper, 15 [1].

25. With respect, that example reflects a misunderstanding of the nature of insurance and therefore would result in an inappropriate application.

26. An insurance contract is a contract by which the insurer, in return for payment of the premium, agrees to pay an amount of money to the insured (or some third party), on the happening of a contingency (risk).

27. The main subject of a contract for the sale of a house may include the location and type of house. However, the main subject matter of a contract of house insurance is not, simply, the house itself but rather:

    (a) the happening of a particular event (e.g. a storm);

    (b) which causes damage to;

    (c) the house.

28. Thus the 'terms which define what it being insured' cannot sensibly be said to be confined to the terms which detail the insured property such as the location and type of dwelling, but must extend also to the terms which define the contingency (being in this example the happening of the insured event (e.g. storm) and the damage.

29. Moreover, whether a particular event is insured may depend not only on the coverage clause in the policy but also on other terms which seek to detail the contingency(s) insured including exclusions.

30. Thus a policy may cover storm damage but exclude flood damage. The fact that the contingency insured is defined by way of exclusion does not detract from the fact that the description of the contingency remains an essential part of the main subject matter of the contract.

31. The High Court has rejected distinctions of form in its application of the consumer protection provisions of the IC Act. That is, the High Court has held that the application of such consumer protection provisions should depend upon the substance of the contract not upon its form.[2]

32. Consistent with the High Court's approach, as a matter of policy, the proposed UCT laws should exclude from their scope terms which define the contingency or risk in respect of which indemnity is granted regardless of whether such grant is defined in the insuring clause or by exclusion or condition.

33. Any attempt to define the main subject matter of the contract in a matter which ignores that the subject matter of any insurance contract is a contingency risk is commercially unrealistic and is inappropriate as a matter of policy.

34. Moreover, the example given in the Proposal Paper gives no consideration to how the 'narrow' definition proposed would apply in the context of insurance policies which contain a multiplicity of covers or liability policies.

35. For example:

[2] *FAI General Insurance Co Ltd v Australian Hospital Care Pty Ltd* [2001] HCA 38 (27 June 2001); approving *East End Real Estate Pty Ltd v CE Heath Casualty & General Insurance Ltd* (1991) 25 NSWLR 400 (Gleeson CJ, Mahoney, Clarke JJA).

(a) where a home policy also contains cover for liability to visitors to the house are the terms which describe the visitors insured also part of the subject matter of the insurance or does the main subject matter remain, simply, the house?

(b) what is the main subject matter of a management liability policy which covers both first and third-party losses caused by management decisions, employee fraud, employment practices and statutory liability?

36. The attempt to apply a 'narrow' definition of the thing insured will create significant uncertainty which is not addressed in the Proposal Paper. More importantly, it is flawed as a matter of policy. Because it artificially limits the 'main subject matter of the contract' exclusion in a manner not reflective of the actual subject matter of insurance contracts – namely the contingency or risk insured – it would give the UCT laws a fundamentally broader application in insurance than in any other area of commerce.

37. For these reasons, the Committee supports the adoption of the EU approach in the ECD 93/13 which relevantly states:

> *Whereas, for the purposes of this Directive, assessment of unfair character shall not be made of terms which describe the main subject matter of the contract nor the quality/price ratio of the goods or services supplied; whereas the main subject matter of the contract and the price/quality ratio may nevertheless be taken into account in assessing the fairness of other terms; whereas it follows, inter alia, that in insurance contracts, the terms which clearly define or circumscribe the insured risk and the insurer's liability shall not be subject to such assessment since these restrictions are taken into account in calculating the premium paid by the consumer.*

38. That approach is consistent with the UK approach, under which terms which define or circumscribe a risk, and will play a role in determining the premium are exempt from scrutiny.

39. The NZ approach differs in that it does not include an explicit exemption but deems particular types of clauses (each of which to satisfy the 'unfairness criteria' of being reasonably necessary to protect the legitimate interests of the insurer. while the Committee considers that it is conceptually preferable to deal with such clauses at the stage of identifying the 'main subject matter of the contract', there is attraction in the clarity provided by the greater degree of proscription contained in the NZ laws.

40. The Committee supports an approach which:

(a) adopts the main subject matter test to exclude from the operation of the UCT laws any term which 'describes or circumscribes the insured risk' as adopted by the EU and UK; and

(b) further clarifies that test by reference to an inclusive list of terms which have that effect as contained in the NZ laws.

41. The Committee considers that the UCT laws should enact within the IC Act a provision in the form of 12BI(1) of the ASIC Act together with a provision to the effect:

> *(2) To avoid doubt:*

(a) the main subject matter of a contract of insurance shall be the insured risk such that a term which describes or circumscribes the insured risk shall constitute a term which defines the main subject matter of the contract for the purpose of subsection (1)(a) above.

(b) Terms which describe or circumscribe the insured risk, for the purpose of subparagraph (2)(a), include terms which:

(i) identify the uncertain event or that otherwise specify the subject matter insured or the risk insured against;

(ii) specify the sum insured;

(iii) exclude or limit the liability of the insurer to indemnify the insured on the happening of certain events or on the existence of certain circumstances.

42. The same approach should apply to both general and life insurance.

Key Element 3 – Upfront Price

Relevant questions addressed:

Question 10: Do you support this proposal or should an alternative proposal be considered?

Question 11: [Not addressed]

Question 12: Should additional tailoring specific to either general of life insurance contracts also be considered?

43. The Committee considers that the upfront price of a contract of insurance should:

(a) include the premium paid, or to be paid; and

(b) the quantum of the excess or deductible payable *in respect of any insured risk*.

44. The italicised words in paragraph 42(b) are important to ensure that the exemption applies in respect of all relevant excesses provided for in the contract of insurance. Deductibles should also be included.

45. The Committee does not propose any additional tailoring of the upfront price definition.

Standard form contracts

Relevant questions addressed:

Question 13: Is it necessary to clarify that insurance contracts that allow a consumer or small business to select from different policy options should still be considered standard form?

Question 14: If yes, do you support this proposal or should an alternative definition be considered?

46. The Committee agrees with the proposal that an option which allows consumers to choose between different *standard* policy options or levels of coverage before the contract is entered into should not prevent a contract from being a standard form contract.

47. However, where a consumer or small business has selected a particular scope of cover, the consequences of that selection should not be capable of constituting an unfair term.

48. In the event that the main subject matter of the contract is clarified in accordance with paragraph 36 above, this will be the case.

49. If the definition of 'main subject matter of the contract' is not so clarified (or is eviscerated in the manner currently proposed by the Treasury proposal), then a specific clarification ought to be inserted to prevent insured's arguing that a particular level of cover expressly selected by them is unfair.

Meaning of unfair

Relevant questions addressed:

Question 15: Do you consider that it is necessary to tailor the definition of unfairness in relation to insurance contracts?

Question 16: Do you support the above proposal or should an alternative proposal be considered?

Question 17: Should tailoring specific to either general or life insurance contracts also be considered?

50. In the event that the main subject matter of the contract is clarified in accordance with paragraph 39 above, it would be unnecessary to include a clarification of the concept of the insurer's legitimate interests to the effect proposed.

51. If the definition of 'main subject matter of the contract' is not so clarified (or is eviscerated in the manner currently proposed by the Treasury proposal), then it is essential that a clarification is inserted to the effect that:

    (1) A term will be reasonably necessary to protect the legitimate interests of an insurer if it reasonably reflects the underwriting risk accepted by the insurer in relation to the contract.

(2) A term will reasonably reflect the underwriting risk accepted by the insurer where the term describes or circumscribes the insured risk and the insurer's liability under the contract of insurance and is relevant to the decision of the insurer whether to make terms available and, if so, at what price.

(3) Terms which describe or circumscribe the insured risk, for the purpose of subparagraph (2), include terms which:

(a) identify the uncertain event or that otherwise specify the subject matter insured or the risk insured against;

(b) specify the sum insured;

(c) exclude or limit the liability of the insurer to indemnify the insured on the happening of certain events or on the existence of certain circumstances.

52. The Committee does not consider that that proposition should be qualified so as to require the insurer to prove a precise relationship between such underwriting risk and the premium charged.

53. That proposal does not reflect the nature of underwriting which prices in aggregate a combination of coverages based upon actuarial data in respect of similar contracts or sets of coverage. In some cases, specific terms will have a direct and measurable change in explicit premium rating. For example, optional extensions such as the addition of flood cover are likely to be the subject of specifically developed pricing models.

54. However, in other cases, the effect on premium may be difficult to individually isolate as the premium applied reflects the performance of a particular combination (or 'bundle') of coverages over time. Implicitly each aspect of coverage will have contributed to the historic performance of the product and hence current premium rating structures but the insurer may not hold accessible data to link any particular term forming part of that bundle of covers to an explicit proportion of the premium.

55. As such, a proposal that placed an onus on the insurer to identify an explicit part of the premium referable to an individual coverage term would place a commercially unrealistic burden on the insurer.

56. Further, the words 'reasonably reflects the underwriting risk accepted by the insurer in relation to the contract' do not match the Proposal Paper's explanation of the concept as the words impose a 'reasonableness' hurdle. Someone could take the view a term defining the underwriting risk which is taken into account in the calculation of the premium (i.e. in accordance with the Consultation paper explanation), is unfair if it doesn't 'reasonably reflect the underwriting risk actually accepted'. This is likely to result in many challenges to the underwriting decisions of insurers by regulators and consumers and cost increases associated with these disputes will be passed on to consumers. It is not clear whether the 'reasonable test' is subjective or objective in terms of the insurer's position?

57. The proposed drafting set out at paragraph 50 above provides the necessary clarification to address these issues.

58. Further, the Committee considers that where an insurer proves that a term is reasonably necessary to protect its legitimate interests in that it reasonably reflects

the underwriting risk accepted by the insurer in relation to the contract, there is no valid policy reason why the insurer ought to be required to also prove that the term does not disproportionately or unreasonably disadvantage the insured.

59. There are three problems with this part of the proposal:

    (a) It is not clear how the concept of 'proportionality' would apply. That is, against what would the proportionality of a particular insured outcome be weighed? Where the effect of a coverage provision is to disentitle the insured to cover in the context of a particular claim, that outcome would have a significant direct financial effect on the insured. It would commonly, in the context of a particular insured, be the case that such outcome would be disproportionate to the additional premium for which that insured might have been able to obtain cover.

    However, that type of disproportionality is not unfair. Indeed, it is the very essence of insurance that risk is pooled across a book of similar risks such that the indemnity provided to an individual insured will be paid for (together with a profit margin) by premium paid by all insureds (many of whom will not have claims and therefore be indirectly subsidising the insured whose claim is paid. In that context, the context of proportionality could only be applied by reference to the effect of any particular term across a whole book of similar risks.

    Where an insurer's standard policy does not cover a particular risk, it would be difficult to quantify what the effect of any particular term on the insurer would be but for the operation of that term. Placing an onus of the insurer to prove that the provision does not disproportionately disadvantage the insured would require the insurer to provide actuarial data on the hypothetical performance of its book of business if it had been issued to all insureds on different terms.

    For the reasons set out above, that exercise would present a costly and possibly unachievable evidentiary burden as the insurers' actuarial data will usually be limited by reference to the cover in fact provided. It is commercially unrealistic to expect an insurer to be able to build actuarial models to quantify how a hypothetical alternative bundle of covers (which it has not in fact offered to the market) might perform so as to provide the alternative scenario against which the effect on the insured can be measured to determine whether the effect on the insured is disproportionate.

    (b) The proposal would place a substantially greater burden on insurers than any other contracting party which is only required to prove that the term is reasonably necessary to protect its legitimate interests. There is no valid policy reason why such an additional burden should be placed on insurers only.

    (c) Consistently with the overarching policy considerations set out above, the concept of proportionality between the consequences of the term for an individual insured in the context of a specific claim, is a matter properly dealt with by reference to the concept of utmost good faith already contained in the IC Act. The proper scope for the operation of the UCT laws is in respect of standard terms which are inherently unfair on their terms (rather in their application to the individual circumstance of an insured).

60. The end result of the current Treasury proposal on this point would make it extremely difficult for an insurer to safely price its insurance and for reinsurers to do the same. It

may result in insurers adopting pricing uplifts to build in a contingency to reflect the uncertainty of the current proposal.

Terms that may be considered unfair

Relevant questions addressed:

Question 18: Do you consider that it is necessary to add specific examples of potentially unfair terms in insurance contracts?

Question 19: Do you support the kinds of terms described in the proposal or should other examples be considered?

Question 20: Should tailoring specific to either general or life insurance contracts also be considered?

61. The Committee considers that it is useful to provide a non-exhaustive list of terms which might be considered unfair on the basis that such examples provide guidance but do not prohibit the use of these terms or create a legal presumption that they are unfair.

62. The Committee notes that many examples cited in submissions to earlier consultations on UCT laws in an insurance context specify terms which might be unfair in particular circumstances but which are not inherently unfair.

63. Any such list should be careful to include only terms which are inherently unfair within the principles set out earlier in this submission.

64. The Committee considers that such terms should include:

    (a) terms which permit the insurer to elect to pay a claim based on a cash settlement calculated by reference to the cost of repair which may be achieved by the insurer, but could not reasonably be achieved by the policyholder;

    (b) terms in a contract that is linked to another contract (for example, a credit contract) which limit the insured's ability to obtain a premium rebate on cancellation of the linked contract;

    (c) terms which impose unreasonable procedural of financial conditions upon the insured exercising a right to terminate the contract (for example a requirement that such termination be in writing signed by the insured or requires an excessive notice period).

65. In terms of the examples provided in the proposals paper, no information is provided on why these are considered unfair terms, nor scenarios of when and why this has been found to be the case. This should be done. In many cases they will not be unfair and other cases, unfair depending on the circumstances.

66. In relation to example (a), this differs from the first example provided in the Treasury proposal in that it in restricted to terms which have that effect in circumstances where the insurer can make the election to provide a cash settlement. The Committee does not consider that a term which provides the insured with a right to have the property insured replaced or repaired by the insurer or to elect a cash settlement on that basis is inherently unfair.

67. By way of illustration, if an insurer wishes to repair under the policy and has a right to do so, but an insured wants a cash settlement, it may not be unfair for the insurer to rely on a term that permits it to pay a claim based on the cost of repair or replacement that it may achieve (but not the policyholder) where it has priced the policy on this basis.

68. In relation to example (b), this is the same as example 3 in the Treasury proposal.

69. The Committee does not consider that the second example used in the Proposal Paper is appropriate as drafted. Such provision would effectively undermine the foundation of claims made based insurance policies. The Committee further notes the existing remedial effect of section 54 of the IC Act and sections 13 and 14 of the IC Act.

Remedies for unfair terms

Relevant questions addressed:

Question 21: Do you support the remedy for an unfair term being that the term will be void? Is a different remedy more appropriate (for example, that the term cannot be relied on)?

Question 22: Do you consider that it is appropriate for the Court to make other orders?

Question 23: Should tailoring specific to either general or life insurance contracts also be considered?

70. The Committee agrees that it is appropriate that:

    (a) where an action is brought by an insured, any declaration that the contract is unfair should apply as between that insured and the insurer (noting that, as the declaration will apply to a standard form contract there is the potential that it could be considered unfair for a number of other consumers or small businesses); and

    (b) ASIC may seek court orders to obtain a declaration that the contract is unfair in respect of:

        (i) all consumers and small businesses; or

        (ii) a specific class of consumers or small businesses.

71. The Committee considers that, where the Court has made a determination that a term is unfair, the Court ought to have the flexibility to make (or not make as the circumstances of the case require) a consequential order that:

    (a) the unfair term is void; or

    (b) the unfair term cannot be relied upon by the insurer.

72. Such orders should not flow automatically from a declaration that the term is unfair. That is because, a term may be unfair because if it gives the insurer rights which are broader than are necessary having regard to the legitimate interests of the insurer.

Such a term may be declared to be unfair. However, the insurer's reliance on the term, in the circumstances of the particular claim and particular insured under consideration, may not necessarily be unfair.

73. For example, a term in a motor policy may exclude cover where the insurer determines, in its absolute discretion, that the insured deliberately caused the damage to the car the subject of the claim. Such a term may be unfair because it has the effect of allowing the insurer to unilaterally determine whether the contract has been breached and/or reduces the insurers usual evidentiary burden of proving to the usual standard that the breach. However, in the case of a specific claim, where the insurer is able to prove to the usual standard that the insured deliberately caused the damage which is the subject of the claim, the insurer should not be prevented from relying upon the term.

74. The Committee agrees that a finding that a term was unfair under the UCT laws should not automatically lead to a conclusion that the insurer had breached its duty of utmost good faith. That remedy should be subject to the existing provisions of the IC Act. The Committee refers to the principles in paragraphs 72 and 73 above.

75. The Committee agrees that a finding that a term was unfair under the UCT laws should not automatically lead to a conclusion that the insurer had engaged in conduct which was unconscionable or misleading or deceptive. That remedy should be subject to the existing provisions of the IC Act (subject to section 15 of the IC Act).

76. The Committee considers that any remedy broader than those set out at paragraphs 69 and 70 above, go beyond the legitimate scope of the UCT laws and are more properly the subject of relief under existing consumer protection laws available in respect of insurance contracts and dealings pursuant to the IC Act and ASIC Act.

77. In particular, the Committee considers that there is no sound policy basis to allow the court an unconstrained discretion to provide any other orders it thinks fit. The existing provisions of the IC Act provide carefully tailored relief which strikes a fair balance between the rights of insureds and insurers including, in the sections 13 and 14, a broad discretion to make orders designed to redress unfairness.

78. The proposal to provide such an unconstrained remedial discretion goes well beyond the policy rationale of the UCT laws as they apply in all other contractual contexts and general law principles.

79. While the Committee supports the extension of UCT laws to insurance contracts pursuant to the principles identified in this submission, the reversal of the usual legal onus is justified only to the extent of the remedies available under existing UCT laws.

Third party beneficiaries

Relevant questions addressed:

Question 24: Do you consider that UCT protections should apply to third-party beneficiaries?

Question 25: Do support the above proposal or should an alternative proposal be considered?

Question 26: Superannuation trustees may have substantial negotiating power and owe statutory and common law obligations to act in the best interest of fund members. Do these market and regulatory factors already provide protections comparable to UCT protections such that it would not be necessary to apply the UCT regime to such products?

80. The theoretical underpinning of the UCT laws are based upon the imbalance of negotiating power during the contracting process as between the contracting insured and the insurer.

81. It is not appropriate to apply the UCT laws to third party beneficiaries because the imbalance in negotiating power as between the third-party beneficiary and the insurer is a redundant concept. By definition, the third-party beneficiary is not a contracting party.

82. The IC Act provides significant consumer and small business protections to third party beneficiaries.

83. The Treasury proposal is based upon consideration of (at least primarily) trustee arrangements in the accident and health or life contexts. It does not contain any analysis or consideration of the broad range of third party beneficiaries across the broader spectrum of insurance products.

84. Nor does it reflect the reality that the contracting insured may quite deliberately wish to secure only limited cover for the third-party beneficiaries.

85. For example, where a small business building contractor contracts to provide insurance to its principal to a standard specifically negotiated between the contractor and its principal, it is not in the interest of the contractor that the principal would be able to rely upon UCT laws to expand the cover provided beyond that which was obtained by the contractor. The contractor's interest is to minimise payments to third parties' beneficiaries which would affect the contractor's future cost and availability of insurance. It would be perverse to apply the UCT laws for the benefit of a third-party and against the interest of both the contracting insured and the contracting insurer.

86. Further, where a large corporate trustee purchases insurance on behalf of a group of beneficiaries, the trustee will often be a have significant bargaining power as against the insurer and will carefully negotiate the scope of cover obtained. It would be inappropriate, and without any theoretical justification, to apply UCT laws by reference to the status of the beneficiary in circumstances where there was no imbalance of power between the negotiating parties. Moreover, it should be noted that the trustee's duties are not simply to obtain the broadest possible cover on behalf of the group members which make claims but are more complex and extend to

ensuring that the group policy remains affordable, and sustainable, for the benefit of all group members.

87. In addition, it is not clear how the new tests (i.e. 'reasonably reflects the underwriting risk' and not 'disproportionately or unreasonably disadvantage the insured') would apply in a group policy context especially if the third party beneficiary can access the benefit without paying anything.

88. In addition, the Committee queries how the actions of the group purchasing body would be taken into account.

Tailoring for specific insurance contracts

Relevant questions addressed:

Question 27: Do you consider that any other tailoring of the UCT laws is necessary to take into account the specific features of general and/or life insurance contracts?

Question 28: Do agree that unilateral premium adjustments by life insurers should not be considered unfair in circumstances in which the premium increase is within the limits and under the circumstances specified in the policy?

89. Not considered.

90. Treasury should have regard to submissions made on behalf of stakeholders in the life industry in relation to necessary additional tailoring particularly with respect to premium adjustments.

Transitional arrangements

Relevant questions addressed:

Question 29: Is a 12 month period adequate? If not, what transition period would be appropriate?

Question 30: Are the transition arrangements outlined above appropriate or should alternative transition arrangements be considered??

Question 31: What will insurers need to do during the transition period to be ready to comply with the new UCT laws?

Question 32: Should tailoring specific to either general and/or life insurance contracts be considered?

91. Not considered.

92. Treasury should have regard to submissions made on behalf of the industry in finalising the transition arrangements.

Other Issues

Application to standard form contracts

93. The existing UCT laws apply where it is determined that the relevant contract is a 'standard form contract' within the meaning of section 12BK of the ASIC Act which provides:

> *2BK Standard form contracts*
>
> *(1) If a party to a proceeding alleges that a contract is a standard form contract, it is presumed to be a standard form contract unless another party to the proceeding proves otherwise.*
>
> *(2) In determining whether a contract is a standard form contract, a court may take into account such matters as it thinks relevant, but must take into account the following:*
>
> *(a) whether one of the parties has all or most of the bargaining power relating to the transaction;*
>
> *(b) whether the contract was prepared by one party before any discussion relating to the transaction occurred between the parties;*
>
> *(c) whether another party was, in effect, required either to accept or reject the terms of the contract (other than the terms referred to in subsection 12BI(1)) in the form in which they were presented;*
>
> *(d) whether another party was given an effective opportunity to negotiate the terms of the contract that were not the terms referred to in subsection 12BI(1);*
>
> *(e) whether the terms of the contract (other than the terms referred to in subsection 12BI(1)) take into account the specific characteristics of another party or the particular transaction;*
>
> *(f) any other matter prescribed by the regulations.*

94. That tests applies by reference to the particular circumstances of the manner in which the contract was prepared and the parties' dealings at the time of entry into the insurance contract including whether a party was given an effective opportunity to negotiate the terms of the contract.

95. It is proposed that the same test applies in respect of insurance contracts.

96. The application of those provisions does not have regard to the particular features distribution within the insurance market.

97. Insurance products for consumers and small businesses are generally distributed wither directly between the insurer and the insured or via an insurance broker.

98. It is arguable that, where a policy is distributed via an insurance broker, the contract will not be a 'standard form contract' as it is usual for insurance brokers to negotiate the terms with insurers either by:

(a) agreeing to 'white labelled' policies which contain terms and conditions different to those of the insurers standard policies for the benefit of all the broker's clients); or

(b) by specific negotiation on behalf of the particular insured.

99. Indeed, the power dynamic between insurers and brokers is such that, in many cases it could be said that, where an insured uses an insurance broker the insured will have '*an effective opportunity to negotiate the terms of the contract*'.

100. There is a risk that the use of the standard contract definition will have the effect of distorting the market for distribution of insurance products by:

(a) insurers choosing to make certain products available only through insurance brokers; and

(b) insureds choosing to not use an insurance broker because a policy purchased directly will be more likely to attract the protections of the UCT laws.

101. Neither of the above distortions of the distribution market would be beneficial to consumers or small businesses.

102. A further disadvantage of the application of the 'standard form contract' definition as a criteria determining the application of the UCT laws is that it creates uncertainty for insurers seeking to ascertain which of its products are subject to, or potentially subject to, the UCT laws. Such uncertainty will significantly increase the costs to insurers of compliance with the UCT laws, which costs are likely to be passed on to consumers and small business through higher premiums.

103. It is also inconsistent with all other consumer and small business protection laws in respect of insurance contracts. In other contexts, the application of consumer and small business protection laws and remedies are tailored to apply only to 'prescribed contracts'.

104. Limiting the application of the UCT laws to terms contained in prescribed contracts, which terms have not been the subject of negotiation between the contracting insurer and the insured, would be a more appropriate approach because it would:

(a) achieve consistency with other consumer and small business protection laws applicable to insurance;

(b) achieve significant additional protections for consumers and small businesses in respect of insurance products principally aimed at those markets;

(c) avoid unintended distortionary effects on the market for distribution of insurance products (which effects would not be beneficial to consumers); and

(d) reduce the compliance costs to the industry (and therefore any flow on effect to pricing).

Group insurance arrangements

105. It is not clear if any consideration been given to whether the protection in an insurance context should be limited, especially in the context of group insurance arrangements.

106. By way of example, if a group of companies purchase a Management Liability policy covering all members of the group, and only one is a small business, the whole policy is caught. As a result, if a term is unfair only in relation to the small business and is voided, this may adversely affect other participants.

Contact – NILG Committee

107. For further comment or clarification on any of the matters raised in Part C please contact Andrew Sharpe, Chair, National Insurance Lawyers Group on (T) 02 9018 9915 or at (E) asharpe@meridianlawyers.com.au.