



Unfair Contract Terms Consultation Paper
Small Business, Competition and Consumer Policy Division
The Treasury
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Dear Sir/Madam

EXTENDING UNFAIR CONTRACT TERMS (UCT) PROTECTIONS TO SMALL BUSINESSES

The Insurance Council of Australia¹ (Insurance Council) appreciates the opportunity to respond to the Consultation Paper “Extending Unfair Contract Term Protections to Small Businesses” (the Consultation Paper) which Treasury released on 23 May 2014.

This submission has two parts. The first looks at the need for small businesses to be protected from unfair contract terms (UCT) in general insurance contracts; the second whether small businesses need such protection when entering contracts for the supply of goods and services to general insurers.

1. Insurance contracts for small businesses

The Insurance Council acknowledges that, in regards to some sectors of the economy, it may be beneficial for UCT protections to be extended to small businesses. However, in relation to general insurance, nationally small businesses have been well protected for some time by the Insurance Contracts Act 1984 Cth (IC Act), supplemented by other laws such as the Corporations Act 2001 Cth (Corporations Act) and ASIC Act 2001 Cth (ASIC Act). We submit that these laws collectively provide equivalent, if not greater, protections to small businesses from UCT in relation to insurance they purchase.

Statistical data points to the effectiveness of the consumer protection currently provided to general insurance policyholders. The Financial Ombudsman Service’s (FOS) Annual Report on the General Insurance Code of Practice for 2012-2013 shows that of 540,936 claims lodged with insurers in relation to all commercial classes of business (not just small

¹ The Insurance Council of Australia is the representative body of the general insurance industry in Australia. Our members represent more than 90 percent of total premium income written by private sector general insurers. Insurance Council members, both insurers and reinsurers, are a significant part of the financial services system. March 2014 Australian Prudential Regulation Authority statistics show that the private sector insurance industry generates gross written premium of \$41.4 billion per annum and has total assets of \$111.5 billion. The industry employs approximately 60,000 people and on average pays out about \$111 million in claims each working day.

Insurance Council members provide insurance products ranging from those usually purchased by individuals (such as home and contents insurance, travel insurance, motor vehicle insurance) to those purchased by small businesses and larger organisations (such as product and public liability insurance, professional indemnity insurance, commercial property, and directors and officers insurance).

business), only 4,862 (0.9%) was declined. Only 1,598 (0.29%) involved an internal dispute raised with the insurer.

The Insurance Council is not aware of any complaints from small businesses about UCT in general insurance contracts. To apply the UCT remedy to general insurance would result in unwarranted layering of regulatory requirements on insurers and would lead to operating inefficiencies, the cost of which ultimately is passed on to the insured.

The application of a UCT remedy to insurance contracts rather than assisting small businesses will create uncertainty in the application of insurance terms to claims, which will likely lead to further disputes resulting in inconvenience and delay, increasing costs and possibly premiums.

Therefore the Insurance Council strongly submits that the existing exemption under section 15 of the IC Act for insurance contracts from the operation of UCT legislation should be retained in its entirety.

Protections provided by the IC Act

Australian small businesses when buying general insurance benefit from robust protection provided by the detailed provisions of the IC Act. When it was introduced into Parliament in December 1983, the Act's purpose was described as:

- to improve the flow of information between the insurer and insured so that the insured can make an informed choice as to the contract of insurance he enters into and is fully aware of the terms and limitations of the policy, and
- to provide a uniform and fair set of rules to govern the relationship between the insurer and insured.*(our emphasis)*²

The preamble to the Act describes it as:

*"An Act to reform and modernise the law relating to certain contracts of insurance so that a **fair** balance is struck between the interests of insurers, insureds and other members of the public and so that the provisions included in such contracts, and practices of insurers in relation to such contracts, operate **fairly**, and for related purposes." (our emphasis)*

Insurance is a rare but important example where, decades ago, Parliament had the forethought to establish a comprehensive set of rights and obligations specifically around the insurance contract.

It's important to note that the amendments made to the IC Act in 2013 strengthened the protections available to insureds. Of particular relevance:

- failure to comply with the duty of utmost good faith is a breach of the IC Act (section 13(2));
- where an insurer fails to comply with the duty of utmost good faith in the handling of a claim or settlement of a claim or potential claim, ASIC may treat this failure as a breach of financial services laws under the Corporations Act (section 14A); and

² See Senate Hansard, 1 December 1983, pp3134-3138.

- ASIC has the power to intervene in any proceedings relating to a matter under the IC Act (section 11F).

Attachment A explains the provisions in the IC Act that protect small businesses against unfair terms.

Section 15 of the Insurance Contracts Act

Section 15 of the IC Act excludes insurance contracts from the operation of a Commonwealth, State or Territory Act that provides relief in the form of judicial review of unfair contracts or the making of a misrepresentation except for relief in the form of compensatory damages. As explained below, this exemption leaves untouched a number of avenues of consumer redress.

In its report which laid the foundation for the Act, the Australian Law Reform Commission concluded that in light of the utmost good faith obligation, it was unnecessary for insurance contracts to be subject to a facility for judicial review of unfair contractual terms.³ The Panel which reviewed the IC Act in 2004 concluded that the exclusion provided by section 15 was still valid.⁴

The Review Panel did go on to comment that:

“If a nationally consistent model for review of consumer unfair contracts is developed, the balance of consideration may shift and the issue should be revisited.”⁵

However, it also concluded that:

“The Review Panel believes that sections 13 and 14 of the IC Act relating to the duty of utmost good faith, have potential to be utilised by insureds in connection with insurer conduct that might otherwise be dealt with under statutes dealing with unfair contract terms or unconscionable conduct. This capacity will be enhanced further if the Review Panel’s proposal for treating a breach of the duty of utmost good faith in Chapter 1 is adopted.”⁶

As mentioned above, the IC Act was amended last year to treat a breach of the duty of utmost good faith as a breach of the IC Act and further it would be a breach of the financial services laws if it were in relation to a claim. This gives ASIC significant powers to punish insurers for such breaches, including withdrawal of an insurer’s Australian Financial Services Licence (AFSL).

Other protections available to small businesses

Apart from the IC Act, there is also a variety of additional generic protections available to insurance policyholders. (See Attachment B for details.) In particular, under the Corporations Act 2001 there is an overarching obligation on general insurers as the holders of an AFSL to do all things necessary to ensure that financial services covered by their licence are provided efficiently, honestly and fairly⁷.

³ Australian Law Reform Commission 1982, Insurance Contracts ALRC 20, para 51.

⁴ Review of the Insurance Contract Act 1984, Final Report on second stage, page 53.

⁵ Ibid.

⁶ Review of the Insurance Contract Act 1984, Final Report on second stage, page 54.

⁷ Section 912A(1).

Further, section 991A of the Corporations Act states “A financial services licensee must not, in or in relation to the provision of a financial service, engage in conduct that is, in all the circumstances, unconscionable.” This section provides if a person suffers loss or damage because a financial services licensee contravenes this provision they may recover the amount of the loss or damage against the licensee. This provision is not impacted by the section 15 exemption.

FOS

It is also very important to note the ability of small business policyholders to access the FOS.⁸ There is a requirement under the Corporations Act for a general insurer to be a member of an external dispute resolution scheme. Almost all general insurers choose to be members of the FOS.

This independent umpire provides free, fair and accessible dispute resolution for those unable to resolve a dispute directly with their general insurer. External dispute resolution processes can help to resolve disputes through negotiation or conciliation as an alternative to court proceedings and can make decisions which are binding on participating general insurers.

In dealing with disputes, FOS:

- a) must do what in its opinion is appropriate with a view to resolving disputes in a cooperative, efficient, timely and fair manner;
- b) shall proceed with the minimum formality and technicality; and
- c) shall be as transparent as possible, whilst also acting in accordance with its confidentiality and privacy obligations.⁹

General Insurance Code of Practice (the Code)¹⁰

The Code which has been adopted by members of the Insurance Council has the following objectives:

- a) commitment to high standards of service;
- b) promotion of better, more informed relations between insureds and insurers;
- c) maintenance and promotion of trust and confidence in the general insurance industry;
- d) provision of fair and effective mechanisms for the resolution of complaints and disputes; and
- e) promotion of continuous improvement of the general insurance industry through education and training.

To the extent they acquire retail insurance¹¹, small businesses enjoy the protections of the Code, in areas such as buying insurance and standards for service suppliers.

⁸ Under 4.1 of its Terms of Reference, FOS can hear a dispute involving a business that, at the time of the act or omission by the Financial Services Provider that gave rise to the Dispute:

- a) if the business is or includes the manufacture of goods: had less than 100 employees; or
- b) otherwise: had less than 20 employees.

⁹ FOS Terms of Reference, 1.2.

¹⁰ <http://www.codeofpractice.com.au>

Impact of contravening the IC Act

Under the UCT provisions of the Australian Consumer Law and the equivalent applying to financial services in the ASIC Act (the model favoured by the Government), if a term in a consumer contract is unfair, the supplier (or party that is not the consumer) will not be able to rely on that term as it will be void. The remainder of the contract will still be valid to the extent it is capable of operating without the unfair term.

As can be seen by looking at the IC Act provisions listed in Attachment A, the same remedy is already provided by the IC Act, with parties being unable to rely on an UCT. The Insurance Council submits that if a general insurer were to seek to rely on a clause in a policy and it was found to be void (for example under section 14) and the contract could not effectively operate without it, an insurer would clearly be prevented from seeking to rely on the rest of the contract.

To the extent an insurer sought to do so, the consumer would potentially be entitled to a claim for damages for breach of the insurer's duty of utmost good faith under section 13. The insurer would also be in breach of its Corporations Act obligations (as explained above).

As noted above, after the amendments made in 2013, ASIC can now bring an action on behalf of the consumer for breach of the duty of utmost good faith as it does under the Australian Consumer Law and ASIC Act for use of an unfair term.

In summary, **taking action under the current UCT regime would in many cases see small businesses worse off than if they had taken action under the IC Act.**

UCT protection does not need to be applied to insurance contracts for small businesses

In light of the matters discussed above, the Insurance Council submits that there is no need to apply UCT protection to insurance contracts for small businesses.

Apart from being unnecessary, adding another layer of requirements will lead to confusion for the insured and the insurer.

2. Contracts involving small business as suppliers

Small businesses currently enter into contracts for the supply of goods and services to general insurers for a variety of commercial arrangements. The Insurance Council is not aware of any circumstance in which the extension of the UCT provisions to contracts in relation to the supply of goods and services by small business to the general insurance industry would be warranted.

We note that in addition to the industry-specific codes that protect small business noted in the Consultation Paper, the Motor Vehicle Insurance and Repair Industry Code of Conduct (the Code) is relevant to the general insurance industry. The Code, first released in 2006,

¹¹ Retail Insurance is defined by the Code to mean a general insurance product that is provided to, or to be provided to, an individual or for use in connection with a small business, and is one of the following types of insurance: motor vehicle; home building; home contents; sickness and accident insurance; consumer credit; travel; or personal and domestic property.

Small business means a business that employs:

- (a) less than 100 people, if the business is or includes the manufacture of goods; or
- (b) otherwise, less than 20 people.

was implemented to improve the effectiveness of relationships between insurance companies and smash repair businesses, many of which are small businesses. The Code is voluntary, except in New South Wales where adherence to the Code is legislated, but has widespread support with all major insurance companies and smash repair trade associations being signatories to the Code.

While the Code is subject to continuous review and improvement, from our perspective, the Code demonstrates the benefits of a dialogue based on consensus and cooperative relationships to enhance commercial processes and arrangements, as opposed to the use of black letter law to achieve the same objectives. The general insurance industry is currently working with repairers and their trade associations in considering potential improvements to the Code, identified through the most recent external review in 2013. Importantly, the review noted feedback from stakeholders that the Code has provided greater contractual certainty to insurer-repairer network commercial arrangements.

Despite the above observations in relation to general insurance, the Insurance Council acknowledges that some of the benefits identified in the Consultation Paper in relation to the extension of the UCT protections to small businesses acquiring goods and services could also be applicable to small businesses supplying goods and services, if such provisions were appropriately scoped.

If the Government is minded to extend the UCT protections to contracts for goods and services supplied by small business, we submit that the provisions need to be appropriately designed and scoped to ensure that the regime is practical to comply with and associated compliance costs are contained. Importantly, appropriate processes need to be established to ensure that vexatious and illegitimate claims are minimised. We note that an overly onerous compliance regime could result in the perverse outcome of reducing incentives to engage with small business.

In this context, we agree with the policy objective, as stated in the Consultation Paper, of providing certainty to business as to the application of any laws from the outset of contract formation. We submit that, consistent with the current UCT protections for consumers, any extension of the provisions to small businesses as suppliers should only apply to standard form contracts.

The Consultation Paper identifies a number of options for defining “small business”. In our experience, definitions that incorporate measurement of business size on the basis of employee number or revenue are impractical given such information is fluid and non-transparent. The ICA submits that a transaction threshold (option A.2) presents the option of defining small business that is most practical to implement, given this information is readily available to all contracting parties. We suggest that an appropriately-set transaction threshold should be coupled with an exclusion of publicly listed companies, which will eliminate businesses that are obviously not small businesses.

If you have any further questions or comments please contact John Anning, Insurance Council's General Manager Policy, Regulation Directorate on tel: (02) 9253 5121 or email: janning@insurancecouncil.com.au.

Yours sincerely



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IC ACT PROVISIONS WHICH PROTECT SMALL BUSINESSES FROM UCT

j) Sections 13 and 14

Two very important obligations are contained in sections 13 and 14 of the Act. Section 13 provides:

"A contract of insurance is a contract based on the utmost good faith and there is implied in such a contract a provision requiring each party to it to act towards the other party, in respect of any matter arising under or in relation to it, with utmost good faith."

Although there is no statutory definition of the requirement to act in utmost good faith, it has been held by the Courts that it means to act with scrupulous fairness and honesty and the courts have broadly interpreted this concept. The High Court in *CGU v AMP* (2007) HCA 36 recently discussed utmost good faith in detail.¹²

Gleeson CJ and Crennan J noted at paragraph 15 of the judgment that the concept of good faith is not limited to dishonesty. Further their Honours stated:

"In particular we accept that utmost good faith may require an insurer to act with due regard to the legitimate interests of an insured, as well as to its own interests. The classic example of an insured's obligation of utmost good faith is a requirement of full disclosure to an insurer, that is to say, a requirement to pay regard to the legitimate interests of the insurer. Conversely, an insurer's statutory obligation to act with utmost good faith may require an insurer to act, consistently with commercial standards of decency and fairness, with due regard to the interests of the insured. Such an obligation may well affect the conduct of an insurer in making a timely response to a claim for indemnity."

Kirby J noted at paragraph 127:

"The language of s13 [of the Insurance Contracts Act 1984] including the statement of the general principle as a legal obligation separate from the implication of a provision into the contract, supports AMP's submission that s13 of the Act had the effect of introducing a larger and reciprocal obligation between the insurer and the insured in place of what had, for all practical purposes, previously been a one-way street. Such a view of s13 would fit comfortably with other protections for consumers, introduced into the Act, based on the report of the Australian Law Reform Commission"

His Honour further states at paragraph 176 to 178:

"The principle is that the parties to insurance contracts in Australia, unlike most other contracts known to the law [our emphasis], owe each other, in equal reciprocity, an affirmative duty of utmost good faith. This is so now by s13 of the Act. In the context

¹² See also:

- Australian Associated Motor Insurers Ltd –v- Ellis (1990);
- Sheldon v Sun Alliance Ltd (1989);
- Barbaro v NZI Insurance Australia Ltd (1994); and
- Maksimovic v Royal & Sun Alliance Life Assurance Australia Ltd (2003).

of that section, emphasis must be placed on the word “utmost”. The exhibition of good faith alone is not sufficient. It must be good faith in its utmost quality.

The resulting duty is one that pervades the dealings of the parties to an insurance contract with each other. In consequence of the Act, and of the reform that it introduced in s13, the duty of good faith as between insurer and insured now takes on a true quality of mutuality. It governs the conduct of insurers whereas, previously, as a practical matter, the duty of good faith was confined to a duty cast upon insureds because the remedies for proof of the absence of good faith were usually of no real use to the insured.

The duty is more important than a term implied in the insurance contract, giving rise to remedies for breach, although, by the express provision of s13, it is certainly that. The duty imposes obligations of a stringent kind in respect of the conduct of insurer and insured with each other, wherever that conduct has legal consequences.”

Callinan and Heydon JJ note at paragraph 257:

“At the outset we should say that we agree with the Chief Justice and Crennan J that a lack of utmost good faith is not to be equated with dishonesty only. The analogy may not be taken too far, but the sort of conduct that might constitute an absence of utmost good faith may have elements in common with an absence of clean hands according to equitable doctrine which requires that a plaintiff seeking relief not himself be guilty of tainted relevant conduct.”

Importantly, the 2013 amendments added:

“(2) A failure by a party to a contract of insurance to comply with the provision implied in the contract by subsection (1) is a breach of the requirements of this Act.”

Section 14(1) provides:

"If reliance by a party to a contract of insurance on a provision of the contract of insurance would be to fail to act with the utmost good faith, the party may not rely on the provision."

Section 14 renders any unfair clause void. The effect is the same as under the unfair contracts provision of the Australian Consumer Law:

- *Barwon Region Water Authority v CIC Insurance Ltd (1997);*
- *Banks v NRMA Insurance Ltd (1988); and*
- *ACN 007 838 584 v Zurich Australia Ltd (1997).*

As part of the 2013 changes, section 14A was introduced:

- “1) This section applies if an insurer under a contract of insurance has failed to comply with the duty of the utmost good faith in the handling or settlement of a claim or potential claim under the contract.*
- 2) Despite any provision of Chapter 7 of the Corporations Act 2001 or any regulation made under that Chapter, ASIC may exercise its powers under Subdivision C of Division 4 of Part 7.6 of that Act or Subdivision A of Division 8 of that Part in relation to the insurer as if the insurer’s failure to comply with the duty of the utmost good faith were a failure by the insurer to comply with a financial services law.”*

ii) Section 21, 21A, 22 and 28- non disclosure

These sections place significant limits on when an insurer can rely on non disclosure by an insured to reduce or refuse a claim. For example, for eligible policies of insurance (being motor, home, sickness & accident, consumer credit and travel) an insurer when cover is first offered is required by law to ask specific questions rather than just relying on a general duty of disclosure.

iii) Sections 23, 24 26, 27 and 28- misrepresentation

These sections of the Act place significant limits on when an insurer can rely on misrepresentation to refuse to pay a claim. For example, section 26 provides that where a statement that was made by a person in connection with a proposed contract of insurance was in fact untrue but was made on the basis of a belief that the person held, being a belief that a reasonable person in the circumstances would have held, the statement shall not be taken to be a misrepresentation.

Section 27 provides that a person shall not be taken to have made a misrepresentation by reason only that the person failed to answer a question included in a proposal form or gave an obviously incomplete or irrelevant answer to such a question.

iv) Sections 35 and 37

Section 35 requires insurers in relation to prescribed contracts¹³ to clearly inform customers up front as to how their contract terms differ from standard contract terms which are outlined in the Regulations to the Act.

Section 37 requires insurers in relation to non prescribed contracts to clearly inform the insured up front as to unusual terms in their policies.

If section 35 or section 37 are not complied with then the insurer will not be able to rely on those terms (except in the case of section 35 where the insured or a reasonable person in the circumstances could have been expected to have known of the term).

v) Section 39 and 62

Section 39 says an insurer cannot refuse to pay a claim in whole or part by reason of non payment of an instalment of the premium unless the instalment has remained unpaid for a period of at least 14 days and before the contract was entered into the insurer informed the insured in writing of the effect of the provision.

Section 62 says an insurer cannot cancel a instalment contract of insurance unless at least one instalment of the premium has remained unpaid at the time the contract is sought to be cancelled for a period of at least one month and before the contract was entered into the insurer clearly informed the insured of the effect of the provision.

vi) Section 46

Section 46, in relation to prescribed contracts, restricts the ability of insurers to rely on certain terms in their policy where there was a defect or imperfection in property and the insured was not aware or the defect or imperfection and a reasonable person in the circumstances could not have expected to have been aware of it.

¹³ Contracts prescribed in the regulations to the Act are for the following classes of insurance: motor vehicle, homebuilding, home contents, sickness and accident, consumer credit and travel

vii) Section 52

Section 52 prevents an insurer from contracting out of the Act.

viii) Section 53

Section 53 makes void a term of an insurance contract that seeks to authorise or permit the insurer to vary, to the prejudice of the insured, the contract (unless the contract is exempt from the section by the Regulations to the Act).

ix) Section 54

Section 54 limits the ability of the insurer to rely on terms of the policy in relation to acts or omissions of the insured. There are two arms to the section. If the act or omission could not be reasonably regarded as being capable of causing or contributing to the loss (or even if it could but the insured proves none of the loss was actually caused by act or omission), the insurer cannot rely on a clause in the policy to refuse the claim on the basis of that act or omission unless it can prove actual prejudice.

Thus for example, if the insurer was seeking to rely on an alcohol exclusion to refuse a motor vehicle damage claim, it could only generally do so if it could be shown the act of driving under the influence of alcohol could be reasonably regarded as being capable of causing or contributing to the loss.

Further even if the insurer can prove this, if the insured can prove none of the loss was actually caused by the act of driving under the influence then the insurer must generally pay the claim.

OTHER LEGISLATIVE PROTECTIONS FOR INSURANCE POLICYHOLDERS

Corporations Act

The Corporations Act also contains provisions that protect directly or indirectly against unfair contract terms. There is an over arching obligation on insurers as the holder of an AFSL to do all things necessary to ensure that financial services covered by their licence are provided efficiently, honestly and fairly¹⁴.

Further, section 991A of the Corporations Act 2001 states:

“A financial services licensee must not, in or in relation to the provision of a financial service, engage in conduct that is, in all the circumstances, unconscionable.”

This section provides if a person suffers loss or damage because a financial services licensee contravenes this provision they may recover the amount of the loss or damage against the licensee.

The unconscionable conduct remedies under the Corporations Act and ASIC Act (see below) are presumed to be unaffected by section 15 of the Insurance Contracts Act 1984 which does not impact actions for compensatory damages.

There are also a number of other protections which apply when small businesses purchase retail policies¹⁵:

i) Cooling off

There is a 14 day cooling-off period for risk insurance products acquired by retail clients.¹⁶ This means the customer can always cancel in this period and receive a fair refund of premium.

ii) Product Disclosure requirements

The Act prescribes minimum content requirements for Product Disclosure Statements (PDS). For general insurance, PDSs usually comprise part of the contract of insurance between the insurer and insured. They must be provided to the customer either at the time of sale or, in some circumstances, within 5 business days of the sale and be written in a clear, concise and effective manner.¹⁷ For general insurance, the PDS must include:

- information about significant characteristics or features of the product or of the rights, terms and conditions and obligations attaching to the product;
- dollar disclosure of significant benefits, and the costs of the product;

¹⁴ Section 912A(1).

¹⁵ Retail Insurance is defined under Section 761G(5) to mean a general insurance product that is provided to, or to be provided to, an individual or for use in connection with a small business, and is one of the following types of insurance: motor vehicle; home building; home contents; sickness and accident insurance; consumer credit; travel; or personal and domestic property.

Under Section 761G(12) Small business means a business that employs:

(a) less than 100 people, if the business is or includes the manufacture of goods; or
(b) otherwise, less than 20 people.

¹⁶ Corporations Act section 1019A(1)(a)(i)

¹⁷ Corporations Act sections 715A and 1013C.

- the terms and conditions of the policy itself (with the meaning of the Insurance Contracts Act and in particular section 35 and 37 Insurance Contracts Act notice information);
- information about the dispute resolution process available to the customer; and
- information about the cooling off regime.

There is also a general obligation to include other information in a PDS that might influence a decision of a consumer whether or not to acquire the product.¹⁸

A customer may recover the amount of any loss or damage suffered because a PDS was defective¹⁹. ASIC also has specific powers in relation to issuing a stop order on a defective PDS²⁰.

iii) Compensation Arrangements

AFSL holders are obliged under section 912B of the Corporations Act to maintain compensation arrangements for retail clients²¹.

ASIC Act

In terms of wrongful conduct as distinct from unfair terms, there are also the following provisions in the ASIC Act:

- unconscionability (ss 12CA, 12CB);
- misleading or deceptive conduct or representations (ss 12DA and 12DB); and
- remedies (Part 2 Div 2G).

¹⁸ Sections 1013D and 1013E, Regulation 7.9.15D, 7.9.15E and 7.9.15F.

¹⁹ Sections 1022A and 1022B.

²⁰ Section 1020E.

²¹ Section 912B.