INSURANCE COUNCIL OF AUSTRALIA

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Dear Ms Calder

UNFAIR CONTRACT TERMS (UCT) IN CONTRACTS OF GENERAL INSURANCE

The Insurance Council of Australia (Insurance Council) is responding to the public invitation from Assistant Treasurer Bradbury on 10 May 2013 for comment on the Exposure Draft of the Insurance Contracts Amendment (Unfair Terms) Bill 2013 (UCT Exposure Draft).

Recognising the Government's decision that a remedy for UCT should apply to general insurance, the Insurance Council remains committed to workable outcomes that are in the interests of all stakeholders. However, the Insurance Council cannot support the introduction into Parliament of the UCT Exposure Draft in its current, seriously flawed form. We take the opportunity in this submission therefore to identify the key drafting concerns however have been unable to identify possible amendments to the Bill given the serious drafting issues, complexity and potential legislative interactions which requires considerable additional analysis.

UCT remedy needs to be tailored to the detailed regulatory regime for general insurance

In one of its earliest submissions to Treasury on this issue, dated 27 March 2009, the Insurance Council said:

> "If the decision is taken to ignore the existing protections and additionally apply the proposed unfair contract term provisions to general insurance contracts, the Insurance Council submits that it will be **essential** for the Government to provide clear guidance as to how the obligations under the various relevant pieces of legislation interact. NB: Such interaction of legislation is likely to have significant implications for the systems and procedures of insurers."

A major theme of the Insurance Council's submissions since then has been how the UCT remedy in the *Australian Securities and Investments Commission Act 2001 (Cth)* (ASIC Act) can apply appropriately to general insurance contracts so that its operation is equivalent to that in other sectors. This equivalence needed to be not only in terms of the protection provided to the consumer but also the certainty of contract which could be relied upon by an insurer compared to that enjoyed by other suppliers of goods and services.

The application of the UCT remedies to general insurance was considered against the background of the broad regulatory regime which applies generally to the sale of goods and services but not in the context of a comprehensive, detailed consumer protection regime which had been established with the commencement of the *Insurance Contracts Act 1984* (Cth) (IC Act).

The Insurance Council and its members were optimistic after the discussions which industry had in late 2012 with consumer advocates, Treasury and other stakeholders that an effort was being made to tailor the UCT remedies to sit within the general insurance regulatory regime centred on the IC Act. This was mentioned in the Assistant Treasurer's media release of 20 December 2012 which announced the principles upon which the Government would base its introduction of UCT remedies to general insurance. In particular, the industry was encouraged by the proposal that in the event of a term being found to be unfair, the term could not be relied upon by an insurer rather than being voided as would apply under the ASIC Act. However, the Insurance Council made it clear to Treasury that careful drafting of the legislation foreshadowed by the Assistant Treasurer would be crucial and we understood that Treasury welcomed the offer of assistance.

Inadequate time for consultation

Given the long history of discussions on whether, and if so how, UCT remedies should apply to general insurance contracts, the Insurance Council is very disappointed that just over three weeks has been allowed for consultation and that soon afterwards the intention is to introduce the Bill into Parliament. The Government's Best Practice Regulation Handbook suggests that a consultation period of at least six weeks is appropriate[1].

The haste with which this consultation is being undertaken is in contrast to the five months that have elapsed since the Assistant Treasurer's announcement of the proposed inclusion of UCTs to the IC Act, during which time there has been no discussion with the industry on the drafting of the UCT Exposure Draft. In particular, our members require sufficient time to consider the implication of the detail of the proposals, and the Insurance Council also requires sufficient time to consult with its members to establish an informed industry view. Three weeks is insufficient to comprehensively assess the consequences of the complex changes proposed in the UCT Exposure Draft.

This is especially the case when its interaction needs to be analysed not only against the existing regulatory regime but the significant changes that will follow from the passing of the *Insurance Contracts Amendment Bill 2013* (Cth) (IC Bill). This is expected to occur in the next several weeks and will make key changes to the treatment of the duty of utmost good faith, rights of third parties and ASIC powers.

Inadequate Regulatory Impact Statement (RIS)

Under the Government's commitment to good regulation, agencies are required in most cases to complete a RIS for legislative changes. The Draft Explanatory Memorandum (Draft EM) released with the UCT Exposure Draft referred to a RIS completed in November 2012 on the overall question of applying UCT remedies to insurance contracts. The RIS did not consider the principles announced by the Assistant Treasurer nor the specifics of the UCT Exposure Draft.

[1] Best Practice Regulation Handbook Appendix C, p57, C45.

This is more than unfortunate; it is the opposite of good regulatory practice. The RIS's cost/benefit analysis needs to take account of the specifics of the legislative proposal. An examination of the UCT Exposure Draft's provisions indicates that the damage likely to be done to the established regulatory fabric of the general insurance industry could well exceed the anecdotal estimates in the RIS of consumer detriment that would be redressed by the introduction of UCT remedies, which remain undefined.

UCT Exposure Draft is not tailored to the existing regulatory regime for insurance

It is apparent from a close examination of the UCT Exposure Draft that those provisions have not, with few exceptions, been drafted with regard to well-established principles of insurance law, the existing provisions of the IC Act and the meaning of terms found elsewhere under the IC Act. This is most obvious in relation to the duty of utmost good faith and the treatment of various parties who have a connection with an insurance contract. The danger is that the UCT provisions will be affected by and will, in turn, affect other provisions in the IC Act.

For example, phrases such as "main subject matter of the contract" and "underwriting risk" have long been a source of debate, particularly in connection with the operation of section 54 of the IC Act. What the "underwriting risk" accepted by a particular insurer comprises is a matter which has been considered in the past and found to have a different meaning for different insurers and even different underwriters. There is a body of law under section 21 of the IC Act concerning this issue.

The Insurance Council wants to bring the Government's attention to several serious concerns with the UCT Exposure Draft. These are detailed below. A number of specific significant issues are explained in Attachment A.

Unknown implications of UCT Exposure Draft in its current form

Under the proposed section 15A, an insurer fails to comply with the duty of utmost good faith if a term is declared to be an unfair term or if the insurer relies on or seeks to rely on such a term. The notes appear to provide that this is a breach of the duty of utmost good faith under both sections 13 and 14 of the IC Act. Under section 15A, there is no reference to sections 13 and 14 of the IC Act other than in the notes which themselves are not entirely clear.

It is necessary therefore to understand both sections 13 and 14 and the impact of the amendments to be made by way of the IC Bill. Section 13 concerns the duty of utmost good faith as a term of the contract, while Section 14 creates a particular type of breach of the duty of utmost good faith. It is reliance on a term itself that may amount to a breach of the duty of utmost good faith. It is important to note that it is the reliance on the term rather than the term itself that creates the breach. This tailors the application of s 14 to individual circumstances. A particular term may not create a breach in other circumstances. By way of contrast, if a term is found to be unfair under the UCT Exposure Draft then any reliance will automatically be a breach of the duty of utmost good faith such that the unfair term may not be relied upon.

Under the IC Bill, section 13 will be expanded to include rights of third party beneficiaries of cover but only in relation to certain post contractual breaches of the utmost good faith. However, section 14 will continue to concern reliance on a term by a "party to a contract of insurance". The UCT Exposure Draft in referring to parties generally (as opposed to parties to the contract) appears to encompass not only parties to a contract of insurance but also

third party beneficiaries of cover. Therefore, the proposed UCT provisions will be inconsistent with sections 13 and 14 of the IC Act, if the IC Amendment Bill is passed, due to the conflicting definition of 'party'.

The existing provisions of the IC Act carefully deal with the issue of third party beneficiaries of cover. The amendments in the IC Bill also carefully address the distinction between a party to a contract and a third party beneficiary. For example, the proposed section 13(4) will cause section 13 to apply to third party beneficiaries only in respect of conduct after a contract has been entered into and section 14 will not extend to third party beneficiaries. The UCT Exposure Draft ignores the ambiguity that is created by use of the word "party" in an insurance context.

UCT Exposure Draft introduces a lower threshold for breach of utmost good faith

The proposed UCT provisions provide a much lower threshold for what is considered to be a breach of utmost good faith than that which currently exists under the IC Act. There is a considerable amount of case law that deals with the current ambit of the duty of utmost good faith which is not defined in the IC Act. A degree of certainty concerning the scope of the duty is important in establishing the rights and obligations of parties to a contract of insurance. The duty of utmost good faith is a foundation stone of insurance law. By lowering the threshold as to what constitutes a breach of the utmost good faith, albeit in relation to an unfair term, an unacceptable level of uncertainty is likely to occur. The changes may well impact on how utmost good faith is considered outside the immediate amendments to the IC Act by way of the UCT Exposure Draft and in the IC Act generally.

Possibility of multiple breaches of the duty of utmost good faith

The form in which the UCT provisions are presently drafted creates a risk that a successful challenge to a term of an insurance contract by an individual on the grounds of fairness (in their particular circumstances and subject to the insurer not being able to show that the term was reasonably necessary to protect legitimate interests) will cause the term to be deemed an unfair term in all other contracts in which it appears.

The resulting breach of the duty of utmost good faith in relation to other contracts may not be accompanied by a uniform "unfairness" across all contracts in which the term appears. In making this observation, it has to be noted that there is uncertainty as to the proof that will be required for an insurer to demonstrate that a term of the contract is necessary in order to protect the legitimate interests of the insurer. It is unclear whether legitimate interests have to extend to all contracts in which the term appears or if it be sufficient that it extend to only some. Putting the legitimate interest question to one side, the UCT provisions do not ensure that a breach of the duty of utmost good faith over multiple contracts arises because of inherent unfairness, in that term will operate unfairly in every contract in which it appears.

Insurance contracts are unique in that the application of terms may result in different outcomes depending on the facts underlying an insurance claim. It was this understanding that prompted the careful drafting of the IC Bill to distinguish between a breach of the duty of utmost good faith separately in the context of pre-contractual and post-contractual conduct. It is the reason that section 14(1) of the IC Act is drafted in terms that see a breach occur only when an insurer *relies on* a particular term in a contract of general insurance. There is no necessary uniformity of application of terms of a contract of insurance.

UCT Exposure Draft does not address notification

A fundamental issue which is addressed in the IC Act is the issue of notification to an insured, for example, the notification required under section 35 when derogating from standard cover. Notifications to an insured and an insured's awareness of terms is a fundamental issue that is carefully dealt with under the IC Act. The involvement of brokers and agents in connection with a purchase of insurance is also recognised and dealt with under the IC Act pursuant to section 71. The UCT Exposure Draft disregards these fundamental concepts which ought to be recognised in determining whether a term is unfair. If an insured has employed an insurance broker who is an insurance professional in dealing with an insurer in respect of the terms, this should be taken into account. The UCT provisions deal with issues such as negotiations and transparency but are silent on the issue of intermediaries.

In practice, a lower threshold for unfairness would apply to general insurance

When careful consideration is given to the requirements for a term to be unfair, it becomes apparent that two of the requirements are readily satisfied when considering insurance contracts. Assuming that a term is being challenged because its application has caused an insurance claim to be refused or short paid then the first requirement is readily satisfied. This is because it could be strongly argued by the consumer that the term has caused a significant imbalance in the parties' rights under the contract. This would satisfy section 15B(1)(a).

Similarly, it would follow that the term has caused financial detriment to a party if it were to be applied or relied upon with the result the insurance claim would not be paid. This would satisfy 15B(1)(c). Accordingly, for an insurer the only requirement that would give rise to any significant consideration is that in section 15B(1)(b). Therefore, arguably in practice the only effective consideration as to whether a term of a contract of general insurance is unfair is whether it is reasonably necessary in order to protect the legitimate interests of the insurer.

In the context of insurance, in the absence of further guidance, the formulation will give rise to many questions, creating uncertainty for insurers. Examples are:

- What does "reasonably necessary" mean?
- What are the "legitimate" interests of an insurer assuming the fortuity of a risk within a defined scope for a price?
- What proof is required? The importance of a term to a cedant's reinsurers? The basis of the term reflected in past claims or actuarial studies?

Inadequate Transition Period

In discussions with the Assistant Treasurer on 31 August 2012, he offered the Insurance Council a "generous" transition period for the introduction of a UCT remedy. In his announcement of 20 December 2012, the Assistant Treasurer stated the new regime would have "an adequate transition period". Both of these statements had led the Insurance Council and its members to expect more than the twelve months transition period contained in the UCT Exposure Draft.

Twelve months is inadequate to implement necessary changes to insurance contracts in light of the renewal cycle common to general insurance. To illustrate, a contract may be due for renewal one month after the Royal Assent. If the standard renewal period is twelve months, the contract will apply until the thirteenth month following the date of Royal Assent. In this

scenario, the contract could be in breach of the UCT provisions in its final month. Allowing that a renewal is sent out six weeks in advance of the renewal date, in order to avoid the breach of an annual contract, insurers would in effect be required to make changes to the contract **before** the legislation is approved and its terms are certain.

As has occurred in relation to the disclosure provisions of the IC Bill, the Insurance Council urges Treasury to again recognise that general insurance contracts almost always are set to run for twelve months and the work needed to review, prepare and distribute new policy documents. A thirty month transition period is necessary to enable insurers to prepare for the commencement of the new remedy.

Willingness to work to improve the Bill

The Insurance Council and its members are willing to meet you and your Treasury colleagues at your earliest convenience to commence work on how the practicality of the Exposure Draft's provisions can be improved. We consider that a thorough analysis of the Bill's interdependencies with the insurance legislative framework will serve to better promote agreeable solutions for stakeholders.

If you require further information in relation to this submission, please contact Mr John Anning, Insurance Council's General Manager Policy – Regulation Directorate at janning@insurancecouncil.com.au.

Yours sincerely

Robert Whelan
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INSURANCE COUNCIL OF AUSTRALIA

ATTACHMENT A

Main subject matter

The proposed section 15D is in identical terms to section 12BI of the ASIC Act. If the UCT Exposure Draft is adopted it will be left to the courts to determine the meaning of the phrase "main subject matter of the contract". This would result in there being a considerable amount of uncertainty as to what terms of an insurance contract are actually subject to section 15A. The same level of uncertainty is not present in connection with other types of contracts where a clear line can be drawn between the contract for the exchange of a good or service and the good or service itself.

Another level of uncertainty is caused by the apparent different use of the term elsewhere in the IC Act. For example:

- Section 16 refers to having “an interest in the subject matter of the contract”;
- Section 17 refers to “property that is the subject matter of the contract”;
- Section 42 refers to a contract that is “in the same terms and in respect of the same subject matter and risk as those of the first mentioned contracts”;
- Section 50 refers to a situation where a building is the “ subject matter of a contract of general insurance”;
- Section 54 refers to an “act or omission that has the effect of altering the state or condition of the subject matter of the contract or of allowing the state or condition of the subject matter to alter”.

It would be confusing to introduce the same term with a different meaning that would depend upon its context within the IC Act. Clearly, subject matter of the contract where it appears elsewhere in the IC Act means other than scope of cover.

If the term does mean something equivalent to scope of cover, it should be noted that there will also be a level of uncertainty unless it is further defined. Similar issues have risen under section 54 of the IC Act. There has been confusion in respect of which section 54 has no application because a claim is simply not within the “scope of cover” or falls outside of a “core promise”. There has been much debate over what falls within these terms when considering particular contracts of insurance. The law has been developing on a case by case basis.

Contrary to previous assurance from Treasury, the drafting of the Bill does not appear to ensure that a term that goes into price (15D(1)(b)) is part of the main subject matter. The draft in its current form does not seem to support the expectation that where a term goes to price or a term protects the legitimate interests of the insurer, it is not reviewable.

Implications of section 15C (grey list)

The IC Act already provides tailored remedies for almost all of the situations addressed in the proposed list of potentially unfair terms (the ‘grey list’) (see Attachment B). It is recognised that the explanatory materials makes it clear that the list does not prohibit the use of those terms, or create a presumption that they are unfair. However, in respect of individual terms, due to them being included on the grey list, it is likely that a court would be more inclined to find that such a term is unfair without having regard to how those terms are dealt with under the existing provisions of the IC Act. In that regard, certain existing provisions of the IC Act may have reduced significance. Further, it is unclear from the Bill as to how consumers may obtain redress if a term of the contract is considered to be unfair.

Difficulty of determining what is a standard form contract for general insurance

One of the factors in determining the existence of a standard form contract for general insurance is the existence of an “effective opportunity” for the consumer to negotiate its terms (section 15E2(d)). However, there is no definition of what constitutes an "effective opportunity". In the commentary to the Australian Consumer Law (ACL), it was noted that the drafters had avoided express definitions as they might provide parties the opportunity to structure contractual arrangements to circumvent the application of the provisions.

The statutory language is ambiguous. It is unclear whether what constitutes an "effective opportunity" to negotiate will:

- change according to the circumstances of the parties and the nature of the contract, e.g. whether a greater opportunity to negotiate must be afforded to an insured with a poor grasp of English or a low level of education or in circumstances where the size or nature of the risk being insured warrants a greater opportunity; or
- be an objective standard which requires that the insured be given some level of opportunity to engage in negotiations.

What is meant by the "main subject matter of the contract" in s15D(1)(a) will significantly impact upon what constitutes an "effective opportunity" to negotiate. In determining whether an insurance contract is a standard form contract, the court must take into account whether the insured was given an effective opportunity to negotiate the terms of the contract other terms specified in s 15D(1), which include a term that defines the "main subject matter of the contract".

Accordingly, if the main subject matter of the contract is given a narrow interpretation, more terms will fall outside the main subject matter. If the insured is afforded an effective opportunity to negotiate those terms which fall outside the main subject matter, a court is less likely to find that a contract of general insurance is a standard form contract. For example, terms which may be likely to be negotiated are those relating to the level of excess that will be applicable or the different coverage options. Depending on whether such terms are the "main subject matter of the contract" (or another type of term specified in s 15D(1)), a court may or may not be required to consider any negotiation of those terms in determining whether the contract as a whole is a standard form contract.

Requiring a court to give consideration to the opportunity to negotiate terms other than those which define the main subject matter of the contract and not also requiring the court to consider the opportunity an insured has to negotiate the terms that define the main subject matter of the contract (which presumably would be of more significance to the insured) is an unusual outcome which appears to result from the proposed drafting of section 15E(2). This is particularly so in circumstances where the nature and number of terms of an insurance contract which fall within the meaning of "main subject matter of the contract" is so uncertain.

The proposed s 15E(2)(c) requires that, in determining whether a contract of general insurance is a standard form contract, the court must consider "*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 15D(1)) in the form in which they were presented*". The form in which s 15E(2)(c) is drafted clearly specifies an irrelevant matter which a court must take into

account. In doing so, it necessarily prejudices an insurer in connection with a determination by a court as to whether a contract of general insurance is a standard form contract.

As a matter of course, every contract of insurance would, perhaps notionally, require the insured to either accept or reject the terms of the contract in the form in which they were presented immediately before the insured agreed to purchase the insurance. This would be so regardless of how many amendments might have been made to the terms of the contract prior to them being presented in a form to which the insured was willing to accept.

However more fundamentally this provision does not take into account the order in which insurance is contracted. The terms mostly are presented as an invitation to treat. The proposal by an insured is then accepted or rejected by the insurer and at that point in time, the negotiation, if any, takes place. Putting this to one side, arguably there ought to be some limitation on the drafting as to when the terms “were presented". For example, s 15E(2)(c) might end with "*were first presented*".

It is difficult to see how a determination as to whether a contract is a standard form contract could be made prior to the contract being made. That being the case, technically speaking, there will never be a standard form contract prior to a contract being entered into for the purposes of the UCT provisions even if the form of the contract is one which is capable of becoming a standard form contract at a later date. It would be correct to say that the same collective terms contained in a contract may not be a standard form contract at one point in time and later become a standard form contract.

As to precisely when a contract of general insurance becomes a standard form contract, we note that pursuant to section 15E(1) a contract of general insurance only becomes a standard form contract if a party to a proceeding alleges that it is one. At that point it is presumed to be a standard form contract unless another party to the proceeding proves otherwise.

By drafting the UCT provisions in this way, an allegation that a contract is a standard form contract may trigger a breach despite the contract later being found to not be a standard form contract. If ASIC has made a declaration that a term of a general insurance contract is an unfair term under section 12GND of the ASIC Act, an allegation made by a party to a proceeding that one or more contracts of general insurance are standard form contracts will technically trigger a breach of section 15A(1) in respect of each of those contracts. This will be so even if that presumption is later rebutted when a court determines that the contract of general insurance is not a standard form contract.

Underwriting risk

Subsection 15B(5) states:

(5) An insurer under a standard form consumer contract of general insurance is taken to have proved that a term of the contract is reasonably necessary in order to protect the legitimate interests of the insurer, if the insurer proves that the term reflects the underwriting risk accepted by the insurer.

Accordingly, there is effectively a carve-out from the UCT provisions for a term which the insurer is able to prove "reflects the underwriting risk accepted by the insurer". However, the precise nature of the terms which are intended to fall within this carve-out is not clear.

What constitutes the "underwriting risk" accepted by the insurer might encompass a subjective or objective test dependent upon whether the relevant underwriting risk is that which was actually taken into account by the particular insurer or underwriter or whether it is relevant to look objectively at what would reflect the underwriting risk of an insurer in similar circumstances. The drafting is unclear on this point.

Section 12GND of the ASIC Act permits the court to declare a particular term of a standard form contract to be unfair, with the consequence that the same term may be taken to have been declared to be unfair for the purpose of section 15A where it is included in similar contracts. If an insurer is unable to prove that a term reflects the underwriting risk accepted in connection with a particular insured because of that insured's circumstances, it should not follow that the insurer would similarly be unable to prove that the term did not reflect the underwriting risk in connection with other contracts for which the insured's circumstances may be different. The current drafting appears to create a risk that such an outcome could arise.

The Insurance Council previously suggested that consideration be given to words along the lines of "which circumscribe the risk which the insurer accepts under the contract". However, these have not been adopted for reasons well known to Treasury.

Priority to existing remedies

Given that the IC Act already provides long established remedies for most of the situation identified as being potentially unfair in the grey list (refer Attachment B), participants in the discussions in late 2012 favoured these remedies being applied first. The Assistant Treasurer's principles included this as:

> "in addition to the above (UCT) remedy, a court may consider whether there is another more appropriate remedy;"

Section 15H(1) of the UCT Exposure Draft provides that the insertion of applied enforcement provisions in favour of ASIC into the IC Act is not intended to limit the court's powers under the act in respect of a contract what contains an unfair term. It does not establish priority nor require consideration of appropriateness between the different remedies that will be available under the IC Act.

Section 15H(2) sets out two considerations to which a court must have regard when considering whether to exercise a power under the act governing unfair contract terms:

a) the contract as a whole, and

b) the extent to which the insurer complied with the other requirements of the act in relation to this contract.

The statutory language clearly establishes these as being mandatory considerations - the court must turn its mind to them as a pre-requisite to exercising a power. However, there is no prescribed consequence of a court reaching a particular conclusion on either consideration.

Accordingly, neither of these subsections can be taken to mean that the remedies currently provided in the IC Act must be considered before the proposed remedies for unfair contract terms.

Third party beneficiaries of cover

Contracts of insurance are distinguishable from other consumer contracts on the basis that they may confer rights and obligations on a person who is not a party to the contract, which are enforceable by the third party subject to the existing provisions of the IC Act. The wording of the UCT Exposure Draft, and its interaction with the IC Bill leave it unclear what the position of such a third party beneficiary of cover is in relation to unfair contract terms.

As noted above, the existing provisions of the IC Act carefully deal with the issue of third party beneficiaries of cover and the amendments in the IC Bill also carefully address the distinction between a party to a contract and a third party beneficiary of cover. The UCT provisions make references to a "party" in such a way that it is not possible to determine whether a reference is being made to a contracting party or a third party beneficiary of cover.

Consequently, it is not clear whether the term 'party' where used throughout the UCT Exposure Draft extends to third party beneficiaries and, if so, whether it does so in also places where a "party" is referred to. If the latter is the case, it could lead to unintended consequences. For example:

- Section 15B(3)(d) states that a requirement of term of a standard form contract being transparent is that it is 'readily available to any party affected by the term'. The terms are unlikely to have been made available to many third party beneficiaries of cover.
- Section 15E(2)(d) includes as a matter to be taken into account when determining if a contract is a standard form contract whether 'another party was given an effective opportunity to negotiate the terms of the contract…' It is unlikely that any third party beneficiary would be involved in the negotiation of the policy.

The use of the word "individual" in the definition of a "consumer contract"

The intent of the UCT provisions is to provide protection to "consumers". However, the nature of some insurance contracts undermines the mechanism by which the UCT provisions seek to confine protection to "consumers".

The definition of a "consumer contract" makes reference to an "individual" whose acquisition is for personal, domestic or household use or consumption. However, what constitutes a "consumer contract" is only relevant to determining whether a particular contract is a standard form contract. To the extent that an insurance contract is purchased by both an individual for personal, domestic or household use and consumption and also for a business purpose, the contract may become a standard form consumer contract of general insurance.

To the extent that it is, a term which relates only to cover for the business would nevertheless be capable of being declared unfair because there is a disconnect between the conduct which constitutes a breach of section 15A and the requirement that the breach be contrary to the interests of a "consumer". It is theoretically possible therefore that a challenge on the basis of unfairness could be mounted by someone other than a "consumer". This would be a strange result given that the purpose of the UCT provisions is to protect consumers.

Problems associated with introduction of the term “transparency

The draft Bill proposes the following in Section 15B:

(2) In determining whether a term of a standard form consumer contract of general insurance is unfair under subsection (1), a court may take into account such matters as it thinks relevant, but must take into account the following:

(a) the extent to which the term is transparent;

(b) the contract as a whole.

*(3) A term of a standard form consumer contract of general insurance is **transparent** if the term is:*

(a) expressed in reasonably plain language; and

(b) legible; and

(c) presented clearly; and

(d) readily available to any party affected by the term.

There are presently disclosure obligations applicable to the type of consumer insurance contracts this provision is directed towards. If an insurance contract provides cover that is less than the minimum statutorily prescribed cover for certain events, the IC Act requires an insurer to 'clearly inform' the consumer of limitation, unless the consumer actually knew or a reasonable consumer would have known of the limitation. In the case of a policy containing unusual terms, an insurer is likewise required to 'clearly inform' the consumer.

Product Disclosure Statements required in connection with "retail products" under the Corporations Act also include obligations to be "clear, concise and effective".

Having regard to section 15B(3), meeting the requirement for a term to be transparent appears to be less onerous than the obligation to be "clear, concise and effective" but is perhaps more onerous than the obligation to "clearly inform". The exception to this observation is in the case of third party beneficiaries who are unlikely to have had the terms “readily available” to them.

It would be preferable to use the "clearly inform" language to maintain consistency within the ICA and avoid creating a different threshold for the level of disclosure required.

Current case law in connection with the obligation to "clearly inform" under section 35(2) of the IC Act suggests:

> “ ... a fair reading of section 35(2) does not warrant the conclusion that the result need go further than provide for the relevant exclusion in the policy wording in clear and unambiguous language and in a manner which a person of average intelligence and education is likely to have little difficulty in finding and understanding if that person reads the policy in question.”

The requirement to use clear and unambiguous language and in a manner which a person of average intelligence and education is likely to have little difficulty in finding and understanding is similar to the transparency measure of expressing a term in reasonably plain language and legibly.

Importantly, section 15B(2) requires consideration of the extent to which a term is transparent. Subsection 15B(3) states when a term will be entirely transparent. Because what is required by the court is a determination of how transparent a term is, it would not seem to be of great consequence if the concept of transparency was replaced by a measure of the extent to which an insured was clearly informed of a term.

There is also a good argument that a term is transparent if the contract of insurance has been transacted through a broker. However, this assumes that an individual contract is the touchstone.

Introduction of the concept of consumer contract into IC Act

The introduction of the concept of a 'consumer contract' would create a third method[2] by which different classes of insurance contracts can be distinguished and would cause there to be further overlaps. This overlap raises three clear problems.

First, the same off the shelf standard cover policy may fall in or out of the UCT regime depending on how it is used. This makes it difficult for a consumer or insurer to know the scope of their obligations. For example, one can consider two identical travel insurance policies purchased by someone about to embark on a business trip, and someone who will accompany them as a holiday will be treated entirely differently. Both could be standard cover, only one will be capable of being a standard form contract.

Second, it is possible for a standard cover contract to fall partly in and out of the unfair contract terms regime. For instance a travel insurance policy used on a trip that combines work and a holiday may have mixed personal and business use, and so fall outside of the test for a standard form consumer contract of general insurance. Similar difficulties arise from the exclusion of life insurance. Consumer credit insurance policies and trauma policies often contain a combination of general and life insurance covers and are underwritten by both general and life insurers. The legislation does not make clear how these situations are treated, and whether it is possible for the unfair contracts regime to apply to only part of a policy.

Third, the proliferation of contract types adds unnecessary layers of regulatory complexity.

[2] Apart from retail policies under the Corporations Act, there are already eligible/Standard cover contracts, and prescribed contracts for the purposes of flood insurance.

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ATTACHMENT B

HOW TERMS FROM THE GREY LIST ARE ALREADY DEALT WITH UNDER THE IC ACT

Example of unfair contract term	**Application to insurance policies**
a term that permits, or has the effect of permitting, one party (but not another party) to avoid or limit performance of the contract	Avoidance: An insurer is permitted by sections 28 and 29 of the IC Act to avoid a contract, subject to the provisions of those sections. Sections 31 and 56 contain limitations on the right of avoidance. We should say that the question of "avoidance" relates to pre-contractual conduct of the insured and the impact of that conduct on the validity of the policy. The 'grey list' appears to be contemplating something broader than "avoidance", namely: one party having a right to choose not to perform its obligations (under an otherwise valid contract). This is generally not applicable to insurance. Limitation: Not applicable. Policies generally contain agreed limits on liability, but not provisions allowing the insurer to limit its performance beyond that which is set out in the policy terms and conditions.
a term that permits, or has the effect of permitting, one party (but not another party) to terminate the contract	Sections 63 of the IC Act prevents an insurer cancelling a contract of insurance, except as provided by the IC Act. Sections 59, 60, 61 and 62 permit cancellation in certain circumstances. An insurer must give reasons for cancellation (section 75) and the notice of cancellation must be sent in accordance with a prescribed method (section 77). Section 58 allows an insurer not to renew a policy that would usually be renewed or re-negotiated. Some policies allow the insured, but not the insurer, to terminate the contract. Otherwise, insurance policies that are consumer contracts would not usually allow the insurer, but not the insured, to terminate the contract.
a term that penalises, or has the effect of penalising, one party (but not another party) for a breach or termination of the contract	Section 54 of the IC Act provides important protection for insureds who breach a contract of insurance. Sections 28, 31 and 56 will also be relevant here. Sections 59, 60, 62 and 63 may also be applicable. Penalties: Not applicable. Insurance policies that are consumer contracts would not usually contain penalties for one party (but not the

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	other party) for breach or termination of the contract. We should say that this conclusion is based on a narrow interpretation of "penalises" (i.e. in the sense of applying a penalty). If "penalise" is interpreted more broadly, then it could be said that a claims condition which, when applied, results in an insurance claim being denied, "has the effect of penalising" a party for their conduct (for their breach of the claims condition). It also possible (although not common) for a contract of insurance to contain a term that requires the insured to forfeit the entire premium paid if the insured chooses to terminate the contract before expiry of the policy period. This would have the effect of penalising the insured for early termination. A clause which allowed the insurer to charge a pro rata premium for "time on risk" would, arguably, **not** penalise the insured.
a term that permits, or has the effect of permitting, one party (but not another party) to vary the terms of the contract	Section 53 of the IC Act renders ineffective a provision in a contract of insurance permitting the insurer to vary unilaterally the contract to the prejudice of the insured. It is possible for an insurer to vary the terms of a contract of insurance in a way that advantages or benefits the insured. Section 52 of the IC Act prevents an insurer excluding, restricting or modifying the operation of the IC Act to the prejudice of a person other than the insurer itself. Some policies may give the insurer a discretion to choose the nature of the benefit to be paid (e.g. repair or replacement). Arguably, this is not a right to vary the terms of the contract (which remain unchanged) but an agreed discretion.
a term that permits, or has the effect of permitting, one party (but not another party) to renew or not renew the contract	Section 58 of the IC Act provides important protection for insureds in relation to the renewal of a contract of insurance. It requires a notice to be provided to the insured in respect of renewable insurance covers and provides for the cover to continue where that requirement is not met. Some policies allow an insurer to choose not to renew the contract if there is a change in the risk during the policy period.

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a term that permits, or has the effect of permitting, one party to vary the upfront price payable under the contract without the right of another party to terminate the contract	Some policies allow an insurer the right to charge an additional premium if there is a change in the risk during the policy period. For example, a home insurance policy may allow the insurer to charge an additional premium if the value of the home increases as a result of renovations. However, an insured would usually have a right to terminate an insurance policy at any time (subject to payment of a pro rata premium for the time that the insurer was on risk).
a term that permits, or has the effect of permitting, one party unilaterally to vary financial services to be supplied under the contract	To the extent that providing insurance cover is a "financial service", section 53 of the ICA renders ineffective a provision in a contract of insurance permitting the insurer to vary unilaterally the contract to the prejudice of the insured. A contract of insurance could contain a term that allows a unilateral variation to the prejudice of the insurer.
a term that permits, or has the effect of permitting, one party unilaterally to determine whether the contract has been breached or to interpret its meaning	Insurance policies that are consumer contracts would not usually contain terms of this nature. In addition, no decision of an insurer is final – the insured may seek a determination from FOS or other judicial relief.
a term that limits, or has the effect of limiting, one party's vicarious liability for its agents	Insurance policies that are consumer contracts would not usually contain terms of this nature. In addition, Part 7.6, Div 6 of the Corporations Act 2001 provides for the holder of an Australian financial services licence to be responsible for the conduct of its representatives.
a term that permits, or has the effect of permitting, one party to assign the contract to the detriment of another party without that other party's consent	Insurance policies that are consumer contracts would not usually contain terms of this nature. Generally speaking, a contract of insurance is a personal contract which is not capable of assignment.
a term that limits, or has the effect of limiting, one party's right to sue another party	An insurer will often agree to waive its rights of subrogation against insureds under the policy. Given the overriding duty of good faith in section 13, such a right could only operate in very limited circumstances.

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a term that limits, or has the effect of limiting, the evidence one party can adduce in proceedings relating to the contract	Insurance policies that are consumer contracts would not usually contain terms of this nature. Given the overriding duty of good faith in section 13 of the IC Act such a right could only operate in very limited circumstances.
a term that imposes, or has the effect of imposing, the evidential burden on one party in proceedings relating to the contract	It is not uncommon for insurance policies that are consumer contracts to contain a term of this nature. However, the insurer's ability to include such a term will be significantly restricted by provisions of the Act such as sections 21A(8), 35, 37, 74(2) and 75(7) and the duty of good faith in section 13 of the Act.
a term of a kind, or a term that has an effect of a kind, prescribed by the regulations	[Not applicable - no terms are currently prescribed regulations.]