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By email: ICAReview@treasury.gov.au

Unfair terms in insurance contracts: Options Paper
Corporations and Financial Services Division
The Treasury
Langton Crescent
PARKES ACT 2600

Dear Sir/Madam

Submission to Unfair terms in insurance contracts - Options paper

Consumer Action Law Centre (**Consumer Action**) thanks the Government for seeking stakeholder input on addressing unfair terms in insurance contracts, facilitated by the publication of the *Unfair terms in insurance contracts - Options paper* (the **Options Paper**).

In summary, we strongly support Option A. Below we set out our detailed comments on the issues canvassed in the Options Paper.

About Consumer Action

Consumer Action is an independent, not-for-profit, campaign-focused casework and policy organisation. Consumer Action provides free legal advice and representation to vulnerable and disadvantaged consumers across Victoria, and is the largest specialist consumer legal practice in Australia. Consumer Action is also a nationally-recognised and influential policy and research body, pursuing a law reform agenda across a range of important consumer issues at a governmental level, in the media, and in the community directly.

Since September 2009 we have also operated a new service, MoneyHelp, a not-for-profit financial counselling service funded by the Victorian Government to provide free, confidential and independent financial advice to Victorians with changed financial circumstances due to job loss or reduction in working hours, or experiencing mortgage or rental stress as a result of the current economic climate.

The problem

The Options Paper usefully sets out the problem it is seeking to scope, assess and, if justified, remedy (at p2):

> the actual or potential disadvantage or loss suffered by consumers as a result of insurance contracts containing contract terms that are harsh and/or unfair

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and the main objective of Government action in relation to this problem (at p6), being:

> to prevent consumers (including third party beneficiaries) of standard form insurance contracts from suffering detriment due to terms in the contract that are unfair or harsh.

Accordingly, the Options Paper sets out some relevant information and asks for any additional data or information that would assist in determining the extent to which unfair contract terms in insurance contracts are causing consumers actual or potential loss or damage.

Are unfair terms in insurance contracts causing consumers loss or damage?

Consumer Action strongly believes that unfair terms exist in Australian insurance contracts and that they are causing Australian consumers harm. We therefore support the Government's objective to address and prevent this harm.

The Options Paper sets out a number of actual examples of consumer detriment that were given in submissions last year to the Senate Economics Committee's inquiry into the Trade Practices Amendment (Australian Consumer Law) Bill (the **Senate Inquiry**). These examples are based on real case studies in which Australian consumers were disadvantaged by unfair terms in their insurance policy.

The Options Paper also notes that a significant number of the insurance disputes that are taken to the Financial Ombudsman Service involve the terms of the policy.

In our submission to the Senate Inquiry, Consumer Action also noted a number of real cases relating to travel insurance that had been considered by the General Insurance division of the Financial Ombudsman Service (formerly the Insurance Ombudsman Service). At the Senate Inquiry hearings, we also provided an additional case study relating to uninsured motorist extension, which is set out below.

Further, in the 2004 Annual Review of the General Insurance Enquiries and Complaints Scheme (the predecessor to the Insurance Ombudsman Service), the Panel Chair's report and the Panel's report specifically discussed harsh outcomes that arose from the legally correct application of the terms of insurance contracts.

Case study – unfair term in UME insurance policy
August 2009

Sam (name changed) had purchased third party property insurance cover for his car with a major insurer. Third party property insurance generally includes an "Uninsured Motorist Extension" that covers damage to the insured vehicle if it is damaged in an accident that is the fault of another driver who is uninsured. For example, Sam's policy stated that his insurance provided a limited amount of cover for his car if damaged in a no fault accident with an uninsured vehicle.

Sam was involved in an accident where he was not at fault. The police report on the incident, provided to the insurance company, stated that:

- the other driver was on a learner's permit;
- the other driver had a blood alcohol reading of .14; and
- the accident occurred as a result of the other driver being on the wrong side of the road after running a red light.

Sam also provided a copy of his statement to the police to his insurer, in which Sam stated that the other driver had produced a knife with a 10 to 15 centimetre blade at the scene of the accident.

This evidence suggested that the other driver was at fault and also that it might not be safe for Sam to continue to communicate with the other driver. However, a term of the policy stated that:

> If the car is involved in a no fault accident with an uninsured vehicle, we will cover your damage up to $3000 or the market value of the car, whichever is the lesser, but only if you report the accident to the police and provide evidence that the other vehicle is uninsured.

The insurer wrote to Sam stating that Sam must provide a letter from the third party stating that the third party was at fault for the incident and that he had no insurance cover, before Sam's claim would be accepted.

The Options Paper correctly notes that the number of disputes considered by the Financial Ombudsman Service represents only a small number of the claims made on insurance policies each year, but it is generally understood that only a small number of consumers who experience problems ever make a formal complaint.[1] Thus, quantitative complaint numbers are not particularly helpful in terms of determining the extent of consumer problems with a product or service, although the qualitative nature of complaints received does provide some indication of trends in consumer markets.

The Options Paper also includes some figures on the number of insurance claims rejected, which provides useful information because it does not rely on consumers choosing to bring a complaint (although the data is still of only limited use because it does not capture instances in which consumers may have suffered detriment due to the way in which a claim was paid, for example where a lower sum than originally claimed is paid due to reliance on the contract terms). The Options Paper notes that overall rejection rates are low, but that they are significantly higher for certain types of insurance, including consumer credit and travel insurance.

This accords with practical experience in assisting consumers with insurance problems. For example, the national Insurance Law Service specifically noted in its submission to the Senate Inquiry that travel insurance, consumer credit insurance and uninsured motorist extension in

[1] For example, in its 2006 report on consumer detriment in Victoria, Consumer Affairs Victoria found that only 4% of revealed consumer detriment is reported to it and smaller percentages are reported to other nominated parties, including police or an ombudsman, while 26% of people do not make any complaint at all upon experiencing detriment, even directly to the supplier: Consumer Affairs Victoria, *Consumer detriment in Victoria: a survey of its nature, costs and implications*, Research Paper No. 10, October 2006, p9.

third party property damage car insurance policies were types of insurance where it is extremely difficult for a consumer to claim precisely because the contract terms are so unfair.

Beyond the question of whether unfair terms cause consumers harm on an individual by individual basis, unfair terms in consumer contracts cause harm in a broader sense. As we have stated in previous submissions to the Government, unfair contract terms laws are intended to address the widespread inclusion of unfair terms in standard-form contracts as a general feature of the modern marketplace. The nature of the problem is that it is a market-wide problem, not one that affects the odd individual or group of individuals.

It follows, therefore, that another of the strong benefits of unfair contract terms laws is their strong pro-competitive effect more generally – by promoting consumer confidence and increased market participation and in addressing sub-optimal contracts. We believe that unfair contract terms provisions would bring these same benefits to the insurance market.

Is this consumer harm being caused by terms that are inherently unfair or terms that are otherwise fair but are capable of being applied unfairly in particular cases?

The distinction between terms that are inherently unfair and terms that are otherwise fair but are capable of being applied unfairly is a false one.

It is precisely when the question of whether and how a term is applied is at the discretion of the supplier that a term may be considered unfair.

The new national unfair contract terms law provides for a two-part definition of unfair. First, a provision sets out the general meaning of unfair and, secondly, a further provision sets out a non-exhaustive list of examples of the kinds of terms of a consumer contract that may be unfair under the general meaning. These include:

- a term that permits, or has the effect of permitting, one party (but not another party) to avoid or limit performance of the contract;
- a term that permits, or has the effect of permitting, one party (but not another party) to terminate the contract;
- a term that permits, or has the effect of permitting, one party (but not another party) to vary the terms of the contract;
- a term that permits, or has the effect of permitting, one party (but not another party) to renew or not renew the contract;
- 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;
- a term that permits, or has the effect of permitting, one party unilaterally to vary the characteristics of the goods or services to be supplied under the contract; and
- 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.

These kinds of terms do not clearly state what will occur in certain circumstances. Rather, they are terms that give the supplier but not the consumer certain rights, which the supplier can choose whether to apply and in what circumstances.

A good example is unilateral variation terms. A contract term that gives a supplier the right to vary a term of a contract unilaterally will be unfair if can be applied by the supplier at their discretion – in practice a supplier may propose a unilateral change to the contract using such a term on quite reasonable grounds, but the point is that the term is unfair *on its face* because the consumer is beholden to the supplier's discretion. By contrast, a term that clearly set out that a supplier could make a unilateral variation but only to certain terms of the contract and only for certain reasons, and/or that a consumer had the right to terminate the contract without charge or obtain other redress if a unilateral change was made, would be unlikely to be unfair on its face because its application would not be subject to the pure discretion of the supplier but would require reference to external and reasonable criteria. As Consumer Affairs Victoria states in its guidelines on Victoria's unfair contract terms laws:

> in long-term and ongoing contracts, some traders may have a legitimate need to be able change terms to keep abreast of dynamic market conditions or to accord with changes in the terms of their own supply contracts. However, as the AAPT case illustrates, unilateral variation powers cannot be justified solely on the basis that they are required to enable the supplier to respond to upstream changes in its commercial environment...
>
> In these cases, consumers must be given adequate (personal) notice of the changes and have the right to exit the contract without penalty where the changes are materially detrimental. In these circumstances, there could still be unfairness if the effect of the variation is substantially to deny the consumer the benefit for which he or she contracted.[2]

With regard to the insurance contract examples that have been provided, Consumer Action considers that it is the unfair nature of a contract term itself that has caused detriment to the consumers. For example, in Sam's case set out earlier, an insured would reasonably believe that the uninsured motorist extension cover in Sam's policy would apply to cover damage:

- up to the amount clearly stated in the policy; and
- incurred in the circumstances clearly stated in the policy, namely an accident with an uninsured motorist where the insured is not at fault.

However, the insurer attempted to deny Sam's claim by relying on the term in the policy that required Sam as the insured to collect and provide evidence of the other motorist's insurance status, regardless of whether Sam was in a position to be able to collect such evidence and regardless of the other objective facts surrounding the accident.

It is the contract term itself that is unfair in Sam's case, because it requires the insured to collect and provide evidence that they will not have (and which the third party may often be unlikely to want to volunteer). The term makes the insurance cover contingent on the actions of a third party over whom the insured has no control, and this is inherently unfair. Sam would have been denied $3,000 of cover if he had not subsequently obtained legal help. The fact that the insurer in such cases may be prevailed upon by a consumer legal service to waive their contractual right to such evidence does not render the term one that it is merely "capable of being applied unfairly in particular cases".

[2] Consumer Affairs Victoria, *Preventing unfair terms in consumer contracts*, Guidelines on unfair terms in consumer contracts, June 2007, pp9-10.

We make a similar comment with regard to travel insurance policies and the common term they contain that excludes cover where the insured has left their baggage "unattended" or "unsupervised" "in a public place". At first glance this seems like a reasonable exclusion term in itself, and that it may merely have been applied unfairly in certain cases in which a harsh outcome has resulted, for example the one noted in the Options Paper where the stolen baggage was within the insured's reach but they were distracted at the time of the theft asking for directions.

However, an understanding of the case law in this area makes it clear that it is the term itself that is unfair, not merely its harsh application by insurers in some situations. This is because the well-established case law makes it clear that such a term operates extremely broadly and excludes cover in any circumstances in which the insured has taken their eye off the baggage, for even an instant.[3] In fact, a consumer would essentially need to have their baggage stolen from their grasp (as in a mugging) to be covered for loss suffered due to stolen baggage under most current Australian travel insurance policies, whereas it is precisely when a consumer is distracted or has left baggage out of their sight momentarily that it is most likely the baggage would be stolen. Consumers would reasonably want and expect cover for their baggage in this situation, within reason, when deciding to take out a travel insurance policy covering the risk of loss due to stolen baggage.

The ordinary consumer would be unaware of the way in which insurance case law operates to render a term excluding cover for "unattended" baggage so broad, but insurers are well aware of this. A term excluding cover for unattended baggage could easily be drafted to exclude cover in more defined circumstances, such as if baggage was left unattended for a certain amount of time, out of the direct line of sight of the insured and/or out of the insured's reach, but instead insurers continue to use the unfettered exclusion.

Existing regulation

The Options Paper sets out a useful summary of some of the existing regulation relevant to insurance contracts.

Insurance Contracts Act regulation of insurance contracts

Section 14 (duty of utmost good faith) and sections 35 and 37 (standard cover) of the *Insurance Contracts Act 1984* (the **ICA**) are the first provisions discussed in the Options Paper. They are obviously relevant in the context of a discussion about consumer rights in relation to insurance contracts.

These provisions and the current ICA more generally arose out of the Australian Law Reform Commission's (**ALRC**) 1982 review of insurance contracts.[4] The ALRC's recommendations on the duty of utmost good faith and standard cover provisions were grouped together as addressing the issue of the 'variety of contract terms'.[5] The ALRC described the problem in this

[3] See *Starfire Diamond Rings Ltd v Angel* [1962] 2 Lloyd's Rep 217.
[4] The Law Reform Commission, *Insurance Contracts*, Report No. 20, 1982.
[5] As above, pp xxv – xxvi, 30-51.

area by stating that even if all the difficulties that can contribute to consumer misunderstandings about their insurance cover (such as illegible contracts or obscured terms) were removed:

> many insureds would continue to buy insurance on the basis of general description rather than actual content. They would remain ignorant of limitations on the risks covered, as also of obligations which are designed to control the risks covered and are imposed on them during the period of insurance. Unexpected limitations and obligations are contained in numerous policies purchased in this country.
> ...
> The question dealt with in this chapter is whether existing law offers adequate protection to the insured against his understandable ignorance of provisions like these or whether there should be some form of general control over policy terms.[6]

The ALRC therefore considered possible reforms to protect insureds 'against the risk of policy terms whose operation may result in injustice to him'.[7] It recommended reforms which are now found in section 14 and the standard cover provisions in the ICA.

On what was to become section 14, the ALRC said that a provision preventing a party from relying on a contractual provision when to do so would involve a breach of the duty of utmost good faith:

> should provide sufficient inducement to insurers and their advisers to be careful in drafting their policies and to act fairly in relying on their strict terms. In the context of a reformed set of laws applying to insurance contracts, such a requirement would not have to be relied on frequently by the courts. It would give rise to less uncertainty than a general power of review. State and Territorial laws allowing for judicial review of contracts should be overridden in relation to insurance.[8]

On what were to become the standard cover provisions, the ALRC said that:

> Policies contain numerous terms which affect in unexpected ways the cover offered. In a few cases, the insured's attention is drawn to the relevant limitation at the time when cover is arranged. In the vast majority of cases, however, nothing is said. The insured's ignorance remains undisturbed until he makes a claim. Standard cover should be prescribed in certain fields of insurance, including the five fields of cover examined in this chapter. The control of policy terms is not a matter which can be left to self-regulation.[9]

If it is accepted that, as Consumer Action believes and as discussed above, we continue to have a problem in Australia with consumers suffering actual or potential disadvantage or loss as a result of insurance contracts containing contract terms that are harsh and/or unfair, then it is clear that the ALRC's hopes for section 14 and standard cover protection have not been realised.

Further, it becomes clear that it was in the context of a belief that these reforms *would* work that what is now section 15 was recommended - it would exclude State and Territory laws allowing

[6] As above, p30.
[7] As above, p31.
[8] As above, p32.
[9] As above, p44.

for judicial review of insurance contracts, because section 14 would be sufficient to generate fairly drafted insurance policies.

The Options Paper discusses the standard cover provisions only briefly and correctly notes that insurers can still rely on non-standard or unusual terms reasonably easily, by simply providing a potential insured with a copy of the policy wording prior to entering the contract. Consumer Action submits that it is fairly clear it is for this reason that the standard cover provisions have not been of great assistance in improving protection for insureds against harsh or unfair terms.

Regarding section 14, the Options Paper goes into more detail and makes an effort to discuss both some possible advantages and possible disadvantages of section 14 relative to the national unfair contract terms law.

We agree with most of this list as a theoretical exercise. However, we make the point that the possible advantages are of little value in practice, because they assume that the underlying protection is actually working to protect insureds. Two decades of experience with section 14 demonstrates that it is, in fact, largely ineffective and we understand that other submissions will provide further details to this effect. Thus, it may be true that, unlike the unfair contract terms law, section 14 applies to any insurance contract, all policyholders and (if changes are made) third party beneficiaries, but if in so applying section 14 does not actually provide this wider group with assistance, it remains of limited value.

The other ICA provisions listed in the Options Paper are noted but not discussed further. The provisions relating to the duty of disclosure and misrepresentation can be beneficial to consumers, but they relate to matters other than contractual terms. The other provisions do relate to contractual terms and some of these provisions have proven of help to consumers, but they apply only to very limited and particular circumstances.

On the third party beneficiaries issue, we agree that it would be desirable for third party beneficiaries under insurance contracts to have the benefit of any unfair contract terms protections.

In our view, it is not clear that the new national unfair contract terms law would not apply to third party beneficiaries. This is because if a contractual term was unfair to a third party beneficiary within the general meaning of the provisions, save that the unfairness was to a non-party to the contract, it would be likely that the term was also unfair to the consumer contracting party, given that one of the principal reasons the consumer would have entered into the insurance contract in such a situation would have been to provide cover for the third party beneficiary.

However, under the current enforcement and remedies powers relating to the unfair contract terms provisions, the problem is that a third party beneficiary would have limited ability to enforce any rights under the unfair contract terms law, because only parties to the contract or the regulator can bring an application for a declaration that a term of a contract is unfair, which is a precursor to the ability to bring applications for further remedies for unfair terms. However, if a consumer contracting party or the regulator obtained a declaration, any party (including third party beneficiaries) could then bring applications for an injunction or compensation. The regulator could also bring an action for non-party consumer redress for affected third party beneficiaries.

To remedy this problem generally, not just in relation to insurance contracts, a simple amendment could be made to the national unfair contract terms law to extend their coverage to third party beneficiaries, which we note below in our discussion of Option A.

Other existing regulation of insurance contracts

The Options Paper does not discuss existing regulation that affects insurance contracts but is not contained in the ICA.

Even with section 15, the ICA does not cover the entire field of laws relevant to insurance contracts. Section 7 of the ICA clearly states that other laws would continue to operate in the insurance area unless otherwise provided for by the ICA:

> It is the intention of the Parliament that this Act is not, except in so far as this Act, either expressly or by necessary intendment, otherwise provides, to affect the operation of any other law of the Commonwealth, the operation of law of a State or Territory or the operation of any principle or rule of the common law (including the law merchant) or of equity.

Thus, for example, the general prohibition on misleading or deceptive conduct continues to apply to conduct relating to insurance transactions. For insurance, this prohibition is found in section 12DA of the *Australian Securities and Investments Commission Act 2001* (the **ASIC Act**) rather than in section 52 of the *Trade Practices Act 1974* (the **TPA**) because dealing in insurance is a financial service. Misleading or deceptive conduct could occur in broader contexts than merely dealings leading to the formation of a contract, but it does also apply to conduct relating to entering into a contract.[10]

In our view, a proper reading of ICA section 15 also suggests that the general prohibition on unconscionable conduct (ASIC Act s.12CB) continues to apply to insurance dealings, only not to matters relating to the contract itself. Some support for this view has been provided by the Federal Court, which considered the previous form of section 15 prior to its amendment in 1994 (for current purposes the analysis is still valid regarding present section 15):

> Though a contract can come within s 15(1)(d) as an unconscionable contract because of conduct leading up to the making of the contract and not because of any of the provisions of the contract itself, s 15(1)(d) only operates to bar an action under another Act where there is in existence a concluded contract. It does not bar an action under another Act that provides for relief in respect of unconscionable conduct that does not involve the conclusion of a contract. That approach gives proper effect to s 15.[11]

[10] In *Australian Competition & Consumer Commission v IMB Group Pty Ltd (ACN 050 411 946) (in liq)* [2002] FCA 402 (5 April 2002), Drummond J found that ICA section 15 did not bar the ACCC from making claims based on representations made by the respondents that contravened s 52 the TPA: at §116. See also Warren Pengilly, 'Insurance Arrangements: Are they Exempt from Section 52 of the Trade Practices Act' (1998) 9 *Insurance Law Journal* 1.

[11] *Australian Competition & Consumer Commission v IMB Group Pty Ltd (ACN 050 411 946) (in liq)* [2002] FCA 402 (5 April 2002) §112. See also Pengilly, above n10 , at 9-11.

Once the second Australian Consumer Law Bill is enacted,[12] the new national unfair contract terms law will sit together with the general protections against misleading or deceptive conduct and unconscionable conduct as the three parts of the "General protections" Chapter of the new Australian Consumer Law.

Financial services licensing obligations also apply to insurance. This means that, for example, insurers have a general obligation to provide their services efficiently, honestly and fairly and must comply with detailed disclosure obligations.[13] These or similar licensing obligations apply to other providers of financial services including, shortly, consumer credit,[14] but unlike insurance the provision of all of these other financial services to consumers is also covered by the new national unfair contract terms law.

Options and impact analysis

The Options Paper asks for information that would help to assess the costs and benefits of each of the listed options. It assess the options against the current status quo.

Option A

Consumer Action strongly supports Option A. This is the option that accords with the Productivity Commission's recommended reforms now being implemented via the two Australian Consumer Law Bills[15], and which have led to the new national unfair contract terms law.

The Options Paper does not take into account that Option A – to permit the unfair contract terms provisions of the ASIC Act to apply to insurance contracts – formed part of the Productivity Commission's original recommendations for the new national consumer law including unfair contract terms provisions in its 2008 *Review of Australia's Consumer Policy Framework*, and thus part of the Productivity Commission's broad assessment and quantification of the prospective gains of its proposed reforms to consumer policy.[16]

The first paragraph of the Options Paper does observe that two of the central elements of the Productivity Commission's recommended proposals were that a new generic, national consumer law should apply in all sectors of the economy and that this generic law should include a national unfair contract terms law.

The Productivity Commission noted that it was impossible to undertake a precise cost-benefit analysis of either the individual elements of its proposals or the proposed framework as a whole. However, it did undertake a broad examination of how the package of reforms might generate

[12] Trade Practices Amendment (Australian Consumer Law) Bill (No. 2) 2010.
[13] *Corporations Act 2001* s.912A(1)(a) and Part 7.7.
[14] *National Consumer Credit Protection Act 2009*.
[15] Originally the Trade Practices Amendment (Australian Consumer Law) Bill but passed as the *Trade Practices Amendment (Australian Consumer Law) Act (No. 1) 2010*, and the Trade Practices Amendment (Australian Consumer Law) Bill (No. 2) 2010.
[16] Productivity Commission, *Review of Australia's Consumer Policy Framework*, Productivity Commission Inquiry Report No. 45, April 2008.

benefits and costs and quantified the benefits as probably producing net gains for the Australian community of between $1.5 billion and $4.5 billion per year.[17]

The two Australian Consumer Law Bills[18] are the vehicles for implementing the generic national consumer law including a national unfair contract terms law. However, the Government decided to carve out insurance contracts from the national unfair contract terms law, contrary to the Productivity Commission's recommended proposals, by not including a provision to amend section 15 of the ICA in those Bills.

The Options Paper, after noting the Productivity Commission's recommendations in its opening paragraph, jumps straight to a discussion of the Senate Inquiry and its consideration of the issue that section 15 of the ICA would operate to prevent the unfair terms provisions from applying to insurance contracts. However, the Options Paper does not include any information on how the Government came to make its decision to carve out insurance contracts in the first place, and any modelling it undertook of the costs and benefits of such a carve-out, including relative to the Productivity Commission's assessment.

Given the above background, Consumer Action considers that any information or data that the Government used in making its original decision to carve out insurance contracts from the national unfair contract terms law is relevant to the current process and should be provided to stakeholders.

We also suggest that it would be useful to assess the status quo and the other options against Option A, which formed part of the package of reforms already quantified and recommended by the Productivity Commission due to the large benefits they would bring to the community.

The arguments that have been raised by insurers against Option A relate largely to the interaction of the general unfair contract terms provisions with the industry-specific regulation provided by the ICA. None of these arguments raises any difference between insurance and the variety of other industries that are also subject to industry-specific regulation, some quite complex, together with the general unfair contract terms provisions. These industries include other financial services and consumer credit, energy services and telecommunications.

The existence of a low-cost dispute resolution service is clearly beneficial to consumers, but does not relate to the issue of what rights a consumer is able to rely on in bringing a dispute to such a service. In fact, as noted earlier, the General Insurance Enquiries and Complaints Scheme (as it then was) itself raised concerns about the harsh outcomes that arose from its legally correct application of insurance contracts terms to consumer disputes in its 2004 Annual Review.

The argument that the unfair contract terms provisions may not be preferable to ICA section 14 because they do not give review rights to third party beneficiaries, again, assumes that section 14 is, in fact, effective in protecting insureds and third party beneficiaries from detriment, which we disputed above. However, as discussed earlier we do agree that third party beneficiaries

[17] Productivity Commission, *Review of Australia's Consumer Policy Framework*, Productivity Commission Inquiry Report No. 45, Volume 2 – Chapters and Appendixes, April 2008, p353.
[18] Above, n15.

under insurance contracts should have the benefit of unfair contract terms protections. As was advocated to the Government in relation to the national unfair contract terms law more generally, this would be better remedied by simply inserting a definition of 'party' to a standard form contract into the Australian Consumer Law and equivalent ASIC Act provisions that includes third party beneficiaries as parties.

Finally, the assessment of Option A does not take into account the broader benefits that an unfair contract terms law for insurance would bring to the insurance market, such as increased consumer confidence and contracting decisions that better reflect consumer preferences. These benefits were discussed earlier and they should be included in the Option A impact analysis.

In fact, it is for these reasons that one of the most important features of unfair contract terms laws is that they allow a regulator to take proactive action to address the inclusion or use of an unfair term in a standard-form contract in use in the marketplace, rather than merely giving individual consumers the legal right to take action. These broader market benefits do not accrue if a law addressing unfair terms does not enable pre-emptive regulator action to weed out unfair terms and instead is limited to remedies after the fact because, under this sort of model, consumers continue to face a high risk of encountering unfair terms and carry the burden of having to pursue a remedy. This is one of the flaws in the current regulatory provisions, which expect individual consumers to raise section 14 on a case by case basis once they are made subject to an insurance dispute.

Option B

Option B proposes to extend the ICA remedies to include unfair contract terms provisions.

Consumer Action opposes this option, as we do not consider that there is a special case to regulate insurance separately to other consumer contracts, particularly other financial services contracts.

The Options Paper states that a policy commitment to maintain the consistency, 'to the extent appropriate', of unfair contract terms laws across each piece of legislation would ensure that the insurance provisions did not diverge from the general unfair contract terms law. However, in doing so the Options Paper has already flagged that it contemplates differences by stating that this would be done 'to the extent appropriate', and it goes on to consider purported differences between other contracts and insurance that would require the unfair contract terms provisions to be amended.

It is clear that the Option B approach will inevitably lead to inconsistency in unfair contract terms protections for insurance contracts relative to all other consumer contracts.

It is this sort of inconsistency that was criticised numerous times by the Productivity Commission in its *Review of Australia's Consumer Policy Framework*.[19] It is far from best practice to restrict the coverage of generic law because of industry-specific laws, as opposed to using generic laws

[19] Productivity Commission, above n16. See, eg, Table 14.1 on p327.

first and using industry-specific laws only to address important and additional issues that are specific to a particular industry.

On all sorts of consumer policy issues, arguments in support of the worst-practice approach tend to come from industries looking for special treatment. This issue does not appear to be an exception to that tendency, with the three arguments advanced in the Options Paper in support of Option B sitting firmly in that basket. They are set out below with our responses.

1. *Option B would allow the ICA to continue to be the primary source of regulation regarding insurance contracts and 'dual pleadings' in insurance disputes would not be an issue.*

   As discussed above, other general laws do regulate insurance and it is quite simply an industry myth that the ICA contains all insurance contract regulation. This argument could easily be made about other industries but has been rightly rejected in relation to other consumer contracts in accordance with the Productivity Commission's recommendations on the roles of generic and industry-specific regulation. The concern about 'dual pleadings' is contrived as it is already standard practice that a consumer would raise or plead all available and relevant rights in an insurance dispute, including ICA, ASIC Act, *Corporations Act* and general law rights. These rights would all be raised in a single dispute or legal pleadings.

2. *Option B would enable the unfair contract terms provisions applying to insurance contracts to be tailored so that the regime fits in with existing concepts in the ICA, for example consideration could be given to replacing 'standard form' and 'consumer contract' with concepts already established under the ICA such as 'eligible contract of insurance'.*

   This purported advantage highlights that Option B would lead to inconsistencies between the unfair contract terms provisions applying to most consumer contracts and those applying to insurance contracts.

   The Options Paper states that replacing concepts in the generic law with concepts in the ICA would minimise regulatory complexities and anomalies due to marginal gaps/overlaps between the ICA and the unfair contracts regime in the ASIC Act. However, we again question whether this might be a contrived disadvantage given that the unfair contract terms provisions are new protections designed to do something different to existing regulation in any case, and this argument could be made in relation to other industry-specific regulation but has been rejected in those cases.

   Further, in fact Option B would *create* gaps and anomalies between the ICA and the ASIC Act. We point out that this approach might be viewed as minimising regulatory complexity for insurers, but it would increase regulatory complexity for consumers and government regulators who, respectively, would have to try to understand the ways in which their unfair contract term protections differ for insurance contracts and would have to produce different sets of guidance on unfair contract terms laws for insurance contracts. In addition, a whole different set of case law or jurisprudence would need to be developed for each set of unfair contract terms provisions and they could not be cross-applied, further adding to the complexity and regulatory costs. This would also be a much greater challenge for ordinary

consumers than for well-resourced insurers with experienced legal advisers. These costs have not been included in the impact assessment for Option B.

Further, this approach would narrow the coverage of the unfair contract terms provisions, for example the concept of a 'eligible contract of insurance' does not include important kinds of insurance contracts such as life insurance. This cost should also be noted in the impact analysis.

3. *Option B would allow the ICA unfair contract terms provisions to be limited in their application to narrower categories of terms, in particular, to exclude their application to contract terms that provide for exclusions from cover.*

This argument claims that the unfair contract terms provisions should be limited in their application to insurance contract terms because general and life insurance contracts can be distinguished from other types of consumer contracts in that the contract for the product and the product are the same thing. The Options Paper explains that it is arguable that the extent of the cover provided (and not provided) is, in the insurance context, of a similar nature to or the same as the 'main subject matter' of a contract, which is exempted from review for unfairness under the general unfair contract terms law.

The obvious point to make here is that the general unfair contract terms law does indeed exempt contract terms that define the main subject matter of the contract, thus to the extent that any insurance contract terms fall within this category, they will already not be subject to review.

Further, the meaning of "unfair" under the general unfair contract terms law includes a limb providing that the term is only unfair if 'it is not reasonably necessary in order to protect the legitimate interests of the party who would be advantaged by the term'. To the extent that terms providing for exclusions from cover are a reasonable requirement for the insurer in relation to the underwriting risk covered by an insurance policy, exclusion terms will not be considered unfair.

In our view, therefore, the general unfair contract terms provisions in the ASIC Act are more than capable of addressing these issues.

However, we also dispute the contention that all terms providing for exclusions from the cover provided under an insurance policy are part of central underwriting risk provided for in an insurance policy.

As noted earlier, the ALRC in its 1982 report proposed the standard cover protections precisely to address the fact that insurance policies commonly contain limitations and obligations that can affect the cover offered in ways that are *unexpected*, in the sense that it a consumer would reasonably find such limitations a surprise upon making a claim.

Not all exclusions could be said to be important to the central insurance cover under an insurance contract. For example, to take a case noted in the Options Paper, we question whether a term excluding cover for the insured and main driver under a comprehensive

motor vehicle insurance policy, which the insured has paid a higher premium for due to their higher risk, should be excluded from review because it purports to define the cover.

Further, we again note that terms not exempted from review would still need to be shown to be unfair before any remedies arose. This gives an insurer an opportunity to demonstrate that such a term is reasonably necessary to protect their legitimate business interests.

Options C and D and the status quo

In our view, the remaining options are unacceptable for consumers.

The status quo would simply allow the current problems to continue, thus it will not achieve the Government's objective of preventing consumer detriment due to unfair insurance contract terms.

Option C, like Option B, proposes that the ICA regulate the problem under specific ICA provisions but via smaller modifications to the existing ICA section 14 rather than inserting new unfair contract terms provisions. In addition to the concerns we discuss above relating to Option B, we simply do not believe that Option C would be effective in achieving the Government's objective. First, as partly recognised by the Options Paper, section 14 even as modified is not directed at addressing systemic or market-wide unfair terms in standard form contracts, which is one of the principal drivers and benefits of unfair contract terms regulation. instead, it requires a case by case assessment of the conduct of the particular parties. Secondly, section 14 does not provide that an insurer is in breach of the duty of utmost good faith merely because of the fact that they wish to rely on a contractual term that is unfair. Rather, reliance on an unfair contractual term might be prevented by section 14 in particular circumstances, but again this would need to be assessed on a case by case basis.

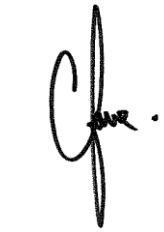
Option D proposes industry-self regulation. Again, we consider that Option D's costs and benefits are a secondary consideration to assessing whether it is likely actually to be effective in achieving the Government's objective.

We strongly believe that Option D would not be effective. It requires the industry to adopt rules on including unfair terms in their insurance contracts, however, the Options Paper highlights that industry representatives do not yet even accept that there is a problem with unfair terms in insurance contracts. They question and attempt to dismiss individual examples on a case by case basis rather than considering the systemic issues raised, and attempt to argue that there is a distinction between terms that are inherently unfair and terms that are fair but are capable of being applied unfairly. Further, the industry has made no attempt to address the issue to this point, for example using existing self-regulatory instruments. The ALRC in 1982 summarised some of the problems with attempting to rely on industry self-regulation to address unfair insurance policy terms, including that not all insurers would sign up to self-regulatory instruments and that the practices of the industry in relation to previous self-regulation initiatives gave no cause for confidence.[20] There remain no indications that the industry is capable of addressing the problem of unfair insurance contract terms via self-regulation.

[20] The Law Reform Commission, above n4, p44.

Thank you again for the opportunity to provide input into the Government's process for addressing unfair terms in insurance contracts. Please contact us on 03 9670 5088 or at nicole@consumeraction.org.au if you have any questions about this submission.

Yours sincerely
CONSUMER ACTION LAW CENTRE



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