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Unfair Contract Terms: Not if but how

Debate as to whether Australia's unfair contract terms laws (UCT laws) should be extended to insurance contracts has raged periodically since the UCT laws were introduced. In December 2017 the Government announced that it would extend the UCT laws to insurance. In June 2018 Treasury released a Proposals Paper outlining its proposed model.

On 24 July, I took part in a symposium arranged by the Australian Insurance Law Association (AILA) to discuss the proposed Treasury model. Other speakers included representatives of Treasury, ASIC, the Insurance Council and consumer advocates. It was clear from the mood of the room, and the contributions from the floor, that many in the insurance industry are still unconvinced by the need for the reforms at all and somewhat concerned by Treasury's proposed model.

Lorraine Lenthall from Treasury opened the symposium by setting the ground rules. It is no longer a matter of whether the UCT laws would be introduced but, rather, the form which the laws will take in the context of insurance. Ms Lenthall welcomed input from all stakeholders as part of the consultation process.

Main subject matter

The key area of contention was whether, and to what extent, the UCT laws should apply to provisions which regulate the scope of cover. The current UCT laws exclude terms that define 'the main subject matter of the contract'.

Insurers argue that the main subject matter of an insurance contract is the indemnity which the insurer agrees to provide. As such, the UCT laws should not apply to any terms which define the scope of that indemnity. The EU legislation adopts that approach by exempting from the UCT regime terms which 'clearly define or circumscribe the insured risk and the insurer's liability'.

Consumer advocates argue for a narrow definition of the main subject matter of the contract so as to achieve the broadest possible application of the UCT laws. They point to the power imbalance between insurers and consumer/small business insureds and the lack of practical redress achieved by the existing concept of utmost good faith.

Treasury proposes a narrow definition which limits the 'main subject matter' of an insurance contract to terms which describe 'what is being insured' - for example, a house, a person or a motor vehicle.

It is not clear how that definition would apply in the case of policies which contain a varied array of covers. Would the definition of each 'thing' insured be exempted or only the 'main' thing insured? What is the 'thing' insured in a liability policy? If it is the 'claim', is it confined to the definition of the claim or any term affecting the types of claims which are covered?

Meaning of unfair

Treasury proposes that, in addition to the general unfairness test applicable to other contract types, a specific test be added which provides that a term will be reasonably necessary to protect the legitimate interests of an insurer if it reasonably reflects the underwriting risk accepted by the insurer provided that it does not disproportionately or unreasonably disadvantage the insured.

Many insurers and insurance lawyers at the AILA symposium expressed concern about how that test would operate in practice. It would often be the case that a term may operate to disentitle the insured to cover - an outcome which would have a significantly adverse effect on the insured. When would such an outcome be considered 'disproportionate' or 'unreasonable'?

Which policies are affected?

UCT laws apply to a contract which is:

- a. a consumer contract or small business contract; and
- b. a 'standard form contract'.

Whether a contract is a 'consumer contract' or a 'small business contract' will depend upon the objective characteristics of the contracting parties (or at least one of the contracting parties). In addition, Treasury proposes that the definition of those terms be extended to include contracts where a third party beneficiary of the contract is a consumer or small business.

In determining whether a contract is a standard form contract, a court is required to take into account a range of factors including the relative bargaining power of the parties, whether the contract was drafted by one party, whether the other party had an effective opportunity to negotiate terms and whether any terms are specific to the circumstances of the other party.

As such, the determination of the insurance policies to which the UCT laws will apply will depend on the actual circumstances of the dealings between the insurer and the contracting insured. The same policy may be a 'standard form contract' or not depending upon the method of distribution (direct or intermediated) and the actual interactions between the insurer and the contracting insured(s).

This marks a departure from other remedial 'consumer protection' laws affecting insurance contracts which apply only to 'eligible contracts of insurance' or a 'prescribed contracts of insurance' (characterised by reference to the policy type and/or the objective characteristics of the contracting insured). There is a strong argument for maintaining consistency with that approach.

Consultation

Submissions to the Treasury consultation are due by 24 August 2018. If the discussion at the AILA symposium is any indication, there is some way to go before there will be any consensus on the model by which UCT laws will be extended to insurance contracts. For now, the only certain thing is that the UCT laws will be extended.

This article was written for InsuranceNews by Principal Andrew Sharpe. Please contact our Insurance team if you would like further information.