ARE INSURANCE CONTRACTS UNFAIR?

27 FEBRUARY 2012 | PROFESSIONAL INDEMNITY & FINANCIAL LINES

Australian Consumer Law saw the introduction of unfair contract term laws which restrict the operation and legality of some contract terms ie. terms that are seen to be unfair. These unfair contract terms laws apply only to consumer contracts.

A term will be regarded as unfair if:

- It would cause significant imbalance in the party’s rights and obligations.
- It is not necessary to protect legitimate interests of the party who would be benefitted by the terms.

Unfair terms may include for example terms that permit one party (but not the other) to terminate the contract or vary its terms.

Since 1 July 2010 ASIC has administered laws dealing with unfair terms in consumer contracts for financial products and services. However insurance has so far been excluded from the operation of these unfair contract laws.

As part of the government’s review of the Insurance Contracts Act 1984 (Cth), the Minister for Financial Services, Superannuation and Corporate Law released an options paper back in 2010 seeking public comment on whether insurance contracts should be subject to unfair contract laws. There were no shortage of people who wanted this to happen. However the insurance industry’s arguments that insurance contracts are unique and already adequately regulated by the Insurance Contracts Act 1984 (Cth) were persuasive. Specifically the industry pointed to the requirement that insurers act with the utmost good faith and not rely on a term of a contract if to do so would be to fail to act with the utmost good faith.

There was no further mention of the issue until the Queensland floods in 2011. Before the last of the waters had resided the media was itself flooded with complaints against insurers by affected property owners alleging that insurers were acting unfairly. On 4 March 2011, Bill Shorten announced an independent review into disaster insurance in Australia. The report released in September last year recommended that unfair contract terms laws be applied to general insurance. Insurance contracts and unfair contract terms were back on the government agenda.

In December 2011 the Parliamentary Secretary to the Treasurer called for public feedback (submissions) on previously canvassed options “for ensuring that consumers who purchase insurance have an equivalent level of protection as that which currently applies to other
financial products and financial services”. Submissions closed on 17 February 2012. Thirteen public submissions were made, largely from the insurance industry arguing against the application of unfair contract terms laws to consumer insurance contracts.

This week the House of Representatives Standing Committee on Social Policy and Legal Affairs released a report “Volume One: The Operation Of The Insurance Industry During Disaster Events”. One of its recommendations was that legislation be enacted to remove the exemption of general insurers from unfair contract terms laws.

The odds on general insurance contracts being subject to unfair contract terms are now only slightly better than Black Caviars odds at Caulfield in the Lightning Stakes.

Will the world as insurers know it end if consumer (retail) general insurance products are subject to these laws? If similar UK legislation and public reaction to it are any guide, then the answer is no.

Insurance contracts in the UK have been subject to unfair contract terms legislation since 1999. By all reports it has not caused insurers too many headaches nor has it resulted in any, or any significant litigation. The Financial Services Authority in the UK released a guidance paper on 31 January 2012 (FG12/2 – Unfair Contract Terms: Improving Standards In Consumer Contracts By The Financial Services Authority) which examined the operation of these laws in the UK. That report provided some examples of terms in insurance contracts which have been found to be unfair. The main examples include:

1. Terms which give an insurance company a wide discretion to cancel the contract, for example where the insurer does not specify the grounds on which it can be cancelled.
2. Terms which allow the insurer to cancel without giving the insured adequate notice.
3. Technical or legal language in contracts which consumers may find confusing. Examples given were words such as “indemnify”, “tort”, “lien”, “consequential loss”, “force majeure”, “time is of the essence”. In these cases the FSA required insurance companies to clarify the wording so that no consumer would be disadvantaged. The FSA also noted that terms which exclude liability for “consequential loss” without further explanation are likely to be struck out as unfair.

In Australia the Insurance Contracts Act provides the consumer with safeguards regarding cancellation of contracts. It prevents an insurer from doing so unfairly. There is no equivalent legislation in the UK.

To the extent to which UK experience acts as a guide, it may be that Australian insurers will need to review policy wording and remove, or better explain, terms which are not part of everyday language.

Article by Robert Samut, Partner

AUTHORS
ROBERT SAMUT
PRINCIPAL
+61 7 3231 6326
robert.samut@bnlaw.com.au