INSURANCE COUNCIL OF AUSTRALIA

The Hon Kelly O'Dwyer MP
Assistant Treasurer and
Minister for Small Business
Parliament House
CANBERRA ACT 2600

20 October 2015

Dear Assistant Treasurer

EXTENDING UNFAIR CONTRACT TERM PROTECTIONS TO SMALL BUSINESS – IMPLICATIONS FOR MARINE INSURANCE

The Insurance Council of Australia[1] (the Insurance Council) has addressed this submission to you as it primarily concerns the Government's proposal to extend unfair contract term (UCT) protections to small business, a matter that falls within your portfolio of responsibilities. However, as this submission also addresses the *Marine Insurance Act 1909* (MI Act), which is administered by the Attorney General's Department, we have also copied it to Senator the Hon George Brandis QC, Commonwealth Attorney-General.

The Insurance Council supports the principles driving the Government's proposed UCT protections. However, we are concerned at the possible consequences if these protections apply to marine insurance contracts with small business. These contracts are regulated under the MI Act, and the Insurance Council submits that, without any detriment to small business, these contracts should be exempt from the proposed protections.

We understand that the proposed legislation intends to insert a provision into the *ASIC Act 2001* and the *Competition and Consumer Act 2010*, providing the Minister with a regulation-making power to prescribe that the UCT protections for small business do not apply to a law of the Commonwealth, a State or a Territory.

The Insurance Council submits that the MI Act should be one of the laws prescribed in the proposed legislation. This would ensure that marine insurance contracts with small business are clearly exempt. This submission elaborates on our concerns underpinning our proposition.

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[1] The Insurance Council of Australia is the representative body of the general insurance industry in Australia. Our members represent more than 90 percent of total premium income written by private sector general insurers. Insurance Council members, both insurers and reinsurers, are a significant part of the financial services system. June 2015 Australian Prudential Regulation Authority statistics show that the private sector insurance industry generates gross written premium of $42.2 billion per annum and has total assets of $121.1 billion. The industry employs approximately 60,000 people and on average pays out about $109.6 million in claims each working day.

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

Marine insurance contract law

Marine insurance contracts are generally[2] regulated under the MI Act and not by the *Insurance Contracts Act 1984* (IC Act). Section 15 of the IC Act currently excludes insurance contracts from the operation of a Commonwealth, State or Territory Act that provides relief in the form of judicial review of unfair contracts or the making of a misrepresentation except for relief in the form of compensatory damages. As such, insurance contracts regulated under the IC Act are exempt from the Australian Consumer Law and the UCT protections applying to consumers.

However, a similar exemption is not provided for marine insurance contracts regulated under the MI Act. Therefore, the proposed UCT protections would apply to MI Act marine insurance contracts with small business.

While the potential detriment from the proposals may not be immediately apparent, there are fundamental reasons why the proposed UCT protections should not interfere with the MI Act. Chiefly, the MI Act is a codification of marine law that is practised globally; care has been taken to maintain consistency in the domestic law with well-established international practice. The Australian Law Reform Commission (ALRC), in its final report on its *Review of the Marine Insurance Act 1909*, explores these important considerations.

In its report, the ALRC noted that Australia has a close association with marine insurance law and practice in the United Kingdom and many other common law jurisdictions, including New Zealand, Canada, Singapore, Malaysia, Hong Kong and India, which have their marine insurance legislation derived from the United Kingdom's Marine Insurance Act (MI Act UK)[3].

The ALRC found that the present codification of marine insurance law and practice is long established and well known and that this has contributed to a business environment in which the meaning of contracts is well understood and is backed up by comprehensive case law[4].

The ALRC went further to warn that unilateral changes to Australian marine insurance law may impact adversely on and isolate the Australian market by severing the association between Australian and United Kingdom law and practice, a link shared with marine insurance regimes in other common law systems and also many other countries as well[5].

As marine law has been long established, it is well understood by industry participants and the legal and judicial profession, both in Australia and in our overseas trading partners. This has produced consistency and certainty in the global application of marine law.

Implications of applying UCT protections to marine insurance

The Insurance Council is concerned that if the proposed UCT protections apply to MI Act contracts, it will create contract uncertainty, leading to higher premiums or reinsurance charges for Australian insurers or insurers becoming more selective. The adverse economy-wide implications resulting from this could be substantial.

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[2] Insurance for pleasure craft is covered under Section 9A of the IC Act, while insurance for the transport of cargo is subject to the MI Act.
[3] Australian Law Reform Commission 2001, *Review of the Marine Insurance Act 1909*, ALRC Report 91, para 3.43
[4] Australian Law Reform Commission 2001, *Review of the Marine Insurance Act 1909*, ALRC Report 91, para 3.3
[5] Australian Law Reform Commission 2001, *Review of the Marine Insurance Act 1909*, ALRC Report 91, para 3.5

Principally, this would make marine insurance in Australia less attractive and diminish the international competitiveness of Australian marine insurers. In that case, marine insurance contracts for Australian risks are likely to be increasingly issued by Australia's global competitors.

This would have a material flow on impact to associated domestic industries, including surveyors and other service providers appointed by insurers, as well as resulting in dispute resolution and litigation being managed in foreign jurisdictions. As an indicator of domestic market size and potential economic impact, the value of gross written marine insurance premium from Insurance Council members was worth over $0.5 billion in 2014.

Indeed, there is already some uncertainty and debate whether the IC Act or MI Act applies in certain scenarios. Under some marine insurance contracts (e.g. cargo transit), different legislation can apply to different transit methods under the same policy, e.g. land transit (IC Act) versus sea transit (MI Act). In these circumstances, industry practice is for the contract to explicitly recognise that either the MI Act or the IC Act may apply through policy wording which acknowledges this – for example, disclosure provisions state that:

> "*Where the Marine Insurance Act 1909 applies, we may…*" and
>
> "*Where the Insurance Contracts Act 1984 applies, we may*…"

One other area that this uncertainty may arise is with private/pleasure craft, which may be subject to both the IC Act and the MI Act. For instance, a charter hire of pleasure craft is expressly exempt from the IC Act under subparagraph 9A(2)(a)(ii); in other circumstances it may however be subject to the IC Act.

Our concern is that there would be a high level of uncertainty around how the proposed UCT protections would apply to the contract in practice, given the exemption from UCT protections for IC Act contracts under Section 15 of the IC Act.

Further, the Insurance Council submits that the rationale for the operation of Section 15 of the IC Act would equally apply to the MI Act. The explanatory memorandum to the Insurance Contracts Bill 1984 set out a rationale for the operation of Section 15 that is:

> "…*it is appropriate that there should be no question whether the Bill or State legislation or other Commonwealth legislation applies in a particular case and so no room for lengthy disputes as to which should apply*".

In other words, a contract of insurance should not become subject to two existing pieces of legislation where both are intended to govern terms of a contract. Arguably, a similar approach should be adopted with insurance contracts subject to the MI Act.

Equivalent protection for small business

Small businesses that purchase marine insurance are already protected from unfair contract terms under the MI Act. Specifically, parties to a marine insurance contract are subject to duties of utmost good faith. Section 23 of the MI Act provides:

> "*A contract of marine insurance is a contract based upon the utmost good faith, and, if the utmost good faith be not observed by either party, the contract may be avoided by the other party*".

The High Court has stated that:

> "… *an insurer's statutory obligation to act with utmost good faith may require an insurer to act, consistently with commercial standards of decency and fairness, with due regard to the interests of the insured."* [6]

The duty of good faith requires the insurer and the insured to act honestly and fairly with each other throughout the duration of the policy. This duty would extend to pre-contractual disclosure and non-misrepresentation, requiring that an insurer must not misrepresent facts about the policy (or any other facts) that are material to the policy. The insurer must also disclose any relevant policy terms that have major consequences.

The Insurance Council submits that this duty of good faith provides equivalent protection to small business from unfair contract terms in relation to MI Act marine insurance they may purchase.

Further to this, many marine insurance policies on cargo and hull are issued subject to the provisions of Institute Clauses, developed by the Lloyd's Market Association (LMA) and International Underwriting Association of London (IUA). Around 200 of these clauses are in common use and which form the basis of many Australian marine insurance contracts with small businesses for the import or export of cargo. Their overseas suppliers or purchasers (and their financiers) will almost inevitably require any insurance forming part of the purchase or sale price to include the applicable Institute Clauses. This helps ensure that parties to the contract have certainty over the insurance arranged by the supplying party covering the shipment. For this reason, Australian marine insurers generally must offer Institute Clauses on import/export cargo insurance.

Institute Clauses have been adopted internationally as the accepted basis of any marine insurance contract forming part of international trade terms. The clauses are published on the IUA's website and proposed amendments/new wordings are subject to a lengthy consultation process. In practice, the clauses minimise the scope for misrepresentation by insurers. If the clauses were scrutinised under the proposed UCT protections, the international competitiveness of Australian small business would be diminished, as would that of Australian insurers (as explained above).

As a partial reflection of these protections, feedback from our members is that there has been no experience of customers contesting MI Act contracts due to unfair contracts terms. With no detriment to small business identified, the Insurance Council submits that extending the proposed UCT protections to MI Act insurance with small business would be unjustified.

Benefit of insurance brokers

The Insurance Council appreciates that the proposed UCT protections are intended to offer support to small businesses that lack the time, expertise, and bargaining power to directly negotiate potentially unfair contract terms with an insurer.

However, direct interactions between individuals and corporate entities do not generally extend to Australian marine insurance practice. Commercial marine insurance contracts – including for small business – are not directly negotiated between an insured and insurer.

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[6] *CGU v AMP* (2007) HCA 36

Rather, these contracts are negotiated through insurance brokers that act on behalf of their purchasing clients and represent their client's best interests. Notably, the broker's client does not interact with the insurer during contract negotiations.

Brokers provide advice in the interests of their clients, helping their clients identify their individual and/or business risks to help them decide what to insure, and how to manage those risks in other ways. Brokers are aware of the terms and conditions, benefits and exclusions and costs of a wide range of competing insurance policies, so they can help clients find the most appropriate cover for their own circumstances. Indeed, brokers would also be able to provide advice to clients on any potential unfair contract terms.

Given the relationship between the consumer, broker and insurer, the Insurance Council submits that it is unnecessary to extend the proposed UCT protections to MI Act insurance contracts with small business, as the proposed protections are intended to specifically target direct end consumer-insurer relationships.

Other considerations

You may be aware that the United Kingdom's Consumer Rights Act (CR Act) came into force on 1 October 2015. Parts 1 and 2 of the CR Act consolidate and replace the United Kingdom's former Unfair Terms in Consumer Contracts Regulations (UTCCRs) and relevant provisions of its Unfair Contract Terms Act[7] (UCTA).

We understand that the unfair contract term protections under the United Kingdom's CR Act apply to marine insurance, so far as the contracting party is a 'consumer'[8]. We also understand that the extension of the term 'consumer' to include small business was considered but not adopted. Therefore, the new legislation does not appear to apply to marine insurance contracts with small business.

In the United Kingdom, protection for small business from unfair contract terms in marine insurance contracts is provided for under Section 17 of the United Kingdom's *Marine Insurance Act 1906*, which provides that marine insurance contracts are contracts based upon the utmost good faith; this legislation is the basis of current Australian marine law.

[7] Guidance on the unfair terms provisions in the United Kingdom's Consumer Rights Act states that the UCTA will be amended so that it covers business to business and consumer to consumer contracts only.

[8] The United Kingdom's CR Act defines a consumer as "… *an individual acting for purposes that are wholly or mainly outside that individual's trade, business, craft or profession*". The requirement that the consumer be an individual excludes companies from claiming consumer rights under the CR Act.

If you have any questions or comments in relation to our submission, please contact John Anning, the Insurance Council's General Manager Policy, Regulation Directorate, on (02) 9253 5121 or janning@insurancecouncil.com.au.

Yours sincerely

Robert Whelan
Executive Director & CEO

cc: Senator the Hon George Brandis QC, Commonwealth Attorney-General