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Dear Ms Jones

EXTENDING UNFAIR CONTRACT TERM PROTECTIONS TO SMALL BUSINESS – EXPOSURE DRAFT LEGISLATION

The Insurance Council of Australia[1] (the Insurance Council) welcomes the opportunity to comment on the Government's proposal to extend unfair contract term (UCT) protections to small businesses. This submission responds to the exposure draft of the Treasury Legislation Amendment (Small Business and Unfair Contract Terms) Bill 2015; the exposure draft of the Explanatory Material; and the Decision Regulation Impact Statement.

While the Insurance Council supports the principles driving the proposed reform, we submit that the legislation should be clear and unambiguous about:

i) The exemption of small business insurance contracts from the UCT protections as proposed under the *ASIC Act 2001*; and
ii) How small business is defined for contracts where a small business is supplying the goods and services.

The following submission elaborates on these two key aspects of the proposed small business UCT protections.

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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. December 2014 Australian Prudential Regulation Authority statistics show that the private sector insurance industry generates gross written premium of $41.7 billion per annum and has total assets of $114.7 billion. The industry employs approximately 60,000 people and on average pays out about $107 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).

Small Business Insurance Contracts

Section 15 of the *Insurance Contracts Act 1984* (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. In its report which laid the foundation for the IC Act, the Australian Law Reform Commission concluded that in light of the utmost good faith obligation imposed on insurers, it was unnecessary for insurance contracts to be subject to a facility for judicial review of unfair contractual terms.[2] As such, insurance contracts are exempt from the Australian Consumer Law (ACL) and the UCT protections applying to consumers.

While we believe Section 15 of the IC Act will exempt small business contracts in the same way that consumer contracts are exempt, we submit that there should be no ambiguity in the application of the exemption. The exposure draft legislation proposes to insert a provision into the ASIC Act 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 IC Act should be one of the laws that is specifically prescribed in the legislation. This would ensure that small business insurance contracts are clearly exempt.

The rationale for excluding small business insurance contracts from the UCT protections was outlined in detail in the Insurance Council's submission to the Treasury consultation paper released on 23 May 2014. Nationally, small businesses have been well protected for some time by the IC Act, supplemented by other laws such as the *Corporations Act 2001* and ASIC Act.

Small businesses, when purchasing general insurance, benefit from robust protection provided by the detailed provisions of the IC Act. The key protections in the IC Act include:

- *Sections 13 and 14* – requires a contract of insurance to be based on "…the utmost good faith", which in effect renders any unfair clause void;
- *Sections 21, 21A, 22 and 28* – places significant limits on when an insurer can rely on non-disclosure by an insured to reduce or refuse a claim;
- *Sections 23, 24, 26 and 28* – places significant limits on when an insurer can rely on misrepresentation to refuse to pay a claim;
- *Section 35* – applies to home, motor, consumer credit insurance, travel and most relevantly to small businesses sickness and accident insurance, and requires insurers to clearly inform customers upfront as to how their contract terms differ from standard contract terms which are outlined in the Regulations to the Act. For other insurance, section 37 requires the insurer to notify the insured of terms that are not usually included in contracts of insurance that provide similar cover;
- *Sections 39* – states that an insurer cannot refuse to pay a claim by reason of non-payment of an instalment of the premium unless the instalment has remained unpaid for a period of at least 14 days and before the contract is entered into, the insurer clearly informed the insured of this right;

[2] Australian Law Reform Commission 1982, Insurance Contracts ALRC 20, para 51.

- *Section 46* – restricts the ability of insurers to rely on certain terms in their policy where there was a defect or imperfection in property and the insured was not aware of the defect or imperfection;
- *Section 53* – makes void a term of an insurance contract that seeks to authorise or permit the insurer to vary, to the prejudice of the insured, the contract; and
- *Section 54* – limits the ability of the insurer to rely on terms of the policy to refuse to pay claims in relation to acts or omissions of the insured.

Insurance is a rare but important example where, decades ago, Parliament had the forethought to establish a comprehensive set of rights and obligations specifically around the insurance contract.

Apart from the IC Act, there is also a variety of additional protections available to insurance policyholders. In particular, under the Corporations Act, there is an overarching obligation on general insurers as the holders of an Australian Financial Services Licence (AFSL) to do all things necessary to ensure that financial services covered by their licence are provided efficiently, honestly and fairly[3]. Further, section 991A of the Corporations Act states, "A financial services licensee must not, in or in relation to the provision of a financial service, engage in conduct that is, in all the circumstances, unconscionable." If a person suffers loss or damage because a financial services licensee contravenes this provision, they may recover the amount of the loss or damage against the licensee. This provision is not impacted by the section 15 exemption in the IC Act.

There is also a requirement under the Corporations Act for general insurers to be a member of an external dispute resolution scheme. Almost all general insurers choose to be members of the Financial Ombudsman Service (FOS). This independent umpire provides free, fair and accessible dispute resolution for those unable to resolve a dispute directly with their general insurer.

We submit that these laws collectively provide equivalent, if not greater, protections to small businesses from unfair terms in relation to insurance they purchase.

As proposed in the exposure draft legislation, if a term in a small business contract is unfair, the supplier will not be able to rely on that term as it will be void. The remainder of the contract will still be valid to the extent it is capable of operating without the unfair term. For insurance contracts, the same remedy is already provided by the IC Act, with parties being unable to rely on an UCT. The Insurance Council submits that if a general insurer were to seek to rely on a clause in a policy and it was found to be void (for example under section 14 of the IC Act) and the contract could not effectively operate without it, an insurer would clearly be prevented from seeking to rely on the rest of the contract.

To the extent an insurer sought to do so, the small business would potentially be entitled to a claim for damages for breach of the insurer's duty of utmost good faith under section 13. The insurer would also be in breach of its Corporations Act obligations.

In summary, taking action under the small business UCT protections in the ASIC Act would in many cases see small businesses worse off than if they had taken action under the IC Act.

[3] Section 912A(1).

While insurers are already subject to extensive legislation prohibiting the inclusion of UCT in insurance contracts, the key concern with any uncertainty in the application of the exemption is the confusion and additional costs of compliance associated with needing to comply with two separate regimes. The application of an UCT remedy to insurance contracts, rather than assist small business, will create uncertainty in the application of insurance terms to claims, which will likely lead to further disputes resulting in inconvenience and delay, increasing costs and possibly premiums. Therefore, we submit that the IC Act should be specifically prescribed in the regulations as being exempt from the small business UCT protections in the ASIC Act.

Contracts Covering the Supply of Goods and Services to Insurers

Small businesses currently enter into contracts for the supply of goods and services to general insurers for a variety of commercial arrangements. These contracts will be captured under the proposed changes to the ASIC Act and *Competition and Consumer Act 2010*. We suggest that there needs to be greater clarity on how businesses apply the definition of small business in practice and there should be a significantly longer transition period than the proposed six months.

Definition of small business

As proposed in the exposure draft legislation, a small business contract will be defined as a contract where at least one party to the contract is a small business having less than 20 employees and the "upfront" price payable under the contract does not exceed $100,000 or $250,000 for contracts with a duration of more than 12 months.

As noted in our earlier submission, definitions that incorporate measurement of business size on the basis of employee number are impractical given such information is fluid and non-transparent. Members have advised that the definition of small business as a business of less than 20 employees is difficult to verify, and will contribute substantially to compliance costs given the vast number of small business suppliers they contract with. The Insurance Council had previously suggested that an appropriately set transaction threshold should be coupled with an exclusion of publicly listed companies to eliminate businesses that are obviously not small businesses. We suggest that reconsideration is given to this aspect of the small business definition.

There also needs to be greater clarity around how the two-tiered transaction value threshold (TVT) is calculated for contracts incorporating a head agreement and multiple individual service order agreements. For these contracts, the draft legislation is ambiguous as to whether the TVT is applied to the overall contract or individual service order agreements under the contract.

The explanation about the design of the TVT in the Decision Regulatory Impact Statement suggests that the "upfront price" should capture the total value of the overall contract, and not the value of individual service order agreements. It is stated that the TVT is not intended to capture high value transactions where it is reasonable to expect that a small business will undertake appropriate due diligence (page 23). Capturing individual service order agreements, rather than the overall contract, may place contracts with a relatively high overall transaction value within scope of the small business UCT regime. In addition, guidance developed on the ACL states that "…the definition of up-front price in the laws

would also cover a future payment or series of future payments provided these were disclosed at the time the contract is entered into"[4].

There is also ambiguity around how the "upfront" price should be calculated where the "upfront" price may not be clear when the contract is entered into. As already noted, there are some contracts that include an overall agreement, with accompanying individual service order agreements through the term of the contract. When entering into the contract for the overall head agreement, it may be difficult to determine an "upfront" payment, and some contracts may have no monetary value at all.

In these circumstances, we suggest that guidelines issued by the Australian Competition and Consumer Commission (ACCC) and the other relevant agencies, like those already in place for the ACL applying to consumers, should be developed to provide greater clarity to business on the practical application of the law.

Transition period

It is suggested in the "Fact Sheet" accompanying the exposure draft legislation that, once the legislation received Royal Asset, a transition period of six months will ensue before the protections come into effect. Contracts that are entered into or renewed, or terms of existing contracts that are varied on or after the date the legislation comes into effect, will be required to comply with the new protections. We suggest that an 18 month transition period would provide businesses with a more adequate timeframe to review existing contracts and future contracts to be entered into, and implement an appropriate supporting compliance regime.

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

[4] Commonwealth of Australia 2010, *A guide to the unfair contract terms law*, page 10.