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ICNZ submission on discussion paper: Protecting businesses and consumers from unfair commercial practices

Thank you for the opportunity to submit on the discussion paper titled *Protecting businesses and consumers from unfair commercial practices* ('discussion paper'), which was released by the Ministry of Business, Innovation and Employment (MBIE) in December 2018.

ICNZ represents general insurers that insure about 95 percent of the New Zealand general insurance market, including about a trillion dollars' worth of New Zealand property and liabilities, and paid out approximately $2.7 billion to consumers and businesses in 2017. ICNZ members provide insurance products ranging from those usually purchased by individuals (such as home and contents insurance, motor vehicle insurance and travel 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).

Please contact Andrew Saunders (andrew@icnz.org.nz or 04 914 2224) if you have any questions on our submission or require further information.

This submission is in two parts:

- Part 1 - Overarching comments
- Part 2 - Responses to questions in the discussion paper

Part 1 - Overarching comments

ICNZ supports the imposition of regulatory frameworks that aim to ensure good conduct between businesses and with consumers. We welcome regulatory solutions that address clearly identified problems and provide overall benefits.

For the financial services sectors and insurers in particular, we note the proposals in the discussion paper come on top of conduct related changes being pursued through the *Financial Services Legislation Amendment Bill* and its supporting instruments, the Insurance Contract Law Review (which is considering unfair contract terms ('UCT') legislation) and the recent announcement of plans to introduce new conduct related regulation for banks and insurers (to be consulted on in May). How the measures being considered in the discussion paper might relate to all these other changes would need to be worked through carefully.

Importantly, in regard to UCT legislation, certain insurance terms are specified in section 46L of the *Fair Trading Act 1986* ('FTA') as being reasonably necessary. Indeed, it is the unique nature of those insurance terms that leads them to be considered within the Review of Insurance Contract Law and we submit therefore that this is the forum for considering their treatment rather than as part of this process.

Given the proposals in the discussion paper are significant, key issues of detail need to be worked through and given the progression of the parallel processes noted above, we are concerned that there are currently no plans to consult further on the detail of the proposals in the discussion paper should they be progressed. We recommend that further consultation takes place should Government agree to progress any or all of the proposals and that such consultation should consider the detailed design of the proposals and issues including penalties/remedies.

Our responses to the specific issues and proposals in the paper follow in Part 2 of this submission.

Part 2 - Responses to questions in the discussion paper

Potential issues

Issue 1: Unfair business-to-business contracts

1	**What types of unfair business-to-business contract terms are you aware of, if any? How common are these?**

We note the results of the opt-in survey of predominately small businesses conducted by MBIE in mid-2018 is the main evidence cited in the discussion paper to underpin a potential extension of the UCT regime to business-to-business contracts. As largely recognised in the discussion paper itself, the methodology of the survey (e.g. opt-in, subjective conclusions) means that there are significant limitations in the conclusions that can be drawn from it in terms of the prevalence and impact of 'unfair' contract terms in business-to-business contracts. The paper does not otherwise provide evidence that the inclusion of 'unfair' terms is a particular issue for business.

As noted in our July 2018 submission to MBIE on the Insurance Contracts Law Review, ICNZ does not consider there are systemic issues with terms in insurance contracts being unfair.

2	**What impact, if any, do these unfair contract terms have?**

We recognise the potential for the enforcement of 'unfair' contract terms to have adverse effects. A range of these are outlined in paragraphs 67 and 68 of the discussion paper, though it should be noted that a number of these could equally apply to terms that might not meet criteria for being categorised as 'unfair'. Clearly identifying detrimental effects can also be difficult given the challenges associated with differentiating between 'unfair' terms as opposed to terms that a firm may disagree with or not find to its liking. The specific impact in a particular situation would of course depend on the specific term used, how it was enforced and other contextual factors.

3	**Is government intervention to address unfair business-to-business contract terms justified? Why/why not?**

As noted above in response to Question 1, the evidence base outlined in the discussion paper for supporting a wide-ranging government intervention to address unfair business-to-business contract terms is limited. Based on the evidence currently available we do not consider the case has been made for an extension of UCT provisions to business-to-business contracts generally or to insurance contracts in particular. We are mindful the benefits and disbenefits of such an approach need to be carefully evaluated to avoid the risk that a change of this kind creates more issues than in solves.

Should however UCT legislation be applied to some or all business-to-business contracts, there are specific factors associated with insurance and re-insurance contracts that need to be provided for and these must be considered specifically and separately as part of the Insurance Contract Law Review. We address these issues in our responses to Questions 18 – 22 below.

We also note that there is no experience of the impact of UCT provisions on commercial insurance contracts in Australia as while UCT legislation has been applied to small business, insurance contracts are currently exempt from these provisions entirely (although an extension to insurance law subject to specific provisions is being considered currently).

Issue 2: Unfair business-to-business conduct

4	**What types of unfair business-to-business conduct are you aware of, if any? How common is this type of conduct?**

No comments.

5	**What impact, if any, does this conduct have?**

No comments.

6	**Is government intervention to address unfair business-to-business conduct beyond existing legislative protections justified? Why/why not?**

ICNZ considers that it would be premature to introduce further conduct regulation if an attempt has not first been made at stricter enforcement of existing legislative protection. There is already a not-insignificant body of law in New Zealand relating to "unfair" conduct and because of this, ICNZ is not convinced that a legislative gap exists. This belief is supported by the evidence at page 22 of the discussion paper which states "*the prevalence of this conduct as reported by businesses therefore suggests that:*

- *businesses are not complying with the law; and/or*
- *the threshold at which a specific form of conduct is prohibited under the law is higher than the threshold at which some businesses feel aggrieved.*"

This suggests that compliance and the ability to enforce the law are the real issues and in the first instance, the government should seek stricter enforcement of the existing protections in order to see whether there are improvements in the resultant behaviour.

There are also difficulties in defining what 'unfair' conduct is. Indeed, the discussion paper notes at least twice that what is 'unfair' is highly subjective. ICNZ agrees. What one business considers as being 'unfair' may in fact be reasonable commercial practice. In relation to business-to-consumer conduct, the discussion paper states that it is not the role of government to protect all consumer from all instances in which they may suffer harm, or from making any decision that they might ultimately regret. This could also be extended to business-to-business conduct. ICNZ agrees that not every instance of harm, and every instance where one party regrets the transaction means that there has been 'unfair' conduct.

However, ICNZ is aware that some small businesses may be at a level of vulnerability similar to consumers and should therefore be afforded greater protections if there is compelling evidence of unfair business-to-business conduct.

Finally, ICNZ stresses that if the government proposes to introduce new business-to-business protections they must take care to ensure that those protections do not infringe on competition or the efficient operation of markets. The potential impacts of these also needs to be considered in terms of international contracting by New Zealand businesses, for example the attractiveness of New Zealand as a jurisdiction for resolving disputes on contracts between domestic firms and those overseas.

Issue 3: Unfair business-to-consumer conduct

7	**What types of unfair business-to-consumer conduct are you aware of, if any? How common is this type of conduct?**

No comments.

8	**What impact, if any, does this conduct have?**

No comments.

9	**Is government intervention to address unfair business-to-consumer conduct beyond existing legislative protections justified? Why/why not?**

ICNZ supports efforts to rule out unfair business-to-consumer conduct and notes the legislation which is already in place to protect consumers. As an industry we strongly support good customer outcomes and have introduced the Fair Insurance Code, which sets out industry best-practice standards for insurers in all their dealings with customers. However, we echo the comments made in response to Question 6 above about whether further regulation is the answer to a perceived problem, or whether government could first try stricter enforcement of the existing measures. Non-compliance with the law is different to there being gaps in the law.

As briefly raised in the Overarching Comments to this submission, ICNZ also questions where possible government intervention in this area fits with the other reviews and reforms currently being carried out. The *Financial Services Legislation Amendment Bill*, the Insurance Contract Law Review, and the conduct and culture review of banks and insurers all focus on the consumer, as does this discussion paper. ICNZ does not believe that there is enough clarity around how this particular piece of work fits into the bigger picture and reserves its right to comment further once we have been provided with additional information.

We would also note that in relation to insurance, the parties to an insurance contract are already subject to a duty of utmost good faith.

Objectives

10	**Do you agree with our proposed high-level objectives and criteria for assessing any potential changes to the regulatory framework governing unfair practices? If not, why not?**

ICNZ agrees that the objectives and criteria are appropriate.

Options for reform

Option 1: Introduce a high-level protection against unfair conduct

11	**Should a high-level prohibition against unfair conduct be introduced? Why/why not?**

ICNZ would be open to the introduction of a high-level prohibition against unfair conduct. However, please also see our comments at Questions 6 and 9 above. If further legislation is to be introduced it should only be for truly egregious behaviour for which there is demonstrable evidence the current legislation is not able to prevent or sanction. As already stated, the Government will also need to be careful that any further protections do not inhibit competition.

If, after careful analysis of the existing laws it is decided that stricter enforcement is not an adequate solution and a new high-level prohibition is to be introduced, then ICNZ agrees that it should be accompanied by legislative guidance as to what is unfair. This will help to reduce uncertainty for consumers, businesses, and the courts (as litigation will likely arise from any new prohibition).

12	**What are the advantages and disadvantages of Options 1A, 1B, and 1C (Refer to Annex 1 for more information)? Which option, if any, do you support?**

Subject to what has already been raised in response to Questions 6 and 9 above around whether further legislation is needed, if ICNZ were to choose an option it would be Option 1B. ICNZ believes that it would be the most logical choice and would appear to incorporate the concept of unconscionable conduct in Option 1A and good faith in Option 1C. In the assessment of unconscionable conduct under Australia's Competition and Consumer Act 2010, one of the criteria to be considered is whether the parties acted in good faith. New Zealand's *Credit Contracts and Consumer Finance Act 2003* then includes "unconscionable" in its definition of oppressive. It would therefore appear that both the existence of good faith and unconscionable conduct could be considered when looking at whether a party has acted in an oppressive manner.

ICNZ is of the view that Option 1C would be too vague and uncertain to be workable, and should not be advanced as an option.

As noted in the discussion paper, Options 1A and 1B also have the benefit of an established body of case law which would help to lessen uncertainty around implementation.

13	**If unconscionable conduct were prohibited (Option 1A), should a definition of unconscionability be included in statute, and if so, how should it be defined?**

If one of the options is to be advanced, ICNZ believes that Option 1B would be more appropriate than Option 1A. However, if Option 1A were chosen, we agree that a definition of unconscionability should be incorporated.

ICNZ thinks that it would be appropriate, as in the Competition and Consumer Act 2010 in Australia, for there to be a number of factors a court is required to consider when assessing whether conduct in unconscionable, including, but not limited to:

- the relative bargaining strength of the parties;
- whether any conditions were imposed on the weaker party that were not reasonably necessary to protect the legitimate interests of the stronger party;
- whether the weaker party could understand the documentation used;
- the use of undue influence, pressure or unfair tactics by the stronger party;
- the extent to which the stronger party's conduct with the weaker party is consistent with its conduct in similar transactions with other parties;
- the willingness of the stronger party to negotiate; and
- the extent to which the parties acted in good faith.

In relation to unconscionability, ICNZ also has concerns around the findings in the Australian *ACCC v Lux Distributors Pty Ltd* case, which lowered the threshold at which conduct may be considered unconscionable. If New Zealand were to incorporate a prohibition on unconscionable conduct this case would be part of the legal precedent we would likely refer to in building our own case law, and this case appears to run contrary to the very high level of behaviour this discussion paper is aiming to minimise.

14	**Is it appropriate to require businesses to act in good faith (as per Option 1C – see Annex 1)? Are there situations in which doing so could have negative economic outcomes?**

ICNZ also holds concerns about the uncertainty that introducing a requirement to act in good faith would create. We echo the wording in the discussion paper that "*while it is difficult to argue that the concepts of honesty, co-operation and reasonableness are not laudable, we are unsure if a requirement of good faith is desirable in all instances*".

Further, we note the findings in the 2010-2015 consumer law reforms in which the Ministry of Consumer Affairs found that there was significant stakeholder concern about the uncertainty that referencing good faith could lead to. It would take time to gain clarity around the scope of the provision.

15	**Are there any other variations on Option 1 that we should consider?**

ICNZ does not propose any variations on Option 1.

16	**If a version of Option 1 is selected, should it also extend to matters relating to the contract itself?**

As ICNZ is not convinced at this stage that further regulation around unfair conduct is necessary, it is firmly of the view that extending a version of Option 1 to matters relating to the contract itself would be going too far. ICNZ believes that unfair terms alone should not be sufficient for there to be a breach of a prohibition. To support this view we reference an article from Buddle Findlay, released in light of this review, which states "[extending Option 1 to matters relating to the contract itself] … *goes significantly further than the Fair Trading Act's current Unfair Contract Term regime… In other words, this is uncharted territory for consumer law in New Zealand*[1]*".*

17	**Should any protection against unfair conduct apply to consumers only, consumers and some businesses (and if so, which ones?), or all consumers and businesses?**

ICNZ believes that if new protections against unfair conduct are introduced, they should only apply to the most egregious instances of behaviour against consumers as consistent with other consumer law. If these were to be extended to business at all, then we consider the protections should be limited to small businesses rather than all businesses as there is an assumption that large businesses have the sophistication and resources to either protect themselves from unfair conduct, or to take action should they perceive themselves as being the victim of unfair conduct.

ICNZ notes there are inherent challenges, both conceptual and practical, with treating "small businesses" differently and in defining the distinction. This is also covered further in Question 20 below.

[1] https://www.buddlefindlay.com/insights/alls-fair-in-love-and-war-but-maybe-not-in-business-get-your-submissions-in/

Option 2: Extend unfair contract terms protections to businesses

18	**If the UCT protections are extended to businesses, do you agree that the current consumer UCT provisions should be carried over without major changes? If not, why not?**

Before addressing this question, we note that as outlined below in response to Question 20, we consider that the specifics of any extension of UCT provisions to business-to-business insurance contracts should be considered in the Insurance Contract Law Review.

Insurance contracts can be distinguished from many other types of contracts in that the contract for the product and the product are, in effect, one and the same thing. If UCT provisions were to be introduced for some/all standard form business-to-business contracts there are range of aspects of insurance contracts that need to be considered and it would be critical the specific treatment of the unique features of insurance contracts provided currently in section 46L of the FTA was applied as the rationale for these applies to commercial insurance contracts. These issues were comprehensively outlined in the context of contracts with consumers on pages 19 to 23 of our July 2018 submission[2] to MBIE on the Insurance Contract Law Review.

In a business-to-business context there are some contextual factors specific to insurance contracts that warrant consideration, including:

- Most insurance contracts for businesses are put in place through insurance brokers, sometimes relying on insurer wording and sometimes with broker specific wording.
- The definitions of a standard form contract might catch contracts well beyond those that might be expected to or appropriate for UCT-type protection (e.g. professional indemnity insurance) and might also be triggered if one insured is a small business under the policy when all others are not or there might be uncertainty on this (for example, where a liability policy covers both a large entity and its small business subsidiary as contracting insureds, the cover provided to the large entity could be then subject to review under the UCT provisions.).

It is also noteworthy that any extension to business-to-business contracts would raise the risk for New Zealand if business contracts between insurers and re-insurers, upon which New Zealand depends for much of its insurance support, were subject to such a regime. Such contracts should not be subject to UCT provisions. This sort of issue further illustrates the need for changes in this area, if any, to focus on egregious behaviour towards small businesses.

Notwithstanding the above, as a general proposition, if the UCT protections are extended to businesses it would seem logical for these to align to consumer UCT provisions. We note however that the discussion paper mentions that consumer UCT provisions are subject to separate review as part of MBIE's evaluation of the 2010–2015 consumer law reforms and it also suggests that a material change to the current consumer UCT provisions is planned, stating in paragraph 139 that "we think that, at a minimum, businesses should be able to seek to have a contract term to be declared unfair and thus void without the Commerce Commission having previously sought a court declaration". This would be a significant change to the current UCT framework that would have different implications in a business-to-business context and so the implications of this would require careful consideration, an example of why further consultation should take place if the Government decides to extend UCT provisions.

[2] https://www.icnz.org.nz/fileadmin/Assets/Submissions/ICNZ_submission_on_MBIE_Issues_Paper_re_ICLR_130718.pdf

19	**If the UCT protections are extended to businesses, should the FTA's 'grey list' for consumer UCTs be carried over 'as is'? Are there any existing examples of unfair terms that should be removed from the list, or any new examples that should be added?**

As outlined elsewhere in this submission we consider that the specifics of any extension of UCT provisions to business-to-business insurance contracts must be considered in the review of insurance contract law.

20	**Should the protections against UCTs apply to consumers only (as at present), consumers and some businesses (and if so, which ones?), or all consumers and businesses?**

As noted above in response to Questions 1 and 3, the evidence base outlined in the discussion paper for supporting government intervention to address unfair business-to-business contract terms is limited and further evidence or rationale is necessary to justify intervention in this area. As outlined elsewhere in this submission we also consider that the specifics of any extension of UCT provisions to business-to-business insurance contracts should be considered in the current Insurance Contract Law Review.

Notwithstanding the above, if UCT provisions were to be extended to commercial contracts we agree with paragraph 134 of the discussion paper that there does not appear to be a strong case for protecting larger, better-resourced businesses from unfair terms. However as outlined in paragraph 133, this requires drawing an arbitrary line between businesses based on some measure of business size, or by relying on either a transaction value threshold or whether there is a material imbalance in negotiating power. All these approaches have pros and cons and any demarcation needs to be carefully chosen as amongst other issues there is also a risk that the demarcation chosen starts to influence business responses and behaviours.

Size is not necessarily a reflection of a business's sophistication and does not recognise that small firms will logically carefully consider and take legal advice before entering high value contracts. Using employee numbers as a demarcation (e.g. fewer than 20 employees) would in relation to the financial services industry align with scope of the Dispute Resolution Schemes under the *Financial Service Providers (Registration and Dispute Resolution) Act* 2008, which is in turn followed by ICNZ's Fair Insurance Code. Turnover as a distinguishing factor is something that is not necessarily transparent or obvious to other parties and varies over time. A transaction value threshold is discussed in response to Question 21 below.

Relying on whether there is a material imbalance in the negotiating power between the relevant parties, as determined on a case by case basis would likely carry a significant degree of uncertainty as to when it might be applied.

21	**If the protections against UCTs are extended to businesses, should a transaction value threshold be introduced, above which the protections do not apply? If so, what should the threshold be?**

A transaction value threshold places the onus on small businesses to undertake due diligence for high-value transactions (largely avoiding a moral hazard situation occurring where a small business relied solely on the UCT protections rather than undertaking due diligence) and is transparent/certain to the parties to the contract.

We note however that if a transaction value was to be implemented, there are logical reasons to treat general insurance contracts differently from other contracts in terms of a transaction value. First, it is difficult to identify a meaningful monetary limit for insurance, as either the premium or sum insured could be used. Secondly, if the premium were relied upon, few (if any) policies would exceed a likely value threshold with the result that all/virtually all purchasers of general insurance policies would be included, which would be inconsistent with the policy objectives.

If a specific transaction value was provided in regard to the premium paid for an insurance contract, to act as a relevant demarcation between small and larger businesses it would need to be much lower than the likely hundred of thousands of dollars that would be applied to other transactions. We note that in Australia the transaction threshold is where the upfront price payable under the contract is no more than $300,000 or $1 million if the contract is for more than 12 months. In response to this and as part of a recent consultation the Insurance Council of Australia noted the average annual premium for a small business customer is $2,500.

22	**Should there be penalties for breaching any new provisions regarding UCTs, and should there be civil remedies available, even if unfair terms have not previously been declared by a court to be unfair? How should any penalties and remedies be designed?**

Overall, we consider further consultation on penalties and remedies would be warranted if a decision is made to apply UCT provisions to some/all business-to-business contracts and once the detail of this determined (e.g. whether the change to the UCT regime referred to in paragraph 139 of the discussion paper is progressed?). It would also be important to consider issues such as whether courts would have discretion to be able to make orders other than orders limited to damages?

In relation to the discussion in paragraph 142 of the discussion paper. If the inclusion of UCTs (without needing to have previously been declared unfair) was made an offence, and given the uncertainty noted in paragraph 142, it would seem appropriate to provide a defence where a person believed, on reasonable grounds, that the term was not an unfair contract term.

Other options, Other options, Impact analysis

23	**Are there other options to address unfair conduct or unfair contracts that we should consider? If so, what are these?**

No comments.

Options packages

24	**Do you have a preferred options package? If so, which is your preferred package, and why?**

No comments.

Impact analysis	
25	**Do you agree with our assessment of the impact of each package against the criteria? If not, why not? Do you have any further evidence on the costs and benefits of this option?**
No comments.	

Other comments	
26	**Do you have any other comments?**
Should UCT provisions be altered and/or extended to business-to-business insurance contracts, and of course depending on what is provided, a significant transition period would be required to reflect the time required to prepare for such a change and address potential re-insurance implications, and to recognise the fact that policies are renewed annually.	

Conclusion

Thank you again for the opportunity to submit on the discussion paper. If you have any questions, please contact our Regulatory Affairs Manager on (04) 914 2224 or by emailing andrew@icnz.org.nz.

Yours sincerely,

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