they would have made anway, that is no bad thing; but most cases have more substance to them, or at least the insurers sincerely believe they were misled before they resort to avoidance, and the *Pine Top* decision should not discourage meritorious cases or make them more difficult for insurers. In practice, an insurer who has a proper case should not notice the difference.

UNFAIR CONTRACT TERMS DIRECTIVE
by Keith Long, DTI

You have invited me to speak to you today on the Unfair Contract Terms Directive. This directive was adopted in April last year and is due to come into force at the end of this year. The directive has, I know, provoked a good deal of concern amongst insurance companies, for whom legislation in this field is something new.

What I want to do now is not to explain the ins and outs of the Directive itself – I assume you will all have read the two consultative documents published by the Department in October 1993 and September this year – nor to give a detailed Government reaction to the responses that the Department has received to the second Consultative Document – after all, the closing date for comments was only last Monday – but to give you some thoughts on the underlying reasoning for why insurance is included in the directive and what the implications may be.

The purpose of the Directive is to change the balance between suppliers and consumers in consumer contracts by "eliminating unfair terms", that is, terms that act unfairly towards consumers.

In the European Commission's own Explanatory Memorandum in 1990 explaining their proposal, the problem of unfair contract terms had already been recognized by a number of member States. Since 1974 most States have adopted unfair contract terms legislation. The Commission noted specifically that "British law differed from the law of other member States in that it excludes contracts of insurance from the application of the Unfair Contract Terms Act 1977, whereas insurance is not excluded by the law of other countries". The Commission did not refer to the alternative of the voluntary ABI Statement of Recommended Practice that has stood alongside the UCTA, but even if it had it is doubtful whether this would have altered their position. It was always the Commission's intention therefore that the

directive *should* apply to insurance contracts. In a European context, the argument put forward by the UK insurance industry when the Unfair Contract Terms Act was being proposed, that insurance contracts were different from other contracts because the contract of insurance was itself both the product and the contract itself, was extremely weak given that other member States' unfair terms legislation *did* apply to insurance contracts and there would have been little or no support from others for their exclusion.

Moreover, a significant body of opinion has developed in the UK since 1977 that insurance contracts are somehow unfairly balanced against the interests of consumers. Take for example the perennial reports in "Which" magazine and more recently in the Sunday Times several months ago. I am not suggesting that the Government has concluded that the allegations contained in these articles are justified: simply that the public climate has become such that special exclusions for the insurance industry are politically much harder to justify. And I have to say that the industry has not been its own best friends. I have seen advertisements for conferences with titles along the lines of "How to avoid paying claims": who needs enemies with publicity like that?

The Government judged therefore that a total exclusion of insurance contracts from the scope of the directive should not be pursued. Instead, we sought to clarify more precisely what the object of the directive was. In relation to insurance contracts and other service suppliers we came to the view, along with other member States, notably the Germans, that a difference could be drawn between the terms of a contract that represented the subject matter of the contract and those terms that represented a subsequent stage in the performance of the contract.. The former became known in the negotiations as the "core provisions", and are referred to as such in the latest consultative document.

In association with the ABI, the Department proposed a form of words which could so limit the scope of the directive. The ABI tabled this at a meeting of the CEA (the European insurance body); they were adopted and offered by the CEA to the Commission. This subsequently developed into what is now Recital 19 to the directive, namely:

> "whereas for the purposes of this Directive, assessment shall not be made of terms which describe the main subject matter of the contract nor the quality/price ratio of the goods or services supplied; whereas the main subject

matter of the contract and the price/quality ratio may nevertheless be taken into account in assessing the fairness of other terms; whereas it follows, *inter alia*, that in insurance contracts the terms which define or circumscribe the insured risks and the insurer's liability shall not be subjected to such assessment since these restrictions are taken into account in calculating the premium paid by the consumer".

What this meant was that insurance companies could continue to limit the risks covered, by specifying exclusions from risks, because the inclusion or exclusion of that risk would have a bearing on the premium charged to the consumer. In a simple case, for example, a higher premium is normally charged for a house with a thatched roof as opposed to one which is tiled. If an insurer did not wish to cover thatched roofing in its standard contract, it could specify that this cover was excluded from the contract and that exclusion could not be deemed in itself to be unfair within the terms of the Directive, because if this risk were included would affect the premium charged.

An example of a contract term which might be deemed to be unfair could be one where, for example, the consumer is required to submit a detailed claim within an unreasonably short period of time following the incident which gave rise to the claim. Another might be where a consumer is required by the company to obtain an unreasonable number of independent assessments of the injury or damage. These types of contract terms relate to the performance of the contract and would have no direct bearing on the premium.

So, and I think this possibly goes to the heart of consumer's perception of the alleged unfairness of insurance contracts, it must be clear – crystal clear – to the consumer that the policy provides the cover that the policyholder thinks it does. Thus when the policyholder submits a claim he should be able to do so with the confidence that the insurance company will meet the claim witout hassle.

This of course leads to two important disclosure requirements. First, it must be made clear by the insurance company to the policyholder which risks the policy actually covers. Second, it is equally incumbent on the prospective policyholder to make clear to the insurance company that the company has all the information necessary to enable it to calculate the risk to be insured and thus the premium to be charged.

This leads to the vexed question of material disclosure and whether the policyholder should be expected to know what information the insurance company might regard as being material in any particular case. I believe that it is this sort of issue that goes to the heart of the change in the balance of interests between the supplied and the consumer in the directive.

Now I appreciate that the examples I have given are rather vague and also occupy oppsite ends of the range of possibilities. I agree that the very nature of insurance contracts is such that there is a considerable grey area in the middle where it is not clear whether a term would or would not be covered by the directive. Only the court could determine whether or not such a middle-ground term is subject to the directive or not. I could not possibly anticipate today what a court might decide in respect of any one case. I also know that lack of legal clarity goes to the heart of the insurance industry's concerns about this directive. The safest course of action, which I know insurance companies are embarking on, is to ensure that, to the greatest extent possible, where there is any doubt the terms should be drafted in such a way as to avoid ambiguity.

The Department has recognised that insurance companies will need time to assess the security of their contract terms. For this reason the Department was persuaded, in its second consultative document recently published, that there should be a transitional provision allowing companies to carry out this assessment. As the consultative document explained, the terms of such a transitional provision would be along these lines:

> "Where a contract to which the implementing regulations apply has been concluded before 30 June 1995, on terms contained in a written pre-formulated standard contract, those terms shall not be assessed for fairness, if terms identical to those in written pre-formulated standard contract had been offered to consumers generally by the seller or supplier at any time in the 6 months immediately before the coming into force of the implementing regulations".

In other words, you will have until 30 June 1995 to consider the security of any contract terms that you are currently offering. The implementing regulations will not have the retrospect effect. I believe the inclusion of this transitional provision has been welcomed by the ABI.

On the other hand I know that the ABI submission to the DTI raises a number of

other important concerns on behalf of the industry. It may therefore be helfpful if I give just a brief reaction to some of the more significant points that were raised. This may help to inform the question and answer session which we will open in just a moment.

First the ABI has said that insurers are extremely keen to avoid issuing policies which will fall foul of the directive. I understand and welcome this of course. But then the ABI go on to say that it is unreasonable for it to be left to each seller and supplier to make his own mind on provisions which are ambiguous. At first sight this is an appealing argument; but I have to tell you that as an objective it is quite unattainable. Absolute certainty of the kind implied is simply not possible in statute law. There are many aspects of British law which rely for their interpretation on the development of the law through common interpretation and individual case law. I do not think that is something we should apologise for: no statute could hope to predict in advance every human circumstance. I sometimes feel that if Moses had been accompanied up Mount Sinai by commercial lawyers they would be there still, arguing with the Almight about whether "Thou shalt not steal" unambiguously embraced jumping out of a taxi at the lights without paying. But I agree that we should try to help insurance companies to have a fighting chance of getting it right and I suggest that over the next few months the ABI set up a little working party involving the DTI, the BILA and any other august body that the ABI wishes to invite, to draw up some interpretative guidance notes, as we have done for the interpretation of some aspects of the implementation of the third insurance directive.

Second the ABI has noted with regret the deletion of specific references to the exclusion of insurance terms from the implementing regulations. I agree that insurers might have more legal clarity if terms relating to insurance contracts had received special mention in the regulations. But there is a risk that including a specific reference for insurance companies would simply fuel claims for other special cases to be mentioned. Imagine, if you will, a playing field with a sign saying "No football". We all understand that. But then someone points out that cricketers sometimes kick the ball so the owners feel obliged to add "Football does not include cricket". And then someone else points out that in tennis, as in cricket, the ball is hit by a bat. The regression is infinite. Arguably core provisions are core provisions and the current philosophy behind UK implementation of EC Legislation is inclined to more towards the notion of copy-out that over regulation; hence the decision that the Department has taken to implement Article 4(2) in this

way. However, as I said earlier, my comments can only be a provisional reaction to the ABI response and I feel sure that our Consumer Affairs Division, who are in the lead on this Directive, would want to reflect carefully on the further representations that the ABI have made.

Moving on to definitions, the ABI has commented on the status of persons such as trustees. I am sure these points are valid and that Consumer Affairs Division will want to take those comments into account in reassessing the regulations.

Next, the ABI has said that insurers will expect the courts and the Director General of Fair Trading to accept that the bargaining positions of the parties in relation to the provision of insurance contracts is evenly matched, and that insurers deal farily and equably with their customers. As I said before I very much hope that this will remain the case, and to the extent that this already reflects current insurance practice should not cause undue problems for insurance companies.

The the ABI has referred to the Annex of terms which may be considered to be unfair, that will appear in Schedule 3 as a copy-out of the terms that are contained in the Annex to the Directive. The ABI, rightly in my view, has said that it should be made clearer that the terms listed in Schedule 3 are not themselves unfair and must be judged against a criteria set out in draft regulations C(1) and Schedule 2. They also suggested that Insurance Division might seek legal advice from their own lawyers on a number of questions which they have asked about the terms in the Annex. We would certainly want to ensure that our legal advisers do have a chance to comment on the points raised by the ABI in an internal response to Consumer Affairs Division.

On the question raised by the ABI about the concept of plain intelligible language – a comment that is not clear what standard is to be applied – I doubt myself that any such standard will be applied to this concept. The important point is that which I made earlier, that both parties to the contract know what is expected of them and that, ideally, there should be no room for misunderstandings. In my view, an insurance contract term which does not make its meaning clear to the consumer *should* be regarded as unfair to the consumer. The insurance industry has made great strides in recent years to improve the clarity of the information that is given to consumers, and I greatly applaud that. But that does not excuse an insurance company which produces a contract that is not clear.

Finally, I am sure that Consumer Affairs Division would want to take account of the observations made by the ABI in relation to the prevention of continued use of unfair terms.

To sum up therefore, the Department, acting as sponsors of the insurance industry, has done what it can to limit the scope of the Directive to that which is reasonable, short of complete exclusion. We accept that there is a grey area between those terms which are clearly excluded from the scope of the Directive and those which are clearly included in the scope of the Directive. We are of course, as I said, willing to assist in attempting to draft guidance notes which may provide insurers with some help in interpreting terms which fall into this grey area. I also hope that the transitional period which insurers will be allowed will give us sufficient time for proper assessment of the likely risk of a term being found to be unfair. At the end of the day, however, it rests with the courts, in the context of individual contracts, as it always does.

OBITUARY

Ian Smith

Ian Smith died suddenly on the 8th October 1994. He was for many years an active member, indeed a life member, of BILA. He is particularly appreciated for the fact that while having the onerous task of editing the CII Journal, he also carried on as Editor of the BILA Journal. Holding down a senior post with the then Phoenix Assurance, he added to his other spare time tasks that of Insurance Correspondent of the Financial Times. Our sympathies go out to his widow Anne, and son and daughter at their sad loss at the early age of 68.