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Consumer insurance: the risks of contracting on unfair terms

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Introduction

The Unfair Terms in Consumer Contracts Regulations were first enacted in 1994, in order to implement Council Directive 93/13/EEC on unfair terms in consumer contracts ("the Directive"). After five years, the Regulations were replaced by the Unfair Terms in Consumer Contracts Regulations 1999 ("the Regulations"). Although the Regulations have given rise to little in the way of reported cases in the insurance context, the Financial Services Authority has used its enforcement powers under the Regulations to secure undertakings in relation to unfair terms from a number of UK firms in the insurance sector. These include AXA Insurance UK plc, National House-Building Council, Legal & General Insurance and RBS Insurance.

This article considers the current state of the law in relation to terms in contracts between consumers and insurers or brokers or other intermediaries which are found to be unfair. It discusses the impact on *Bankers Insurance Co Ltd v South*[1] of the recent decision of the European Court of Justice ("ECJ") in Case C-618/10 *Banco Español de Crédito SA v Camino*[2] and the approach of the Financial Services Authority ("FSA") to enforcement of the Regulations in relation to the insurance market.

The Directive and the Regulations

The Directive is a consumer protection measure which applies to unfair terms in contracts concluded between sellers or suppliers and consumers where those terms are standard (or, in the words of the Directive and the Regulations, "have not been individually negotiated").[3] The earlier domestic legislation on unfair contract terms – the Unfair Contract Terms Act 1977 – excludes contracts of insurance from its scope, thereby increasing the importance in the consumer context of the 1999 Regulations. The Directive and Regulations require that contract terms be in "plain intelligible language". Where there is doubt about the meaning of a term, the interpretation most favourable to the consumer must prevail.[4]

This reflects the English principle of interpretation of contracts against the party putting forward, or benefitting from, the wording (commonly denoted by the Latin phrase "contra proferentem"), and is therefore not of great significance. Of potentially greater significance is Article 6(1) of the Directive, which sets out the consequences of a term being found to be unfair, as follows:

> "Member States shall lay down that unfair terms used in a contract concluded with a consumer by a seller or supplier shall, as provided for under their national law, not be binding on the consumer and that the contract shall continue to bind the parties

upon those terms if it is capable of continuing in existence without the unfair term."

This is implemented in the United Kingdom by Regulation 8, "Effect of unfair term", which provides as follows:

> "(1) An unfair term in a contract concluded with a consumer by a seller or supplier shall not be binding on the consumer.
>
> (2) The contract shall continue to bind the parties if it is capable of continuing in existence without the unfair term."

A term is unfair if, contrary to the requirement of good faith (which is not defined), it causes a significant imbalance in the parties' rights and obligations arising under the contract, to the detriment of the consumer.[5]

Bankers Insurance Co Ltd v South

Neither Article 6(1) nor Regulation 8 gives any hint that a national court is expected or even permitted to modify an unfair term in a contract between a consumer and a seller or supplier. However, that was the approach taken by Mr. Justice Buckley in 2003 in *Bankers Insurance Co Ltd v South*[6], a decision in relation to the 1994 Regulations the reasoning of which is equally applicable to the 1999 Regulations. The insured's travel insurance policy stated that the payment of claims was dependent on him observing certain conditions. These included requirements to report in writing to the insurers, as soon as reasonably possible, full details of any incidents which might result in a claim under the policy and to forward to the insurers immediately upon receipt every writ, summons, legal process or other communication in connection with the claim.

The judge construed these requirements, with which the insured had failed to comply, as conditions precedent. This meant that the consequence of the insured having failed to comply with them was that insurers were not obliged to pay his claim even if his failure had caused them no prejudice.

Having reached the conclusion that the requirements were conditions precedent, the judge decided that the fact that they entitled the insurers not to pay the claim even if they had suffered no prejudice meant that they caused a significant imbalance in the parties' obligations to the insured's detriment. They were accordingly unfair contract terms within the meaning of the Regulations. He then considered the consequences of this finding, and decided to hold that it was "only that part of the clause denying recovery whatever the consequences of the breach, which is not binding on the insured". In so doing, the judge recognised, at least implicitly, that this was inconsistent with the strict wording of the Regulations, saying: "I regard this as consistent with the spirit, at least" of the Regulations. The judge went on to hold that the breaches of the conditions precedent by the insured were "manifestly serious" and had caused the insurer significant prejudice. On this basis the insurers were entitled to rely on the insured's breach of the conditions precedent in order to deny liability under the policy.

Case C-618/10 *Banco Español de Crédito SA v Camino*

Banco Español de Crédito SA v Camino concerned a loan agreement entered into by a borrower with a bank. The rate of interest on late payments was 29% and the term of the loan was seven years. Early into the second year of the term, the borrower had failed to make seven of the monthly repayments. The bank made an application to the relevant Spanish court for repayment of the outstanding sum, contractual interest (including interest for late payment) and costs. The court held that the term was unfair and void, but amended it so that interest on late payments was fixed at 19%.

One of the questions put to the ECJ was whether Article 6(1) of the Directive precluded legislation of a member state which allowed a national court to revise the content of a term which it found to be unfair term.

The ECJ answered this question in the affirmative. In reaching its conclusion, the ECJ relied on the wording of Article 6(1), which expressly required member states to provide that unfair contract terms "shall not be binding on the consumer", and on the objective and overall scheme of the Directive. In relation to the latter, the long term objective of the Directive is to prevent the use of unfair terms in contracts concluded between consumers and sellers or suppliers. The ECJ was concerned to preserve the "dissuasive effect" of the Directive. It agreed with Advocate General Verica Trstenjak, who had described Article 6(1) as having a "deterrent effect" on sellers or suppliers, and effectively raising the stakes for sellers or suppliers who gambled on including unfair terms in their contracts.[7]

Advocate General Trstenjak had said that if national courts were able to modify, rather than declaring void, unfair terms, the risks to a seller or supplier from the use of unfair terms in commercial practices would be reduced considerably. In this way, if national courts were permitted to revise the content of unfair contractual terms, sellers and suppliers would be tempted to continue to use those terms. Even if they were declared to be invalid, the national court could revise the unfair terms in such a way as to safeguard the interests of sellers and suppliers. Not only would this compromise the attainment of the long-term objective of preventing the use of unfair terms in consumer contracts by sellers or suppliers, it would not ensure such efficient protection of consumers as the refusal to apply, in their entirety, terms found to be unfair.

The implications of the *Camino* ruling for English law are clear: terms found to be unfair cannot be modified by the courts and must be disregarded in their entirety. The approach taken in *Bankers Insurance Co Ltd v South* to the construction of the Regulations is, in the light of the interpretation of the Directive by the ECJ, incorrect as a matter of law and will not be followed.

The impact of the ruling in practice is less certain. It is uncommon for the Regulations to be relied on in litigation involving insurance policies, and reference is rarely, if ever, made to *Bankers Insurance Co Ltd v South*. However, the ECJ also considered an aspect of

Spanish procedural law, and held that the Directive precluded procedural arrangements in national courts which did not allow the court to assess of its own motion at the outset or at any time the fairness of a term. The ECJ also referred to its own earlier judgment in Case C-473/00 *Cofidis*[8] in which it decided that, in order for the Directive to provide effective protection for consumers:[9]

> "The protection which the Directive confers on consumers … extends to cases in which a consumer who has concluded with a seller or supplier a contract containing an unfair term fails to raise the unfair nature of the term, whether because he is unaware of his rights or because he is deterred from enforcing them on account of the costs which judicial proceedings would involve."

It seems, therefore, that national courts may be obliged in some circumstances to assess of their own motion the fairness of a contractual term falling within the scope of the Directive. The answer to the question posed in the *Camino* case was put in negative terms – the Directive precludes legislation which does not allow a national court to assess of its own motion whether a term in a consumer contract is unfair. However, the judgments in *Camino* and *Cofidis* together at least arguably give rise to the intriguing prospect of courts raising, of their own motion, the question of whether a term in a consumer insurance contract is unfair within the meaning of the Regulations. They do this at present in cases which appear to involve illegality.

Wider implications for insurers and intermediaries

Since 2001, the Financial Services Authority ("FSA") has had power in certain circumstances to take action against the firms that it regulates to enforce the Regulations. The firms concerned include insurers and intermediaries and the FSA's powers extend to general insurance and life assurance. In 2007, the FSA published guidance in the form of the Unfair Contract Terms Regulatory Guide ("UNFCOG"). This guide sets out the FSA's policy on how it will use its powers under the Regulations. It was updated in August 2012.

Paragraph 1.3.6 of UNFCOG states that where a court finds a term to be unfair in litigation between a seller or supplier and a consumer, the seller or supplier will "have to stop relying on the unfair term in existing contracts governed by the Regulations". Not only is this entirely consistent with the decision in *Camino*, but it means that a finding in litigation brought by one party will be applied by the FSA to all current contracts which include that term. The finding will seemingly not be limited to contracts entered into after the term has been found to be unfair. There is no scope for consideration of the unfairness of the term in a different contract involving a different consumer and her particular circumstances. To put it shortly, a finding of unfairness is a knockout blow to a contractual term in all of the consumer contracts in which a particular seller or supplier (including an insurer or intermediary) deploys it.

UNFCOG also focuses on the language used in the terms of contracts concluded between a consumer and a seller or supplier. Under Regulation 6(2), terms written in plain, intelligible language cannot be reviewed for fairness within the meaning of the Regulations if the terms relate to either the definition of the main subject matter of the contract or the adequacy of the price or remuneration, as against the goods or services supplied in exchange. A recital to the Directive makes plain that, in insurance contracts, these include terms which clearly define or circumscribe the insured risk and the insurer's liability, as those restrictions are taken into account in calculating the premium paid by the consumer. Terms which are not written in plain, intelligible language do not fall within the exemption. Under Regulation 13, the FSA has the power to challenge sellers or suppliers using terms which it regards as unfair. It is clear from the FSA's approach, which can be seen from its website publications including its "Library" in relation to unfair contract terms, that there is a particular focus on the use of language which is neither plain nor intelligible.

Examples of terms which the FSA has challenged as being unfair and which have subsequently been amended are on the FSA website. For example, a home insurance policy contained the following term:

"The buildings are insured against loss or damage caused by … subsidence or heave of the site on which the buildings standThey discuss the recent decision of the European Court of Justice in *Banco Español de Crédito SA v Camino* and the approach of the Financial Services Authority to enforcement of the Unfair Terms in Consumer Contracts Regulations 1999. This is also a theme in Alison's book which is reviewed in this issue (see below). or landslip

We will not pay for loss or damage …[c]aused by settlement, shrinkage or expansion"

The terms "subsidence", "heave", "landslip", and "settlement" were not defined in the policy. The FSA considered that this term was not drafted in plain and intelligible language because "settlement, shrinkage or expansion" was not defined in the policy. It believed that the possible definition of these words was very broad and that the average consumer would have difficulties in determining whether she was insured under the policy. Nor did this term clearly define the insurer's liability. As a result of the FSA's challenge, the original term was deleted from all contracts of insurance in which it appeared. It was replaced with a term which provided definitions of the terms used and set out clearly the extent of the insurer's liability.

Similarly, the FSA challenged a term in a 2011 home insurance policy which was similar to one of the terms at issue in *Bankers Insurance Ltd v South*. This particular term stated, under the heading "What you must do when making your claim", that the insured was required to give the insurer, at the insured's reasonable expense, all the information, reports, certified plans, specification information and assistance that it may need in progressing the claim. A similar clause in a 2009 policy relation to what the insured must do after making a claim required the provision of the same information, but was to be provided at the insured's expense, without the qualification that the expense must be "reasonable".