

8 August 2008

By email: adjudication@accc.gov.au

The General Manager
Adjudication Branch
Australian Competition and Consumer Commission
PO Box 1199
DICKSON ACT 2602

Dear Sir/Madam

**Joint consumer submission
Insurance Council of Australia application for authorisation A91086**

We refer to our preliminary written submissions dated 1 August 2008 regarding the application for authorisation lodged by the Insurance Council of Australia (**ICA**). These were provided to the Australian Competition and Consumer Commission (**ACCC**) to assist in considering our concerns prior to the pre-decision conference in this matter.

We now provide a joint consumer submission further detailing our concerns with the ICA's proposal. We strongly urge the ACCC to reject authorisation of the ICA's application, as the proposal for a common definition of 'inland flood' is likely to cause significant public detriment.

As we stated at the pre-decision conference, we would be happy to work with the ICA on developing a new and appropriate common definition for flood that actually provided legal certainty, public clarity and a fair outcome for consumers, for possible re-submission to the ACCC for authorisation at a future time. The current proposal, however, could not be said to bring sufficient public benefit (if any) to justify ACCC authorisation of what is otherwise inherently anti-competitive conduct.

1. Anti-competitive detriment versus lack of public benefit – voluntary proposal

The ACCC has already accepted that the ICA's proposal has the potential to create significant anti-competitive detriment as, by its nature, it permits insurers to collude as to the nature of the insurance cover they will offer consumers. For this reason, the ICA's proposal must offer the potential for public benefit that outweighs this detriment before the ACCC can authorise the ICA's application.

Insurance coverage for flood damage is an issue that has raised, and continues to raise, significant public concern. There is undoubtedly consumer confusion surrounding insurance coverage in the event of flood damage, for example, to what extent such damage may be excluded by their own household insurance policy or, when shopping around, whether other

insurance policies cover flood damage and to what extent. For this reason, there is the *potential* for an initiative related to standardisation of the definition of flood damage in Australian household insurance policies to generate public benefit.

However, for the reasons set out in this submission we strongly consider that the ICA's current application is not such an initiative. We doubt that it will generate much public benefit at all, let alone sufficient to outweigh the anti-competitive detriment generated by allowing for collusion in this area.

The potential benefits of a proposal to standardise the definition of flood damage relate to a reduction in consumer confusion and more informed decision-making, and fairer coverage for consumers with flood exclusions in their policy, especially those consumers unable to afford flood coverage and thus not in a position to make a different "choice" as to insurance policy (and fairer coverage also reduces the cost to the community of assisting consumers without insurance coverage in the event of damage).

In order to realise such benefits, however, it is likely that the mandatory adoption of such a common definition for 'flood' exclusion would be necessary. Any potential benefits in terms of reducing consumer confusion that might arise from the adoption by insurers of a common definition for flood damage are fatally undermined by a voluntary initiative. A voluntary measure cannot, by its very nature, ensure any greater consistency in the coverage provided by different insurance policies than is now the case. However, the ICA's proposal is not for mandatory adoption of a common definition of 'inland flood' by insurers. Rather, if authorised the proposal would allow insurers to adopt the common definition if and when they wish.

Indeed, the ICA's proposal has the significant potential to increase further consumer confusion as to insurance coverage for flood damage. By adopting and promoting a common definition of 'inland flood', members of the community might well come to assume that this definition automatically applies to their own policy and/or when shopping around to all policies, whether this is the case or not. The ACCC's proposed conditions regarding the authorisation might have the perverse effect of increasing this confusion even further because the more effective the communications campaign, the more likely it is that consumers will be aware of the common definition and assume it applies to all cases of flood exclusion, whether it does or not.

Moreover, there is a risk that consumers will be confused due to the fact that this definition has been "ACCC approved". This may lead consumers to assume that the definition applies and/or is reasonable and appropriate, due to the fact that the ACCC has "authorised" it.

We recognise that there is an argument that a proposal to adopt a mandatory common definition of 'flood' could be argued to increase the anti-competitive detriment of a standardisation initiative, as it would further lower the ability of insurers to 'compete' as to flood damage coverage. However, there is no point in authorising a voluntary initiative, which would also generate anti-competitive detriment, if it cannot bring public benefit. There is greater potential for public benefit to arise from a mandatory initiative, which in the appropriate case might well exceed any anti-competitive detriment generated. Further, an initiative for the mandatory adoption of a common definition in relation to flood exclusions

would not prevent insurers from continuing to compete to offer insurance products that provided *fuller* coverage, only limiting them where flood damage is proposed to be excluded.

2. Lack of public benefit - less coverage for consumers and lack of legal clarity and certainty

The proposed common definition of 'inland flood' will be used primarily, as it appears now in most consumer general insurance policies, in relation to **exclusions** of cover for flood damage, not the inclusion of such coverage, in insurers' policies.

This is the case due to the operation of the *Insurance Contracts Act 1984* (the **Act**) and the Insurance Contracts Regulations 1985 (the **Regulations**). The Act provides that, for prescribed types of insurance contracts, the insurance contract **must cover** prescribed events, **unless** the insurer clearly informs the insured in writing (whether by providing the insured with a document containing the provisions, or the relevant provisions, of the proposed contract or otherwise) or the insured knows, or a reasonable person in the circumstances could be expected to know, that liability is reduced or excluded (s.35).

The Regulations prescribe home building and home contents insurance contracts for this purpose, and the events that must be covered include 'storm, tempest, flood, the action of the sea, high water, tsunami, erosion or land slide or subsidence' (rr.9-16). Thus flood, storm and sea water damage are covered by household insurance policies unless clearly excluded. Indeed, we are very concerned that this proposal is a "backdoor" attempt to avoid the operation of the statutory standard protection provisions, which have been implemented by the Parliament and Government in the public benefit.

The proposed common definition of 'inland flood' is far more expansive than the definition of flood currently seen in any insurance policy on the market. As set out above, given the statutory cover for flood currently afforded to consumers under s.35 of the Act, the only reasonable conclusion that can be drawn is that the common definition will be used as an exclusion clause. The effect of the ACCC approving this expansive definition is therefore likely to be a reduction in the coverage for flood damage that consumers would otherwise have.

To assist in understanding the extent to which the usual definition of flood has been expanded, we attach a summary of the definition of flood in five major insurance policies currently being offered in the country (Annexure 1). It is worth noting that, of these five general insurance policies, the majority stipulate that flood is an exclusion to the coverage offered by the insurance policy. Below we set out in more detail some of the problematic aspects of the proposed common definition.

Inland

The common definition does not define 'inland'. It is our view that the use of the word 'inland' is not only unhelpful, it may also mislead consumers who live within the vicinity of the sea (which includes most Australians) to believe that an exclusion of 'inland flood' in a policy does not apply to them.

The Oxford English Dictionary defines inland as ‘situated in the interior of a country; 1. in the parts of a country remote from the sea or frontiers, 2. the interior of Australia or towards the interior of a country’.¹ As the operation of the common definition is not intended to be confined to events situated in the interior of Australia, or even necessarily remote from the sea, this aspect of the definition clearly has the potential to be decidedly confusing or misleading for consumers.

First limb of the definition

The first limb of the proposed common definition of ‘inland flood’ covers:

water that overflows or escapes from a naturally occurring or man made inland watercourse (such as a river, creek, canal or storm water channel) or a water pool (such as a lake, pond or dam), whether it is in its original state or it has been modified

Water pool

‘Water pool’ is a new term that, as far as we are aware, has never before been included in an Australian household insurance policy in respect of flood cover.

The ordinary meaning of ‘water pool’ is not one usually associated with flood. This definition therefore adds a level of artificiality to the ordinary meaning of flood. This is problematic, particularly for disadvantaged consumers, in that no level of community education can remedy an artificial meaning being given to ordinary words.

By introducing this new concept of ‘water pool’ into the definition of flood, the common definition adds a layer of complexity and confusion to this area of law for consumers. It also flies in the face of the purpose of adopting a common definition, namely, to clarify and educate consumers on the meaning of flood, not create further confusion.

Man made watercourse

‘Man made’ watercourse is an expansion of the usual definition of flood, which is ordinarily confined to a natural watercourse. By including this term, the common definition would capture water flowing through stormwater channels or private dams.

The ICA submitted that the proposed expansion of the meaning of flood to include ‘man made watercourse’ is acceptable:

- i. as stormwater channels are examples of natural watercourses that have been ‘domesticated’; and
- ii. to alleviate consumer confusion about whether the inundation is to be considered a flood event.

¹ Fourth Edition, 2000 Oxford University Press.

With respect, these arguments do not seem to be substantiated by factually-based evidence. In relation to the first argument, this is simply incorrect. As far as we are aware, there is no evidence before the ACCC supporting the assertion that stormwater channels are simply natural watercourses that have been domesticated. This assertion simply cannot be relied upon by the ACCC as a statement of fact. Secondly, any consumer confusion as to whether an inundation related to a watercourse is a flood event would arise primarily because of this new definition, which expands the limits of the ordinary meaning of the word 'flood' beyond natural watercourses.

Second limb of the definition

The second limb of the proposed common definition of 'inland flood' covers:

water released from a dam whether it be accidentally released or intentionally released to control, mitigate, regulate, or otherwise respond to excess water

The impact of this section of the definition, which as we understand the ICA acknowledges, is to diminish the effect of the doctrine of proximate cause. The concern this raises is that it would prevent an analysis as to whether the activities of an intervening party may establish a second proximate cause of the damage. Such circumstances may include the negligent or intentional acts of a dam operator. It is our understanding that such circumstances have been raised before in this country in relation to release of water by dam operators. It would be significantly unfair to consumers if they bore the brunt of any negligent or intentional acts of such a third party.

Third limb of the definition

The third limb of the proposed common definition of 'inland flood' covers:

water that cannot drain or run off as a result of water that is overflowing or escaping from an inland watercourse or water pool preventing the escape of water

The third limb of the common definition is a new and novel addition to the ordinary meaning of flood. When used as an exclusion, which will be the usual scenario, it will have the effect of denying cover in a range of circumstances that would ordinarily be covered by a general insurance policy. These include:

- Storm

Unlike flood damage, currently storm damage is usually covered in most household insurance policies. The third limb of the common definition may be used to exclude from cover excessive storm water (which would normally run off into storm water drains) when it is prevented from escaping into storm water drains that have already been blocked by flood waters.

- Sewage overflow

Sewage overflow is also usually covered in most current household insurance policies. The third limb of the common definition may be used to exclude from cover sewage which flows back up the pipes of a home as a result of the presence of flood in the general vicinity of the home.

- Flash flood

Some household insurance policies currently offer cover for flash flood. The common definition throws this area of coverage into confusion. Whilst the ICA asserts that the proposed common definition is not intended to include flash flood, the actual words of the definition are not at all clear in this regard. If there were any dispute in respect of whether this definition of 'inland flood' includes flash flood, a consumer would not be entitled to rely upon the ICA's submissions to the ACCC that it is not the intention of the ICA that the common definition apply to flash flood. Quite simply, if the common definition is intended not to apply to flash flood, this should have been clearly stated within the definition.

A practical example of how the proposed inland flood clause may restrict insurance cover for water damage for consumers is the well known case of *Hams v CGU Insurance Limited*.² In that case the New South Wales Supreme Court found that the damage done to much of the Hams' farm in outback New South Wales was initially caused due to local run-off from a large downpour which pooled into a large depression and inundated the insured property. These waters then subsequently mixed with flood waters which overflowed from surrounding rivers and creeks but the court found that the initial damage was caused by the local run-off, which did not fall within the flood exclusion under the policy. However, under the proposed common definition, damage such as to the Hams' property could be caught by an inland flood exclusion as water overflowing from a "water pool" or "pond".

In addition to the general detriment that would be caused by introducing new legal uncertainty to this area as detailed above, we simply do not consider that it is appropriate for an application authorisation to essentially become a vehicle for the introduction of new and uncertain legal concepts into the insurance law field.

Finally, we note that there have been a number of floods across Australia in recent years and, further, it is now generally acknowledged that Australia will be affected by climate change. There is no doubt that risk for insurers is increasing as a result of climate change. Although in the shorter term insurers may wish to cover flood, this is not guaranteed in the medium to longer term. As the impacts of climate change become more apparent, it is quite possible that the availability of such an expansive common definition could result in widespread collusion to exclude flood from insurance coverage.

² (2002) 12 ANZ Ins Case 61-525.

3. Lack of public benefit – disproportionate impact on low-income and disadvantaged consumers

The proposal, if approved, would be likely to be disproportionately detrimental to low-income and otherwise disadvantaged consumers.

As a general proposition, insurance premiums are priced according to risk. The risk profile will also change depending on the level of coverage provided by an insurance policy. Lower premiums will often mean less coverage, for example flood damage cover may be excluded.

Many (arguably most) consumers simply do not read the policy in detail when purchasing insurance. Decisions on the purchase of insurance are determined primarily on premium price, although of course consumers who, for example, have previously experienced flood may also shop around for a policy that covers flood damage. However, there are several groups of consumers who are basically forced to take the lowest premium policies due to lack of available income. Those groups include:

- older people whose sole source of income is the aged pension;
- home owners, including disabled home owners, whose sole source of income is Centrelink; and
- consumers experiencing financial hardship due to unemployment, illness, unaffordable debt, rising costs and rising interest rates.

In addition, there is a group of consumers who have bought homes in flood-prone areas, often because these homes are lower cost. This group of consumers has great difficulty in obtaining insurance that covers flood.

If the proposed common definition of 'inland flood' were authorised, one possible outcome is that low-cost insurers may seek to use this wider definition of flood in excluding flood from cover under their policies. Given that this would result in a significant expansion to the sorts of damage that would be excluded as discussed above, it would lead to the rejection of more claims and would be significantly detrimental to these groups of low-income and disadvantaged consumers.

Another possible outcome is that insurers may seek to offer broader coverage to avoid this expansive common definition of 'inland flood'. However, this would be likely to result in higher premiums, which could render household insurance even more unaffordable for these low-income consumer groups, leading to more under-insurance. The Australian Securities and Investments Commission (**ASIC**) also noted this possibility in its submission dated 18 April 2008. The ICA's submissions have not addressed ASIC's concern on this issue, instead simply stating that insurers will continue to be free to offer and price policies as they so choose.

4. Communications campaign

As a final matter, we note that the ACCC's draft determination proposed to authorise the ICA's application subject to conditions surrounding the ICA's communications campaign, expressing some concerns about the communications campaign proposed by the ICA.

To the extent that a communications campaign might provide public benefit (but see section 2 above), we share those concerns. We would also like to draw attention to the following issues in terms of the capacity of the ICA to conduct an effective communications campaign.

First, the lack of effectiveness of the ICA's website is concerning. The mere fact that the ICA considered it appropriate to simply rely on its website as a sufficient communications plan demonstrates a lack of capacity to conduct an effective communications campaign. However, in our view it is even more problematic that the ICA has yet to develop its website to provide comprehensive and effective consumer information in any area, let alone on the important issue of flood coverage.

The ICA website's response to the issue of flood insurance contains the following information to "assist" consumers:

Apart from choosing to not establish a home in an area of known flood risk - the most prudent prevention method...

Consumers...should review the terms and conditions of their cover by reading their Policy Disclosure Statement (PDS).

*...the Insurance Council Board in November 2006 endorsed an approach for the industry to pursue a framework which **will lead to residential flood coverage becoming available for nearly all households in Australia**... To reduce consumer confusion, in 2006 the general insurance industry worked to develop a minimum standard definition of flood. It is envisaged that this standard definition of flood would be adopted on a voluntary basis by individual insurers and treated, by those who adopt it, as a minimum standard. i.e. – **Insurers would be free to offer coverage to a level above the standard definition, to the minimum standard, or as is the current situation not offer flood coverage at all.** [emphasis added]³*

A comparison between the ICA and Australian Bankers' Association (**ABA**) website is also illuminating in this respect. The ABA website has a section on financial literacy which includes consumer information and fact sheets. The ICA website has no consumer section, information or fact sheets.

In our view the provision of advice in the current format on the ICA's website gives little reason for confidence in the capacity of the ICA to deliver an appropriate and effective communications campaign on the issue of a common definition for 'inland flood'.

³ www.insurancecouncil.com.au/Default.aspx?tabid=1297

Secondly, the ICA's previous history of communications with consumers demonstrates significant problems. ASIC has previously raised serious concerns about the capacity of consumers to obtain appropriate information from the insurance industry to avoid the under-insurance of their house and contents.⁴ Despite the long term interest of the ICA in the issue of under-insurance, no information about this issue is available on the ICA website. For example, the excellent research report, *The Non-Insured: Who, Why and Trends*,⁵ commissioned by the ICA and released in 2007, identified a number of issues including the failure of pensioners to maintain insurance after retirement, however, no reference to the solutions to these issues is available on the ICA website.

Another example relates to the General Insurance Code of Practice. The review of the first Code of Practice by George Pooley in 1998 contained a recommendation that the ICA conduct a communications campaign targeted at consumers following the release of the new Code.⁶ The new Code was released in July 2006 but the ICA chose not to follow that recommendation.

Further, there has been no consultation with consumer representatives on the current proposal, despite long-standing consumer interest in the issue of flood coverage and the ICA's own Consumer Consultative Committee expressing interest in discussing flood coverage as an issue.

It is also significant that the flood definition is, as we have referred to above, likely to impact most on lower-income consumers buying properties in new, cheaper housing estates. In our view the ICA has a poor track record of reaching precisely this group of consumers.

If the ACCC does ultimately authorise the application (which we do not support), it should reconsider leaving the ICA responsible for the communications campaign. A better approach would be to have an appropriate and proactive communications plan formulated and included in the authorisation, rather than simply requiring the ICA to report after-the-fact. It seems difficult to consider the ICA's proposal properly without knowing in advance whether the communications campaign has been planned appropriately and effectively.

In our view any communications campaign or education strategy should be supervised by, and be accountable to, ASIC, with its objectives clearly stated in advance. It would also be necessary to require the ICA to report on the use of the common definition, including whether the definition had been used to exclude or include cover for flood, to enable a proper assessment of the impact of authorisation. This information should be made available to the public to enable full assessment.

⁴ See ASIC, *Is your home underinsured*, www.fido.gov.au/underinsured; ASIC, *Getting home insurance right: A report on home building underinsurance*, September 2005, www.fido.gov.au/fido/fido.nsf/byheadline/Canberra+bushfire+report

⁵ Dr Richard Tooth and Dr George Barker, *The Non-Insured: Who, Why and Trends*, Insurance Council of Australia, May 2007.

⁶ George Pooley, *Formal Review of the Insurance Council of Australia Ltd's General Insurance Code of Practice*, Canberra, 1998, recommendation 11(b) p.12.

About us

Consumer Action Law Centre

Consumer Action is an independent, not-for-profit, campaign focused, casework and policy organisation. Consumer Action provides free legal advice and representation to vulnerable and disadvantaged consumers across Victoria, and is the largest specialist consumer legal practice in Australia. Consumer Action is also a nationally-recognised and influential policy and research body, pursuing a law reform agenda across a range of important consumer issues at a governmental level, in the media, and in the community directly.

Consumers' Federation of Australia

The Consumers' Federation of Australia (**CFA**) is the national peak body for consumer groups in Australia. We have over 100 members including legal centres, health rights groups, local consumer organisations and public interest bodies. CFA's role is to put the view of its member organisations to government and industry and advocate on behalf of consumers.

Insurance Law Service

The Insurance Law Service (**ILS**) is a pilot service operated by the Consumer Credit Legal Centre (NSW) Inc and funded by the Legal Aid Commission of New South Wales, the Law and Justice Foundation of New South Wales and the Victoria Law Foundation. The ILS is a community-based service that offers free telephone advice, advocacy and education for consumers. Since commencing operation in late June 2007, the ILS has taken over 850 calls from consumers in relation to insurance issues, including largely insurance claims disputes and debts claimed by insurance companies. The service has also provided representation in about 60 insurance matters. A series of fact sheets for consumers is currently being developed for the Consumer Credit Legal Centre website in relation to motor vehicle, and home and contents, insurance. In its brief period of operation the ILS has received numerous calls from residents of New South Wales, Queensland and Victoria affected by major storm and flood events.

Legal Aid NSW

The Legal Aid Commission of New South Wales (Legal Aid NSW) is established under the *Legal Aid Commission Act 1979* (NSW) and is an independent statutory body. It provides legal services to socially and economically disadvantaged people. Legal services include representation in federal and state courts and tribunals as well as through various External Dispute Resolution (EDR) schemes. It also works in partnership with private lawyers in representing legally aided people. In the 2006-2007 financial year, Legal Aid NSW assisted more than 162,736 clients with civil law matters through information, advice or representation. Legal Aid NSW solicitors frequently advise clients and litigate a range of matters under consumer protection legislation, including insurance matters covered by the *Insurance Contracts Act 1984* (Cth). Legal Aid NSW has developed a particular level of expertise in the area of insurance law and consumer credit law through the running of litigated consumer cases through the courts and EDR schemes. In the 2006 -2007 financial year Legal Aid NSW either acted in or funded approximately 205 new consumer law litigation cases. Legal Aid NSW also has recognised expertise in policy development in the area of consumer insurance law and has

made numerous previous law reform submissions in respect of the recent *Insurance Contracts Act* reforms as well as a review of the Insurance Ombudsman Service.

Legal Aid Queensland

Legal Aid Queensland (LAQ) provides free advice and information to up to 200,000 Queenslanders each year. In 2006-07 LAQ provided approximately 13,000 advices concerning civil law matters. LAQ's Civil Justice (Consumer Protection) Unit specialises in consumer injustices, including disputes with credit providers and insurers. In that capacity it provides direct advice to clients, undertakes follow up casework and advocates for systemic law reform on behalf of vulnerable clients.

West Heidelberg Community Legal Service

West Heidelberg Community Legal Service (**WHCLS**) is a not for profit legal practice that provides a range of free legal services to the Banyule community in Victoria. WHCLS aims to ensure access to justice for all persons in Banyule and advocate for the legal needs of those in the wider community. WHCLS empowers and supports individuals to access the law and legal system through the provision of information, advice, casework, community development and legal education initiatives. WHCLS' key partners are Banyule Community Health who allow for a more holistic legal service provision; and La Trobe University Law School who operate a legal education clinic at WHCLS for law students.

Please contact us on 03 9670 5088 (Consumer Action) or via our contact details below if you have any questions.

Yours sincerely

CONSUMER ACTION LAW CENTRE



Nicole Rich
Director – Policy & Campaigns

Also on behalf of:
Denis Nelthorpe
West Heidelberg Community Legal Service
denis.nelthorpe@inet.net.au

Catherine Uhr
Legal Aid Queensland
cuhr@legalaid.qld.gov.au

John Berrill
Consumers' Federation of Australia
jberrill@mauriceblackburn.com.au

Katherine Lane
Insurance Law Service
Katherine.Lane@clc.net.au

Legal Aid Commission, New South Wales
Civil Litigation Division
Tel: 02 9219 5000