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REINSURANCE – TERMS OF ART

Introduction

The New South Wales Court of Appeal recently considered the interpretation of terms used in a reinsurance agreement to determine the scope of the class of business reinsured in circumstances where the class of business was referred to in a slip and there was no agreed wording.[1]

Whilst this is one of a small (but increasing) number of reinsurance cases considered by Australian appellant courts, it provides an example of the approach an Australian court may take on interpretation issues of this nature and it reinforces the importance of agreed wordings.

Outline of facts

The terms of the reinsurance treaty were recorded in a slip which described the class of business to be reinsured as 'Trade Credit and Export Credit' which was not defined. There was no wording and no further terms were negotiated.

The direct insurance policy was described as a 'trade credit' policy (**trade credit policy**). In broad terms, the policy covered the risk to the insured (in this case a financial institution) of the non-payment of debts owed to it for goods sold on credit to a manufacturer.

The features of the underlying transactions which were the subject of the claim on the trade credit policy included that the supplier of goods invoiced the financial institution (the insured), the financial institution then paid the supplier and in turn invoiced the manufacturer.

The reinsured sought indemnity under the reinsurance treaty for losses arising under the trade credit policy. The issues in the case were whether the trade credit policy fell within the scope of the treaty's class of business and whether the underlying transactions were covered by the trade credit policy.

The above issues required an understanding of the scope of 'Trade Credit insurance'. There appears to have been limited specific precontractual communications between the parties about the scope of that phrase. Evidence was provided about the way in which the reinsured generally entered into the field of trade credit insurance and the parties each relied on underwriting guidelines produced by the other. The parties also called underwriting and broking experts with experience in trade credit insurance.

Findings

The court found that the trade credit policy fell within the scope of the reinsurance treaty's class of business and that the financial institution's insurance claim fell within the trade credit policy. Allsop P, with whom Hodgson JA and Macfarlan JA agreed, held that:

> 'trade credit risk and trade credit insurance were sufficiently ample expressions to encompass the risk of a financial institution for non-payment by a buyer from it in circumstances where the financial institution did not in the ordinary course of its business trade in such goods or trade in goods generally and in circumstances where it passed title in a sale contract to the buyer.'[2]

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[1] *General Reinsurance Australia Limited v HIH Casualty & General Insurance Ltd (in liquidation)* [2009] NSWCA 22.

[2] Paragraph 36.

Observations

This case reinforces the importance of:

- agreeing a wording for the reinsurance contract;
- defining any industry terms or terms of art (even those which are generally recognised in the industry) with precision to assist to avoid disputes;
- recording the intended meaning of terms of art elsewhere in precontractual communications if, for some reason, such terms cannot be defined with precision in a slip or wording.

At the time of the entry into a reinsurance agreement there is often a presumption, or reasonable basis for belief, that there is a consensus about terms used in the agreement. However, both parties may not share the same understanding and the use and applicability of such terms can change over time or be deployed in contracts for various reasons. Therefore, even if the term is recognisable in the industry, one party to a contract should be cautious about presuming that the other party has the same intention or understanding.

The Court of Appeal's consideration of expert evidence as to the market's understanding of the relevant term is an example of the interpretation of terms as used in their commercial context. While the use of evidence of this nature may be welcomed (particularly in a reinsurance context and from a court with less exposure to reinsurance disputes than other jurisdictions such as the United Kingdom), the outcome of such evidence may lead to a result not expected by one of the parties.

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