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POLITICAL RISK INSURANCE AND THE IMPLIED SUE AND LABOR DOCTRINE AS A BASIS FOR RECOVERY

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Introduction

Political risk insurance generally covers a loss to an insured for confiscation, expropriation, appropriation, requisition for title or use, or nationalization by a foreign "host" government. Such insurance has growing importance as capitalist countries encourage investment in foreign countries which resort to nationalization.

The insurance policy often does not define terms such as "confiscation," but relies upon the recognized meanings for such terms in international law. In the United States, political risk insurance is generally available from the Overseas Private Investment Corporation ("OPIC"), a corporation owned by the United States, for risks in certain countries. In those countries where such government insurance is not available, Lloyds of London generally offers political risk insurance. The governments of the European Economic Community also have created corporations to provide such insurance to their citizens.

A loss under political risk insurance can often be a creature of differing shapes and sizes. Damage does not come like a flood or fire. Often the encroachments come through a series of events, which cumulatively expropriate the insured's investment in a host country. For example, an insured may be expropriated by a series of taxes that cumulatively prevent the insured from making any profit in the host country. If the insured had invested $100 million with the expectation of making a $6.9 million annual profit, but the host country robs the insured of 60% of that profit, then the insured has probably lost effective control of the investment and has apparently been confiscated. Other regulations by a host country may seem less innocuous, but have the same effect. An order freezing assets for two years of an insured in the host country likely has the effect of seizing control of the company. The insured's investment was predicated upon the ability to repatriate profits, but such a suspension terminates such a right for a significant period.

The dilemma for a political risk insured in such situations is to decide whether to close its company and attempt to remove its assets (which might be met with another seizure order) or to make efforts to avoid or mitigate a loss. This business decision will be complicated by the question whether the insured could abandon the country and make an immediate claim upon its insurer. At that point, the question becomes whether the assets have been "effectively" seized. Leaving the country may be a means to cut the insured's losses over the long-term. The insured knows that continuing the operation may be a total gamble. To make the project continue, the insured may have to continue to infuse investments into the program. Abandoning the country, however, often involves the loss of a huge investment and may not be palatable if the insured can "buy" its way out of a creeping or total confiscation.

In making its determination whether to try to stay in the host country, the insured should consider paying the "ransom" or buy-out price, if one is available. As discussed in this article, the insured may arguably then demand the political risk insurer should reimburse the insured for such expenses incurred to avoid or diminish a loss. This article discusses the viability of such an implied

"sue and labor" doctrine, *i.e.*, a right to reimbursement of prevention or mitigation costs, in the context of a political risk claim. It also explains the steps necessary to set up the claim.[1]

THE IMPLIED SUE AND LABOR DOCTRINE

Marine insurance policies have typically included sue and labor clauses which allow an insured to recover against its insurer expenses for "suing and laboring" to prevent or mitigate the loss of a ship or cargo. This coverage is separate and apart from the "insured peril" coverage of the policy. This express obligation of the insurance company to reimburse the insured, however, is implied into any kind of insurance policy based on quasi-contractual principles of unjust enrichment. A California court of appeal explained:

> An insured who avoids or minimizes an insurable loss acts for the benefit of the insurer. It is the benefit conferred which creates the duty on the part of the insurer to reimbursement of the insured for prevention and mitigation expenses.[2]

The reason for such a rule was explained by the Pennsylvania Supreme Court in *Leebov v. the United States Fidelity and Guaranty Co*:[3]

> It would be a strange kind of argument and an equivocal type of justice which would hold that the [insurer] would be compelled to pay out, let us say, the sum of $100,000 if the [insured] had not prevented what would have been inevitable, and yet not be called upon to pay the smaller sum which the [insured] actually expended to avoid a foreseeable disaster. . . . It is folly to argue that if a policy owner does nothing and thereby permits the piling up of mountainous claims at the eventual expense of the insurance carrier, he will be held harmless of all liability, but if he makes a reasonable expenditure and prevents a catastrophe, he must do so at his own cost and expense.[4]

Such a duty is implied in the law apart from the contract. As a Louisiana Court has stated:

> "[A]n insured is entitled to reimbursement of expenses incurred in protecting his insurer against loss by application of general principles of law and equity."[5]

This duty also is found by implication from the express terms of the insurance contract. Many types of insurance policies, including those for political risks, typically provide that the insured must use every effort practicable to avoid or diminish a loss. When this is the case, the duty to reimburse the insured also arises by implication from the contract. In *Slay Warehousing Co., Inc. v. The*

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[1] The insured's predicament here is not unique to political risk claims, although by its nature, it can only arise in cases like a political risk loss. Other contexts where the same analogy can be drawn may include toxic torts, slide damage, volcanic or weather damage, etc..

[2] *Southern California Edison Co. v. Harbor Ins. Co.*, 83 Cal. App. 3d 747, 757, 148 Cal. Rptr. 106 (1978).

[3] 401 Pa. 477, 165 A.2d 82 (1960).

[4] 165 A.2d at 84.

[5] *Harper v. Pelican Trucking Co.*, 176 So. 2d 767, 773 (La. App. 1965).

Reliance Ins., Inc.,[6] the Eighth Circuit referred to such clause and stated:

> "The cooperation clause under Paragraph 4 of the policy requires the insured to exercise all reasonable means to protect, safeguard and salvage the property. If it fails to do so, there exists a strong possibility that it may forfeit its coverage altogether. Protective acts may be to the direct or incidental benefit of the insured since it is to prevent further loss to its own property--but it is patently clear that the primary reason for such provision within the policy is for the company's protection against liability for greater loss. [A]s indicated, the obligation on the insurer [to pay expenses] can also be implied by the terms of the cooperation clause which requires the insured to take such action. Thus, we can conclude that the obligation to pay the expenses in protecting the exposed property may arise from either the insurance agreement itself, or an implied duty under the policy contract based upon principles of law and equity."[7]

Finally, if an insured by statute is required to use every effort to avoid or diminish a loss, an Australian court found that the insurer, by implication *from the statute*, has an obligation to reimburse the insured for expenses incurred to avoid or diminish a loss.[8]

While the cases adopting this theory are the few cited above, no appellate court has rejected applying an implied sue and labor theory to an insurance contract. This is not surprising because the underpinnings for such a theory are time-honored and well-accepted principles of equity. For example, under the doctrine of "general average," which dates back in maritime law 2,800 years, the owner of a vessel who benefitted by expenses incurred by other parties to protect the vessel must contribute ratably to make up the loss to those who so expended money or sacrificed property.[9] This duty is implied in law for the same reason that courts have found an implied sue-and-labor clause in all insurance policies.

Example of a Sue-and-Labor Claim

To illustrate the application of an implied sue-and-labor clause, let us examine a hypothetical example taken from real life.

An American oil company operates in a Latin American country. Total assets are estimated to be $650 million. This country decrees on January lst that the company's operating service agreements are rescinded. The host country then seizes certain shipments of the subsidiary's oil, and unilaterally reduces the per-barrel price from $15 a barrel (which the company was entitled to receive under its contract) to $5 a barrel. Contemporaneous with that decree, the host country issues decrees mandating that the company pay retroactive taxes in an amount to be determined later. In July, back taxes are estimated to be approximately $70 million based on the retroactive nullification of certain decrees regulating depreciation and repatriation of currency. The Latin American country indicates that the rescission of the contracts can be canceled if the insured will pay the $70 million in "taxes"

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[6] 471 F.2d 1364 (8th Cir. 1973).

[7] 471 F.2d at 1367-68.

[8] *Emperor Gold Mining Co., Ltd. v. Switzerland General Ins. Co., Ltd.* [1964] 1 Lloyd's Rep. 348 (Aust. S. Ct. N. So. Wales).

[9] Alamo Chemical Transportation Co. v. Stan/V Overseas Valdes, 469 F. Supp. 203, 215 (E.D. La. 1979); *Australian Coastal Shipping Comm. v. Greene* [1971] All E.R. 968 (1970) Lloyd's Rep. 209 (Q.BD.).

without disputing them. This $70 million thus becomes a ransom fee.

In this scenario, the company must determine whether it has a claim presently on its insurer (before seizure of its entire operation). Based on the lawyer's assessment, the insured must then determine if it makes economic sense to attempt to negotiate with the host country. The insured may be permitted to continue with new contracts on some accommodation made to pay the trumped-up tax claims. Even if it does not make pure economic sense, the insurance policy for political risks normally requires the insured to use every effort practicable to avoid or diminish a loss under its policy. So the insured must make such effort to reach an accommodation or, otherwise, possibly be barred from making a claim if the failure to do so caused the host country to seize all of the company's assets. In making a determination whether to pay the $70 million trumped-up tax claim, the insured's lawyer can advise that a arguably viable theory — the implied "sue and labor" doctrine--can afford potential recovery against the insurer. The lawyer should notify the insurance company of every step taken, under the expectation of coverage as a sue-and-labor expense. If the insurance company does not object (and it likely will not), then the claim is thereby bolstered.

Under this doctrine, the oil company will contend that because it acted to avoid or diminish a loss that would otherwise have come within the insurance company's coverage, it is entitled to reimbursement for such expenses separate and apart from the coverage limits.

In preparing a demand on the insurers, the first question is how to apportion that demand. Under most forms of business insurance, there are numerous layers of coverage. In a political risk claim for implied sue-and-labor expenses, it should be contended that each insurer, at each layer of coverage, must reimburse the insured for these sue and labor expenses (and not merely the primary insurer), if each insurer received a benefit from the insured's actions. This assists the insured in obtaining a settlement.

In 1984, the Queen's Bench in *Integrated Container Service, Inc. v. British Trader's Insurance Co., Ltd.*[10] said:

> "'Each underwriter will, whether if the result there is a total or partial loss, or no loss at all, not as part of the sum assured, but as a contribution independent of and even in addition to the whole sum insured, pay a sum bearing the same proportion to the cost of expense incurred as a sum they would have had to pay if the probable loss had occurred, or to the loss, which because the efforts had failed has occurred, that loss bears to the sum insured.'"[11]

Thus, in the example of a threatened confiscation of the $650 million oil company, if there was an insurance company covering the first $100 million of loss, another covering the second $100 million and another insuring the $300 million excess of the other two (the company is bare over $500 million in this hypothetical), then their proportionate benefit from a $70 million "ransom" payment is:

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[10] [1984] 1 Lloyd's Rep. 154 (Ct. App. Civ. Div. QB).

[11] American law is in accord. See *Seaboard Shipping Corp. v. Jocharanne Tugboat Corp.*, 461 F.2d 500, 503 n.3 (2d Cir. 1972).

	Proportionate Limit	Proportionate Coverage	Benefit
Insurer No. 1	$100 million	25% ($100/$500)	$17,500,000 ($70m X 25%)
Insurer No. 2	$100 million	25% ($100/$500)	$17,500,000 ($70m X 25%)
Insurer No. 3	$300 million	20% ($300/$500)	$35,000,000 ($70m X 50%)
	$500 million	100%	$70,000,000

The argument could be made that the rule in *Integrated Container* should not apply where the insured would also have suffered a loss, here $150,000 million (the insured portion of the $650 million loss). Instead, the insurer should only pay in the proportion that their coverage is to the entire loss, not the sum insured. To do this, however, is improper for three reasons: (1) it makes the insured into an insurer, which is not a risk it assumed; (2) it is a windfall to an insurer who thereby received a reduction in the scope of coverage with every additional dollar invested by the insured; and (3) such reduction in coverage would discourage foreign investment which is exactly counter to the purpose that political risk insurance affords in the world economy.

The attorney advising the insured should tell their client that even after being paid for a sue and labor claim, the insured would be entitled to coverage under the full policy limits for any legitimate confiscation losses in the host country (*i.e.*, seizure of equipment, uneconomical reduction in per barrel prices). All such claims should be reserved in any communication of settlement with the insurer.

Moreover, the payment of the ransom can be argued to be alternatively an insured peril depending on all the circumstances. In this example, retroactive, illegal taxes may be confiscatory and the basis for a loss under the insured peril of "confiscation," yet this does not prevent other circumstances making the payment of such "taxes" something else entirely such as a sue and labor expense.

To illustrate the difference, had the host country not rescinded the company's contracts and not made overtures on how a ransom could unwind the rescission, and simply made illegal, retroactive taxes of $70 million which impaired the company's fundamental rights in the host country, the insured could probably *only* claim a confiscation occurred. In that scenario, payment of these "taxes" only avoided a $70 million lien and forced a sale up to that amount, not the confiscation of the entire operation. On the other hand, once the host country rescinds the operator's contracts and ties, expressly or impliedly, the unwinding of the rescission decree to payment of trumped-up "taxes," payment of such "taxes" can now be looked upon as a sue and labor expense. Thus, the insured's attorney must be careful not to prejudice in communications this alternative view of the insured's rights.

Conclusion

When confronted with a potential political risk loss (or any insurance loss, for that matter), the lawyer should analyze whether a sue and labor claim can be set up so that the client can evaluate its options to the fullest extent. These options are to claim either a sue-and-labor claim or a covered loss, depending on the circumstances. The advantage of a sue-and-labor claim is that it will allow you to fashion the demand in the proportion that the coverages of each insurer bears to the combined coverage. It thereby facilitates settlement by demanding only a portion from each of the insurers in proportion to the benefit conferred. It also is perceived as fairer.

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