

AN HISTORICAL PERSPECTIVE ON ATTEMPTED RECOVERY OF Y2K EXPENSES UNDER SUE AND LABOR CLAUSES

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Over the past two years or so, there has been a fair amount written about the potential for coverage of Y2K claims. Necessarily, there has been considerable speculation about the nature of possible claims against insureds and about the possible claims (and under what policies) insureds might make for coverage for expenses incurred to avoid electronic date recognition problems. Recent declaratory judgment actions have brought into sharper focus one of the contentions of insureds as to first party policies. Several insureds are making claims and filing suit based on policy provisions which either track or mimic "sue and labor" clauses in traditional marine policies, typically hull policies, cargo policies and voyage policies.

The earliest known sue and labor clause appeared in early English marine policies, as early as the 1600s. A typical later English marine policy wording includes the following:

In case of any loss or misfortune it shall be lawful to the assured, their factors, servants and assigns, to sue, labour and travel for, in, and about the defence, safeguard and recovery of the said goods and merchandises, and ship, etc., or any part thereof, without prejudice to this insurance, to the charges whereof we the assurers will contribute.

A U.S. wording is as follows:

In case of loss or misfortune, it shall be lawful and necessary for the assured, his or their factors, servants and assigns, to sue, labor, and travel for, in and about the defense, safeguard, and recovery of the interest insured or any part thereof, without prejudice to this insurance; to the charges whereof this Company shall contribute according to the rate and quantity of the sum hereby insured; nor shall the acts of the assured or this Company in recovering, saving, or preserving the property insured, in case of disaster, be considered as a waiver or acceptance of abandonment.

Some non-marine wordings use similar clauses, but other wordings may use what is frequently referred to as "preservation of property" clauses:

Additional Coverages -

b. Preservation of Property

If it is necessary to move Covered Property from the described premises to preserve it from loss or damage by a Covered Cause of Loss, we will pay for any direct physical loss or damage to that property:

While it is being moved or while temporarily stored at another location; and

Only if the loss or damage occurs within 10 days after the property is first moved.

Loss Conditions

3. DUTIES IN THE EVENT OF LOSS OR DAMAGE

You must see that the following are done in the event of loss or damage to Covered Property:

(2) Give us prompt notice of the loss or damage. Include a description of the property involved.

(3) As soon as possible, give us a description of how, when and where the loss or damage occurred.

(4) Take all reasonable steps to protect the Covered Property from further damage, and keep a record of your expenses necessary to protect the Covered Property, for consideration in the settlement of the claims. This will not increase the Limit of Insurance. However, we will not pay for any subsequent loss or damage resulting from a cause of loss that is not a Covered Cause of Loss. Also, if feasible, set the damaged property aside and in the best possible order for examination.

Commentators have previously suggested on insureds' behalf (and those insureds now apparently claim) that policy provisions such as these offer an opportunity for reimbursement of expenses incurred to correct computer and technology systems so that they are Y2K compliant or, in simpler terms, do not stop running at midnight on January 1, 2000. The position seems to be that recovery is based on the sue and labor clause alone. However, historic and current admiralty jurisprudence makes clear that expenses recoverable under sue and labor clauses are dependent upon a number of factors, not the least of which is that expenses incurred must be related to a risk covered in the first place. As stated by the U.S. Court of Appeals for the Fifth Circuit:

This clause is tied irrevocably to the insured perils coverage. Because the purpose of the clause is to reimburse the assured for expenses incurred in satisfying his duty to the underwriter, there is no such duty where the policy, for one reason or another, does not

afford coverage. The sue and labor clause does not operate as an enlargement of the perils underwritten against.¹

The avoidance of the diminution of the loss which would otherwise fall on the underwriter is at the consideration of the promise to contribute to the expense of preserving the insured property.² If the insured fails to take such measures as are dictated by its duty, it incurs the risk of its claim for loss or damage being rejected in whole or in part.³ The question which must be asked in the Y2K context then is what claim of the insured is it that might have been rejected by the insurer had the insured not incurred the expenses which are sought to be recovered under sue and labor clauses?

The reality apparently is that what is involved is not efforts to save or minimize loss to any tangible or even intangible property, but rather to make arrangements so that technology systems on which a business enterprise has come to rely will continue to operate past a certain date. While there may be involved the incidental saving of some electronic data, what is happening is a system correction to keep the system running. If what is being proposed is that these expenses are recoverable solely by virtue of a sue and labor clause, such a position is inconsistent with the longstanding and universally recognized intent of the clause.

At the time marine insurance inception, communication between the vessel and its insurer, and indeed between the vessel and the vessel's owners, was impossible. The sue and labor clause was included in marine policies to encourage the insured to take all reasonable steps that a prudent uninsured owner would take once a misfortune had overtaken the venture to protect the property insured and to save it from further damage after a loss had been incurred.⁴ Again, only those expenditures related to the preservation or protection against a covered loss are recoverable. Simply because funds are expended for some reason even having to do with the insured's property does not make those funds recoverable under a sue and labor clause.

Would an underwriter to a marine hull policy cover under a sue and labor clause expenses incurred on a vessel's computer system to ensure that it does not stop running on January 1, 2000? If not, it seems inappropriate to argue that Y2K remediation expenses should be covered under a sue and labor clause which may be contained in an insured's first party property policy. This article evaluates whether such a hypothetical claim would be covered under traditional principles surrounding sue and labor claims. There are four fundamental principles at work: fortuity, immediacy of peril, the need for a covered loss and benefit to the insurer. These concepts do tend to run together, and the last two will, in fact, be discussed as one.

Fortuity

Fundamentally, and overarching all other considerations, there must have been a fortuitous circumstance, i.e., the risk of outside forces altering events. In pre-Y2K litigation buildup, much has been made of the distinction between the traditional marine policy wording (which is a "named perils" wording) and an "all risks" wording, the point being made that the latter is broader (and perhaps inclusive of all risks such that any loss is covered). It is certainly the case that an all risks policy provides a broader coverage grant than does a named or enumerated perils wording. It is not, however, the case that an all risks policy eliminates the need for fortuity. For example, in the case of *F.W. Burk & Co., Ltd. v. Style*,⁵ a shipment of cargo packed in paper bags was loaded aboard a vessel for carriage to London where upon arrival many of the bags were noted to have been broken. The shipper rebagged the cargo for further shipment and made a claim under the sue and labor clause of an all risks cargo policy. The court rejected the claim, making the point that there was no fortuitous risk because the loss was caused not by an outside source but by something inherent in the property insured causing the expense to be inevitable. Expenses made even under an all risks policy are not recoverable under a sue and labor clause if the cause of the expense is the thing insured itself.

Since the reason for the expenses and remediating the shipboard technology in the hypothetical posed here is a problem with the equipment itself, there is no outside force causing the expense and no recovery would appear available under the sue and labor clause.

Even if there were requirements imposed by the Coast Guard in this respect (which there are) such that a vessel owner would feel compelled to undertake the expenses, the expenses are not covered under a sue and labor clause. The standard sue and labor clause covers a voluntary expenditure by the insured.⁶ This is so because it is the effort by the insured in furtherance of the insured's duty to the underwriter that forms part of the basis of recovery. Expenses not incurred in furtherance of the insured's duty to the underwriter to protect the insured property from further loss which is the subject of the policy in the first place would not be recoverable under a sue and labor clause. For example, in *Charleston Shipbuilding & Drydock Co. v. Atlantic Mutual Insurance Co.*,⁷ the policy covered a marine railway (drydock) against loss and damage. While a vessel was being launched, the cradle of the marine railway moved and the vessel became stuck. Damages were sustained to the railway and expenses were incurred in completing the launch of the vessel. The insured paid for the damage to the railway and made a claim under the policy for expenses in completing the launch of the vessel. It turns out that the expenses incurred in completing the launch were for the purpose of fulfilling the insured's contract with the Department of Commerce to repair and launch the vessel involved. In arbitration between the owner of the railway and its insurer, the arbitrator concluded that those expenses were incurred by the insured to fulfill its contract with the Department of Commerce and to avoid a claim against it, which is not covered under the policy.

Immediacy

Equally fundamental to the reason for the sue and labor context is that the efforts of the insured must be undertaken in the face of an immediate and active threat.⁸ In *National Oilwell (UK) Limited v. Davy Offshore Limited*, the court stated that the insured peril must have occurred or its occurrence was "obviously imminent."⁹ Otherwise, there would be no need to impose upon the insured a duty to protect the underwriter's interest in the property insured; the insured would merely notify the insurer of the loss and leave it to the insurer to protect the property threatened. This particular concept can also be expressed in the context of the expenditure or exertion on the insured's part having to be extraordinary. In *Aitchison v. Lohre*,¹⁰ the court stated expenses would be recoverable

...if by perils insured against, the subject matter of insurance is brought into such danger that, without unusual or extraordinary labour or expense, a loss will very probably fall on the underwriter, and if the assured or his agents or servants exert unusual or extraordinary labour, or if the assured is made liable to unusual or extraordinary expense in or for efforts to avert a loss, which, if it occurs, will fall on the underwriters....

It is the immediacy of the loss or misfortune that compels the extraordinary effort contemplated by a sue and labor clause.

Y2K problems have been known in the developed part of the world to all but the most reclusive of souls for at least the past two years. If in the hypothetical situation of the vessel owner spending money to make onboard computers Y2K compliant, he truly believed there was some interest his hull underwriter had for which he was duty bound to make those expenditures, surely he would have and could have notified his underwriters well before the funds were spent. Perhaps our hypothetical owner could plead reclusion and ignorance of the problem which he would now claim has become a crisis, but that raises other issues which militate against recovery, such as whether the expenses were reasonable in the first place. While the concept of time is no doubt elastic, "immediacy" is not what comes to mind in this context.

Benefit to the Insurer

The sue and labor clause “contemplates the benefit of the insurer only....”¹¹ According to one U.S. court, the benefit to the insurer is the “principal ultimate aim.”¹² This is because, as has been expressed in American admiralty jurisprudence, the sue and labor clause is “tied irrevocably” to the perils covered.¹³ The concept of the sue and labor clause as a separate, or “stand alone,” coverage was rejected quite explicitly by the U.S. Fifth Circuit Court of Appeals in *Reliance Ins. Co. v. The Escapade, supra*. A yacht insured by a standard yacht hull policy stranded and sustained damages. A surveyor appointed by the underwriter attended the repairs and, on behalf of the underwriter, insisted that the insured spend money to remove and preserve machinery. The insurer later sought to deny coverage on the basis of a breach of a warranty. The court found that the insurer was estopped from denying coverage, and the issue became the extent to which the estoppel extended to the obligation of the indemnity provisions of the policy as opposed to merely obligations under the policy’s sue and labor clause. The insurer, evidently relying on the principle that the sue and labor clause is a “supplemental” coverage, argued that the two coverages were separate contracts, one having nothing to do with the other. The Fifth Circuit rejected the argument stating:

The obligation [under the sue and labor clause] comes into being only when the action taken is to minimize or prevent a loss for which the underwriter would be liable. If the underwriter would not be liable at all—here because of a breach of the personal use warranty—there would be no contractual obligation to repay sue and labor. The sue and labor coverage is therefore tied irrevocably to the insured perils coverage.¹⁴

While the sue and labor clause is referred to as “supplemental” or even “separate” coverage, since the sue and labor clause does not enlarge the coverage grant, it does not therefore provide a broader duty than does the duty to indemnify. Indeed, the insured has the burden of establishing a covered loss before sue and labor expenses can be recovered.¹⁵ It is for this reason that a sue and labor clause is not appropriately analogized to a defense obligation in a liability policy, which does provide a broader duty than does the indemnity obligation and which requires only that one show the possibility of coverage in order to trigger the obligation. This point is illustrated from a number of perspectives in the jurisprudence, but perhaps best by the holding in *Munson v. Standard Marine Insurance Co.*¹⁶ Involved was a policy on a tug indemnifying against liability to the tug’s tow. One of the barges was lost, and suit was filed against the tug which the tug’s owners successfully defended. The tug’s owners then sued their hull underwriters to recover the expenses incurred in the successful defense of the tug, arguing that the expenses were recoverable under the sue and labor clause. The court, bottoming its decision on the strict relationship between the sue and labor clause and the fundamental indemnity obligation, held that since the underwriter was not to be liable for the loss against the tug in the first instance, it had no obligation under the sue and labor clause to reimburse expenses incurred even in the successful defense of that claim.

In one of the few decisions of the United States Supreme Court on the scope of sue and labor clauses, the court made clear how closely tied to the fundamental coverage obligation the sue and labor clause is. In *Biays v. Chesapeake Ins. Co.*, the insurance covered the total loss of a shipment of hides on board several lighters. One of the lighters sunk; the shipper salvaged some of the hides but the rest of the hides carried on that lighter were lost. The shipper made a claim under the policy’s sue and labor clause for expenses incurred in connection with the salvaged hides. The court refused recovery. Contrasted with what insureds no doubt will argue, no less than the United States Supreme Court stated:

If this clause be construed with a reference to what is most evidently its subject matter, that is a loss within the policy, and in connection with other parts of the instrument, it seems impossible to misunderstand it...The parties certainly meant to apply it only to

the case of those losses or injuries for which the assurers, if they had happened, would have been responsible....the underwriters not being answerable for the principal loss in this case, they cannot be so for the subsequent expenses which were incurred in recovering the property [emphasis added].¹⁷

Even where the ultimate harm might even be caused by an insured peril, if that harm is not in fact covered, no recovery is available under a sue and labor clause. Accordingly, charges incurred merely to avoid delay in delivery of property insured under a voyage policy are not recoverable.¹⁸

In the case of *Xenos v. Fox*,¹⁹ the insured owned a vessel which had been involved in a collision with another vessel. Typical of hull policies, there was an additional provision, the “running down” clause, which provided partial coverage for damages paid by reason of the insured vessel having damaged another vessel. The insured successfully defended the claim by the other vessel interests and sought reimbursement of those defense expenses on the basis that had the defense not been asserted and litigation expenses incurred, the underwriter would have been held liable under the running down clause. The court refused reimbursement holding that the sue and labor clause was of limited application extending only to the ordinary marine perils to which it applied, and not to obligations imposed by other sections of the policy. Similarly (and as was the case in the *Charleston Shipbuilding & Drydock* case), in *Cunard S.S. Co. v. Marten*,²⁰ no recovery was permitted under the sue and labor clause of a policy against liability for negligent loss on a shipment of mules for expenses incurred in landing, feeding and saving the mules. The court concluded that the subject of the insurance was not the mules themselves, but liability therefor.

There seems to be no benefit to the insurer in the hypothetical presented here. Even if one could bootstrap a claim into a speculative risk, it would not appear to be one borne out of fortuitous circumstances or of an immediate peril. Accordingly, based on the traditional marine insurance principles as articulated in the jurisprudence (and the history of the usage of the sue and labor clause as expressed therein), the hypothetical claim for expenses in preventing the ship’s computer systems from failing would not be recoverable under the vessel owner’s marine hull policy’s sue and labor clause.

There are many reasons why companies have undergone extensive Y2K remediation, including meeting industry standards, protecting business reputations, maintaining market shares, complying with government regulations and preventing liability to third parties. However, the notion that these expenses were undertaken by insureds with the view toward principally protecting their insurers’ interest in respect of property insured is quite clearly an afterthought borne out of a lawyer’s review of a client’s insurance policies. Mindful of the issue, insureds are evidently taking steps to address this vulnerability by distinguishing between costs expended to remediate their computer systems and costs expended to “upgrade” their computer systems. Those insureds evidently will take the position that they do not intend to hold their insurers responsible for costs of upgrade. Even in respect of the remediation expenses, however, one is compelled to ask precisely what insurer interest (and in what property) was to be benefitted as the principal purpose of the expenditures in making computer systems Y2K compliant? The question is particularly intriguing in respect of policies not in effect on January 1, 2000. That is when the “loss” would be expected to occur. If an insurer would not bear a loss because the policy is not in effect, to what peril would the sue and labor duty be tied?

This is not a situation as was confronted by the American judicial system in the context of environmental claims when courts were asked to find coverage for cleanup of first party property under third party liability policies on the theory that those costs minimized or averted ultimate third party property damage. Courts, by and large, agreed to do so, but rationalized such rulings not on policy wording, but on the basis of a public policy to avoid undue expense and imminent contamination damage to the property of innocent third parties, which courts concluded would be covered if it, in fact, occurred and which otherwise might not be cleaned up. Again, that is not what is involved here.

In the context of pollution exclusions, insureds have argued quite vigorously that so-called “historical intent” (much of which seems of questionable reliability) dictate how courts should narrowly construe those exclusions and indeed ignore the very words used in favor of some suggested original historical purpose. In the context of sue and labor, the historical intent is quite clear and universally enforced. Consistency, at least, would require those insureds to embrace as vigorously a *bona fide* historical record of hundreds of years of custom, practice and jurisprudence in the context of sue and labor clauses.

END NOTES:

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- 1 *Continental Food Products, Inc. v. Insurance Co. of North America*, 544 F.2d 834
(5th Cir. 1977).
- 2 *American Merchant Marine Ins. Co. v. Liberty S.&G. Co.*, 282 Fed. 514 (3rd Cir. 1922).
- 3 *Integrated Container Service v. British Traders Ins. Co. Ltd.*, [1984] 1 Lloyd’s
Rep. 154; Buglass, *Marine Insurance and General Average in the United States*,
355 (3d ed. 1991).
- 4 Bruns, “The Hull Policy: Sue and Labor, General Average, Salvage and Special
Charges,” *Tulane L. Rev.*, Vol. XLI, No. 2, p. 360 (February 1967).
- 5 [1955] 2 Lloyd’s Rep. 382, 3 All E.R. 625.
- 6 *Berns & Koppstein, Inc. v. Orion Ins. Co.*, 170 F. Supp. 707, 273 F.2d 415 (2d
Cir. 1960).
- 7 1946 A.M.C. 1611, 1617 (Arbitration New York).
- 8 Buglass, *supra*, at 356.
- 9 [1993] 2 Lloyd’s Rep. 582.
- 10 4 App. Cas. 755; 4 Mar. L. Cas. 169 (1879).
- 11 2 Arnould’s *Law of Marine Insurance and Average*, §909A (16th ed. 1981).
- 12 *Reliance Insurance Co. v. The Escapade*, 280 F.2d 482, 488-489, at n.11 (5th Cir.
1960).
- 13 *Reliance Insurance Co. v. The Escapade*, 280 F.2d, at 489; *Continental Food
Products, Inc. v. Insurance Co. of North America*, *supra*.
- 14 *Reliance Insurance Co. v. The Escapade*, 280 F.2d, at 489.
- 15 *Continental Food Products, Inc. v. Insurance Co. of North America*, *supra*.
- 16 156 Fed. 44, 48 (1st Cir.), cert. denied, 208 U.S. 543 (1907).
- 17 11 U.S. (7 Cranch) 415, 419 (1833).
- 18 *Weissberg v. Lamb*, [1950] 84 Ll. L. Rep. 509.
- 19 L.R. 4 C.P. 665 (1869).
- 20 [1902] 2 K.B. 511, 9 Mar. L. Cas. (n.s.) 452; [1902] K.B. 624, 9 Mar. L. Cas.
(n.s.) 342 (C.A. 1903).