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## EDITOR'S NOTE

*Besides being a requirement of most insurance policies, taking action to protect threatened property from damage or further damage seems to make sense from everyone's point of view. Losses are reduced, dollars are saved and devastation is minimized. Yet, however valid and simple the concept might be, coverage for the costs associated with carrying it out is less clear and often debated.*

*In this issue of* Adjusting Today, *expert Donald Malecki examines policy provisions for mitigating and/or expediting expenses, especially their root in the historic sue and labor clause. He goes further to present an interesting discussion of how several court cases have interpreted that clause.*

*It is relevant and informative reading.*

*Sheila E. Salvatore*
*Editor*

# Sue and Labor Clauses: The Basis for Mitigating, Expediting and Other Policy Provisions

*By Donald S. Malecki, CPCU*

When buildings, structures or personal property are threatened by physical loss or damage, most insureds will instinctively take immediate action to protect the property. In fact, property policies generally require insureds to take immediate action to protect covered property from loss — or further loss — by moving the property to a safe location temporarily. It is also a person's common law duty to protect their property from loss.

These provisions are found in property and inland marine forms and usually appear in the section having to do with what must be

done in case of loss. Some examples are:

2. **You Must Protect the Property —** "You" must take all reasonable steps to protect covered property at and after an insured loss to avoid further loss.[1]

3. **Duties In The Event Of Loss Or Damage**

a. (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 claim. 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.[2]

*"Commercial property forms also will provide limited coverage if the covered property is stolen, for example, after that property is temporarily removed from the premises because of an actual covered loss."*

Commercial property forms also will provide limited coverage if the covered property is stolen, for example, after that property is temporarily removed from the premises because of an actual covered loss. The commercial property forms of AAIS refer to this as "emergency removal coverage," whereas the term "preservation of property" is the term used by ISO. These coverage provisions of AAIS and ISO are similar. Both require that the covered property be moved from the described premises when endangered by a covered cause of peril. The time period for such covered property while at a temporary location is 10 days under the AAIS forms and 30 days in ISO forms.

If fire breaks out in a building located in a crime-prone area, and the business owner hires the services of an off-duty law enforcement officer to protect the inventory from theft, vandalism and any further fire damage, rather than moving the property elsewhere, an interesting question is whether the policy will pay for those services. At least one court has answered that question affirmatively.

In this case of *American Commercial Finance v. Seneca Insurance Co., 850 N.E.2d 1114 (App. Ct. MA 2006),* the insured had to bring an action against the insurer to recover expenses

for protecting property from vandalism and further fire damage.

Briefly, the facts are as follows: After pipes burst in a large commercial building, the sprinklers became inoperable. As fate would have it a fire occurred, causing extensive damage to the building. To protect the property from vandalism and further damage (because the sprinklers were inoperable), the insured hired the services of a private security company for several months. In doing so, the insured incurred expenses of approximately $79,000, which the insurer declined to pay even though that amount, when added to the amount paid by the insurer for damage to covered property, did not exceed the limits of insurance.

The Massachusetts court of appeals, in affirming the trial court's decision in favor of the insured held that those expenses incurred were covered for the following reasons:

First, following loss, the policy required the insured "to 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 claim." "The most natural interpretation of this language," the court said, "was that such expenses will be paid, perhaps subject to a consideration of their reasonableness and amount."

Secondly, following the provision dealing with the requirement of the insured to take all reasonable steps, is the additional sentence stating that such expenses "will not increase the limit of insurance." This sentence, the court said, obviously refers to "expenses" as the only monetary reference that could be included in the concept of increasing the limits of insurance. If such amounts were not to be paid, the court added, "there would be no need to state, in effect, that such amounts could only be paid if in doing so the limits of insurance would not be exceeded."

The insurer, on the other hand, pointed out that the language relied on by the insured was under the provision titled, "Duties [of the insured] In the Event of Loss or Damage," and appeared within the conditions section of the policy. (This loss condition is identical to

***"It is important to note that the mitigating expense provision is not to be confused with extra expense coverage or with the expense to reduce loss provisions of earnings forms, although there are similarities."***

the condition of ISO forms.) The insurer, in other words, argued that with the language of the above provision, located in an area of the policy involving conditions, it did not deal with coverage. (Conditions are said to be the ground rules that both the insured and insurer must observe, and do not deal with the grant of coverage.)

The court disagreed. In doing so, it held that if such amounts were not to be paid, there would be no need to state that the amounts could only be paid if, in doing so, the limits of insurance would not be exceeded.

Some insureds also incur additional expenses to mitigate their losses by taking steps to repair or replace the damaged or destroyed property. This effort — which commonly includes extra wages and transportation costs — falls into the category and is referred to as *expediting costs*. (It is referred to here interchangeably as an expediting cost or mitigating expense provision.) These kinds of expense provisions are not found in standard AAIS or ISO provisions, but instead are found in some inland marine and equipment breakdown forms, and manuscript property and builders risk policies.

***"A sue and labor clause usually clarifies that when the insured takes steps to prevent or reduce a loss, the insured will be reimbursed for the expenses incurred in those mitigating efforts, commonly on an allocated basis."***

These mitigating (expediting) expense provisions are viewed as a coverage extension but are usually subject to a sublimit. One such provision reads as follows:

> Subject to the specific sublimit entered in Item__, this policy shall also pay for the reasonable extra costs to make temporary repairs and to expedite the permanent repair or replacement of the insured property which is damaged by an insured peril, including additional wages for overtime, night work, and work on public holidays and the extra costs of express freight or other rapid means of transportation.

It is important to note that the mitigating expense provision is not to be confused with extra expense coverage or with the expense to reduce loss provisions of earnings forms, although there are similarities. Mitigating

> *"One of the reasons this clause was introduced — and there are different versions — was that early on, underwriters came to realize that if mitigation expenses were not covered, the insured would have less incentive to mitigate losses."*

(expediting) cost coverage does not require an additional purchase. It is either included in a policy or it is not. Extra expense coverage, on the other hand, usually requires an additional premium. Also, to the extent expediting costs are covered in earnings forms, coverage is typically limited to the extent expediting costs actually reduce the loss amount otherwise payable.

### Sue and Labor Clause: a Brief History

Many of these mitigating and expediting provisions of modern day policies undoubtedly have their genesis with what is referred to as the "sue and labor" clause, which originated with marine insurance. It has been said that this kind of clause is so old that it is found in the first written Anglo-American marine insurance policy on record. That policy, drafted by British underwriters, insured the hull of the good ship *Tiger,* in the

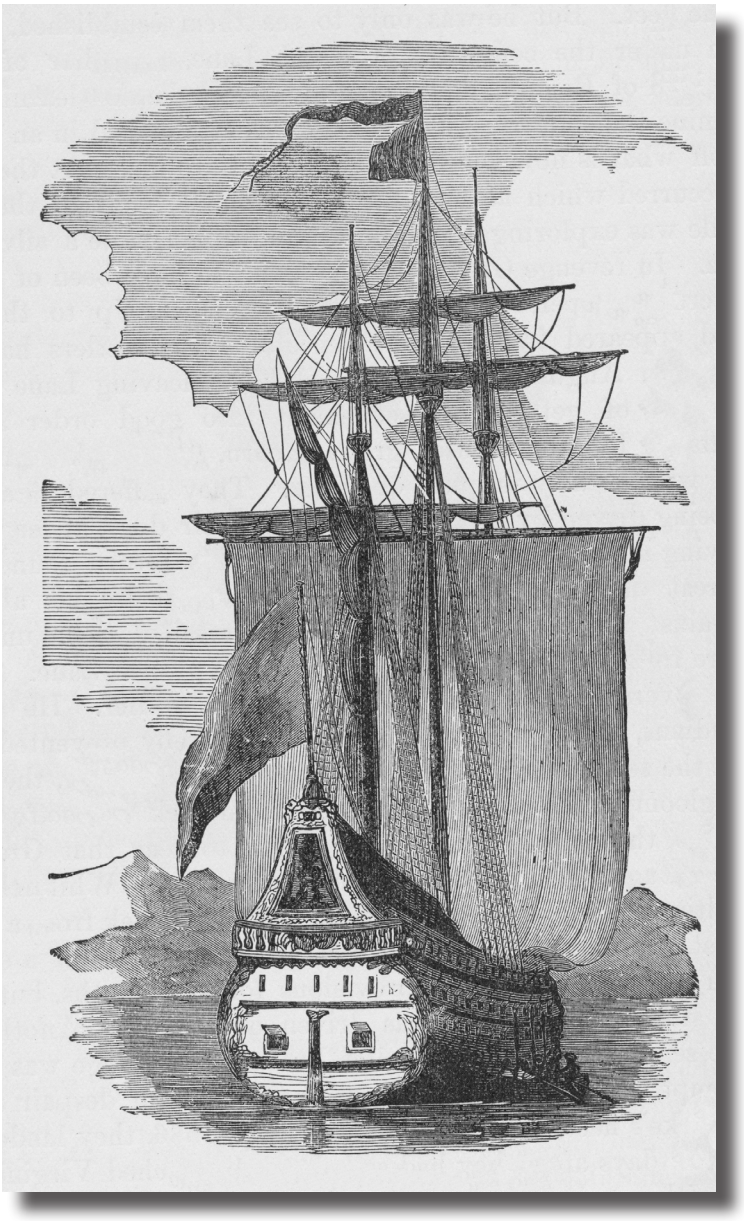
year 1613. Some maintain that the concept behind this clause was first put to use many years earlier.[3]

A sue and labor clause usually clarifies that when the insured takes steps to prevent or reduce a loss, the insured will be reimbursed for the expenses incurred in those mitigating efforts, commonly on an allocated basis.

One of the reasons this clause was introduced — and there are different versions — was that early on, underwriters came to realize that if mitigation expenses were not covered, the insured would have less incentive to mitigate losses.

The court in the case of *White Star S.S. Co. v. North British & Mercantile Ins. Co., 48 F.Supp. 808 (E.D. Mich. 1943)* explained the rationale for the sue and labor clause this way:

> The law is well settled that the sue and labor clause is a separate insurance and is supplementary to the contract of the underwriter to pay a particular sum in respect to damage sustained by the subject matter of the insurance. Its purpose is to encourage and bind the assured to take steps to prevent a threatened loss for which the underwriter would be liable if it occurred, and when a loss does occur to take steps to diminish the amount of the loss.



Although the court stated that the sue and labor clause is, in effect, a separate insuring agreement for the benefit of the insured and insurer, it is today a matter of dispute that it is an insuring agreement. It is true that the insured benefits from such a provision because it can be reimbursed for expenses incurred in eliminating or at least reducing a covered loss. The consensus of the courts, however, is that the sue and labor clause is primarily for the benefit of insurer, which may be able to pay less than what otherwise would be payable, if the insured takes certain steps or precautions when loss is imminent or occurs.

In fact, it has been stated by some courts that the sue and labor

clause is a separate insurance provision only in the sense that the insured's losses are not subject to the application of any deductibles or the policy's limits of liability. One of the earliest forms of this clause read:

> And in the 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 defense, safeguards, and recovery of the said goods and merchandise, and ship, or any part thereof, without prejudice to this insurance.[4]

> [T]o the charges whereof we, the assurers, will contribute each one according to the rate and quantity of his sum herein assured.[5]

> And it is especially declared and agreed that no acts of the insurer or insured in recovering, saving, or preserving the property insured shall be considered as a waiver, or acceptance of abandonment.[6]

According to one source, a "cardinal principle" in dealing with these clauses insofar as marine insurance is concerned is that "the loss averted or minimized must arise out of the basic and standard perils insured against . . . and must be loss for which the underwriters are liable."[7] This confirms that the sue and labor clause is for the benefit of the insurer, which may be able to capitalize on having to pay less for a covered loss when an insured takes steps to minimize a loss.

**Property Policies**

Sue and labor clauses can be found today in some property policies, including builders risk and difference in conditions (DIC) forms. The following is taken from a policy of a domestic insurer providing coverage on a special causes of loss basis (all risks):

> Sue and Labor:
> In case of actual or imminent loss or damage, it shall, without prejudice to this insurance, be lawful and necessary for the Assured, their factors, servants, or assigns, to sue, labor, and travel for, in, and about the defense, the safeguard, and the recovery of the property or a part of the property insured hereunder; nor, in the event of loss or damage, shall the acts of the Assured or of this Company in recovering, saving and preserving the insured property be considered a waiver or an acceptance of an abandonment. This Company shall contribute to the expenses so incurred according to the rate and quantity of the sum herein insured.

Not all of these provisions are the same. The above one applies to both imminent or actual loss.

***"In the absence of coverage involving concurrent causes or covered ensuing loss situations, such as where there is a clear case of faulty design or construction, and nothing more, it is highly unlikely that a sue and labor clause will respond for the costs and expenses incurred by an insured to correct the situation or to take special measures to prevent further loss."***

As clear as imminent might mean, it can still be the focus of argument. In fact, this was one of the points of disagreement in the case of *Washington Mutual Bank v. Commonwealth Insurance Company, et al., 133 Wash. App. 1031 (Ct. App. Wash. 2006),* which involved a commercial building owned by Washington Mutual (WaMu) and insured for $12.5 million by three insurers with substantially identical language.


> ***"The primary purpose for a sue and labor clause is for the benefit of the insurer, even though the insured benefits from being reimbursed for costs and expenses incurred in reducing or eliminating loss."***

In anticipation of its building being renovated, WaMu retained the services of an engineering firm to evaluate the property. In a report WaMu received, the engineering firm concluded that the property was unsafe and should be evacuated. WaMu hired another engineering firm for a second opinion. Because the second opinion could not be conducted as promptly as WaMu had wished, the building had to be evacuated. It turned out that first opinion was incorrect. As a result, WaMu filed suit against the engineering firm and settled out of court.

WaMu then filed an action against its property insurers to obtain coverage for the economic losses associated with the evacuation. The trial court ruled for the insurers and WaMu appealed.

One of the disputes was over the sue and labor clause that applied to both imminent loss and actual loss. Since there was no direct physical loss or damage, and a covered loss did not have to actually occur in order to invoke coverage, the question was whether any such loss was imminent. Addressing this question, the WaMu argued that absent a definition of "imminent" in the policy, the insured's subjective determination of imminence is the touchstone to determine coverage. WaMu thus argued that because the parties agreed that WaMu acted reasonably, its losses are covered by the sue and labor provision.

The insurers argued, however, that the loss or damage must have had to be "imminent in fact," rather than reasonably perceived to be imminent.

The court agreed with the insurers, stating that a reasonable but incorrect perception of imminence of covered loss does not suffice as a basis for coverage under the sue and labor provision. To obtain

coverage under this provision, the court explained, the insured's actions must have been taken to protect insured property from a risk of covered loss that was imminent **in fact.** Because there was, in fact, no imminent risk of covered loss, the court said, WaMu's actions were not taken to prevent a covered loss. Its expenditures, instead, were not primarily for the benefit of the insured and are not compensable under the sue and labor clause. (In other words, since imminent loss was at best questionable, in light of two different opinions, the loss was not imminent in fact.)

As mentioned, there are variations of the sue and labor clause. An example of one that is more restrictive than the preceding one reads:

> In the event of any loss or damage insured against, it shall be lawful and necessary for the insured, his or their factors, servant and assigns, to sue, labor and travel for, in and about the defense, safeguard and recovery of property insured hereunder, or any part thereof, without prejudice to this insurance, nor shall the acts of the Insured or Underwriters, in recovering, saving and preserving the property insured in case of loss be considered a waiver or an acceptance of abandonment.

Note that the above provision, unlike the preceding one, does not mention anything about an imminent loss. It is easier said than done, but in the event of an imminent loss — and not one that is in dispute — the insured still needs to obtain the insurer's acknowledgement, even though time is of the essence. However, if immediate action were to end up benefiting the insurer, it would not be surprising if the insurer were to honor such conduct despite what the above condition says. In fact, it says nothing about paying a portion of those expenses. But if the steps taken benefit the insurer, some expenses are likely to be paid as well. The problem is to make sure the loss is covered, i.e., results from a covered cause to covered property.

### Y2K Remediation

Next to construction-related subjects, one of the issues in which the sue and labor clause was commonly raised involved the highly anticipated year 2000 or Y2K rollover date recognition problems of computers. As explained by the court in the case below, computer programmers wrote computer codes using only two digits to specify the calendar year, instead of four digits. When a year was designated as "88," the computer would presume that the first two digits were "19," and it would read the date as "1988." The year 2000, therefore, presented a problem, because computers with time-sensitive applications would not be able to recognize that 2000 followed after 1999 and would, instead, erroneously read the number as 1900. As it turned out, this potential problem did not materialize into any major crisis, although there were some court cases.

One of these was *GTE Corporation v. Allendale Mutual Insurance Co., et al., 258 F.Supp.2d 364 (U.S. Dist. Ct. Dist. N.Y. 2003),* where GTE filed an action seeking coverage for costs and expenses incurred in remediating its computer systems to avoid year 2000-related date recognition problems. One of GTE's arguments was that the costs associated with preventing Y2K-related loss were covered by the sue and labor provisions of its property policies.

In 1999, GTE filed a claim with its insurers seeking reimbursement of the costs it incurred for its Y2K program. GTE contended that its remediation costs were covered under its primary policies' sue and labor provisions, which read like the foregoing one repeated that covered both imminent and actual loss. GTE also argued that the preservation and protection of property clauses under its excess property policies also covered these costs. This latter provision read in part:

> In case of actual or imminent physical loss or damage of the type insured against by this Policy, the expenses incurred by the Insured in taking reasonable and necessary actions for the temporary protection and preservation of property insured hereunder shall be added to the total physical loss or damage

> otherwise recoverable under this Policy … .

Despite the fact that the primary and excess property policies provided coverage on an "all-risks" causes of loss basis, the court held that no coverage applied for the costs and expenses incurred under either one of the provisions that addressed coverage for mitigating covered losses. The court's reason was the policies' exclusion having to do with defects in design and specifications.

The insurers also relied on the inherent vice exclusion. For support, the insurers looked to the case of *Port of Seattle v. Lexington Ins. Co., 48 P.3d 334 (2002),* where the court determined that the Y2K limitation was an inherent vice. In doing so, the court stated that "[B]ut for the two-digit date field code programmed into the Port's software, the arrival of January 1, 2000, would not result in a loss. Thus, the Port's Y2K problem was an excluded inherent vice because the date field was an internal quality that brought about its own problem."

**Faulty Design or Construction**

In the absence of coverage involving concurrent causes or covered ensuing loss situations, such as where there is a clear case of faulty design or construction, and nothing more, it is highly unlikely that a sue and labor clause will respond for the costs and expenses incurred by an insured to correct the situation or to take special measures to prevent further loss. A commonly cited case that provides a good example of this kind of an uninsured event is *Southern California Edison Company v. Harbor Insurance Co., 148 Cal Rptr. 106 (1978),* which involved a builders risk policy.

The insured in this case sought reimbursement of expenses incurred in mudjacking operations deemed necessary to protect the superstructure of a building from damage resulting from faulty foundation design. The court held that since damage from a faulty design was not covered, the preventive action likewise was not covered.

Another more recent builders risk case is *Swire Pacific Holdings, Inc. v. Zurich Insurance Co., 845 So. 2d 161 (Fla. Sup. Ct. 2003).* Swire spent approximately $4.5 million in costs to correct the structural deficiencies and filed a claim with the insurer seeking coverage for these costs, which the insurer denied. The court held that a sue and labor clause, when read in conjunction with a design defect exclusion, did not cover expenses incurred by the insured builder to correct design defects. The reason was that the builder acted directly and primarily to correct design defects, even though the builder may have incidentally benefited the insurer by possibly preventing collapse of the building at some unknown point in the future.

However the provisions of the sue and labor clause read, the underlying requirement is that the steps taken are because of an otherwise covered loss. A surprising number of cases are litigated where insureds attempt to obtain coverage for their costs and expenses incurred for situations that are not covered. Some examples are:

- *John S. Clark Company, Inc. v. United National Insurance Co., 304 F. Supp.2d 758 (U.S. Dist. Ct., M.D. N.C. 2004).* Portions of a construction project collapsed due to strong winds and poor construction. Other portions sustained damage due to faulty workmanship. The insured sought reimbursement for costs to clean up and reconstruct the collapsed portions of the construction project, as well as the costs to repair the other defectively built portions of the project and to correct its own faulty workmanship. The insurer reimbursed the insured for the costs related to the collapse of strong winds and poor construction, but denied costs for everything else. The court agreed that these costs were not covered by the policy's sue and labor clause.

- *National Housing Building Corp. v. Acordia of Va. Ins. Agency, Inc., 591 S.E. 2d 88, (2004)* involved a construction project built on a steep slope requiring multiple retaining walls. Due to structural concerns regarding the lowest wall, which supported the other walls and foundations of the uphill apartment buildings, the insured instituted remedial

measures and eventually replaced the first wall. The insured also instituted remedial measures to underpin the foundations of the uphill buildings so as to prevent any loss or damage. The Virginia court determined that the remediation expenses were not subject to reimbursement because they resulted from a cause of loss that was not a covered cause of loss.

While the great weight of authority shows that the sue and labor clause is not going to apply to a loss that is not covered, cases still arise from time to time presumably for at least two reasons: The first is that the costs incurred to remediate are substantial and probably an amount that could cause an insured a financial hardship to assume. The second reason is that the facts of cases differ and so, too, do the arguments. Thus, while the courts are fairly uniform in their decisions not to honor remediation costs for losses not involving covered causes to covered property, there is always the chance that a court may see the insured's argument to be more convincing than the insurer's.

> ***"The sue and labor clause, to the extent it is otherwise applicable, only applies to a covered cause of loss. Although there may be situations where insureds still obtain coverage based on the facts and how they are pled, the consensus of the court cases appears to be that the sue and labor clause will not apply to losses that are not covered, such as error in design or faulty workmanship."***

**Summary — Conclusion**

- The mitigating and expediting expense provisions of property policies undoubtedly had their genesis with the sue and labor clause. This is quite like many other policy provisions whose heritage is attributable to old London insurance forms and provisions.

- Several different versions of the sue and labor clause are used with nonstandard property policies, such as difference in conditions, builders risk, and protection and indemnity forms. Its first use was with maritime exposures.
- The primary purpose for a sue and labor clause is for the benefit of the insurer, even though the insured benefits from being reimbursed for costs and expenses incurred in reducing or eliminating loss.
- The sue and labor clause is not a separate insuring agreement. It is a *condition*, even though this point is litigated on occasion.
- When a sue and labor clause applies to both imminent and actual loss, the imminent loss must be one where there is no question about being covered. Also, with time being of the essence in the wake of a loss, insureds should not automatically assume that all expenses and costs incurred to reduce or avoid loss will be covered.
- The sue and labor clause, to the extent it is otherwise applicable, only applies to a covered cause of loss. Although there may be situations where insureds still obtain coverage based on the facts and how they are pled, the consensus of the court cases appears to be that the sue and labor clause will not apply to losses that are not covered, such as error in design or faulty workmanship.

[1] Transportation Coverage Form, AAIS IM 7250 0404, Copyright American Association of Insurance Services, 2004.
[2] Building and Personal Property Coverage Form, CP 00 10 06 07, Copyright, ISO Properties, Inc., 2007.
[3] "Allocation of the Costs of Preventing An Insured Loss," Columbia Law Review, Vol. 71:1309, p.1311.
[4] Columbia Law Review, p. 1312. This wording was said to be the extent of the original sue and labor clause. Its purpose was said "to permit the insured to use every possible opportunity he had to preserve the cargo and hull without waiving his right to tender abandonment and claim a total loss."
[5] This part of the sue and labor clause was said in this Law Review to have been added sometime before the year 1783.
[6] This waiver in the above treatise was said to have been added after the decision in Peele v. Merchants' Ins. Co., 19 F. Cas. 98 (C.C.D. Mass. 1822).
[7] Alex L. Parks, The Law and Practice of Marine Insurance and Average, Vol. I, p. 632, Cornell Maritime Press, Centreville, Md. 1987.

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