Good Cop/Bad Cop: Kidnap, Ransom & Extortion Insurance in an Ambiguous World

AUTHOR: ROBERT P. JACOBS, PARTNER

Although doing business in any foreign country can be risky, certain countries are, needless to say, far riskier than others. Indeed, risks in certain regions of the globe extend far beyond what generally would be considered a garden-variety business risk. It is an unfortunate reality that the risks in some regions include the very real possibility that employees may be kidnapped, or that a company may be extorted to pay large sums of money to prevent employees from being injured—or even killed. So-called Kidnap, Ransom and Extortion ("K, R & E") insurance is a unique type of insurance that is designed to protect companies against those risks.

K, R & E coverage is becoming an increasingly common component of corporate insurance portfolios; however, the coverage issues that might arise as a result of some of these policies' unique features are not fully developed. This is especially true if events transpire in less developed countries or in regions where there is no undisputed or recognized governing body. The vagaries surrounding "who is in charge" in certain countries can give rise to some challenges in assessing coverage under a K, R & E policy, especially if the "perpetrators" (for want of a better term) of the events in question are purporting to act under the guise of some governmental authority.

Some of the coverage assessment issues include (1) whether a purported "arrest" by someone wearing a uniform is, in reality, a kidnapping or is a part of an extortion scheme; (2) whether the incarceration of a person by purported government officials, under unsanitary or abusive conditions, may constitute a "threat" of bodily injury; and (3) whether the abandonment of property seized under the guise of some legal intention may, in reality, be the surrender of a ransom or extortion payment.

OVERVIEW OF K, R & E INSURANCE

K, R & E policies are sold to protect policyholders from monetary losses arising from making a ransom payment to secure the release of an "Insured Person" or from making some form of extortion payment. The policies generally are sold to corporations that conduct business in foreign countries, particularly those known to have a high level of violent criminal activity and/or an ineffective police force. The policies generally define an "Insured Person" as an employee of the corporation or a relative of an employee.

The policies protect policyholders from a loss "by reason of the actual alleged kidnapping of an Insured Person." The policies often define "Kidnapping" as "the involuntary abduction of an Insured Person and the holding of such person by persons who demand money or other consideration for the release of the captive person." The policies also protect against an extortion loss—one that arises from "the receipt of a threat, communicated directly or indirectly to the insured, to kill, injure or kidnap an Insured Person." This coverage generally is referred to as "extortion bodily injury" coverage. An extortion loss also may arise from "the receipt of a threat communicated directly or indirectly to the insured to damage or destroy property of the insured." This coverage is generally referred to as "extortion property damage" coverage.

The policies generally define a "loss" as "the sum of monies or the monetary value of any other consideration surrendered by, or on behalf of, the INSURED as a ransom or extortion payment arising from one event or a connected series of events involving one or more Insured Persons, RELATIVES or GUESTS."

Finally, one of the more unique features of a K, R & E policy is that they generally provide as an additional grant of coverage the services of a crisis response firm, which is meant to act as a negotiator or facilitator for policyholders in instances of kidnappings and extortion threats. The policies typically designate the crisis response firm as the entity to which notice of a claim should be given.
KIDNAPS, EXTORTION AND THE "ACT OF STATE" DOCTRINE

A K, R & E insurer’s investigation of an incident may be tricky with respect to events taking place in countries where the lines between legitimate governmental action and criminal conduct are blurred. Specifically, the analysis may raise issues akin to the "Act of State" doctrine—a somewhat arcane policy that is meant to prevent a court from "declare[ing] invalid the official act of a foreign sovereign performed within its own territory." W.S. Kirkpatrick & Co., Inc. v. Envtl. Tectonics Corp., Int’l, 493 U.S. 400, 405 (1990). The doctrine’s purpose is to prevent the judicial branch of the government from interfering in foreign affairs. In theory, courts are not allowed to potentially disturb diplomatic relations by "disrespecting" a foreign government. An insurer may argue that the operative incident was a legitimate governmental action relying on the Act of State doctrine; in these circumstances, a policyholder should be aware of two critical points that bear on whether the doctrine may properly apply.

First, the party asserting the applicability of the doctrine—presumably the insurer—has the burden of proof. Liu v. Republic of China, 892 F.2d 1419, 1432 (9th Cir. 1989). This will require the insurer to "offer some evidence that the government acted in its sovereign capacity . . . ." Id. In addition, if the facts presented are not "sufficient to demonstrate that the conduct in question was the public act of those with authority to exercise sovereign powers," a court will not presume that the conduct that issue was an official act of a foreign sovereign. Alfred Dunhill of London, Inc. v. Republic of Cuba, 425 U.S. 682, 694 (1976). It also has been recognized that, even if the act in question—e.g., an "arrest"—is carried out by a government official acting "under color of authority," it is possible that the official may, in reality, not be acting within an official mandate.

Second, the Act of State doctrine applies only if a court is required to "declare invalid the official act of a foreign sovereign performed within its own territory." Kirkpatrick, 493 U.S. at 405. Pursuant to Kirkpatrick, the Act of State doctrine does not apply if a court can determine coverage without having to determine the legality or validity of a sovereign state’s official acts. This is especially relevant in the context of K, R & E insurance, because the policies typically are triggered by what the policyholder is told—there is no requirement that the information must be true. For example, a policyholder may be told that an employee has been taken into captivity and may be tortured if money is not paid or if property is not relinquished. The company has no idea whether the possibility of torture is real. The relevant inquiry here is whether the policyholder received a communication that embodied a threat of bodily injury and, based on that information, the policyholder was therefore motivated to make some form of a payment.

In the context of the Act of State doctrine, this distinction is critical because it means that a court would not need to assess the validity of the information—the court would need to assess only whether the policyholder received information that falls within the definition of threat or demand under the K, R & E policy language. As Kirkpatrick makes clear, if a court can find a way to rule on an issue without having to declare invalid the act of a foreign sovereign, then the Act of State doctrine does not apply.

To the extent an insurer is looking to the Act of State doctrine for guidance, this same principle should apply—if a coverage determination can be made without also having to make a judgment call as to whether any given act was an act of a legitimate foreign sovereign acting within its official capacity, then the insurer should do so. This is not to suggest that an insurer is not permitted to make any judgment calls as to whether any given incident was the legitimate act of a foreign sovereign; rather, the point is that looks can be deceiving. The mere fact that a governmental entity may have been involved does not necessarily mean that coverage under a K, R & E policy does not apply.

K, R & E ISSUES IN UNSETTLED COUNTRIES

Set forth below are discussions of how incidents taking place in the context of unsettled or erratic governments can give rise to issues under a K, R & E policy.

ARREST OR "KIDNAPPING"?

Although the distinction between an "arrest" and a "kidnapping" may seem relatively clear, that clarity vanishes in circumstances in which there is a question as to who is in charge and, further, whether those who are in charge are legitimate representatives of a formal government or are something else—namely, criminals or even terrorists. Specifically, if an employee on the ground in a country with an unstable or unformed government happens to be apprehended by someone

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wearing what appears to be some kind of a uniform, the question arises: has the employee been arrested, or has the employee been kidnapped? Indeed, there are countless reports of police officers in Mexico showing up at a person's home in uniforms and wearing badges, and "arresting" someone merely for the purposes of exacting some payment for the person's release. Although the perpetrator is, in fact, a real police officer, the perpetrator is not acting within the scope of an official mandate—the victim committed no crime—and, therefore, there is no legal basis for an arrest.

Obviously, there is a wide spectrum between legitimate governments that happen to have some rogue or corrupt individuals on the one end to much murkier situations on the other end, where there may be no recognizable government whatsoever. For example, the next step down the spectrum from Mexico may be Uzbekistan, where there is a recognized government, but widespread corruption prevails—and it is generally understood that certain powerful politicians control various government instrumentalities, including police, prosecutors, and judges, for their own personal benefit. Further down the spectrum may be Gaza, which is recognized in some circles as having a legitimate government, but which the United States regards as a terrorist organization.

Using an Act of State doctrine–style analysis, an insurer evaluating coverage in any of these circumstances should consider whether any given "arrest" was, in fact, a legitimate act of a foreign sovereign acting within its official capacity. In the Mexico example, the police officers are representatives of a foreign sovereign, but they are not acting in their official capacity. In the Uzbekistan example, the government officials might be acting in their official capacity, but the act itself may not be legitimate. In the Gaza example, there may be no recognized foreign sovereign altogether.

**LEGITIMATE GOVERNMENTAL ACTION OR "THREAT" OR "DEMAND"?**

In the context of the extortion coverage, the second necessary element is the receipt of a "threat" to destroy property or inflict bodily injury. In the context of kidnapping coverage, the policy requires a "demand" for a ransom payment. Regardless, policyholders frequently maintain that determining whether a "threat" or a "demand" has been made should not require any magic words. Rather, this determination should consider the totality of the information that the policyholder receives. Significantly, it usually does not matter under a K, R & E policy how that information reaches the policyholder—it may come directly from the perpetrators or it may come indirectly, particularly through the crisis response firm.

For example, the policyholder's employees may be rounded up and taken into some form of captivity. It is possible that the circumstances of any such captivity could certainly pose inherent risks of bodily injury, ranging from nutritional and medical deprivation to sexual assaults, all the way to torture and even death. If those risks of injury are communicated to the policyholder, that may be considered a "threat" of bodily injury within the meaning of the extortion bodily injury coverage, even if no one ever communicates an express threat to the policyholder. Likewise, if it is communicated to the policyholder that a captive employee might be released if the policyholder makes some form of payment, or walks away from some property (see below), that communicated information may be a "demand," even if not clearly expressed as such.

Regardless of whether there is a threat or demand communicated to the company, an issue may arise if uniformed individuals are involved or if the violation of the law—however vague or obscure—is mentioned. For the Act of State doctrine to apply, "the conduct in question [must have been] the public act of those with authority to exercise sovereign powers . . . ." Dunhill, 425 U.S. at 694. Significantly, the United States Supreme Court has stated that a court should not presume that the conduct at issue was the official act of a foreign sovereign. Id. Policyholders argue that insurers should follow the same rule—if there is some evidence that an "arrest" and incarceration, or the seizure of property, may not necessarily have been the acts of a foreign government acting within its sovereign capacity, then coverage may apply, notwithstanding the purported governmental involvement.

**SEIZURE OR "SURRENDER"?**

A policyholder may find that its offices, warehouses, or other facilities in a foreign country are raided and seized—again, undertaken by individuals wearing some kind of a uniform and making some vague reference to a violation of the law. The perpetrator of the seizure may then threaten to destroy the inventory, supplies, or equipment that they seize unless the
policyholder pays what might be described as a “fine.” Or, if an employee of the policyholder also was taken into captivity, the perpetrators may condition the employee’s release on the surrender of the seized property. Again, in countries with unformed governments or where there is widespread corruption, it is possible that the company’s property was seized not because of any legitimate law was violated, but rather, merely to extract some payment or profit from the value of the seized property.

Of course, the policyholder may decide that the most prudent approach would be to surrender the seized property rather than attempt to challenge that seizure through a government’s “legitimate” channels, on the premise that doing so would be futile or would put an employee at great risk. Is that decision—to walk away from the property rather than fight—effectively a ransom or extortion of payment?

Many K, R & E policies do not define the concept of “surrender,” thereby opening up that term’s application to a variety of circumstances. If a policyholder walks away from seized property because it believes an employee’s safety is at risk, or simply because it would be futile to attempt to recover the property from a corrupt entity, it undoubtedly would argue that its actions constitute a “surrender” of a ransom or an extortion payment within the meaning of a K, R & E policy.

CONCLUSION

K, R & E insurance is meant to protect companies doing business in volatile foreign countries from the risk that criminals will take their employees captive or will steal their property. However, in countries where governments are unstable, unformed, or there is no undisputed governing body, criminals may assume the roles of government officials and vice versa. The wearing of a uniform or the flashing of a badge should not necessarily be determinative of coverage under a K, R & E insurance policy. Under these circumstances, a diligent Act of State doctrine analysis is proper.

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For more information, please contact Robert Jacobs at rpjacobs@perkinscoie.com or 202.654.6210.