

Insurance aspects of climate change in the US



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Insurers and insured parties face many unique and, as yet, untested challenges in the face of damage caused by global warming. As the fact of global warming becomes more widely accepted, and its effects manifest themselves more visibly and profoundly, the scope and frequency of lawsuits against greenhouse gases emitters and claims made against insurance companies are bound to increase. This article examines:

- Emerging climate change litigation and the impact this could have on insurance.
- Insurance coverage for global warming claims.
- The pollution exclusion in insurance contracts.
- Whether greenhouse gases are characterised as pollutants.
- Potential liabilities of directors and officers for global warming damage, and potential coverage under directors and officers insurance policies.

EMERGING CLIMATE CHANGE LITIGATION

Litigation in the US over global warming is in its earliest stages. Most of the claims that have been filed to date are in the pleadings stage and the viability of such claims remains to be seen. Several states and a number of private landowners have filed lawsuits against greenhouse gas emitters for property damage allegedly caused by global warming.

In April 2007, the US Supreme Court potentially opened courtroom doors to a wide variety of claims for property damage caused by global warming. In *Massachusetts v Environmental Protection Agency* (127 S.Ct. 1438 (2007)), a number of states challenged the Environmental Protection Agency's (EPA's) decision that it did not have authority to regulate greenhouse gas emissions. The Court ruled that greenhouse gases are "air pollutants" under the federal Clean Air Act, and that the EPA has the authority to regulate them.

A key aspect of the Court's ruling was its conclusion that the states had standing to sue the EPA. The states had "quasi-sovereign interests" to protect their land and citizens. Also, each state owns a substantial portion of the state's coastal property and therefore alleged a particularised injury in its capacity as a landowner. *Massachusetts* now provides states and major landowners that have allegedly suffered property damage because of global warming with a strong argument that they have legal standing to seek redress in the courts.

Private litigation is already underway. In *California v General Motors* (No. 3:06-CV-05755), for example, the State of California is suing General Motors, Ford, Chrysler, Toyota, Nissan and Honda

for public nuisance under California's Civil Code. Using these statutes, California's Attorney General has alleged that:

- These automobile manufacturers have produced millions of vehicles which have generated carbon dioxide emissions in the US alone equal to 9% of the entire world total.
- The manufacturers knew of the danger of global warming but produced these vehicles anyway.
- As a result they have created a public nuisance in California.

The complaint alleges specific injuries to California's water, snow pack, rivers, streams, wildlife, coastline, and air quality. It alleges damage to its water storage and delivery systems, and the need for infrastructure changes, such as levees to protect inland agricultural areas from salt water infiltration as sea levels rise. It alleges damage to drinking water supplies, agriculture and fisheries, erosion of the state's beaches and islands, and impacts on the health of California residents and on California's health system. Dozens of other impacts have allegedly begun or are anticipated (*Complaint, paragraph 56*).

California demanded billions of dollars to compensate it for remediation of such damage now and in the future. The case went to the pre-trial stage, with motions to dismiss briefed and argued. The defendants argued the claims were non-justiciable, raising issues better left to the determination of the Legislative and Executive branches of government. The state of California countered that the case raised ordinary tort issues, no different from many other product claims routinely decided by the courts, and should be permitted to proceed. On 17 September 2007, the trial court ruled that the suit was a non-justiciable "political question" as it would require the court to make "an initial policy determination of a kind clearly for non-judicial discretion" (for the docket and papers, see <http://pacer.psc.uscourts.gov>). The Attorney General's office is reportedly considering an appeal to the Ninth Circuit Court of Appeals.

Another closely watched case was *Comer v Murphy Oil USA, Inc.*, filed as a class action against 121 oil and energy companies in the federal court for the Southern District of Mississippi in the aftermath of Hurricane Katrina, which caused immense destruction along the American coastline of the Gulf of Mexico, including the catastrophic flooding of New Orleans. The *Comer* case alleged claims of nuisance, negligence, and a number of other torts, based on "demonstrable changes" in the earth's climate as a result of the defendants' greenhouse gas emissions. The demonstrable changes include higher and rapidly increasing air and water temperatures, rapid sea level rise, melting of arctic, Antarctic, and alpine glaciers, more severe droughts, increased El Niño events, and increased weather-related economic losses (*Proposed Fourth Amended Complaint, ¶ 14*

[Document 304]). The *Comer* plaintiffs claim that the defendants' actions "were a proximate and direct cause of the increase in the destructive capacity of Hurricane Katrina". On 30 August 2007, the trial court dismissed this complaint, based on the political question doctrine. An appeal was filed on 17 September 2007 to the Fifth Circuit Court of Appeals. The US Supreme Court may ultimately be called on to decide this issue in either *Comer* or *General Motors*.

Even if these basic issues of standing and justiciability are ultimately resolved in favour of the claimants, there are practical problems with imposing tort liability on energy companies and other corporations for the effects of global warming. This is particularly the case in terms of providing evidence of the degree to which the actions of any party are responsible for global warming, or any damage allegedly caused by it. There are also theoretical problems with establishing the necessary duty which is a prerequisite to tort liability.

However, it must be remembered that global warming litigation is in its infancy, and these problems may not remain insurmountable forever. For one thing, as the awareness of the dangers of greenhouse gas emissions grows more pervasive in the business community, as well as in the public generally, it will become ever harder for companies to maintain that they could not be expected to foresee their effects. Even if these claimants do not ultimately prevail with their claims, their claims may still be sufficiently plausible to require companies or their insurers to provide a costly defence.

Actions for damages are not the only forms of global warming litigation beginning to emerge. For example, in *Connecticut v American Electric Power Co., Inc.* (406 F.Supp.2d 265 (SDNY 2005)), several states sued public utilities for abatement of nuisance over global warming issues. The complaint was dismissed as presenting non-justiciable political issues, but is on appeal. In *Friends of Earth, Inc. v Mosbacher* (488 F.Supp.2d 889 (NDCal. 2007)) environmental groups sought injunctive relief against the Overseas Private Investment Corporation and Export-Import Bank for not conducting adequate environmental review of international fossil fuel projects.

INSURANCE COVERAGE FOR GLOBAL WARMING CLAIMS

Given this new liability exposure, it is possible that insurance companies may have to pay claims for damage caused by emissions of greenhouse gases by their insured parties. Commercial general liability (CGL) policies carried by most US businesses may cover defence costs and liabilities associated with global warming litigation. While many CGL policies exclude coverage for damage resulting from pollution in many situations, global warming claims present unique factual circumstances that may allow insured parties to avoid the pollution exclusions.

Generally, coverage will usually extend to an insured party's liability for bodily injury or property damage, but does not extend to claims for injunctive or other non-monetary relief. Therefore, insurance companies' exposure to claims turns in part on whether the suit involves potential monetary damage.

Exposure may also turn in part on when this property damage is alleged to have occurred. In the US, CGL insurance is usually occurrence-based rather than claims-made. This means that coverage is provided by the policy or policies in effect at the time the property damage occurred, rather than the date the claim was made. For a company which is being sued for its long-term

business activities and cumulative impact on the environment, this means that all policies issued to the insured over those many years are potentially available to cover the liability.

POLLUTION EXCLUSION

Insurers will likely look to the pollution exclusion in their general liability policies to attempt to avoid coverage for global warming claims. The use of pollution exclusions and their terms have changed significantly over the years. Most general liability policies issued before 1973 did not have any pollution exclusion. Because a defendant's emissions of greenhouse gases, and therefore their contribution to global warming, may date back decades, pre-1973 policies may apply and will probably not contain a pollution exclusion. Such policies will therefore be valuable assets in addressing liability associated with global warming litigation, although carriers will undoubtedly raise other defences despite the absence of a pollution exclusion, including whether the damage was intended or expected by the insured. This defence, of course, will likely prove difficult to establish given the state of knowledge in that era.

Most general liability policies issued in 1973 or after do contain a pollution exclusion. The standard form of exclusion has changed over the years. The exclusion added to most policies starting in 1973 precludes coverage for claims arising out of the discharge of pollutants unless the "discharge, dispersal, release or escape is sudden and accidental".

In 1985, insurers sought to limit coverage for pollution-related liabilities even further by amending the exclusion, typically referred to as the "absolute" pollution exclusion. That exclusion precludes coverage for liabilities arising out of the discharge of pollutants, and deleted the exception for "sudden and accidental" pollution contained in the earlier form. The absolute pollution exclusion is typically limited, however, to discharges on sites owned or occupied by the insured party or where it performed its operations. Therefore, even this form has important limits on its scope. A third and more recent version of the exclusion has been adopted, known as the "total" pollution exclusion, which deletes these limitations from the absolute exclusion.

Because of the federal system in the US, insurance coverage is a matter of state law. Even when the litigation is conducted in federal court, the federal court must apply the law of the state as the rule of decision. A threshold question is whether carbon emissions will be deemed to constitute "pollutants" and fall within the exclusion at all. The answer to this question may vary from state to state based on existing precedent involving similar claims. Each state will also apply its own law to the interpretation of the specific exceptions or limitations expressly contained in both the sudden and accidental, and absolute forms.

GREENHOUSE GASES AS POLLUTANTS

There is an increasing scientific consensus that worldwide climate changes are the result, at least in large part, of the emission of greenhouse gases (especially carbon dioxide but also methane, nitrous oxide and some fluorinated gases) into the atmosphere by modern industrial processes. Of course, carbon dioxide is emitted into the atmosphere by other processes too, including human and animal respiration. Other gases which are not industrial by-products, notably water vapour, also have greenhouse effects. This raises the important question of whether greenhouse gases are pollutants within the meaning of the pollution exclusion.

As liability claims based on climate change are just now underway, there is no precedent directly addressing coverage for greenhouse gas emissions. One of the first American courts to consider a similar question was the Wisconsin Supreme Court, in *Donaldson v Urban Land Interests, Inc* (211 Wis.2d 224, 564 N.W.2d 728 (1997)). This case concerned personal injury claims arising from inadequate ventilation of exhaled carbon dioxide in an office building. The trial court held carbon dioxide was a “gaseous irritant”, and therefore the policy’s pollution exclusion defeated the claim. The Wisconsin Supreme Court disagreed, holding that inadequately ventilated carbon dioxide from human respiration would not usually be classified as a “pollutant” and would not necessarily be understood by a reasonable insured party to meet the policy definition of a pollutant (211 Wis.2d at 231-232).

There was coverage, the Wisconsin court held, because this harmful concentration of carbon dioxide fell into the class of “everyday activities gone slightly, but not surprisingly, awry,” and for which a policyholder would ordinarily expect coverage. Further, the court did not think that a reasonable insured party would necessarily view exhaled carbon dioxide as in the same class as “smoke, vapor, soot, fumes, acids, alkalis, chemicals and waste” (*Id.* at 234).

One justice (out of seven) dissented, arguing that “[t]he mere fact that it is a common and natural product does not, as the majority suggests, mean that it cannot also be considered a ‘pollutant’ within the meaning of the policy” (*Id.* at 238 (*dissent of Justice Steinmetz*)).

In response, insurance carriers will cite the Supreme Court decision in *Massachusetts v Environmental Protection Agency*, discussed above. In that case, the EPA refused to issue rules under the Clean Air Act (42 USC §§ 7401 *et seq.*) to regulate greenhouse gas emissions from motor vehicles. The EPA contended it had no authority to do so because greenhouse gases were not pollutants. Several states, led by lead plaintiff Massachusetts, challenged this position and sued to force the EPA to issue rules.

The Supreme Court decided that carbon dioxide is a pollutant, at least within the Clean Air Act’s definition, which included “any air pollution agent or combination of such agents, including any physical, chemical ... substance or matter which is emitted into or otherwise enters the ambient air ...” (42 USC § 7602(g)). The Court found this definition included all airborne compounds of “whatever stripe” and also includes methane, nitrous oxide, and hydrofluorocarbons (127 S.Ct. at 1460). Because greenhouse gases fit well within the Clean Air Act’s broad definition of air pollutant, the EPA has the statutory authority to regulate the emission of such gases from new motor vehicles (*Id.* at 1462).

This ruling by the Supreme Court addressed an issue of statutory interpretation and was decided under the rules applicable to statutory construction, not the much different rules applicable to the interpretation applicable to insurance policies.

Policies are to be interpreted in the manner most favourable to the insured party, and exclusions must be construed narrowly, with all ambiguities resolved against the insurer. Further, the statutory definition of pollution at issue in *Massachusetts* was very broad, applying to any substance entering the ambient air, while pollution exclusions in insurance policies are typically limited to “any solid, liquid, gaseous or thermal irritant or contaminant”. Because virtually any substance may become an irritant or

contaminant in sufficient quantities or under the proper conditions, the absolute pollution exclusion has been held to apply only to substances “commonly thought of as pollution”. As noted, courts generally resolve any doubts in favour of the insured party in determining coverage, including whether a substance qualifies as a pollutant under this definition.

There is currently little consensus among the courts:

“State and federal courts are split on the issue of whether an insurance policy’s total pollution exclusion bars coverage for all injuries caused by contaminants, or whether the exclusion applies only to injuries caused by traditional environmental pollution” (*Meridian Mutual Insurance Co. v Kellman*, 197 F.3d 1178, 1181 (6th Cir. 1999)).

OTHER CONSIDERATIONS

While the definition of pollutant will be the threshold question, insured parties may still have coverage even if they lose on this threshold issue. The interpretation of the 1973 pollution exclusion has varied in different states. Some states hold that such policies cover only sudden events and exclude all gradual pollution, whether intended or otherwise. Other states hold it excludes only intentional pollution, and that such policies cover unintentional pollution regardless of the duration of the polluting event. Therefore, in the latter states, an insured party may have coverage for even long-term discharges of greenhouse gases, so long as it did not intend the resulting damage.

Surprisingly, the absolute pollution exclusion may allow for broader coverage for global warming than the earlier exclusion it replaced, at least for some insured parties. As noted above (*see Pollution exception*), the absolute exclusion removed the previous exception for sudden and accidental events, but also at the same time limited the new exclusion to discharges at the insured party’s own premises or where it was conducting operations. This modification was made intentionally and for the very purpose of restricting the pollution exclusion to operational discharges, such as emissions into the air or water from the insured party’s factory, but to preserve coverage for pollution events resulting from other exposures such as claims resulting from products sold by the insured, which occur after purchase and away from the insured party’s place of operations.

Of course, emissions from motor vehicles sold by an auto manufacturer typically do not occur on the premises of the insured party. Therefore, the absolute exclusion should not apply to such claims as the California suit against General Motors and other major automobile manufacturers. The manufacturers should have coverage for the period in which they had absolute pollution exclusions in place.

Oil companies and other similar defendants that have been sued mainly for the effect their products have on the environment, would have the same claim to coverage. On the other hand, defendants such as power companies sued for emissions from their power plants would not be able to make this particular argument, and their claims for coverage would stand or fall based on the threshold argument of whether carbon dioxide is a pollutant, as well as arguments under the sudden and accidental form.

In short, potential insurance coverage for global warming claims is clearly an issue that insured parties facing such exposure must

carefully evaluate, bearing in mind the numerous difficulties presented by the nature of the claims asserted, as well as the nature of the insured's business activity. Insured parties can expect insurers to assert all possible bases for avoiding this potential exposure given the unknown, but potentially enormous, scope of this liability.

DIRECTORS' AND OFFICERS' LIABILITY

Another area of global warming exposure relates to the potential liability of directors and officers for wrongful acts done in their official capacities. A significant exposure would be if directors or officers misstate risks presented to the company by global warming.

One of the forms which publicly traded companies must file with the US Securities and Exchange Commission is that prescribed by Regulation S-K:

- Item 101 requires the company to disclose material effects that laws regulating the discharge of materials into the environment or otherwise relating to the protection of the environment, may have on the capital expenditures, earnings and competitive position of the registrant and its subsidiaries (17 CFR § 229.101(c)(xii)).
- Item 303 requires the company to identify any known trends or uncertainties that are reasonably likely to result in the registrant's liquidity increasing or decreasing in any material way (17 CFR § 229.303(a)(1)).
- Similar requirements in Item 303 apply to trends or uncertainties which could affect capital resources, sales or revenues.

Material in this context means information as to which "there is a substantial likelihood that a reasonable investor would attach importance in determining whether to purchase the security registered" (17 CFR § 230.405).

Obviously global climate change is an uncertainty which could have significant adverse effects, directly or indirectly, on almost every company's business. Many companies may be required to change their business operations to reduce carbon emissions, or be forced to buy carbon emission credits to offset their emissions, and take the risks inherent in relying on the potentially volatile spot market or hedging that exposure in the futures market at significant cost.

Further, any number of companies may be at risk of enormous damages as a result of global warming litigation of the kind discussed above. Failing to adequately report such risks may result in a securities class action lawsuit. In addition to disclosure risks, the directors and officers could be subject to shareholder derivative claims for mismanagement based on their failure to take prudent action with respect to these issues.

These claims will likely be covered under the directors' and officers' liability insurance purchased by most public companies. Directors' and officers' insurance is typically claims-made rather than occurrence-based, and coverage depends on the form in place when the claim is made. Coverage may depend in part, therefore, on whether insurers choose to modify their policies in the future to expressly address such claims. There will also be arguments raised by insurers based on exclusion in the current policies.

Such policies, for example, typically include a pollution exclusion similar to the CGL exclusion. If global warming is construed to fall within the pollution exclusion, the question arises whether the pollution exclusion applies only to clean-up type claims or extends to misrepresentation or mismanagement claims.

Several cases have addressed this issue in the context of traditional environmental pollution. *National Union Fire Insurance Co. of Pittsburgh v US Liquids, Inc.* (88 Fed.App. 725, 2004 WL 304084 (5th Cir. 2004)) concerned a shareholders' claim about the insured party's misleading reporting in securities filings, which improperly concealed prior unlawful polluting activities. In a non-precedential decision, the Court of Appeals for the Fifth Circuit, applying Texas law, held the pollution exclusion applied because "the factual allegations of the securities and derivative suits bore more than an incidental relationship to the broad polluting conduct excluded in the policy and that 'but for' such illegal activities those underlying claims would not exist" (88 Fed.App. at 731).

Other courts have taken the opposite approach. For example, in *Owens Corning v National Union Fire Insurance Co. of Pittsburgh* (1998 WL 774109 (6th Cir. 1998; unreported)), applying Ohio law, the Sixth Circuit held an exclusion for claims "based upon, arising out of or related to asbestos", including "any alleged act, error, omission or duty involving asbestos" or the "use, exposure, presence, existence, detection, removal, elimination or avoidance of asbestos in any environment" did not exclude claims regarding misleading statements about the company's exposure to asbestos claims.

The action, said the court, is based on financial misrepresentations, not on the excluded matters of asbestos and its use. This is the sounder approach. Although the *Owens Corning* case is also not precedential, the same reasoning should apply to misrepresentations about global warming exposure; the applicable claim for wrongful conduct would not be pollution as such, but misreporting its financial effects or mismanaging the business response to the challenges it presents.

LONG-TERM IMPACT

Tort litigation over global warming is in its earliest stages and it is not yet possible to tell what the new liability and insurance environment will be. But it seems safe to predict that, whether or not suppliers of carbon-based fuels and carbon-emitting equipment are held legally responsible for the environmental effects of global warming, the risks posed by those environmental effects are becoming greater and the effects themselves more severe.

Insurers and reinsurers are reportedly modifying their premium calculation formulas in some markets. Insurance in some areas and for some risks will become more expensive and harder to get. Some companies may condition insurance on certain protective measures being taken by insured parties. We may also see, as we have for the recent stock option backdating controversy, a shift in focus in underwriting process with directors' and officers' questionnaires exploring the company's exposure to climate risks, its disclosures, and its plans for addressing such risks. Insurance may therefore turn out to be an influential supplement to government regulation and political action in shaping the corporate response to the challenges of climate change.



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