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Insurance Coverage Alert

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Greenhouse Gas Emission Liabilities and Insurance Coverage

In the last three months, two federal court decisions in the United States have resurrected previously dismissed lawsuits for greenhouse gas (GHG) emission and climate change liability. In one, plaintiffs sued for injunctive relief asking the court first to cap defendants' emission levels and then to reduce them. In the other, plaintiffs asked for money damages potentially totaling billions of dollars. Although the trial courts in both cases dismissed the complaints, the respective courts of appeal reinstated the plaintiffs' claims and have allowed them to proceed for now.

The courts' final word on the business community's exposure to injunctive relief and damage claims may be a long way off, but companies may now want to start asking questions about insurance coverage for litigation defense and indemnity for traditional third-party property damage claims as well as director and officer exposures.

Because the risks are new, the issues are likely to remain unsettled in the near term. Many companies with significant GHG emissions may be a step behind because of the lack of coordination between their risk managers and their climate change and sustainability programs. Now is a good time to start folding these issues into a company's overall business strategy.

Recent Litigation

Several years ago plaintiffs groups, modeling their efforts in part after cases against the tobacco industry and handgun manufacturers, began to bring climate change lawsuits. In the first case, Connecticut v. American Electric Power, eight states, the City of New York, and several environmental groups sued AEP and four other electric utilities claiming their GHG emissions constituted 2.5% of the world's carbon dioxide emissions and created a public nuisance. Plaintiffs sought injunctive relief, asking the court to order a cap on, and then the reduction of, defendants' GHG emissions.

Shortly after the plaintiffs filed suit, the trial court dismissed the complaint. The court reasoned that the issue of global warming was a "political question" outside of the judiciary's constitutional role. Because the case presented important and wide-ranging public policy issues better left to the legislative and executive branches of government, the court declined to hear the case.

In September 2009, the U.S. Court of Appeals for the Second Circuit reversed and reinstated the plaintiffs' complaint. The court disagreed that climate change presented an exclusively political question, and further held that plaintiffs had standing to bring the claim, because injury had already begun and was "fairly traceable" in part to defendants' actions.

In another significant case, Comer v. Murphy Oil, the U.S. Court of Appeals for the Fifth Circuit reinstated a complaint that the trial court had dismissed on similar grounds as AEP. Plaintiffs in that case, however, were property owners who sued an assortment of Gulf coast oil and gas producers, utilities, and other energy-related companies claiming their GHG emissions had in part contributed to the strength of Hurricane Katrina. They sought billions of dollars in property and punitive damages arising out of the devastating August 2005 storm that flooded parts of New Orleans.

In Native Village of Kivalina v. Exxon Mobil, the Center on Race, Poverty, and the Environment and a well-known plaintiffs class action law firm filed claims on behalf of a tiny Inupiat village in Alaska claiming that the GHG emissions from numerous oil and gas producers and utilities reduced levels of sea ice that previously protected the village from dangerous winter storms. The diminution of this protection, plaintiffs claimed, will require the relocation of the village costing hundreds of millions of dollars. The U.S. District Court in San Francisco recently dismissed the complaint on similar theories of political question and lack of standing, although the court's location in the U.S. Court of Appeals for the Ninth Circuit (which some view as a liberal federal circuit court) may cast doubt on the longevity of that decision.
In addition to public nuisance claims, some of these plaintiffs groups have also sued for civil conspiracy, fraudulent misrepresentation, and unjust enrichment, arguing that defendants have misled the public about the fact of global warming and their companies' role in its cause, and profited from their actions in the process. All of the cases seeking damages have included punitive damages under a variety of legal theories.

GHG Reporting Obligations

The obligation to calculate and disclose GHG emissions for many companies is here. The United States Environmental Protection Agency in September issued a final rule requiring companies emitting about 85% of the United States' GHGs to begin reporting in 2010. While the EPA rule has a threshold exclusion for most businesses (generally those less than 25,000 metric tons of CO2 equivalent/year), non-governmentally imposed reporting obligations are also gaining currency. For example, Walmart announced this year that it will require all of its suppliers to disclose their GHG emissions including whether they have previously participated in, and disclosed emissions under, the Carbon Disclosure Project. Further, 18 states now have their own reporting rules.

For public companies in the United States, management must disclose material trends, uncertainties and other factors that are reasonably likely to affect earnings. For some businesses, various climate change risks may fall into these categories. Securities regulations also have specific disclosure requirements for any material effect that compliance with environmental laws may have on earnings. Risks posed by climate change may fall into this obligation to disclose.

General Liability Insurance

Since 1980, the rise of pollution cleanup liability has conditioned businesses to look to their historic comprehensive general liability (CGL) policies for defense of litigation and indemnity for costs and damages. These older policies typically provide coverage for an "occurrence" during the policy period. Thus, if a climate change claim includes allegations that historic releases of GHGs have caused long-term damage over a period of years, businesses may turn to these old policies for assistance. With current climate change litigation years away from a jury's decision to award damages, a chief benefit of these older policies is the unlimited defense costs they typically afford. And in many of these policies, defense costs do not erode policy limits. At present, since the principal exposure for the unlucky targets of these actions is the cost to defend the litigation, a business facing suit should look to its old CGL policies.

Most liability insurance issued in the United States since the mid-1980s contains what is known as the "absolute pollution exclusion," and excludes coverage for third-party pollution damages. In Massachusetts v. EPA, the United States Supreme Court held that carbon dioxide emissions were a pollutant under the Clean Air Act, and that EPA must regulate them. Although this decision might seem to foreclose coverage under contemporary liability policies, the Supreme Court's decision

turned in large part upon the expansive statutory language of the Clean Air Act. The drafters of the typical pollution exclusion chose a narrower set of terms, defining "pollutants" as "any solid, liquid, gaseous or thermal irritant or contaminant, including smoke, vapor, soot, fumes, acids alkalis, chemicals and waste." Although certainly gaseous at ambient temperatures, carbon dioxide may not be either an "irritant or contaminant," and it does not seem to fit easily within the list of specific pollutants in the exclusion. Thus, any company finding itself in litigation should consider tendering defense of the claim under all of its current and historic third-party liability policies.

Pollution Legal Liability Insurance

Even if the courts were ultimately to conclude that CO2 is a pollutant and thus outside the scope of the typical general liability policy, businesses concerned about climate change exposures have other options. In today's market, carriers are increasingly making available pollution legal liability (PLL) policies that provide coverage for pollution injuries, although insurers have substantially narrowed the scope of these policies compared to the old general liability policies. One leading insurer, for example, has an Environmental Site Liability policy specifically designed for Superfund-style liabilities but potentially applicable to climate change damages such as those alleged in Kivalina and Comer. This policy agrees to pay for third-party property damages resulting from a "pollution incident" (defined to include, among other things, the discharge of gaseous contaminants into the atmosphere) that is migrating beyond the boundaries of the insured site. There are, however, various limitations and exclusions to coverage. If the claim results from a past release, the insured must have disclosed the release to the carrier at the time of applying for the policy. Further, unlike the old CGL policies, these are "claims-made" policies and require the insured to bring the claim for coverage within the policy period or any negotiated extended reporting period. In addition, litigation defense costs are typically counted against, and thus reduce, the available coverage limit.

As comprehensive climate change and GHG emission regulation continues to move from discussion to reality, the exact contours of the future scheme are becoming more defined. One area of potential financial exposure is regulatory penalties assessed for the violation of rules requiring businesses to calculate and disclose emissions. While every coverage claim will depend upon the facts of the individual case and the language of the particular policy at issue, many of the PLL policies available today include penalties within the definition of a "loss." However, these polices cover losses "resulting from a pollution incident" (again, such as the release of gaseous contaminants), so coverage for such claims will depend in part upon whether the penalty "results" from the release of the contaminant, as opposed to the fact that the business did not report it accurately.

Directors and Officers Insurance

In addition to the company's exposure to damages and penalties, there is the possibility that investors in publicly traded corporations will sue the corporation's directors and officers alleging liability for individual losses or for damage to the corporation itself as a result of the directors' and officers' failure to disclose fully to shareholders the corporation's climate change risks and liabilities or failure to report or disclose emissions under the pending reporting regimes. Such claims could be brought through the usual tools available to plaintiffs and their counsel, including shareholder derivative suits for corporate mismanagement and individual or class action claims for securities fraud for failure to disclose.

Directors and officers coverage is something almost every public corporation provides its management, but most policies contain pollution exclusions similar to those found in general liability policies. For example, one carrier's typical policy provides that:

> The Insurer shall not be liable to make any payment for loss in connection with any claim made against the Directors or Officers … arising out of the discharge, dispersal, release or escape of smoke, vapors, soot, fumes, acids, alkalis, toxic chemicals, liquids or gases, waste material or other irritants, contaminants or pollutants into or upon land, the atmosphere or any watercourse or body of water.

The industry designed these clauses to preclude coverage for environmental cleanup costs under

statutes that impose individual "operator" liability for certain corporate decision-makers. The applicability of these clauses to, and thus the exclusion of coverage for, the most likely types of climate change exposures is much less certain. No statute yet creates individual liability for specific waste disposal decisions outside the hazardous substance cleanup arena. Instead, as in Kivalina and Comer, plaintiffs are pursuing ordinary common law torts such as nuisance and misrepresentation. Allegations against directors and officers arising out of these types of claims would most likely fall within the traditional "wrongful acts" that directors and officers policies cover. Thus, the courts should find coverage for the typical mismanagement claims (e.g., the shareholder derivative suit context) or failure to disclose (e.g., the securities fraud context).

Coordination Between Risk Management and Sustainability

In the United States, climate change regulation has arrived. And unless Congress acts to foreclose climate change litigation, we can expect eager plaintiffs groups and their counsel to bring more actions. Management should be cognizant of all of the potential impacts of these trends, and ensure that their sustainability and climate change groups are working with the company's risk managers to ensure adequate protection for the company and its officers and directors.