Protecting Against D&O Liability for Climate Change–Related Disclosures

By William G. Passannante

In recent years, a growing number of governmental actions or shareholder suits against corporations or their D&Os have been filed alleging environmental-related, though not specifically climate change–related, disclosure failures. Last summer, a federal court in California denied the defendants’ motion to dismiss an amended complaint in a securities suit brought by a class of investors alleging that corporate executives and members of the board of directors of a lead-acid battery recycler mislead investors and omitted material information in disclosures regarding the company’s compliance with environmental regulations. See Loritz et al. v. Exide Technologies et al., 2014 U.S. DIST LEXIS 111491 (C.D. Cal. 2014). Similarly, the Second Circuit Court of Appeals vacated the dismissal of a complaint alleging violations of federal securities law for defendants’ failure to disclose ongoing and serious pollution problems rendering the description of environmental issues provided in the prospectus misleading. See Meyer v. JinkoSolar Holdings Co. Ltd., 761 F.3d 245 (2d Cir. 2014).

Since the Supreme Court’s landmark climate-change decision in Massachusetts v. Environmental Protection Agency, 549 U.S. 497 (2007), which held that greenhouse gas emissions from cars constitutes an air pollutant and that the EPA failed to support its refusal to decide whether the emissions contributed to climate change, the number of climate change–related lawsuits against public companies has grown. At the same time, climate change issues are the subject of increasing state, federal and international regulatory efforts. Add to this the fact that weather-related catastrophes have produced costly tolls in the last five years, and the risk that directors and officers may become the targets of governmental and private lawsuits based on their companies’ climate change–related disclosures has increased, and likely will continue to increase.

The potential growing risks faced by D&Os was first previewed at the beginning of the decade when the Securities and Exchange Commission issued its first-ever climate

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change–related financial disclosure guidelines on February 8, 2010. These guidelines indicate that the SEC has recognized that climate change–related regulations and liabilities increasingly may trigger potential corporate reporting requirements under a variety of SEC rules and regulations. The guidance to public companies, entitled “Commission Guidance Regarding Disclosure Related to Climate Change,” focuses on the SEC’s “existing disclosure requirements as they apply to climate change matters.” It identifies a variety of climate change–related issues that might trigger corporate disclosure requirements, including:

- Enacted or proposed state, federal or international legislation that may have a material effect on a public company

- Legal, technological, political and scientific developments regarding climate change that may create risks for companies, such as decreases in demand for existing products or services, or adverse effects on a company’s reputation

- The potential physical effects of climate change on weather-sensitive business operations, such as the financial effects on companies with operations on coastlines or effects from disruptions to the operations of major customers or suppliers from severe weather

While some initial climate change–related lawsuits were brought by private and state litigants asserting tort-based theories alleging that defendants’ companies emissions have caused or contributed to climate change with resulting environmental damage, the United States Supreme Court has ruled that federal common law addressing certain environmental issues, such as greenhouse emissions, is displaced by congressional action, specifically the Clean Air Act and the EPA action the law authorizes. See American Electric Power Company, Inc. v. Connecticut, 131 S. Ct. 2527 (2011).

Although we have yet to see any significant number of governmental actions or shareholder suits against corporations or their D&Os in relation to climate change–related disclosure failures, the seeds for the future growth of such actions are being sown.

Is D&O Insurance Adequate Protection?

Lawsuits against directors and officers alleging damages arising out of climate change–related issues likely will trigger the coverage provided by D&O insurance policies for claims alleging “losses” as a result of a director’s or officer’s “wrongful acts.” Insurance companies, however, have already indicated that they will likely take the position — improperly in our view — that a so-called “pollution exclusion” contained in many D&O policies would somehow eliminate coverage for such lawsuits.

Pollution exclusions typically purport to exclude claims “based on, arising out of, or in any way involving” pollution.

It is far from clear, however, whether the courts will agree that such exclusions apply to D&O claims stemming from alleged disclosure failures. In an analogous case, at least one court in recent years has rejected the insurance companies’ position. In Sealed Air Corp. v. Royal Indem. Co., 404 N.J. Super. 363, 372, 961 A.2d 1195 (2008), the court held that a pollution exclusion in a D&O policy did not bar coverage for a lawsuit against directors and officers based on their alleged misleading financial statements with respect to asbestos environmental liabilities.

Another issue that may arise is whether the intentional act of emitting greenhouse gases qualifies as an “accident” under liability policies. Though examining a CGL policy, the Supreme Court of Virginia held in such a case that the defendant energy company’s act of intentionally releasing greenhouse gases with
the knowledge that the probable consequence of such an act was global warming did not constitute an “accident” and thus was not covered under the relevant policies. AES Corp. v. Steadfast Ins. Co., 283 Va. 609 (2012).

Since the law on this issue is far from settled, policyholders should note that with the rise of climate change–related D&O litigation, it may be possible to purchase D&O policies with clauses specifically carving out climate change–related securities lawsuits from a policy’s pollution exclusion. A similar carve-out may also be possible for claims against directors and officers for which they are not being indemnified by their corporation. At the same time, some insurance companies are offering new insurance policies to address climate change and environmental liability losses.

Of course, insurance companies themselves must adapt to the increased risk faced by climate change issues, and several states, including California, New York and Washington, require insurance companies to disclose their own climate change–related risks.

An Uncertain Future
The increased regulatory activity and private litigation activity surrounding the climate change issue suggests future increased liabilities. While the treatment of liability for climate change–related issues by the courts and governmental entities is in an early stage of evolution, the liability and regulatory machinery are grinding forward. Ensuring that corporate indemnities and insurance are in place to respond is an important step.

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