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CLIMATE-CHANGE-RELATED D&O LIABILITY – THE COMING FLOOD?

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As the number of climate-change-related lawsuits against public companies grows, and climate-change issues become the subject of increasing state, federal, and international regulatory efforts, the risk that directors and officers ("D&Os") of those companies will become the targets of governmental and private lawsuits based on their companies' climate-change-related disclosures is becoming all the more likely. Perhaps the clearest indication of the potential future landscape of climate-change-related D&O liability is the SEC's issuance, for the first time this year, of climate-change-related financial disclosure guidelines.

The Rise of Climate-Change-Related Lawsuits

The number of climate-change-related lawsuits has risen in the last three years.

The landmark case against a governmental entity is *Massachusetts. v. Environmental Protection Agency*, 549 U.S. 497 (2007). In the *Massachusetts* case, several states and private organizations challenged the EPA's denial of the plaintiffs' petition for the EPA to regulate emissions from new cars because of the EPA's alleged duty to promulgate emission standards for "any air pollutant" under the Clean Air Act. The EPA had denied the plaintiffs' petition based on the conclusion that the Clean Air Act did not give the EPA the power to issue mandatory regulations to address climate change and that in any event it would have chosen not to do so. In rejecting the EPA's position, the Supreme Court made its first ruling on climate-change issues and held that greenhouse gas emissions from cars (including carbon dioxide) constituted an air pollutant under the terms of the Clean Air Act and that the EPA had failed to support its refusal to decide whether the emissions contributed to climate change and endangered public health and welfare. In addition, the Court found that state-entity plaintiffs had standing to bring the lawsuit insofar as they were able to demonstrate injury, causation, and the existence of a remedy. In December 2009, in response to the Supreme Court's ruling, the EPA issued a finding that greenhouse gas emissions "in the atmosphere threaten the public health and welfare of current and future generations."[1]

A number of climate-change-related lawsuits against corporations also are at various stages in the judicial system. The lawsuits, brought by private and state litigants, generally assert a variety of tort-based theories alleging that the defendant companies' emissions have caused or contributed to climate change with resulting environmental damage. *See, e.g., Connecticut v. American Electric Power Co.*, 582 F.3d 309 (2d Cir. 2009); *Comer v. Murphy Oil USA*, 585 F.3d 855 (5th Cir. 2009). A frequently asserted defense in these lawsuits is that they present a "nonjusticiable political question" based on the notion that "the allocation of fault—and cost—of global warming is a matter appropriately left for determination by the executive or legislative branch in the first instance." *Native Village of Kivalina v. Exxon-Mobil Corp.*, 663 F. Supp. 2d 863 (N.D.Cal. 2009). *See also People of State of California v. General Motors Corp.*, 2007 WL 2726871 (N.D. Cal. 2007) (holding climate-change-related suit as nonjusticiable political question). In addition, defendants in these suits typically challenge the plaintiffs' standing based on causation—asserting that plaintiffs cannot meet the necessary standard of proof to prove the nexus between the alleged emissions and the alleged injuries. *Id.*

The decision of the United States Supreme Court in *Massachusetts* and the subsequent EPA finding regarding the link between greenhouse gas emissions and climate change have set the stage for increased regulation and climate change- related lawsuits, not least because they represent the first Supreme Court and federal agency findings on climate-change-related issues, and are being used as the support for climate-change-related lawsuits against companies. Moreover, although corporate defendants continue to assert "nonjusticiable political question" and "standing" defenses, those defenses may have been significantly undermined both

[1] *See* http://www.epa.gov/climatechange/endangerment.html.

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by the Supreme Court's *Massachusetts* decision and by the rejection of those defenses in a number of lower courts.[2]

D&O Liability for Climate-Change-Related Corporate Disclosures

The first wave of lawsuits, essentially based on tort theories, will likely be only the start. Increased regulatory activity often leads to increasing liability. Because of the likelihood of increased regulation on climate-change issues, the growing number of lawsuits alleging corporate liability for climate-change-related damages, and the possibility that those regulations and lawsuits will have a significant effect on a corporation's financial status, corporations and their management and directors are facing more risks in connection with climate-change-related financial disclosures and the potential for shareholder and derivative suits based on alleged climate-change-related financial nondisclosures.

A variety of SEC regulations potentially require disclosure of a corporation's climate-change-related issues. In a sign that the SEC has recognized that climate-change-related regulations and liabilities may increasingly trigger corporate reporting requirements under these and other SEC rules and regulations, on February 8, 2010, the SEC issued guidance to public companies regarding the SEC's "existing disclosure requirements as they apply to climate change matters."[3] In its guidance, the SEC identified a variety of climate-change-related issues that might trigger corporate disclosure requirements under its rules and regulations, including:

- Enacted or proposed state, federal, or international legislation that may have a material effect on a public company.[4]
- 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.[5]
- 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.[6]

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.

D&O Insurance—Protection Against the Flood?

Lawsuits against D&Os alleging damages arising out of climate-change-related issues are likely to trigger the coverage provided by D&O insurance policies for claims alleging "losses" as a result of D&Os' "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" containedin many D&O policies would eliminate coverage for such lawsuits.

Such a pollution exclusion typically purports to exclude claims "based on, arising out of, or in any way involving 'pollution.'" Insurance companies have already indicated that they will take the position that climate-change-related D&O claims are not covered under D&O policies based on the "pollution exclusion" and the Supreme Court's *Massachusetts* decision finding carbon dioxide and other greenhouse gas emissions to be a "pollutant" under the Clean Air Act.

It is far from clear, however, whether the courts will agree with such a position. Even though the Supreme Court classified carbon dioxide as a "pollutant" for the purposes of EPA regulation under the Clean Air Act in the *Massachusetts* decision, no certainty exists that the same classification would be adopted in the context of "pollution," as that term has traditionally been interpreted in a D&O liability policy. Moreover, a lawsuit against D&Os asserting, for example, damages as a result of the alleged nondisclosure of climate-related liabilities or issues, asserts liability based on the nondisclosure, not liability for a "pollution"-related activity. In an analogous case, at least one court in recent years has agreed. 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 D&Os based on the D&Os' allegedly misleading financial statements with respect to asbestos environmental liabilities. Companies may also find that with the rise of climate-change-related D&O litigation, however, 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" or claims against D&Os for which the D&Os are not being indemnified by their corporate employer.[7]

Accordingly, although standard D&O liability insurance may ultimately provide insurance for climate-change related lawsuits against D&Os, those lawsuits are likely to spawn parallel disputes between policyholders and insurance companies regarding the coverage provided for such suits under standard D&O policies.

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[2] See, e.g., Connecticut v. American Electric Power Co., 582 F.3d 309; Comer v. Murphy Oil USA, 585 F.3d 855.

[3] Commission Guidance Regarding Disclosure Related to Climate Change, http://www.sec.gov/rules/interp/2010/33-9106.pdf, at 1.

[4] *Id*. at 22-23.

[5] *Id*. at 26-27.

[6] *Id*. at 27.

[7] *See* "Global Warming—Are D&Os in the Hot Seat?," *Directors & Officers—The ACE Report* No. 66, Nov. 2007, *available at*: http://www.acebermuda.com/AceBermudaRoot/AceBermuda/Media+Centre/D+and+O+Newsletter/Global+Warming++Are+DampOs+In+The+Hot+Seat.htm.

Building Levees Against the Uncertain Future

The increased regulatory activity and private litigation activity surrounding the climate-change issue suggests future increased liabilities. Whether D&Os will face significant climate-change-related lawsuits in the future is an open question. Ensuring that corporate indemnities and insurance respond is one important task. While the treatment of liability for climate-change-related issues by the courts and governmental entities is in an early stage of evolution, however, the liability and regulatory machinery is grinding forward.

About Anderson Kill & Olick, P.C.

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