Climate Change and its Impact on the Insurance Industry

by John G. Nevius and Robert M. Horkovich

It may be hard for people who experienced a polar vortex to believe, but 2014 was the hottest year ever globally. This global warming has consequences. The U.S. Supreme Court recognized in 2007 that there is a relationship between global warming and severe weather events. And severe weather always has been a driver of property and casualty claims. It is no surprise that the insurance industry has been considering the impact of climate change for years.

For example, Munich Re has done studies estimating that domestic weather-related losses have increased fourfold since 1980 and that extreme weather events led to more than $500 billion in covered losses between 1980 and 2011.

The incidence of hurricanes, superstorms, and mega-tornados will increase as temperatures rise. Flooding incidents will become more frequent as sea levels rise as a result of climate change. In addition to hurricanes, superstorms like Sandy, and mega-tornados, scientists predict 50% more lightning strikes will occur domestically over the next century based upon increases in precipitation and temperature. Additional risks include habitat loss, famine, and an increase in diseases such as malaria because of wetter weather conditions spawning mosquitoes.

An increase in weather related claims may put financial stress on some sectors of the insurance industry. In 2010, the National Association of Insurance Commissioners (NAIC) adopted a simple eight-question disclosure survey assessing the risk of potential-insurance-company insolvency resulting from climate change and related global warming.

At least 18 states administer the survey and California requires all companies writing more than $100 million in direct premiums to respond. The survey is designed to assess company strategy and preparedness with respect to climate change in terms of investment, mitigation, emissions/carbon footprint and engaging consumers.

In 2010, the Securities and Exchange Commission (SEC) adopted voluntary disclosure guidelines for all publicly funded businesses related to the potential business impacts of climate change. On a related note, because of a likely increase in shareholder lawsuits, a major insurance broker has stated that "best practices" call for "enhancing" existing D&O insurance to expressly include coverage for potential "environmental mismanagement claims."

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In the meantime, many insurance companies have been retreating from near-shore risks. On the property side, insurance companies are urging renewed risk-management focus on prudent land-use, stronger building codes and better planning. On the liability side, minimizing all sorts of potential harm to the environment is seen as a key factor in maintaining a responsible—and lower—profile as a means to avoid potential lawsuits.

To date, most such suits are against high-profile energy and manufacturing industry companies and focus on the scope of historic emissions alleging a greenhouse effect causing global warming. While the spate of recent climate-related suits has not met with success to date, defense costs and potential future liability risks should not be discounted. From a coverage standpoint, rules are determined state-by-state depending on whether and how the malleable term "occurrence" or pollution-exclusion language potentially apply to long-term alleged historic emissions.

A Zurich subsidiary recently sought to avoid any defense obligation with respect to such suits in Virginia. In that case, Steadfast Insurance Company successfully argued before the Virginia Supreme Court against the idea that long-term air emissions constituted an "occurrence," but left any pollution-exclusion and so-called known-loss defenses (that lack any basis in policy language) to be decided on another day. The underlying lawsuit was brought by Alaska natives seeking relocation costs. A central issue was a higher sea-level eliminating a village, but the requested relief also centered around heightened storm exposure as a result of diminished distribution of sea ice which acted as a buffer for the village. The underlying lawsuit was dismissed. This duty-to-defend declaratory-judgment case likely was brought by Steadfast in Virginia because the courts there previously applied the pollution exclusion favorably to the insurance industry.

In May 2014, a Farmers Insurance subsidiary filed lawsuits against various Chicago communities for failure to properly prepare for heavy rains and flooding which allegedly could have been anticipated because of global warming. Two weeks later, these suits were withdrawn, apparently having had the desired effect.

Future litigation by communities facing extinction, shareholder lawsuits challenging corporate officers and directors for their emission management practices, and coverage lawsuits seeking the defense benefit provided by policies to protect companies from both, are inevitable.

As a result, the insurance industry will continue to circle the wagons. The specter of climate change continues to raise fears, cause a retreat from markets, and prompt the attempted inclusion of policy form restrictions. Exactly how and when these changes will cause further losses or lawsuits remains unclear, as does the potential impact on premiums or coverage availability. Whether the insurance industry will be permitted to evade its obligation to defend its policyholders from underlying climate change litigation will be played out on a state-by-state basis in future court rulings. ■

John G. Nevius *is a shareholder in the New York office of Anderson Kill and chairs the firm's environmental law group. He is also a registered professional engineer and adjunct professor of law at Pace University Law School where he teaches a class on climate change and insurance.*

Robert M. Horkovich *is managing partner and shareholder in the New York office of Anderson Kill. He is a trial lawyer who has obtained more than $5 billion in settlements and judgments for policyholders from insurance companies.*