The Metropolitan Corporate Counsel®

www.metrocorpcounsel.com

Volume 20, No. 4 April 2012

Avoiding Emerging Climate Change Pitfalls: What Directors And Officers Need To Consider

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Corporate officers and directors face an array of risks arising from climate change. The most salient at this point would appear to involve disclosure obligations and flooding associated with rising sea levels – including liability associated with such flooding. Coastal flooding reportedly is on the rise and is likely to impact directly the approximately 3.7 million Americans who live within a few feet of high tide, as well as all sorts of related business activities. Other risks that have not yet matured may loom large in the future. The predicted shift to alternative energy and away from petroleum, while likely to bring dramatic change at some point, has not as yet given rise to a clear slate of potential losses. In addition, the handful of nuisance claims related to industrial emissions have so far failed to gain real traction, but that could change.

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All of these exposures include liability risks that may prove very expensive to defend. Managing these risks therefore entails ensuring that the broad duty to defend, a staple of virtually all liability insurance policies, is not compromised by creative new interpretations of policy exclusions. Below, we consider some key climate change cases, including those in which the duty to defend has been at issue, and how those decisions may affect the duty to defend in climate-related litigation going forward.

The Duty To Defend In Global Warming Nuisance Suits

The door was opened to lawsuits holding companies responsible for greenhouse gas emissions when, in June 2007, the Supreme Court held that more severe weather engendered by global climate change could give rise to redressable injury. *See Massachusetts v. E.P.A.*, *549 U.S. 497 (2007)*. As mentioned above, a handful of cases have come along since, in which damages from various large industrial defendants for alleged injury and nuisance arising out of greenhouse gas emissions over time were sought. These cases have fared poorly because the door was closed somewhat by a subsequent Supreme Court decision last summer. Essentially, the Supreme Court has held that the EPA has occupied the field when it comes to nuisance from emissions. Nonetheless, the duty to defend emerged as a central issue associated with such nuisance claims. While there are numerous stumbling blocks to establishing a viable climate change claim of any kind, including causation, standing, the "political question doctrine" (under which phenomena referred to as "climate change" and "global warming" are considered unjusticiable) and the ephemeral and intermittent nature of historic air emissions, even frivolous claims must be defended.

One of the early nuisance claims alleging harm from global warming has spawned a bellwether dispute over the duty to defend that appears to be the first of its kind involving climate change-related lawsuits. In *AES Corp. v. Steadfast Ins. Co., 282 Va. 252 (Sep. 16, 2011 No. 100764)*, a Zurich subsidiary argued that no possibility of coverage existed for underlying climate change-related nuisance claims brought by a native Alaskan village against an array of energy companies.

Three coverage defenses were asserted initially, and summary judgment subsequently was obtained on one of the defenses. First, Steadfast argued that there was no occurrence, in part because intentional emissions allegedly could not give rise to a covered claim (i.e., erroneously arguing that the relevant inquiry was the conduct itself, rather than the resulting harm). Second, Steadfast cited a somewhat non-traditional pollution exclusion (the insurance policy at issue expressly provided limited spill coverage) despite that fact that other state courts have refused to hold that carbon dioxide (a component of air and a product

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of human respiration) is an excluded "pollutant." *See, e.g., Peace v. Northwestern Nat'l Ins. Co.,* 596 N.W.2d 429, 228 Wis.2d 106 (Wis. 1999). Third, Steadfast argued that the alleged damages were somehow excluded as a "known loss" or "loss in progress" based upon a judicially implied limitation on coverage previously invoked by some courts in reforming policy language to support coverage denial. After initially upholding the trial court's determination on summary judgment that there was no occurrence, a different slate of Supreme Court of Virginia judges recently agreed to reconsider the earlier holding.

The Duty To Defend Alleged Disclosure Failures

Another form of liability exposure is likely to emerge out of requirements that companies disclose an array of climate change-related risks. The SEC recently issued a set of advisory climate change-related financial disclosure guidelines for public companies. This guidance, 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; and
- 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.

These guidelines have upped the ante on appropriate disclosure. Suits based upon a company's climate change-related disclosures can now be brought citing government requirements. The seeds of future governmental actions and/or shareholder suits against corporations or their directors and officers in relation to climate change-related disclosure appear to have been sown.

In virtually all liability insurance, the duty to defend is broadly available. Accordingly, climate change-related claims against directors and officers likely will trigger the defense-coverage provisions of D&O insurance policies. The broad D&O duty-to-defend standard applies where "losses" as a result of a director's or officer's "wrongful acts" are alleged. Insurance companies, however, may take the position that so-called pollution exclusions contained in many D&O policies operate to defeat the broad duty-to-defend coverage for underlying claims involving climate change and greenhouse-gas emissions. These pollution exclusions purport to exclude claims "based on, arising out of, or in any way involving . . . pollution." Are these exclusions broad enough to eviscerate defense provisions? Can carbon dioxide, the product of human respiration, properly be characterized as a "pollutant" for exclusion purposes? One answer to these questions is suggested by a ruling in New York's highest court that rejected certain applications of overly broad pollution exclusion language, reasoning that it can lead to absurd results. *See Belt Painting Corp. v. TIG Ins. Co., 99 N.Y.2d 502 (N.Y. 2002).*

Whether other state courts will determine that pollution exclusions apply to D&O claims stemming from alleged climate change disclosure failures depends on the specific underlying facts. Nonetheless, in at least one analogous case, attempts by the insurance company to avoid all coverage obligations were rejected. The court in *Sealed Air Corp. v. Royal Indem. Co., 2008 WL 3539964 (N.J.Super.A.D. 2008) (No. A-5951-06T3)* held that a pollution exclusion in a D&O policy did not bar coverage for a lawsuit against directors and officers based upon allegedly misleading financial statements involving asbestos-related environmental liabilities.

In light of the potential uncertainty, however, at least one multinational brokerage firm has advised that "best practices" call for obtaining clarification on these issues from insurance companies before coverage is purchased or renewed. Moreover, it should be possible to purchase D&O coverage carving out climate change-related securities lawsuits from the potential ambit of any "pollution exclusion." Similar carve-outs may also be possible for claims against directors and officers for which their corporate employer has not agreed to indemnify them.

As Flood Waters Rise, Will A Wave Of Liability Claims Follow?

Another important arena in which disclosure obligations may become an issue is in the event of flooding. Shareholders or others may allege that a company knew or should have known that a flood was likely or substantially certain to happen.

Commercial property insurance today generally is sold on an "all-risk" basis. However, in certain flood-prone areas, insurance against flood-related losses can only be obtained from the federal government, and in limited amounts. As a result, several cases have arisen over whether sufficient supplemental flood coverage – "Difference in Conditions" coverage – was obtained. Many of these cases involve actions against brokers and agents. *See, e.g., Archer Daniels Midland Co. v. Phoenix Assurance Co.*, 975 F. Supp. 1129 (S.D. Ill. 1997). Given that recently published studies suggest, as reported in the *New York Times*, that "coastal flooding at levels that were once exceedingly rare could become an every-few-years occurrence by the middle of the century," particularly in Florida, these flood-related cases could be the wave of the future (no pun intended). With the expansion of potential flood-related losses, corporate executives may supplant agents and brokers as the focus of discontent over insufficient coverage, including difference in conditions coverage, to offset flood losses.

The increased regulatory activity and litigation surrounding climate change suggests that future liabilities will increase. It is important to ensure that these issues are taken into consideration at the highest levels in a corporation and that appropriate corporate indemnities and insurance are in place to respond. Corporate directors and officers and those who are charged with managing corporate risk need to be aware of nuisance claims, flooding and whether and how the insurance purchased will respond in the event of a loss or claim. A robust defense often is essential given the existing hurdles to a successful lawsuit. Environmental decision making is often complex, but the stakes would seem to be rising along with projected sea levels.