Ongoing Consequences, Untested Coverage

Potential Effects of Climate Change on Liability Insurance

By Dominic T. Clarke and Brian Lau

We can expect not only that familiar claims based on familiar types of losses will rise, but also that climate change will produce novel claims involving unprecedented issues.

Climate change already is and will increasingly become a major concern of the insurance industry. Extreme weather events are becoming more frequent and more severe. The aftermaths can be expected to touch more people and businesses in the future. In a speech to the World Affairs Council in 2007, Lord Peter Levene, then-chair of Lloyd's, emphasized the challenges posed by climate change to insurers by noting that between the 1960s and 1990s the number of "natural" catastrophes had doubled. During that period, insured losses increased nearly seven-fold, many of them weather related. Lord Peter Levene further remarked that 2005 was arguably the worst year to date, with total global insurance claims estimated at 83 billion dollars, of which over 80 percent arose from the hurricanes in the United States. There is no indication that this current trend will do anything other than continue in the United States and Canada. Scientists predict that as global temperatures increase, so will the number and severity of natural disasters. This article explores some anticipated effects of this growing problem on liability policies.

Climate Change and Liability Insurance

While property insurance has been at the forefront of insurers' concerns resulting from climate change, liability insurance will also very probably be affected. As the effects of climate change become increasingly apparent, insurers can anticipate a corresponding increase in the number of claims. Not only may the volume of claims based on the existing types of losses with which insurers are familiar increase, climate change can be expected to produce novel claims involving issues that have not yet been litigated.

Business interruption coverage promises to be at the center of climate change claims. Actions may be brought against businesses that are unable to meet their obligations due to disruptions in supply chains, transportation, utility services, and communications. Businesses may be sued for failing to have had appropriate contin-

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gency plans in place and for losses arising from delays in bringing operations back to normal.

Product liability claims associated with materials or products that contribute or fail adequately to respond to climate change can be anticipated. Environmental liability claims are among the more obvious claims associated with climate change. In addition, as has already occurred with respect to so-called Chinese drywall, natural disasters can lead to extraordinary demands for products that then have to be purchased from nontraditional sources. These untested products can lead to liability exposure. Claims in excess of $100 million have been made against the liability policies of builders, suppliers, and developers for the damage caused by the use of Chinese drywall.

Directors and officers insurance may also be triggered by climate change. For example, claims may be brought against corporate directors and officers of companies for alleged wrongful acts in emitting pollutants. Somewhat more esoteric claims based on failures to safeguard shareholder value from the effects of climate change may also arise.

An increase in traditional claims can be anticipated. It would be no surprise to see a rise in personal and commercial vehicle liability claims as a result of increased roadway accidents related to adverse weather. Similarly, an increase in slip and fall incidents leading to bodily injury claims should be anticipated. Municipal liability insurers can expect more claims related to negligence in zoning and planning given the likely increase in flooding and icy conditions caused by climate change. In addition to this, municipalities, engineers, and architects can anticipate increased exposure related to the design and construction of infrastructure that is exposed to extreme weather.

Ironically, one major source of more liability claims will likely be the insurance industry itself. Property insurers, which are expected to face the biggest insurance burden for the costs of climate change, will consider bringing subrogated liability claims to mitigate their exposure. While a house may have flooded due to a severe rainstorm, a subrogated claim might be brought against the homeowner's municipality for failure to maintain an adequate sewage system capable of responding to increasing severe floods. Alternatively, a subrogated claim may be brought against neighboring property owners for creating severe runoff conditions. Similarly, a structure that gives way to strong winds after sustaining many years of abuse from similar events may arguably have collapsed due to negligence in construction or design or lack of regulation.

While a number of the above scenarios may not necessarily lead to covered claims, insurers will undoubtedly be forced to expend considerable resources investigating claims and considering their coverage obligations. Uncertainties in how policies should respond will necessitate retaining coverage counsel frequently. Until these issues have been judicially clarified, insurers will be forced to bear the costs of the inevitable coverage actions for those claims that they deny. Insurers will also face underwriting challenges. The work of underwriters and actuaries assessing risks and pricing policies will become more complex in the face of unpredictable climate change.

One factor that compounds the problem facing insurers is that liability policies, as they exist today, may not be suitable to control the risks that insurers assume with respect to climate change issues. As will be discussed below, standard policy language may do little to limit the exposure of insurers to climate change risks. Exclusionary language may be difficult to draft. Underwriters may not have adequate data or the means to assess the ever-changing risks properly.

Feasibility of a Climate Change Exclusion

Although the actual cause of climate change remains under debate in some circles, its significance to the insurance industry is clear. Appropriate policy wording needs to be considered in response to increasing exposure. In addition, insurers will need to price insurance products correctly.

In response to these evolving circumstances, insurers might consider whether they can draft "climate change" exclusions. It is, however, difficult to perceive how an insurer could word an effective exclusion. Wording such as "this policy will not cover losses caused directly or indirectly by climate change" would require a definition of "climate change." That definition is problematic. Many of the recognized consequences of climate change are simply to increase the severity and the frequency of events that would take place anyway. Storms, floods, droughts, and fire all occur with or without climate change. These are events for which insurance coverage is available and are within the core expectations of policyholders. It is difficult to see how insurers can effectively exclude such events if they are caused by climate change and still have a marketable product. Would a policy state, for example, that damages resulting from up to four storms per year are covered but damage caused by the fifth storm in a year and any subsequent storms are not covered, on the rationale that historically there have only been four storms per year in a given area? Irrespective of the obvious failings of the example, it highlights the difficulties of attempting to define climate change in an insurance policy. Solving insurers' problems by inserting a climate change exclusion into an insurance policy appears largely unattainable.

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The difficulty of drafting a simple exclusion for climate change is that climate change as a cause of loss does not fit well into the traditional framework of causes

of loss that have been developed by insurance jurisprudence. As climate change is expected to increase the frequency and severity of extreme weather events, arguably it would be a concurrent or indirect cause of all of the losses that are remotely related to the weather. Depending on the jurisdiction and the case law on direct, indirect, and concurrent causes, a simple climate change exclusion would likely prove insufficient to address the risks, and a court may well find that it does not apply in any event. Such an exclusion could be viewed as overly broad, taking away much of the coverage that an insured had originally sought to insure against. On the other hand, the effect of climate change on an individual loss may be of such little significance that a court may not find that it even reaches the threshold of an indirect or a concurrent cause.

Whether insurers will be able to charge significantly increased premiums to account for the anticipated rise in climate change-related events remains uncertain.

Given the anticipated difficulties associated with drafting an effective climate change exclusion, we next will consider how courts have held current policies to respond to events that are arguably caused by climate change.

Climate Change Issues and Current CGL Policy Wording

Climate change litigation is still in its infancy. Although lawsuits have been initiated, none concerning commercial general liability (CGL) policies have yet been successfully litigated.

We discussed above the possibility that insurers and insureds would assert novel climate change-related claims. One such claim was put forward in *Illinois Farmers Insurance Co. v. Metro Water Reclamation District of Greater Chicago*, Case No. 14CH06608, in the Circuit Court of Cook County, Illinois. In that case, the plaintiff was an insurer that indemnified property owners who had incurred losses as a result of an April 2013 rainstorm. In an attempt to recoup some of its payments, the insurer sued local governments. The insurer argued that the defendants had acknowledged that climate change existed and that increased the intensity, duration, and frequency of rainfall. However, the local governments had failed to take the necessary steps to mitigate the problem. Sewer water had been flushed out of the system in preparation for the storm, but this proved inadequate.

Shortly after initiating the action, the plaintiff voluntarily dismissed its lawsuit. Nevertheless, we might still hypothesize how liability insurance would respond to such a claim. Would an insurer have a duty to defend a local government? An insurer could plausibly argue that it would not. Given the general knowledge and acceptance that extreme weather events are on the rise, it leaves an insured vulnerable to being denied coverage on the basis that the losses alleged, such as building damage due to a failure to update a building code to account for climate change, were the natural and probable consequence of the insured's inaction, not an "occurrence" or accident. A similar finding to that in *Illinois Farmers* was made by the Virginia Supreme Court in *The AES Corporation v. Steadfast Insurance Company*, 725 S.E.2d 532 (Va. 2012), which will be discussed in more detail below.

The possibility that a claim may not satisfy the "occurrence" requirement is not confined to circumstances involving losses after climate change-related events. In the case of *Cinergy Corp. v. St. Paul Surplus Lines Ins. Co.*, 915 N.E.2d 524 (Ind. App. 2009), the government filed suit against Cinergy, the insured, requiring it to install government-mandated equipment to reduce future emissions to prevent future environmental harm. Cinergy tendered the claim to its insurer, which, in turn, commenced declaratory proceedings for a determination of coverage. Ultimately, the Indiana Court of Appeals held that the remedy sought by the government was not caused by an "occurrence" but rather, it was intended to prevent such an "occurrence." Accordingly, the insurer did not owe a duty to defend.

Another issue that we have already alluded to is that claims in the construction industry would increase when buildings fail to endure in the face of severe storms, hurricanes, flooding, and other weather events. It may be that such buildings complied with the building codes in force at the time of construction. However, these codes may prove inadequate when taking into account the effects of climate change. Commercial general liability policies typically respond to such claims provided that damage to property occurred on property other than the property that the insured was working on. In many jurisdictions, the "your work" and "your product" exclusions would operate to exclude from coverage the cost of redoing the particular contractor's work. However, the "occurrence" issue discussed above may preclude coverage entirely. If a contractor was aware of the existence and effects of climate change, arguably the damage to a building would be a natural and probable consequence of the contractor's actions or inactions. Accordingly, it would be excluded under the policy. Conversely, if a contractor complied with the building codes, arguably the contractor should not be found to be at fault if the contractor met the standard of care of the day. Insurers should consider whether an action should be commenced against regulators, similar to the situation in *Illinois Farmer*. Given the nascent stage of climate change litigation, the above questions are presently largely academic. It seems doubtful, on the other hand, that this state of affairs will continue.

Implications for the Insurance Industry

What is not academic at this point is how insurers can control their exposure to climate change. One way to control risk is to increase premiums. The problem with this approach is that rates are generally set according to historical data such as historical weather patterns. These sources are likely to be inaccurate if an insurer attempts to set rates that account

for unpredictable future climate change. To this end, new models are needed. In addition to this actuarial uncertainty, whether insurers will be able to charge significantly increased premiums to account for the anticipated rise in climate change-related events remains uncertain. While increased premiums may address the costs of climate change coverage, consumers may become increasingly reluctant about having to bear the costs of what may be viewed as a problem for which they arguably have little responsibility or over which they have little control. As will be discussed below, a significant proportion of carbon emissions can be attributed to a limited number of emitters.

Another method of controlling risk is to work proactively with or to lobby the appropriate governments to update building codes or to achieve land-use planning policy to mitigate the effects of climate change. Relatedly, lower premiums could be offered in such jurisdictions to indirectly encourage government policy.

These issues will undoubtedly be addressed as the current business models of most insurers are challenged by the consequences of climate change. Interesting times lie ahead.

Claims Against Carbon Emitters

Along with the anticipated first-party claims, insurers should also expect litigation to grow against those thought to have caused the problem, such as emitters of environment-damaging greenhouse gases. Regardless of the specific cause of climate change, it is suspected to have led to economic losses of $700 billion (USD) in 2010. Fundacion DARA Internacional, *Climate Vulnerability Monitor: A Guide to the Cold Calculus of a Hot Planet* (2nd ed. 2012, Madrid, Spain). These numbers are anticipated to rise further. It can be anticipated that it will not be long before governments, corporations, and individuals stop trying to bear these costs themselves and look to the carbon emitters for compensation.

To date, it does not appear that a case seeking damages against a carbon emitter has been argued on its merits in the United States. One clear challenge to such litigation is proving causation. Given the diffuse nature of environmental carbon dioxide, it is difficult to link any one emission source to localized climate change effects. That said, developments in climate science and increased damages from extreme weather events are likely to spur change. Courts may import existing legal approaches from environmental, product liability, and other mass tort litigation, such as Canadian tobacco litigation, to facilitate claims against carbon emitters.

We can also anticipate more climate change litigation originating in other jurisdictions brought against carbon emitters located in Canada and the United States. In particular, certain countries such as Vietnam, Ghana, and India are considered "low emitters" and receive relatively few benefits from fossil fuels. However, they claim to suffer significant harm caused by climate change. Andrew Gage & Michael Byers, *Payback Time? What the Internationalization of Climate Litigation Could Mean for Canadian Oil and Gas Companies*, Canadian Centre for Policy Alternatives, October 2014. Courts in such countries may seek to find liability against foreign carbon emitters. Depending on where and how a judgment is obtained in a foreign jurisdiction, it could be enforced in counties such as Canada and the United States where a defendant company has assets.

The first significant U.S. decision addressing this topic from an insurance standpoint is *The AES Corporation v. Steadfast Insurance Company*, 725 S.E.2d 532 (Va. 2012). At issue was whether Steadfast Insurance Company (Steadfast) owed a duty to defend its insured, the AES Corporation (AES), against a complaint brought by Kivalina, a native community located on an Alaskan barrier island. Kivalina alleged that AES's activities intentionally emitted greenhouse gases and contributed to "global warming." Kivalina claimed that this climate change in turn caused environmental damages and rendered the community uninhabitable. Steadfast brought an action for declaratory judgment that it owed no duty to defend. The circuit court ruled that the complaint did not allege an "occurrence" under the policy, and therefore, Steadfast had no duty to defend. AES appealed.

On appeal, the Supreme Court of Virginia affirmed the judgment of the circuit court. The court found that the complaint alleged that AES's acts were intentional and that the natural consequences of the emissions were global warming and damages such as those which Kivalina suffered. Kivalina also alleged negligence in that AES "knew or should have known" that its actions would cause injury. However, the court found that when an insured knew or should have known that certain results were the natural or probable consequences of intentional acts, there was no "accident or occurrence" within the meaning of the CGL policy. Steadfast had no duty to defend AES against the complaint.

Of course, the *Steadfast* decision turned on pleading issue. Going forward, climate change cases may well plead theories of negligence, which, subject to precise policy wording and the applicable jurisdiction's interpretation, might be expected to attract coverage. That said, at least in Canada, insurers are entitled to look to the true nature of the claim being advanced. If an emitter's acts are truly intentional, the "no occurrence" submission may still be accepted by a court in Canada.

Irrespective of the "no occurrence" or intentional act issues, further coverage issues that can be expected to arise include whether naturally occurring greenhouse gases such as carbon dioxide qualify as "pollutants" under the various different pollution exclusions. A further question to be determined will be whether a corporation's reasonable expectations preclude application of a pollution exclusion to claims arising from that entity's normal business operations that involve burning fossil fuels. The answers to these questions will likely differ from one jurisdiction to another.

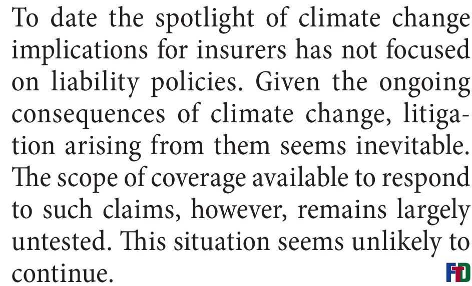
To date, climate damage litigation has largely been limited to the United States. However, parallel litigation, and ensuing coverage issues, are also likely to arise in Canada. In October 2014, the Canadian Centre for Policy Alternatives (CCPA) released a lengthy paper entitled "*Payback Time? What the Internationalization of Climate Litigation Could Mean for Canadian Oil and Gas Companies*" which touched on the internationalization of climate change-related litigation and its possible effect on Canadian oil and gas companies. At least five oil and

gas companies trading on the Toronto Stock Exchange are included in the list of the top 90 entities responsible for extracting most of the fossil fuels that have been burned over the past 150 years. It is estimated that emissions from burning the fuel produced by these so-called "carbon majors" total nearly two-thirds of all carbon that has been emitted into the atmosphere during the industrial era. Fundacion DARA, *supra*. The Canadian companies, including Encana, Suncor, Canadian Natural Resources (CNR), Talisman, and Husky would appear to be at risk of litigation both at home and abroad. So too is Alberta's oil sands, a particularly divisive energy project. Such litigation is likely to affect stock values, thereby raising the possibility of shareholder claims triggering directors and officers policies.

Insurers are likely to face similar challenges in Canada as in the United States. However, historically, pollution exclusions have been interpreted very narrowly in Canada. That said, certain case law indicates that the exclusions are generally understood to bar coverage for damages arising from environmental pollution: *Zurich Insurance Co. v. 686234 Ontario Ltd.*, (2002) 62 OR (3d) 447 (Ont. C.A.). Coverage is more likely to be denied if the pollution results from the normal business activities of the insured: *Palliser Regional (School) Division #26 v. Aviva Scottish & York Insurance Co. Limited*, 2004 ABQB 781. Presently, it remains unclear how courts in Canada will respond when faced with a claim seeking a duty to defend in a climate damages case.

Developments in climate science and increased damages from extreme weather events are likely to spur change.

Conclusion



To date the spotlight of climate change implications for insurers has not focused on liability policies. Given the ongoing consequences of climate change, litigation arising from them seems inevitable. The scope of coverage available to respond to such claims, however, remains largely untested. This situation seems unlikely to continue.