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Climate Change Liability Moves Forward: Does Your Insurance Cover Your Risk?

If your company faces risk of exposure to climate change liabilities, you need to be aware that there were two significant decisions that favor plaintiffs seeking to hold companies liable in court for damages allegedly caused by greenhouse gas (GHG) emissions. There are also recent regulatory developments advancing these issues. This alert addresses these new developments and how companies should assess their insurance to mitigate litigation expenses and potential liability.

For more information, contact:

Meghan Magruder

(404) 572-2615
mmagruder@kslaw.com

Anthony P. Tatum

(404) 572-3519
ttatum@kslaw.com

Robert D. Stonebraker

(404) 572-3536
rstonebraker@kalw.com

**King & Spalding
Atlanta**

1180 Peachtree Street, NE
Atlanta, GA 30309
Tel: (404) 572-4600
Fax: (404) 572-5100

www.kslaw.com

- **Summary:** Climate change liability exposure is advancing and insurance coverage with respect to this potential exposure has not been tested. A company can increase the probability that its CGL, D&O and/or Pollution Legal Liability insurance covers costs associated with these claims by ensuring the broadest possible coverage terms in these policies. Given the complex coverage issues, companies should work closely with their risk manager, broker, and experienced outside coverage counsel to (1) assess the company's operations for potential climate change exposures; (2) determine which of the company's insurance policies may provide coverage for those liabilities and any "gaps" in coverage; (3) assess any threatened or actual claims to make sure all potentially responsible carriers are timely notified; and (4) to review any new exclusions and limitations targeted at eliminating coverage for climate change in ongoing insurance renewals.
- **Appellate Victories By Climate Change Plaintiffs:** The first wave of climate change suits was dismissed at the trial-court level on grounds that the plaintiffs lack standing to sue (because they do not allege an injury that is sufficiently traceable to alleged conduct of the defendants) and on grounds that their claims present a non-justiciable "political question." But, in September and October 2009, the Second and Fifth Circuit Courts of Appeals reversed trial courts'



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dismissals of two leading-edge climate change lawsuits, holding that those plaintiffs did have standing and the “political question” doctrine did not apply.

The first of these reversals came in *Connecticut v. American Electric Power Co., Inc.*, No. 05-5104-cv (2d Cir. 2009), *appeal of* 406 F.Supp.2d 265 (S.D.N.Y. 2005). In this case, several states and environmental groups sued a set of public utilities, citing a “clear scientific consensus” and alleging that the utilities’ emissions contribute to the public nuisance of global warming. Reversing the trial court, the Second Circuit held that the political question doctrine does not apply, that all of the plaintiffs have standing to sue, that plaintiffs have stated claims under the federal common law of nuisance, and that federal law does not displace their claims.

The second reversal was in *Comer v. Murphy Oil USA, Inc.*, No. 07-60756 (5th Cir. 2009), *appeal of* No. 05-CV-436LG (S.D. Miss. Aug. 30, 2007). This case is a class action lawsuit against energy and chemical companies filed in the wake of Hurricane Katrina, alleging “demonstrable changes” in the earth’s climate caused by the defendants’ GHG emissions, including the extreme intensity of Hurricane Katrina. The Fifth Circuit reversed the trial court’s dismissal, finding that plaintiffs’ common law claims are justiciable and finding that plaintiffs claimed an injury that was sufficiently traceable to alleged conduct of the defendants to provide standing.

- **Regulatory Developments:** The Obama administration continues to prepare the way for regulation of GHGs. In December 2009, the EPA made an “endangerment finding” under the Clean Air Act that GHG emissions, including carbon dioxide, endanger public health and welfare. Further, under the EPA “Final Mandatory Reporting of Greenhouse Gases Rule,” which was issued in September 2009 and took effect on January 1, 2010, suppliers of fossil fuels or industrial greenhouse gases, manufacturers of vehicles and engines, and facilities that emit 25,000 metric tons or more per year of greenhouse gas emissions must submit annual reports of their emissions to the EPA.

On January 27, 2010, the SEC provided guidance that a company should consider, and disclose when material, (1) the impact of existing and pending laws and regulations regarding climate change, (2) the risks or effects on its business of international accords and treaties relating to climate change, (3) the actual or potential indirect consequences it may face due to climate change related regulatory or business trends, and (4) the actual and potential physical impacts of climate change on their business.

Insurance regulators also have taken note of the climate change risks insurers face. On March 17, 2009, the National Association of Insurance Commissioners (NAIC) adopted a mandatory requirement that insurance companies annually disclose the financial risks they face from climate change, as well as actions the companies are taking to respond to those risks. The insurers are to report on how they are altering their risk-management and catastrophe-risk modeling in light of the challenges posed by climate change, report on steps they are taking to engage and educate policymakers and policyholders on the risks of climate change, and report on whether and how they are changing their investment strategies.



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- Insurance Coverage For Climate Change Risks: With the appellate rulings in *American Electric Power Co., Inc.* and *Comer*, climate change litigation is showing potential new promise to plaintiffs targeting the energy, automotive, and other industries for billions of dollars in alleged damages and injunctive relief based on public nuisance and other common law theories. Any company that generates carbon dioxide, methane, nitrous oxide or other GHGs in its operations, or sells products that do so, is a potential target defendant. The scope of insurance coverage available to cover climate change liabilities is already a hotly debated issue. In the first climate change coverage case, *Steadfast Ins. Co. v. The AES Corp.*, No. 2008-858 (Cir. Ct. Arlington Cty, Va. filed July 9, 2008), which concerns coverage for the defendants in the *Kivalina* suit, the court is currently considering insurer Steadfast's motion for summary judgment. These issues are likely to be litigated in various venues throughout the country.

The allegations in a particular climate change lawsuit may trigger multiple insurance coverages, some of which may not be noted herein. Three of the most likely coverages that companies will rely upon to protect against climate change litigation expenses and potential liabilities are: General Liability (CGL), Director's and Officer's, and Pollution Liability Coverage.

The CGL policy addresses third-party liability coverage for defense costs and liabilities from climate change suits alleging bodily injury or property damage. Companies should expect insurers to vigorously assert all possible policy defenses and exclusions to avoid defense and indemnity obligations. Companies facing alleged climate change liability will need to review historical policy records as the alleged harm from greenhouse gas emissions typically occurred over many decades. It is expected that such issues as whether the greenhouse gas emissions constitute one or many separate "occurrences," which can have a profound impact on the number of deductibles the insured must pay and the available limits of insurance will need to be addressed.

D&O insurance should also be carefully reviewed. SEC regulations require companies to disclose material effects of environmental laws on capital expenditures, earnings, and competitive position, as well as any known trends or uncertainties that are reasonably likely to result in the company's liquidity increasing or decreasing in any material way. If climate change liability risks are misstated in documents provided to the SEC and public domain, there is potential liability from a securities class action lawsuit. Directors and officers also may face shareholder derivative claims for alleged mismanagement based on their failure to take action with respect to these issues. Companies should give particular scrutiny to the scope of the D&O pollution exclusion, the exclusion for regulatory actions, the provisions providing for rescission of the policy in the event of misrepresentations in the application for insurance, and the provisions providing coverage for securities liability.

Finally, to ensure climate change liability does not fall through the cracks in traditional CGL and D&O policies, some companies augment their coverage with separate pollution liability policies. Such policies typically pay all sums the company is legally obligated to pay as a result of emission, discharge, release, or escape of any contaminants, irritants, or pollutants into or on land, the atmosphere, or any water course or



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body of water, provided this results in “environmental damage,” as well as reasonable and necessary cleanup costs and the defense of any claim or suit that is the subject of the insurance. “Environmental damage” is typically defined in the policy as “the injurious presence in or on land, the atmosphere, or any water course or body of water of solid, liquid, gaseous, or thermal contaminants, irritants, or pollutants.” As with the CGL pollution exclusion, the application of the term “pollutant” to greenhouse gas emissions will likely be a key threshold issue under the pollution legal liability policies.

- In sum, insurance may exist to provide coverage for climate change liabilities and it is prudent for risk managers and counsel to assess these issues now in light of the recent successes by plaintiffs in climate change litigation.

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