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No, Virginia, There Is No Greenhouse Gas Clause

Law360, New York (December 12, 2011, 12:08 PM ET) -- Apocalyptic reports seemingly abound: worldwide catastrophic losses in 2011 — from earthquakes, tsunami, floods, tornadoes and storms — are the highest on record.

In the first half of 2011, there was more than $17 billion of insured losses in the U.S. alone from more than 100 catastrophic events. The October snowstorm in the Northeast might have been the eleventh billion-dollar loss this year. And the recent flooding in Thailand produced insured losses in excess of $13 billion.

Environmentalists speculate that global warming and the emission of so-called greenhouse gases are significant contributing factors to these losses. Plaintiffs' lawyers increasingly are focused on pursuing legal theories that seek to make private industry legally responsible for the consequences of global warming.

The new global-warming claims follow a long history of air pollution liability suits.

From the 1948 "death cloud" of smog enveloping Donora, Pa., to "public nuisance" cases launched against, in particular, energy and chemical companies over the past few years — and the U.S. Environmental Protection Agency's announcement that carbon dioxide was a regulated pollutant under the Clean Air Act — corporations have faced claims for compensation from private and public parties for damage and injury alleged to have resulted from effluents from smokestacks and the byproducts of other industrial activities.

Where liability goes, insurance should follow. Companies will want to look to their general liability insurance for help with the increasing docket of global-warming-based tort cases.

But as we have seen in so many other sources of loss, particularly cases involving somewhat novel exposures, the insurers are likely to "run for cover" rather than run to provide coverage to their insureds in need.

The Kivalina Claim

This is the lesson of the very disappointing decision of the Virginia Supreme Court in September this year. AES Corp. v. Steadfast Ins. Co. (Va. Sept. 16, 2011).

AES is an energy company with holdings in the generation and distribution of electricity throughout the U.S. In 2008, an Alaska native community filed suit against AES alleging essentially that AES was responsible for certain losses that were tied to global warming.

That case, the Kivalina action, did not claim that some particular fallout from an AES plant caused damage. Rather, the claim was considerably more generic and diffuse: the Kivalina plaintiffs alleged that AES's uses of fossil fuels contributed to global warming that affected the formation of sea ice near the shoreline, which in turn allowed for more severe storm surges, seashore erosion, and impairment of the habitability of their seacoast village.

The theory of liability included a civil conspiracy among the power, coal and oil companies to mislead the public about the science of global warming and in turn to delay or defer regulation while those companies reaped profits.

The Kivalina plaintiffs alleged special damages from a more general public nuisance caused by action of the power, coal and oil companies, which "knew that their individual greenhouse gas emissions were, in combination with emissions and conduct of others, contributing to global warming and causing injuries to entities such as the Plaintiffs." (Complaint, ¶ 255)

AES turned to its insurer to provide it a defense in the Kivalina action. In most jurisdictions, an insurance company has a duty to defend its insured when the allegations of a complaint permit proof of a claim, that, if established, would be covered by the policy.

The question presented to the Virginia Supreme Court was whether any of the allegations described conduct that could properly be considered to be an "occurrence" covered by the policies.

The policy used the following definition of "occurrence:" "an accident, including continuous and repeated exposure to substantially the same general harmful condition."

The question before the Virginia court is the same as has been presented in scores of prior cases over the past 75 years: Does long-term activity by an insured qualify for coverage when tort claims are made?

The Elusive "Accident"

One might think that insurance companies should decide through the underwriting process whether the insured's ordinary business conduct is insurable — and price the policy accordingly. But the Virginia court became fixated on the word "accident" in the occurrence definition.

Insurance literature often refers to something called a "classical accident." The paradigm is an automobile wreck, where the negligence and injuries occur in a confined moment in time. But whether insurance policies that cover injury "caused by accident" ineluctably are limited to classical accidents has routinely been rejected by courts over the past century.[1]

Indeed, whether general liability insurance policies should cover damage from long-term or ongoing activities was a central question that the insurance industry confronted in moving from the "caused by accident" form of liability insurance prevalent before 1966 and the "occurrence" form used ever since.[2]

The insurance industry, through their trade associations responsible for drafting the standard from policy, answered this question unequivocally with a "yes" in adopting the "occurrence" form, using the definition of "occurrence" virtually identical to the one at issue in the AES v. Steadfast Ins. case.

That occurrence policies were meant to cover long-term events producing contamination and other harms is confirmed by contemporaneous accounts in the insurance industry.

For example, one of the major insurance brokers in the 1960s, Johnson & Higgins, commented, "Perhaps the most significant change is that all policies now cover injury or damage ... from gradual happenings such as pollution of streams, emanations of effluent from stacks, disposal of waste products and so forth."

Another broker, Alexander & Alexander, contemporaneously explained, "Examples of events covered on an 'occurrence' basis ... are found in the gradual or continual (a) pollution or contamination of air, vegetation or water, and (b) vibration of land."

Even before the widespread adoption of the "occurrence" form, the "caused by accident" form policies in use before 1966 were not construed by most courts as precluding coverage for the consequences of long-term actions.

One of the architects of the 1966 form policy wrote in a 1959 article about a case called Cross v. Zurich General Accident & Liability Ins. Co., Ltd., 184 F.2d 6098 (7th Cir. 1950), where a "a 'caused by accident' provision has been held to apply where an insured deliberately undertook an operation which he knows, or an average man in his business should have known, would cause injury or damage of the type which resulted."[3]

As a result, courts had not limited coverage for the consequence of long-term conditions, with another example being the case Moffat v. Metropolitan Cas. Ins. Co., 238 F. Supp. 165 (M.D. Pa. 1964), which involved nuisance and trespass claims from a culm bank of coal dust from mining.

By the 1966 form policy's development and eschewing of the "caused by accident" form, the insurance concept of "accident" was "a blob of jelly."[4]

Novel Cases Make Novel Law

Against this long history, the Virginia Supreme Court's decision in AES v. Steadfast Ins. is all the more surprising.

In AES, the court found that the key question was "whether the resulting harm is alleged to have been a reasonably anticipated consequence of the insured's intentional act."

Thus the court said the question was whether the injuries "resulted from unforeseen consequences that a reasonable person would not have expected to result from AES's deliberate act of emitting carbon dioxide and greenhouse gases."

The insured argued that "the damage to the village resulting from global warming caused by AES's electricity-generating activities was accidental because such damage may have been unintentional."

The Virginia Supreme Court disagreed. The court ruled: "If an insured knew or should have known that certain results would follow from his acts or omissions, there is no 'occurrence' within the meaning of a comprehensive general liability policy."

The court continued: "Even if AES were actually ignorant of the effect of its actions and/or did not intend for such damages to occur, Kivalina alleges its damages were the natural and probable consequence of AES's intentional actions ... [and thus] was [not] the result of a fortuitous event or accident."

This ruling contravenes three-quarters of a century of law. Particularly given the rather diffuse nature of the allegations against AES, which arguably had no knowledge of even the existence of the Kivalina people and their seaside village in Alaska — the suit was brought in California — the best explanation for the Virginia court's ruling is some sort of fear of opening the floodgates of greenhouse-gas or global-warming litigation.

The court may have been concerned that, were coverage afforded to AES, then every global-warming case would be the subject of coverage.

The rejoinder to this, of course, is that Steadfast then should never have sold insurance to AES, rather than to have the courts engraft a sub silientio greenhouse-gas exclusion into policies.

In other words, if Steadfast did not want to cover the tort liabilities of AES from its power-generation activities, Steadfast should have said so before collecting the premiums, not years later after a claim had arisen.

What is disturbing about the AES decision was the court's ruling that there was no "occurrence." Novel or cutting-edge theories of liability — and the courts entertaining them or not — are precisely among the risks intended to be insured in commercial general liability (CGL) policies.

Indeed, when the CGL was developed in the early 1940s, insurers used to include an "unknown hazard" premium charge, which inter-insurer competition drove out of the pricing model, in order to make clear that insurers were undertaking to insure against the risk of all hazards, known and unknown.

If insurers want to exclude a hazard, they should do so expressly and allow the insured to "buy back" the exclusion for an adequate price.

One problem with the Virginia decision, then, is that it ostensibly precludes an insurer from expressly, and for a price, undertaking to insure against the risk of Kivalina-type claims, because to do so, under the logic of the AES court, would be to insure against "nonfortuitous" events, which insurance companies are not permitted to do by statute.

If a state's law is to preclude coverage for all forms of global-warming cases, then that should be a public-policy decision reached by the legislature or, perhaps, insurance regulators. That should not be a result created ex cathedra by a court engaged in common-law adjudication of the most basic terms of liability insurance, that is, the "occurrence" concept.

Viewed in this light, the AES v. Steadfast ruling is a significant usurpation of legislative prerogative and the prerogative of freedom of contract for sophisticated parties like AES and Steadfast.

If Steadfast wasn't covering unanticipated liability of AES, then what was it covering?

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[1] E.g., American Mut. Liab. Ins. Co. v. Agricola Furnace Co., 183 So. 677 (Ala. 1938); King v. Travelers Ins. Co., 192 A. 311 (Conn. 1937); Canadium Radium & Uranium Corp. v. Indemnity Ins. Co., 104 N.E. 2d 250 (Ill. 1952); Webb v. New Mexico Publ. Co., 141 P.2d 333 (N.M. 1943).

[2] See Marc S. Mayerson, Affording Coverage for 'Gradual' Property Damage Under Standard Liability Insurance Policies: A History, 8 COVERAGE 3-11 (1988).

[3] Gilbert L. Bean, The Accident Versus the Occurrence Concept, 1959 INS. L. J. 550, 555.

[4] David Mellinkoff, THE LANGUAGE OF LAW 377 (1963).