

ANNEX B

Potential implications of climate-related litigation on D&O liability policies

This annex provides an overview of various perspectives from the insurance industry, insurance experts, and legal practitioners about the risks climate-related litigation poses to directors and officers (D&O) liability insurance coverage. The first section provides a selection of statements on the increasing risk of climate litigation. The second section provides a selection of statements on the implications of climate-related litigation on D&O liability coverage.

The insurance industry is a leader in addressing the risks of climate change. An example of this is Lloyd's 2014 report, *Catastrophe Modelling & Climate Change*.¹ It "calls for the insurance industry to think about climate change and the potential impact it will have on their bottom line" and the use of tools, such as models, to "adequately measure and price risks, including the influence of climate change."² The insurance industry is tracking broad-spectrum climate-related risks including litigation.

1. Increasing litigation risk

Fossil fuel companies and utilities have been and will continue to be the target of climate-related lawsuits.³ As greenhouse gas emissions increase and associated climate impacts intensify, the number of lawsuits filed in countries around world will only increase over time. According to Anderson Kill & Olick, a U.S.-based law firm specialized in insurance coverage:

*"Corporations and their management and directors are facing more risks in connection with climate change-related financial disclosures and the potential for shareholder and derivative suits based on alleged climate change-related financial nondisclosures."*⁴

Generally speaking, directors and officers have fiduciary duties to act in the best interests of the corporation, and to do so with reasonable care and due diligence. Bailey Cavalieri, another U.S.-based law firm with experience in insurance coverage issues, explains in the context of climate change litigation:

*"If the company incurs large losses, unexpected expenses or significant penalties, shareholders may allege the directors and officers mismanaged the company by failing to properly anticipate, plan for or react to the underlying cause. In some circumstances, the directors and officers could be personally liable to the company for the resulting damage."*⁵

Liberty Insurance Underwriters affirms in this context:

“One of the major duties of a director is to protect the assets of the company (and thus, ultimately, the assets of shareholders) and to address effectively the risks and opportunities underlying the company’s business operations. Most companies nowadays would most likely have in place internal management guidelines and policies to determine if and how their business activities may negatively affect the environment. However, that is only one aspect of assessing climate risk within the business.”⁶

2. Implications of climate-related litigation on D&O liability coverage

Some insurance industry experts believe that the fiduciary duties of directors and officers are evolving in the context of climate change, and that this will potentially have a major effect on D&O coverage. For example:

“In recent years, shareholder resolutions related to climate change have been on the rise, and investors have demanded increased disclosure of climate change-related risk.... Regulators are also taking action on climate change disclosure. All of these activities may create a new and evolving standard of care for directors and officers in the climate change context. Directors and officers may face actions by regulators and actions by shareholders related to climate change risk. A rise in such claims would have major implications for D&O coverage.”⁷

Corporations and their directors and officers facing claims related to concealment, misrepresentation, and mismanagement of climate change-related risk may look for reimbursement of defense costs and indemnification pursuant to D&O policies. However, there is a risk that D&O liability policies might not cover certain types of claims and costs incurred by litigation, thereby creating a personal risk for directors and officers.

While law firms might not agree with insurers on potential exclusions, they do recommend that their clients are well aware of them. Anderson Kill & Olick, addressed this issue, stating that insurance companies are likely exclude climate change-related claims, even if the claims concern disclosure issues: “Insurance companies, however, have already indicated that they will likely take the position – improperly in our view – that a so-called pollution exclusion contained in many D&O policies would eliminate coverage for such lawsuits.”⁸

As early as 2006, insurance companies offering D&O liability policies were wary about writing insurance for companies that are at risk from lawsuits arising out of climate change damages. Carbon majors, such as ExxonMobil, were said to look vulnerable in this respect.⁹ At that time, ExxonMobil accounted for around 1% of carbon emissions globally but was actively lobbying against efforts to tackle greenhouse gas emissions.¹⁰

In 2006, Christopher Walker, then head of the greenhouse gas risk solutions unit at Swiss Re, said his company may be forced to approach Exxon Mobil and tell them that “since you don't think climate change is a problem, and you're betting your stockholders' assets on that, we're sure you won't mind if we exclude climate-related lawsuits from your D&O insurance.”¹¹

A few years earlier, in 2004, Christopher Walker vocalised his concerns about climate change as a corporate governance issue: “The rapid rise in shareholder action on climate risk is sending a loud and clear signal to management and boards of corporations that climate risk is an issue they must take seriously. As part of its Directors and Officers insurance, it is currently asking what companies are doing to address climate change.”¹²

The 2008 Integro's D&O Liability Evolution report says:

“Though a landmark 2007 U.S. Supreme Court case, Massachusetts v. Environmental Protection Agency, did not directly address insurance policies, it quite possibly may have a significant impact on D&O pollution exclusions going forward. In its decision, the Supreme Court acknowledged greenhouse gas emissions as “pollutants” under the Clean Air Act. Accordingly, insurers could argue that the exclusion applies to claims arising out of disclosures concerning greenhouse gas emissions or similar environmental discharges.”¹³

The report further states, “D&O policies typically contain broad pollution exclusions, which are designed to prevent the policy from covering physical and environmental perils. But when physical climate perils intersect with financial disclosure, the bright line of the pollution exclusion may become a bit blurry.”¹⁴

Finally, MEALEY'S Pollution Liability Report confirms that “[t]he increasing exposure to liability may lead insurers to refuse to write D&O coverage to particular companies, or severely restrict the coverage provided. A complete climate change exclusion may be soon to come. After all, global warming is also increasing the heat in insurance companies' own boardrooms.”¹⁵

¹ Lloyds. 2014. Catastrophe Modelling & Climate Change, Available at: [http://www.lloyds.com/~media/Lloyds/Reports/Emerging Risk Reports/CC and modelling template V6.pdf](http://www.lloyds.com/~media/Lloyds/Reports/Emerging_Risk_Reports/CC_and_modelling_template_V6.pdf) Last visited on 14 May 2014.

² Lloyd's. 2014. *Insurers Should Push for Climate Resilience*, Interview with John Nelson, 13 May 2014, Available at: <http://www.lloyds.com/news-and-insight/news-and-features/lloyds-news/lloyds-news-2014/insurers-can-make-the-world-more-resilient-to-climate-change> Last visited on 14 May 2014.

³ D. Zegart. 2014. Want to Stop Climate Change? Take the Fossil Fuel Industry to Court, *The Nation*, 21 April 2014, Available at: <http://www.thenation.com/article/179459/want-stop-climate-change-take-fossil-fuel-industry-court> Last visited on 23 April 2014.

⁴ W.G. Passanante & A.D. Hardiman, - *Climate-change related D&O liability- the coming flood?* 2011, Available at: http://www.andersonkill.com/webpdfext/ART-Climate-Change-RelatedD_OLiability-theComingFlood.pdf Last visited on 15 April 2014.

⁵ Bailey Cavalieri LLC, *Global Warming - Are D&O's in the Hot Seat?* 2011, Available at: http://www.google.nl/url?sa=t&rct=j&q=&esrc=s&source=web&cd=3&ved=0CD0QFjAC&url=http%3A%2F%2Fwww.baileycavalieri.com%2F77-Global_Warning_DO.pdf&ei=7khNU9q1GMHmOcufigMgH&usq=AFQjCNFqARRCNVgII8HUrqvixGbxrwYGYg&bvm=bv.64764171_d.ZWU p. 3. Last visited on 15 April 2014.

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- ⁶ Liberty Insurance Underwriters, *Directors' and Officers' Liability and The Business Judgment Rule*, August 2010, Available at: <http://assets.liuasiapacific.com/?LinkServID=E737ED39-5056-A25B-C6F95B79758163E5> Last visited on 24 April 2014.
- ⁷ Carroll et.al., *Climate Change and Insurance*, 2012, American Bar Association, p. 138.
- ⁸ W.G. Passanante & A.D. Hardiman, *Protecting Against D&O Liability for Climate Change-Related Disclosures*, 2011, Available at: <http://www.andersonkill.com/webpdfext/ART-ProtectingAgainstDOLiabilityForClimateChange.PDF> Last visited on 15 April 2014.
- ⁹ Elliott, L. 2006. Winds of Climate Change are about to make their impact felt in many a Boardroom. *The Guardian*, 6 February 2006, Available at: <http://www.theguardian.com/business/2006/feb/06/environment.climatechange> Last visited on 15 April 2014.
- ¹⁰ Elliott, L. 2006. Winds of Climate Change are about to make their impact felt in many a Boardroom. *The Guardian*, 6 February 2006, Available at: <http://www.theguardian.com/business/2006/feb/06/environment.climatechange> Last visited on 15 April 2014.
- ¹¹ Elliott, L. 2006. Winds of Climate Change are about to make their impact felt in many a Boardroom. *The Guardian*, 6 February 2006, Available at: <http://www.theguardian.com/business/2006/feb/06/environment.climatechange> Last visited on 15 April 2014.
- ¹² Harvard University, Sustainability and Risk, 23 September 2004, page 10, Available at: http://www.hks.harvard.edu/m-rcbg/CSRI/publications/report_3_Sustainability%20and%20Risk%20Report.pdf Last visited on 23 April 2014.
- ¹³ Integro, Climate Change: The D&O Liability Evolution, 2008, p.3 Available at: http://www.integrogroupp.com/data/File/white-papers/climate_change_the_dando_liability_evolution.pdf Last visited on 15 April 2014.
- ¹⁴ Integro, Climate Change: The D&O Liability Evolution, 2008, p.3 Available at: http://www.integrogroupp.com/data/File/white-papers/climate_change_the_dando_liability_evolution.pdf Last visited on 15 April 2014.
- ¹⁵ MEALEY'S Pollution Liability Report, 2008