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Climate change and insurance law

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"Climate change is an issue of justice as much as of economic development"
Gordon Brown, while UK Chancellor, at G8 meeting of environment and development ministers
15 March 2005

"You get justice in the next world; in this world you have the law"
William Gaddis, A Frolic of his Own[2]

1. Introduction

With the onset of the global economic downturn, continuing widespread uncertainty in the financial markets and the distractions of political upheaval in many strategically sensitive territories, it is perhaps understandable that for many the issue of climate change has temporarily slipped down their immediate political, economic or business agenda[3]. Yet, the combined effect of growing unpredictability of events, a current underwriting year of major "natural disaster" losses and the need to continue to comply with a raft of existing measures directed at adaptation to, and the mitigation of, the effects of climate change, all means that few current business decisions remain immune from the phenomenon of climate change.

The insurance industry was not slow to recognise that concerns about climate change were not mere abstract scientific hypotheses, particularly when gaining political and public attention and support[4]. Such concerns threaten to have a major impact both upon insurers' and their clients' own businesses. Proven climate change itself, and any physical impact it may generate, may both yet lie some years ahead. Precise predictions will be difficult. Disputes over scientific proof and legal attribution will abound. It is not, however, hard to see that taking stock of the fast-changing landscape of regulation, legislation and rulings about liability, from local to global levels, is already having an early significant impact upon most traditional classes of insurance across all property, liability, life and personal lines. For many insurers, any parallels drawn with asbestos or tobacco litigation are enough to make them fear any "worry later" approach.

Insurers and reinsurers have already taken a series of both defensive and innovative steps in the form of policy and underwriting provisions, "green" product initiatives, exploring how best to cover, prevent, contain or even exclude from cover many new perceived exposures. This extends to developing new forms of coverage or methods of risk transfer or containment and securing other funding sources for traditional as well as new technology risks emerging[5].

In current conditions it should perhaps be no surprise that renewed attacks have been made upon the science upon which has been based the predicted effect of climate change and any responsive measures introduced[6].

Much has already been written upon the speculation and worries about the threats. Also, upon many of the opportunities such developments may present to insurers. In contrast relatively little time and energy has yet been devoted to the legal aspects of quite how insurers may more specifically be affected.

2. AIDA climate change General Report and Working Party

AIDA[7] is an international association of nearly sixty national insurance law associations (including the British Insurance Law Association (BILA)). It saw the need to identify the most important insurance law issues posed by the phenomenon of climate change.

It adopted "*Climate Change and Insurance Law*" as one of its two major themes to study at its XIIIth World Congress in Paris in May 2010. A questionnaire was prepared by Professor Marcel Fontaine of L'Université Catholique de Louvain in Belgium. Responses gathered over two years by associations operating in over 20 countries served to inform both discussions at the Congress and the General Report published earlier this year by Prof Fontaine.[8]

From the information obtained among the areas considered most to merit comparative study were the following:

a. Analysis of reports on climate change (and insurance implications) generated by governments, industry, associations, research groups etc.

b. Identification/consideration of significance of legislation and other regulatory measures/protocols/ initiatives (at national, regional and international level) implemented to combat the effects of climate change.

c. Evolution of climate change litigation in the US and elsewhere.

d. Impact of climate change upon traditional lines of insurance and reinsurance (and legal issues arising).

e. Creation/development of new lines/types of (re)insurance and other products (and legal issues arising) and classification of certain existing products (such as weather derivatives) in the insurance/financial markets.

f. Special interest topics: i) Carbon Capture & Sequestration/Storage (CCS); ii) Use of cat bonds/ART for weather/carbon market risks etc; and iii) Large-scale natural hazard/pollution liability issues.

To embark upon this task an AIDA Climate Change Working Party was formed last November. Since then much has occurred.

3. Events of 2011

As the Working Party's new chair, I was invited to participate this January in the 1st Climate Change Summit for Asia's Insurance Industry in Singapore. Then to travel on to Australia to address meetings of three regional sections of the Australian Insurance Law Association (AILA) held in Perth, Sydney and Brisbane.

In Singapore, at the event co-hosted by the Asia Insurance Review and the Geneva Association[9], the phenomenon of huge new concentrations of potential insured losses becoming established in increasingly climatically-vulnerable locations was identified as a major insurance concern in Asia. Large-scale developments were rapidly appearing in many countries in exposed coastal regions. Mass urbanisation was sweeping the region at remarkable speed and on an unprecedented scale. The diversity of the challenges faced in Asia was also striking. The significance is obvious of any roles played in world level climate discussions by countries of the size of China and India. Concerns about deforestation have particular pertinence in countries where economies are heavily dependent upon timber and logging. Microinsurance may offer a lifeline for many in less developed countries, where physical and economic vulnerability to the impact of extreme weather events is particularly acute.

Australia was experiencing highly varied and volatile weather conditions. As I left Perth the Western Australian authorities were contending with the ravaging effects of bushfires tearing through some parts of the state. In Sydney there was much pre-occupation with the devastating effects of flooding sustained in Victoria, southern Australia and most seriously, Queensland. Large parts of Brisbane, including my final scheduled speaking venue, had been left under several feet of water with opinion already stormily divided over whether this had actually constituted a "flood".

A new venue in Brisbane was found, but a remaining concern was whether we, and much of Queensland, would then escape the impact of Cyclone Yasi, fast heading towards the shoreline. Also, whether insurers, lawyers, politicians and local water company bosses alike would require safe passage from the resulting waves of anger events had generated.

Within weeks came the earthquake in Christchurch, the tsunami and later horrors befalling Tohoku in Japan, then the Puyehue volcanic eruption in Chile, among other events. In a challenging year for insurers each has provided an illustration of just how complex issues of causation, liability, peril definition and proof (and measure) of loss all may be when a natural disaster strikes. It is not the physical effects of weather- or climate-related events which may cross national borders. Supply, manufacturing and delivery lines in any enterprise affected may increasingly commonly involve operations in several countries, even continents. Legal issues arising may become yet more challenging if there is already public concern or a dispute over the adequacy or expense of preventative measures demanded to combat the effects of alleged anthropogenic contributory causes of climate change.

Against this background, two working party meetings have so far been held: in Amsterdam this May and in Tel Aviv in early September. Further meetings have already been scheduled for Istanbul on 3 May 2012 and for London on 13 September 2012 (the latter on the occasion of the IVth AIDA Europe Conference to be staged in London for the first time)[10]. There is much to occupy us.

4. Tensions abound

Many battle lines are apparent at a global, down to the most local, level. A potentially critical stalemate exists between many developed and developing countries over what financial responsibility should be assumed for past emissions. Who should bear what share of the full economic cost of growing nations averting future emissions? What role is to be accepted by the likes of the US and China? Within nations, as we have seen, calls to act in the best long-term national interest can prove highly divisive if one state or region is currently prospering from exploiting valuable mining contracts, while a neighbouring region without such resources is being bailed out - in more ways than one.

Public spending on expensive projects, such as desalination plants, can all too easily be deferred by politicians succumbing to the need for short-term ballot box popularity or prey to economic jitters. Any perceived economic prudence of saving such costs, perhaps by expecting local water companies or dam operators instead to manage water levels much more efficiently (and so help protect communities against the effects of both drought *and* major inundation) will inevitably be viewed in a less flattering light in the wake of a national disaster which, with hindsight, it may be said could have been averted. Accusations proliferate. Was the policy or its operation flawed? Was any loss genuinely unavoidable? Consumer lobbies might persuade politicians that standard wordings for flood cover or cross-subsidised levels of premium should be resisted as anti-competitive. When, in the wake of a disaster, homeowner policyholders suffer the rejection of claims, for losses not deemed covered by specific peril definitions, blame is passed in all directions.

When the Commission appointed to investigate the 2010/11 Queensland Flood events finally reports[11] no doubt their findings will be of great interest to more than just those with any immediate financial interests at stake or with potential legal actions pending. Their findings, like those of other such commissions appointed to investigate major weather-related losses may yet have a direct bearing upon how liability issues continue to evolve and their impact upon many classes of insurance.

Other tensions – or distractions or the temporary relegation of longer-term concerns about climate – are currently evident in many areas, such as carbon trading, renewable energy subsidies for CCS projects, wind farms and the like, as well as the future role of nuclear energy. Hopes are muted over how much top-level progress may be made at Durban in December, when the UN COP17/CMP7 convenes, following disappointments for many in Copenhagen in 2009 and then Cancún last December.

As has already been seen, however, any delay in the advancement of treaty obligations or the enactment of legislation at national or regional level does not of itself delay the need for concern, nor often the commencement of litigation. In many instances, and in a growing number of countries, litigation has been commenced ***because*** of such lack of action. For insurers it remains as essential as ever to monitor all current disputes over alleged responsibility for any exacerbation of losses arising from natural disasters or other major events. Particularly, all attempts made in presently financially straitened times for any burden to be shifted to those seen simply to have the deepest pockets.

5. Insurance and Legal Issues Arising

5.1 *Impact of climate change and responses around the world*

Our Working Party was established in response to the widely held expectation that the physical impact of climate change would be felt in two ways: first, by making weather patterns more variable and extreme weather events potentially more intense and unpredictable; secondly, by causing more gradual phenomena, such as rising sea levels, temperatures etc. however unevenly experienced around the globe[12].

The likely effect upon most forms of property coverage has been readily identified. Equally, there is an impact upon many liability risks. All enterprises, in the public or private sectors, have had to reappraise their responsibilities owed to regulatory authorities, shareholders, investors or even the public at large. These may variously be imposed by legislation, regulation or by courts. Personal lines of insurance may similarly be affected by impact on health and mortality rates.

Attempting effectively to address legal issues arising across such a broad sweep of exposures and territories is a considerable challenge.

We must use our energies and resources wisely: to gather and analyse information from lawyers and insurers around the world, but not simply to replicate work already done by others, nor dwell too much upon mere speculation. We are seeking to select issues of either fundamental importance or of acute concern at any one time and to benefit from astute collaboration with other interested parties.

Insurers' responses to the phenomenon have already been striking in their range. In many respects the market has been highly innovative, with initiatives involving a mixture of awareness-raising, information-gathering, the conducting of research and development into new products and the tailoring of existing products to cater for, or to counter, new or aggravated exposures.

A number of legal issues have been identified. A particular difficulty for insurers is to distinguish what, in coverage or exclusion terms, precisely constitutes the new or aggravated element of risk arising from the phenomenon of climate change for which

provision is to be made. There are problems of both definition and causation. Both "climate" and "weather" may be distinguished and defined, but few existing definitions of "climate change"[13] may be adopted with ease into policy terminology. Contract provision is always harder where invariably, as here, a combination of causes will be responsible for losses. Are risks intended to be included or excluded where a climate change-attributed loss (how determined?) has been exacerbated by a separate human or corporate failure (to maintain, comply etc)? Familiar limiting phrases such as "***exclusively*** attributable to…" may prove much harder for insurers to rely upon when seeking to confine their coverage obligations where issues of attribution and causation may be complex. It is to be hoped that the market will permit sufficient access to examples of policy drafting currently in use to help us in any quest to analyse wordings and to help enhance and develop appropriate provisions.

The scale of exposures and the potential size of climate change-related losses readily prompt the question whether such losses are actually insurable in the private market. If insurers do cap or exclude exposure even with reliance upon reinsurance markets, then in many jurisdictions recourse may be made to the use of schemes of various kinds. Risks may be pooled, made the subject of mandatory cover or the government may stand behind risk-bearers as a reinsurer of last resort. We have already begun to examine differences in approach in different jurisdictions to existing "flood" provision. Strict liability regimes exist in some contexts and are being considered. Compulsory insurance is commonly resisted by the private market, but it has been aired in the context of environmental damage (and suggested as essential for new risks such as carbon capture and storage – see further below – where risks may otherwise prove uninsurable).

5.2 *Climate change liability and litigation Issues*

Even confining oneself to exposures arising under voluntarily-purchased insurance covering fault-based liability, there is already much to address from a legal perspective. A review of climate-related litigation filed over the past fifteen years across the world records a dramatic rise in the past five years in the number and variety of actions commenced, reaching record levels by 2010[14]. One may see that already a number of fundamental issues are being tested.

Many of the most headline-catching claims brought to date have been by environmental pressure groups, local authorities or regulators for injunctive relief against major emitters, rather than necessarily seeking any compensation, although both of course may be pursued. Many insurers remain sanguine that courts in most jurisdictions, even in the United States, will remain reluctant to extend the boundaries of those who are customarily entitled to compensation. Actions founded in nuisance or negligence variously require the establishment of an identifiable duty owed to any injured party by a defendant. It is unwise however to assume that the pressures being brought to bear upon

legislators, regulators or local authorities – or any more willing accommodation of class action or mass tort arrangements - may not yet affect how such issues may be interpreted or developed by the courts over time.

Certainly a series of cases in the US involving appeals to the Supreme Court in the course of 2010 and 2011 has merited particularly close attention[15]. In that of *Comer v Murphy Oil* (2009) (concerning claims of residents and landowners that the defendants' emissions made Hurricane Katrina more ferocious and damaging), a claim for mandamus was defeated, but a new action for damages, based in nuisance and negligence, has since been filed. In late June in the case of *State of Connecticut v American Electric Power (*2005, 2009) (an action brought against one of the largest greenhous gas emitters in the US) the Supreme Court did ***not*** decide the question, which had divided the lower court, of whether emissions levels were rather a matter for government policy makers, nor whether the claimants had any requisite standing. Instead, they declared the issue was wrongly brought. Since the commencement of the action this was now governed by the Clean Air Act legislation and so a matter for the regulator, if always subject to judicial review. Consequently, with no dismissal of the claimants' standing grounds, other environmental nuisance claims may yet have to decide whether such claims may succeed.

The issue of standing is but one of a number of difficult legal hurdles a party must expect to clear to establish a claim for damages. The boundaries of tortious duty are bound to be tested. Will insured defendants be able to argue that they were permitted to cause emissions until ordered to desist? Will it not be enough simply to argue that they complied with minimum standards? In terms of establishing foreseeability of damage, from what date will parties be taken to have known of damage from emissions being likely? How might this realistically have been averted? The issue of when or whether any physical damage has actually been suffered by a claimant so as to trigger policy coverage has already been raised in litigation. Cases have already been seen where the major economic losses involved take the form of dropped property values, especially in coastal areas, in anticipation of any physical impact of climate change still yet to arise. If planning consents or urbanisation schemes have failed to address all necessary climate change concerns, losses and alleged failures may be inevitable.

A major task for the Working Party will be to try to track not just the progress of such litigation issues around the globe, but also any effect these may, or indeed should, have in different jurisdictions. Are boundaries of liabilities widened? If so, with what impact upon underwriters?

5.3 *Carbon insurance and other "new" products*

In our initial studies we identified the need to address legal issues arising in respect of three broad categories of so-called "new" products. First, "green" policies, not covering any new type of loss linked to climate change, but designed primarily to encourage a reduction in

greenhouse gas emissions, notably in respect of motor, buildings etc. "Adapted" policies representing traditional property or liability lines of cover, but designed specifically to take into account climate change issues. Finally, genuinely "new" policies catering, perhaps in traditional fashion, for a range of activities involved with alternative energy sources (such as wind farms) through to exposures arising from the "cap and trade" carbon market itself and carbon offsetting. More specific forms include microinsurance. Also, those designed for the largest scale schemes intended to help fund and underwrite Carbon Capture & Storage (CCS) and other still quite embryonic projects.

From promotional market literature alone we experienced great difficulty in identifying the exact nature of many so-called "new" products. One needs to study specific forms and terms used. It became clear that there was a gap in many cases between what was anticipated or promoted and what had yet come to fruition. An invaluable piece of work[16] conducted by one of our Working Party members, Cedric Wells of SCOR in Paris, with support from many market practitioners, helped to identify some of the issues and difficulties in this regard. This also helped to demonstrate how significantly the start of the economic downturn had slowed progress in the funding and advancement of many new projects and insurance products alike.

Concerns for the healthy continuation of the whole existing "cap and trade" carbon market and the evolution of further schemes in other areas of the world have already been mentioned. In the context of carbon capture & storage (CCS) earlier pledges by major countries to commit to the development of pilot CCS projects are under threat[17]. Nonetheless a number of new products continue to appear[18]. The need to monitor progress and the form of any new insurance contractual provisions appearing in market circulation nonetheless remains every bit as vital as before.

5.4 *Reinsurance/ART/funding for weather/carbon-market risks and regulatory treatment*

Over and above the traditionally important role played by reinsurance in catastrophe risk coverage, a variety of alternative risk transfer products have emerged in recent years. These include the likes of weather derivatives (put options, caps and swaps) and catastrophe bonds. They are designed to help to spread the risks of climate change by 'insuring', by means of the capital market, risks that are uninsurable within the insurance market. Second, by doing so, enhancing prevention.

From an insurance law perspective an area of particular interest lies in how any such products are to be legally characterised. The markets regularly serve as both end-users and as offering issuers. To some extent the rapid expansion of weather derivatives has more recently turned this resource into a threat for the insurance industry, given the fierce competition many new players have represented. If such products are deemed to be insurance policies, at present in many places only a licensed insurance intermediary may

sell the instrument. Any derivative's counterparty, if not licensed, may thereby be acting unlawfully.

6. The Future

The four broad categories outlined immediately above have been adopted by the AIDA Climate Change Working Party as our principal workstream areas. They should help guide our work in advance of our further scheduled meetings in 2012. Also, to help structure the growing body of materials we are collecting on our Working Party website page[19].

Of particular importance in the coming few months will be our monitoring of legal and coverage developments in the wake of the major Australian and Japanese losses. We shall also analyse the progress of climate-related litigation more widely. We are seeking to align ourselves with those doing important research work at the Geneva Association[20]. Also with those engaged in maintaining valuable databases at Columbia Law School and elsewhere. This should allow us to monitor most effectively many essential litigation, legislation and liability issues of interest to insurers through and beyond the high-level Durban talks this December.

We shall look to draw upon the resources of AIDA's large number of national insurance law associations around the world. In the coming twelve months it is hoped that a number of new important Asian national associations will be joining AIDA. Not least among these are associations forming in the People's Republic of China and India. Equally critically, to make our work most relevant, we must encourage input from active market participants.

Particularly anyone with a market involvement who is interested in participating in, or nominating someone to support, the Working Party's work, is invited to make contact.[21] Similarly, if they identify any specific issue or any materials which they believe merit attention. With so many interesting developments in prospect and with London being the venue for the AIDA Climate Change Working Party meeting for the first time in just under a year[22], any such assistance would be both very timely and greatly welcomed.

Endnotes

1 Chairman, AIDA Climate Change Working Party; AIDA Assistant Secretary-General-Administrative Affairs; BILA Vice President and Charitable Trustee; currently non-practising solicitor and CEDR accredited mediator.

2 Taken from "*The Finance of Climate Change*" Myles Allen, Chap 29: The Spectre of Liability

3 In his 3 Oct 2011 speech to the Conservative Party Conference the UK Chancellor revealed clear divisions within the UK's coalition government over its pledge to continue to position the UK as a leader in the low carbon economy. With the UK responsible for only 2% of the world's carbon emissions and said to be "bearing the cost of a decade of environmental laws adding to energy bills", he said the UK should resolve to cut its emissions "no faster than other European countries".

[4] Of course support for past or future measures may still dramatically ebb and flow. At the time of writing it has been observed by the FT that while the carbon markets (valued by the World Bank in 2011 at $142bn) are kept alive by a confidence that climate change fears will inevitably prompt more, not less, global action to limit greenhouse gas emissions that underpin demand for carbon credits, there is no absolute certainty even that the whole Clean Development Mechanism (CDM) itself will necessarily continue after Dec 2012. http://www.ft.com/cms/s/0/6d3796fe-e8e6-11e0-ac9c-00144feab49a.html#ixzz1ZRuCwGRL

[5] Inevitably the speed of innovation here is dependent upon both available capital and market confidence, neither of which has been in plentiful supply of late.

[6] For an interesting recent discussion of the dispute over the merits of the "science" of climate change, see *Climate Change Denial, Haydn Washington and John Cook, Earthscan, April 2011 • 224 pages • ISBN 9781849713368*

[7] Association Internationale de Droit des Assurances (The International Insurance Law Association) founded in 1960 (www.aida.org.uk)

[8] The full text of the Report may be found on the AIDA Climate Change Working Party website page: http://www.aida.org.uk/workpart_climatechange.asp

[9] Whose work, including their establishment of a Climate Risk + Insurance Project, is of particular interest and with whom the AIDA Climate Change Working Party is keen to establish a productive working relationship – see http://www.genevaassociation.org/Home/Climate_Risk.aspx

[10] Full details of all the WP meetings, presentations and future events are to be found on the Climate Change Working Party website page, see above.

[11] The Queensland Floods Commission of Inquiry was appointed on 17 January 2011. It delivered its interim report on 1 August 2011 making recommendations to be implemented before the next expected wet season. It is scheduled to deliver its final report on 24 February 2012 (http://www.floodcommission.qld.gov.au/home).

[12] In response to a recent suggestion that in its General Report (and subsequent work) AIDA had too unquestioningly accepted the majority view held about climate change - see the introduction to *Forum de l'Assurance*, special issue of February 2011, pp. 21-51 (Anthemis, Louvain-la-Neuve, Belgium) - Prof Fontaine presented a short paper at our most recent Tel Aviv meeting on 7.9.11 – "*Global Warming or Climate Change?"* (http://www.aida.org.uk/workpart_climatechange.asp). In this he recognises the need for us to take account of all research being conducted, but also to acknowledge the current prevailing view that insurance risks are at least likely to be aggravated by climate change, irrespective of whether this is manifested by any warming or cooling in any region.

[13] UNFCCC definition of "climate change" is "… *a change of climate which is attributed directly or indirectly to human activity that alters the composition of the global atmosphere and which is in addition to natural climate variability observed over comparable time periods*…"

[14] See *Gerrard, Climate Change Litigation, Geneva Association Etudes et Dossiers no. 367* for a table of

filings and other useful reference sources. (An updated chart since records cases filed in 2011 by June to be headed for at least a second highest year ranking.)

[15] *State of Connecticut et al –v- American Electric Power Inc (2005, 2009), Native Village of Kivalina –v- Exxon Mobil Corp et al (2009), Comer –v- Murphy Oil USA (2009) and State of California –v- General Motors Corp et al (2007) - and Steadfast Ins Co –v- AES Corp (2008)* concerning insurance exposures for the *Kivalina* claims – saw appeals lying before the US Supreme Ct upon a number of threshold questions. These included whether the cases were non-justiciable, i.e. raised policy questions over GHG emissions which ought more properly to be decided by government rather than the courts; whether the claimants had standing (were their injuries deemed fairly traceable to the defendant's conduct and redressable by the courts?); were the claims in common law now pre-empted by statutory provisions passed?; and whether the claimants had suffered any incurred injury in fact at the time of the suit.

[16] Cedric's dissertation, "***Carbon credits and insurance:*** *Can insurance address the current and future needs of the industries?",* delivered to ENASS (L'école nationale d'assurances) in Paris in April 2011 and accepted with honours, served as an invaluable basis for our consideration of many issues arising in this context at the Working Party's first meeting held in Amsterdam in May 2011: www.aida.org.uk/workpart_climatechange.asp.

[17] In July of this year in the US American Electric Power became the latest major energy suppliers to announce that it was "putting on hold indefinitely" any plans to build a full scale carbon capture plant at a coal-fired power plant in West Virginia. In the UK the Department of Energy and Climate Change (DECC) had originally declared they would use European funding for the development of no fewer than four CCS projects. By this October it was revealed that Scottish Power, the sole surviving bidder for the only presently remaining viable project, was threatening to withdraw its bid for a power plant scheme in Fife.

[18] At our Amsterdam meeting in May 2011 the Working Party was informed of a new product issued that week by the Chartis Group designed to insure the value of government subsidies to renewable energy projects. Many projects continued to stall on account of concerns for slow financial returns deterring investors. Any support which insurance products might bring was naturally encouraged.

[19] http://www.aida.org.uk/workpart_climatechange.asp, already cited.

[20] The Geneva Association, International Association for the Study of Insurance Economics http://www.genevaassociation.org/

[21] My contact details, and those of the other Working Party officers, appear on the Working Party website page.

[22] The meeting, as already mentioned, will coincide with the IVth AIDA Europe Conference (13-14 September 2012) which BILA is helping to stage. A large overseas attendance is anticipated. More details of this will be announced shortly on the AIDA website: www.aida.org.uk.