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Climate Change and the Issues Facing the Insurance Industry



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Aviation and Climate Change - Law & Policy is a collaborative effort of the firm of Condon & Forsyth LLP, Attorneys at Law, and The Hodgkinson Group, Aviation and Climate Change Advisors, to address and analyze current topics related to the issue of aviation and climate change.

Each edition aims to familiarize the reader with important climate change issues facing the aviation industry, serving as a resource for comprehensive analysis of potential solutions. It is not a legal opinion and neither provides legal advice for any purpose nor creates the existence of an attorney-client relationship.

Previous editions have covered: incorporation of the aviation industry into the EU's existing ETS; Australia's proposed ETS; industry and governmental action response to climate change; significant EU ETS deadlines and reporting requirements focusing to incorporate the aviation industry; a discussion of sectoral agreements emphasizing those proposed by the aviation industry; and, an update on global negotiations seeking to achieve a successor agreement to the Kyoto Protocol. *See page 15 for links to previous editions of Aviation and Climate Change - Law & Policy.*



This edition addresses issues facing the insurance industry arising from the effects of climate change, as well as current climate change action impacting the aviation industry within both the EU and U.S.

The next edition will cover developments at the UNFCCC Conference in Cancun, Mexico 29 Nov. – 10 Dec. 2010.



We are proud to note Marshall S. Turner, co-author and editor of this Newsletter, will be attending the UNFCCC in Cancun as a credentialed NGO-Observer and will be providing up-to-date reports on developments at the conference.

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Climate Change and the Issues Facing the Insurance Industry

"...Climate Science is credible, compelling and growing stronger" – U.S. Environmental Protection Agency ("EPA"), July 29, 2010

In July 2010, the U.S. Environmental Protection Agency ("EPA") "denied 10 petitions challenging its 2009 determination that climate change is real, is occurring due to emissions of greenhouse gases from human activities, and threatens human health and the environment."¹ The petitions claimed "climate science" was untrustworthy and went as far as to assert there was a conspiracy among the Intergovernmental Panel on Climate Change (IPCC), the U.S. National Academy of Sciences, and the U.S. Global Change Research Program.² After months of debate, the EPA, in a strong rebuttal, concluded:

"The [EPA's] endangerment finding is based on years of science from the U.S. and around the world. These petitions – based as they are on selectively edited, out-of-context data and a manufactured controversy – provide no evidence to undermine our determination. Excess greenhouse gases are a threat to our health and welfare...Defenders of the status quo will try to slow our efforts to get America running on clean energy. A better solution would be to join the vast majority of the American people who want to see more green jobs, more clean energy innovation and an end to the oil addiction that pollutes our planet and jeopardizes our national security."³

The effects of climate change have impacted individuals, governments and businesses globally. The insurance industry is no exception and, due to its very nature and involvement with weather-related disasters, the industry will be in the forefront of dealing with the effects of climate change. This article discusses the ways in which climate change has impacted the insurance industry, the types of insurance claims that have been or are expected to be increasingly asserted, general coverage issues arising out of the effects of climate change, and the effect

that the occurrence of climate change has had on the way the insurance industry conducts business.

Physical Damage Linked to Climate Change

Physical damage to insured property worldwide, resulting from extreme/more frequent weather events attributed to climate change has increased significantly over the last decade. For example, according to the World Meteorological Organization (WMO), the years 1996 to 2005 were among the ten warmest recorded across the globe since 1861.⁴ Environmentally challenging events include warmer temperatures, rising sea levels, floods, draughts, heat waves, wildfires, etc. causing drastic fluctuations in weather patterns and resulting in property damage. The statistics over the years clearly have a story to tell. Weather related losses covering the period of 1980-2005, made up eighty-eight percent of property claims paid by insurers. In 2005 alone, insurers in the U.S. paid \$62 billion of the \$80 billion in weather-related catastrophic losses.⁵ In contrast, costs averaged only \$4 billion a year in the 1950s and \$40 billion in the 1990s.⁶ In fact, the global economic cost of damages attributed to climate change - which amounted to \$1.4 trillion from 1980 through 2004 with only \$340 billion actually insured – are understated because smaller events are typically excluded from the statistics.⁷

Increased Claims for Property/Casualty Insurance

It is expected that there will continue to be an increasing number of property/casualty claims based on damage to, *inter alia*, structures, automobiles, marine craft and aircraft, crops and livestock. Claims based on liability arising from pollution, business interruption, loss of utility of service, loss of data from power surges and the breakdown of equipment due to severe weather events are also expected to increase dramatically.⁸ Not only are insurers facing an increased number of claims arising out of property damage attributed to extreme weather and other consequences of climate change, insureds are defending themselves against mass tort lawsuits seeking redress for climate change damages resulting from the emission of greenhouse gases. Several noteworthy cases have commenced in the U.S. asserting public nuisance claims against, *inter alia*, power companies, automakers and oil refining and coal mining companies.

Litigation Commenced Within the U.S.

One of the most notable cases on point is *Comer v. Murphy Oil USA*,⁹ a class action suit filed against more than one hundred named defendants in the oil and energy industries made by a group of Coastal Mississippi property owners suffering damage they attributed to Hurricane Katrina. The plaintiffs, alleging claims of, *inter alia*, nuisance, trespass, negligence, civil conspiracy, and unjust enrichment, asserted that the defendant oil companies, coal companies, and chemical manufacturers “knowingly and willfully” engaged in activities that contributed to global warming via their emissions of greenhouse gases which caused climate change resulting in Hurricane Katrina. In August 2006, the District Court denied the class certification motion. On August 30, 2007, the District Court dismissed the complaint, ruling that the claims were based on a “political question” or non-justiciable issue. The plaintiffs appealed to the Fifth Circuit which issued a decision in October 2009 reversing, in part, the District Court’s decision.¹⁰ The Fifth Circuit held that the plaintiffs’ claims were justiciable and that the plaintiffs had standing to raise the nuisance, trespass, and negligence claims.

The Fifth Circuit subsequently granted the defendants’ petition for a rehearing en banc.¹¹ However, after the Court granted the defendants’ petition, which the Court found “vacate[d] the panel

opinion and judgment of the court and stay[ed] the mandate,”¹² only eight of the nine judges were left to hear the case due to the disqualification and recusal of the ninth judge.¹³ Without a quorum, the Court could no longer entertain the case and ordered dismissal on June 1, 2010.¹⁴ The plaintiffs were left with only one option to pursue their claims - to petition the U.S. Supreme Court, which they have done via a *writ of mandamus*. It will take some time for this process to run its course.

Connecticut v. Am. Elec. Power Co., Inc.,¹⁵ is a case with public nuisance claims similar to *Comer* (both of which have nudged the actions of climate change closer to the U.S. Supreme Court). In *Connecticut v. AEP*, several state attorneys general and non-profit land trusts sued electric power producers alleging that the power facilities of the defendant utilities constituted a public nuisance under the state and federal common law and seeking to have defendants abate carbon dioxide emissions at each of their plants. Plaintiffs, claiming to represent more than 77,000,000 people (in theory), sought an order holding each of the utility defendants jointly and severally liable for contributing to the ongoing public nuisance of global warming.

The District Court in New York granted the defendants’ motion to dismiss in October 2005, holding that the suit raised non-justiciable “political questions” that were beyond the limit of the Court’s jurisdiction. In September 2009, finding that the plaintiffs had standing to seek redress on the claims which the Second Circuit found were justiciable, the Second Circuit reversed the District Court’s decision.¹⁶ The Second Circuit stressed in its decision that it was not being asked to solve the issue of climate change and that the plaintiffs were seeking only injunctive relief. The defendants filed a writ of certiorari with the Supreme Court of the United States seeking to reverse the Second Circuit’s decision.¹⁷ The plaintiffs’ petition is pending before the Supreme Court.

Another notable public nuisance case is *Native Village of Kivalina v. ExxonMobil Corp.*,¹⁸ wherein the plaintiffs filed suit in the Northern District of California contending that global warming is destroying the land upon which the native Inupiat village of Kivalina is located. The plaintiffs sought damages and alleged, specifically, that their village of approximately 400 people, located on the tip of a barrier reef about 70 miles above the Arctic Circle in Alaska, is disappearing due to massive erosion caused by the reduction and melting of arctic ice that formerly acted as a protective barrier to coastal winter storms, storm waves, and surges. Both the U.S. Army Corps of Engineers and the U.S. Government Accountability Office (“GAO”) concluded that as a result of the melting ice the ancestral home of the Inupiat, which

The Insurance Industry’s Response to Climate Change

The insurance industry has been active in addressing the impact of climate change. In the mid-1990s, a group of approximately 80 insurers representing about 25 countries cosigned a statement of environmental commitment and formed the Insurance Industry Initiative within the United Nations Environment Programme (“UNEP”) which was intended to assist the insurance industry in developing environmental risk management awareness. *Insurance in a Climate of Change – The Greening of Insurance in a Warming World*, U.S. Dep’t Energy, Energy Analysis Dep’t, Feb. 1, 2007. Members of the Initiative also participate in the Conference of the Parties (COP) meetings where international participants discuss and negotiate agreements relating to climate change. *Id.*

While UNEP often plays a role in the financial sector by working closely with financial institutions to bring the issue of climate change to an international forum, UNEP’s Finance Initiative (UNEP FI) together with ClimateWise, The Geneva Association and the Munich Climate Insurance Initiative (MCII) (which represent more than 100 insurers among the four groups) released a joint statement on September 6, 2010 entitled *Adaptation to Climate Change in Developing Countries*. The release was directed at international government leaders to highlight the role that the insurance industry could play in assisting insurers and governments to adapt to a world changing due to climate change, particularly with managing risks in developing countries.

UNEP FI is a partnership forged between UNEP and over 190 members of the worldwide financial industry. ClimateWise, established in 2006 by the Prince of Wales, is a group of international insurers that have agreed to abide by the ClimateWise Principles which include, *inter alia*, researching climate change issues and sharing results, and working with governments to support carbon emissions caps. The Geneva Association refers to itself as “the leading international ↓

began to fall into the ocean, needed to be relocated at an estimated cost of \$95 million to \$400 million. The *Kivalina* complaint asserted the defendants “conspired to create false scientific debate about global warming in order to deceive the public.”

The insurers involved in the case filed a declaratory action in a Virginia state court – reportedly the first coverage case relating to climate change - seeking a declaration that the insurers are not obligated to provide a defense for or to indemnify its policy holder, AES Corporation, even though the insurer had agreed to defend the case under a reservation of rights under the Commercial General Liability policies that it issued from 2003 to 2008.¹⁹ The Virginia Court found in favor of the insurers on their motion for summary judgment, holding that there can be no coverage because there was no occurrence. The Northern District of California dismissed the public nuisance case on September 30, 2009, holding that the claims were non-justiciable and that the plaintiffs lacked standing to pursue the claims. The plaintiffs have appealed to the Ninth Circuit where briefs have been filed by all parties with no further action taken by the Court to date.

In a case asserted against automakers, *California v. General Motors Corp.*,²⁰ the State of California brought suit against GM, Ford, Toyota, Honda, Chrysler and Nissan alleging injuries to California, its environment, economy and the health and well-being of its citizens caused by the defendants’ production of millions of automobiles that collectively released carbon dioxide into the atmosphere in mass quantities, thereby contributing to an elevated environmental level of carbon dioxide. The State sought a declaratory judgment to hold the defendant automakers liable for future monetary damages due California caused by defendants’ past and ongoing contributions to global warming. In 2007, the District Court granted defendants’ motion to dismiss on the grounds that the complaint raised non-justiciable political questions that were beyond the federal court’s jurisdiction. The State appealed to the Ninth Circuit but voluntarily dismissed its appeal in June 2009 due to policy changes commenced by President Barack Obama's administration, including the increase in fuel economy standards and the EPA's Endangerment Finding that greenhouse gases constitute a hazard to public health pursuant to the Clean Air Act.

Clearly, litigation asserting that large emitters of greenhouse gases are responsible for rising sea levels and other harms attributable to global warming is in its infancy and it remains to be seen whether these lawsuits will be successful. Inevitably the liability and coverage of climate change actions will be answered by the U.S. Supreme Court.

The Insurance Industry’s Response to Climate Change

(continued)

insurance ‘think tank’ for strategically important insurance and risk management issues.” See The Geneva Association website

(<http://www.genevaassociation.org/>). The Association, which is comprised of a maximum 90 CEOs “from the world's top (re)insurance companies,” examines trends affecting the insurance industry, including the impact of climate change on the industry. *Id.* Munich Re established MCII in April 2005 to identify and respond to issues affecting the insurance industry arising out of climate change and to create insurance solutions.

The National Association of Insurance Commissioners (“NAIC”), a quasi-regulatory coalition of U.S. insurance commissioners from across the 50 states, the District of Columbia and 5 U.S. territories, is another industry group working to assist the industry adapt to climate change. Formed in 1871 to help facilitate the coordination of insurers from the different U.S. states, NAIC has recently been active in the area of climate change through its Climate Change and Global Warming Task Force which coordinates NAIC’s analysis of the impact of climate change on all aspects of the insurance industry.

In 2008, the Task Force's white paper, *The Potential Impact of Climate Change on Insurance Regulation*, noted that “[global warming and the associated climate change represent a significant challenge for Americans. As regulators of one of the largest American industries, the insurance industry, it is essential that we assess and, to the extent possible, mitigate the impact global warming will have on insurance.” Robert D. Allen, Scott M. Seaman, and John E. DeLascio, *Emerging Issues: Global Warming Claims and Coverage Issues*, Def. Couns. J., Jan. 2009.



Defenses to Claims for Property Damage Attributed to Climate Change

Litigants pursuing claims for property damage attributed to climate change resulting from the emission of greenhouse gases will likely find it difficult to assert and maintain their claims. Although most climate related lawsuits may not be successful, their defense could be costly to insurers and eventually the tide may turn against them. For the present, however, even if plaintiffs were to prove a causal link between human influence on climate and a specific climate event, plaintiffs must contend with the difficult task of identifying specific potential defendants from the enormous pool of those that contribute to the damage.²¹ Businesses faced with such claims could counter that damaging climate events are linked to normal weather fluctuations and are not caused by human activities occurring over a long period of time.²² It could further be argued that carbon dioxide and greenhouse gases are released via an enormous range of global human activities and cannot be pinpointed to a particular activity occurring in a particular place.²³

It is also believed that such damage is exacerbated by aging populations, increased urbanization and settlement in areas now prone to flooding.²⁴ According to Conrad Lautenbacher, administrator of the National Oceanic and Atmospheric Administration, its studies demonstrate a huge increase in population growth along coastal areas – almost 40 million more in 2000 than in 1970.²⁵ Lastly, with the exception of the Second Circuit decision discussed above (*Connecticut v. AEP*), plaintiffs are clearly having a difficult time overcoming the justiciability and standing defenses.

Health Insurance and Implications for D&O Liability Claims

Climate change-related claims and subsequent tort lawsuits have the potential to affect multiple types of insurance coverage. For example, while the effects of climate change have impacted property and casualty insurance, it is anticipated that health insurance providers will face additional claims for respiratory illnesses and other health concerns arising from the increase in airborne allergens, dust, particulates and mold caused by rising temperatures and greater humidity.²⁶

With respect to Directors and Officers (“D&O”) policies, it is expected that insurers will likewise face increasing claims arising out of “non-disclosure” allegations against corporate directors and officers.²⁷

The Insurance Industry’s Response to Climate Change *(continued)*

In March 2009, Pennsylvania Insurance Commissioner Joel Ario, who is also chair of NAIC's Climate Change and Global Warming Task Force, explained, "climate change will have huge impacts on the insurance industry and we need better information on how insurers are responding to the challenge As regulators, we are concerned about how climate change will impact the financial health of the insurance sector and the availability and affordability of insurance for consumers."

Also in March 2009, NAIC promulgated a rule requiring large insurers (those with premiums of \$500 million or more in 2009 and \$300 million or more after 2010) to complete an annual survey which is disclosed to regulators and which delineates for each affected insurer: (1) the risk that climate change poses to the insurer’s business and (2) the procedure that the insurer has undertaken to diminish those risks. Richard Moore, *Obscure State Regulator Leads National Climate Change Charge*, *Lakeland Times*, Apr. 9, 2010.

As a result of being required to complete the survey, it is hoped that insurers will, in turn, urge their policyholders to implement “best management” practices and policies to lessen their carbon emissions and climate change risk. *Id.*



Such allegations could include: (1) the failure to protect the interests of shareholders prior to damage caused by climate change; (2) the failure to “predict or disclose liabilities, loss of revenue or market share, stock price drops, bad faith, trespass, misrepresentation, reputational damage, or even business opportunities missed in the clean-tech wave,”²⁸ and (3) the failure to prevent non-compliance with regulations.²⁹

Corporate directors and officers may also face claims based on their failure to discharge either their statutory duties under the applicable state and federal securities laws or their fiduciary duties to the shareholders. In turn, these allegations may well be asserted against the professionals that advised the corporate directors and officers, including lawyers, accountants and other advisors.³⁰

Relating to the issue of D&O insurance liability, the U.S. Securities and Exchange Commission (“SEC”) released on February 8, 2010, its *Commission Guidance Regarding Disclosure Related to Climate Change*. The “interpretive guidance,” while imposing no new disclosure obligations, aimed to provide U.S. publicly-traded companies with guidance on SEC disclosure requirements as they apply to climate change matters. The SEC had been pressed to issue guidance for institutional investors, state treasurers seeking full disclosure requirements for climate-related business for the benefit of investors, and groups like Ceres (a U.S. network of investors, environmentalists and other public interest groups that work with businesses and investors to seek solutions to “sustainability challenges” including climate change).³¹ In issuing its 2010 guidelines, the SEC was careful to state that it was not commenting on climate change itself or issuing new regulations but was merely clarifying the application of existing regulations in relation to climate change.

SEC disclosure requirements are mandatory, but only when certain conditions are met. For example, disclosure is required if the event triggering disclosure is likely to occur. Thus, if the company’s management makes a determination that the event is not reasonably likely to occur, no disclosure is required.³² Also, disclosure is only required where the event is likely to have a material effect on the company’s finances or operations. Thus, if the company’s management makes a determination that the event is not reasonably likely to have a material effect on the company’s finances or operations, no disclosure is required.³³

The SEC’s 2010 “interpretive guidance” specified four areas where risks arising from climate change may trigger disclosure requirements:



UPCOMING EVENTS

United Nations Framework Convention on Climate Change (UNFCCC)

16th Conference of the Parties (COP 16) held in conjunction with the 6th Conference of the Parties serving as the meeting of the Parties to the Kyoto Protocol (CMP 6) 29 November – 10 December 2010 in Cancun, Mexico.



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Impact of Legislation and Regulation. In the case of pending laws or regulations, companies should make disclosure on the assumption that such regulation or legislation will be enacted (unless the company's management makes the determination that it is not reasonably likely to be enacted).

Impact of International Accords. Companies should examine the impact of compliance with international accords, such as a successor agreement to the Kyoto Protocol.

Indirect Consequences of Regulation or Business Trends. Companies should examine the indirect effect on their businesses such as the lesser demand for goods that emit large amounts of greenhouse gases (or cause the emission of large amounts of greenhouse gases during production) and the increased demand for more climate-friendly goods.

Physical Impacts of Climate Change. Companies should consider risks arising from the impact of severe weather on the business operations of the company, its personnel and its supplies based on the mere physical location of the business.

Thus, publicly traded companies must comply with such federal securities laws and regulations regarding climate change disclosure requirements or face the possibility of claims by shareholders for their failure to do so – claims which may then become the burden of the company's insurers.

Implications for CGL Policies

Although insurers are concerned about an increase in claims arising out of the effects of climate change, it is not at all clear that an insured's claims for coverage arising out of its emission of greenhouse gases would be fruitful, particularly under a commercial general liability ("CGL") insurance policy. Typically, a CGL policy provides coverage for bodily injury or property damage that is caused by an "occurrence" which is defined as "an accident, including continuous or repeated exposure to substantially the same general harmful conditions." CGL policies usually exclude coverage for bodily injury or property damage that was "expected or intended from the standpoint of the insured." (As is well known, much litigation has resulted from interpreting the meaning of an "occurrence.")

Further, because the purpose of insurance is to pay for fortuitous and not certain loss, CGL policies typically exclude coverage for damage that began prior to inception of the policy under the loss-in-progress doctrine.³⁴ Since 1985, most CGL policies contain an absolute pollution exclusion of damage caused by a "pollutant" which is typically defined as "any solid, liquid, gaseous or thermal irritant or contaminant, including smoke, vapor, soot, fumes, acids, alkalis, chemicals and waste"

This exclusion has been refined in some policies with a 72-hour clause which excuses application of the exclusion if certain conditions are met. These conditions can include that the pollution loss manifested itself during the policy period or the loss was discovered within 72 hours of the pollution event or the reporting of the pollution loss to the insurer was made within thirty days.

To counter "climate change" claims, insurers are expected to assert that the insured intentionally emitted greenhouse gases and, thus, there was no occurrence, or that the policyholder expected and/or intended that it was causing harm via its emissions.

When the applicable policy contains an absolute pollution exclusion, insurers may look to the U.S. Supreme Court's definition of "pollutant" in *Massachusetts v. EPA*,³⁵ though slightly different from the typical CGL definition of "pollutant", for support in denying "climate change" claims resulting from the emission of greenhouse gases, which the Supreme Court defined as pollutants. The Supreme Court's finding is important because the Court determined that greenhouse gases are included in the Clean Air Act's definition of pollutants, which include "any air pollution agent or combination of such agents, including any physical, chemical, biological, radioactive (including source material, special nuclear material, and byproduct material) substance or matter which is emitted into or otherwise enters the ambient air."³⁶ For years, the EPA failed to make such a finding. Moreover, an insured will likely have difficulty demonstrating that the emission of greenhouse gases was sudden and accidental when the insured knowingly emitted the greenhouse gases over a long period of time and incidental to its business.

Responding to the increase in claims involving climate change, insurers are reported to be, *inter alia*, updating risk models, assessing the ways in which different types of insurance could be impacted by climate change, assisting insureds by developing risk management incentives to control or reduce costs, directing attention to the actual occurrence of climate change, and supporting enactment of carbon-reducing legislation.³⁷ As an integral component to the global business community insurers are finding it is essential to continue to address climate change issues and policies, thereby providing security for not only their insureds but also for the global economy as well.

Effect of Climate Change on the Way the Insurance Industry Does Business

The foreseeable benefit to the insurance industry resulting from climate change is that insurers are developing business opportunities and are adapting to climate change risks. For example, insurers could develop new risk management products for emissions reductions and loss-prevention technologies, analysis and advisory services, participation in adaptation services, and increased demand for insurance covering damage related to climate change.³⁸ One important area for risk management is the long term liability of the carbon capture and sequestration industry.³⁹

Climate change may also result in other new insurance products including energy savings insurance, which protects the insured from underachievement of predicted energy savings, and credit delivery guarantee, which protects against non-delivery of carbon emissions reductions due to a specific event.⁴⁰

Naturally, whatever financial benefits insurers gain from new insurance products arising from climate change, losses could continue to amass faster than insurance premiums if insurers fail to adapt and to plan accordingly. Indeed, the trend of increased claims attributed to climate change will undoubtedly adversely impact not only insurer revenues and profitability but also insurance affordability and availability.⁴¹ The combined effect of increased losses, pressure on reserves, and rising costs of risk capital has resulted in a gradual decline of the industry's profitability.⁴²

As the insurability of risk arising out of climate change declines, insurers may reduce their exposure through higher premiums and deductibles, lowered limits, nonrenewals and even new exclusions.⁴³ Of course, higher premiums and deductibles could have the effect of pushing insurance products out of the economic reach of consumers while lowered limits and new exclusions will preclude coverage altogether for some insureds.

Moreover, continuous major losses may cause insurers to react in extreme ways. For example, Hurricane Andrew caused severe loss in Florida in 1992 totaling about \$16 billion and Hurricane Katrina caused severe

loss along the Gulf Coast in 2005 totaling about \$45 billion.⁴⁴ Such disasters and resulting claims could force insurers to withdraw from offering certain types of insurance or from offering insurance in particular geographical areas. In addition to including stricter policy terms and adhering to a broad policy of denying claims, insurers could also seek to redistribute such risk to reinsurers or to go out of business altogether. The result of such practices could ultimately shift the responsibility for losses to governments and their taxpayers.

The Taxpayer and the Insurer of last resort...

U.S. insurance programs have been hard hit by episodic climate disasters. In 2007, U.S. Senators Joseph Lieberman and Susan Collins requested a report from the GAO on the cost effect of global warming since the U.S. government would be “the insurer of last resort.”⁴⁵ The report, according to Collins showed that “global warming also threatens to burden consumers and taxpayers with billions of dollars in added costs as insurance losses from floods and storms cause increases in federal spending and insurance premiums.” Indeed, the National Flood Insurance Program’s exposure rose to \$875 billion in 2005 in contrast to \$207 billion in 1980 while the Federal Crop Insurance Corporation’s exposure increased to \$44 billion from \$1.7 billion.⁴⁶ Droughts, hurricanes, flooding and other factors of climate change are considered in risk calculations by many large private insurers, but the government’s flood and crop and insurance programs “have done little to develop comparable information,” the study said. The GAO recommended more research to help Congress cap “an emerging high-risk area with significant implication” for the U.S. budget. The impact of climate change on the insurance industry may either alter the way the industry does business, abandoning its insurance of damage caused by climate change events, or cause taxpayers to shoulder the financial burden of such damage.

Conclusion:

The emission of greenhouse gases has impacted climate change and has increased risk to insurers in nearly every line of insurance. As an integral part of the global economy, insurers are expected to continue preparing for and adapting to the advent of additional claims attributed to climate change in order to not only protect the business of insurance but also worldwide businesses which require the security provided by the insurance industry to develop and grow. As realized by the World Economic Forum, “‘climate change’ is one of the most important global risks that key decision makers will face in the years to come.”⁴⁷



Developments in the EU and the U.S.

The European Union (“EU”) has been actively pursuing the incorporation of international aviation into its existing Emissions Trading Scheme (“ETS”) while the U.S. has been unable, or unwilling to enact climate change legislation.

The Impact of EU and Climate Change Action Upon the Aviation Industry

The EU is moving forward with its inclusion of international aviation into its Emissions Trading Scheme ETS⁴⁸. In July of this year, the European Commission adopted a Regulation which provided a process for small emitters of carbon dioxide to comply with the EU ETS.⁴⁹ Pursuant to the Regulation, small emitters can utilize the Small Emitters Tool developed by Eurocontrol to model fuel consumption rather than actually measure consumption. Operators utilizing the Small Emitters Tool must indicate that they are doing so in their Monitoring Plans and they must be non-commercial operators with less than 243 flights to, from or within the

EU per year (measured in three consecutive four month periods rather than calendar year) or emit less than 10,000 tonnes of carbon dioxide annually.

Each operator was required to submit its Monitoring Plan to its administering Member State by August 31, 2010. The EU has urged aircraft operators to begin submitting their monitoring and benchmarking data collected during this monitoring year for verification. It is hoped that early submission will allow time for corrections, as necessary, to obviate the imposition of penalties for non-compliance. Each administering Member State is responsible for accrediting agencies to which the aircraft operators submit their data for verification. Aircraft operators must apply for free emissions allowances by March 31, 2011, and submit their verified tonne-kilometre reports to substantiate those applications. Failure to submit the verified tonne-kilometre reports will prevent the operator from receiving free emissions allowances and may result in the imposition of a fine of 100 Euros per tonne of the operator's annual carbon dioxide emissions.

Since the EU will give free allowances to emit carbon dioxide to applying operators based on a benchmarking procedure whereby each operator's allocation of free allowances will be proportional to the reported and verified tonne-kilometres that the operator flew in 2010, it is in the best interest of aircraft operators to report the emission of as many tonnes of carbon dioxide as possible this year. However, aircraft operators are concerned that the volcanic ash crisis, which grounded flights in some parts of Europe for several days earlier this year, will cause aircraft operators to report and benchmark too few emissions and, in turn, will cause them to receive fewer free allowances.⁵⁰ For example, in Ireland, which was hit hard by the volcanic ash crisis, total aviation emissions for April 2009 were 311,748, but dropped to 263,402 in April 2010. The International Air Transport Association ("IATA") asserts that the volcanic ash crisis compels a delay in including international aviation into the EU ETS but the EU has rejected this claim, dismissing the volcanic ash crisis's effect on emissions as only minimal.

In another effort to convince the EU to abandon its inclusion of international aviation into its ETS, the Air Transport Association of America ("ATA") and three of its airline members, American, Continental and United ("ATA Plaintiffs") sued the United Kingdom ("UK") Secretary of State for Energy and Climate Change in the UK Administrative Court of the High Court of Justice on December 16th 2009 to halt the inclusion of international aviation in the EU's ETS. The ATA Plaintiffs argue that the EU is without jurisdiction to include non-EU flights, including flights to and from the U.S. The ATA Plaintiffs claim that the unilateral application of the EU ETS to non-EU airlines violates international law:

1. The EU's action violates the fundamental principle of international law set forth in Article 1 of the Chicago Convention that each state has complete and exclusive sovereignty over the airspace above its territory. The ETS will regulate air services over the territory of other states because each flight's emissions will be calculated from the beginning to the end of the flight, including whatever portion of the flight that occurs entirely within another state's airspace;
2. The EU action violates a number of other provisions of the Chicago Convention, including Article 12's recognition that the International Civil Aviation Organization ("ICAO") is vested with the authority to regulate international aviation. For example, the Convention requires all signatory countries (including the EU Member States and the U.S.) to acquire the approval of ICAO before placing any charges on airlines flying into their airports. The "charge" imposed by the ETS comes in the form of purchasing allowances in excess of permitted emissions or paying a fine for non-compliance; and
3. It violates the terms of other international agreements, including the Open Skies Agreement which entered into force in 1997 between the EU and the U.S. Article 15(3) of the Open Skies Agreement

requires that “environmental measures affecting air services” be taken in accordance with the provisions of the Chicago Convention (by reference to Article 3(4) of the Agreement).

The ATA Plaintiffs argue that emission of greenhouse gases by aircraft operators should be addressed by a global approach administered by ICAO, the entity charged with regulating current international aviation activities, and not through unilateral action by the EU. Interestingly, after remaining somewhat dormant in regulating international aviation emissions, the recent 37th Session of the Assembly of ICAO adopted a resolution calling for improvement of fuel efficiency by two percent per year until 2050 and a cap on total aviation carbon dioxide emissions by 2020, goals that are based on the new global emissions standard for aircraft engines that will take effect in 2013, when ICAO’s Assembly is scheduled to meet again. Although the U.S., Canada and Mexico pressed ICAO to pass a resolution, albeit non-binding, that countries “seeking to implement an emissions trading system that applies to other contracting states’ aircraft operators” do so only “on the basis of mutual agreement,”⁵¹ it seems that ICAO rejected this request with its current resolution which does not require the mutual agreement of other States to implement a cap-and-trade program like the EU’s ETS.⁵² The UK Department of Energy and Climate Change “firmly refutes” the ATA Plaintiffs’ case and maintains that it is “confident on the merits of the defence and intends to make a robust defence of the European legislation in the European Court.”⁵³

While the UK filed opposition papers with the High Court in January 2010, IATA and the National Airlines Council of Canada filed amicus briefs to support the ATA Plaintiffs’ arguments. In March 2010, the ATA Plaintiffs sought to have their case heard by the European Court of Justice (“ECJ”). (The ECJ has jurisdiction over the EU Member States and, thus, the authority to rule on the EU ETS.)

On May 27, 2010, the High Court ruled that it would refer the case to the ECJ and on July 8, 2010, the High Court transmitted to the ECJ an Order for Reference to be published in the Official Journal of the European Union. The Order for Reference seeks a preliminary ruling from the ECJ on six questions in relation to the validity of Directive 2003/87/EC,⁵⁴ as amended by Directive 2008/101/EC.⁵⁵ The Order asks the ECJ to make a determination whether customary principals of law⁵⁶ provide a basis for challenging the incorporation of international aviation into the EU ETS and whether the Directive 2008/101/EC is invalid to the extent that it applies to flights not occurring within the EU and, thus, contravenes the customary principals of international law.

It is not clear when the ECJ will rule on the case but it is hoped that action will be taken before the end of 2010, which is the monitoring year for airlines. In the interim, airlines continue to seek operating efficiencies to reduce fuel consumption and to develop long range plans to acquire more efficient engines and aircraft, and to investigate the use of biofuels. Thus, while the EU presses to include the international aviation industry’s mandatory participation in its ETS by January 1, 2013, the aviation industry and other governments continue to fight the EU’s unilateral action.

The Brussels Summit: During a two-day summit in October 2010 in Brussels, Belgium, EU leaders met to debate solutions to the financial crisis affecting particular EU Member States and the manner in which the EU will continue to address the issue of climate change given the fiscal problems caused by the weak economy. With the Kyoto Protocol set to expire at the end of 2012, the EU leaders in attendance agreed to endorse a second phase of the UN’s climate treaty but only if other big economic powers would agree to make deep reductions in their greenhouse gas emissions and “provided the conditions...are met,” alerting world leaders that the EU could walk away from a second phase of the Kyoto Protocol if other governments fail to commit to significant emissions reductions.⁵⁷ Additionally, the EU asserted that it was not presently prepared to go beyond a planned 20 percent cut in greenhouse gas emissions referring to the commitment the EU made in

2008 to cut its carbon emissions by 20 percent by 2020 based on 1990 levels) – at least not until after the commencement on November 29, 2010, of the UNFCCC meeting in Cancun.⁵⁸

The U.S. and Climate Change Action

In the U.S., several attempts to enact climate change legislation were made in 2009 and 2010.

Waxman-Markey Bill: On June 26, 2009, the U.S. House of Representatives passed the Waxman-Markey Bill⁵⁹ by a vote of 219 to 212.⁶⁰ The Bill was ultimately placed on the Senate Calendar in July 2009 with no further action to date.

The Clean Energy Jobs and American Power Act: On September 30, 2009, Senators John Kerry and Barbara Boxer unveiled a draft of The Clean Energy Jobs and American Power Act.⁶¹ On November 5, 2009, the Environment and Public Works Committee voted to report the Act out of Committee and onto the Senate floor for debate during a Republican Committee Member boycott of the vote. (Committee rules require the presence of two minority members to conduct business, including the consideration of amendments to the Act, but only a majority vote to report a bill from Committee.) In February 2010, this Bill was placed on the Senate Calendar with also no further action to date.

American Power Act: On May 12, 2010, Senators John Kerry and Joseph Lieberman released a discussion draft of their Bill entitled The American Power Act.⁶² In addition to reducing greenhouse gases, the Bill supports the development of clean energy technologies and the enhancement of energy security in a sector-based program. Notably, the Bill calls for the increase in nuclear power and a cap-and-trade program covering stationary sources (about 7,500 sources emitting more than 25,000 tons of greenhouse gases per year) with the following cap scale based on 2005 levels: 4.75 percent by 2013, 17 percent by 2020, 42 percent by 2030 and 83 percent by 2050. However, at the end of July 2010, Senators Harry Reid and John Kerry with Carol Browner, Director of the White House Office of Climate Change and Energy Policy, announced that upcoming legislation would not regulate greenhouse gas emissions but would focus on cleaning up the Gulf Coast oil spill and energy efficiency.

It has been speculated that the U.S. government was too preoccupied with the passage of health care legislation and, understandably, responding to the Gulf Coast oil spill to concern itself with enacting climate change legislation. Undoubtedly, the economic crisis has also caused the American public to be more concerned with unemployment and resulting financial effects than with regulating climate change through legislation.

Though U.S. Senator Harry Reid recently indicated that there is a “chance” that climate change legislation could be included in another Congressional Bill later this year it appears for now that the U.S. will not succeed in enacting climate change legislation in 2010. The willingness to enact legislation and the prospects for action by Congress in difficult economic times remains a tough sell. This may ring especially true after the recent midterm U.S. elections where Republican victories may boost efforts to block the EPA’s climate regulations.

Conclusion:

While it is most likely that the U.S. will ring in 2011 without a trade bill or any meaningful climate change legislation, operators must be prepared to comply with the requirements of the EU’s ETS unless the industry challenge to the regulation is successful.



- ¹ See *EPA Rejects Claims of Flawed Climate Science*, EPA, Jul. 29, 2010 (<http://yosemite.epa.gov/opa/admpress.nsf/e77fdd4f5afd88a3852576b3005a604f/56eb0d86757cb7568525776f0063d82f!OpenDocument>).
- ² *Id.*
- ³ *Id.*
- ⁴ See *Press Release, WMO Statement on the Status of the Global Climate in 2005*, WMO, Dec. 15, 2005 (http://www.aussmc.org/pdf/WMO_press_release_2005_Final.pdf).
- ⁵ Paul E. Gutermann, Esq., John T. McLane Jr. and Michael P. Long, *Storm Clouds Ahead: Climate Change and the Insurance Industry* in *Climate Change: Litigation, Regulation and Risk*, Thomson Reuters/West, 2008.
- ⁶ *Id.*
- ⁷ Evan Mills, *Insurance in a Climate of Change*, *Science*, Aug. 12, 2005, vol. 309, no. 5737, pp. 1040-1044.
- ⁸ *Id.*
- ⁹ *Comer v. Murphy Oil USA*, No. CIV 1:05-CV436LGRHW, 2007 WL 6942285 (S.D. Miss. Aug. 30, 2007).
- ¹⁰ *Comer v. Murphy Oil USA*, 585 F.3d 855 (5th Cir. 2009).
- ¹¹ *Comer v. Murphy Oil USA*, 598 F.3d 208 (5th Cir. 2010).
- ¹² *Id.*
- ¹³ *Id.* at 1054.
- ¹⁴ *Comer v. Murphy Oil USA*, 607 F.3d 1049, 1053-54 (5th Cir. 2010).
- ¹⁵ *Connecticut v. Am. Elec. Power Co., Inc.*, 406 F. Supp. 2d 265 (S.D.N.Y. 2005).
- ¹⁶ *Connecticut v. Am. Elec. Power Co., Inc.*, 582 F.3d 309 (2d Cir. 2009).
- ¹⁷ *Connecticut v. Am. Elec. Power Co., Inc.*, 9 U.S.L.W. 3092 (Aug. 2, 2010).
- ¹⁸ *Native Village of Kivalina v. ExxonMobil Corp.*, No. C 08-01138, 2008 WL 2951742 (N.D. Cal. May 15, 2008).
- ¹⁹ *Steadfast Ins. Co. v. The AES Corp.*, No. 2008-858 (Va. Cir. Ct. Feb. 5, 2010).
- ²⁰ *California v. General Motors Corp.*, No. C06-05755, 2007 WL 2726871 (N.D. Cal. Sep. 17, 2007).
- ²¹ Myles R. Allen, *Attributing Extreme Weather Events: Implications for Liability* in *Munich Re Liability for Climate Change? Experts' Views on a Potential Emerging Risk*, March 2010.
- ²² Richard Stewart, *Climate Liability Under the Obama Presidency* in *Munich Re Liability for Climate Change? Experts' Views on a Potential Emerging Risk*, March 2010.
- ²³ *Id.*
- ²⁴ Christina Ross, Evan Mills & Sean B. Hecht, *Limiting Liability in the Greenhouse: Insurance Risk-Management Strategies in the Context of Global Climate Change*, 26A *Stan. Env'tl L.J.* 251, 257 (2007).
- ²⁵ See *Warming a \$900 Billion Insurance Risk?* AP, Apr. 20, 2007.
- ²⁶ Christina Ross, Evan Mills & Sean B. Hecht, *Limiting Liability in the Greenhouse: Insurance Risk-Management Strategies in the Context of Global Climate Change*, 26A *Stan. Env'tl L.J.* 251, 257 (2007).
- ²⁷ Paul E. Gutermann, Esq., John T. McLane Jr. and Michael P. Long, *Storm Clouds Ahead: Climate Change and the Insurance Industry* in *Climate Change: Litigation, Regulation and Risk*, Thomson Reuters/West, 2008.
- ²⁸ *Insurance in a Climate of Change – The Greening of Insurance in a Warming World*, U.S. Dep't Energy, Energy Analysis Dep't, Feb. 1, 2007 (<http://insurance.lbl.gov/opportunities.html>).
- ²⁹ Scott M. Seaman and John E. Delascio, *Professional Liability and Global Warming Claims* in *Munich Re Liability for Climate Change? Experts' Views on a Potential Emerging Risk*, March 2010.
- ³⁰ *Id.*
- ³¹ Ceres at <http://www.ceres.org/Page.aspx?pid=415>.
- ³² See *Challenges on Implementing the SEC's New Interpretive Guidance on Climate Change*, *Westlaw J., Corp. Officers & Director's Liab.*, Vol. 25:19, Mar. 15, 2010.
- ³³ *Id.*
- ³⁴ See, e.g., *Certain Underwriters at Lloyd's v. KKM, Inc.*, 215 S.W.3d 486 (Tex. App. 2006). However, some courts have refused to apply the doctrine to defeat coverage for a loss when, at the time coverage under the policy commenced, the policyholder may have known about the conditions that eventually caused the loss but did not intend the resulting loss. See, e.g., *Westchester Fire Ins. Co. v. Gulf Coast Rod, Reel & Gun Club*, 64 S.W.3d 609 (Tex. App. 2001) (interpreting CGL policy).
- ³⁵ *Massachusetts v. EPA*, 548 U.S. 903 (2006).

³⁶ *Id.*; see also 42 U.S.C. § 7602(g).

³⁷ Paul E. Gutermann, Esq., John T. McLane, Jr. and Michael P. Long, *Storm Clouds Ahead: Climate Change and the Insurance Industry* in *Climate Change: Litigation, Regulation and Risk*, Thomson Reuters/West, 2008.

³⁸ Evan Mills, *Insurance in a Climate of Change*, *Science*, Aug. 12, 2005, vol. 309, no. 5737, pp. 1040-44.

³⁹ Cyril Tuohy, *Capturing the Carbon Market: Commercial Insurance Carriers Gear Up to Cover the Risks of Sequestering Carbon, But For Now, Stop Short of Offering the Long, Long Long-Tail Coverage that Such Projects Require*, *Risk & Ins.*, Oct. 15, 2009 (<http://www.riskandinsurance.com/story.jsp?storyId=269538953>).

⁴⁰ Paul E. Gutermann, Esq., John T. McLane, Jr. and Michael P. Long, *Storm Clouds Ahead: Climate Change and the Insurance Industry* in *Climate Change: Litigation, Regulation and Risk*, Thomson Reuters/West, 2008.

⁴¹ Christina Ross, Evan Mills & Sean B. Hecht, *Limiting Liability in the Greenhouse: Insurance Risk-Management Strategies in the Context of Global Climate Change*, 26A *Stan. Env't'l L.J.* 251, 257 (2007).

⁴² Evan Mills, *Insurance in a Climate of Change*, *Science*, Aug. 12, 2005, vol. 309, no. 5737, pp. 1040-44.

⁴³ *Id.*

⁴⁴ See Virginia Haufler, *Insurance and Reinsurance in a Changing Climate*, *Encyclopedia of Earth*, Jul. 23, 2009; see also Robert D. Allen, Scott M. Seaman and John E. DeLascio, *Emerging Issues: Global Warming Claims and Coverage Issues*, *Def. Couns. J.*, Jan. 2009.

⁴⁵ See *Warming a \$900 Billion Insurance Risk?* *AP*, Apr. 20, 2007.

⁴⁶ *Id.*

⁴⁷ Robert D. Allen, Scott M. Seaman and John E. DeLascio, *Emerging Issues: Global Warming Claims and Coverage Issues*, *Def. Couns. J.*, Jan. 2009.

⁴⁸ See European Parliament and Council, Directive 2003/87/EC, Oct. 13, 2003; see also European Parliament and Council, Directive 2008/101/EC, Nov. 19, 2008.

⁴⁹ See Commission Regulation (EU) No. 606/2010, Jul. 9, 2010 (regarding the approval of a simplified tool to estimate the fuel consumption of certain small emitting aircraft operators).

⁵⁰ It has been estimated that the volcanic ash crisis “closed nearly 80% of European airspace” and caused “losses exceeding \$1.7 billion.” Andy Pasztor, *Airline Industry Remains Divided on Ash Threat*, *Reuters*, July 22, 2010.

⁵¹ James Kantor, *U.S. Steps Up Its Effort Against a European System of Fees on Airline Emissions*, *N.Y. Times*, Sept. 9, 2010.

⁵² See *Breakthrough in Climate Change Talks at UN Aviation Body*, *Air Transp. News*, Oct. 11, 2010.

⁵³ James Murray, *Government Vows to Fight US Airlines' Emissions Trading Legal Challenge*, *BusinessGreen*, Jan. 26, 2010.

⁵⁴ See European Parliament and Council, Directive 2003/87/EC, Oct. 13, 2003 (establishing the EU ETS).

⁵⁵ See European Parliament and Council, Directive 2008/101/EC, Nov. 19, 2008 (incorporating international aviation into the EU ETS).

⁵⁶ The High Court seeks a ruling as to whether the following rules of international law can be relied upon to challenge the validity of the EU action: (a) each state has sovereignty over its airspace; (b) no state may purport to subject any portion of the high seas to its sovereignty; (c) freedom to fly over the high seas; (d) that aircraft flying over the high seas are subject to the exclusive jurisdiction of the country of registration except as otherwise provided by international treaty (UK does not accept this statement); (e) the Chicago Convention; (f) the Open Skies Agreement; and (f) the Kyoto Protocol.

⁵⁷ *EU Sticks to 20-Percent Carbon Cuts*, *AFP*, Oct. 29, 2010.

⁵⁸ *Id.*

⁵⁹ The Waxman-Markey Bill was formally entitled the American Clean Energy and Security Act (ACES).

⁶⁰ See The American Clean Energy and Security Act of 2009, H.R. 2454, 111th Cong. § 1 (2009).

⁶¹ See The Clean Energy Jobs and American Power Act of 2009, S. 1733, 111th Cong. § 1 (2009).

⁶² See The American Power Act of 2010, S. _____, 111th Cong. § 2 (2010)

(<http://kerry.senate.gov/imo/media/doc/APABill3.pdf>).

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