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Quite An 'Occurrence': Rehearing Steadfast V. AES

Law360, New York (February 09, 2012, 1:53 PM ET) -- The Virginia Supreme Court recently agreed to rehear a coverage dispute involving the defense of climate-change lawsuits. The court previously had held that historic emissions of greenhouse gases were not a covered "occurrence." The rehearing decision is unusual and the case is considered an important bellwether as the first of its kind.

As global temperatures rise and the apparent shift away from the combustion of fossil fuels continues to affect the global economy, properly managing environmental risks becomes even more vital. This case, Steadfast Ins. Co. v. AES (hereafter, Steadfast), involves a dispute over an insurance company's duty to defend claims involving nuisance and emissions.

These types of claims, however, likely are just the tip of the iceberg.

In addition to underlying nuisance claims, property damage, business interruption and director and officer (D&O) insurance claims also involving climate change are likely to proliferate as atmospheric and oceanic circulation patterns transition in response to planetary temperature increases. Steadfast raises issues that are likely to be salient in all of these types of claims alleging harm from global warming.

Steadfast is the first insurance coverage case to come out of climate-change litigation. The case arose out of a 2008 lawsuit brought by a native Inupiat village in Northern Alaska captioned the Native Village of Kivalina v. ExxonMobil Corp.

The Village of Kivalina was forced to relocate from its exposed peninsula, in part, because sea ice no longer protected the spit of land from severe winter storms. The underlying case seeking relocation costs and other relief presently is under appeal to the U.S. Court of Appeals for the Ninth Circuit.

The case was filed in U.S. District Court for the Northern District of California, which dismissed the one federal nuisance claim. In doing so, the district court expressly suggested that the severed state nuisance claims be pursued in Alaska courts.

One of several defendants that allegedly acted "intentionally or negligently" in creating a nuisance, the energy company AES, was then sued in Virginia by its insurance company, a Zurich subsidiary. Steadfast's lawsuit sought, among other things, a declaration of no duty to defend. The duty to defend has been called "peace of mind" insurance and is triggered almost universally under a broad "any possibility of coverage" standard.

Steadfast initially argued that no “property damage” was alleged and put forth three additional coverage defenses. In addition to the alleged lack of an “occurrence,” Steadfast argued that a pollution exclusion in its general liability insurance policy, which included some pollution coverage for reported spills, etc., applied.

Steadfast also argued that the judicial concept of “known loss,” which excludes coverage for a loss the policyholder knew about prior to obtaining the insurance policy, also operated to preclude any possibility of coverage.

Virginia courts are known for construing pollution exclusions broadly. Virginia’s Supreme Court previously had held that chlorination of drinking water involved an excluded pollutant, and this case was cited prominently by Steadfast in its briefing.

At oral argument before the Supreme Court in April 2011, Steadfast made the following two more specific arguments on the duty to defend based on the above defenses. The first, as discussed above, involved the alleged inability to identify an "occurrence" — that is, an accidental happening of the sort that can trigger a viable liability claim.

The “occurrence” concept is vague, but has been used to argue that claims should be denied because they are not sufficiently accidental or because they do not arise out of a specific event or events. Steadfast argued that because the Kivalina plaintiffs alleged long-term corporate knowledge of AES’s emissions, which emissions were not sufficiently “accidental,” the underlying lawsuit did not involve conduct that could be an “occurrence.”

AES countered that it was the resulting harm from the alleged conduct that was the issue, not whether the conduct itself that led to the harm was intentional.

Part of the reason for the rehearing may be some procedural glitches on the Steadfast case’s path to appeal. The Circuit Court of Arlington County, Va., reached its initial grant of summary judgment on the "occurrence" issue after an earlier round of summary motions from both sides in which judgment was denied because of questions of fact related to reliance on extrinsic evidence by both sides in supporting their motions.

Given the potential stakes, the parties' initial emphasis on extrinsic background materials is understandable. This initial denial, however, may also explain the procedural glitch that seems to have arisen, but which now may be revisited on rehearing.

The first round of trial court briefing also involved the application of standard-form exclusionary language regarding pollution. The “absolute” pollution exclusion was introduced in or around 1985 as a way to exclude liability coverage for Superfund cleanup liabilities; the language of the exclusion borrows heavily from the federal statute.

It has since been used beyond its original intent in attempts to preclude coverage for all manner of claims where some sort of “irritant” or “contaminant” may be involved — even parts of the air we breathe or where products or negligence also are involved.

The procedural glitch arose because the parties disputed whether the pollution exclusion issue was properly before the court on appeal. The pollution exclusion initially was rejected as a coverage defense based upon questions of fact in the initial summary judgment round and apparently was not assigned as cross-error after appeal of the results of the second round of summary judgment.

This second round of summary motions was based solely upon the “eight corners” of two documents, the underlying complaint and the insurance policy at issue. After this second round of briefing and a grant of summary judgment in favor of Steadfast on the "occurrence" issue, AES appealed directly to the Virginia Supreme Court.

The issue of whether and how carbon dioxide (CO2) emissions might be excluded from coverage as "pollutants" has been the subject of considerable debate. Steadfast asserted during oral argument before the Supreme Court that while every substance may be "proper and benign in its proper place and proper quantity," it may become a pollutant in higher concentrations.

AES countered that the underlying complaint alleged negligence as well as that AES knew or should have known that harm would result. The allegations of negligence and that AES “should have known” both involve unintentional conduct which seemingly would involve accidental conditions.

AES also argued that CO2 was not identified specifically in the insurance policy, as some other substances are, and also did not clearly fall within the class of excluded “pollutants” because it is an "omnipresent" and a naturally occurring "odorless and colorless gas" "critical to the survival of animal and plant life".

Meanwhile, Chief Justice Cynthia Kinser observed that the trial judge had identified questions of fact surrounding application of the pollution exclusion and that no cross-error had been assigned.

Turning back to the central issue of an "occurrence," another judge who will remain on the court for the forthcoming rehearing identified a key issue during oral argument, i.e., whether and how an "accident" could be identified based upon the allegations in the village’s underlying complaint. Several other issues also came up on oral argument.

First, there was a question about from whose perspective the accident determination should be made — an objective standard or from the subjective viewpoint of the policyholder?

Second, as touched upon above, is the conduct at issue the intentional business activity or the unintended consequences thereof? On this point, Steadfast argued the former and that "insurance does not and should not cover harm resulting from ordinary business operations."

Steadfast also countered a traffic-accident analogy put forth by AES by arguing that a motorist intentionally changing lanes after glancing in the rear view mirror and seeing a vehicle in its way could not then have an accident with that same car behind it as the term "accident" is used in commercial general liability insurance policies.

In a decision issued Sept. 16, 2011, the Virginia Supreme Court held that under the facts in Steadfast, an allegation of negligence was insufficient to establish an occurrence. Whether or not AES's intentional act(s) constituted negligence, the court held that, under the circumstances, the natural and probable consequence of AES's intentional act(s) would not be an accident under Virginia law and, thus, a covered "occurrence" did not exist.

Two senior justices sitting by designation to fill vacancies who participated in this opinion have since been replaced by permanent members of the court. These two senior justices wrote a concurring opinion at the time cautioning against overbroad application of the court's majority holding. The rehearing may revisit and clarify this issue.

After the Virginia Supreme Court's first decision, AES petitioned for rehearing, arguing that the Virginia case law cited by the court does not support the idea that allegations that a defendant should have known its conduct would cause harm do not give rise to an "occurrence" or "accident."

AES previously had argued that the standard ought to be whether a defendant should have known to a substantial probability that the conduct would cause harm. On Jan. 17, 2012, the court set aside its prior decision and granted AES's petition for rehearing.

Additional briefing and oral argument are set to take place during the court's February session, which is scheduled to conclude by the middle of March 2012.

Rehearings are very infrequent and only occur in about 3 percent of Virginia Supreme Court cases. The court's prior Steadfast decision was hailed by insurance interests as definitive. However, as discussed, two former justices cautioned against broad application.

Moreover, Virginia is not necessarily representative, because it generally is not known for its pro-policyholder-consumer judiciary. There are those who believe that the case easily could have been distinguished under other circumstances and that perhaps the issues would be decided differently in more favorable jurisdictions. Obviously, this would do no good for AES in the present dispute.

Nonetheless, this case is important. However, the case was disappointing to many because it did not address the pollution exclusion issue.

Both sides seemingly now have another bite at the apple. The duty to defend is broad for a reason. The irony here is that the insurance industry has a common interest with policyholders such as AES in defending these kinds of underlying suits involving climate change.

In other words, rather than fight over the duty to defend this one case and save a relatively modest amount of defense costs, a more enlightened strategy might be to cooperate in nipping costly nuisance suits involving climate change in the bud.

Steadfast had an opportunity to participate in AES's defense and contribute to defense strategy. Instead, Steadfast cut and ran. The Virginia Supreme Court may think better of its determination that no possibility of coverage exists based upon the underlying allegations.

Then again, more bad news might be on the way for policyholders. The court may broaden its holding and throw in that the pollution exclusion also bars coverage. One thing is certain: legal disputes related to climate change and the insurance industry's obligations will be with us for a long time to come.

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