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Climate Change and the Pollution Exclusion — Are You in Jeopardy of Losing Your D&O and E&O Insurance?

By John G. Nevius and Kathleen F. Donovan

In light of the emerging risks associated with climate change and related environmental liabilities, the proliferation of pollution exclusions in directors & officers (D&O) and errors & omissions (E&O) insurance policies is an alarming trend. The insurance industry's long history of efforts to expand the scope of these exclusions adds cause for concern, because virtually any substance can be an irritant or pollutant in sufficient concentrations or under specific circumstances. The highest courts of many states recognize that this can lead to absurd results and have refused to allow overboard application of "absolute" or "total" pollution exclusions.

Beware: The Pollution Exclusion Can Render Anticipated Coverage Illusory

Many policyholders, particularly directors and officers, and professionals with E&O coverage, may not have even considered their potential exposure to liability arising from environmental risks, let alone that a pollution exclusion could render anticipated coverage illusory. This is especially true in certain industries. Regrettably, these exclusions have even been used to defeat the exceedingly broad duty to defend. In fact, a large brokerage has publicly asserted that "best practices" call for clarification of the purpose and scope of pollution exclusions in D&O coverage, at least when it comes to climate change.

The use of pollution exclusions to evade the duty to defend D&O and E&O claims is of particular concern when it comes to mixed allegations involving negligence or business judgment, which should almost automatically give rise to a duty to defend. In some jurisdictions claims routinely are denied on the basis that the underlying harm "arises from" or is "based on" the involvement of a pollutant in the broadest sense.

Among other things, D&O insurance policies are designed to protect corporate directors

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and officers from liability arising from the routine exercise of business judgment. D&O insurance policies, however, typically exclude "claims related to pollution, libel and slander, bodily injury and property damage, ERISA, or claims for which the directors have other insurance policies in force or for which their corporation indemnifies them." One of the purposes of these exclusions may be to encourage the sale of more specialized, "environmental" insurance, but not all circumstances should require businesses to carry specialty coverage.

Pollution exclusions may differ in their precise language, but more modern exclusions have been labeled "absolute" and "total" to differentiate them from the circa-1970 "sudden and accidental" qualified exclusion. These labels, however, should not be used to afford limitless scope to the exclusion, as less scrupulous insurance companies have been known to attempt. See, for example, *Robert E. Lee & Assocs., Inc. v. Peters*, 557 N.W.2d 457 (Wis. App. 1996), which found that the "absolute" pollution exclusion is not applicable to products/completed operations.

These issues take on added urgency in light of Securities and Exchange Commission disclosure guidelines regarding climate change. The promulgation of these guidelines means that courts will continue to wrestle with the novel argument that a D&O's liability for failure to disclose environmental factors may be excluded by a pollution exclusion aimed at industrial clean-up costs.

Litigation Dealing with Pollution Exclusions in D&O Policies

Owens Corning v. National Union Fire Ins. Co. of Pittsburgh, PA (6th Cir. 1998) is typical of recent litigation dealing with pollution exclusions in D&O policies. Although *Owens Corning* addressed the applicability of an asbestos exclusion, the various pollution-related exclusions are analogous, and the *Owens Corning* court's reasoning has been cited favorably by other courts confronted with similar conflicts. In *Owens Corning*, the U.S. Court of Appeals for the Sixth Circuit reversed the District Court's grant of summary judgment for the insurance company, holding that coverage existed. Owens Corning sought coverage from Chartis subsidiary, National Union, with respect to a shareholder suit alleging that the company and its directors "had misrepresented the company's future financial exposure to asbestos claims, that the defendants had 'failed to disclose the danger' that…products liability insurance coverage would eventually be exhausted, and that [they] had 'misled investors concerning the impact that asbestos claims would have on…future financial condition and prospects.'" National Union denied coverage based upon an asbestos exclusion in the policy.

The Sixth Circuit analyzed the underlying complaint to determine whether the allegations were "based upon," "arising out of" and "related to" asbestos as the terms are used, and held for the policyholder. The court dismissed National Union's argument that the shareholders' claims were "based upon" the use of asbestos, holding instead that "the alleged 'act, error, or omission' here was misleading investors, which has no discernible connection to products liability issues such as the 'use, exposure, presence, existence, detection, removal, elimination or avoidance' of asbestos." The court then turned to the proper interpretation of "arising out of" as utilized in the exclusion. Relying on Ohio case law, the court held that this language "require[s] more than a 'but for' analysis." Instead, the proper test is whether there was an intervening cause or activity to break the chain of causation between the use of asbestos and the shareholders' claim: "the alleged misrepresentations by the directors and officers broke the chain of causation linking the [underlying] claim to asbestos." Finally, the court rejected National Union's broad interpretation of the term "related to," reasoning that such an interpretation would eviscerate all coverage. The court's holding was based, in part, on the fact that Owens Corning used asbestos in the ordinary course of its business.

Recognizing the Risks and Taking Steps to Protect Interests is Key

Insurance companies may deny coverage under D&O and E&O policies for alleged liability that remotely relates to pollution or the environment. Corporations and their

D&O's, insurance underwriters, brokers and other policyholders and professionals facing substantial professional liability exposure(s) potentially related to products or substances that may pollute or irritate need to be aware of, and must recognize the risks inherent in, these divergent interpretations and take the necessary steps to protect their interests.

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