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Tom Hagy
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Editorial Office

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Articles and Submissions

Direct editorial inquiries and send material for publication to:

Tom Hagy, Editor-in-Chief, tom.hagy@litigationconferences.com

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Morgan Morrissette Wright, Publisher, Full Court Press at mwright@fastcase.com or at 202.999.4878

For questions or Sales and Customer Service:

Customer Service
Available 8am–8pm Eastern Time
866.773.2782 (phone)
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Sales
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Climate Change, ESG, and D&O Insurance: Collision or Cooperation?

Robert D. Chesler, Dennis J. Artese, and Joseph Vila*

Abstract: *Climate change has been tied to the recent increase in catastrophic weather events. Insurance coverage for often billions of dollars in damage becomes a source of argument between insurers, who want to limit their exposure, and policyholders, who want the coverage they argue the carriers are contractually obligated to pay. The authors discuss the nature of the underlying suits and the potential coverage issues; the types of policies implicated; cases that have addressed these issues; the rising societal concern over climate change that have played a role in the new corporate emphasis on environmental, social, and governance, or ESG, and the insurance industry's response to this trend.*

Introduction

Catastrophic loss because of climate change is here: witness the recent damage caused by flooding from Hurricane Ida and the swathe of destruction created by the tornados in the Southeast and Midwest. Climate change has disrupted traditional weather patterns. What was a once a hundred-year risk of a catastrophic hurricane is now occurring with frightening frequency. Wildfires ravage the West Coast and are spreading inland as well. Tornados also are occurring with increased frequency and destructiveness.

The most obvious insurance policy implicated by catastrophic climate change is the first-party property policy, which responds to damage to the policyholder's own property and to business interruption. Historically, insurance disputes principally meant disputes over liability insurance coverage. Now, because of the calamitous property loss caused by climate change events, property insurance

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disputes, too, are quickly rising in number and complexity. The insurance industry is aware of these increasing risks. Reports in the insurance industry press indicate that the industry is considering a variety of changes to property policies aimed at curtailing climate change coverage—and increasing the uninsured exposure to policyholders.

Nature of Underlying Suits and Potential Coverage Issues

Directors and Officers (D&O) policies, however, are also directly affected by climate change. Two types of suits are already happening. First, there are at least 1,375 climate change–related suits pending in the United States, about two dozen of which have been filed by local municipalities and states seeking damages because of climate change. For example, the attorneys general of New York, Massachusetts, and the U.S. Virgin Islands launched investigations to determine whether Exxon Mobil Corporation misrepresented to investors the risks of how climate change might impact its business. Although the U.S. Virgin Islands attorney general terminated its investigation, the New York and Massachusetts attorneys general filed separate suits against Exxon.

In the seminal case *People of the State of New York, By Letitia James v. Exxon Mobil Corporation*, 119 N.Y.S.3d 829 (N.Y. Sup. Ct. 2019), the State of New York sued Exxon, alleging that it violated the state's securities act by making materially false and misleading statements to the public and investors about how the company manages risks of climate change and the cost of carbon in assessing demand for its products. The state dropped its common law fraud claims prior to trial, but proceeded with a claim under New York's Martin Act, which permits the attorney general to sue for fraud in connection with the marketing of securities without requiring proof of scienter, reliance, and damages, as well as under New York's Executive Law, which prohibits persistent fraudulent acts. After a trial, the New York Supreme Court held that the state failed to demonstrate by a preponderance of the evidence that Exxon made any material misrepresentations to investors.

Precisely one year after New York filed its complaint, the Massachusetts attorney general filed a similar complaint in state court against Exxon. The Massachusetts lawsuit expanded upon New York's allegations, alleging that Exxon misled consumers regarding its long-standing knowledge of the risk of climate change, and deceived consumers and investors about the systematic financial risk of climate change to the global economy by, among other things, advertising Exxon as leading efforts in clean energy research and climate action. Unlike New York's case, which has been decided on the merits, the Massachusetts litigation has focused on jurisdictional issues to date, with Exxon's attempt to remove the case to federal court being unsuccessful thus far. *See* *Massachusetts v. Exxon Mobil Corp.*, 462 F. Supp. 3d 31 (D. Mass. 2021).

Although brought directly against the company, these enforcement actions have, in turn, spun off private civil litigation against directors and officers. Indeed, Exxon is litigating at least two securities-related lawsuits against its executives in federal court in Texas relating to its climate change disclosures. The seminal securities class action related to climate change disclosures was filed in 2016 in the Northern District of Texas against Exxon and certain directors and officers. *Ramirez v. Exxon Mobil Corp.*, No. 3:16-cv-3111 (N.D. Tex. Filed Nov. 7, 2016). Like New York's lawsuit, the shareholders in the dispute allege that Exxon and its executives made materially false statements in its public disclosures. The shareholders claim that this, and other changes in oil and gas marketing conditions, resulted in Exxon artificially inflating the value of its assets in order to maintain the company's credit rating and secure a $12 billion debt offering on favorable terms.

In a related case, *In re Exxon Mobil Corp. Derivate Litigation*, 3:19-cv-01067 (N.D. Tex. Filed May 2, 2019), shareholders filed derivative suits against certain Exxon directors and officers for breach of fiduciary duty, waste of corporate assets, unjust enrichment, and contribution and indemnification under the Exchange Act from Exxon's directors and officers to Exxon should they be determined to have violated the Exchange Act. Broadly speaking, the complaint asserts that Exxon has a history of intentionally misleading the public as to the effects of climate change, and the company's contribution thereto, as well as misrepresenting the

effect of climate change on Exxon's reserve values and long-term business.

Climate change suits against D&O insurance companies may present difficult coverage issues. Many D&O policies contain pollution exclusions, and insurance companies already have indicated their intention to rely on pollution exclusions to deny coverage for lawsuits alleging "losses" as a result of D&Os' "wrongful acts" in financial reporting related to climate change. No case law exists yet on the effect of pollution exclusions in D&O policies in this context. Case law on absolute pollution exclusion clauses in general liability policies is split. Some courts have construed this exclusion very broadly to include almost anything that enters the environment, including, for example, fumes from a floor sealant. Other courts construe the exclusion to apply only to "traditional environmental pollution," a standard the borders of which are unclear: Is a suit over climate change a suit concerning "traditional environmental pollution"?

One issue in this analysis is proximate cause. In *Sealed Air Corp. v. Royal Indem. Co.*, 404 N.J. Super. 363 (App. Div. 2008), shareholders alleged that the company and its directors and officers misrepresented the company's environmental exposure. The insurance company denied coverage under the D&O policy on the basis of a pollution exclusion. The New Jersey Appellate Division disagreed and found coverage. It essentially held that the proximate cause of the loss was not the pollution but the misrepresentations and, therefore, the D&O policy's pollution exclusion did not apply.

Another typical coverage exclusion that D&O policyholders need to be mindful of when seeking coverage for climate change–related suits is what is commonly referred to as the conduct exclusion. This type of exclusion generally excludes coverage for intentional, willful, or deliberate misconduct or criminal acts. This exclusion might limit or eliminate coverage, for example, in lawsuits alleging the company's directors and officers intentionally implemented a program of regulatory non-compliance, or in lawsuits alleging that the deliberate withholding of information relating to the company's climate change–related vulnerabilities. This exclusion, however, is typically subject to a "final adjudication" requirement, so that it is not triggered until there is a final court

decision finding such misconduct. In other words, the presence of the "final adjudication" requirement is beneficial for policyholders because the insurance company will have to fund defense costs until there is such a determination. With that said, if there is ultimately a final adjudication of such misconduct, then the insurance company may be entitled to recover amounts it paid to defend the director or officer.

Environmental, Social, and Governance Issues

The rising societal concern over climate change is a major factor in the recent corporate emphasis on ESG—environmental, social, and governance issues. One prong of ESG is sustainability and making companies more socially conscious and responsive to climate change. Companies are announcing aggressive programs to reduce their carbon footprint and their emissions, particular favorites of activist investors. A company's failure to meet its goals can result in shareholder suits against the company's officers and directors.

One example is *Meyer v. Jinkosolar Holdings Co.*, 761 F.3d 245 (2d Cir. 2014). In that case, the Second Circuit Court of Appeals held that shareholders could proceed with their "greenwashing" lawsuit—that is, misrepresenting success in meeting its environment goals—against the company and its officers, directors, and underwriters. Specifically, the shareholders claimed that the company made materially misleading statements in its prospectus issued as part of its public offering regarding its compliance with environmental laws at its production facility in China. Subsequently, the parties settled the shareholders' claims for more than $5 million while new motions to dismiss were pending. *See Meyer v. Jinkosolar Holdings Co.*, Case No. 11-cv-7133, Dkt. No 100 (S.D.N.Y. Mar. 11, 2016).

The insurance industry's reaction to climate change and ESG is following two paths. The first is to reduce coverage. As noted, climate change–motivated reductions to property insurance may already be in the works. Additionally, some insurance industry commentators have advocated adding a climate change exclusion to D&O policies.

At the same time, the insurance industry is aware that ESG measures can reduce directors' and officers' exposure to suits.

Insurance companies are paying increased attention in underwriting to companies' ESG activities. In particular, global insurance broker Marsh has partnered with certain insurance companies to provide more favorable coverage terms to companies that can demonstrate strong ESG programs through a review process.

Conclusion

As regulatory activity and private litigation activity surrounding climate change issues continue to increase, liabilities likely will follow. D&O insurance companies will be called on to address those liabilities with increasing frequency. Those claims will present complex coverage issues of first impression, and policyholders can expect a fight. Policyholders also should be on the lookout for more restrictive coverage terms on D&O renewals. Policyholders should work with their brokers to obtain the broadest coverage available, and consult with sophisticated coverage counsel in the event that they are faced with climate change–related claims.

Note

* Robert D. Chesler (rchesler@andersonkill.com) is a shareholder in Anderson Kill's New Jersey office and is a member of the firm's Cyber Insurance Recovery Group. Bob represents policyholders in a broad variety of coverage claims against their insurers and advises companies with respect to their insurance programs. Dennis J. Artese (dartese@andersonkill.com) is a shareholder in Anderson Kill's New York office and chairs the firm's Climate Change and Disaster Recovery Group. Joseph Vila (jvila@andersonkill.com) is an insurance recovery attorney in Anderson Kill's New Jersey office.