

Will Global Warming Liability Risks Exceed Property Risks?

by Dan R. Anderson

This article was published in PROGRES No. 44, December 2006

Within the scientific community, there is virtually unanimous agreement that global warming is happening, will continue, and is caused by greenhouse gas (GHG) emissions from the burning of fossil fuel. The Intergovernmental Panel on Climate Change, comprised of 2000 of the world's leading scientists from 40 countries, has issued three assessments (1991, 1996, 2001) documenting global warming, with a fourth due out in 2007. Other scientific groups, including the National Academy of Sciences, the American Meteorological Society and the American Geophysical Union, have issued studies/statements supporting this conclusion. A study in *Science* (December 3, 2004) by Naomi Oreskes examined 928 scientific papers on climate change over the period 1993 to 2003, and none of the papers disagreed with the position that global warming is being largely caused by human activity in burning fossil fuels. Considerable debate on the exact risks associated with global warming does exist. It is these risks that must be dealt with by the risk management and insurance community.

The most obvious risk is increasing property damages, primarily in coastal areas, from stronger storms and hurricanes (typhoons, cyclones). Global warming models predict more intense rain events, stronger storms and hurricanes, rising sea levels and increased flooding, all of which will augment coastal property damage. Munich Re reports record breaking natural disaster damages of \$200 billion and insured losses of \$75 billion in 2005, which doubled the record amounts set in 2004. While these escalating damages and insured losses present challenges for the insurance industry, I think that property insurance losses can be controlled. Sophisticated catastrophe modeling gives insurers a clear picture of their aggregate exposures, which can be reduced through cancellations, non-renewals and diminishing writing of new business. This is precisely what happened following the 2004-2005 hurricane seasons. Coupled with increasing premiums and deductibles, as well as more stringent underwriting, property insurers and reinsurers should be able to write business profitably. In a worst case scenario, insurers and reinsurers could just withdraw from the markets and refuse to write coverage.

I feel that liability risks deriving from global warming/climate change have the potential to cause insurers more financial problems. Much of global warming can be tied to corporate activity. If damages increase as expected, impacted parties may look to corporations and their insurers, and even countries, for compensation. Several areas of litigation are being considered and several have been initiated. For instance, island states, like Tavalu, Kiribati and the Maldives, are threatening to sue corporations and certain western nations for loss of life and property damages from rising sea levels associated with global warming. Similar litigation is being considered by a coalition of environmental groups, including Greenpeace, WWF (World Wildlife Fund), NRDC (Natural Resources Defense Council), FOE (Friends of the Earth) and Climate Justice. High carbon users like the fossil fuel industries (oil, coal, natural gas), and non-signers of the Kyoto Protocol, like the United States, are the targets of this anticipated litigation. The Inuits plan to seek a ruling from the Inter-American Commission on Human Rights that the United States is threatening their existence by contributing to global warming. While the Commission has no enforcement powers, a declaration that the United States is violating human rights could create the basis for a subsequent lawsuit in international courts or against American companies in U.S. federal courts. Hurricane Katrina victims have also initiated litigation against the oil companies for property damages caused by hurricanes associated with global warming.

Due to the lack of action at the federal government level in the United States, several states have instituted litigation against high carbon producers. In 2004, eight states, California, Connecticut, Iowa, New Jersey, New York, Rhode Island, Vermont and Wisconsin, and New York City sued five large utilities – AEP, Cinergy, Southern Company, TVA, and Xcel Energy over carbon dioxide emissions. This case represents the first state legal action taken directly against companies that discharge carbon dioxide. In 2006, the State of California sued six major auto makers alleging their vehicles contributed to global warming, hurt the state's environment and cost millions of dollars to address the effects. This state driven litigation is reminiscent of the coalition of states that sued the tobacco companies over increased health care costs caused by smoking with the result being a settlement of nearly \$250 billion. While the insurance industry wisely chose not to insure tobacco companies, it may have a considerable exposure with global warming litigation.

It is doubtful that the pollution exclusion in general liability and umbrella/excess policies will shield insurers against global warming litigation. Greenhouse gases, like CO₂, would not appear to be a pollutant as defined in the pollution exclusion. A ruling in a case now before the U.S. Supreme Court that CO₂ is not a pollutant would further erode insurers' defenses against global warming litigation. Besides general and excess liability policies, litigation would also probably trigger directors and officers liability policies. D&O policies typically have an exclusion for actions arising out of a pollution event. Again it is questionable whether this pollution exclusion would shield insurers from global warming litigation. Studies by the Carbon Disclosure Project and Innovest Strategic Value Advisors have estimated that the market values of heavy carbon emitters in the United States could be slashed by 35-40 percent if abrupt mandatory emissions standards were instituted. Corporations whose directors and officers have made little effort to reduce greenhouse gas emissions would be particularly vulnerable.

I anticipate that corporations and their insurers operating in the United States and Australia, as non-signers of the Kyoto Protocol, will have the greatest exposure to global warming litigation. Even if exclusions are put into general and D&O liability policies, they will offer no protection for any existing and older occurrence based policies. Insurers unfortunately could find themselves in the same position as they were in the asbestos and Superfund risk areas. Insurance companies' best defense would be to bring pressure on their policyholders, and even governments, for reducing greenhouse gas emissions.

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*This article was published by The International Association for the Study of Insurance Economics (**The Geneva Association**). Articles, documents and recent publications of the Association can be found on its website, at www.genevaassociation.org*