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# *Lessons From the First Climate Change Liability Insurance Case*

*2012 Emerging Issues 6265*

McCarter & English LLP on Conflicting Interpretations of "Occurrence": Lessons From the First Climate Change Liability Insurance Case, AES Corporation v. Steadfast Insurance Company

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March 27, 2012

**SUMMARY:** This commentary demonstrates that in AES Corp. v. Steadfast Insurance Co., the Virginia Supreme Court used a more restrictive standard than most states for demonstrating an underlying lawsuit alleges an insurable "occurrence." Corporate policyholders that conduct business in a number of states should consider how each interprets "occurrence" prior to or at the inception of coverage litigation.

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**ARTICLE:** The recent decision in *AES Corp. v. Steadfast Insurance Co.*,[1] in which the Supreme Court of Virginia found no "occurrence" in an underlying suit that alleged property damage resulted from the policyholder's intentional emission of greenhouse gases, demonstrates the need for corporate policyholders to do their homework when a coverage dispute arises. As described below, Virginia sets a tougher standard than most states for demonstrating an underlying lawsuit alleges an "occurrence." After summarizing the *AES* opinion, this commentary provides an overview of the conflicting approaches to interpreting "occurrence" across the country. Finally, the commentary demonstrates that, had the court hearing the dispute applied the law of one of the majority of jurisdictions applying a more policyholder-friendly standard, the policyholder may have secured coverage. The lesson is simple: corporate policyholders that conduct business in a number of states should consider how each interprets "occurrence" prior to or at the inception of coverage litigation.

## I. The Supreme Court of Virginia's Decision in *AES*

In *AES*, the Supreme Court of Virginia recently addressed whether a policyholder can secure insurance coverage for alleged property damage resulting from global warming allegedly caused by emission of greenhouse gases.[2] The Native Village of Kivalina and City of Kivalina (collectively, "Kivalina"), located on an Alaskan barrier Island, brought suit in California federal court against the AES Corporation ("AES"), a Virginia-based energy company that generates

and distributes electricity in numerous states.[3] Kivalina alleged, in sum, that AES's emission of greenhouse gases contributed to global warming, causing land-fast sea ice along Kivalina's shoreline to form later or melt earlier in the annual cycle, exposing the shoreline to storm surges, resulting in erosion, and rendering the village uninhabitable.[4]

AES sought coverage from its commercial general liability insurer, Steadfast Insurance Company ("Steadfast").[5] Steadfast initially defended AES under a reservation of rights, but subsequently filed a declaratory judgment action in Virginia state court.[6] Steadfast argued, among other things, that it had no coverage obligations because the underlying lawsuit did not allege "property damage" caused by an "occurrence" within the meaning of its policies.[7] The policies defined "occurrence" as "an accident, including continuous or repeated exposure to substantially the same general harmful condition."[8] The trial court granted summary judgment to Steadfast, concluding the underlying litigation did not allege an "occurrence."[9]

The Supreme Court began its review with a recitation of Virginia law on the definition of "occurrence," stating:

"The terms 'occurrence' and 'accident' are synonymous and ... refer to an incident that was unexpected from the viewpoint of the insured. We have held that an 'accident' is commonly understood to mean 'an event which creates an effect which is not the natural or probable consequence of the means employed and is not intended, designed, or reasonably anticipated.' An accidental injury is one that 'happen[s] by chance, or unexpectedly; taking place not according to the usual course of things; casual; fortuitous.'"[10]

The term "accident" does not include "the natural and probable consequence of an insured's intentional act."[11]

Nonetheless, when an intentional act initiates a chain of events, an alleged injury resulting from "an unforeseen cause that is out of the ordinary expectations of a reasonable person" may satisfy the definition of "occurrence."[12] In such a case, determining whether an accidental injury occurred does not depend on whether the policyholder acted intentionally, but on whether "the resulting harm is alleged to have been a reasonably anticipated consequence of the insured's intentional act."[13] Because Kivalina alleged AES intentionally released emissions, the Supreme Court described the issue as whether Kivalina asserted, at least in the alternative, that its injuries "resulted from unforeseen consequences that a reasonable person would not have expected to result from AES's deliberate act of emitting carbon dioxide and greenhouse gases."[14]

AES argued Kivalina's allegations qualified as an "occurrence" under Virginia law.[15] First, AES pointed to Kivalina's allegation that AES either "intentionally or *negligently*" caused global warming, asserting a policyholder is entitled to coverage when a pleading alleges negligence.[16] Second, Kivalina alleged AES "knew or should know" its electricity generating activities would result in environmental harms.[17] AES construed this language to allege the consequences of its intentional emission of greenhouse gases were unintended and, therefore, accidental.[18]

The Supreme Court rejected AES's arguments. In addition to alleging AES intentionally released greenhouse gases, Kivalina asserted a scientific consensus exists that "the natural and probable consequence of such emissions is global warming and damages such as Kivalina suffered."[19] Moreover, allegations of negligence do not necessarily comport with an "accident."[20] The Supreme Court concluded that, even if AES did not intend the damage, "the gravamen of Kivalina's nuisance claim is that the damages it sustained were the natural and probable consequences of AES's intentional emissions."[21] Under Virginia law, where a policyholder "knows or should have known" of the consequences of its actions, there is no "occurrence" and, therefore, no coverage.[22]

**II. Jurisdictional Interpretations of "Occurrence"**

The interpretation of "occurrence" was fundamental to the Supreme Court's conclusion in *AES*. Courts nationwide have split on how to interpret the term within a liability policy. The Court of Appeals of Maryland summarized the diverging approaches:

"There is a definite split of authority ... as to what acts of negligence result in liability covered by the terms of ... a policy [insuring against liability caused by accident]. Some courts have held that such policies do not cover liability for the natural and probable consequences of the negligence of the insured or his agent .... Other courts have held that such policies include liability for negligence-caused injury or damage, provided that the injury or damage was not in fact intentional."[23]

As described below, jurisdictions that consider the "natural and probable" consequences of a policyholder's act apply an "objective" approach, while those that analyze only whether the policyholder intended the damage follow a "subjective" assessment.

**A. The "Objective" Approach to Interpreting "Occurrence"**

A number of jurisdictions have adopted "objective" approaches. The Northern District of Texas, for instance, applied the typical objective interpretation of "occurrence" in HVAW v. American Motorists Insurance Co.[24] There the policyholders sought coverage under a commercial general liability policy for two lawsuits alleging legal malpractice, a number of fraud-related causes of action, and breach of fiduciary duty.[25] The insurer alleged the suits did not satisfy the definition of "occurrence," which the policy defined as an "accident, including continuous or repeated exposure to substantially the same general harmful conditions."[26]

The Northern District of Texas found the allegations did not fall within the definition of "occurrence."[27] Under Texas law, the term accident requires "an unexpected, unforeseen or undesigned happening or consequence."[28] An injury is not an accident if it is "the natural and probable consequence of the action [which produced it]."[29] Applying these principles, the Northern District concluded:

"...it was natural and foreseeable that [underlying plaintiffs] would suffer financial harm as a result of these alleged acts. The fact that [the policyholders] may not have foreseen that this financial harm would result in [underlying plaintiffs] entering bankruptcy does not mean that this injury was 'accidental.'"[30]

As a result, the insurer had no coverage obligations.[31]

Sixty years ago, the Tenth Circuit explained the rationale for the "objective" approach in *Neale Construction Co. v. United States Fidelity & Guaranty Co.*[32] There, the policyholder faced underlying lawsuits alleging defective construction.[33] In the coverage action that followed, the Tenth Circuit defined "accident" as "an undesigned, sudden, and unexpected event, usually of an afflictive or unfortunate character, and often accompanied by a manifestation of force."[34] It then elaborated:

"The natural and ordinary consequences of a negligent act do not constitute an accident. If one negligently erects a roof by the use of weak or inadequate rafters, the roof is liable to collapse but its fall is not an accident because such is the ordinary result of such construction."[35]

The results of the policyholder's work "were the usual, ordinary and expected results of such negligent construction" and "were in no sense sudden, unexpected or unanticipated."[36]

The Eighth Circuit utilized a variation of the objective approach in *City of Carter Lake v. Aetna Casualty & Surety Co.*[37] In that case, the policyholder, a city, faced a lawsuit after multiple failures of its sewage pump repeatedly caused damage to a homeowner's basement.[38] The insurer contended that only the initial pump failure was an "occurrence," whereas the subsequent failures led to "reasonably foreseeable" damage.[39] The policy defined "occurrence" as "an accident, including continuous or repeated exposure to conditions, which results in bodily injury or property damage neither expected nor intended from the standpoint of the Insured."[40]

Applying Iowa law, the Eighth Circuit stated that determining whether a claim alleges an "accident" requires analysis of "whether a result is 'expected' as a matter of probability."[41] The court rejected the insurer's argument that a

result is expected whenever it is reasonably foreseeable, holding:

"An insured need not know to a virtual certainty that a result will follow its acts or omissions for the result to be expected. Rather, each case must be determined by examination of the totality of the circumstances. For the purposes of an exclusionary clause in an insurance policy the word "expected" denotes that the actor knew or should have known that there was a substantial probability that certain consequences will result from his actions ... [in which case] there has not been an occurrence or accident."[42]

Although it was "beyond dispute" that the city never intended to cause any of the sewer backups, the Eighth Circuit concluded "there was clearly a substantial probability of another backup" after the first pump failure.[43] Therefore, none of the sewer failures after the initial one constituted an "occurrence."[44]

**B. The "Subjective" Approach to Interpreting "Occurrence"**

Although some jurisdictions apply an "objective" assessment when construing "occurrence," most jurisdictions utilize the "subjective" approach.[45] Unlike "objective" jurisdictions, which generally consider the "natural and probable" result of a policyholder's actions, courts applying a "subjective" test examine only the policyholder's "knowledge and intent."[46] Accordingly, those jurisdictions consider the "specific standpoint of the particular policyholder."[47]

The Court of Appeals of Maryland, for example, adopted the "subjective" approach in *Sheets v. Brethren Mutual Insurance Co.*[48] The underlying tort suit alleged the defendants "both intentionally and negligently misrepresented" the condition of a septic tank prior to the sale of property.[49] In analyzing whether the suit qualified as an "occurrence," defined as "an accident, including continuous or repeated exposure to substantially the same general harmful conditions," the court concluded an "accident" occurs whenever "a negligent act causes damage that is unforeseen or unexpected by the insured."[50]

The Court of Appeals, moreover, explicitly rejected the "objective" approach, finding it would render liability policies:

"... all but meaningless. Under such an interpretation, the policy would provide no coverage for negligent acts resulting in objectively foreseeable or expectable damage. Only acts of negligence resulting in objectively unforeseeable or unexpectable damage would be covered. Of course, under basic principles of tort law, the insured is unlikely to be held liable for unforeseeable or unexpectable damages resulting from his negligence. Thus, interpreting 'accident' as encompassing only negligent acts resulting in unforeseeable and unexpectable damages would leave the insured covered against only those damages for which he or she is not likely to be held liable."[51]

The "subjective" approach, in contrast, accords with the reasonable expectations of the average policyholder.[52]

Even the Tenth Circuit, which has applied the "objective" approach under state law, recognizes the limitations it places on liability coverage. In *Hutchinson Water Co. v. United States Fidelity & Guaranty Co.*, the court reviewed prior cases applying the "objective" test and stated:

"Apparently we did not contemplate whither this logic would lead us. For, if the policy did not cover the loss because the natural and probable consequences of the negligent act did not constitute an accident, then by the same logic, there would be no liability where the damage was the unexpected, hence unforeseen result of the negligent act. In the first instance, the damage would be foreseeable and therefore not accidental; in the latter instance, the damage would not be foreseeable and hence no liability upon the insured for his negligent acts. In either instance, the insurer would be free of coverage and the policy would be rendered meaningless."[53]

Nevertheless, the court continued to find no "occurrence" for the "natural and probable consequences" of the policyholder's actions.[54]

Courts have cited additional reasons for applying a "subjective," rather than "objective," approach. Some jurisdictions, such as Minnesota, find the "subjective" test "mandated by the policy language" and the "objective" approach contrary to clear policy language."[55] Others find the definition of "occurrence" ambiguous and, consistent with the canon of insurance policy interpretation mandating construction of ambiguities in favor of the policyholder, apply the more policyholder friendly "subjective" approach.[56]

Lastly, certain jurisdictions, such as New Jersey, utilize a "subjective" test, but recognize limited circumstances in which the "objective" analysis applies. In *Voorhees v. Preferred Mutual Insurance Co.*, the New Jersey Supreme Court held:

"... the accidental nature of an occurrence is determined by analyzing whether the alleged wrongdoer intended or expected to cause an injury. If not, then the resulting injury is 'accidental' even if the act that caused the injury was intentional .... Even when the actions in question seem foolhardy and reckless, the courts have mandated an inquiry into the actor's subjective intent to cause injury.[57]

Nevertheless, the Supreme Court required an "objective" approach "when actions are particularly reprehensible," such as those involving sexual assault and abuse of children.[58] In those "exceptional circumstances," the "intent to injure can be presumed from the act without an inquiry into the actor's subjective intent to injure."[59]

**III. The Varying Interpretations of "Occurrence" and *AES***

The Supreme Court of Virginia applied an "objective" interpretation of "occurrence" in *AES*. Rather than focusing on whether AES intended to cause the damage alleged by Kivalina, the court analyzed whether "the resulting harm [was] alleged to have been *a reasonably anticipated consequence*" of AES's actions.[60] In the end, the Virginia Supreme Court based its decision that no "occurrence" had been alleged on Kivalina's allegation that its damages were, in fact, the "natural and probable consequences" of AES's emissions.[61]

*AES*, however, may have secured coverage under a "subjective" test. The Virginia Supreme Court did not address - and certainly presented no evidence regarding - whether AES intended to cause Kivalina's alleged damages. Instead, the court rejected this consideration, choosing to find no "occurrence" even if AES "actually [was] ignorant of the effect of its actions and/or did not intend for such damages to occur."[62] Had the court considered only AES's subjective intent, AES may have been able to demonstrate Kivalina's complaint did not allege AES intended the damages and, therefore, did allege an "occurrence."

The Virginia Supreme Court's use of the "objective" approach, consequently, created a more stringent standard for AES to demonstrate the underlying pleading alleged an "occurrence." Considering the "natural and probable consequences" of AES's actions allowed the court broad discretion to determine whether an "occurrence" had been alleged. In essence, the "objective" approach to interpreting "occurrence" may be what allowed the Supreme Court of Virginia to find no "occurrence."

**IV. Conclusion**

Policyholders can derive an important lesson from *AES*. Large corporations, such as AES, which conduct

operations in a number of different states, generally have contacts with many jurisdictions. When a coverage dispute arises, particularly where the underlying action involves climate change allegations, policyholders should consider all potential venues, determine which jurisdictions utilize the "subjective" or "objective" approach to interpreting "occurrence," and conduct a conflicts-of-laws analysis. Ultimately, if suit is necessary, the policyholder can file in the more favorable venue.[63] As the *AES* decision demonstrates, applying the law of a state that adheres to the "subjective" approach may mean the difference between securing and foregoing liability coverage.

[1] *715 S.E.2d 28 (2011).* On January 17, 2012, the Virginia Supreme Court granted the policyholder's petition for rehearing. The policyholder argues, among other things, that the Supreme Court misapplied Virginia law regarding the definition of "occurrence" and misconstrued the underlying complaint. At the time of publication of this commentary, the court's decision on rehearing remains outstanding.

[2] *Id. at 30.*

[3] *Id. at 29-30.*

[4] *Id. at 31.*

[5] *Id. at 30.*

[6] *Id.*

[7] *Id.*

[8] *Id.*

[9] *Id.*

[10] *Id. at 32* (internal citations omitted).

[11] *Id.*

[12] *Id.*

[13] *Id. at 32-33.*

[14] *Id. at 33.*

[15] *Id.*

[16] *Id.* (emphasis added).

[17] *Id.*

[18] *Id.*

[19] *Id.*

[20] *Id.*

[21] *Id.*

[22] *Id. at 33-34.*

[23] *Sheets v. Brethren Mut. Ins. Co., 679 A.2d 540, 546 (Md. 1996)* (*quoting* J.P. Ludington, Annotation, *Liability Insurance: "Accident" or "Accidental" as Including Loss Resulting from Ordinary Negligence of Insured or His Agent*, 7 A.L.R.3d § 2, 1264-65 (1966)).

[24] *968 F. Supp. 1178 (N.D. Tex. 1997).*

[25] *Id. at 1180-81*.

[26] *Id. at 1182.*

[27] *Id.*

[28] *Id.*

[29] *Id.*

[30] *Id.*

[31] *Id.*

[32] *199 F.2d 591 (10th Cir. 1952).*

[33] *Id. at 592.*

[34] *Id. at 593.*

[35] *Id.*

[36] *Id.*

[37] *604 F.2d 1052 (8th Cir. 1979).*

[38] *Id. at 1055.*

[39] *Id. at 1058.*

[40] *Id. at 1056.*

[41] *Id. at 1058.*

[42] *Id. at 1058-59* (citations omitted). Notably, the Supreme Court of Virginia cited *City of Carter Lake* in *AES* as support for the somewhat different proposition that there is no "occurrence" if "an insured knew or should have known" certain results would follow from its actions. *AES, 715 S.E.2d at 262-63.*

[43] *Id.* at 1059.

[44] *Id.*; *see also Western Cas. & Sur. Co. v. Waisanen, 653 F. Supp. 825, 831 (D.S.D. 1987)* (applying "substantial probability" test); *Weber v. IMT Ins. Co., 462 N.W.2d 283, 288 (Iowa 1990)* (same).

[45] Peter J. Kalis, Thomas M. Reiter & James R. Segerdahl, Policyholder's Guide to the Law of Insurance Coverage § 6.03[A] (2012).

[46] *Id.*

[47] John H. Mathias, Jr., John D. Shugrue & Thomas A. Marrison, Insurance Coverage Disputes, 9-36.15 (Aug.

2011).

[48] *679 A.2d 540.*

[49] *Id. at 541.*

[50] *Id. at 548.*

[51] *Id. at 549.*

[52] *Id.*

[53] *250 F.2d 892, 894 (1957).*

[54] *Id.*

[55] Mathias, *et a*l., Insurance Coverage Disputes, at 9-36.17; *Domtar, Inc. v. Niagara Fire Ins. Co., 563 N.W.2d 724, 735 n.6 (Minn. 1997).*

[56] Mathias, *et al*., Insurance Coverage Disputes, at 9-36.17.

[57] *128 N.J. 165, 183-84 (1992).*

[58] *Id. at 184-85.*

[59] *Id.*

[60] *715 S.E.2d at 32-33* (emphasis added).

[61] *Id. at 33.*

[62] *Id. at 34.*

[63] An insurance company's speed in reaching the courthouse doors is not necessarily dispositive of which court ultimately will hear a case. As stated by the New Jersey Supreme Court, "the solution to problematic situations, such as a race to the courthouse, an anticipatory filing, or the choice of an inappropriate forum, is resort to the 'usual panoply of rules governing judicial economy, the integrity of judgments, comity between federal and state courts, and the like.'" *Chubb Custom Ins. Co. v. Prudential Ins. Co. of Am., 948 A.2d 1285, 1292 (N.J. 2008)* (citation omitted).



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