Managing Climate Risk With Insurance And Contractual Provisions

INTRODUCTION

Extreme weather events are on the rise. Since 2013, Canada has witnessed eight of its most economically devastating disasters.[1] Floods have emerged as the costliest hazard for urban properties,[2] while large swaths of the country now contend with longer and more damaging wildfire seasons. The unprecedented wildfires that scorched B.C. last year burned over 2.84 million hectares.[3] Scientists report that the changing climate is exacerbating the frequency and severity of such events, with worse to come.[4] Insurers are feeling the heat, reducing coverage and increasing prices.

As we will discuss in this Bulletin, tailor-made insurance where available as well as carefully crafted contractual clauses can help effectively manage the escalating risks posed by extreme weather events.

A SHIFTING LANDSCAPE

Often, parties to a contract address the risk of property damage with clauses that require each party to buy and maintain appropriate insurance coverage. The cost of insuring such damages has risen significantly, testing the resilience of the insurance industry and eroding the effectiveness of a once reliable risk-shifting tool. Recent years have seen a staggering increase in losses attributed to extreme weather, with annual damages consistently surpassing $2 billion.[5] The Insurance Bureau of Canada (IBC) reports that in 2022, insured damage for severe weather events reached $3.4 billion, marking it as the third-worst such year in Canadian history.[6] These challenges are contributing to the rising cost of insurance and reinsurance and driving consumer demand for enhanced but affordable risk protection.[7] As disaster costs accumulate, bluelining – the practice of raising prices for coverage or withdrawing insurance services in regions determined to present higher risks[8] – is on the rise. Insurance premiums are determined by evaluating various risk factors associated with the property and the policyholder, including estimated future claims.[9] With extreme weather events on the rise, estimated future claims are following suit.[10]

The home insurance market is feeling the strain, reporting a net underwriting loss of $24.5 billion the first half of 2023, more than four times the net losses recorded during the first half of 2022. Home insurers have begun passing their increasing coverage costs onto homeowners by raising premiums and deductibles.[11] In 2023, home

insurance premiums surged by an average of 7.7% across the provinces, with B.C. and Nova Scotia experiencing the most significant increases.[12] A rise is also noted in the real estate sector[13].

Meanwhile, in the United States, insurance companies are beginning to pull out of certain housing markets entirely.[14]. In U.S. states, regulatory price caps push insurers to withdraw from unprofitable markets by limiting their ability to raise rates to cover increasing costs.[15] This is because, in states where regulators rigorously scrutinize rate adjustments, insurers encounter challenges in justifying and implementing rate hikes necessary to offer such insurance for reasonable profit, whereas, in states where regulators impose fewer restrictions on rate increases, insurers face fewer obstacles in adjusting premiums to reflect rising costs.[16] By contrast, Canadian insurance markets operate without government-imposed price caps on premiums[17], which could be making it easier for insurers to remain in the market, albeit it with a higher sticker price.

Reinsurance premiums have also risen quickly, particularly for catastrophic losses – those exceeding predefined thresholds – seeing increases of as much as 50% to 70% from 2022 to 2023.[18] This surge reflects adjustments made by reinsurers in response to significant losses, such as those from Canadian wildfires and flooding, which impacted insurers across all regions of Canada during the year.[19] Rising re-insurance premiums trickle down to increase customer premiums.[20]

Moreover, despite reassessing the risk in certain neighbourhoods and facing increasing costs associated with climate-related challenges like flooding, Canada's largest insurers have affirmed their commitment to the market by maintaining coverage.[21] Although Canadian insurers are not yet pulling out of entire regions, they are charging greater amounts for high-risk properties and reducing the scope of their products by making coverage for catastrophic events optional, excluding them from their portfolio altogether, or requiring that policy holders implement preventative measures on their properties.[22]

Methods and materials used in construction may also affect insurability. For example, wood frame structures have higher insurance rates because of the greater risk of fire as compared to concrete structures[23].

REDEFINING CONTRACTUAL RISK ALLOCATION

As the gap in insurance coverage widens, there is increased need for contract parties to get creative to ensure effective risk management and allocation.

1. ***Force Majeure Clauses***

Historically, *force majeure* clauses have been the go-to for shielding parties from liability due to unforeseeable events beyond their control. A *force majeure* clause "operates to discharge a contracting party when a supervening, sometimes supernatural, event, beyond the control of either party, makes performance impossible".[24] In other words, such a clause can transfer or relieve the risk associated with a significant unforeseen event that could potentially prevent fulfilment of parties' obligations or otherwise nullify the agreement.

In common law jurisdictions in Canada, the test for invoking force majeure clauses derives from *Atlantic Paper Stock Ltd. v. St. Anne-Nackawic Pulp & Paper Co*.[25] In that case, St. Anne-Nackawic Pulp & Paper Co. ("St. Anne") agreed to buy ten thousand tons of secondary fibre from Atlantic Paper Stock every year for ten years.[26] Just a year later, St. Anne decided that it would no longer purchase the fibre because its resale market had dried up. St. Anne contended that the contract's force majeure clause

shielded it from liability for "non-availability of markets".[27]

The Court in *Atlantic Paper Stock* established that to qualify as a *force majeure* event, an occurrence must (1) be "beyond reasonable human foresight and skill" and fall outside of both contracting parties' control; and (2) make the contract impossible to execute.[28] Unsurprisingly, St. Anne's "lack of an effective marketing plan" did not qualify as an event outside its control.[29] The test sets a high bar for the application of force majeure clauses,[30] reflective of the courts' general reluctance to let parties evade their contractual obligations.[31]

Extreme weather events may satisfy *Atlantic*'s high standard. Although there is little modern jurisprudence applying force majeure clause disputes to environmental events, *Kilislian v Copper Creek GP* offers one example.[32] The plaintiffs in that case held their wedding at the defendant's golf course, but a severe thunderstorm caused an electricity outage, ruining the reception. The golf course filed a motion to dismiss the claim based on the force majeure clause.

Applying *Atlantic*, the Ontario Superior Court held that the storm (1) was unforeseeable due to its uncharacteristic intensity for that time of year in southern Ontario; and (2) was outside the control of either party, as preventative measures could not reasonably be expected for that time of year.[33] The golf course was accordingly excused from performing the contract.

In Québec, *force majeure* is codified in the *Civil Code of Quebec*, but parties to a contract may depart from these general rules, and we typically see in commercial contracts governed by Québec law force majeure clauses that are tailored by the parties to either extend or restrict the scope of the provisions of the *Civil Code of Quebec*.

Under these provisions "a person may free himself from his liability for injury caused to another by proving that the injury results from superior force, unless he has undertaken to make reparation for it." Superior force is defined as "an unforeseeable and irresistible event, including external causes with the same characteristics".

For an event to be qualified as a superior force under these provisions, it must meet three conditions developed in the case law: exteriority, unpredictability and irresistibility. Exteriority requires the event take place outside the field of activity for which the party relying on force majeure is normally responsible. Unpredictability is assessed at the time the obligation was contracted by the party relying on force majeure and consists in determining whether the event was reasonably predictable by a person in the same circumstances. In the case of a hurricane, the unpredictability was not met in a case where weather data predicted its occurrence and the party relying on force majeure had sufficient time to act to prevent damage[34].

Finally, the event is irresistible when it is a force that a prudent and diligent person, placed in a similar situation, would not be able to resist[35]. Very few cases discussing force majeure clauses have relied on scientific data introduced as evidence. However, this may change as data around climate change becomes more readily available and as contract parties more frequently make reference to historic weather data in the context of weather events and *force majeure*.

2. ***Foreseeability and Force Majeure in the Era of Climate Change***

Traditional *force majeure* clauses are designed to allocate risk, not share it. The vague language used to describe weather events can expose all parties to protracted litigation over semantics. In particular, as discussed above, litigation may arise

over what constitutes a covered event and whether extreme weather is foreseeable, in light of the latest climate science.[36]

Relying on boilerplate *force majeure* language sets you up for a protracted dispute should the worst happen. The era of climate change calls for risk-management clauses tailored to the specific risks facing the project, industry, or region, with a long-term perspective on climate change impacts, and defined measurement techniques that an independent expert can apply to assess whether a covered weather event has occurred and if so, whether it was foreseeable. Clauses setting out conditions of indemnity, relief events, or excused delays may provide additional opportunities for risk-sharing language.

In addition to revisiting *force majeure* clauses, it is critical to consider insurance for climate-related liabilities. In Canada and other jurisdictions, gaps in insurance coverage for damages or injuries resulting from climate-related events may leave businesses exposed to legal and financial risks. These gaps require the development of tailored insurance products that specifically address the evolving nature of climate risks and provide adequate protection against related liabilities.[37]

3. ***Industry-Specific Examples***

We recommend parties wishing to allocate climate risks in their contracts adopt an early-stage intervention approach. The first step a party should undertake when it comes to mitigating climate risk in the context of a contractual relationship is to identify the climate risks associated with the contract and their potential impact on the party. Climate risks may be divided in two broad categories: physical risks and transition risks. The former category refers to the damages and losses that occur due to the physical consequences of climate change. The latter category is related to the process of adjusting to a low-carbon economy and those risks arise notably from the uncertainty and challenges involved in shifting away from fossil fuels and other high-emission activities. Transition risks include risks associated with changes in policies, laws, and regulations to force emissions reductions as well as those related to climate litigation.

The identification of each party’s risks and the assessment of their impact allow the parties to undertake discussions around risk allocation in an informed manner. While recognizing the bargaining power may favor a party, the parties should then try to determine which party is best positioned to manage each identified risk and allocate responsibilities accordingly, notably through the use of tailored force majeure clauses. In addition, mechanisms for ongoing monitoring, periodic reassessment of risks, and adjustment of the climate-related provisions should be included in the contract.

Climate change has significantly impacted the construction industry, just one example among many, causing project delays, increased costs, and supply chain disruptions. Nearly 45% of construction projects globally have been impacted by adverse weather,[38] prompting development of various risk management strategies. Contractors regularly seek to account for weather events that will inhibit performance in their schedules for construction and builders are increasingly considering the financial consequences of failing to meet energy efficiency standards, leading to changes in risk profiles and contractual behaviors. Properly integrating climate resilience and the impacts of severe weather into construction contracts requires careful consideration as it can be challenging to fairly allocate risk for anticipated or potential future conditions.

CONCLUSION

The escalating frequency and severity of climate-related events necessitate a proactive and adaptable approach to risk management. Insurance and contractual provisions play pivotal roles in this process. Tailored insurance products are essential to address emerging gaps in coverage, while contract clauses, particularly *force majeure* provisions, must evolve to reflect the realities of climate change. These measures require precise language, scientific data, and industry-specific strategies to ensure fair risk allocation and enhanced resilience. As climate risks continue to challenge traditional methods, stakeholders must collaborate to innovate, reassess, and implement robust frameworks that protect assets, operations, and communities in an uncertain future. We will continue to monitor the developments in this area as we work with the construction industry.

Footnotes

1. Insurance Bureau of Canada, “Okanagan and Shuswap area wildfires cause over $720 million in insured damage”, (3 October 2023), online.

2. *A Primer on Severe Weather and Overland Flood Insurance in Canada*, by Insurance Bureau of Canada (2019) at 8; Adapting to Rising Flood Risk – An Analysis of Insurance Solutions for Canada, by Government of Canada, (2022); O’Hara, Clare, “Rise in climate-related floods leaves Windsor residents uncertain about insurance coverage”, The Globe and Mail (15 July 2024), online.

3. “BC residents encouraged to prepare for the 2024 wildfire season”, (18 March 2024), online.

4. *Tip of the Iceberg: Navigating the Known and Unknown Costs of Climate Change for Canada*, by Canadian Institute for Climate Choices (2020); *2023 Facts of the Property and Casualty Insurance Industry in Canada*, by Insurance Bureau of Canada (2023).

5. Insurance Bureau of Canada, “Severe Weather in 2023 Caused Over $3.1 Billion in Insured Damage”, (8 January 2024), online.

6. Insurance Bureau of Canada, *supra* note 1 at 15.

7. *Ibid*.; Leslie Kaufman, “US Home Insurance Still Priced Too Low for Climate Risk, Says Swiss Re Chair”, (July 1 2024), online.

8. Lilith Fellowes-Granda, “4 Principles for Addressing Climate Risks in the Insurance Industry – Center for American Progress”, (13 March 2024), online.

9. Insurance Bureau of Canada, “How home insurance rates are set”, online; Government of Canada, “Home Insurance”, (8 December 2023), online.

10. Zimonjic, Peter, “Extreme weather causing billions of dollars in damage, driving up insurance premiums: StatsCan”, *CBC News* (15 May 2024), online.

11. Michael Kolomatsky, “As Natural Disasters Get Worse, So Do Home Insurance Premiums”, *NY Times* (12 October 2023), online; Renee Cho, “With Climate Impacts Growing, Insurance Companies Face Big Challenges – State of the Planet”, (3 November 2022), online.

12. Matthew Roberts, “Home Insurance Predictions for 2024 | MyChoice”, (5 March 2024), online.

13. Deloitte, “State of the Canadian Commercial Property & Casualty Insurance Market 2022: An Update on the Pressures Facing the Canadian Commercial Insurance Market” (August 2022), online and Mika Pangilinan, “What is happening with commercial premium rates in Canada?” (14 April 2023), online.

14. This trend can also be observed across Europe, as insurers warn that some areas have become uninsurable. In 2023, insurance companies deemed homeowners insurance unprofitable in 18 states, up from only 8 states in 2013.

15. *Ibid*.

16. Flavelle, Christoper & Mira Rojanasakul, “Home Insurance Rates in America Are Widely Distorted.

Here's Why.", *The New York Times* (8 July 2024), online.

17. Clare O'Hara & Jeffrey Jones, "Climate change is making insurance more expensive and more limited – and it's only going to get worse", *Globe and Mail* (1 December 2023), online.

18. David Gambrill, "What P&C execs predict for 2024 reinsurance rates", (24 October 2023), online.

19. *Ibid*.

20. *Supra* note 15.

21. *Supra* note 2.

22. *Supra* note 2 and 18.

23. Canadian Underwriter, "Insurance costs more than six times greater for wood frame buildings than for concrete buildings, new study finds", online.

24. *Atlantic Paper Stock Ltd v St Anne-Nackawic Pulp and Paper Company Limited*, [1975. 1 SCR 580]

25. *Ibid*.

26. *Ibid*.

27. *Ibid* at 4.

28. *Ibid*. The Alberta Court of Appeal has taken a more relaxed approach to this last prong, adopting instead a "commercial unfeasibility" standard. *See Atcor Ltd v Continental Energy Marketing Ltd. [Atcor Ltd. v. Continental Energy Marketing Ltd*, [1996] ABCA 40 at 11], characterizing "commercial unfeasibility" as meaning that "continuing to execute the contract would cause excessive or unreasonable financial hardship on a party", a standard is akin to the American doctrine of commercial impracticability. [*Ibid]*.

29. Atlantic Paper Stock Ltd *supra* note 30 at 4; Lokash *supra* note 35.

30. Lorne Neudorf & Geoffrey Hunnisett, "Force Majeure Clauses in Comparative Perspective: The Canadian Common Law Approach in Light of Recent Developments in the Courts of Singapore and the United Kingdom" (2014) UNBLJ at para 2.

31. *Ibid*.

32. *Kilislian v. Copper Creek GP Inc*, [2015] ONSC 7072.

33. *Ibid*.

34. This situation occurred in *Lepage v. Vacances Tours Mont-Royal Inc*.[34] 2002 CanLII 12824 (QC CQ)., where a travel wholesaler who maintained the travellers' departure despite the hurricane warnings issued by meteorological officials was barred from relying on the force majeure clause to excuse him from indemnifying travelers. See also Vincent Karim, *Les obligations* [vol. 1], 5e éd., Montréal, Wilson & Lafleur, 2020, JuriBistro eDOCTRINE – CAIJ, par. 3777.

35. Vincent Karim, *Les obligations* [vol. 1], 5e éd., Montréal, Wilson & Lafleur, 2020, JuriBistro eDOCTRINE – CAIJ, par. 3779.

36. Dale Smith, "Coping with foreseeable events", (16 September 2019), online.

37. Other jurisdictions, like the UK, currently lack specific insurance coverage for climate-related liabilities, highlighting a global trend in insurance market gaps and evolving product offerings.

38. Courtney DuChene, "Insuring the Climate Transition: How Can the Construction Industry Confront Escalating Storm Damage?" *Risk Insur* (28 February 2023), online.

Authors: Ralph Cuervo-Lorens, Annik Forristal, Emily Hush, Martin Thiboutot