

IS THE GLASS HALF-FULL? WHY AN INSURANCE
COMPANY’S LATE NOTICE DEFENSE TO AN
ENVIRONMENTAL CLAIM SHOULD FAIL

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I. INTRODUCTION

The defense of untimely notice of a claim is endemic to contract litigation. Although the defense appears most frequently in insurance and construction disputes,¹ many long-term or liability shifting arrangements typically include some provision setting a time limit for submitting a demand for compensation. Despite the frequency with which insurance companies assert this defense, courts have rendered very few decisions in which the issue is dispositive. For example, the author recently tried an environmental coverage case on behalf of the policyholder in which notice of the claim to the insurance carrier was allegedly twelve years late.² Yet after a two-week trial, the jury took only one and one-half hours to dispose of the late notice defense, along with the insurance company's other defenses. Although the author would like to believe that the policyholder's trial team had something to do with the result, the nature of the late notice defense itself likely necessitated the jury's decision.

The law has long been that because late notice and similar defenses, such as cooperation and conditions subsequent, can cause a forfeiture—the loss of contractual rights irrespective of the merits of the plaintiff's position—the defendant must prove prejudice in order to prevail.³ In the case of late notice, insurance companies most often allege prejudice in the form of the loss of evidence necessary to evaluate the claim. The reality is, however, that, at least for an environmental claim, irreplaceable evidence is not likely truly lost. In the context of an environmental claim, evidence is fungible, and evidence of one sort or another sufficient to determine what occurred can usually be found.

Moreover, the insurance company, the party that bears the burden of proof on the issue of late notice, often struggles to provide convincing answers to the questions: “what has the insurer done to actually try to find the allegedly missing evidence,” and “what would the insurer have done differently if it had found such evidence?” Unless the insurance company has a credible answer to these questions, the company will face an uphill battle trying to prove the plaintiff's delay caused it any prejudice. That is, the insurance company may not be able to prove that the alleged prejudice suffered is anything other than self-inflicted or unavoidable. For example, the following discussion of cases contains instances in

1. The late notice and prejudice considerations discussed herein also arise, for example, in the government contract area. See Steven N. Tomanelli, *Rights and Obligations Concerning Government-Furnished Property*, 24 PUB. CONT. L.J. 413, 427 (1995) (certain rights under government contracts not barred by delay unless government is prejudiced thereby).

2. *Employers Ins. of Wausau v. Tektronix, Inc.*, No. CCV 9908032 (Clackamas County Or. Cir. Ct.) [hereinafter *Wausau*]. *Wausau*, although an unreported trial court case, provides useful examples of the principles set forth in this article.

3. *Lusch v. Aetna Cas. & Sur. Co.*, 538 P.2d 902, 905 (Or. 1975).

which the insurance carrier seemed more interested in building a case to deny an environmental claim than in taking all reasonable steps to discover what actually occurred. Indeed, for certain kinds of claims, including environmental, asbestos, mold, or construction defect claims, insurance carriers may deny claims, not as the result of any investigation, but based upon a cost-benefit analysis of litigation risks. In these circumstances, prejudice is a non sequitur.

Juries, in particular, often understand this dynamic as consistent with their everyday experience with insurance companies and other large institutions. In response to a focused presentation, a jury will therefore often reject a late notice defense. As shown below, a jury can readily and properly reach this result because the insurance company usually cannot show that facts the law makes relevant are unavailable from *any* source. Although the insurance company can always speculate that if it had additional facts, it could have proved a defense to coverage, courts are not often eager to hold that speculation about what might exist is a valid basis to cause the forfeiture of the policyholder's contractual rights.⁴

II. DISCUSSION

A. *The Legal Test: The Insurance Company Must Prove Some Concrete, Nonspeculative Prejudice to Its Rights*

The law of Oregon, like that of most other states,⁵ requires the insurance company to prove prejudice in order to prevail on a late notice defense.⁶ In the insurance context, prejudice does not mean merely that the insurance company experiences some difficulty or has to spend more time and money on an investigation. Instead, the inquiry typically focuses on what the insurance company's investigation could or would have found if it had diligently performed an investigation. The prejudice inquiry, which the case law states with some precision, considers whether a policyholder provided notice in time for the insurance company to make a reasonable investigation and adequately protect its interests and those of its policyholder.⁷

This, however, is not the end of the inquiry. Even if the insurance company can prove all the elements of prejudice, a late notice defense likely will not succeed if the policyholder can show that its delay in providing

4. *Aetna Cas. & Sur. Co. v. Dow Chem. Co.*, 10 F. Supp. 2d 800, 813 (E.D. Mich. 1998); *Canron, Inc. v. Fed. Ins. Co.*, 918 P.2d 937, 941 (Wash. Ct. App. 1996).

5. See LEE R. RUSS & THOMAS F. SEGALLA, *COUCH ON INSURANCE* § 193.1 (3d ed. 2000) (“[A] majority of jurisdictions now require that the insurance company show that it has been prejudiced by late notice.”).

6. *Lusch*, 538 P.2d at 904.

7. *Id.* at 905; *Carl v. Or. Auto. Ins. Co.*, 918 P.2d 861, 863 (Or. Ct. App. 1996); *N. Pac. Ins. Co. v. United Chrome Prods., Inc.*, 857 P.2d 158, 160 (Or. Ct. App. 1993).

notice was reasonable.⁸ Because of the low probability that an insurance company can actually show prejudice, the policyholder likely will not often be put in a position of having to defend the reasonableness of its conduct. This article will therefore examine only the issue of prejudice. In particular, this article will examine the requirement that the insurance company prove some actual and concrete loss of information unavailable from any source whatsoever and show, without speculation, that this loss of information has impaired the insurance company's rights. The leading authorities explore the notice prejudice tests with a particular relevance to environmental claims.

1. The Black Letter Law

A commonly cited insurance treatise, *Couch on Insurance*, describes the prejudice test as follows:

[A]n insurer must show the precise manner in which its interests have suffered, meaning that an insurer must show not merely the possibility of prejudice, but, rather, that there was a *substantial likelihood of avoiding or minimizing the covered loss*, such as that the insurer could have caused the insured to prevail in the *underlying action*, or that the insurer could have settled the *underlying case* for a small sum or smaller sum than that for which the insured ultimately settled the claim.⁹

Couch on Insurance emphasizes the point that the insurance company must do more than speculate about the existence of prejudice, that it must do more than engage in wishful thinking that more information would have reduced its obligations. Instead, the insurance company must show a substantial likelihood that this is the case.

2. *Canron*

The decision of the Washington Court of Appeals in *Canron, Inc. v. Federal Insurance Co.*,¹⁰ is instructive on the point that prejudice is easy to claim but hard to prove. In *Canron*, the policyholder received a potentially responsible party¹¹ notice at the Western Processing Superfund Site in May

8. *Lusch*, 538 P.2d at 905. For example, in an environmental case, a delay might be reasonable based upon the insurance company's representation that coverage does not exist for environmental claims or during the time the policyholder takes to locate evidence of missing policies.

9. *Russ & Segalla*, *supra* note 5, § 193.29 (emphasis added) (footnotes omitted). The second emphasis is added to make clear that cognizable prejudice does not include the ability to settle the *coverage case* for a smaller sum. In *Wausau*, for example, the insurance company argued that prejudice existed because had notice been made earlier, it could have denied the claim under state intermediate appellate decisions later overruled by the state supreme court. The trial court did not allow the insurance company to take advantage of the fact that until the state supreme court had spoken, the lower courts were wrong about the law.

10. 918 P.2d 937 (Wash. Ct. App. 1996).

11. Hereinafter PRP.

1983, but did not provide notice to the insurance company until May 1984. Conducting no investigation, the insurance company asserted a late notice defense and a number of other defenses to coverage.¹² Noting that Washington law applies the actual prejudice test, the court explained “what is at issue is not an abstract right, but some concrete detriment, some specific advantage lost or disadvantage created which has an identifiable prejudicial effect on the insurer.”¹³

The Washington Court of Appeals found that although the insurance company “identified possible detriments resulting from Canron’s delay, [it] presented no evidence of specifics and no evidence of resulting actual harm.”¹⁴ On the first point, the lack of specifics, the insurance company relied upon the facts that the site had changed, some documents had been destroyed, and witnesses had become unavailable. The insurance company failed, however, “to isolate the changes [to the site] which occurred during the delay period,” failed to identify the lost records with specificity or show how the loss of records affected its interests, and failed to identify specific witnesses who had become unavailable and what information those witnesses might have had.¹⁵ Moreover, other PRPs had performed extensive site investigations, and the insurance company failed to explain “what further investigation was necessary but precluded, why other investigations were inadequate . . . , or why expert reconstruction was unavailable.”¹⁶ Thus, the insurance company’s assertions about lost evidence amounted to nothing more than mere speculation, which did not give rise to a notice defense in light of the court’s previous decisions that “reject speculation, and require evidence of concrete detriment resulting from delay, together with some specific harm to the insurer caused thereby.”¹⁷

On the issue of the lack of any harm resulting from the delay, the court pointed out that “once notified, [the insurance company] conducted no investigation. It is thus unclear how Canron’s delayed notice detrimentally affected [the insurance company’s] ability to investigate and caused actual prejudice.”¹⁸ Put simply, if the insurance company does not perform a real and thorough investigation, the company will be hard-pressed to identify what was actually prejudiced.

3. *Darcy*

Darcy v. Hartford Insurance Co.,¹⁹ although not involving an environmental claim, also makes the point that an insurance company must actually

12. *Canron*, 918 P.2d at 940.

13. *Id.* at 941.

14. *Id.* at 942.

15. *Id.*

16. *Id.*

17. *Id.* at 941.

18. *Id.* at 942.

19. 554 N.E.2d 28 (Mass. 1990).

attempt an investigation in order to claim prejudice to an investigation. In *Darcy*, in response to a personal injury claim, the only investigation performed by the insurance company before denying the claim on the grounds of late notice was to look through the phone book to try to locate the policyholder's principal and review a few public records. The insurance company adjuster identified not the policyholder's principal, but a relative, and sent the denial letter to the relative, despite his investigator being aware this was the wrong person.²⁰ The court held that the insurance company must show prejudice to prevail:

[B]efore a denial of coverage by an insurer is justified, the delay in notice must be accompanied by a showing of some other facts or circumstances (such as, for example, the loss of critical evidence, or testimony from material witnesses despite diligent good faith efforts on the part of the insurer to locate them) which demonstrates that the insurer's interests have been actually harmed. We see no reason to absolve the insurer of the burden of identifying the precise manner in which its interests have suffered.²¹

The court found that the insurance company had failed to meet its burden of showing prejudice because the company made no meaningful attempt to identify employees or other witnesses with knowledge of the claim, and could not show that the outcome of the claim would have been any different had notice been provided earlier.²² Thus, the insurance company's prejudice arguments did "not rise beyond the level of speculation."²³ The court also observed that "[a]ny prejudice which resulted from the entry of the default judgment in this case is directly due to [the insurance company's] inaction in its investigation rather than to [its insured's] failure to provide prompt notice."²⁴

4. *Dow*

*Aetna Casualty & Surety Co. v. Dow Chemical Co.*²⁵ describes the critical late notice issues in a thorough and detailed manner, a discussion necessitated by the fact that Dow sought coverage for ten cleanup sites in several states on policies it purchased between 1944 and 1985, and provided notice at different times for each site.²⁶ In order to avoid the possibility of a forfeiture, Michigan law, like that of most states, requires the insurance company

20. *Id.* at 30.

21. *Id.* at 31-32 (citation omitted).

22. *Id.* at 32.

23. *Id.* at 32 n.5.

24. *Id.*

25. 10 F. Supp. 2d 800 (E.D. Mich. 1998).

26. Notice was also made under excess policies, which added a further complication to the analysis because of the need to determine when the policyholder understood that the excess policies would be implicated. *Id.* at 809.

to show actual prejudice to prevail on a late notice defense. Of significance and not often discussed in the case law, the court cited Michigan precedent for the proposition that prejudice does not exist if the insurance company has adequate information about the incident regardless of the source of its information.²⁷ The court described the insurance company's showing necessary to establish prejudice as follows:

An insurer's bald assertion that witnesses have died, documents have been lost or destroyed, or opportunities have been lost is insufficient to show actual prejudice to its position. . . . If the function of the prejudice requirement is to protect the insurer's interests from being prejudiced, then the insurer must come forward with proof that its interests were actually prejudiced; not speculation that its interests were "possibly" prejudiced. Accordingly, the insurer must identify "the precise manner in which its interests have suffered."²⁸

The court also stressed that the existence of prejudice will depend upon the insurance company's diligence in attempting to obtain the allegedly necessary information.²⁹

A related consideration is *when* the information was lost, a particularly important issue for environmental claims, which may involve damage to the environment occurring over many years and a lengthy claims investigation. In addressing this issue, the court stated:

Insurers must also establish that the missing evidence was lost between the time the insured should have provided notice and the time it gave notice. Evidence lost before the insured's duty to provide notice arises cannot be used to establish prejudice to the insurer's position because, under those circumstances, both parties are equally disadvantaged by the missing evidence.³⁰

Thus the temporal window in which missing information becomes relevant opens when the policyholder reasonably should have provided notice. The window closes after notice when lost information is the result of "the insurance carrier's failure to act upon receiving notice."³¹

The *Dow* court applied these principles in a detailed discussion of each site in the case. For example, at one site Dow excavated leaking underground storage tanks and disposed of contaminated soil several years *after* Dow gave notice to its insurer. The court expressed skepticism about the claim of prejudice from these activities because of the insurance companies' "failure to independently investigate after notice."³² Similarly, the court

27. *Id.* at 811 (quoting *Koski v. Allstate Ins. Co.*, 572 N.W.2d 636, 639 (Mich. 1998)).

28. *Id.* at 813 (citations omitted).

29. *Id.*

30. *Id.* at 814.

31. *Id.* (quoting *Burgess v. Am. Fid. Fire Ins. Co.*, 310 N.W.2d 23, 25 (Mich. Ct. App. 1981)).

32. *Id.* at 818.

rejected the claim of prejudice based upon an underground storage tank removal and cleanup that occurred *before* Dow gave notice to its insurer, allegedly hindering the insurance companies' ability to determine whether the releases were sudden and accidental. Although the insurance companies argued that the environmental investigation performed by independent professionals was a poor substitute for the insurance companies' own hypothetical investigation, the court found prejudice not to exist because the insurance companies failed to show that the investigation was inadequate and because holes documented in the underground storage tank showed sudden and accidental polluting events.³³ In response to one insurer's argument that prejudice existed because it could not determine when these events occurred, the court noted that the insurer had "not established whether and why this information cannot be obtained from other sources," for example, the widely used technique of modeling the migration of a contaminant plume.³⁴ The court reasoned that

[i]n the context of environmental insurance disputes where actual property "damage is not discovered until years after the pollution began," the insured and insurer often use experts on hydrogeology and contaminant transport to determine how quickly discharged pollutants would have traveled through the soil and how and when soil and groundwater contamination would have occurred.³⁵

At another site, an insurer claimed that it did not receive notice of the claim until 1996. However, the insurer's records indicated that it learned about remediation activities from other unidentified sources in 1989. Consequently, the court found prejudice not to exist as a matter of law.³⁶

At a third site, the court rejected the insurance companies' contention that "key documentary or testimonial evidence" was lost because of a delay in notice.³⁷ The court found that the insurance companies failed to "specify what insurance coverage issues are left unexplored in the transcripts of 17 former [Dow] employees who were deposed" in the underlying litigation.³⁸ In addition, the court observed that in the case

Dow also presents evidence that Insurers, even when given the opportunity, do not take advantage of the opportunity to investigate Dow's claims and do not find that arrangement objectionable. . . . Dow also produces testimony from [an insurer's] employee who handled Dow's claims stating that she could not recall any instances where an investigation was requested for a Dow claim.

33. *Id.* at 818–19.

34. *Id.* at 819.

35. *Id.* (quoting *Gelman Scis., Inc. v. Fid. & Cas. Co.*, 572 N.W.2d 617, 620, 628 (Mich. 1998)).

36. *Id.* at 821–22.

37. *Id.* at 824.

38. *Id.*

Dow also presents testimony supporting its claim that [another insurer's] investigations were also cursory; i.e., consisting of requesting information from the insured, from environmental agency personnel, or making Freedom of Information requests.³⁹

The evidence presented by Dow, that insurance companies do not actually perform the investigations that they claim are prejudiced by late notice, is likely to be the evidence in most coverage cases, and should lead to the same result—the rejection of a late notice defense.

5. The Oregon Cases

In contrast to the in-depth analysis of late notice prejudice issues in the cases discussed above, the case law in Oregon is limited and contradictory, and is not alone in this regard.⁴⁰ Unquestionably, the notice prejudice test applied in the jurisdiction since the Oregon Supreme Court's 1975 decision in *Lusch v. Aetna Casualty & Surety Co.*⁴¹ However, the Oregon appellate courts have only at times, and then not consistently, taken seriously the requirement that the insurance company show actual prejudice rather than merely speculate about it.

For example in *North Pacific Insurance Co. v. United Chrome Products, Inc.*,⁴² the City of Corvallis received a PRP notice for a site in 1983 and provided notice to the insurance company in 1989, years later and after it had incurred millions of dollars in liability for cleanup costs. The form of the city's notice appears to have been its complaint against the insurance company for indemnity.⁴³ The insurance company argued that the prejudice caused by the delay in notice was obvious because it could not determine when the contamination occurred. The city responded that the years in which the releases occurred could be "narrowed down to certain years, which would give [the insurance company] enough information to identify the appropriate policies."⁴⁴ Taking the actual prejudice test seriously, the court of appeals held that this created a material issue of fact for trial.⁴⁵

In contrast, in *Carl v. Oregon Automobile Insurance Co.*,⁴⁶ one year before the policyholder gave notice to its insurer, the policyholder decommissioned leaking underground storage tanks, identified a hole in one tank, and then sold the tank for scrap. The contaminated soil was either excavated and disposed of or remediated by aeration. The insurance company's

39. *Id.* (citations omitted).

40. *E.g.*, *Employers Ins. of Wausau v. Ehlco Liquidating Trust*, 708 N.E.2d 1122, 1135–36 (Ill. 1999) (resolving conflicting Illinois law on aspect of late notice defense).

41. 538 P.2d 902 (Or. 1975).

42. 857 P.2d 158 (Or. Ct. App. 1993).

43. *Id.* at 160.

44. *Id.*

45. *Id.*

46. 918 P.2d 861 (Or. Ct. App. 1996).

claims supervisor therefore testified that the evidence was destroyed or altered to such an extent that an investigation was impossible.⁴⁷ The policyholder countered that test results, soil samples, photographs, and even an audiotape of the investigation existed, documenting the cleanup actions. The court nonetheless reasoned that because the professionals who performed the cleanup “had no interest in determining when the contamination began or at what rate it progressed,” prejudice existed.⁴⁸ The court found prejudice resulting from the alleged impossibility of determining which of several policies was in effect at “critical times” and the apportionment of liability among the insurance carriers.⁴⁹

In the author’s view, the *Carl* court’s analysis does not withstand scrutiny. First, the court did not identify or explain when the purported “critical times were” under the Oregon “injury in fact” trigger rule discussed in *St. Paul Fire & Marine Insurance Co. v. McCormick & Baxter Creosoting Co.*,⁵⁰ all insurance policies in effect while the contamination was damaging the environment are triggered. Therefore, the only critical date is the year in which the contamination began. Although the plaintiff’s expert had a theory on this subject, the court rejected the testimony without explanation. In addition, the *Carl* decision does not discuss whether inventory records or other sources were available to determine when the leakage began, or whether a migration modeling analysis as was discussed in *Dow* could have been performed.⁵¹ Second, as to the apportionment issue, apportionment among triggered policies is unconnected to the amount of property damage in a given year. Instead, under the *Lamb-Weston* decision, the primary considerations under Oregon law are policy limits and the amount of coverage.⁵²

The Oregon appellate courts also demonstrated this lack of consistency on the issue of whether the allegedly missing information would have changed the insurance company’s conduct. For example, in *Halsey v. Fireman’s Fund Insurance Co.*,⁵³ the policyholders gave notice to the insurance company after judgment had been entered against them in a landlord-

47. *Id.* at 863–64.

48. *Id.* at 864.

49. *Id.* at 864–65.

50. 870 P.2d 260, 265 (Or. Ct. App. 1994), *rev’d in part on other grounds*, 923 P.2d 1200 (Or. 1996).

51. *See also* Port Servs. Co. v. Gen. Ins. Co. of Am., 838 F. Supp. 1402, 1405 (D. Or. 1993) (accepting without analysis an argument that the removal of underground storage tanks and excavation of soil before notice necessarily proved prejudice).

52. *Lamb-Weston, Inc. v. Or. Auto. Ins. Co.*, 346 P.2d 643 (Or. 1959). This assumes that the court will not apply an “all-sums” approach, allowing the policyholder to choose the triggered policies. *See generally* David A. Bledsoe & Stephen M. Feldman, *All Sums or Pro Rate? Dealing with Multi-Year Insurance Coverage Issues*, 21: 3 *LITIG. J.* 3 (Or. St. B. 2002).

53. 681 P.2d 168 (Or. Ct. App. 1984).

tenant dispute. The trial court granted summary judgment for the insurer, based on its defenses that the insureds had breached the policy's notice and cooperation provisions and had failed to comply with conditions precedent in policy. On appeal, the insurance company argued that it was prejudiced because it had received notice too late to perform a reasonable investigation. The policyholders, on the other hand, argued "that defendant was not prejudiced, because it denied *coverage* even after it was notified."⁵⁴ The court held that notice after judgment did not in itself prove prejudice. In addition, the court found that because the policyholders had successfully defended the case, reducing the damages sought at trial by half, there was no evidence that the insurance company was prejudiced, that is, it could not have done any better. The court also stressed that no prejudice existed because the insurance company might have denied coverage on the merits, even if it had been given notice and an opportunity to investigate before trial.⁵⁵ Consequently, the court reversed summary judgment in favor of the insurance company and remanded the case for trial.

Halsey thus teaches that if the insurance company would have denied coverage, at least for reasons on which the allegedly precluded investigation would not have been determinative, its prejudice case becomes highly problematic. In *Carl*, however, after remarking that under *Halsey* a court is not "precluded from finding prejudice" when the insurance company would have denied coverage regardless of its investigation, the court found "wholly speculative" the policyholder's contention that the insurance company would have denied coverage, as it did, on the basis of the qualified pollution exclusion, even if notice had been timely.⁵⁶ The facts as reported in the appellate decision are insufficient to determine whether investigation might have changed the insurance company's decision, but the issue surely merited more analysis than a conclusory finding of speculation.

Nonetheless, despite the rather incongruous nature of some of the Oregon case law, the decisions are nevertheless consistent with the more thoughtful analysis in *Canron* and *Dow*. Under *City of Corvallis*, the insurance company still must identify concrete facts proving prejudice. Under *Halsey*, prejudice does not exist if the insurance company would have denied the claim regardless of the presence or absence of the missing information. Therefore, in Oregon, as elsewhere, the determinative issues to establish prejudice remain whether the insurance company can show with specificity a loss of relevant information because of late notice and whether the insurance company would have done anything differently had notice been given sooner.

54. *Id.* at 170.

55. *Id.*

56. *Carl*, 918 P.2d at 865.

B. *The Practical Test: What Relevant Evidence Existed When Notice Was Given*

Based upon the case law, the critical prejudice question for summary judgment or trial of an environmental claim can be summarized as *whether sufficient evidence existed at the time notice was provided to determine the facts related to the claim that the law makes relevant*. Although this assertion might appear self evident, this formulation of the issue bears closer inspection.

1. Only the Loss of Legally Relevant Facts Makes a Difference

The preliminary question in responding to an assertion of prejudice is whether the allegedly missing evidence is actually material to anything. In the nature of any organization and consistent with the law of entropy, certain facts are lost or forgotten every day, and in any large organization employees come and go. Consequently, an insurance company asserting late notice will argue that due to the passage of time, the company must have suffered prejudice. If there is no dispute that facts and witnesses have been lost, particularly after a number of years, how could there not be prejudice? The answer is that the defendant must show, by something other than speculation, that the lost information is necessary to determine the material facts of the incident.

For example, in an environmental coverage case based upon events occurring over several decades, company executives and supervisors will more likely be unavailable simply because they are generally older than are production workers. If the relevant question is how a solvent got into the groundwater, however, the company's vice presidents are unlikely to have any relevant information to contribute. Similarly, office workers, salespeople, and employees who were not involved in handling the solvent would also be irrelevant to the prejudice analysis.

Undoubtedly, documents will also be lost over the years. But if the documents relate to production, sales, or accounting, these too might not provide relevant evidence. In *Wausau*, for example, the insurance company stressed that trainloads of documents had been subject to routine destruction. Yet when the policyholder explained that it assigned personnel to ensure that all documents relating to insurance and environmental issues were preserved, the insurance company appeared to be trying to mislead the jury rather than to make any legitimate point.

2. Consider Evidence Remaining from Any Source

The next question is to consider what evidence existed at the time the policyholder provided notice, not what evidence has been lost. An insurance company will typically view the glass as half-empty, that is, what witnesses are no longer available and what documents no longer exist. Policyholders will argue, however, that the issue is not who died or what

documents have been lost, but rather the primary question is what witnesses and documents *currently exist or existed when the claim was made* and whether this evidence is sufficient to determine what occurred.⁵⁷ In other words, is the glass half-full?

As the court's decision in *Dow* demonstrates, this evidence may be from any source, not only the insurance company's claims investigation. For example, in *Wausau*, Wausau's loss control specialists inspected the insured's premises and described potential environmental liabilities more than twelve years before the policyholder gave formal notice. Similarly, suppose an insurance company has multiple policyholders that are implicated in a site's contamination, for example, a landfill. If the insurance company obtains adequate information about the landfill after Policyholder A gives notice, it remains in possession of this information when Policyholder B gives notice at a later date. The insurance company should therefore not be able to claim prejudice as a result of Policyholder B's allegedly late notice, just because its claims adjusters do not communicate with each other or it has not set up a system to easily retrieve the information it has in its possession.⁵⁸

In the author's view, this issue is more than a matter of emphasis; it is one of substance. If three out of four witnesses to an event are unavailable, but the fourth has a sufficiently complete recollection to determine what occurred, the policyholder possesses an availing argument that the insurer has suffered no prejudice. Indeed, if no witnesses are available, but the event is thoroughly documented, the insurer will be hard-pressed to demonstrate actual prejudice. Although the argument can and will be made that the unavailable witnesses might have remembered things differently, unless there is some additional evidence such as documents contradicting the available witnesses, this argument may fall into the realm of speculation. One can always wish that one's case would be stronger with additional evidence, but absent any reason to believe that such evidence actually existed, such wishful thinking amounts to nothing more than speculation.

3. Consider the Evidence That Existed at Relevant Times

Finally, as *Dow* explains, the question of timing is by no means trivial. In a complex coverage case, for example, years may elapse between the date

57. *Aetna Casualty & Surety Co. v. Dow Chemical Co.*, 10 F. Supp. 2d 800, 814 (E. D. 1998).

58. *See Canron, Inc. v. Federal Insurance Co.*, 918 P.2d 937, 942 (Wash. Ct. App. 1996) (site investigation by other PRPs); *Dow*, 10 F. Supp. 2d at 821. The *Canron* decision does not state whether the other PRPs who performed the site investigation were also policyholders, or whether the site investigation documents were present in the insurance companies' claims files for these other policyholders. This example points out, however, why policyholders need to conduct discovery about other claims made against an insurance company at a particular site, and why it is erroneous, as often occurs, to preclude such discovery on relevancy grounds.

of notice and the trial. The defendant will undoubtedly regale the jury with lists of witnesses who have become unavailable or documents that were lost before the trial. The relevant question, however, is whether the witnesses or documents were available at the time notice was given and at the time it should have been given.⁵⁹

If a witness dies between the time notice was given and the trial, but the insurance company fails to preserve that witness's testimony, the policyholder possesses a strong argument that this unfortunate circumstance should not be held against it. In *Wausau*, the insurance company stressed the number of witnesses who had died, but its claims adjuster lost credibility when counsel pointed out on cross-examination that the witnesses had died either long before a claim could have been contemplated or sufficiently after the claim was made for the insurance company to have interviewed the witnesses.⁶⁰ Similarly, if documents the policyholder reasonably believed to be irrelevant to the dispute were subject to routine destruction and the insurance company did not timely request them, again, the insurance company's lack of energy in its investigation should not be held against the policyholder.

C. *Witnesses, Documents, and Physical Facts*

The three bases of prejudice an insurance company is likely to assert relate to the loss of witnesses, documents, and physical facts. As a practical matter, these are not separate issues. Instead, each is part of the totality of evidence that may or may not be sufficient to understand an incident. For example, if documents are lost, there may be witnesses to the subject matter of the documents, or the authors of the documents might even be available. If the physical facts have changed, there may be witnesses and documents sufficient to show what facts existed before the changes. Thus, witnesses, documents, and physical facts are not independent facets of a prejudice test; rather they are in effect fungible. Under the case law, the proper inquiry relates to the overall existence of the evidence about an incident and the type of evidence should not be material.

1. *Witnesses*

Witnesses are one source of information, but given the paper-intensive nature of modern business and governmental organizations and extensive regulatory reporting requirements, eyewitnesses are often not an indispensable source of proof. Applying the analytical framework set forth

59. *Dow*, 10 F. Supp. 2d at 814.

60. The adjuster's credibility was further diminished, and the superficial nature of the insurance company's investigation highlighted, when witnesses whom the adjuster claimed had died proved sufficiently lively to testify at trial.

above, the first question with regard to a witness who becomes unavailable is whether that person was likely to have evidence relevant to the dispute. The next question is whether there are other witnesses or documents that can fill in the allegedly missing information. Finally, the proponent of late notice must show that the witness became unavailable before it could reasonably have been expected to contact the witness, but after the policyholder should have made a claim. The loss of witnesses outside this temporal window should not be relevant.⁶¹ Outside of this window, either the insurance company is at fault for failing to preserve the testimony or, if the witness became unavailable before a claim should have been made, nothing the policyholder did caused the insurance company's prejudice.

For a policyholder that is a large organization, in particular, the insurance company will have a difficult time meeting this burden. The policyholder may employ a large number of production or maintenance workers, each of whom has similar knowledge about the incident or incidents at issue. Although the insurance company will argue that it must interview *every* employee, thereby perhaps placing an unreasonable burden on the policyholder, a representative sample of employees familiar with the operations should be sufficient, absent a document or testimony tying a particular employee to a particular incident. Similarly, if there are contemporaneous documents describing an incident or if the incident can be reconstructed from the available physical evidence, the loss of witnesses is unlikely to be outcome determinative.

2. Documents

As noted above, relevant documents will inevitably be missing. This does not answer, however, the question of whether there is any likelihood the missing documents contained anything material and irreplaceable. Indeed, as in *Wausau*, the insurance company's reasoning on this issue is likely to be circular. The insurance company will argue that it has been prejudiced because it cannot find any documents supporting a denial of the claim, for example, documents showing that the policyholder expected or intended to damage the environment. This begs the question, of course, of whether such documents actually existed. If the documents that do exist show no such guilty knowledge, the reasonable inference, rather than that the insurance company has been prejudiced, is that the missing documents would have been similarly unhelpful to the insurance company.

Often, if site contamination resulted from regular and statistically inevitable de minimis spills, the policyholder may not have generated any documents describing such spills. The insurance company will argue that it has been prejudiced because there is no documentation of the spills,

61. See *Dow*, 10 F. Supp. 2d at 813–14.

without considering whether such documentation ever existed. To paraphrase Sherlock Holmes, it is the fact that the dog did not bark in the night that is significant. Suppose employees testify that they would not have written memoranda about small solvent spills, because they did not believe the spills to be significant or likely to cause any harm. The absence of documents will then be explained and will be itself important evidence about the policyholder's actual expectations and intentions at the relevant time.

Counsel should also note that policyholders are not the only source of documents. For example, documents may be available from environmental regulatory agencies, permitting agencies, and outside vendors or consultants. The insurance company may have information in its own files from claims made by other policyholders or from loss control inspections.

Moreover, as with witnesses, documents themselves are fungible. In *Wausau*, the insurance company argued that the loss of notes from certain interviews performed by an environmental consultant caused it prejudice. The policyholder was able to point out, however, that the interviews were summarized in the consultant's report and that the insurance company had not tried to locate the interview subjects to test their recollections. Thus, when testimony or physical evidence can fill in the blanks allegedly caused by missing documents, there has been no prejudice shown.

3. Physical Facts

With regard to physical facts, the insurance company will argue that a site has changed in a manner that prevents the insurance company from performing its own investigation to determine what occurred. This assertion begs the question of whether the insurance company would have actually performed such an investigation if the policyholder had provided notice earlier. As seen in the case law, for some insurance companies at least, such an independent investigation may be more a theoretical construct than a reality in practice. However, setting aside the hypothetical nature of the defense, if, for example, buildings have been constructed or destroyed at the site, contaminated soil excavated and disposed of, leaking storage tanks sold for scrap, or the like, has the insurance company proved its case?

In the author's view, the answer is not necessarily. Again, the first question is whether the physical changes are relevant. If the insurance company attempts to distract the jury with changes unrelated to the claim, this should be pointed out and will reflect negatively on the insurance company's credibility. For example, in *Wausau*, the insurance company stressed that the policyholder had demolished buildings at its facility. However, the insurance company could not explain why this demolition made a difference or how the buildings would have provided relevant evidence.

The relevance of the changes must be more than a matter of speculation. For example, is there any real reason to believe that a storage tank sold for scrap or a demolished building was a source of the site contamination? If not, the insurance company has not proved its case. In *Wausau*, the insurance company repeatedly referred to the loss of certain concrete sumps that were identified as a source of the contamination. The insurance company's assertion of prejudice was first put in doubt because the removal of the sumps was extensively documented by reports and photographs, which the insurance company's experts and claims adjusters failed to review, and described by witness testimony. The insurance company was left with an argument that it was unable to test or inspect the sumps themselves. However, when the policyholder's expert showed that the solvent in question would necessarily have seeped through concrete and that an inspection was unnecessary to determine this, the insurance company was left with hours of testimony and argument about a nonissue, again appearing to be trying to mislead the jury.

This example also demonstrates that, even assuming the physical facts have some relevance, the next step in the analysis, whether the missing information is available from other sources, must be conducted. Did insurance company representatives visit the site before the changes occurred? Are there witnesses, photographs, or videotapes that can describe the relevant facts? In the environmental context, the U.S. Environmental Protection Agency and state agency protocols require extensive investigations, which are subject to strict quality control and quality analysis standards. When an investigation meets these standards, there is no reason to believe that the hypothetical investigation an insurance company claims it would have performed would have reached any different conclusion. Thus, in a coverage case, the policyholder can and should bring lengthy reports and boxes of analytical data into the courtroom in order to provide weighty and concrete evidence contradicting the insurance company's abstract claim that it was prejudiced by not being able to perform its own investigation.

D. Focus on What the Insurance Company Did and Would Have Done

The discussion above relates to a defensive case in response to an insurance company's claim of prejudice. In addition, a prejudice defense asserted by an insurance company also gives the policyholder an appropriate opportunity to present to the jury the insurance company's conduct. An insurance company receiving a claim may merely send a form letter requesting information and documents, requirements designed to be impossible to satisfy. As demonstrated by *Darcy* and *Dow*, thereafter, instead of actually performing any investigation to obtain sufficient evidence of what occurred, the insurance company will begin to document a case of prejudice—

putting together a case that the glass is half-empty without ever trying to fill it. The evidence may show that an insurance company will almost never engage in independent testing of the physical evidence such as environmental sampling, when it has the opportunity to rely on a prejudice defense. The evidence may also show that an insurance company will not likely interview more than a handful of witnesses unless litigation is filed, and that these interviews will be for the purpose of proving its defenses, not determining the facts.⁶²

The insurance company will nonetheless argue that its conduct is irrelevant unless the law allows a claim for bad faith claims handling. However, it would be a novel result indeed, however, if in a breach of contract case, the conduct of only the nonbreaching party were relevant. As *Darcy* points out, there is no reason to absolve the insurance company of its duty of demonstrating "diligent good faith efforts" to find the information sought.⁶³ There is nothing peculiar about an insurance contract that immunizes an insurance company from scrutiny about how and why it allegedly breached a contract.

The fact that the insurance company is only going through the motions of an investigation is highly relevant to evaluating a prejudice defense. How can it be determined that the insurance company's investigation is prejudiced if the insurance company never attempted to obtain the evidence it claims is missing? Absent proof that it diligently tried to obtain the evidence, its prejudice case is merely speculation.⁶⁴ For example, the insurance company in an environmental coverage case has the burden of proving the policyholder expected or intended a spill.⁶⁵ If an insurance company argues that it could not identify witnesses who saw the chemical being spilled, this necessarily puts at issue the steps the insurance company took to find such witnesses. If the insurance company claims that it has lost the ability to test physical evidence about chemicals in the groundwater, this necessarily puts at issue whether it performed any testing of the groundwater to find this information when it had the opportunity to do so.

A similar inquiry is necessary into the issue of whether the insurance company's position would in fact have changed had the information been available. Suppose an insurance company has a practice of denying environmental claims over a certain dollar amount no matter what the facts.

62. See, e.g., *Darcy v. Hartford Ins. Co.*, 554 N.E.2d 28, 32 (Mass. 1990); *Dow*, 10 F. Supp. 2d at 824.

63. *Darcy*, 554 N.E.2d at 31-32.

64. See *Canon*, 918 P.2d at 941 (rejecting speculative proof of prejudice).

65. See *St. Paul Fire and Marine Ins. Co. v. McCormick and Baxter Creosoting Co.*, 923 P.2d 1200, 1218 (Or. 1996) (qualified pollution exclusion bars coverage only for expected and intended releases); *Fredericks v. Universal Underwriters Ins. Co.*, 915 P.2d 472, 478-79 (Or. Ct. App. 1996) (insurance company has burden of proving applicability of exclusions).

The company has made the economic decision that, on an overall basis, it is more profitable to fight the claims than to pay them. Setting aside the issue of bad faith, as a matter of contract law, the insurance company will not be able to show the *causation* necessary to establish prejudice, that is, the existence of “resulting actual harm.”⁶⁶

In summary, the alleged prejudice must result from the late notice, not from some other source.⁶⁷ If the missing information would not have been factored into the analysis of the claim, the insurance company cannot show that the loss of information caused it any prejudice under the “ability to adequate investigation prong of the prejudice analysis. Therefore, the insurance company is left with an argument that the missing information made it more difficult for the company to succeed in protecting its interests.”⁶⁸ This interest is presumably in being able to deny a claim and then, when litigation arises, discover missing evidence to support the decision that the insurance company would have made in any event. However, unless the insurance company has a legitimate interest in being able to deny claims without determining the facts of each claim, no cognizable interest has been prejudiced.

As a practical matter, presenting this evidence helps the jury evaluate the credibility of the insurance company’s assertion of prejudice. It is easy, for example, for a claims adjuster to take the stand to testify about information that he or she wanted but that was unavailable. It is much more difficult for the adjuster to respond to questions about the steps he or she took to obtain the information and to explain away evidence that he or she would have denied the claim even if the information existed. Additionally, as a matter of public policy, recognition that an insurance company’s claims investigation will be the subject of close scrutiny if the company raises a late notice defense would create an incentive for insurance companies to perform thorough investigations and to provide coverage when it is merited.

III. CONCLUSION

A late notice defense to an environmental claim is unlikely to succeed in the face of a well thought out and appropriately focused presentation. Nor should it succeed in most cases, because insurance companies typically cannot make the threshold showing that the information necessary to determine the facts the law makes relevant were unavailable from any source at the time the policyholder provided notice. These pertinent facts are generally (a) how did the contamination occur and (b) when did it occur, and

66. *Carron*, 918 P.2d at 942.

67. *Darcy*, 554 N.E.2d at 32.

68. *Lusch v. Aetna Casualty & Surety Co.*, 538 P.2d 902, 904 (Or. 1975).

both may be proved by evidence from witnesses, documents or physical facts existing at the time of notice, including by any combination of these sources.

As to the mechanism of the contamination, where the law does not import a temporal component into the sudden and accidental pollution exclusion, the only question is generally whether the policyholder expected or intended the contamination to occur.⁶⁹ Even for contamination occurring some time ago, there will usually be witnesses or company documents showing that the policyholder had no corporate policy or individual intent to harm the environment, and no subjective expectation that the conduct in question would do so. The insurance company might speculate that additional witnesses or documents would tell a different story, but will be unable to explain why former company officers or employees would lie under oath about their intent or why the documents that do exist paint a picture of a responsible business enterprise. The probable implication follows that additional witnesses or documents would paint a picture consistent with those that do exist, not the contrary.

Where a temporal component is imported into the sudden and accidental pollution exclusion or where the timing of the property damage is at issue, both of these questions can usually be resolved by a scientific investigation of site conditions, or a review of policyholder, insurance company, or agency files documenting site conditions before a cleanup was conducted. On the latter question, that of when the property damage occurred, where a jurisdiction has adopted some variant of the injury in fact rule, a showing of property damage during a policy period is unlikely to be problematic. All the policyholder need show is the existence of contamination damaging the environment during a policy period, a showing easily made by modeling or evidence of earlier releases still present in the soil or groundwater.

Even in the unlikely event that some critical piece of evidence is lost, the analysis must then turn to the timing of this loss and the nexus between the insurance company's conduct and the missing evidence. If the information was lost before notice should reasonably have been provided, the insurance company was not prejudiced by the timing of the notice. If the information is lost after the insurance company had the opportunity to obtain it, the insurance company has only itself to blame. As important, if the insurance company would have denied the claim for reasons other than the missing information, it cannot prove the late notice caused it any prejudice: that but for the missing information, it would have taken a different course.

69. See e.g., *St. Paul Fire & Marine Ins. Co. v. McCormick & Baxter Creosoting Co.*, 923 P.2d 1200, 1218 (Or. 1996).

Finally, insurance companies may protest that under this reasoning it would be extremely difficult for an insurance company to ever to prevail on a late notice defense. This may be true, but this is as it should be. The analysis set forth above started with the proposition that the law disfavors forfeitures. In a typical environmental coverage case, the insurance company will have had the time value of hundreds of thousands or millions of dollars in the policyholder's premium funds, often for decades. Where there is sufficient evidence in actuality for the insurance company to uncover the facts relevant to coverage—evidence from any source because such evidence is fungible—no rational law or policy would favor the forfeiture of these premium dollars.

