OVERVIEW OF ENVIRONMENTAL RECOVERY ISSUES

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I. INTRODUCTION

When an insurer is hit with an environmental loss the ability to pursue recovery from potentially responsible parties should be carefully investigated. In many ways environmental losses are no different than other property losses. However, there are important distinctions arising from the fact that environmental losses typically have a regulatory dimension that demands effective management, including early loss investigation, careful management of environmental regulatory/liability issues, and preservation of evidence necessary for subrogation and recovery against potentially responsible third parties.

A. Managing the Loss Scene At Multiple Levels

Effective management of the loss scene is critical. How one responds in the early phases of an environmental loss will have important ramifications later on when big ticket items are negotiated such as the nature and scope of cleanup remedy and of any natural resource damage assessment. Mitigation of liability occurs on several levels. First and foremost, physical control of the loss scene, such as effective containment and response, is vital to prevent progressive environmental injuries and damages. Establishing evidentiary and regulatory control over the loss scene is equally important. Evidentiary control means conducting an effective factual investigation to determine causation and to identify and to secure critical evidence that could be relevant in any subsequent recovery action. The investigation should be directed by counsel so that appropriate confidentiality can be maintained, if necessary, under the attorney-client privilege and the attorney work product doctrine. This will include early retention of consulting experts to assist in the physical investigation of the loss scene, including:

- evaluating exposure risks to humans, flora and fauna,
- evaluating potential natural resource damage,

- soil and groundwater sampling, if necessary,
- interfacing with environmental regulatory authorities,
- evaluating critical pieces of equipment that may have contributed to the loss (e.g. storage tanks and secondary containment systems)
- interviewing fact witness, and
- reviewing relevant compliance documents, such as RCRA Contingency Plans and Clean Water Act Spill Prevention, Control and Countermeasure ("SPCC") plans.

It should be recognized that evidence generated by an investigation may be of keen interest to environmental regulatory authorities, who may want to conduct their own parallel investigation. Therefore, it is important to establish credibility with environmental authorities early in the response effort. Open and frank communication with regulatory authorities—to the extent possible—is essential.

B. Avoiding Spoliation

Perhaps the most common barrier to successful subrogation and recovery following an environmental loss is the failure to preserve important evidence. This is known as "spoliation"--the idea that a negligent defendant is not liable for a loss if the plaintiff failed to preserve relevant evidence that if not destroyed could be exculpatory. A good example is a loss involving the catastrophic failure of a hazardous substance storage tank in which an insurer's investigation concludes that the tank was installed improperly. A subsequent recovery action against the tank installer could be barred under the doctrine of spoliation if the insured disposed of the tank before the defendant has an opportunity to inspect it, particularly if the only evidence of the installer's alleged negligence is the plaintiff's report evaluating the tank following the loss. In this not uncommon scenario, the installer may claim the doctrine of spoliation precludes plaintiff's reliance on the report. Therefore, it is vitally important that the loss investigation have

an eye toward identifying and preserving relevant evidence. Once the evidence is secured, potentially responsible third parties should then be notified so that they have an opportunity to conduct their own inspection of the evidence and can not later claim spoliation.

C. Recovering Against Third Parties

Not unlike typical property losses, environmental losses often occur as a result of a third party's negligence. Obviously, if the insured is solely negligent then there is no recovery opportunity. However, careful investigation can reveal other parties who may have had some substantial role in the loss. Using our tank failure example, above, the manufacturer and/or installer of the failed tank system is a potentially responsible party, as are ancillary component part manufacturers, third-party maintenance contractors, and product suppliers. If the covered environmental loss concerns latent contamination from historic operations, there may be an opportunity to recover from a prior owner or operator of the facility that caused the contamination, or from a nearby facility that contributed to the contamination. The Comprehensive Environmental Response, Compensation and Liability Act ("CERCLA" or "Superfund") provides an insurer who has paid for a clean-up with a right of contribution against a past or current owner or operator of a facility from which a hazardous substance has been released. Most states have analogous laws that afford similar contribution rights, such as the New Jersey Spill Compensation and Control Act, the New York Oil Spill Prevention, Control and Compensation Act, the Connecticut Water Pollution Control Act, and the Massachusetts Hazardous Material Release Prevention and Response Act.

In sum, environmental losses differ from property losses because of the need to control and mitigate environmental liability. As discussed more fully below, thorough evaluation of subrogation and recovery opportunities requires early involvement of

environmental subrogation counsel, careful use of experts to evaluate potential causes and to identify potentially responsible third parties so that subrogation potential are maximized.

II. INVESTIGATION TECHNIQUES

It is not possible to devise a comprehensive checklist that spells out the activities or procedures that should or must be performed in investigating each and every environmental loss. Experience and common sense suggest certain procedures that are generally desirable to follow in the investigation of any casualty including environmental claims arising out of events such as leaks, spills, pipe failures and tank collapses. Some of these protocols can even enhance recoveries in long term and historical contamination situations.

While environmental recoveries are different from fire claims, some of the investigative techniques developed in fire litigation are applicable to contamination claims. For example, in the field of fire investigation, the National Fire Protection Association ("NFPA") has issued and periodically revises a collection of "guidelines" for fire investigators. The most current version of the NFPA's fire investigation guidelines is the 1998 Edition of NFPA 921, "Guide for Fire and Explosion Investigations". These guidelines codify tested investigative methods, protocols and techniques and to some extent are instructive in our environmental investigations.

The appropriate procedure to follow in any particular situation will vary depending upon the specific circumstances of a loss, including the severity of the loss in terms of the extent of the damage suffered by the insured and others as well as any associated personal injuries or deaths, the number of potentially interested parties known to be involved at the outset or who are identified as the investigation progresses, the potential for an ongoing criminal or other parallel governmental investigation, the extent of any environmental or other safety

hazards at the site, both to the investigators and to the public, the urgency of commencing site restoration activities, and countless other factors. Even NFPA 921 recognizes the flexibility an investigator must employ in conducting a fire investigation.

Because there is no "one size fits all" investigative checklist that applies to all cases, those who investigate or supervise the investigation of an environmental loss must rely heavily upon their common sense and experience. However, it is not possible to be sure that an adequate and complete investigation is being performed, unless you are able to:

A. Recognize all potential liability theories;

B. Select the right kinds of experts and use them appropriately; and

C. Recognize what evidence needs to be preserved and how it should be preserved.

The legal concepts that are pertinent to each of these three major considerations are constantly evolving. What follows is a brief discussion of some of the more important legal and practical issues to consider in handling environmental recovery claims.

A. Recognizing Potential Liability Theories (Especially the Less Obvious Theories)

Logically, anybody with an interest in investigating an environmental loss must determine what the relevant facts are first, and then decide, based on those facts, where potential liability for the loss may lie. Many times environmental claims are made days, months even years after an event occurred. The passage of time can change loss sites, contaminate evidence and fade memories. While this unquestionable complicates fact gathering it is still the most important part of the recovery process. If the facts of an event can not be accurately re-constructed, liability can not be properly and fairly evaluated.

Recovery personnel must be creative in the location and utilization of historical resources. Newspapers, court documents, records of local governmental hearings, business histories (even authorized histories found on the Internet) can all provide valuable information, useful in reconstructing conditions at a loss site or fleshing out corporate, business or governmental relationships that might be relevant to the investigation of an environmental loss. For example if a site is contaminated by lead it would be important to know that there was a firearms manufacturer at that location in the past and the current status of that business. Or if groundwater is contaminated with heavy metal, the location of a battery manufacturing facility in the neighborhood might be important to know. The fact finding must begin at the earliest possible time.

However, it is not possible to know what facts are "relevant," or whether all of the relevant facts are at hand, unless there is an appreciation of all of the potentially applicable liability theories. If the personnel responsible for directing the investigation are not tuned in to all potential liability theories, important evidence and many potential opportunities may be lost forever at the early investigation stage. Opportunities can also be irretrievably lost early in the game as a result of imprudent decisions regarding the selection and use of experts and the retention and disposal of evidence.

Unfortunately, many liability theories often go unrecognized, at least until it is too late to act on them. If there is one concept that anyone faced with evaluating recovery prospects in any loss situation should keep in mind, it is the concept of "multiple proximate causes" or "concurrent causation".

Obviously, if conduct did not "proximately cause" a loss, there can be no legal liability for that loss. With minor variations, "proximate cause" is defined in most jurisdictions as either a "but for" cause, or as a "substantial contributing factor" to the occurrence of a loss.

All jurisdictions recognize that there can be more than one proximate cause of a loss. While common sense suggests that there usually is more than one factor that contributed to the occurrence of a loss, the implications of the concept of multiple proximate causes are often not fully appreciated. Here are some examples:

1. There may be recovery opportunities in an environmental loss even when the cause of the loss cannot be specifically identified, or when no financially viable third party bears responsibility for the known cause of a fire, or even where the insured was at fault for actually starting the fire:

(a) There may have been a failure to identify the contamination by an environmental consultant at the time your insured took possession of the property implicating the consultant in a potential breach of contract action;

(b) a contamination may have spread as a result of a change in the condition of the insureds' land prior to their ownership or a change on and adjoining land causing the contamination to spread beyond the immediate loss location;

(c) a piece of equipment may have malfunctioned causing an environmental pollutant to be spread. Liability for the "spread" might attach to the machine's manufacturer regardless of the original cause of the pollution,

(d) water might spread a pollutant as a result of a defective containment device such as a tank, pond, dam of levee potentially placing liability on the designer, manufacturer or owner of that device..

In any case involving a pipe failure or leak, it is important not only to secure the failed tanks, pipes or fittings, but also to document where each was found on site, and to get the failed items into the hands of a qualified expert before corrosion significantly alters their post-loss condition. If possible, the expert should inspect the site before repairs are performed and the specific location in the system of each leak should be documented. If the failed equipment is not available it might be possible to determine the identity of the equipment and have a similar exemplar evaluated to determine if its use was proper.

Sensitivity to recovery opportunities like these has resulted in recovery even in "Cat Loss" situations. However, the examples discussed above illustrate that the evidence required in order to evaluate and pursue such claims must be secured and documented promptly after the loss and there is usually only a very limited time in which to do so. At the same time, in any major natural catastrophe, claims personnel typically have their hands full in attempting to meet the urgent needs of numerous policyholders. It is on such occasions that professionals dedicated to protecting the insurance company's recovery interests can be of greatest assistance to the company, if they are notified and become involved immediately after the loss.

B. Selection and Usage of Experts

1. Kinds of Experts

Common sense will normally dictate which kinds of experts are appropriate for which kinds of cases. The key issue is to be sure that the need for the right kind of expert is identified early enough for the expert to be of maximum assistance.

Steer clear of "generalists" who claim to be experts in everything. The very fact such witnesses spread themselves so thin renders them vulnerable to impeachment. Some so-called experts think that resumes listing dozens of areas of supposed expertise make them look good. However, they are only creating ammunition for opposing counsel to use against them in cross-examination. There is also a much greater likelihood that such a "jack of all trades" will overlook something important during the investigation that a more focused expert would not have missed.

Equally dangerous is an expert who truly has strong credentials in a particular field, but who does not recognize the limits of his or her own expertise, and wants to "do it all for you." For example, most cases will require the services of a qualified environmental investigator or engineer, and it is common to rely exclusively upon such investigators to conduct the preliminary investigation. It is at this preliminary investigative stage that the need for other experts should be identified. However, it may take some probing questioning of the investigator to reveal whether additional consultants in other fields will be needed in order to perform a complete analysis of the situation that will hold up in court. This is true even when the potential cause identified by the investigator does not seem to involve any other scientific disciplines. The determination of an environmental event normally requires the elimination of alternative causes, and the potential alternative causes that must be eliminated may implicate matters beyond the investigator's expertise.

Also beware of entrusting all aspects of an investigation to "full service" forensic consulting firms. Such firms often have qualified personnel on staff, but that does not mean that every expert that the firm employs in every pertinent field is the particular expert you want to work on that particular case. The benefits of individually selecting the most appropriate experts in each field often outweigh any supposed "efficiency" in using multiple experts from the same firm. Also, one of the benefits of working with multiple experts from multiple disciplines is that the experts can identify weak points in each other's analysis, which should strengthen the overall case. Multiple experts employed by the same firm may feel the need to put up a united front, and therefore may be less inclined to challenge one another's conclusions.

3. "Daubert" Issues

An investigation conducted by a licensed and otherwise qualified and carefully selected expert is worthless if the expert will not be allowed to testify at trial. There is no reason to go to the expense of conducting an investigation with the assistance of experts if there is no hope of eventually winning the case at trial, and there usually will be no chance of winning a case, or even having a jury decide the case, if your experts are not even allowed to take the stand. The decision whether or not an expert will be allowed to testify now quite often hinges upon how trial judges interpret the 1993 decision of the United States Supreme Court in Daubert v. Merrell Dow Pharmaceuticals, Inc., 509 U.S. 579 (1993).

In the Daubert decision, the Supreme Court tried to reconcile what are often valid concerns over the use of "junk science" in court, particularly in toxic tort cases, with the rather vague and seemingly liberal language of the Congressionally enacted Federal Rules of Evidence relating to the standards for admission of expert testimony. In broad terms, the Daubert decision basically abandoned a standard for admission of expert testimony that required the expert's

opinion to be based upon "generally accepted" scientific principles, in favor of a supposedly more flexible standard. However, the greater flexibility has given federal trial judges greater leeway to exclude expert testimony that the judges feel lacks an adequate basis and, once the expert's opinions are thrown out of court, the case upon which those opinions is based is normally thrown out with it.

The U.S. Supreme Court's decision in General Electric v. Joiner, 118 S.Ct. 512 (1998), confirmed the broad discretion that federal district judges have to admit or exclude expert testimony based upon the judge's own assessment of the adequacy of the basis for the expert's conclusions. Technically, Daubert and Joiner are controlling only in federal courts. However, the cases are influential in state courts, as well.

Litigation-savvy experts who do not relish the prospect of being "Daubertized" and having a judge exclude their opinions as baseless now recognize that they must amass so-called "Daubert material," consisting of published literature in their field independently supporting their methodology and analysis. While it is ultimately the lawyer's responsibility to develop expert testimony that will not simply be deemed adequate to be heard in court, but that will actually persuade a judge or jury to find in the client's favor, avoiding Daubert problems is not solely the lawyer's problem. Developing expert opinions that have a sufficient basis to withstand an eventual Daubert challenge requires that necessary physical evidence is preserved and site conditions are properly documented, and that the post-loss investigation and evaluation of the evidence otherwise follows generally accepted methodology. If proper steps are not followed immediately after the loss, while the site is undisturbed and all evidence is available, with an eye toward compliance with Daubert standards, it may not be possible to correct the situation later.

4. Reports

Consider carefully whether and when an expert should issue a written report, and for what purpose. Assuming that the expert is providing adequate oral updates either directly or through counsel, on the status of his or her investigation and analysis, the issuance of written reports before completion of formal discovery is particularly unnecessary and potentially dangerous. It is often only after the defendant has been forced to submit to formal discovery proceedings that you can be sure that there is an adequate factual background for an expert report. It is not that the facts will change, but there may simply not be adequate access to all relevant facts, particularly those known exclusively to the defendant, until after discovery has been conducted.

Once sufficient discovery has been completed, the federal courts and many state courts now require expert witnesses to issue a written report setting forth their conclusions and anticipated testimony. On rare occasions, after a financially viable subrogation target has been identified and the lines of communication have been established, the presentation of a report authored by a qualified expert may assist in bringing about a settlement. Apart from these situations, the premature issuance of an otherwise unnecessary expert report is much more likely to impede rather than assist in the resolution of a claim.

Courts generally take a liberal view regarding discoverability of expert's reports, particularly when such reports are contained in a property insurer's claim file. Addressing the reports to counsel can assist in protecting them from disclosure as non-discoverable "work product," but is no guarantee. Also, in most jurisdictions, any reports authored by an expert who is designated to testify at trial will eventually have to be produced. You should therefore assume

that any written reports from an expert will eventually fall into the hands of an opposing party. A preliminary report based upon an incomplete or inaccurate understanding of the facts could needlessly inflect devastating damage to the expert's credibility and to the underlying case.

Similarly, a report which focuses exclusively on heaping responsibility upon a party who turns out to have no assets or insurance or who is protected by an ironclad subrogation waiver could needlessly hinder efforts to recover from defendants with deeper pockets. It may be preferable if such a report never gets written, and a new expert is hired to focus on more financially viable liability theories.

Thus, while it is understood that the experts must independently arrive at whatever conclusions they put in their reports, the decision as to whether or when to write the report is the client's to make, and should be made with due regard for the strategic considerations outlined above.

B. Recognizing What Evidence Needs to be Preserved, and How to Preserve It.

1. Evidence Spoliation Issues

In the "good old days" of loss investigation--10 or 15 or more years ago-- an expert went to a scene, took pictures of whatever the expert deemed important enough to photograph, and saved whatever physical evidence the expert thought was important enough to save. The expert then blithely disassembled the suspected product or device, and conducted whatever destructive testing the expert thought was necessary to verify their theory. Eventually, usually long after the loss site had been rebuilt, the defendant was sued or placed on notice of a claim. The defendant would then retain an expert, and because the loss site was no longer available, the defense expert would have no choice but to use the plaintiff's expert's photographs and whatever physical evidence was available, and come up with a theory that contradicted the

plaintiff's theory. The defense expert and defense counsel might also challenge the adequacy of the plaintiff's expert's investigation and analysis, and challenge the adequacy of the evidence supporting the plaintiff's expert's theory. However, all of these issues were almost always left for the jury to sort out at trial.

In those "good old days," before spoliation fever swept through the courts of the land, both sides spent considerably less money on experts, and defendants probably won just about the same percentage of cases that they do now, because the emphasis on evidence preservation brought about by the expansion of the evidence spoliation doctrine means that plaintiffs are now accumulating the evidence required to more effectively and persuasively prove their cases.

In any case, the "good old days" are long gone. In the modern era of recovery litigation, defendants are pressing the courts for a "level" playing field, so far as the gathering, documentation and preservation of evidence is concerned. The result is a legal minefield for insurers.

The spoliation doctrine is expanding and developing at different rates and is taking shape in many different forms in the many jurisdictions that have considered it. Therefore, it is not possible to devise practical investigative procedures that are guaranteed to pass muster in all cases in all jurisdictions. Obviously, in a product liability case, it is absolutely critical that the remains of the product itself be preserved, ideally in the same condition that it was found immediately following the loss. In Sentry Ins. Co. v. Royal Ins. Co. , 196 Wis.2d 907, 539 N.W.2d 911 (1995), a house fire was alleged to have been caused by the malfunction of a refrigerator. While examining the refrigerator for purposes of identifying the cause of the fire, an expert for the homeowner's insurer removed critical components, without first notifying the

refrigerator manufacturer. The manufacturer was later placed on notice, and provided with a copy of the expert's report which detailed his findings. Only after suit was filed many years later did the refrigerator manufacturer request to examine the refrigerator. By that time, the entire refrigerator had been discarded.

The refrigerator manufacturer moved for sanctions. The trial court concluded that because the defendant was precluded from conducting necessary testing on the refrigerator's electrical circuitry to determine the cause of the fire, a sanction was appropriate. The court then precluded introduction of any evidence of the condition of the refrigerator, which is a sanction tantamount to dismissal in a product liability case.

The court then granted summary judgment and dismissed the case.

The Wisconsin Supreme Court upheld the trial court's ruling, noting that "there is a duty on a party to preserve evidence essential to the claim being litigated". The court noted that, while the disposal of the refrigerator may have been inadvertent, the expert's removal of components from the refrigerator was plainly intentional, and this intentional conduct would have deprived the defendant of the opportunity to conduct necessary testing on the refrigerator, even if the refrigerator had been available. This reasoning suggests that the outcome of the case would have been the same even if the refrigerator had not been discarded. In the Wisconsin Supreme Court's view, the damage was done when the homeowner's insurer's expert partially dismantled the evidence.

Even when the product is preserved, that may not alone be sufficient. This was demonstrated by the decision of the U.S. Court of Appeals for the Seventh Circuit in Allstate v. Sunbeam, 53 F.3d 804 (7th Cir. 1995), a case involving Illinois law. In that case, an engineer investigating a house fire determined that the fire originated in the vicinity of a Sunbeam gas

grill. The engineer and an Allstate adjuster decided that the only evidence that needed to be preserved from scene were the remains of the gas grill's fuel system, including the propane tank and the burner and everything in between. The expert and adjuster did not retain the grill's frame, and also failed to retain a spare propane tank that was located somewhere near the grill, but was not connected to or part of the grill assembly. After suit was filed, Sunbeam moved for sanctions. The trial court dismissed the case and the appellate court affirmed the dismissal, holding that Allstate's failure to preserve evidence that might have indicated that the fire was caused by something other than the grill, such as by a leak from the spare tank, irreparably prejudiced Sunbeam. The appellate court noted that "Allstate should have known that defendant would have wanted to examine the second tank". Thus, this case drives home the fact that, in deciding what evidence to preserve, you should consider the point of view of a potential defendant.

The dismissal of a case, or complete exclusion of expert testimony, which is usually equivalent to dismissal, is normally based upon a trial court finding that no lesser sanction will remedy the prejudice to the defendant from the plaintiff's failure to preserve the evidence. While the appellate courts give the trial courts considerable discretion in such circumstances, the courts are expected to impose the least severe sanction that is appropriate under the circumstances. Bachmeier v. Wallwork Truck Centers, 507 N.W.2d 527 (N.D. 1993).

Thus, in Patton v. Newmar Corp., 520 N.W.2d 4 (Minn.App. 1994), a case involving a motorhome that caught fire, the trial court granted the motor home manufacturer's request to exclude the plaintiff's expert's testimony and to enter summary judgment, when the remains of the motor home had been inadvertently lost or destroyed. The Minnesota Court of Appeals reversed, holding that since the loss of the evidence was not intentional, complete

preclusion of the plaintiff's expert's testimony was an unnecessarily severe sanction. Instead, the court excluded only that portion of the plaintiff's expert's opinions and testimony that was based upon examination of the motor home itself, as opposed to opinions based upon photographs of the motor home, which were equally available to the defendant. Thus, the prevailing attorney for the plaintiff/appellant in Patton "won" the opportunity to try the case with one hand tied behind his back. Moreover, it would be unwise to expect even this degree of lenient treatment from most courts in similar situations. Virtually any product liability defendant in such a situation can be expected to argue that the remedy fashioned by the Patton decision does not truly "level the playing field" or fairly remedy the prejudice to the defendant from disposal of the accused product, because the defendant is still deprived of the opportunity to independently examine the product for evidence of alternative causes. As the Allstate v. Sunbeam case suggests, the same argument could logically (or, illogically, depending upon your perspective) be extended not only to other devices or appliances near the area of fire origin, such as the spare propane tank in the Sunbeam case, but also to the entire fire scene, since any defendant would assure you that they would prefer to independently examine burn patterns, fixed wiring, and other evidence on site in order to ascertain the "true" cause of a fire.

If the defendant's counsel can dream up anything that they would have liked to see for any minimally plausible reason (including all of the items that you are not blaming, for purposes of independently ruling them out), and you cannot produce the requested item, expect a motion for summary judgment or other sanctions based upon an evidence spoliation argument. Even if the court does not award the defendant the "grand prize" of an order dismissing the case, the judge may well give the jury an "adverse inference" instruction as a consolation prize for the

defendant. Such an instruction informs the jury that they can infer that you were concealing something when you failed to preserve the item of evidence in question.

The best of all worlds is to let an adverse party come to the loss site before it has been disturbed, under your supervision, and put them under whatever time constraints are dictated by the circumstances. Then, the opposing party's representatives can photograph whatever they want to photograph, and if they want any artifact or sample preserved, it can be preserved, at least within reason. In that way, the defendant cannot later complain about something being unavailable, because they had the opportunity to ask for it and did not.

Therefore, regardless of whether the law requires you to do it or not, as soon as a potentially responsible party has been identified, they should be placed on notice and afforded some opportunity to visit the scene before proceeding with the next step in the investigation. That will inevitably slow the investigation down and make it more expensive, especially because additional potentially responsible parties may continue to be identified as the investigation progresses. However, it is an excellent precaution against a spoliation claim.

Of course, the site of loss cannot be maintained in an undisturbed, museum-like setting forever especially if there are pollutants or contaminants present. In the real world the theoretically desirable goal of covering all possible bases as far as evidence spoliation issues are concerned is typically in conflict with and must take a back seat to practical concerns over the cost of preserving everything in its post-loss state, not to mention the normal and understandable concerns of the policyholder (and the insurer that has additional living expense or business interruption or other time element coverage) over commencing remediation efforts which may well be ordered by some governmental entity.

The good news is that most courts will be sympathetic to these real-world concerns, so long as some consideration has been given to the opposing parties' point of view. In particular, a court would probably not expect a policyholder to delay remediation efforts and to continue to incur time element losses and expose others to potentially harmful conditions in order to keep a loss site available for inspection, assuming that a diligent effort has been made to identify and notify potentially responsible parties and to afford them some opportunity to inspect the site while it is still available.

In short, courts would normally expect parties to do what is reasonable under the circumstances. The bad news is that what is reasonable under the circumstances will likely be gauged with the benefit of considerable hindsight, viewing events from the perspective of many months or even years after the loss. Also, courts tend to impose a somewhat more rigorous standard on subrogated insurers than on other plaintiffs, on the theory that insurers are more sophisticated and should therefore have a better understanding of their evidence preservation obligations.

Also bear in mind that evidence spoliation concerns are not confined to the realm of recovery cases, but can also adversely affect the insurance company's position with respect to coverage or bad faith issues. For example, in Upthegrove Hardware, Inc. v. Pennsylvania Lumbermen's Mutual Insurance Company, 146 Wis. 2d 470, 431 N.W.2d 689 (1988), the Wisconsin Court of Appeals upheld a jury verdict which found bad faith on the part of a property insurer and awarded punitive damages based upon the insurer's wrongful denial of a fire claim based upon an arson defense. The evidence supporting the jury's finding included testimony that the insurance company's cause and origin investigators had discovered a lamp and cord at the scene, which the insured had suggested might be the cause of the fire. The investigators took

possession of the cord but, without further analyzing the cord or notifying the insured, discarded it as "junk". The investigators and the insured disagreed as to whether the cord was plugged in when they found it.

The court found that this evidence could support a conclusion that the investigators "intentionally discarded the cord because they knew it might have exonerated" the insured, and that they lied about whether or not the cord was plugged in. This was part of the evidence that was deemed sufficient for the jury's award of punitive damages. In a later bad faith case, Weiss v. United Fire and Casualty Company, 197 Wis. 2d 365, 541 N.W.2d 753 (1995) the plaintiff testified that the insurance company's cause and origin investigator, who was one of the same investigators involved in the Upthegrove case, had removed pieces of wire from the areas where the investigator claimed that the fire had originated, without ever analyzing the wires or informing the insurance company of their existence. The Wisconsin Supreme Court's Opinion in Weiss noted that the insurance company's claims supervisor admitted that she had never verified the cause and origin investigator's qualifications, and that if she had done so, she might have found that in another fire investigation (referring to the Upthegrove case) the same investigator "had also failed to disclose that electrical evidence had been removed from the premises, and the investigator's conduct had triggered a punitive damages award against the insurer in that case".

No matter what precautions are taken against an evidence spoliation claim, you can expect that the defendant will claim that some further or additional steps should have been taken. If your expert retains a leaking weld from an oil tank, the defendant tank manufacturer can opener manufacturer will eventually claim that all of the other welds in the tank and perhaps all of the tanks in the area should also have been preserved. If all the tanks are saved, the

defense will contend that the dirt beneath the tanks should have been preserved. If the dirt is secured, the defense will contend that it should not have been removed from the ground before the defense could inspect it in place, and that all the dirt from the surrounding vicinity should also have been saved.

The goal is to make whatever criticisms are eventually leveled at your investigation seem beyond the realm of reason. The safest course, as far as evidence preservation is concerned, is to do everything that common sense suggests should be done, and then go at least one step beyond that, if possible.

B. Other Considerations

Safely navigating the evidence spoliation minefield only keeps you in the game. It does not win the case. Taking precautions to prevent critical evidence or even an entire case from being thrown out based upon evidence spoliation allegations should not overshadow the more mundane but equally important task of gathering the evidence, documentation and information in the immediate aftermath of a loss that may bolster your case, while the evidence is still available. This process includes:

1. Not only seeing to it that the site is thoroughly photographed and videotaped, with critical dimensions sketched out on diagrams or drawings, but also asking around about any photographs or videotapes others may have taken during or following the incident. A surprisingly large number of events are now videotaped while they are still in progress by freelance videographers who monitor emergency radio bands, as well as by bystanders who happen to have a camcorder handy and by conventional news outlets;

2. Identify potentially important witnesses and get their stories while the witnesses are still available and talkative and their memories are still fresh. Decide whether or not to attempt to secure written or recorded statements from the witnesses, recognizing that you probably would eventually have to produce any witness statements you do obtain, even of your insured's own personnel. On the other hand, attorney notes of interviews are normally deemed privileged or non-discoverable work product, but cannot usually be used to impeach a witness or refresh their recollection;

3. Gather pertinent documentation from the insured or other interested parties. ;

II. POTENTIAL OBSTACLES TO RECOVERY

A. Avoiding Contractual Limitations

1. Is Your Insured a Party to the Contract?

Non-parties to a contract may nevertheless have a right to bring a claim against the service provider that is unaffected by any liability limitation provisions in the contract. For example, in Scott and Fetzer Co. v. Montgomery Ward and Co., 112 Ill. 2d 378, 493 N.E.2d 1022 (1986) the Illinois Supreme Court held that a fire alarm company was potentially liable to non-parties to the contract who suffered foreseeable property losses as a result of the failure of a fire alarm system to function properly, and that the claims of such non-parties were not subject to the liability limitation provisions of the alarm contract.

2. Does the Contract Even Apply to the Claim?

For example:

a. In the case of a loss involving an American Institute of Architects ("AIA") construction contract, which almost invariably includes provisions prohibiting subrogation claims for damage to the "work" that is the subject matter of the contract, consider whether the claim at issue involved damage to the "work".

b. Consider whether a subrogation waiver in a construction contract applies to damage which first occurs long after the construction project has been completed. Fairchild v. W. O. Taylor Commercial Refrigeration, 403 So.2d 1119 (Fla. App. 1981).

c. Consider whether a waiver of subrogation clause in a lease necessarily protects the landlord from liability for negligence in a capacity other than as a landlord, such as when the landlord negligently conducts operations on adjoining property which damages the insured's premises.

3. Is the Contractual Limitation Valid Under the Governing Law?

There may be consumer protection or environmental statutes or similar provisions which invalidate contractual limitations, although these are less likely to apply to commercial parties, and even less likely to benefit subrogating insurers.

4. Are There Liability Theories Independent of the Contract?

Again, the ability to avoid contractual limitations based upon non-contractual theories is more likely to succeed with claims by or on behalf of non-commercial entities. Also,

the ability to pursue non-contractual claims may hinge upon the applicability of the economic loss doctrine, discussed in the next section.

B. Economic Loss Doctrine

Over the past decade or so, the expansion of the economic loss doctrine has encroached upon the ability to successfully pursue many kinds of recovery claims, and has probably had an even more profoundly adverse impact upon recovery litigation than has the expansion of the evidence spoliation doctrine. The economic loss doctrine defines the kinds of damages that are recoverable, if at all, only under a contractual theory of liability. When applicable, the doctrine can have a devastating impact upon recovery claims, because contractual theories are often precluded either by liability limitations or disclaimers in the contract itself, or because such claims are barred by the statute of limitations. Unlike tort claims such as negligence or strict liability, where the statute of limitations begins running on the date a loss occurred, the statute of limitations typically begins to run on contractual claims from the date the contract was formed, as opposed to the date a loss occurred, which could be years later. Thus, the statute of limitations on contractual claims often has expired long before a loss has even occurred.

There have always been some distinctions and limitations on the damages that could be recovered under tort theories of liability, as opposed to contractual theories. These distinctions and limitations go back to an era when there was no such thing as strict liability in tort. Over the past forty years, the economic loss doctrine has evolved in conjunction with the advent and development of the doctrine of strict liability for defective products. While the economic loss doctrine is not confined solely to product liability claims, economic loss issues often arise in product liability claims involving property damage. The courts had to decide

whether the recoverability of damages claimed under newly-adopted product liability theories should be evaluated under tort rules or contract rules.

As the economic loss doctrine evolved, various jurisdictions adopted a variety of definitions of non-recoverable "economic loss". The results in similar cases decided in different parts of the country were literally "all over the map". Some courts held that damages resulted from a product's simple failure to live up to its expectations were recoverable in tort (City of LaCrosse v. Schubert, Schroeder & Associates, 72 Wis. 2d 38, 240 N.W. 2d 124 (1974)), while some courts held that such damages were not recoverable. Some courts said that the value of a product that self-destructed, as well as any consequential damages resulting from the loss of the product, were recoverable under tort law. Some courts said that they were not. Many other courts adopted a "middle ground," where the recoverability of damages resulting from the self-destruction of a product hinged upon whether the self-destruction occurred in a "sudden and calamitous" and potentially dangerous fashion.

In a 1985 case, East River Steamship Corporation v. Transamerica Delaval, Inc., 476 U.S. 858 (1986), the U.S. Supreme Court held that damages resulting from a product's self-destruction were never recoverable in tort. East River was a case involving a federal admiralty claim. Almost all product liability and tort claims involve state, not federal law, even where a case is pending in federal court. Therefore, East River is technically controlling in only a very few cases. Nevertheless, most courts that have confronted these issues since 1985 have adopted at least as broad a definition of non-recoverable "economic loss" as that adopted by the U.S. Supreme Court in East River.

Many courts have expanded the doctrine to preclude recovery of any damages, including property damages, that were deemed "foreseeable" at the time the products were sold

or the contract entered into, particularly when the claim is made by or on behalf of a commercial party. The theory is that the claimant should have "bargained for" a right to recover such foreseeable losses at the time of the contract or sale. The Michigan state and federal courts have adopted this position in cases such as Neibarger v. Universal Cooperatives, Inc., 439 Mich. 512, 486 N.W.2d 612 (1992) and Michigan Mutual Insurance Company v. Osram Sylvania, Inc., 1997 W.L. 189545 (6th Cir. 1997). In Michigan Mutual, for example, a 400 watt light bulb exploded, causing a multi-million dollar fire in a manufacturing facility. The court held that the strict liability claim against the light bulb manufacturer was barred by the economic loss doctrine, on the theory that the light bulb purchaser could and should have "foreseen" the inherent risk of fire associated with a 400 watt light bulb and negotiated an appropriate allocation of that risk at the time the bulb was purchased.

Few, if any, other jurisdictions have adopted the extreme view of the Michigan courts that any arguably "foreseeable" losses associated with a defective product are barred under the economic loss doctrine. For example, in Lloyd Smith Company, Inc. v. Den-Tal-Ez, Inc., 491 N.W.2d 11 (Minn. 1992), the Minnesota Supreme Court held that damages to other property from a fire caused by a defective dentist's chair were recoverable under a strict liability theory, even though the damage to the chair itself was not. However, in Fireman's Fund American Insurance Company v. Burns Electronic Security Services, Inc., 93 Ill. App. 3rd 398, 417 N.E.2d 131 (1980), the court held that the plaintiff could not avoid a contractual limitation of liability in a burglar alarm contract by asserting a negligence claim, because the losses claimed by the plaintiff were the foreseeable result of the alarm's failure to perform the very purpose it was intended to perform - to prevent burglaries.

IV. DAMAGES ISSUES: NATURAL RESOURCE DAMAGES

Increasingly, environmental losses may have a “natural resource damage” (“NRD”) component. These are pollution damages to the natural resources held under the public trust doctrine by a state or federal agency, such as fish, wildlife, vegetation, and groundwater. States and the federal government generally treat these damages as separate and distinct from "cleanup" or "remediation" damages, which are generally those costs to remove or otherwise contain hazardous substances that have been discharged into the environment. For example, virtually all clean-up settlements over the past 20 years have a "carve-out" for NRD liability, meaning that states and the federal government have reserved their rights to pursue the responsible party for these damages at a later time.

Effective management of environmental losses should include an eye toward potential NRD exposure. Increasingly, natural resource trustee agencies, such as the National Oceanic and Atmospheric Administration (NOAA), the Fish & Wildlife Service (FWS), and some states (e.g. New Jersey, New Mexico, and Washington, among others) aggressively pursue the recovery of NRD. Many of these efforts focus on sediments contaminated by historic industrial discharges to water bodies, such as Commencement Bay and Elliott Bay/Duwamish River in Washington State, the Fox River/Green Bay in Wisconsin, the Hudson River in New York, and the Housatonic River in Massachusetts. Most sediment contamination NRD areas have long been identified by the U.S. Environmental Protection Agency as sediment “hot spots.” See, e.g. An Overview of Sediment Quality in the United States, U.S. EPA, Office of Water, June 1987, EPA-905/9-88-002 (identifying sediment contamination areas nationwide).

Thus, at the time of a loss involving potential impacts to a water body having pre-existing sediment contamination, it is important to document the divisible harm from any pre-existing

contamination. If a loss involves potential impacts to sediments in a so-called "hot spot" area (i.e. an area of known NRD trustee interest), extreme care should be exercised in developing a sampling plan that will enable a division-of-harm argument. This will include a comprehensive search of other potential contaminant sources that could be responsible of the sediment contamination. To the extent required remedial action involves cleaning-up areas of concern contaminated by third-party sources there may be an opportunity to pursue recovery from these sources.