No. 46654-6-II

COURT OF APPEALS, DIVISION II
FOR THE STATE OF WASHINGTON

THE PORT OF LONGVIEW, a Washington municipal corporation,

Respondent,

v.

ASSICURAZIONI GENERALI S.P.A.; BALOISE INSURANCE COMPANY, LTD.; BISHOPSGATE INSURANCE COMPANY, LTD.; COMMERCIAL UNION ASSURANCE COMPANY, P.L.C.; CONTINENTAL ASSURANCE OF LONDON, LTD.; DRAKE INSURANCE COMPANY LTD.; ECONOMIC INSURANCE COMPANY; EDINBURGH ASSURANCE COMPANY, LTD.; ELDERS INSURANCE COMPANY, LTD.; EXCESS INSURANCE COMPANY, LTD.; FUJI FIRE AND MARINE INSURANCE COMPANY (U.K.) LTD.; HANSA MARINE INSURANCE COMPANY (U.K.) LTD.; INDEMNITY MARINE ASSURANCE COMPANY, LTD.; INTERESTED UNDERWRITERS AT LLOYD'S LONDON; LA REUNION FRANCAISE S.A. d'Assurances ET DES REASSURANCES; LONDON & OVERSEAS INSURANCE COMPANY, LTD.; NIPPON FIRE & MARINE INSURANCE COMPANY (U.K.) LTD.; NIPPON FIRE AND MARINE INSURANCE COMPANY U.K.W. LTD.; NORTHERN ASSURANCE COMPANY LTD.; NORTHERN MARITIME INSURANCE COMPANY, LTD.; OCEAN MARINE INSURANCE COMPANY, LTD.; ORION INSURANCE COMPANY LTD.; PEARL ASSURANCE P.L.C.; PHOENIX ASSURANCE COMPANY LTD.; PROVINCIAL INSURANCE COMPANY, LTD.; PRUDENTIAL ASSURANCE COMPANY, LTD.; RIVER THAMES INSURANCE COMPANY, LTD.; SCOTTISH LION INSURANCE COMPANY, LTD.; SKANDIA U.K. INSURANCE PLC; SPHERE INSURANCE COMPANY LTD.; SWITZERLAND GENERAL INSURANCE COMPANY (LONDON) LTD.; THREADNEEDLE INSURANCE COMPANY, LTD.; VESTA (U.K.) INSURANCE COMPANY LTD.; WURTTEMBERGISCHE FEUREVERISCHERUNG

A.G.W. A/C; YASUDA FIRE & MARINE INSURANCE COMPANY (U.K.) LTD.,

Appellants,

and

ARROW INDEMNITY COMPANY; MARINE INDEMNITY INSURANCE COMPANY OF AMERICA,

Defendants.

BRIEF OF APPELLANTS

Philip A. Talmadge, WSBA #6973
Sidney Tribe, WSBA #33160
Talmadge/Fitzpatrick/Tribe
2775 Harbor Avenue SW
Third Floor, Suite C
Seattle, WA 98126
(206) 574-6661

Carl E. Forsberg, WSBA #17025
Kenneth J. Cusack, WSBA #17650
Charles E. Albertson, WSBA #12568
Forsberg & Umlauf PS
901 5th Avenue, Suite 1400
Seattle, WA 98164-2047
(206) 689-8500

Attorneys for Appellants
London Market Insurers

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A. INTRODUCTION

The trial court misapplied fundamental issues of liability insurance in this case. These mishandled issues go to the core of the purpose of insurance, which is to provide coverage against losses that are unknown to the insured at the time insurance coverage was placed. This case also raises the question of whether an insured can wait decades to notify an insurer of a claim, and still expect coverage to apply.

For liability insurance to cover a claim, there must be a loss that is (1) "fortuitous," which means unexpected and unintended, (2) covered by the insurer's policy, and (3) not specifically excluded from coverage by the terms of the policy. Even when these three prerequisites are met, an insured must abide by policy conditions, for example giving timely notice of a claim to the insurer.

The trial court here misapplied *each* of these core liability insurance principles in its various decisions. The Port of Longview ("Port") expected or intended the property damage for which it seeks coverage. Because the Port expected or intended the property damage at issue, there are no covered "occurrences" as defined in the Port's primary policies, particularly with respect to one site that the Port purchased long after the expiration of LMI's policies, knowing that the damage had already occurred. Because the Port also expected or intended the

polluting events that resulted in the property damage at issue, the pollution exclusions in the excess policies bar coverage. Finally, the Port's decades-late notice to LMI was a violation of a policy condition that prejudiced LMI. The trial court should have dismissed all of the Port's claims on that basis.

In addition to these fundamental errors, the trial court imposed a harsh sanction of issue preclusion *and* monetary sanctions on LMI for producing some documents one week later than the court had ordered, sanctions the Court admitted were "arbitrary." The trial court then refused to sanction the Port's own discovery misconduct revealed during trial, despite the fact that the misconduct resulted in a mistrial.

This Court now has the opportunity to properly apply core liability insurance principles. There is no coverage under the policies at issue, or in the alternative, a new trial is warranted.

B. ASSIGNMENTS OF ERROR

(1) Assignments of Error

1. The trial court erred in denying LMI's motions for summary judgment/judgment as a matter of law regarding the issue of known loss/fortuity in its order dated September 11, 2012.

2. The trial court erred in denying LMI's motions for summary judgment/judgment as a matter of law regarding the issue of an "occurrence" under the policy terms in its orders dated September 11, 2012 and November 12, 2013.

3. The trial court erred in denying LMI's motions for summary judgment/judgment as a matter of law regarding the issue of late notice prejudice in its orders dated September 11, 2012, December 21, 2012, February 5, 2013, October 16, 2013, and November 5, 2013.

4. The trial court erred in restricting the evidence of late notice prejudice to be presented at trial in its orders dated September 11, 2012, December 21, 2012, February 5, 2013, and October 16, 2013.

5. The trial court erred in granting the Port's motion regarding "site wide liability" in two orders dated Sept. 28, 2012.

6. The trial court erred in denying LMI's motions for summary judgment/judgment as a matter of law regarding the issue of qualified pollution exclusions in its excess policies in its orders dated November 13, 2013, March 27, 2014, and April 7, 2014.

7. The trial court erred in giving Instructions 10, 11, 12, and 15, and in giving the special verdict form.

8. The trial court abused its discretion regarding discovery sanctions against LMI in its orders dated February 4, 2013, June 12, 2013 and October 16, 2013.

9. The trial court erred in entering judgment on August 1, 2014.

(2) <u>Issues Relating to Assignments of Error</u>

1. Does an insured's 19-year-late notice of a claim for coverage of pollution damage to the property of a third party preclude coverage as a matter of law, when in the intervening years the insurer has been prejudiced by lost valuable subrogation and contribution rights from the responsible polluters, removed, altered, or degraded evidence, lost ability to investigate the damage and the

claim, deceased or unavailable key witnesses, and other factors?

2. In the alternative, if late notice prejudice does not exist as a matter of law, is a new trial warranted where the trial court improperly restricted the evidence of late notice prejudice to narrow facts, rather than allowing the jury to evaluate all of the evidence of prejudice?

3. Do the known loss/fortuity rules of insurance apply to preclude coverage where an insured knowingly, admittedly, and intentionally purchased one polluted property, and presented no evidence to contradict substantial evidence that it knew another property was polluted before the purchase?

4. An "occurrence" under the insurance policies at issue is an accident that is not expected or intended. Did the Port meet its burden of proving the property damage at issue here was a covered "occurrence" when the Port either presented no evidence regarding its expectations or intentions, or it was undisputed that the Port purchased property knowing the groundwater was damaged?

5. Washington law provides that a party trying to overcome a qualified pollution exclusion must demonstrate that it did not expect or intend a "pollution event" on its property that resulted in the property damage at issue. Is it error to allow that insured and the jury to evaluate only whether that insured had knowledge that the pollution event had actually contaminated the groundwater, and not whether the insured expected open, obvious, and documented pollution events?

6. Is the sanction of issue preclusion and monetary sanctions the least severe means of addressing a one-week delay in disclosing some documents under a discovery order, particularly when any claimed prejudice is eliminated after the opposing party's own discovery violation causes a mistrial, thereby providing 10 additional months to review the week-late documents?

C. STATEMENT OF THE CASE

(1) Factual Background of the Port's Purchase of the Sites at Issue and Pollution History

The Port's claims for third-party liability insurance coverage for damage to the State's groundwater stem from pollution caused entirely by other parties; pollution which occurred when those other parties either owned the properties, or leased/licensed them from the Port. A description of the properties at issue, how they came to be polluted, and how the Port acquired potential liability for them, is important to understanding the arguments on review.

(a) The "Treated Wood Products" ("TWP") Site Was Openly and Intentionally Polluted By a Former Owner of the Property From the 1940's to the 1970's; the Port Purchased the Property in 1999 Knowing It Was Polluted and that Groundwater Contamination Had Already Occurred

From the 1940s until the 1970s, International Paper ("IP") operated a wood treating plant on the TWP site, using creosote first, then pentachlorophenol, as wood preservatives. CP 457-458. IP discharged its process wastewater, containing wood treating contaminants, via an open ditch ("the lineament ditch") that led to seepage ponds. CP 458. According to the Port's own expert and the undisputed evidence, these open and obvious polluting activities on the TWP, adjacent to the Port's property, began long before the date of the first policy at issue in this case.

CP 457, 790. The Port presented no evidence that it lacked knowledge of these open and obvious pollution activities taking place on the Port's doorstep.

The lineament ditch was in operation until 1966, when IP began discharging its waste to ponds on the TWP site. CP 790. In EPA site inspections of the TWP in 1981, groundwater sampling revealed that hazardous wastes were present in the groundwater. In 1985, the EPA inspected the lineament ditch separating the TWP from the MFA. *Id.* The inspection noted, "the ditch water was dark and oily, and the ditch soils were stained black and sludge-like in appearance. An oil sheen was apparent on the soils and on the water." *Id.*

In 1982, the TWP facility ceased operations. CP 791. IP entered into a long process with the EPA, and then with the Washington Department of Ecology ("DOE") to investigate and remediate the TWP site. *Id.* In 1996, IP sent a letter to the DOE stating IP's belief that the Port was a potentially liable party ("PLP") under the Model Toxics Control Act, RCW 70.105D ("MTCA"). CP 3247. Despite IP's assertion, DOE did not name the Port as a PLP with respect to the TWP.

In August 1997, IP entered into an agreed order and a consent decree with the DOE, in which IP assumed complete responsibility for cleaning up the TWP and the associated groundwater. CP 707-741.

In 1999, the Port purchased the TWP site from IP, with full knowledge of the site's contamination. CP 1377. The purchase and sale agreement acknowledged the contamination and assigned all responsibility for the investigation and cleanup to IP. CP 1380-81. However, the Port was aware when it purchased the property that the purchase made it "automatically liable" to clean up any "mess" IP might fail to remediate. CP 12544-12545. DOE and IP eventually agreed on a remedy requiring IP to construct a subsurface barrier wall to prevent the contamination from migrating, and to construct an engineered cap to prevent water infiltration. CP 1365. The remedy also required IP to conduct long-term monitoring. CP 1366.

In 2005, DOE sent the Port – now an owner of contaminated property subject to the consent decree with IP – a PLP letter. CP 2718. However, neither EPA nor DOE has required the Port to conduct any investigation or remediation of the TWP. CP 1625-1626.

(b) <u>The Maintenance Facility Area ("MFA") Site Was Polluted by Migration of Contaminants IP Dumped Into the "Stinky" Lineament Ditch by IP From 1947-1965</u>

In 1963 and 1965, the Port purchased property from IP which is now referred to as the MFA site. CP 2690-2702. The MFA site abuts the TWP site. CP 14007; Appendix A. The open, unlined wastewater

discharge ditch that operated in the 1940s and 1950s traversed the MFA. CP 14103. When the Port purchased the MFA, IP had been engaged in this open and obvious polluting activity for decades. CP 457, 790. The Port never offered any evidence that it lacked knowledge of the open and obvious polluting activity.

IP's pollution emanated from the TWP to the MFA; the MFA is polluted "due to activities on the TWP property." CP 3867. This pollution was partly through groundwater and partly through open disposal of polluted wastewater into the unlined lineament ditch adjacent to the TWP. CP 4507. During construction of the barrier wall around the TWP, IP discovered contamination outside the barrier wall, in the MFA. CP 791. The contaminated area aligned with the former lineament ditch. CP 792.

IP agreed to amendment of the consent decree to include investigation and remediation of the MFA portion of the site, and the Port has only been asked to comment on IP's work. CP 2844. Like the TWP, remediation of the MFA remains solely the responsibility of IP.

(c) <u>The Total Petroleum Hydrocarbon ("TPH") Site Was Polluted By Leaking Oil Pipelines and Tanks; Significant Pollution Emanated from Leaking Pipelines Replaced in the Early 1970's</u>

Port tenants and licensees, notably Chevron, Longview Fibre, and Crown Zellerbach/James River, maintained petroleum pipelines, storage tanks, and loading racks on property leased or licensed to them by the Port over the decades from the 1920s to the mid-1980s. CP 823, CP 17498-17505. In the 1960s and 70s, pollution occurred on many occasions in the form of releases directly into the air and soil. CP 823. For example, spills occurred during the loading and unloading of fuel "through the operational life" of the 80,000 barrel storage tank, as well as from the Calloway Ross tank and the rail operations. CP 827. Numerous other releases occurred during pipeline repairs and replacements until environmental controls were implemented in the late 1970s. CP 826. Again, the Port presented no evidence that it was ignorant of these substantial polluting activities on its property by its lessees and licensees.

By 1985, all of Port's lessees and licensees operating petroleum pipelines and storage tanks had shut down their operations. CP 823-824. In 1991, the Port removed a leaking underground fuel tank that had been used by a lessee, Calloway-Ross. CP 824. Petroleum contamination was evident, not only from the tank but from other sources. CP 21005. The Port began investigating possible groundwater contamination at the TPH site. CP 18253. The Port hired a consultant to investigate the extent of the contamination and retained outside counsel to pursue contribution

from responsible parties. CP 10904. In 1991, the Port's counsel identified 10 potentially liable parties ("PLPs")[1] with respect to the TPH site. *Id.*

The TPH investigation went on for many years. CP 21005. Only limited remediation was performed. CP 21008-21009. The Port expressed concerns that complete remediation of the TPH to protect groundwater would interfere with its operations. CP 5988.

In 1998, the Port voluntarily entered into a cost-sharing agreement with two of the PLPs, Chevron and Longview Fibre. CP 433-441. The Port agreed to contribute 20 percent of investigation/remediation costs going forward, up to certain limits, and agreed to settle its claims for past costs with Chevron upon Chevron's payment of a portion of the past costs incurred by the Port. *Id.* The Port never received a PLP letter from the DOE and has not otherwise conducted an investigation or remediation under the DOE's supervision.

(d) Despite Knowledge of Potential Groundwater Contamination at Each Site Since at Least 1991 and 1996, the Port Does Not Take Action to Protect Its Rights Under MTCA or Notify Its Insurers

Despite knowing as early as 1991 that TPH pollution had reached State-owned groundwater, and despite knowing since 1996 that TWP pollution also contaminated the groundwater, the Port did not notify LMI

[1] A "potentially liable party" under MTCA is explained at Section D(1) *infra*.

of potential liability for 19 and 14 years, respectively. The Port also did not bring a MTCA contribution action against any other PLPs, who were the actual polluters. In August 2010, the Port filed this coverage action. CP 1.

In the intervening decades before the Port notified LMI of its claims, much changed. Key witnesses with knowledge of the sites in the 1960s and 1970s, have died or are otherwise unavailable. CP 13531. In particular, two witnesses that the Port admitted were the most knowledgeable regarding the Port's historical operations and the contamination history. CP 13531, 13741, 17501-17505. Evidence from that time period is either lost or is much more difficult to locate. CP 13503-14089. The Port destroyed documents relating to the TPH site. CP 13540. Calloway-Ross, a PLP as to the TPH site, went out of business. CP 17863. TPH contamination degraded and changed in its chemical nature, making it impossible to definitively establish the dates and sources of property damage. CP 13914. The Port also chose to purchase the TWP before it notified LMI, assuming PLP status as an owner of the TWP. CP 469.

In 2010, special counsel to the Port suggested that the Port's almost two-decades-old liability policies, issued in the 1970s and early 1980s, were "stale." CP 1557. Although the Port acknowledged that "no

one is suing the port right now," it concluded that it should seek coverage under the policies before they became any more "stale." CP 1558. The Port admitted that "witnesses that would have had knowledge are no longer working or no longer reachable." CP 1559.

(2) Procedural Background

The Port sued its insurers in August 2010 for damages and declaratory judgment. CP 1-8. The complaint was filed in Cowlitz County Superior Court and assigned to the Honorable Stephen M. Warning. CP 120.

Among the many entities the Port sued were various London insurance underwriters referred to collectively as "LMI," the appellants in this case. The collective "LMI" refers to certain Underwriters at Lloyds, London and certain London Market Insurance Companies. CP 16. *Id.*

The Port moved to bifurcate the trial on its declaratory judgment and damages claims: Phase 1 would address declaratory judgment relief and Phase 2 would address the issue of damages. CP 40. LMI opposed the motion, arguing that the question of damages related to insurance coverage issues such as late notice, justiciable controversy, occurrence, etc. CP 48. Nevertheless, the trial court granted the Port's motion to bifurcate. CP 118-120, 10102-10104.

(a) Late Notice Prejudice Issue

LMI moved for summary judgment on the issue of the Port's late notice, which breached policy terms regarding prompt notice to insurers. CP 1437-1452, 1984.[2] It argued that the Port's 19-year late notice as to TPH, and 14-year late notice as to TWP, was late as a matter of law. CP 1444. LMI and other defendants argued that the Port's delay caused a significant loss of evidence. CP 1991, 3078. LMI also argued that the Port's voluntary payments of past investigative costs and other payments made under the Chevron cost sharing agreement had prejudiced LMI's position. *Id.*

The trial court found that the Port breached the notice conditions of LMI's policies, stating that "by whatever standard we use," notice to LMI was late as a matter of law. CP 5019. The trial court also ruled the LMI was prejudiced as a matter of law by the Port's breach of the voluntary payment conditions of the policies. *Id.* However, the court ruled that the late notice prejudice did not preclude coverage as a matter of law. Instead, the court ruled that the Port court not recover any alleged damages incurred with respect to the 1998 Chevron cost sharing agreement regarding the TPH, but let litigation proceed on the coverage issue. *Id.*

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[2] One late notice prejudice motion was brought by a co-defendant, Marine Indemnity. CP 1984. LMI joined in that motion. CP 3077.

LMI later moved for summary judgment regarding prejudice from the Port's late notice. CP 6796. It renewed the motion at various points pretrial. CP 8748, 13477. It raised all of the following specific types of prejudice caused by the Port's decision to wait two decades before providing notice:

- The decommissioned Calloway-Ross tank was identified as a source of contamination, making Calloway-Ross a PLP with respect to the TPH site. The Port removed the tank and destroyed evidence of the leak, and never pursued Calloway-Ross or its insurer for contribution or indemnity. CP 10262, 17787.

- In 2006, Calloway-Ross dissolved as a corporation, putting it forever beyond the reach of any subrogation or contribution action by LMI as to the TPH. CP 6830, 6850, 17863.

- The Port entered into a prejudicial cost-sharing agreement with other PLPs as to the TPH, rather than establishing that as the only non-polluting PLP, it should be liable for no cleanup costs (a MTCA contribution action distributes liability based on equity). The Port's own expert hired in the mid-1990s concluded that the Port had zero liability for the TPH pollution. CP 8751, 17394.

- LMI lost the opportunity to investigate and pursue numerous other PLPs as to the TPH site, because witnesses and evidence were no longer available. CP 13503-14089, 16136.

- LMI lost the ability to enforce indemnity agreements with the Port's lessees and licensees at the TPH site because of the Port's earlier cost sharing agreements with them. CP 16133-16136.

- Key witnesses to events on both sites have either passed away, or their memories are faded. Specifically, the Port's former general manager and former director of engineering, who the Port conceded were the most knowledgeable about its historical operations, are no longer available. The Port had no other institutional memory from the 1960's and 1970's. Other potential witnesses to operations, pollution events, and PLP activities passed away before the Port gave LMI notice. CP 8751-8752.

- Substantial evidence regarding the timing, extent, and age of contamination at both sites was no longer available; this evidence was relevant to establishing liable parties and also to establishing when contamination occurred, which is relevant to LMI's policy defenses. CP 13479-13909.

The Port filed its own motion regarding prejudice, arguing that the jury should only be allowed to hear evidence of prejudice on two issues – whether LMI was prejudiced by the Chevron cost sharing agreement, and whether it was prejudiced by the change in site conditions caused by the Calloway-Ross tank and soil removal. CP 16526. The Port argued that LMI should not be able to offer other kinds of evidence unless LMI could *prove that it would have prevailed* on all of its policy defenses if that evidence had been available. CP 16282.[3]

Despite the Port's request that evidence of late notice prejudice be highly restricted, the Port often raised LMI's *lack* of evidence on matters

[3] This impossible standard was only one of many the Port suggested to try to curtail LMI's evidence of prejudice in this case. The trial court ultimately restricted what prejudice evidence LMI could present to the jury to one subject: whether LMI's ability to physically investigate one site had been hampered. CP 16865. As LMI argues infra section D.3(c), this restriction was imposed erroneously.

that occurred in the 1970's and 1980's as grounds for the Port to prevail on issues at trial. For example, the Port stated that LMI had "no evidence" that groundwater contamination had not exceeded regulatory standards in 1982, and argued that it should be covered by certain policies on that basis. CP 15510. LMI's expert, Lauren Carroll, had explained that the extreme passage of time and degradation of contaminants had rendered age dating of much of the contamination, and thus opinions about when groundwater was contaminated, impossible. CP 8395-8404. However, the Port argued that such evidence should be excluded as evidence of late notice prejudice, because the expert could not opine as to whether the age dating would have revealed that the contamination occurred after 1982. CP 16262. In other words, unless LMI's expert could analyze *lost evidence*, LMI was barred from arguing that the loss of that evidence was prejudicial to its defenses.

The trial court agreed with the Port and denied all of LMI's summary motions regarding late notice prejudice, and severely limited the evidence of late notice prejudice at trial. CP 8688, 8700, 10125, 16865. The trial court concluded that, as a matter of law, LMI could not show prejudice from the lost ability to pursue Calloway-Ross for subrogation or contribution, despite the fact that it was a PLP and an actual polluter. CP 16865. The court concluded that LMI was prejudiced by the Port's

actions in entering into the Chevron cost sharing agreement, but limited LMI's remedy to dismissal of any costs resulting from that agreement. *Id.* The court allowed LMI to present limited evidence to the jury on only one issue regarding late notice prejudice: whether its ability to investigate the physical conditions at the TPH site was impaired. *Id.* LMI was not allowed to present any evidence or argument to the jury that there was late notice prejudice with respect to the TWP site. CP 10107, 18651.

(b) Known Loss/Fortuity Issue

Because the Port had purchased the TWP site knowing it was polluted, the issues of known loss and the Port's assumed liability for the TWP also were disputed below. LMI argued that insurance purchased from 1977 to 1985, which was intended to cover unexpected liability, did not cover damage to groundwater that was *known* at the time the Port purchased the TWP in 1999. CP 1651. The Port responded that its ownership of the MFA, which housed no polluting activities but which had been polluted by migration of contaminants from the TWP, rendered the Port jointly and severally liable for all groundwater contamination emanating from the TWP, and thus any alleged Port cleanup of the TWP site was covered by the policies. CP 2677.

The trial court sided with the Port on this issue, stating that the Port had not increased its liability by knowingly becoming an owner of the

polluted TWP site under MTCA. CP 5945.[4] The trial court also ruled that insurance coverage for any portion of the TWP site extended to the entire site, regardless of when it was acquired. CP 8705.

(c) Discovery Sanction

Because the policies at issue were 30 to 40 years old and the Port had lost many of them, and because the Port's brokers simply placed risks with various underwriters, discovery on the policies was challenging. The Port requested 30(b)(6) depositions regarding their lost policies, and LMI complied. CP 4038-4057. However, the Port was dissatisfied with many of the answers to its counsel's questions, which were about complex and broad-ranging matters spanning 40 years. *Id.,* CP 4587. After the depositions, the court ordered disclosure of a specific category of documents by December 28, 2012. CP 9517.

LMI substantially complied with the order, and turned over most of the requested documents by that date. CP 9467. However, some of the documents took longer to locate and produce than others, and were disclosed six days past the court's deadline, on January 4. *Id.* The Port renewed its motion for sanctions based on the week-late disclosure. CP 9462. As a sanction for the delay, the Port asked for the court to rule as a

[4] The trial court concluded that the Port would have been 100% liable for the pollution emanating from the TWP even if it had not become an owner of that property in 1999. This issue is addressed *infra* sections D.4 and D.5.

matter of law that the Port had proved the terms of certain lost policies, and that LMI be precluded from presenting evidence on this issue. *Id.* The trial court granted the issue preclusion sanction, citing the looming February trial date as evidence that the Port was prejudiced. CP 10099, 10538. Specifically, the trial court stated, "in the context of a trial date looming a month later, I think a week is pretty important." CP 10099. The sanction order ruled that the Port could offer certificates of insurance from the Port's broker as evidence of the terms of the LMI policies, and precluded LMI from arguing that the Port had failed to prove the actual terms of the policies. CP 10099.

In the middle of that February trial, however, close to the conclusion of the Port's case in chief, the Port admitted to its own discovery violation. During trial, the Port stated for the first time that it had found highly relevant documents in a storage room. CP 10374, 10472-10473. The trial court ordered a mistrial. RP 106. LMI moved to have the sanction of issue preclusion lifted, arguing that the Port's own conduct in causing a mistrial had negated any potential prejudice that a one-week partial discovery delay might have caused the Port. CP 10514. There was no longer a "looming" trial date, thus issue preclusion was no longer the least severe sanction available to cure any alleged prejudice. *Id.*

The trial court denied LMI's motion for relief from the issue preclusion sanction. CP 12708-12709. Despite the fact that the trial did not take place until almost a year after the documents were disclosed, the trial court still precluded LMI from contesting the issue of the language of certain lost policies. *Id.* The trial court then ordered an *additional* monetary sanction against LMI of $25,000 in fees to the Port. CP 16245. In adding the monetary sanction, the trial court admitted that it thought the question of an appropriate sanction was a "crapshoot" and was "very much an arbitrary number...." RP 5/22/2013 at 172-73.

The trial court imposed no sanction on the Port for its own discovery violation that caused the mistrial. Instead, the trial court simply ordered additional discovery. CP 12700.

(d) Verdict

After the second trial in November 2013, the jury concluded that the Port had coverage for every policy at issue, that LMI was not prejudiced by the Port's late notice as to the TPH site, and that no defenses to coverage applied. CP 18648-18651.

After the verdict had been rendered, the Port moved to dismiss its claim for damages against LMI entirely. CP 19616. Even though the Port had prevailed, it was apparently no longer interested in recovering what it

claimed were hundreds of thousands of dollars of past costs.[5] CP 19617. The trial court entered partial declaratory judgment on the jury's verdict, and granted the Port's motion to dismiss all of its damages claims. CP 18831-18846.

(e) Post-Trial Motions: Occurrence and Qualified Pollution Exclusion Issues

After the jury's verdict, LMI moved under CR 50(b) for judgment as a matter of law on the question of whether the Port presented any evidence that an "occurrence" had triggered coverage under any of the primary policies. CP 18473; RP 1321-1337. LMI argued that the Port failed in its burden to prove that the groundwater contamination was unexpected and unintended by the Port. *Id.* The only evidence the Port offered on this subject was the testimony of one employee, Kenneth O'Hollaren, who began working for the Port in 1980. RP 577-579. He simply stated that they could not recall any discussions about contaminated groundwater. *Id.* The Port offered no evidence of the Port's expectations or intentions up until 1979. The trial court denied LMI's motion for judgment as a matter of law. CP 18498.

[5] LMI had argued all along that it was prejudiced by the Port's voluntary payment of past costs without notifying LMI. LMI had also argued that the Port's action was premature, because it had not paid to clean up any site nor was DOE asking it to.

LMI similarly moved under CR 50(b) on the on the issue of whether the Port had met its burden to prove its claims against the excess policies, which all contained qualified pollution exclusions. CP 18537-18541; RP 1299-1320. LMI argued that the Port was required to prove that it did not expect or intend any polluting events (discharges, dispersals, releases, or escapes of pollutants) into the environment. *Id.* LMI noted that knowledge of release into the environment is different from knowledge of damage to groundwater. *Id.* The Port offered no evidence or testimony that it was unaware of the historical discharges at any of the sites. Nonetheless, the trial court denied the motion. RP 1320; CP 18545.

(f) Post-Trial Motions: Port's Motion to Amend and Entry of CR 54 Order

The Port also moved post-trial to amend its complaint to add various claims regarding LMI's alleged "bad faith" handling of its claim. CP 19622. LMI pointed out that any such amendment was untimely, prejudicial and futile, particularly since the Port had failed to give proper notice to LMI of its claim before filing suit, and any alleged "bad faith" would have arisen in the context of LMI's defense of the Port's coverage lawsuit, rather than LMI's claim handling. CP 19745-19754.

The trial court granted the Port's motion to amend its complaint to add the new bad faith claims. CP 20361. However, it also granted the

Port's request to stay litigation on the bad faith claims, CP 22524, and entered a CR 54(b) order certifying that the jury's verdict was final and appealable, and that there was no just cause for delay of LMI's appeal. CP 22526-22528.[6] The trial court stated that it would retain continuing jurisdiction over the case, and that any dispute over future remediation expenses the Port incurred would be subject to the court's review. CP 18831-18846.

LMI timely filed a notice of appeal from the August 1, 2014 CR 54(b) judgment. CP 22555.

D. ARGUMENT[7]

This case presents fundamental insurance coverage questions, coupled with complex environmental liability issues. Essential to this Court's review is an understanding of the source of the Port's putative liability – the Model Toxics Control Act, RCW ch. 70.105D ("MTCA") – and a review of basic insurance coverage principles.

(1) Overview of MTCA

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[6] The issue of whether the Port was entitled to attorney fees under *Olympic Steamship Co., Inc., v. Centennial Ins. Co.,* 117 Wn.2d 37, 52-53, 811 P.2d 673 (1991) was also raised by all defendants. CP 6960, 8122, 8436, 8708, 8721, 8869, 9389, 10116, 22509. The issue is still in the trial court, discovery is ongoing, and the Port has not yet filed an *Olympic Steamship* motion.

[7] As differing standards of review apply to each of the issues LMI now raises, LMI will address the standard of review separately for each issue.

In 1980, recognizing the Resource Conservation and Recovery Act ("RCRA"), 42 U.S.C.A. §§ 9601 et seq. left a gap in federal regulation of hazardous materials, Congress enacted the Comprehensive Environmental Response, Compensation and Liability Act ("CERCLA"), also known as the "Superfund" law. 42 U.S.C.A. §§ 9601 et seq. CERCLA imposed liability for the release of hazardous substances on various classes of parties and created a mechanism for compelling site cleanup. CERCLA empowered the EPA to undertake various acts to compel compliance. *Id.*

However, EPA could not address all of the contaminated sites in the county, so many were left to the states. Tim Butler and Matthew King, 24 *Wash. Prac., Environmental Law and Practice* § 15.1 (2d ed.) ("Butler/King"). In 1987, Washington enacted MTCA.[8] *Id.* This statute was patterned after CERCLA, but differed in certain respects. For example, if there were no existing state or federal cleanup standards applicable to a particular site, the statute required DOE to establish cleanup levels on a case-by-case basis and allow the proponents of a particular remedial action to propose alternate cleanup standards that were protective of human health and the environment. The statute also specifically allowed voluntary cleanups. Butler/King § 15.1.

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[8] In 1988, the voters enacted an initiative to replace the Legislature's original 1987 version of MTCA. It became effective March 1, 1989, and was codified as RCW chapter 70.105D. *Id.*

The fundamental public policy behind MTCA is to restore contaminated land, air, and water to a healthful state. RCW 70.105D.010. To accomplish these purposes, MTCA establishes a process through which Ecology investigates actual and potential release sites, issues declarations of "potential liability" and undertakes oversight of hazardous waste site cleanups. RCW 70.105D.020(21); RCW 70.105D.030, .050.

MTCA applies to all facilities within the state where there has been a release or threatened release of hazardous substance that may pose a threat to human health or the environment. WAC 173-340-110. A "facility" is defined as (a) any building structure, installation, equipment, pipe or pipeline, well, pit, pond, lagoon, impoundment, ditch, landfill, storage container, motor vehicle, rolling stock, vessel or aircraft; or (b) any site or area where a hazardous substance, other than a consumer product in use, had been deposited, stored, disposed of, or placed, or otherwise come to be located. *See* RCW 70.105D.020(5); WAC 173-340-200.

In general, MTCA liability can attach to five categories of persons. These categories include owners and operators of a facility, and any person who owned or operated a facility at the time of disposal or release of the hazardous substances. RCW 70.105D.040(1). A past or present property owner is liable for the remediation of environmental hazardous

substances that were released on its property. *Olds-Olympic, Inc. v. Commercial Union Ins. Co.*, 129 Wn.2d 464, 472, 918 P.2d 923, 927 (1996). Each past or present owner's liability is strict, joint and several, for all remedial action costs and for all natural resource damages resulting from the actual or threatened releases of hazardous substances. RCW 70.105D.040(2).

A critical feature of MTCA is the right of "contribution." Since MTCA liability is joint and several, any liable party may be made to pay the entire cost of remedial action. RCW 70.105D.080. But contribution allows a liable party to obtain contributions from other liable parties towards those costs. Butler/King § 15.1. The amount of contribution one PLP must pay to another is a question of equity for the court to decide. *Dash Point Vill. Associates v. Exxon Corp.*, 86 Wn. App. 596, 603, 937 P.2d 1148 (1997) *amended on denial of reconsideration,* 86 Wn. App. 596, 971 P.2d 57 (1998). A major equitable factor for the court is which party or parties actually caused the pollution. *Id.* at 607. The right of contribution is critical, particularly to an innocent PLP who owns polluted property but who did nothing to actually cause the pollution. In an equitable contribution action, such a party can recover 100% of the costs of cleanup from others. *City of Seattle (Seattle City Light) v. Washington*

State Dep't of Transp., 98 Wn. App. 165, 175, 989 P.2d 1164, 1170 (1999).

Despite the seemingly broad scope of MTCA strict liability, there are defenses available. *See* RCW 70.105D.040(3); *Pederson's Fryer Farms, Inc. v. Transamerica Ins. Co.*, 83 Wn. App. 432, 441, 922 P.2d 126 (1996), *review denied*, 131 Wn.2d 1010, 932 P.2d 1255 (1997). Generally, if the release or threatened release is caused solely by (1) an act of God, (2) an act of war or (3) actions of a third party, then a landowner can escape liability. RCW 70.105D.040(3)(a). If the purchasing landowner knew about the pollution when it purchased the property, this last defense does not apply.

(2) Washington Law Principles for Interpretation of Insurance Contracts

Liability insurance policies are contracts. They must be interpreted according to the intent of the parties which is discerned from the policy language and the circumstances in which it is formed. *Farmers Ins. Co. of Wash. v. Miller,* 87 Wn.2d 70, 73, 549 P.2d 9 (1976). In interpreting an insurance policy, courts employ the "same interpretive techniques employed in other commercial contracts." *Int'l Marine Underwriters v. ABDC Marine, Inc.*, 179 Wn.2d 274, 282, 313 P.3d 395 (2013); *see*

generally, Thomas V. Harris, Washington Insurance Law § 6.03 (3d ed.) ("Harris").

An insurance policy should be given a "fair, reasonable and sensible construction which fulfills the apparent object of the contract rather than a construction which leads to an absurd conclusion or renders a policy nonsensical or ineffective." *McDonald Industries, Inc. v. Rollins Leasing Corp.,* 95 Wn.2d 909, 913, 631 P.2d 947, 949 (1981). A court must also construe the policy as a whole giving force to all of its provisions. *Kitsap County v. Allstate Ins. Co.,* 136 Wn.2d 567, 575, 964 P.2d 1173 (1998).

While policy language should be interpreted in accordance with the way it would be understood by the average person, *American Star Ins. Co. v. Grice,* 121 Wn.2d 869, 874, 854 P.2d 622 (1993), the commercial context in which the insurance coverage is obtained is also important, and extrinsic evidence may be admissible to prove such context. *Int'l Marine Underwriters*, 179 Wn.2d at 282. Similarly, structure of the policy itself is an important objective source of its meaning and intent. *Int'l Marine Underwriters,* 179 Wn.2d at 282. Thus, this Court should be mindful of the commercial circumstances in which the Port purchased both primary and excess coverages from LMI. *Weyerhaeuser Co. v. Commercial Union Ins. Co.,* 142 Wn.2d 654, 669-70, 15 P.3d 115 (2001).

A court should follow the definitions of policy language in the policy itself; undefined terms are given their "plain, ordinary, and popular meaning." *Queen City Farms, Inc. v. Central Nat'l Ins. Co.*, 126 Wn.2d 50, 66, 882 P.2d 703 (1994).

If in the course of a policy's construction a court determines that a policy provision is ambiguous, a court must resolve such an ambiguity. A court may not interpret a policy, however, to create non-existent ambiguity. *Int'l Marine Underwriters*, 179 Wn.2d at 283. A policy is ambiguous only if "it is fairly susceptible to two different interpretations, both of which are reasonable." *McDonald Industries,* 95 Wn.2d at 912, 631 P.2d at 949 (*quoting Morgan v. Prudential Ins. Co.,* 86 Wn.2d 432, 435, 545 P.2d 1193 (1976)). A court can consider extrinsic evidence in order to clarify an ambiguity. But if the extrinsic evidence does not clarify the ambiguity, then the court construes an ambiguity in policy language against the insurer. *See Key Tronic Corp., Inc. v. Aetna (CIGNA) Fire Underwriters Ins. Co.,* 124 Wn.2d 618, 630, 881 P.2d 201, 208 (1995). If two interpretations are reasonable and the court cannot resolve the ambiguity, the court must construe the ambiguity in favor of coverage. *Int'l Marine Underwriters*, 179 Wn.2d at 288.

Washington courts will enforce policy exclusions that limit an insurer's risk, including pollution exclusions. *Am. Star Ins. Co. v. Grice*,

121 Wn.2d 869, 876, 854 P.2d 622 (1993) *supplemented*, 123 Wn. 2d 131, 865 P.2d 507 (1994); *McDonald v. State Farm Fire & Cas. Co.*, 119 Wn.2d 724, 735, 837 P.2d 1000 (1992); *Kelly v. Aetna Cas. & Sur. Co.*, 100 Wn.2d 401, 408, 670 P.2d 267 (1983). Exclusions are generally not extended beyond their "clear and unequivocal" meaning. *Stuart v. American States Ins. Co.*, 134 Wn.2d 814, 818-19, 953 P.2d 462 (1998).

With these general principles of MTCA liability and the construction of insurance contracts in mind, it is appropriate to turn to their application in this case.

(3) The Port Breached the Notice Conditions of Its Policies and LMI Was Prejudiced as a Result

The Port unquestionably breached one clear condition of any liability policy: bringing notice of the claim to the insurer "as quickly as possible." The trial court here correctly found in its September 11, 2012 order that the Port was late in giving LMI notice of its claims both for the TPH and TWP sites in 2010, because as of that date the Port had been aware of potential pollution damages for 19 and 14 years, respectively.[9] CP 5019, 18644.

[9] The trial court so instructed the jury in Instruction 10: "The Court has determined with regard to the TPH Site, that the Port's notice to London Market Insurers was late." CP 18644.

Late notice of a claim precludes coverage if the insured's delay prejudiced the insurer. Although the trial court found the Port was late, it erred in submitting the issue of prejudice to the jury, when the prejudice here was manifest as a matter of law. Alternatively, LMI is entitled to a new trial on this issue where the trial court made evidentiary rulings excluding vital evidence documenting the prejudice to LMI. The jury only received a small fraction of the total evidence of prejudice that the Port's 19-year (as to the TPH site) and 14-year (as to the TWP/MFA sites) late notice caused.

(a) Late Notice Can Be Particularly Prejudicial in Environmental Liability Cases

Washington law requires that when an insured has a claim brought against it by another, the insured must timely[10] tender[11] that claim to his/her insurer to invoke coverage under a liability insurance policy.

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[10] The LMI policies allegedly provided that notice of an occurrence of any and all losses be given to the insurer "as quickly as possible" and "as soon as may be practicable." *See, e.g.,* CP 1496, 1499. "As soon as may be practicable" has a well-understood meaning in Washington – as soon as can reasonably be expected under the circumstances. *Thompson v. Grange Ins. Assoc.*, 34 Wn. App. 151, 163, 660 P.2d 307, *review denied*, 99 Wn.2d 1011 (1983); *State Farm Mut. Auto. Ins. v. Erickson*, 5 Wn. App. 688, 692, 491 P.2d 668 (1971).

[11] The tender of the claim must be specific and must affirmatively and clearly inform the insurer that its participation in addressing the claim is sought by the insured. Mere notice of the fact that the insured has been sued is not enough. "An insurer cannot be expected to anticipate when or if an insured will make a claim for coverage; the insured must affirmatively inform the insurer that its participation is desired." *Unigard Ins. Co. v. Leven*, 97 Wn. App. 417, 427, 983 P.2d 1155 (1999), *review denied*, 140 Wn.2d 1009 (2000).

Washington law also is clear that an insured's untimely tender of a claim to an insurer bars coverage under the policy when the insurer demonstrates actual and substantial prejudice occasioned by such late notice. This principle was first established in *Canron, Inc. v. Federal Ins. Co.*, 82 Wn. App. 480, 485, 918 P.2d 937 (1996), *review denied*, 131 Wn.2d 1002 (1997). There, an insured that was the subject of an EPA CERCLA claim waited more than a year after first being notified by EPA that it was a potentially liable party before it notified the insurer of the EPA's claim.

The *Canron* court made clear that the insurer bears the burden of proving prejudice and that prejudice is generally a question of fact. *Id.* An insurer must "demonstrate some concrete detriment resulting from the delay which harms the insurer's preparation of presentation of defenses to coverage or liability." *Id.* at 486. The court observed that such factors as settlement of the underlying claim, and inhibitions on the insurer's conduct of a claim investigation, including changes in the accident scene, the preservation of evidence, the inability of experts to reconstruct the scene, or the loss of key documents or witnesses, could be relevant to prejudice. *Id.* at 486-92.

In *Leven*, the insured waited seven years before notifying its comprehensive general liability insurer of his personal status as a

potentially liable party under MTCA, even though his company had previously notified the insurer of MTCA claims against it. The court held that the insurer was prejudiced as a matter of law by the insured's late notice where it was foreclosed from arguing that the insured was not a PLP because he had no personal role in the operation of the MTCA site. The court found significant the fact that the insured took contradictory positions, arguing that he was not a PLP because he did not operate the site in other litigation over the site, while arguing he did operate it when seeking insurance coverage. 97 Wn. App. at 430-31.

The culmination of Washington late notice cases is *Mutual of Enumclaw Ins. Co. v. USF Ins. Co.*, 164 Wn.2d 411, 191 P.3d 866 (2008), where our Supreme Court considered the quantum and nature of the prejudice that the courts should require to meet the burden of the late notice defense, noting that decisions on the issue have "varied widely." *Id.* at 428. The Court approved of the holding in *Canron* on the insurer's burden. *Id.* at 424. The Court articulated a "flexible formulation" of prejudice. *Id.* The prejudice analysis looks to such factors as, were damages concrete or nebulous? Was there a settlement or did a neutral decision maker calculate damages? What were the circumstances surrounding the settlement? Did a reliable entity do a thorough investigation of the incident? Could the insurer have eliminated liability if

given timely notice? Could the insurer have proceeded differently in the litigation? *Id.* at 429-30. The Court concluded:

> We hold that in order to show prejudice, the insurer must prove that an insured's breach of a notice provision had an identifiable and material detrimental effect on its ability to defend its interests. The rule will manifest itself differently depending on the kind of prejudice an insurer claims. If the insurer claims that its own counsel would have defended differently, it must show that its participation would have materially affected the outcome, either as to liability or the amount of damages. If the insurer claims that it was deprived of the ability to investigate, it must show the kind of evidence that was lost would have been material to its defense.

Id. at 430-31.[12] It is important to note that our Supreme Court will find prejudice as a matter of law in appropriate circumstances, such as the insurer's loss of legal right. *Id.* at 431 n.14.[13]

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[12] "Notice," "cooperation," and "consent to settle" clauses in insurance policies, if breached, void any coverage if the insurer is prejudiced by such breach and the courts will analyze prejudice under any policy provisions identically. *Id.* at 428 n.12.

[13] Although our Supreme Court has held that prejudice should only be resolved as a matter of law in "extreme cases," *Staples v. Allstate Ins. Co.*, 176 Wn.2d 404, 419, 295 P.3d 201 (2013), our courts have not shied away from doing so under the appropriate facts. *See, e.g.*, *Sears, Roebuck & Co. v. Hartford Accident & Indemnity Co.*, 50 Wn.2d 443, 313 P.3d 347 (1957) (insured failed to forward summons and complaint to insurer for almost 14 months); *Benham v. Wright*, 94 Wn. App. 875, 881-82, 973 P.2d 1088 (1999) (insured in traffic collision failed to timely notify insurer and failed to ascertain with due diligence whether opposing party had been injured); *Felice v. St. Paul Fire & Marina Ins. Co.*, 42 Wn. App 352, 359-60, 711 P.2d 1066 (1986), *review denied*, 105 Wn.2d 1014 (1986) (attorney/insured breached cooperation clause in policy prejudicing insurer as a matter of law where attorney delayed 6 months after receiving malpractice action to notify insurer of claim; attorney foreclosed insurer's ability to investigate facts and determine course of action as to underlying case); *Pilgrim v. State Farm Fire & Cas. Ins. Co.*, 89 Wn. App. 712, 950 P.2d 479 (1997) (insured's de minimis response to insurer's request for financial records in theft claim constituted breach of cooperation clause as a matter of law); *Northwest Prosthetic & Orthotic Clinic, Inc. v. Centennial Ins. Co.*, 100 Wn. App. 546, 997 P.2d 972 (2000) (insurer was prejudiced as a matter of law

Although no reported Washington MTCA case has involved the extreme late notice and specific types of prejudice at issue here, an Oregon case is instructive. *Carl v. Oregon Auto. Ins. Co./N. Pac. Ins. Co.*, 141 Or. App. 515, 524, 918 P.2d 861 (1996). In *Carl,* the notice was 1 year late, but the Oregon Court of Appeals nonetheless held that summary judgment dismissal on the grounds of late notice prejudice was proper. *Id.* *Carl* involved contamination on property used for an automobile dealership by gasoline escaping apparently from a hole in an underground storage tank, discovered in 1989 after the tanks were decommissioned and removed. *Id.* at 521-24. To remedy the contamination, the insureds excavated the soil and removed and dismantled the storage tanks. *Id.* Approximately one year later, the insureds notified the insurer of a potential claim arising from the damage. In affirming the trial court's granting of summary judgment in favor of the insurer, the Oregon Court of Appeals held that the lack of timely notice precluded coverage under the policy. *Id.*

In so holding, the court in *Carl* found that, similar to the present case, the insurer had been prejudiced by the insured's failure to notify the

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by insured's violation of notice and cooperation clauses in policy where insured settled a debatable defamation claim before notifying the insurer of its existence, thereby foreclosing any real opportunity for the insurer to investigate it); *Key Tronic Corp. v. St. Paul Fire & Ins. Co.*, 134 Wn. App. 303, 139 P.3d 383 (2006), *review denied*, 160 Wn.2d 1011 (2007) (insurer prejudiced as matter of law where insured delayed notice to insurer for six months, disposed of evidence, and settled underlying claim); *Mac Lean Townhomes, LLC v. Am. States Ins. Co.,* 138 Wn. App. 186, 156 P.3d 278 (2007) (insurer prejudiced by loss of a legal right).

insurer prior to undertaking remediation efforts because evidence of the contamination was destroyed, preventing the insurer from conducting a reasonable investigation. *Id.* at 520. The insured's investigation and documentation of the remediation efforts did not ameliorate the prejudice, because the persons performing the remediation were concerned only with the present condition of the site and had no interest in determining when the contamination began or at what rate it progressed. *Id.* at 521-522.

Also similar to the facts here, in *Carl* the insured offered an expert opinion on the cause and dates of the contamination, and argued that because the insured was able to offer an expert that opined on the dates, the insurer was not prejudiced. *Id.* at 523. The Oregon court disagreed: "Notwithstanding plaintiffs' expert's theory, plaintiffs' removal and dispersal of the soil has made it impossible to determine which of the several relatively short-duration insurance policies was in effect at critical times and the apportionment of liability, if any, to each defendant." *Id.* at 523-524.

In sum, time is of the essence where insureds are seeking coverage for liability resulting from environmental contamination. The source, extent, and nature of the contamination is critical not only to establishing coverage, but also quickly remedying the problem and in timely seeking contribution from other potentially liable parties.

(b) The Port's Notice of Claims to LMI Was Late

There is no dispute that the Port was late in giving notice to LMI of its claims associated with the TPH and TWP sites. The Port never made claims against the alleged LMI primary and excess policies until it filed suit against LMI in 2010. CP 1479. The Port notified its insurers about a claim as to the TPH 19 years late. As to the TWP, it notified them 14 years late.

As the trial court noted in its September 11, 2012 order on summary judgment:

> The Court ruled as a matter of law, that the Port of Longview provided untimely notice under the policies when it stated "by whatever standard we use, amounts to late notice."

CP 5019. The Port has not cross-appealed from this ruling, conceding it. RAP 5.2(f).

(c) The Port's Late Notice to LMI Prejudiced LMI As a Matter of Law

Recognizing the Supreme Court's prejudice protocol in *Mutual of Enumclaw* and considering the cases on prejudice to an insurer as a matter of law, it is difficult to envision a more obvious case of prejudice to an insurer as a matter of law than the Port's failure to notify LMI here. The Port's breach of the policies' notice provisions "had an identifiable and material detrimental effect" on LMI's ability to investigate the claim and

defend its interests. *Mutual of Enumclaw*, 164 Wn.2d at 430. The Port waited *decades* before notifying LMI of claims under its policies. *Numerous* actions by the Port as to the TPH and TWP sites in the meanwhile prejudiced LMI as a matter of law.

By the time LMI received belated notice of a claim from the Port as to the TPH site almost two decades after the contamination was initially discovered there: (1) a leaking Calloway-Ross underground storage tank was removed from this site, destroyed, and the tank pit backfilled, CP 21008; (2) two other tanks at the mechanics shop were removed along with impacted soils, *Id.*; (3) key witnesses with critical information about the tank pull and potential contaminant sources, historic operations, contractual agreements with other potentially liable parties, and information observed during site investigations are deceased, have become unavailable (such as Nate Davis, Bob McNannay, and Bob Foster), CP 13530-13531; RP 603, and other witnesses' memories have faded (for example Judy Grigg, the Port's environmental manager, testified numerous times that she could not remember critical events and details), RP 1189, 1195, 1212, 1217, 1221, 1539, 1575, 1578, 1580, 1585, 1595, 1596, 1598; (4) the Port assumed partial responsibility for the contamination and made voluntary payments at the TPH site, CP 10144-10152; (5) the Port did not follow up with suits against real polluters such

as Calloway-Ross, CP 17787; and (6) the Port foreclosed any opportunity to seek contribution at a future date under MTCA. LMI's ability to investigate and defend the Port at the TPH site was frustrated.

If the Port had timely notified LMI, it could have properly investigated and made an informed determination about whether they were obligated to defend the Port with regard to the contamination. This is the same kind of prejudice that constituted prejudice as a matter of law in *Carl.* For instance, with respect to the TPH site, LMI could have considered whether it needed to hire an expert to address missing information or possibly conduct interviews with persons present during the 1991 Calloway-Ross tank decommissioning, the tanks decommissioned at the mechanics shop, and the subsequent investigations conducted over the past almost 2 decades. LMI could have conducted its own soil and groundwater sampling and undertaken their own evaluation of the pollution. Instead, LMI are forced to rely on the Port's very limited investigation of the claim conducted in 1991, testimony from the Port's environmental manager hired in 2010 who has little knowledge of events prior to her hire date, and the Port's speculative expert testimony on the timing and source of releases.

In addition to notifying LMI nearly two decades late, the Port did not even allow LMI to conduct an investigation of its claims prior to filing

the lawsuit. Furthermore, if LMI had been timely notified of the Port's claims, it could have mitigated liability and expenses. If the Port had sought LMI's consent for the payments it made at the TPH site, it may not have entered into the cost sharing agreements with certain PLPs or settled its past costs with Chevron, events that prejudiced LMI just as the insurers were prejudiced as a matter of law in *Sears* or *Key Tronic*. In addition, if LMI was timely notified of the Port's claims in 1991, LMI could have pursued the other PLPs who caused and contributed to the contamination at the TPH site in a MTCA contribution action when those claims were still fresh and evidence was not missing or stale. Such claims will be much more difficult to bring for the same reasons that the present action was greatly complicated by the passage of 19 years.

Likewise, at the TWP/MFA parcels, the Port admitted it knew they were polluted and that IP had questioned whether the Port was a PLP as early as 1996. CP 3247. Even after the Port purchased the TWP and received a PLP later in 2005, LMI was unable to investigate DOE's allegations and defend them accordingly for another five years after that. CP 2718. Since the Port did not assert certain applicable defenses with regard to the PLP letter, such as the third party defense under RCW 70.105D.040(3)(a)(iii), its late notice has undermined LMIs' ability to mitigate the Port's liability. As a result, LMI was unable to control the

defense. The deaths of witnesses prejudiced LMI because they had knowledge of the Port's expectation of polluting events and resulting property damage during the relevant time period, the 1960s and 1970s. CP 13530-13531; RP 603.

This case represents one of the "extreme cases" the Supreme Court instructed that could arise in late notice prejudice cases. *Staples,* 176 Wn.2d at 419. In the next closest Washington environmental case, this Court concluded that 7 years late notice – during which time the insured participated in actions that increased its potential liability – resulted in late notice prejudice as a matter of law. *Leven,* 97 Wn. App. at 430-31.

The trial court erred in denying LMI's motions for summary judgment and its CR 50 motions for judgment as a matter of law. The Port's extremely late notice to LMI, coupled with the undeniable prejudice to LMI's position, should have precluded coverage.

(d) <u>In the Alternative, the Trial Court Erroneously Instructed the Jury on Prejudice to LMI and a New Trial Is Warranted</u>

Even if the issue of prejudice to LMI from the Port's late notice was properly submitted to the jury, the trial court erred by (1) limiting the evidence it allowed LMI to present, and (2) improperly instructing the jury on the issue.

The Supreme Court's articulation of the questions that are relevant to the determination of whether an insurer is prejudiced by an insured's late notice of a claim are *broad* in their scope. *Mutual of Enumclaw*, 164 Wn.2d at 429-30. Yet despite the trial court's finding that the Port's notice was late as a matter of law, LMI was allowed *no* late notice defense as to the TWP site. CP 16865. Regarding the TPH site, the court allowed LMI to present evidence to the jury on only limited facts regarding late notice prejudice at the TPH site: (1) the "alleged inability" to pursue polluter Calloway-Ross for contribution,[14] and (2) whether LMI's ability to investigate the TPH site was impaired.[15] *Id.*

No evidence was permitted at all on prejudice to LMI with respect to the TWP site, the preservation of evidence, the inability of experts to analyze the evidence, the loss of key documents or witnesses, or, of particular importance in this MTCA case, the increased difficulty in gathering evidence and witnesses relevant to policy defenses and/or to potential contribution action, which LMI will have to bring because the Port did not.

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[14] The reference to "alleged" inability to pursue Calloway-Ross also misled the jury. Calloway-Ross dissolved as a corporation in 2005, five years before the Port gave notice. CP 17863. There is no dispute that it can no longer be pursued for contribution.

[15] Despite the wording of the trial court's order, LMI was not allowed to argue that it was prejudiced by the voluntary payments the Port made under the Chevron agreement, the trial court eliminated that as a concern for the Port by ruling that those costs were not recoverable as damages. CP 5019, 16865.

The court's Instruction 10 incorrectly apprised the jury of Washington law on prejudice, by artificially limiting the evidence that the jury could consider. CP 18644. *See* Appendix. The trial court compounded this instructional error when it refused to give LMI's proposed instructions 12 and 15 advising the jury of its earlier rulings on the Port's late notice and prejudice. CP 18620, 18623. *See* Appendix. Simply stated, the court artificially, and improperly, narrowed the evidence of prejudice to LMI that the jury could consider in Instruction 10.

The trial court abused its discretion in excluding relevant evidence of prejudice to LMI and erred in instructing the jury on prejudice to LMI. Its decisions require this Court to order a new trial.

(4) The Trial Court Erred in Failing to Dismiss the Port's Claims as to the TWP Because Coverage Violated the Known Loss/Fortuity Principle of Liability Insurance[16]

LMI moved below for summary judgment on the "known loss" or "fortuity" rule as to the Port's claimed liability in connection with the TWP site. CP 1641. The trial court granted the motion only in part in an order entered on September 11, 2012, stating:

[16] The application of the known loss/fortuity rule is a question of fact. *Frank Coluccio Const. Co., Inc. v. King County*, 136 Wn. App. 751, 768-70, 150 P.3d 1147 (2007); *MKB Constructors v. American Zurich Ins. Co.*, ___ F. Supp.3d ___, ___, 2014 WL 4792034 (W.D. Wash. 2014).

> The Court finds that when the Port of Longview purchased the I.P. property in 1999, the Port fully expected and intended to be subject to all liability associated with the ownership of that property. The Port is not entitled to create, add to, or materially change the insurer's potential liability at any level, whether defense or indemnity, by taking on a new obligation that the Port was aware of. The Motion is denied in all other respects.

CP 5015. The practical result of this order should have been that the Port's claims for coverage at the TWP were precluded, because the Port expected and intended to be liable for the well-known groundwater contamination at the site.

However, at the Port's urging, the trial court denied summary judgment as to the Port's coverage claims at the TWP site less than a month later. CP 5944-5955. In that subsequent order, the trial court found that TWP, which the Port purchased in 1999, and the MFA, which the Port purchased in the mid-1960s, should be considered as one site for insurance coverage purposes. Under this theory, the Port could knowingly purchase the polluted TWP in 1999 and obtain coverage from policies issued in the early 1980s because the Port already owned the MFA. *Id.* In so ruling, the trial court concluded that the Port's liability was unchanged by its 1999 purchase of the TWP property. *Id.* In effect, the trial court *restored* the issue of the Port's coverage for the TWP that it had rejected in its earlier September 11 order, and sent it to the jury.

Then, at trial, the Port failed to present any evidence that it did not expect or intend the discharge of pollutants at the TWP *or* the MFA, and that it did not expect or intend the resulting property damage. The Port did not offer a single document or witness regarding the Port's knowledge, expectations, or intentions of the widespread pollution or groundwater contamination during the 1940s-1970s. The Port's offer of proof regarding its knowledge was limited to testimony from the 1980's that one employee had not heard discussions of groundwater contamination. RP 577-579. Nonetheless, the trial court denied LMI's CR 50(a) motion for judgment as a matter of law at the conclusion of the Port's case and LMI's CR 50(b) motion after the verdict.

The Port purchased the TWP site despite knowing that significant groundwater pollution existed. Even assuming the creative "one site" theory allowed the Port to sidestep this obvious coverage exclusion based on ownership of the MFA, the Port presented no evidence regarding its expectation of the discharge of pollutants or property damage on the MFA. This case never should have been submitted to the jury under the fortuity principle. The trial court erred in failing to dismiss all of the Port's TWP claims as a matter of law.

(a) Fortuity Principle in Liability Insurance

The known loss or fortuity principle is well-understood in the law of insurance:

> Implicit in the concept of insurance is that the loss occurs as a result of a fortuitous event, not one planned, intended, or anticipated. The fortuity principle is central to the notion of what constitutes insurance, and the insurer will not and should not be asked to provide coverage for a loss that is reasonably certain or expected to occur within the policy period. A "fortuitous event" is an event which so far as the parties to the contract are aware, is dependent on chance.

46 C.J.S. *Insurance* § 1235. As our Supreme Court has observed: "The known risk defense is premised on the principle that an insured cannot collect on an insurance claim for a loss that the insured subjectively knew would occur at the time the insurance was purchased." *Pub. Util. Dist. No. 1 of Klickitat Cnty. v. Int'l Ins. Co.*, 124 Wn.2d 789, 805, 881 P.2d 1020 (1994).

Our Court amplified the fortuity principle extensively in *Aluminum Co. of America v. Aetna Cas. & Sur. Co.*, 140 Wn.2d 517, 555-56, 998 P.2d 856 (2000) ("*Alcoa*"). The *Alcoa* court noted that in Washington the fortuity principle encompasses the "known risk," "known loss," and "loss in progress" defenses to coverage. *Id.* at 556. The fortuity principle is inherent in all liability insurance policies and "has the effect of an exclusion." *Id.*

A classic application of the fortuity principle in the pollution setting is *Overton v. Consol. Ins. Co.*, 145 Wn.2d 417, 38 P.3d 322 (2002), where our Supreme Court upheld the denial of coverage with respect to soil contamination the insured knew existed before purchasing its insurance policies. The Spokane Transformer Company operated an electrical transformer manufacturing and repair facility, which it later sold to the insured. *Id.* at 421. In 1976, the EPA took soil samples from the site, and one of the two samples revealed elevated levels of the PCBs. The insurance policies were not purchased until 1977 and 1979. *Id.* at 422. The Court rejected the proposition that the insured did not know of the pollution of the property until officially notified by a government agency, *Id.* at 426, and noted that "the insureds knew of the contamination, and the process was not invisible from their standpoint." *Id.* at 427. But because Spokane Transformer had notice of the PCB contamination before purchasing the insurance policy, it had no coverage under the fortuity principle. *Id.*

The Court also rejected the notion that the insured lacked notice until such time as all its legal damages were known; rather, the insured need only know there was harm or "damage" to the property. *Id.* at 428.

The Court concluded that under the fortuity principle, there was no coverage under policies acquired after the insured was on notice that PCBs had been discovered on the property. *Id.* at 432-33.[17]

(b) Coverage for Property Purchased With Knowledge of Pollution, and Thus Knowledge that Groundwater Contamination Is Probable, Violates the Fortuity Principle

The Port offered no evidence to counter – and the case of the TWP, admitted – that it was subjectively aware of pollution and expected property damage at the TWP and MFA sites when it purchased each. The Port was subjectively aware when it purchased the MFA in the 1960s that it contained what the Port's own counsel referred to as an unlined "stinky" lineament ditch into which IP had been openly ejecting contaminated wastewater for decades. CP 789, 2741; RP 11 (11/5/2013). Yet the only evidence it presented at trial regarding known loss was the testimony of an employee who stated that he personally had not heard any conversations about groundwater contamination from 1980 to 1987. RP 577-579. It was undisputed that the Port was subjectively aware of groundwater

[17] *See also, City of Redmond v. Hartford Acc. & Indem. Ins. Co.,* 88 Wn. App. 1, 943 P.2d 655 (1997), *review denied,* 134 Wn.2d 1001 (1998). There, the insured was repeatedly alerted by metropolitan authority that its discharges into a public sewer system were more acidic than permitted and informed the insured that acidic discharges might damage the system. The court ruled that the insured was deemed to have "notice of the defective condition," i.e., contamination. Therefore, the damage to the city's sewer pipes caused by the insured's discharge of acidic wastes far in excess of what was allowable under its discharge permit was not an "occurrence."

contamination at the TWP site when it bought the property in 1999. IP, its predecessor, was under a consent decree to clean up the site. The Port assumed potential liability for these sites when it purchased them. RCW 70.105D.040(a). Under *Alcoa* and *Overton*, it could not secure coverage under policies issued by LMI.

The trial court's ruling that purchasing the TWP did not affect the Port's liability because of its prior ownership of the MFA is incorrect. The MFA was polluted solely by IP prior to the Port's purchase of it in the 1960's. CP 789-90. Had the Port owned only the MFA and never the TWP, and it was unaware of any contamination prior to purchasing the MFA,[18] it would have been able to raise MTCA defenses. MTCA provides *complete* liability defenses if contamination was caused solely by third parties, and/or the owner had no reason to know that such contamination had occurred. RCW 70.105D.040(3)(a)(iii), (b).

Thus, even assuming that the Port had potential liability for surface water pollution at the MFA site, the Port *vastly* increased the risk to LMI by purchasing the TWP site in 1999 *knowing* it was polluted and subject to court or EPA/DOE clean up orders. The scope of any liability for damage

[18] LMI does not concede that the Port did not know of pollution at the MFA or TPH sites at the time of purchase. But the Port cannot have it both ways. If it did not know, as it claims without evidence, then the MTCA defense is absolute. If it did know, then the fortuity principle applies and there is no coverage.

to the groundwater from the TWP site is far greater than any such liability in connection with the Port's ownership of the MFA site alone.

Here, as in *Overton*, the Port knew about the damage before it purchased the property for which it now seeks coverage. This was not a case about the substantial probability of a loss; *the actual loss had occurred before the Port acquired liability for it.* IP was under EPA/DOE orders and a consent decree. The Port's purposeful act of knowingly subjecting itself to MTCA liability is the basis for its claim for coverage. The Port's purchase of the TWP site was no "accident," and its attempt to claim coverage for the consequences of that act does violence to the concept of fortuity.

The core value at play in the fortuity principle is that the insured's placement of coverage with the insurer plainly alters the risk to be covered by the insurer. The coverage does not involve a "risk" when there is no fortuity involved – it is a *certain loss*. This defeats the whole concept of liability insurance. The trial court should have granted summary judgment to LMI on the Port's TWP claims based on the fortuity principle.

(5) <u>The Port Failed to Establish an Occurrence Under the LMI Primary Policies</u>

An insurance principle closely associated with, but distinct from, the fortuity principle is the requirement of an "occurrence" before liability

coverage is invoked. An "occurrence" is an accident not expected nor intended from the standpoint of the named insured.[19] *Alcoa,* 140 Wn.2d at 556 n.15; *Queen City Farms, Inc. v. Central Nat'l Ins. Co.*, 126 Wn.2d 50, 64-69, 882 P.2d 703 (1994). This is a subjective test. *Id.* at 69.

In addition to rejecting coverage under the fortuity principle, the *Overton* decision (discussed *supra*) also held that coverage for property known to be contaminated prior to purchasing a liability policy was barred as failing to constitute an "occurrence" under the policy's language:

> For purposes of establishing coverage under the "occurrence" analysis, the proper inquiry is whether Spokane Transformer expected the physical injury to tangible property [...] because Spokane Transformer knew of the PCB contamination before purchasing the policies, coverage was properly denied on the ground there was no "occurrence."

145 Wn.2d at 432-33. The existence of an occurrence within the meaning of a policy is a question of fact. *PUD No. 1*, 124 Wn.2d at 805-06.[20] This

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[19] Although the doctrines of fortuity and occurrence are closely associated, they are not identical. "Fortuity" is a common law doctrine inherent in all liability policies, regardless of their specific policy language. *Alcoa,* 140 Wn.2d at 556. Analysis of whether there has been an "occurrence" is governed by the specific insuring language of the policy at issue. *Id.* at 556 n.15.

[20] In *PUD No. 1*, a case arising out of the WPPSS nuclear plant construction, our Supreme Court addressed the known risk principle in conjunction with examination of an "occurrence." At issue there was whether the PUDs knew when the liability coverage was initially obtained that they would likely have losses to bondholders for securities law violations. The court approved a jury instruction that the PUDs had to "know that there was a substantial probability" that they would be sued by the bondholders when they purchased the coverages for the known risk rule to apply. 124 Wn.2d at 806.

test has a temporal feature to it, looking to the insured's expectation at the inception of the coverage, that the damage would occur. *Id.*

A risk of liability is "known" where the insured receives notice indicating a loss has occurred or a loss probably will occur. *Town of Tieton v. Gen. Ins. Co. of America,* 61 Wn.2d 716, 721-22, 380 P.2d 127 (1963) (city constructed sewage lagoon with knowledge that contamination of neighboring well was fully possible); *City of Okanogan v. Cities Ins. Ass'n*, 72 Wn. App. 697, 701, 865 P.2d 576 (1994) (if an event causing loss is known prior the effective date of the policy, there is no coverage).

It is undisputed that the Port expected and intended damage to groundwater as to the TWP site when it purchased that site in 1999. CP 472, 5015, 12544. EPA/DOE orders and a consent decree imposed remediation duties on IP, its predecessor. CP 707. The trial court nevertheless allowed the Port to argue to the jury that it should obtain coverage retroactively on the basis that in the 1970s, it did not expect or intend property damage to a site that it did yet not own. CP 18649-18650.

Even assuming the trial court was correct in allowing the Port to assert this "time travel" theory of coverage as to the TWP, the only testimony offered at trial as to the Port's expectations or intentions of an occurrence was from witnesses who had no *contemporaneous* experience

with Port knowledge in the 1960s and 1970s prior to the first policy period at issue. RP 577-579; CP 18649.[21]

The same temporal problems exist regarding the Port's offer of proof on occurrence with respect to the TPH site. In the 1960s and 70s, pollution occurred on many occasions in the form of releases directly into the air and soil. CP 823. Petroleum contamination occurred during the loading and unloading of fuel "through the operational life" of the 80,000 barrel storage tank, as well as from the Calloway Ross tank and the rail operations. CP 827. Numerous other releases occurred during pipeline repairs and replacements until environmental controls were implemented in the late 1970s. CP 826. Yet the Port presented no evidence at trial regarding its expectation of an actual or probable loss prior to the policy period.

In order to meet its burden, the Port was required to present evidence of its expectations and/or intentions regarding the damage at issue *from the relevant time period*, which is before it purchased the coverage. CP 18649-18650; *Overton*, 145 Wn.2d at 431; *P.U.D.*, 124 Wn.2d at 805. The Port utterly failed to do so. Judgment for LMI as a matter of law should have been granted.

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[21] This is particularly so where the key Port witnesses who had contemporaneous knowledge of the Port's expectations in the 1960s and 1970s had died,

(6) The Excess Policies at Issue Excluded Coverage If the Port Expected or Intended the Polluting Events; LMI Should Have Prevailed on This Issue as a Matter of Law[22]

The trial court erred in both (1) sending to the jury the issue of whether the Port expected or intended the polluting event resulting in property damage, and (2) instructing the jury that the Port only had the burden to prove it did not subjectively believe groundwater had been damaged as a result of the polluting event. The jury's verdict on this issue should be reversed.

(a) An Insured Claiming to Fall Within the Exception to a Qualified Pollution Exclusion Has the Burden of Proving It Did Not Expect or Intend a Polluting Event, Rather Than Whether It Knew of the Resulting Damage

The excess policies at issue contained a pollution exclusion that applied to the Port's asserted MTCA liability. CP 18596-18600. There is an evolving history of pollution exclusions in insurance policies.[23] The

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a fact that exacerbates the prejudice to LMI of the Port's very tardy claim notice here, as was noted *supra*.

[22] Again, the question of whether the trial court erred in refusing to grant LMI's motion for judgment as a matter of law is reviewed *de novo*. *Guijosa v. Wal-Mart Stores, Inc.*, 144 Wn.2d 907, 914-15, 32 P.3d 250, 254 (2001); CR 50(a)(1). This Court also reviews errors of law in jury instructions *de novo*. *State v. Barnes*, 153 Wn.2d 378, 382, 103 P.3d 1219 (2005).

[23] *See, e.g.*, Tyler & Wilcox, *Pollution Exclusion Clauses: Problems in Interpretation and Application Under the Comprehensive General Liability Policy*, 17 Idaho L.Rev. 497, 499 (1981). Even absolute pollution exclusions have been enforced consistently by Washington courts. *See Am. Star Ins. Co. v. Grice*, 121 Wn.2d 869, 877, 854 P.2d 622 (1993) *supplemented*, 123 Wn.2d 131, 865 P.2d 507 (1994) ("many cases" have held that absolute pollution exclusions preclude coverage for pollution damages);

kind of pollution exclusion at issue here, the "qualified pollution exclusion," was interpreted by the Washington Supreme Court in *Queen City Farms,* 126 Wn.2d at 76.[24]

The "exclusionary" portion of an insurance policy's qualified pollution exclusion states that the policy does not apply to property damage "arising out of the discharge, dispersal, release, or escape" of contaminants or pollutants into the environment. CP 18596-18600; *Queen City Farms,* 126 Wn.2d at 77. The insurer bears the burden of proof regarding whether the exclusion applies, i.e., whether there has been damage to the property of others arising out of pollution. *Queen City Farms,* 126 Wn.2d at 71-72.[25]

The exception (or "qualifier") to these qualified pollution exclusions re-triggers coverage for an otherwise excluded damage-causing event if the insured proves that it did not expect or intend the polluting event resulting in the property damage. *Queen City Farms*, 126 Wn.2d at

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Cook v. Evanson, 83 Wn. App. 149, 154, 920 P.2d 1223 (1996); *City of Bremerton v. Harbor Ins. Co.,* 92 Wn. App. 17, 23, 963 P.2d 194 (1998).

[24] In the mid-1980's qualified pollution exclusion provisions were replaced with absolute pollution exclusion provisions. That is why the Port dismissed its claims against policies it purchased after 1985. CP 8681. Because *Queen City Farms* interprets insurance provisions that have not been in use since the mid-1980s, it is still the most authoritative Washington Supreme Court case on the subject.

[25] It was undisputed at trial that LMI proved the exclusion applied, i.e., that the damage to groundwater arose from the release of pollution into the environment. CP 18645.

77, 88; *see also, Key Tronic Corp. v. Aetna (CIGNA) Fire Underwriters Ins. Co.*, 124 Wn.2d 618, 628, 881 P.2d 201, 207 (1994).

The insured must prove lack of expectation or intent of the *polluting event,* rather than lack of expectation or intent of the resulting *property damage*, in order to prove this exception applies. This is a critical legal distinction that was established in *Queen City Farms. Queen City Farms,* 126 Wn.2d at 77. In that case, the Court examined whether a qualified pollution exclusion should apply if the insured had subjective knowledge of pollution, but not subjective knowledge of damage to the groundwater. *Id.* at 86-88. The insurer argued that the exception should not apply if the insured knew that pollution had escaped into the environment in any manner, even if the insured did not know whether the pollution had actually reached and damaged groundwater. *Id.*

Our Supreme Court in *Queen City Farms* agreed with the insurers, and held that in order to obtain coverage under the exception to the qualified pollution exclusion, the insured must prove that it had no expectation or intention that pollution would escape into the environment, regardless of whether the insured knew the pollution had damaged the groundwater. *Id.* at 87-88. It noted that to accept the insured's position would encourage insureds *not* to investigate and address pollution events promptly. *Id.* at 89 (observing that if insureds are covered despite

knowing of pollution but not the resulting environmental damage, they will not have incentive to clean up pollution and thus "minimize the risk of environmental damage").

Under *Queen City Farms*, in order to obtain coverage of the TWP/MFA by any of the policies containing the qualified pollution exclusion, the Port was required to prove that it did not expect or intend the pollutants discharged into the unlined lineament ditch to escape the ditch. With respect to the TPH, the Port was required to prove that it did not expect or intend petroleum and related pollutants had escaped from pipelines, tanks or other containment.

(b) The Trial Court Erred in Refusing to Dismiss the Port's Claims Against the Excess Policies When the Port Presented No Evidence Regarding Its Lack of Expectation of Polluting Events

The despite undisputed evidence of open and obvious pollution at these sites, the Port offered no witnesses or documents from the 1960's and 1970's to demonstrate that it did not expect or intend the polluting events at the TWP or TPH sites. Therefore, LMI moved for judgment as a matter of law that the Port had failed in its burden under *Queen City Farms*. CP 18857-18858. The motion was denied. CP 20191.

Not only did the Port fail to meet its burden, the Port's own evidence confirmed that open and obvious polluting events were occurring

at both sites in the 1960's and 1970's prior to the first policy period at issue. CP 786-794, 820-830. At the TWP site, among other practices, known pollutants such as creosote and pentachlorophenol were dumped into the open, unlined lineament ditch and nearby unlined ponds. CP 458, 17383. This pollution was not accidental, but was part of IP's operations at the TWP site. CP 458. The contaminated nature of the lineament ditch was so uncontroversial the Port's counsel in fact referred to it as "the stinky ditch." RP 11 (11/5/2013).

At the TPH site, the Port knew in the early 1970's that Standard Oil replaced its leaking oil pipelines. CP 2152-2153. Standard Oil's license agreement with the Port required advance permission from the Port prior to constructing or moving pipelines. *Id.* The new pipelines were installed immediately adjacent to the old pipelines that had been leaking for decades, according to a Port report. *Id.* The Port's expert confirmed that much of the TPH contamination resulted from the pipelines abandoned in place in the early 1970's. RP 914; CP 823-825. The Port, despite presenting testimony from its own expert that polluting events occurred up until the early 1970s, failed to offer *any evidence* that it did not expect or intend those polluting events prior to the policy periods at the TPH site. Instead, the offer of proof on this issue was that in the 1980s

a Port employee was unaware that groundwater contamination had occurred. RP 577-79.

The trial court erroneously denied LMI's motion for judgment as a matter of law regarding the excess policies' qualified pollution exclusion. RP 1320; CP 18545. Specifically, the trial court concluded that "Dispersal in the groundwater and damage to groundwater have to be the same thing. There is no distinction that I can find between them." RP 1320.

This is plain error under *Queen City Farms*, which distinguishes between the *polluting event*, which relates to the pollution exclusion, and the "occurrence," which relates to damage to the groundwater. *Queen City Farms,* 126 Wn.2d at 88 ("As we have discussed at some length above, the language of the exclusion involves the polluting event, and not the resultant damages").

The trial court erred in denying LMI's motion for judgment as a matter of law regarding the qualified pollution exclusions in the excess policies. Given that the Port offered no evidence to meet its burden that it did not expect or intend the polluting events, the trial court should have granted LMI's motion.

(c) <u>The Trial Court Erred in Stating the Port's Burden in Instruction 11 and the Special Verdict Form</u>

The trial court also erred in submitting Instruction 11 and the special verdict form to the jury, which misstated what the Port was obligated to prove to fall within the exception to the qualified pollution exclusion. These documents erroneously told the jury that the Port was only obligated to demonstrate a lack of knowledge of groundwater contamination, not that the Port did not expect or intend the polluting events.

Both Instruction 11 and the special verdict form erroneously stated the law. Instruction 11 reads in relevant part:

> Certain policies subscribed to by the London Market Insurers contain a pollution exclusion which bars coverage for the Port's claims unless the Port proves by a preponderance of the evidence that the discharge, dispersal, release, or escape of contaminants or pollutants *into the groundwater* was sudden and accidental. ...The Port of Longview has the burden of proving that it did not expect the discharge or release of contaminants *into the groundwater*.

CP 18645 (emphasis added). The special verdict form, when addressing the pollution exclusion, asked the jury: "Did the Port of Longview prove the Port did not expect or intend *release to the groundwater* at the [TWP and TPH sites] prior to the policy period?" CP 18650 (emphasis added).

The evidence the Port offered at trial related only to lack of knowledge of groundwater contamination in the 1980's and 1990's. It did

not offer any evidence that it was unaware of the continuous discharges of pollutants predating the 1970s that were released into the unlined ponds and lineament ditch that contaminated the TWP site, nor evidence of the continuous discharges caused by Chevron's leaking pipelines into the early 1970s.

Had the jury been properly instructed that the Port's burden was to prove it that it did not expect or intend any of the open, obvious, and well-known discharges of pollutants on the TWP and TPH sites, rather than being ignorant of the fact that the pollution had actually reached the groundwater, LMI would likely have prevailed on this issue. This prejudicial error taints the jury's verdict and requires reversal.

(7) The Trial Court Abused Its Discretion in Imposing an Issue Preclusion Sanction Against LMI for a One-Week Delay in Discovery Disclosure, and then Refusing to Lift that Sanction When the Port Caused a Mistrial[26]

In a complex case where evidence is stale and difficult to come by because the Port delayed acting on its claim for 19 years, discovery did not always proceed smoothly. The trial court was faced with two different sanction motions for discovery violations, and reacted disproportionately and arbitrarily.

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[26] This Court reviews a trial court's discovery sanctions for abuse of discretion. *Wash. State Physicians Ins. Exch. & Ass'n v. Fisons Corp.*, 122 Wn.2d 299, 338, 858 P.2d 1054 (1993). A trial court abuses its discretion when its order is manifestly unreasonable or based on untenable grounds. *Id.* at 339.

When LMI disclosed most documents timely, but some documents one week late,[27] the trial court imposed the extraordinary sanction of issue preclusion: the Port was ruled to have proved the language of lost policies by referring to other documents, and LMI was not allow to dispute the Port's evidence. CP 10099. In other words, the Port prevailed as a matter of law on the critical issue of what its lost insurance policies covered. *Id.*

The court's rationale was that the week-late disclosure prejudiced the Port because trial was imminent. However, after a mistrial caused by the Port, the trial court refused to lift the issue preclusion sanction, even though there was no longer any prejudice to the Port *because the trial did not occur until a year later.*

Even after imposing these harsh discovery sanctions on LMI, the trial court did not see fit to sanction the Port after it claimed to find critical documents *during* trial, causing a mistrial. The trial court's disproportionate reactions were an abuse of discretion.

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[27] The Port had previously claimed that LMI had not been cooperating in discovery, and brought a sanctions motion on that basis. CP 4038. LMI had raised legitimate arguments regarding the scope and relevancy of those requests. CP 4584. Months later, the trial court ordered disclosure of some documents it concluded were discoverable. CP 9527. LMI abided by the trial court's December 28, 2012 deadline with respect to all but a few documents it was searching for in a large and complex database. *Id.* Those documents were disclosed four business days later, on January 4. *Id.* In its renewed motion for sanctions, the Port raised its previous sanctions motion, suggesting that the previous issues they raised were relevant to the document disclosure that was the basis for its second motion. However, the trial court's order specifically

(a) The Trial Court Abused Its Discretion by Ordering the Disproportionate Sanction of Issue Preclusion For a One-Week Delay in Disclosing Some Documents

Certain principles guide the trial court's consideration of sanctions. When the trial court chooses one of the harsher remedies allowable under CR 37(b), it must be apparent from the record that the trial court explicitly considered whether a lesser sanction would probably have sufficed, and whether it found that the disobedient party's refusal to obey a discovery order was willful or deliberate and substantially prejudiced the opponent's ability to prepare for trial. *Burnet v. Spokane Ambulance*, 131 Wn.2d 484, 489, 933 P.2d 1036 (1997), *as amended on denial of reconsideration* (June 5, 1997); *Rivers v. Washington State Conference of Mason Contractors*, 145 Wn.2d 674, 694, 41 P.3d 1175 (2002). The wrongdoer's lack of intent to violate the rules and the other party's failure to mitigate may be considered by the trial court in fashioning sanctions. *Rivers,* 145 Wn.2d at 695. The sanction should be "proportional to the nature of the discovery violation and the surrounding circumstances." *Id.*

Here, after the parties had explained their circumstances and the difficulties of complying with the Port's demands, the trial court set a disclosure date of December 28 for certain documents, which LMI obeyed

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stated that any sanction would depend upon the adequacy of LMI's document disclosure. CP 9517.

to the best of its ability. CP 9525, 10531-10535. Those documents it had not yet located were disclosed less than a week later. *Id.* The trial court acknowledged that LMI had searched in good faith for the information, but should have used an IT professional earlier in the discovery process. CP 10538.

Given these facts and findings, the sanction of issue preclusion – ruling in the Port's favor on a critical issue – under these circumstances was disproportionate and an abuse of discretion.

(b) After the Port's Own Discovery Violation Caused a Mistrial, the Trial Court Again Abused Its Discretion by Refusing to Modify the Sanction Against LMI, and Declining to Sanction the Port

Even if this Court believes that the trial court did not abuse its discretion by entering a sanction of issue preclusion, it was an abuse to *sustain and amplify* the sanction after the Port's own discovery violations caused a mistrial, negating any claimed prejudice.

The trial court's rationale for imposing the issue preclusion sanction in January 2013 was that the trial date was a month away, and LMI's tardy disclosure prejudiced the Port's trial preparation. CP 10538. However, during trial, the Port stated for the first time that it had found highly relevant documents in a storage room. CP 10374, 10472-10473. The trial court ordered a mistrial. RP 106. The second trial was not held

until November 2013, 10 months later. Thus, any claimed prejudice to the Port's trial preparation was negated by the Port's own actions in causing a mistrial. However, when LMI moved for modification or reversal of the issue preclusion sanction under CR 60,[28] the trial court refused. CP 10514, 12706.

Washington courts generally prefer that issues should be decided on their merits. *Showalter v. Wild Oats*, 124 Wn. App. 506, 510, 101 P.3d 867, 869 (2004). When a trial court considers whether to impose a harsh sanction such a striking a claim or dismissing a case, it must be on the basis that the discovery violation "actually and substantially prejudiced the opponent's ability to prepare for trial." *Rivers v. Washington State Conference of Mason Contractors*, 145 Wn.2d 674, 686, 41 P.3d 1175, 1181 (2002).

Here, any claimed prejudice or justifiable grounds for the harsh sanction of issue preclusion was based on the trial court's assessment that LMI's week delay in locating certain documents prejudiced the Port's ability to prepare for trial in a month. Those grounds evaporated when the *Port* caused a mistrial with its own discovery violation. Once the claimed

[28] This Court reviews denial of a CR 60 motion for abuse of discretion. *Hope v. Larry's Markets*, 108 Wn. App. 185, 29 P.3d 1268 (2001).

prejudice vanished, the trial court was left with no tenable grounds for imposing that sanction on the retrial almost a year later.

The trial court's uneven treatment of the parties was made manifest when it failed to sanction the Port in any way for the Port's own discovery violation, which on balance was more egregious than LMI's. LMI disclosed some documents one week late. The Port disclosed critical documents *during trial,* causing a mistrial. This discrepancy highlights the trial court's abuse of discretion.

Finally, the sanction was prejudicial, necessitating a new trial. Had the Port actually been required to prove the language of its lost policies, it would have had to do so by presenting clear, cogent, and convincing evidence. CP 12712. Given the age of the Port's claimed lost policies, its lack of witnesses or other documentary evidence, this clear, cogent and convincing standard would have been difficult to meet.

The trial court's abuse of discretion prejudiced LMI. A new trial is warranted in which the Port should be required to make its case with evidence.

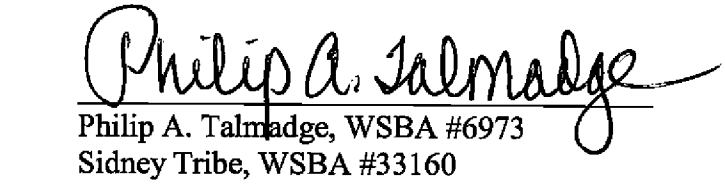
E. CONCLUSION

This Court should reverse the trial court's coverage decisions in this case and dismiss the Port's complaint. The trial court simply erred in concluding that coverage was present here under the LMI policies in light

of well-developed principles of insurance law. Alternatively, this Court should award a new trial on liability to LMI with the issues correctly configured. Costs on appeal should be awarded to LMI.

DATED this 27th day of March, 2015.

Respectfully Submitted,



Philip A. Talmadge, WSBA #6973
Sidney Tribe, WSBA #33160
Talmadge/Fitzpatrick/Tribe
2775 Harbor Avenue SW
Third Floor, Suite C
Tukwila, WA 98188
(206) 574-6661

Carl E. Forsberg, WSBA #17025
Kenneth J. Cusack, WSBA #17650
Charles E. Albertson, WSBA #12568
Forsberg & Umlauf PS
901 5th Avenue, Suite 1400
Seattle, WA 98164-2047
(206) 689-8500
Attorneys for Appellants
London Market Insurers

APPENDIX

APPENDIX A

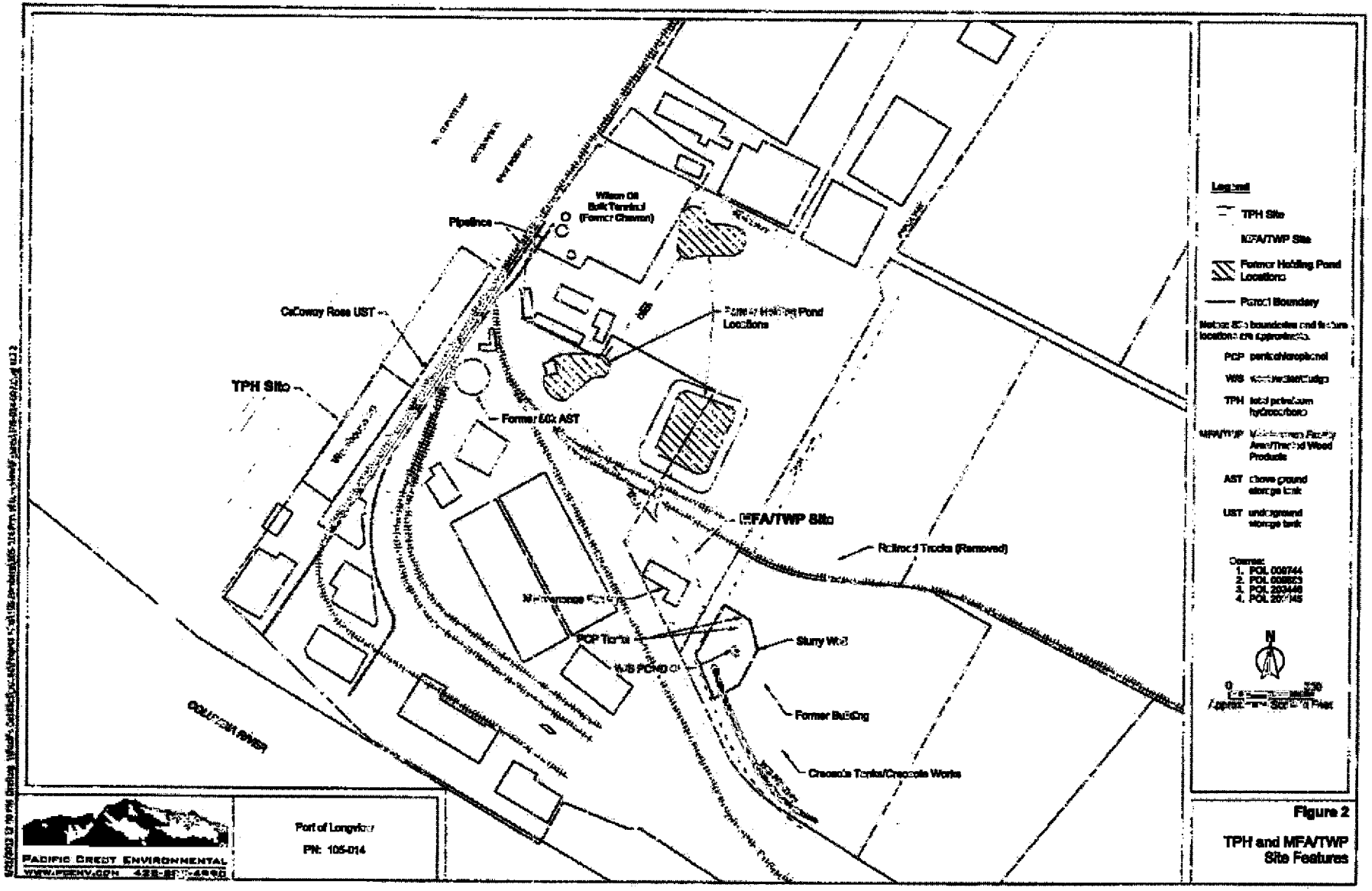


Figure 2

TPH and MFA/TWP Site Features

JURY INSTRUCTION NO.: 16

The Court has determined with regard to the TPH Site, that the Port's notice to London Market Insurers was late.

LMI has the burden of proving, by a preponderance of the evidence, actual and substantial prejudice, which means that the London Market Insurers have offered affirmative proof of an advantage lost or a disadvantage suffered as a result of the Port's breach or breaches, which have an identifiable detrimental effect on their ability to evaluate or present defenses to coverage or liability.

In determining whether LMI has proved their affirmative defense of late notice at the TPH site, you should consider the following:

1) Whether LMI was actually and substantially prejudiced by LMI's alleged inability to pursue Calloway Ross for additional contribution towards cleanup costs at the TPH site;

2) Whether LMI was actually and substantially prejudiced by the change in site conditions;

3) Whether LMI was actually and substantially prejudiced by the Port's signing of the May 19, 1998 Chevron Agreement.

In determining whether or not the London Market Insurers have been prejudiced by the Port's breach of the notice provisions, you are not to consider payments the Port has made pursuant to the 1998 Chevron Agreement.

The Court has already ruled that the Port may not recover the costs the Port has paid under that agreement.

JURY INSTRUCTION NO.: 11

You are instructed that there is no dispute that the property damage alleged by the Port arises out of the discharge, dispersal, release or escape of contaminants or pollutants. Certain policies subscribed to by the London Market Insurers contain a pollution exclusion which bars coverage for the Port's claims unless the Port proves by a preponderance of the evidence that the discharge, dispersal, release or escape of contaminants or pollutants into the groundwater was sudden and accidental. "Sudden and accidental" means "unexpected and unintended."

The Port of Longview has the burden of proving that it did not expect the discharge or release of contaminants into the groundwater.

You must determine whether the Port has met its burden of proving by a preponderance of the evidence that it did not expect or intend the discharge, dispersal, release or escape of contaminants or pollutants into the groundwater.

JURY INSTRUCTION NO.: 12

You are instructed that the London Market Insurers' policies include conditions prohibiting the Port from making payments on claims or potential claims without the consent of the London Market Insurers.

The Court has determined that the Port has breached these "voluntary payment" provisions and that the London Market Insurers have been prejudiced by the Port's breaches for any payments made pursuant to the 1998 Chevron Agreement.

FORSBERG & UMLAUF, P.S.
ATTORNEYS AT LAW
901 FIFTH AVENUE • SUITE 1400
SEATTLE, WASHINGTON 98164-1039
(206) 689-8500 • (206) 689-8501 FAX

JURY INSTRUCTION NO.: 15

You are instructed that the Court has ruled that when the Port of Longview purchased the TWP site, the Port fully expected and intended to be subject to all liability associated with the ownership of that property. The Port is not entitled to create, add to, or materially change the insurer's potential liability at any level, whether defense or indemnity, by taking on a new obligation that the Port was aware of.

September 11, 2012 Order.

FORSBERG & UMLAUF, P.S.
ATTORNEYS AT LAW
901 FIFTH AVENUE • SUITE 1400
SEATTLE, WASHINGTON 98164-1039
(206) 689-8500 • (206) 689-8501 FAX

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SUPERIOR COURT

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COWLITZ COUNTY
BEVERLY R. LITTLE, CLERK
BY

Honorable Stephen M. Warning

IN THE SUPERIOR COURT FOR THE STATE OF WASHINGTON
IN AND FOR COWLITZ COUNTY

THE PORT OF LONGVIEW, a Washington municipal corporation, Plaintiff, vs. LONDON MARKET INSURERS, et al., Defendants.	No. 10-2-01478-1 **SPECIAL VERDICT FORM**

A. Primary Policy MC 6027

1. The Port has brought a claim for coverage under insurance policy MC 6027 subscribed to by the Underwriters at Lloyd's, London. The existence of the policy, the name of the insured (Port), the name of the insurer (Underwriters at Lloyd's, London), the effective dates, and the policy limits have been proved. Indicate (circle yes/no) whether the Port has sustained its burden of proving by clear, cogent and convincing evidence the insuring language (which need not be verbatim) of policy MC 6027.

Policy Number	Policy Period	Did the Port Meet Its Burden?
MC 6027	07/01/84-07/01/85	Yes / No

If you answer "No" do not answer question #2 under Section A.

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2. If you found in Subsection 1 above that the Port has sustained its burden of proving the insuring language for MC 6027, indicate (yes/no) whether the London Market Insurers have sustained its burden of proving by clear, cogent and convincing evidence that policy MC 6027 excluded coverage for pollution under any circumstances.

Policy Number	Policy Period	Did LMI Meet Its Burden?
MC 6027	07/01/84-07/01/85	Yes / No

B. Unexpected and Unintended Occurrence

The Port must prove, by a preponderance of the evidence, that it neither expected nor intended the groundwater contamination resulting in levels exceeding state cleanup standards prior to the policy periods at issue. For each policy period, indicate (circle yes/no) whether the Port has sustained its burden of proof for each site that the Port did not subjectively expect or intend groundwater contamination above state cleanup levels prior to the policy period.

1. Primary Policies

No.	Policy Number	Policy Period	Did the Port of Longview prove the Port did not expect or intend groundwater contamination resulting in levels exceeding mandated cleanup levels at the TWP Site Prior to Policy	Did the Port of Longview prove the Port did not expect or intend groundwater contamination resulting in levels exceeding mandated cleanup levels at the TPH Site Prior to Policy
1	MC 5757	07/01/79-07/01/82	Yes / No	Yes / No
2	MC 5998	07/01/82-07/01/83	Yes / No	Yes / No
3	MC 6016	07/01/83-07/01/84	Yes / No	Yes / No
4	MC 6027	07/01/84-07/01/85	Yes / No	Yes / No

2. Umbrella/Excess Policies

No.	Policy Number	Policy Period	Did the Port of Longview prove the Port did not expect or intend groundwater contamination resulting in levels exceeding mandated cleanup levels at the TWP Site Prior to Policy	Did the Port of Longview prove the Port did not expect or intend groundwater contamination resulting in levels exceeding mandated cleanup levels at the TPH Site Prior to Policy
1	AN 5707	02/01/77-02/01/78	Yes / No	Yes / No
2	JSL 1021	12/31/77-12/31/78	Yes / No	Yes / No
3	JSL 1041	12/31/78-12/31/79	Yes / No	Yes / No
4	JSL 1055	06/03/79-12/31/79	Yes / No	Yes / No
5	830007500 (JSL 1065)	12/31/79-12/31/80	Yes / No	Yes / No
6	JSL 1087	12/31/80-12/31/83	Yes / No	Yes / No
7	820136600 (JSL 1136)	12/31/83-12/31/85	Yes / No	Yes / No

C. Pollution Exclusion in Certain Policies

Indicate, (circle yes/no) whether you find by a preponderance of the evidence, that the Port of Longview has met its burden of proving that the Port did not subjectively expect or intend the release of contamination to groundwater prior to the policy period.

No.	Policy Number	Policy Period	Did the Port of Longview prove the Port did not expect or intend release to groundwater at the TWP Site Prior to the Policy Period	Did the Port of Longview prove the Port did not expect or intend release to groundwater at the TPH Site Prior to the Policy Period
1	JSL 1021	12/31/77-12/31/78	Yes / No	Yes / No
2	JSL 1041	12/31/78-12/31/79	Yes / No	Yes / No
3	JSL 1055	06/03/79-12/31/79	Yes / No	Yes / No
4	830007500 (JSL 1065)	12/31/79-12/31/80	Yes / No	Yes / No
5	JSL 1087	12/31/80-12/31/83	Yes / No	Yes / No
6	820136600 (JSL 1136)	12/31/83-12/31/85	Yes / No	Yes / No

D. Late Notice Defense to Coverage at TPH Site

Indicate, (circle yes/no) whether you find by a preponderance of the evidence, that LMI have proven they have suffered actual and substantial prejudice resulting from the Port's late notice of its claims for coverage at the TPH site under the following policies.

MC 5757	07/01/79-07/01/82	Yes / No
MC 5998	07/01/82-07/01/83	Yes / No
MC 6016	07/01/83-07/01/84	Yes / No
MC 6027	07/01/84-07/01/85	Yes / No

DATED THIS 20 DAY OF NOVEMBER 2013

JURY FOREPERSON

DECLARATION OF SERVICE

On said day below I emailed a courtesy copy and deposited in the U.S. Mail for service a true and accurate copy of the Brief of Appellants in Court of Appeals Cause No. 46654-6-II to the following parties:

Carl E. Forsberg
Kenneth J. Cusack
Charles E. Albertson
Forsberg & Umlauf PS
901 5th Ave Ste 1400
Seattle, WA 98164-2047

Mark Nadler
Liberty Waters
John Dolese
The Nadler Law Group, PLLC
720 Third Avenue, Suite 1400
Seattle, WA 98104

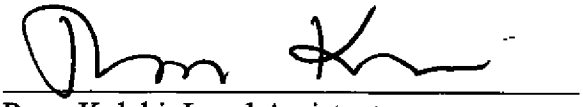
Frank Randolph
Walstead Mertsching PS
1700 Hudson Street, Floor 3
Longview, WA 98632-7934

Original E-filed with:

Court of Appeals, Division II
Attn: David Ponzoha
950 Broadway, Suite 300
Tacoma, WA 98402-4427

I declare under penalty of perjury under the laws of the State of Washington and the United States that the foregoing is true and correct.

DATED: March 27th, 2015, at Seattle, Washington.



Roya Kolahi, Legal Assistant
Talmadge/Fitzpatrick/Tribe

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March 27, 2015 - 1:29 PM

Transmittal Letter

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Petition for Review (PRV)

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Comments:

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cforsberg@forsberg-umlauf.com
kcusack@forsberg-umlauf.com
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mnadler@nadlerlawgroup.com
lwaters@nadlerlawgroup.com
jdolese@nadlerlawgroup.com

randolph@walstead.com