

1

Articles + Publications | July 2, 2024

California Supreme Court Confirms Vertical Exhaustion Rule Applies Before Depletion of All Primary Coverage

WRITTEN BY

Steven D. Allison | Zach Kobokovich | Michael Cassata | Samrah Mahmoud

On June 7, the California Supreme Court issued an important opinion clarifying the circumstances under which an insured may trigger coverage under an excess policy in relation to a loss spanning multiple policy periods. This opinion settles an important question left open by the California Supreme Court's decision in *Montrose Chemical Corp. of California v. Superior Court* (2020) 9 Cal. 5th 215 (*Montrose III*): whether an insured may trigger coverage under excess policies before all primary insurance coverage for the relevant policy periods has been exhausted under a rule of "vertical exhaustion."

In *Truck Ins. Exch. v. Kaiser Cement & Gypsum Corp.*, __ Cal. 5th __, No. S273179 (Cal. Jun. 17, 2024), the California Supreme Court reversed the California Court of Appeal's decision, which applied a "horizontal exhaustion" requirement for primary policies under the reasoning of *Community Redevelopment Agency v. Aetna Casualty & Surety Co.* (1996) 50 Cal.App.4th 329. Under the "horizontal exhaustion" theory, the insured must exhaust all primary coverage for a continuing loss before being permitted to access coverage under any excess policy issued during the relevant time period. Under the "vertical exhaustion" view, however, the insured need not exhaust all primary coverage and is permitted to trigger an excess policy immediately upon the exhaustion of the underlying primary insurance for the policy period.

Truck involved a contribution claim asserted by an insurer that issued a primary policy for the 1974 policy period. The insured, a manufacturer of products containing asbestos, allocated all bodily injury claims with initial exposure dates in or before 1974 to the Truck Ins. Exchange (Truck) policy, under California's continuous trigger and all-sums approach to long-tail claims. After all other available primary policies were exhausted, Truck sought contribution from the insured's excess insurers sitting above those exhausted primary policies. The trial court entered judgment for the excess insurers, reasoning that the "other insurance" provisions in the excess policies required horizontal exhaustion of all primary insurance coverage, including the 1974 Truck policy, before the excess policies were triggered. The California Court of Appeal affirmed.

After granting review, the California Supreme Court reversed. The court explained that adopting a default vertical exhaustion rule was a logical corollary to its 2020 decision in *Montrose III*. In that case, the court addressed the order in which an insured, after all primary insurance had been exhausted, could access excess policies implicated by long-tail exposures and held that the insured "may access its excess insurance whenever it has exhausted the other directly underlying excess insurance policies that were purchased for the same policy period."

As in *Montrose III*, the *Truck* court rejected the excess insurers' arguments that the "other insurance" clauses contained in their policies mandated a rule of horizontal exhaustion. Considering the plain language and intended

scope and function of those clauses, the court emphasized that "other insurance" clauses generally apply only to insurance issued for the same policy period, not all other policy periods that may be implicated.

The court further explained that the structure of the excess policies, such as the specifically identified underlying insurance and attachment points, served as further indicia that the excess policies were intended to respond upon the exhaustion of those specified limits. Beyond that, the court observed that a rule of horizontal exhaustion could prove functionally unworkable due to the differing structures of the insured's towers of insurance from year to year.

Accordingly, the court adopted the vertical exhaustion theory, approving of the California Court of Appeal's decision in *SantaFe Braun, Inc. v. Insurance Co. of North America* (2020) 52 Cal. App.5th 19 (which applied similar logic). Nevertheless, because the court of appeal did not consider how vertical exhaustion would work in the context of a contribution claim asserted by a primary carrier against excess carriers, the court remanded for the court of appeal to decide in the first instance whether contribution was appropriate and, if so, how the rule of vertical exhaustion would apply to contribution claims.

Truck provides a definitive answer to the question the court left open in *Montrose III* and adopts vertical exhaustion as the default rule in long-tail claims. Following *Truck*, insurers with any long-tail exposure should be aware that vertical exhaustion now applies immediately after the exhaustion of any primary policy. The insured need not exhaust all primary policies before it can access excess insurance in that year. However, if and how that rule applies in the context of contribution claims remains to be seen.

RELATED INDUSTRIES + PRACTICES

• Insurance + Reinsurance