

California Supreme Court Says Vertical Exhaustion Triggers Excess Coverage

04.23.20



(Article from *Insurance Law Alert*, April 2020)

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The Supreme Court of California ruled that based on applicable policy language, a policyholder was entitled to coverage under a higher level policy once it had exhausted directly underlying excess policies for the same policy period, and was not required to exhaust every lower level excess policy during the relevant time frame. *Montrose Chem. Corp. of Ca. v. Sup. Ct. of L.A. Cty.*, 2020 WL 1671560 (Cal. Apr. 6, 2020).

Montrose sought indemnity from its primary and excess general liability insurers for millions of dollars expended in environmental remediation. Although the language of the various policies at issue differed in some respects, each provided that Montrose must exhaust the limits of its underlying insurance before accessing coverage under excess policies. Additionally, the excess policies provided that “other insurance” must be exhausted before excess coverage can be accessed. The parties disputed whether the “other insurance” clauses required Montrose to exhaust lower level insurance coverage from other policy periods before seeking excess coverage for any given policy period.

The California Supreme Court endorsed a “vertical exhaustion” approach under which Montrose may access any excess policy once it has exhausted other policies with lower attachment points in the same policy period. The court noted that none of the “other insurance” clauses explicitly address whether Montrose is required to exhaust insurance with lower attachment points in different policy periods. For example, the court explained that language requiring exhaustion of “all underlying insurance” could “fairly be read to refer only to other *directly* underlying insurance in the same policy period that was not specifically identified in the schedule of underlying insurance” (emphasis in original). As such, the court declined to interpret the “other insurance” clauses as “a clear and explicit direction to adopt a requirement of horizontal exhaustion in cases of long-tail injury.” Highlighting the importance of policy language, the court emphasized that “[p]arties to insurance contracts are, of course, free to write the policies differently to establish alternative exhaustion requirements or coverage allocation rules if they so wish.”

Addressing potential contribution claims among insurers, the court ruled that an insurer that is called upon to indemnify Montrose’s loss may seek reimbursement from other insurers that issued policies at other points during the relevant time frame. Finally, the court remanded a choice of law issue for a determination by the lower court as to whether certain policies should be construed under Connecticut or New York law, rather than California law.

Authors and Contacts

[Bryce Friedman](#)

Partner

bfriedman@stblaw.com

+1-212-455-2235

