

California Not Tired of Montrose Yet: Supreme Court Adopts Vertical Exhaustion for Progressive Loss Excess Coverage

In a victory for policyholders, the California Supreme Court recently held that an insured faced with a progressive loss only needs to exhaust all directly underlying policies to access excess layers within that policy period. In Montrose Chemical Corp. v. Superior Court of Los Angeles County,¹ the court concluded that in a case (1) involving progressive loss spanning multiple policy periods, (2) where all primary insurance has been exhausted, and (3) where the policy language permits it, vertical exhaustion applies, allowing the insured to “access any excess policy for indemnification during a triggered policy period once the directly underlying excess insurance has been exhausted.”

Readers should note, in particular, two limitations with this decision. First, the opinion is limited to excess policies covering continuous and progressive loss. The court declined to decide “when or whether an insured may access excess policies before all primary insurance covering all relevant policy periods has been exhausted.” Second, this opinion does not address additional insured issues. Vertical vs. horizontal exhaustion, in the additional insured context, is an entirely distinct issue from vertical vs. horizontal exhaustion in the progressive loss context.

This opinion comes nearly 40 years after Montrose Chemical Corp. was initially filed and after multiple other significant contributions to California insurance coverage law. Montrose argued that it is entitled to coverage under any relevant policy once it has exhausted directly underlying excess policies for the same policy period. The insurers argued that Montrose may only call on an excess policy only after it has exhausted every lower level excess policy covering the relevant years.

The court analyzed two key factors before concluding that Montrose need only exhaust the directly underlying excess policy before accessing the next layer of excess coverage within a single policy period. First, the court noted that the policy’s “other insurance” provision was ambiguous, because it could refer to a variety of underlying or excess insurance. Many of the insurers had cited their “other insurance” provisions as a basis for their policies to be excess to other excess policies in other policy periods with lower attachment points. However, the court determined that the language did not clearly dictate that any of the excess policies were excess to any policies at issue other than the excess policies immediately below them within the same policy period.

Second, practical considerations, such as terms, conditions, and exclusions varying between policies, weigh in favor of vertical exhaustion. Specifically, the court noted that these differences

¹No. S244737, 2020 WL 1671560 (Cal. Apr. 6, 2020).

would make it a litigation nightmare to determine when coverage is triggered if horizontal exhaustion was used. According to the court, horizontal exhaustion would cause the insured to sustain considerable expenses establishing their right to coverage under the definitions, terms, conditions, and exclusions from policies in every policy period triggered by the continuous injury. Such a rule undermines “the policyholder’s reasonable expectation that coverage would be triggered upon the exhaustion of the amount listed as the policy’s stated attachment point.”

Although this opinion does not apply to the relationship between primary and excess policies, the reasoning used by the court could be applied as support for that issue given the right policy language and factual circumstances. While this opinion will clearly have far-reaching effects on past and current policies covering progressive losses, it may also change future policy language because, as the court explained: “Parties to insurance contracts are, of course, free to write their policies differently to establish alternative exhaustion requirements or coverage allocation rules if they so wish.” In the same way insurers modified policy language in response to earlier Montrose Chemical Corp. decisions, the insurance industry may modify policy language in an attempt to avoid vertical exhaustion following this most recent holding.

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