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California Supreme Court Adopts Vertical Exhaustion

By Andrew B. Downs

Yes, there are insurance law developments that do not involve the COVID-19 pandemic. On Monday, April 6, in the latest chapter of a 30 plus year saga, the California Supreme Court issued yet another (and a much anticipated) opinion in Montrose Chemical Corp. v. Superior Court. In this latest opinion, the Supreme Court adopted the vertical exhaustion rule for determining when excess liability insurance policies are triggered, rejecting the insurance industry's effort to make horizontal exhaustion the rule.

Montrose manufactured the long-banned pesticide DDT at a facility in Torrance, California from 1947 to 1982. The federal government and the State of California later sued Montrose for the environmental contamination caused by the operation of the facility. Montrose, in turn, has been embroiled in coverage litigation for decades with the primary and excess liability insurers who insured it between 1961 and 1985. The exhaustion issue, however, dates from only 2015 when Montrose sought declaratory relief in an amended complaint.

Under vertical exhaustion, when the policyholder makes a "targeted tender," i.e. a tender to less than all applicable policies or policy years, the policyholder is only required to prove the primary and/or underlying policies in a single policy year have been exhausted in order for it to reach the excess policies for the same policy year. Those excess insurers may then seek contribution from the insurers who issued policies in other relevant years. In contrast, under horizontal exhaustion, the policyholder must first exhaust all primary policies in all triggered years, before being entitled to coverage from the excess insurers.

The California Supreme Court adopted vertical exhaustion. It explained:

> Reading the relevant policy language in light of background principles of insurance law and considering the parties' reasonable expectations, we conclude that a rule of vertical exhaustion is appropriate. Under that rule, the insured has access to any excess policy once it has exhausted other directly underlying excess policies with lower attachment points, but an insurer called upon to indemnify the insured's loss may seek reimbursement from other insurers that issued policies covering relevant policy periods.

The court concluded the applicable policy language did not "clearly or explicitly" state "that Montrose must exhaust insurance with lower attachment points *purchased for different policy periods.*" (italics in original).

For policyholder attorneys, the *Montrose* case has been the gift that keeps on giving, for decade upon decade. We may assume that it will eventually be over, but not today. Indeed, the Justice who wrote this opinion for the California Supreme Court was a teenager when the Supreme Court issued its first *Montrose* opinion.