

Lawyer Insights

Calif. Supreme Court continues vertical exhaustion trend

The Court expressly noted that excess insurers are free to write policies in a way that requires horizontal exhaustion

By Scott DeVries, Yosef Itkin and Syed Ahmad
Published in PropertyCasualty360 | July 29, 2024



California law has become more favorable toward companies facing liabilities based on alleged events spanning multiple years.

In a series of cases spanning over the last 30 years, the California Supreme Court adopted an all sums with stacking approach to coverage for continuous injuries. Under this approach, where an ongoing loss continued

through multiple policy periods:

1. The insured could call on any primary policy during this period;
2. That policy would be liable for all sums up to its policy limits; and
3. The insured could have access to or "stack" the limits in all the policy periods.

Left to be decided was whether a first-level excess policy could be accessed before all other underlying collectible insurance was exhausted.

On June 17, 2024, the California Supreme Court answered this question, ruling in *Truck Ins. Exch. v. Kaiser Cement and Gypsum Corp.*, or "Kaiser," that it was not necessary to exhaust all underlying insurance. This decision reverses earlier California intermediate appellate decisions holding otherwise.

Vertical vs. horizontal exhaustion

Kaiser involved the interpretation of primary and excess insurance policies in the context of long-term asbestos injury claims. Kaiser Cement and Gypsum Corporation manufactured asbestos-containing products from 1944 through the 1970s. By 2004, Kaiser faced more than 24,000 product-liability lawsuits alleging that its products caused injuries. Multiple insurers provided primary-level coverage to Kaiser from 1947 to 1987, including Truck Insurance Exchange, which covered the insured from 1964 to 1983.

The primary policies contained aggregate limits, except for the 1974-1975 policy issued by Truck Insurance Exchange, which had a \$500,000 per occurrence limit.

Kaiser also purchased first-level excess policies from multiple insurers for various policy years.

Truck filed suit in 2001 to determine its coverage obligations to Kaiser. By the time the trial court ruled, Truck's 1974-1975 policy was the only *primary* policy available to respond to the asbestos-related claims.

This article presents the views of the authors, which do not necessarily reflect those of Hunton Andrews Kurth LLP or its clients. The information presented is for general information and education purposes. No legal advice is intended to be conveyed; readers should consult with legal counsel with respect to any legal advice they require related to the subject matter of the article. Receipt of this article does not constitute an attorney-client relationship. Prior results do not guarantee a similar outcome. Attorney advertising.

Calif. Supreme Court continues vertical exhaustion trend

By Scott DeVries, Yosef Itkin and Syed Ahmad
Published in PropertyCasualty360 | July 29, 2024

The central legal issue was whether Kaiser could access its excess insurance after exhausting the primary Truck insurance limits for a particular policy period (vertical exhaustion), or whether the company had to exhaust all primary insurance across all periods before accessing the excess coverage (horizontal exhaustion). Truck argued for vertical exhaustion so that it could obtain contribution from excess policies sitting over other exhausted primary policies

The court's rationale

The California Supreme Court, in a unanimous decision, reversed the lower appellate court's ruling and adopted the vertical exhaustion method. The court's reasoning was grounded in the language and structure of standard insurance policy provisions.

Back in 2020, the California Supreme Court weighed in on the exhaustion issue in *Montrose Chemical Corporation v. Superior Court*. This case addressed the issue in the context of lower-level excess policies needing to be exhausted before accessing higher-level excess policies.

The *Montrose* court examined the "other insurance" provisions in the policies at issue, concluding that while those provisions "do not clearly specify whether a rule of horizontal or vertical exhaustion applies here," they support allowing the policyholder to access higher level excess policies where the lower level excess policies for the same policy period had been exhausted.

Four years later, the California Supreme Court faced a similar issue concerning exhaustion in *Kaiser*. The difference in *Kaiser* is that it involves the exhaustion of primary policies before an excess policy could be triggered. The Court found this difference immaterial because of similarities in the policies in *Kaiser* and *Montrose*:

"[W]e agree with Truck that the policy language at issue here cannot be meaningfully distinguished from the policies that we addressed in Montrose. We also agree that the qualitative distinctions between primary and excess insurance do not justify assigning an entirely different meaning to standardized "other insurance" clauses merely because the excess policy sits over primary insurance rather than another level of excess insurance."

Not only did the policy provisions virtually mirror each other, the Court recognized that "none of the provisions explicitly reference 'other insurance' purchased for different policy periods."

The Court also found that requiring horizontal exhaustion could impose undue burdens on policyholders in continuous injury claims. Specifically, requiring policyholders to exhaust every primary policy issued over multiple policy periods before being able to access any excess policy for any policy period could lead to significant delays and increased litigation costs, which the court deemed unreasonable.

The Court ultimately held that vertical exhaustion applied to a continuing loss, meaning the excess policy for a policy period could be accessed as soon as the underlying primary policy for that same period was exhausted. There would be no need to wait for other years' primary policies to be exhausted.

Its holding is supported by the language of the excess policies, along with the insured's reasonable expectations and the history of "other insurance" provisions. In a word of caution, the court noted that "[e]xcess insurers do, however, remain free to write their future excess policies in a manner that expressly requires horizontal exhaustion."

Calif. Supreme Court continues vertical exhaustion trend

By Scott DeVries, Yosef Itkin and Syed Ahmad
Published in PropertyCasualty360 | July 29, 2024

Practical takeaways

Prior decisions requiring horizontal exhaustion were challenging for policyholders. In addition to creating issues where decades-old policies were insolvent, the need to exhaust every primary policy for every policy period — each with their own coverage issues — potentially created protracted litigation, delaying benefits owed to policyholders. The Court's adoption of vertical exhaustion mitigates these concerns.

The Court expressly noted that excess insurers are free to write policies in a way that requires horizontal exhaustion. Policyholders should pay close attention to how future policies are worded so they can adjust their expectations accordingly.

When negotiating new insurance contracts, policyholders should consider obtaining assistance from insurance coverage counsel to seek inclusion of terms that accommodate vertical exhaustion.

***Scott DeVries** is a special counsel in the firm's Insurance Coverage group in the firm's San Francisco office. Scott advises and represents business clients with high value insurance claims, and has recovered more than \$500 million from insurers. He can be reached at +1 (415) 975-3720 or sdevries@HuntonAK.com.*

***Yosef Itkin** is an associate in the firm's Insurance Coverage group in the firm's Los Angeles office. Yosef's practice focuses on representing and advising corporate policyholders in complex insurance coverage matters. He can be reached at +1 (213) 532-2117 or yitkin@HuntonAK.com.*

***Syed Ahmad** is the head of the firm's insurance coverage practice and a partner in the firm's Washington, D.C. office where he represents clients in connection with insurance coverage, reinsurance matters and other business litigation. He can be reached at +1 (202) 955-1656 or sahmad@HuntonAK.com.*

Reprinted with permission from the July 29, 2024 issue of PropertyCasualty360. © 2024 ALM Media Properties, LLC. Further duplication without permission is prohibited. All rights reserved.