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Calif. Ruling Creates Uncertainty For Long-Tail Claims

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Recently, the Second District of the California Court of Appeal sought to limit the allocation rules, set by the California Supreme Court, that favor policyholders facing long-tail liabilities. In light of this seemingly divergent authority, policyholders facing horizontal exhaustion arguments by their insurers face possible forum issues in deciding where to sue, with a possible premium placed on initiating litigation outside the Second District.

In *Montrose Chemical Corporation v. Superior Court*, No. B272387 (Cal. App. 2nd Dist. Aug. 31, 2017), the California Court of Appeal adopted a "horizontal exhaustion" method for allocating responsibility among excess and primary injurers for "long-tail" claims that may spread across multiple insurance policy periods. The decision initially appears to be inconsistent with much of the California Supreme Court's reasoning in *State v. Continental Insurance Co*., 55 Cal. 4th 186 (Cal. 2012), which held that, when a long-tail loss stretches across multiple policy periods, the policyholder may "stack" the coverage limits of all triggered policies "to form one giant 'uber-policy'" — also known as the "all sums" approach. Nonetheless, the *Montrose* court emphasized that it was instead considering the method in which the losses would be allocated between excess and underlying insurers in these contexts. The court described the issue as "not whether an insured can access policies written for different policy years (it can), but the order or sequence in which it may or must do so." Because the decision seems at odds with other California decisions, including *Certain Underwriters at Lloyds, London v. Arch Specialty Insurance Co*., 200 Cal. Rptr. 3d 786, 796 (App. Ct. 3d Dist. 2016) and *Associated International Insurance v. St. Paul Fire & Marine Insurance*, 269 Cal. Rptr. 485 (App. Ct. 6th Dist. 1990), we may soon see the issue taken up by the California Supreme Court for the final word.

Montrose argued that it should be permitted to apply a "vertical exhaustion" method used by other courts, which would allow *Montrose* to access an excess policy as soon as the underlying policies within that excess policy's coverage period were exhausted. The insurers argued that the underlying policies must first be horizontally exhausted for each and all years on the long-tail loss before higher-level excess policies may be accessed.

The court adopted a horizontal exhaustion rule closer to the insurer's position. It pointed to the "other insurance" clauses in the policies, which state that the excess policies are excess over "other collectible insurance." Relying on these clauses, the court concluded that "many of the policies attach not upon exhaustion of lower layer policies within the same policy period, but rather upon exhaustion of all available insurance." Although the court refused to adopt a categorical rule requiring horizontal exhaustion in all cases, it held that the presence of "other insurance" and similar policy provisions will

require the policyholder to first exhaust the underlying policies for each and every policy period before accessing the higher-level excess policies.

Montrose may be taken up by the California Supreme Court, given that it appears to be inconsistent with a growing number of decisions from other jurisdictions, as well as several other courts of appeal in California. For example, in *Associated International Insurance v. St. Paul Fire & Marine Insurance,* 269 Cal. Rptr. 485 (App. Ct. 6th Dist. 1990), the Sixth District Court of Appeal held that "other insurance" provisions are intended to refer only to other collectible insurance within the concurrent policy period. Similarly, in *Certain Underwriters at Lloyds, London v. Arch Specialty Insurance Co.*, 200 Cal. Rptr. 3d 786, 795-96 (App. Ct. 3d Dist. 2016), the Third District Court of Appeal held that "other insurance" provisions cannot be used as an "escape clause" which "attempts to have coverage, paid for with the insured's premiums, evaporate in the presence of other insurance."). *Accord Underwriters of Interest Subscribing to Policy No. A15274001 v. ProBuilders Specialty Insurance Co.*, 193 Cal. Rptr. 3d 898, 907 (App. Ct. 4th Dist. 2015). *Montrose* also undercuts the California Supreme Court's stated importance of "acknowledg[ing] the uniquely progressive nature of long-tail injuries," as well as the court's emphasis on ensuring "that the insured has immediate access to the insurance it purchased" and that its conclusion "does not put the insured in the position of receiving less coverage than it bought." *State v. Cont'l Insurance Co.*, 55 Cal. 4th at 201. Under *Montrose*'s "horizontal exhaustion" approach, insureds risk effectively losing access to the excess insurance they purchased if a claim involves long-tail injuries that stretch across policy periods — even though the high costs of such progressive, long-tail injuries are precisely why policyholders purchase excess insurance.

Montrose is likewise at odds with the Proposed Final Draft of the Restatement of Law, Liability Insurance, which states the majority rule that "other insurance" clauses are meant to address situations "in which multiple insurance policies issued during the same policy period cover the same insured concurrently for a given loss," and not multiple policies issued across successive policy periods. See § 42 cmt. i. The restatement, which was adopted (though subject to final revisions) in May 2017, also notes that horizontal exhaustion is generally inconsistent with the all-sums allocation approach. See § 42 cmt. h., which is the allocation approach used in California courts.

The *Montrose* court's refusal to adopt a categorical rule requiring horizontal exhaustion demonstrates that the issue is not settled, and policyholders still have arguments against horizontal exhaustion depending on the language of their policies. The decision is of most significance to policyholders whose policies may be governed by California law. Especially for those policyholders, it should also serve as a reminder for them to exercise care in purchasing policies and eliminate "other insurance" clauses and other provisions that could allow insurers to make arguments for horizontal exhaustion.

Finally, policyholders should consider this ruling when negotiating settlements in complex, long-tail coverage disputes involving multiple insurers. In particular, excess insurers may try to rely on *Montrose* to avoid coverage if policyholders settle with some of their primary carriers for less than the full limits. Policyholders do have counterarguments. For example, policyholders should argue that California case law is unsettled, and, if applicable, should point to the presence of "prior insurance," "non-cumulation," or other policy provisions that may justify a vertical exhaustion approach, as the Second Circuit recognized in *Olin Corp. v. OneBeacon Am. Insurance Co.*, 864 F.3d 130, 144 (2d Cir. 2017). Policyholders should anticipate *Montrose*-like arguments when developing strategies to maximize their insurance recoveries for losses spanning multiple policy years.

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