

ALERT

# California Appellate Court Declines to Follow *Qualcomm* and Holds that Excess Insurer Waived Exhaustion Argument

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The California Court of Appeal has held that an excess insurer's coverage obligation was triggered even though the underlying insurers had settled for less than their policy limits. *Stonewell Ins. Co. v. Superior Court*, 2010 WL 4277559 (Cal. Ct. App. Nov. 1, 2010).

The insured installed and removed building materials containing asbestos for more than four decades. In the late-1980s, the insured began to face thousands of asbestos-related personal injury claims for which the insured sought coverage from its primary general liability insurers. As the number of claims continued to grow in the 1990s, the insured notified its excess general liability insurers of the possibility that the primary policy limits would be exhausted and the excess policies would be triggered. After one of the excess insurers responded that it did not have sufficient information to determine whether its policy covered the asserted losses and identified several potential bases on which it might deny coverage, the insured initiated coverage litigation.

The insured subsequently filed for bankruptcy protection and presented a "prepackaged" bankruptcy plan that it had negotiated with attorneys representing the asbestos claimants. While the excess insurers, including the one at issue in this case, were invited to participate in the negotiations with claimants' counsel, they chose not to and, instead, moved to intervene in the bankruptcy proceeding in order to file objections to the plan. The bankruptcy court denied the excess insurers' motion to intervene, finding that the excess insurers lacked standing because the plan provided that the excess insurers' claims and defenses would be adjudicated in the ongoing coverage

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litigation.

After the plan was confirmed and a settlement trust established, several of the primary insurers settled the insured's claims for coverage by agreeing to contribute some portion of their policy limits to the trust. As part of a bifurcated proceeding, the trial court found that horizontal exhaustion - as opposed to vertical exhaustion - was required to trigger excess coverage. The trial court further concluded that the policies issued by the insurers that had settled were deemed exhausted as a matter of law.

On appeal, the court determined that its decision in *Phoenix Ins. Co. v. U.S. Fire Ins. Co.*, 189 Cal. App. 3d 1511 (1987), controlled the outcome here. As recounted by the court, that case involved a situation in which a special referee had allocated liability for a settlement among various primary and excess insurers in the course of a coverage action initiated by one of the excess insurers. The excess insurer agreed to dismiss the primary insurers in exchange for their payment of their allocated portion of the settlement. A second excess insurer then took the position that it had no liability because the underlying primary insurance had not been fully exhausted. The court rejected this contention, concluding that the underlying insurance "in effect" had been exhausted once the primary insurers were dismissed from the case and the excess insurer failed to bring them back in by cross-complaint.

According to the court here, *Phoenix* "stands for the proposition that when an insurer settles a case for less than its policy limits, and a non-settling insurer fails to assert an objection by way of a cross-claim, the settling insurer's policy limits may be deemed exhausted as a matter of law." In this regard, the court noted that when the bankruptcy court denied the excess insurers' motion to intervene, the excess insurer should have filed cross-claims in the coverage action against the primary insurers. In the court's view, doing so would have put the settling parties on notice of the excess insurer's intentions and allowed them to approach the settlement with that in mind. The court concluded that by failing to raise the exhaustion issue then, the excess insurer waived its right to make the argument.

In reaching this conclusion, the court found its decision in *Qualcomm v. Certain Underwriters at Lloyd's London*, 161 Cal. App. 4th 184 (2008), to be distinguishable on several grounds, including that the excess insurer in that case had participated in a mediation with the primary insurer concerning coverage and that *Qualcomm* involved only vertical exhaustion. As to the latter point, the court noted "*Qualcomm's* narrow rule" was "difficult" to apply in a case such as this involving horizontal exhaustion and numerous primary and excess policies. The court also suggested that to apply *Qualcomm* in this situation would "undermin[e] California's policy in favor early resolutions via settlement."