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State By State Survey: Horizontal and Vertical Exhaustion in the Additional Insured Context



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Horizontal and Vertical Exhaustion in the Additional Insured Context

Construction project owners and general contractors (“upstream parties”) usually require that their subcontractors (“downstream parties”) procure certain minimum limits of Commercial General Liability insurance on a primary/non-contributory basis that names the upstream parties as additional insureds. Parties may assume that the contract language dictates the priority of insurance coverage available to them – i.e. that the downstream parties’ primary and excess policies will react first when the upstream party seeks coverage as an additional insured for damages arising out of the downstream party’s work. However, disputes arise when a downstream party’s primary CGL policy is insufficient to cover the loss. Although the parties may assume that the downstream party’s excess policy responds before the upstream parties’ primary policies, some courts have held otherwise.

Courts have recognized two legal theories on assigning priority of insurance coverage: “vertical” and “horizontal” exhaustion. Vertical exhaustion is the theory that primary and excess policies purchased by the downstream parties must pay before any policies purchased by the upstream parties. Typically, vertical exhaustion reflects the intent of the parties seeking to transfer risk to the downstream party. By contrast, horizontal exhaustion is the theory that the downstream party’s excess policy is not triggered unless all applicable primary policies have been exhausted, including the upstream parties’ own primary CGL insurance.










Illustrative Example













General Contractor enters into a subcontract with Subcontractor. Subcontractor is required to procure \$2 million of primary CGL coverage and \$5 million dollars of excess coverage on a primary and non-contributory basis, naming General Contractor as an additional insured. General Contractor also has its own insurance consisting of \$2 million dollars of primary CGL coverage and \$5 million dollars of excess coverage.












An injury occurs on the construction project arising out of Subcontractor’s work. Judgment is entered against Contractor and Subcontractor in the amount of \$8 million dollars. The order of payment amongst Subcontractor’s and General Contractor’s insurance policies depends on whether vertical or horizontal exhaustion is applied:










Vertical Exhaustion	Horizontal Exhaustion
Subcontractor's \$2 million in primary coverage.	Subcontractor's \$2 million in primary coverage.
Subcontractor's \$5 million in excess coverage.	General Contractor's \$2 million in primary coverage.
General Contractor's primary coverage pays \$1 million.	General Contractor and Subcontractor excess carriers pay \$2 million each.











The following survey identifies which jurisdictions have recognized either vertical or horizontal exhaustion to determine the priority of insurance coverage for losses implicating multiple policies within the additional insured context. It should be noted that few states have dealt with this issue, and that all states lack high court authority on the matter.

State	Applicable Rule	Relevant Authority
 Alabama	No authority	N/A
 Alaska	No authority	N/A
 Arizona	No authority	N/A
 Arkansas	Vertical	The Eighth Circuit, following and predicting Arkansas law, held that an indemnity agreement controls which policies are exhausted first, not the policy's "other insurance" clause. As such, an insured's primary and excess policies had to be exhausted before an additional insured's policies could be triggered in a manufacturer/retailer dispute. <i>Wal-Mart Stores, Inc. v. RLI Ins. Co.</i> , 292 F.3d 583 (8th Cir. 2002).
 CA	Horizontal	<p>California courts were among the first in the country to recognize the concept of horizontal exhaustion in the context of additional insured disputes, and courts have repeatedly reiterated their adherence to the principle. See <i>Cmty. Redev. Agency v. Aetna Cas. & Surety Co.</i>, 57 Cal. Rptr. 2d 755 (Cal. Ct. App. 1996); <i>JPI Westcoast Constr. v. RJS & Assoc.</i>, 68 Cal. Rptr. 3d 91 (Cal. Ct. App. 2007); <i>Padilla Constr. Co. v. Transp. Ins. Co.</i>, 58 Cal. Rptr. 3d 807 (Cal. Ct. App. 2007); <i>Reliance Nat'l Indem. Co. v. Gen. Star Indem. Co.</i>, 85 Cal. Rptr. 2d 627 (Cal. Ct. App. 1999); <i>HDI-Gerling Am. Ins. Co. v. Homestead Ins. Co.</i>, 2008 WL 2740338 (N.D. Cal. July 11, 2008).</p> <p>The courts recognize, however, that horizontal exhaustion can be avoided where the insured's liability has been established, in order to avoid circuitous litigation. See <i>Hartford Cas. Ins. Co. v. Mt. Hawley Ins. Co.</i>, 20 Cal. Rptr. 3d 128 (Cal. Ct. App. 2004). Moreover, the presumption in favor of applying the principle of horizontal exhaustion can also be overcome through the incorporation of specific policy language. See <i>Travelers Cas. & Surety Co. v. Transcontinental Ins. Co.</i>, 19 Cal. Rptr. 3d 272 (Cal. Ct. App. 2004).</p>
 Colorado	No authority	N/A
 Connecticut	No authority	N/A
 Delaware	No authority	N/A
 District of Columbia	No authority	N/A

State	Applicable Rule	Relevant Authority
 Florida	N/A	Applying Florida law, the Eleventh Circuit held that pursuant to an insurance policy's "Other Insurance" clause, an additional insured's own primary liability policy provided coverage before the excess policy on which it was an additional insured. See <i>United Educators Ins. v. Everest Indem. Ins. Co.</i> , 372 Fed. App'x. 928 (11th Cir. 2010).
 Georgia	No authority	N/A
 Hawaii	No authority	N/A
 Idaho	No authority	N/A
 Illinois	Horizontal	An Illinois appellate level court held that an insured must first exhaust all available primary insurance coverage, including uninsured periods and self-insured periods, before an excess policy can be invoked. See <i>Kajima Constr. Servs., Inc. v. Tokio Marine & Fire Ins. Co.</i> , 368 Ill.App.3d 665 (Ill. App. Ct. 2006).
 Indiana	No authority	N/A
 Iowa	No authority	N/A
 Kansas	No authority	N/A
 Kentucky	Vertical	A Kentucky federal court held that the plain language of the policies and the indemnity agreement required the exhaustion of the insured's primary and excess policies before the additional insured's policies could be triggered in a wrongful death action. <i>Chandler v. Liberty Mut. Ins. Group</i> , 2005 WL 5629027 (E.D. Ky. Nov. 3, 2005), aff'd 212 Fed. Appx. 553 (6th Cir. 2007).
 Louisiana	No authority	N/A
 Maine	No authority	N/A
 Maryland	No authority	N/A

State	Applicable Rule	Relevant Authority
 Massachusetts	No authority	N/A
 Michigan	No authority	N/A
 Minnesota	No authority	N/A
 Mississippi	No authority	N/A
 Missouri	Vertical	The Missouri Court of Appeals held that, pursuant to an indemnity agreement, an insured's primary and excess policies had to be exhausted before the additional insured's own policies could be triggered in the context of a construction project. <i>Fed. Ins. Co. v. Gulf Ins. Co.</i> , 162 S.W.3d 160 (Mo. Ct. App. 2005).
 Montana	No authority	N/A
 Nebraska	No authority	N/A
 Nevada	No authority	N/A
 New Hampshire	No authority	N/A
 New Jersey	Horizontal	A New Jersey appellate level court held that an Additional Insured endorsement that provided excess coverage over any other insurance should be construed in accordance with its plain language to provide only excess coverage to an Additional Insured that had primary coverage under its own policy in a construction project. <i>Jeffrey M. Brown Assocs, Inc. v. Interstate Fire & Cas. Co.</i> , 997 A.2d 1072 (N.J. Super. Ct. App. Div. 2010).
 New Mexico	No authority	N/A

State	Applicable Rule	Relevant Authority
 New York	Horizontal	<p>New York courts consistently apply the concept of horizontal exhaustion to additional insured disputes. In the seminal case of <i>Bovis Lend Lease LMB, Inc. v. Great Am. Ins. Co.</i>, 53 A.D.3d 140 (N.Y. App. Div. 1st Dep't. 2008), the court held that excess coverage should be treated as true excess coverage and not as a second layer of primary coverage unless policy terms dictate a different result, and that priority of coverage is determined by policy terms, not trade contracts. <i>See also: Tishman Constr. Corp. of New York v. Great Am. Ins. Co.</i>, 53 A.D.3d 416 (N.Y. App. Div. 1st Dep't. 2008); <i>Cheektowaga Cent. School Dist. v Burlington Ins. Co.</i>, 32 A.D.3d 1265 (N.Y. App. Div. 4th Dep't. 2006).</p> <p>It should be noted, however, that the Second Circuit Court of Appeals recently departed from <i>Bovis</i>. In <i>Century Surety Co. v. Metropolitan Transit Authority</i>, 2021 WL 4538633 (2d Cir., 2021), the Court of Appeals predicted that New York's highest court would find the reasoning in <i>Bovis</i> unpersuasive. Instead, the Court held that under New York law, an indemnity agreement in the underlying trade contract governs the priority of coverage, not the terms of an insurance policy, and applied vertical exhaustion.</p>
 North Carolina	No authority	N/A
 North Dakota	No authority	N/A
 Ohio	No authority	N/A
 Oklahoma	No authority	N/A
 Oregon	No authority	N/A
 Pennsylvania	No authority	N/A
 Rhode Island	No authority	N/A
 South Carolina	No authority	N/A

State	Applicable Rule	Relevant Authority
 South Dakota	No authority	N/A
 Tennessee	No authority	N/A
 TX	Vertical	The Fifth Circuit, following and predicting Texas law, held that an indemnity agreement between insureds or a contract with an indemnification clause may shift an entire loss to a particular insurer, notwithstanding the existence of an “other insurance” clause in its policy. As such, the additional insured was not liable for the full amount in settling an underlying personal injury action per the terms of its indemnity agreement. <i>Am. Indem. Lloyds v Travelers Prop. & Cas. Ins. Co.</i> , 335 F.3d 429 (5th Cir 2003).
 Utah	No authority	N/A
 Vermont	No authority	N/A
 Virginia	Vertical	The Fourth Circuit, following and predicting Virginia law, held that an indemnity agreement between an insured and an additional insured controlled the insurer’s liability for payment of a settlement in a tort action. As such, the insured’s policies served as the first line of coverage before the additional insured’s own policies could be triggered. <i>St. Paul Fire & Marine Ins. Co. v. Am. Int’l Specialty Lines Ins. Co.</i> , 365 F.3d 263 (4th Cir. 2004).
 Washington	No authority	N/A
 West Virginia	No authority	N/A
 Wisconsin	No authority	N/A
 Wyoming	No authority	N/A