

Horizontal and Vertical Exhaustion in the Additional Insured Context

Monday, March 10, 2025

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.

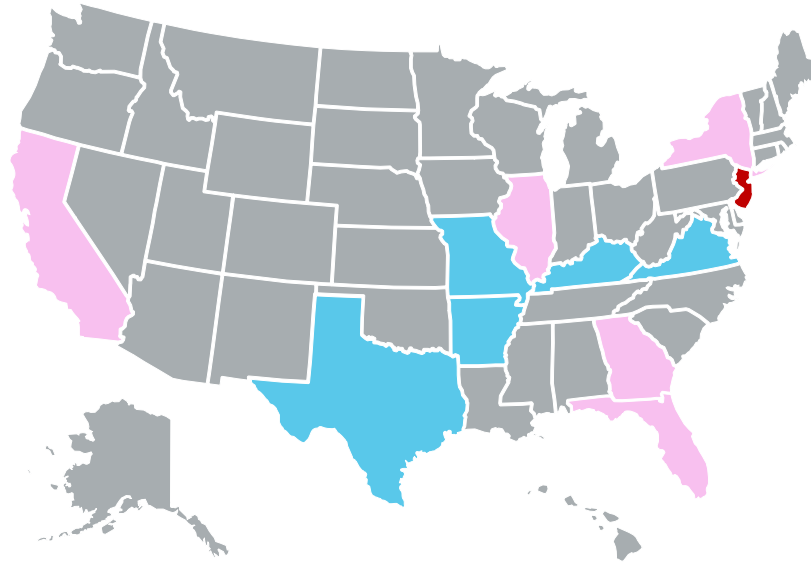
An injury occurs on the construction project arising out of Subcontractor’s work. Judgment is entered against Contractor and Subcontractor in the amount of \$8 million dollars. The order of payment amongst Subcontractor’s and General Contractor’s insurance policies depends on whether vertical or horizontal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

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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.

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Applicable Exhaustion Rule for Additional Insured Disputes

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|  | Highest Court applies vertical exhaustion when analyzing additional insured coverage |
|  | Lower Court or Federal Court applies vertical exhaustion when analyzing additional insured coverage |
|  | Highest Court applies horizontal exhaustion when analyzing additional insured coverage |
|  | Lower Court or federal court applies horizontal exhaustion when analyzing additional insured coverage |

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Horizontal and Vertical Exhaustion in the Additional Insured Context

STATE	APPLICABLE RULE	RELEVANT AUTHORITY
 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).
 California	Horizontal	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>Cnty. 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>, No. C 08-1716, 2008 WL 2740338 (N.D. Cal. July 11, 2008). The courts recognize, however, that horizontal exhaustion can be avoided where the insured's liability has been established, 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. Transcon. Ins. Co.</i>, 19 Cal. Rptr. 3d 272 (Cal. Ct. App. 2004).
 Florida	Horizontal	A federal district court in Florida has recognized the concept of horizontal exhaustion in the context of additional insured coverage disputes. See <i>Twin City Fire Ins. Co. v. Fireman's Fund Ins. Co.</i> , 386 F. Supp. 2d 1272 (S.D. Fla. 2005) (requiring the additional insured's primary limits to exhaust prior to reaching either of the excess policies as part of settlement). Additionally, applying Florida law, the Eleventh Circuit held that pursuant to a particular 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 F. App'x. 928 (11th Cir. 2010) (not selected for publication in West's Federal Reporter).

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 Georgia	Horizontal	Applying Georgia law, the Eleventh Circuit recently held that where a party is an additional insured, the named insured's "primary policy must be exhausted before the [] umbrella policy applies." See <i>Great Am. Ins. Co. v. Allied World Assurance Co.</i>, No. 22-12496, 2023 WL 3736878 (11th Cir. 2023). The court reasons that the Georgia Supreme Court, in <i>Atkinson v. Atkinson</i>, 325 S.E.2d 206 (Ga. 1985), "adopted the 'prevailing rule' that 'umbrella policies, almost without dispute, are regarded as true excess over and above any type of primary coverage, excess provisions arising in regular policies in any manner, or escape clauses'." <i>Great Am. Ins. Co.</i>, 2023 WL 3736878, at *3. (emphasis added as in original). The court writes, "[i]n other words, primary policies take priority to umbrella policies, even when the primary policy includes an applicable excess clause." <i>Id.</i> at *3.
 Illinois	Horizontal	The Appellate Court of Illinois held that an additional 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>N. River Ins. Co. v. Grinnell Mut. Reinsurance Co.</i>, 860 N.E.2d 460 (Ill. App. Ct. 2006). Signaling its approval of Illinois courts' applying horizontal exhaustion in the additional insured context, the Supreme Court of Illinois in <i>Kajima Constr. Servs., Inc. v. Tokio Marine & Fire Ins. Co.</i>, 879 N.E.2d 305 (Ill. 2007) indicates that horizontal exhaustion also applies to situations of targeted tender. The court reasoned that "targeted tender can be applied to circumstances where concurrent primary insurance coverage exists for additional insureds, but to the extent that defense and indemnity costs exceed the primary limits of the targeted insurer, the deselected insurer or insurers' primary policy must answer for the loss before the insured can seek coverage under an excess policy. This holding preserves the distinction between primary and excess insurance policies." <i>Id.</i> at 314. This suggests that, to force vertical exhaustion on the subcontractor's tower of insurance, the general contractor would need to forego seeking coverage from its own tower altogether and limit itself to the policy limit of the named insured's primary policy. The named insured's excess coverage would be unavailable prior to the exhaustion of all available primary coverage.
 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>, No. 2005-71, 2005 WL 5629027 (E.D. Ky. 2005), aff'd 212 F. App'x. 553 (6th Cir. 2007).
 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).

STATE	APPLICABLE RULE	RELEVANT AUTHORITY
 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 York	Horizontal	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. 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. See also <i>Tishman Constr. Corp. of N.Y. v. Great Am. Ins. Co.</i>, 53 A.D.3d 416 (N.Y. App. Div. 2008); <i>Cheektowaga Cent. Sch. Dist. v. Burlington Ins. Co.</i>, 32 A.D.3d 1265 (N.Y. App. Div. 2006). It should be noted, however, that the Second Circuit Court of Appeals recently departed from <i>Bovis</i>. In <i>Century Sur.Co. v. Metro. Transit Auth.</i>, No.20-1474-cv, 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.
 Texas	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).
 Virginia	Vertical	The Fourth Circuit, 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).