

Workshop W6

Wednesday, November 4, 1:30–3:00 p.m. and 3:30–5:00 p.m.

ADDITIONAL INSURED SURPRISE— HORIZONTAL EXHAUSTION

Presented by

Mark E. Christensen
Managing Partner
Christensen & Ehret

Richard Subak
Account Executive
Aon Construction Services Group

A party who requests additional insured status on a contractor's policy almost certainly has the expectation that its own policy will not be required to share in a loss until the contractor's full limit of coverage is exhausted, including the umbrella or excess layers. Recently, however, some courts have applied a horizontal exhaustion approach, which requires the additional insured's own CGL policy to be exhausted before the contractor's excess or umbrella policy is triggered. In most cases, this outcome is contrary to both contracting parties' expectation and intent. This workshop will outline some pivotal decisions regarding horizontal versus vertical exhaustion and then outline strategies for avoiding horizontal exhaustion.



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Mark E. Christensen
Managing Partner
Christensen & Ehret, LLP

Mr. Christensen is copresenting Workshop W6, “Additional Insured Surprise—Horizontal Exhaustion,” on Wednesday afternoon. He is the managing partner at Christensen & Ehret, LLP. He devotes his practice to helping Fortune 500 and privately held businesses with their litigation needs and legal problems. He has over 25 years of experience as a trial attorney and over 17 years of experience in law firm management, focusing on strategic planning and attorney development.

Mr. Christensen is a respected trial attorney and has a breadth of experience in products, construction, professional malpractice, and directors and officers liability defense, having represented boat manufacturers, crane and hoist companies, construction contractors, brokers and financial and nonprofit institutions in litigation nationwide.

Mr. Christensen is coverage and reinsurance trial counsel for commercial, excess, and specialty risk insurers. He has represented their interests in losses exceeding \$100 million, initiating litigation to void policies, and defending bad faith claims. He also coordinates insurer insolvency issues on national accounts.

In addition to being a speaker at the International Risk Management Institute, Inc. (IRMI), Construction Risk Conference, he also speaks at Lloyd’s of London-sponsored seminars in England and at various other industry conferences in the United States. He developed the “American Litigation Process” training materials for various Lloyd’s underwriting agencies and is the author of *Mediation Handbook*, a negotiating paradigm used to resolve high-value, complex litigation.

Richard Subak, CPCU, ARM
Account Executive
Aon Construction Services Group

Mr. Subak is copresenting Workshop W6, “Additional Insured Surprise—Horizontal Exhaustion,” on Wednesday afternoon. He has 29 years of insurance experience, including the past 5 years in his current position and 5 years prior to that in Willis’s Construction Group.

Mr. Subak earned a BBA from the University of Iowa and an MBA from DePaul University. He holds the CPCU, ARM, and AU professional designations. In addition, he has taught CPCU and INS courses and conducted training seminars for clients (group size up to 100 people).

Notes

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Additional Insured Surprise— Horizontal Exhaustion

Presented by:

Mark E. Christensen, Esq.

Managing Partner

Christensen & Ehret, LLP

&

Richard Subak, CPCU, ARM

Vice President

Construction Services Group
Aon Risk Services Central, Inc.

PRIMARY INSURANCE

- Coverage that attaches immediately upon the happening of an occurrence that is covered under the terms of the policy.
- Primary insurance generally carries the primary defense obligation.



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EXCESS INSURANCE



- Coverage that attaches only after a predetermined amount of primary coverage has been exhausted.
- It is not uncommon to have several layers of excess insurance.

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UMBRELLA POLICY

- Insurance policies that are designed to fill gaps in coverage both:

- **Horizontally**
(by providing primary coverage)

- **Vertically**
(by providing excess coverage)



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“OTHER INSURANCE” CLAUSES

- Determine the priority of the policy when there is other insurance that applies to the same loss covered under the policy.
- Varies or limits the insurer’s liability when additional insurance coverage is established.
- The other insurance clause dictates the amount of contribution from co-insurer.
 - **Pro Rata Clauses**—*Pro rata* share of loss, by limits, by shares.
 - **Excess Clauses**—Insurer’s attempt to limit its liability loss to exceed all other coverages.
 - **Escape Clauses**—Absolves insurer of liability for any loss covered by other insurance.

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Examples of “OTHER INSURANCE” CLAUSES

- **Primary Insurance**
This insurance is primary except when Paragraph b, below applies. If this insurance is primary, our obligations are not affected unless any of the other insurance is also primary.
- **This insurance is excess over:**
Any other primary insurance available to you covering liability for damages arising out of the premises or operations, or the products and completed operations, *for which you have been added as an additional insured* by attachment of an endorsement.

Typical Umbrella Policy “Other Insurance” Clause

- Most of the time, the “Other Insurance” section of Umbrella—A will state that it is excess over other insurance, Umbrella—B will state the same.
- Remember a wide variation in umbrella language exists.
- Generally, courts make the two umbrella policies prorate the excess loss in the same manner as the primary policies.

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Horizontal & Vertical Exhaustion

- **Horizontal Exhaustion** generally requires exhaustion of all triggered primary policies before seeking coverage from any policy providing excess coverage.

- **Vertical Exhaustion** requires only that the primary policies underlying a particular excess policy be exhausted before that excess policy is triggered.

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Horizontal vs. Vertical Exhaustion Example

\$5MM Loss with \$1MM GL and \$5MM Excess Limit

Horizontal Exhaustion	Vertical Exhaustion
\$2MM Each Excess Policy	\$4MM on AI Excess Policy
\$1MM on Your GL Policy	\$1MM on AI GL Policy
\$1MM on AI GL Policy	Vertical Exhaustion

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HORIZONTAL & VERTICAL EXHAUSTION

- Depends on applicable state law.
- Majority—Horizontal exhaustion of all applicable primary policies.
- Minority—Vertical and applicability of other insurance clause.

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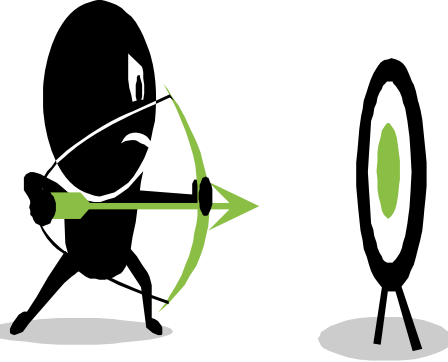
Horizontal & Vertical Exhaustion

- **COVERAGE ISSUES**
 - Identical Coverage Risk
 - Allocation Among Primary Policies
 - Excess Specifically Limits Underlying

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TARGETED TENDER

- *Illinois*—Select 1 Insurer
- *Kajima Construction Services, Inc. v. St. Paul Fire & Marine Insurance*
 - Horizontal exhaustion trumps the targeted tender rule, requiring the insured to exhaust all primary policies before looking to any excess policies for coverage.



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Horizontal & Vertical Exhaustion

- TRIGGER ISSUES:
 - Multiple Occurrences
 - Continuous Trigger
 - Wrap Policy

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Horizontal & Vertical Exhaustion

- RISK SHIFTING ISSUES
 - *Pro Rata* Share of Liability
 - Joint and Several Liability
 - Indemnity Agreements
 - *Wal-Mart v. RLI Insurance*

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Horizontal & Vertical Exhaustion

- PAYMENT ISSUES:
 - Self-Insured Retention
 - Insolvency
 - Insurer Remedies
 - Equitable Contribution
 - Equitable Subrogation

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Horizontal & Vertical Exhaustion

- Broker's Perspective
 - Insurance should respond to the party as your customer requires.
 - Various state law complicates the situation.
 - Education is key, so customers are not surprised by the outcome at time of loss.
- Owner's Perspective
 - Want access to all primary and excess policies that you are an additional insured on, before your own policies respond.

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Horizontal & Vertical Exhaustion



- Contractor's Perspective
- Often has two perspectives
 - Dealing with Owner
 - Meet contractual requirements
 - Dealing with Subcontractors
 - Perspective very similar to an owner

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Actions To Maximize the Possibility That Vertical Exhaustion Will Apply

- 1st—Know the state law in the jurisdictions.
- 2nd—Indemnity agreement meets your needs and is enforceable.
- 3rd—Make sure your own policy’s “other insurance” section supports vertical exhaustion.
 - When you are an AI (Additional Insured) portion of “Other Insurance” applies to both primary and excess policies.



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Actions To Maximize the Possibility That Vertical Exhaustion Will Apply

- 4th—Contract should indicate that ALL Liability (GL & EXCESS) insurance provided to AI is primary and non-contributory
- 5th—General liability when you are an AI, does it use ISO language making that policy primary
 - Caution, does the AI or any other endorsement change the “Other Insurance” section
- 6th—Excess policy where you are an AI, is it endorsed to not seek contribution from AI’s primary or excess insurance

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Verification That Vertical Exhaustion Will Apply

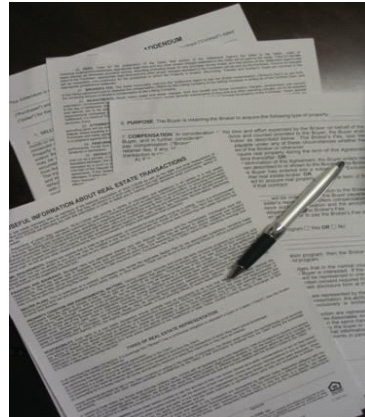
- Review a copy of the insurance policies that you are an AI on to see clauses and endorsements support vertical exhaustion.



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Alternate Method—Vertical Exhaustion Not Involving Excess

- **Require Higher Primary Limits**
 - **As a General Practice:**
If other party cannot amend their umbrella policy to be primary and noncontributory.
 - **Note:**
If you are the party that increases your primary, in a horizontal exhaustion state you can end up paying more in losses, because of your larger limit.



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You Were Not Provided Vertical Exhaustion—NOW WHAT?

- Demand indemnification!
- Breach of contract claim against party that failed to obtain coverage as required!!
- Put your insurance companies on notice!!!



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Q u e s t i o n s



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THANK YOU

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