

# Horizontal vs. Vertical Exhaustion of Insurance: Priority of Coverage and Settlement for Below Policy Limits

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Today's faculty features:

Eric B. Hermanson, Partner, **White and Williams LLP**, Boston, MA

Anna M. Perry, Attorney, **Saxe Doernberger & Vita, P.C.**, Trumbull, CT

Scott M. Seaman, Partner, **Hinshaw & Culbertson LLP**, Chicago, IL

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PANELISTS:

Eric B. Hermanson  
*White and Williams*

Anna M. Perry  
*Saxe Doernberger & Vita*

Scott M. Seaman  
*Hinshaw & Culbertson*

# What Is Exhaustion?

Insurance is purchased in layers.

- Working Layer - Primary / self-insured.  
Often includes defense.
- First Excess.
- Second Excess.

Large losses can trigger multiple layers – “exhausting” primary coverage, and triggering the first excess, second excess, etc.

- Excess policies require exhaustion of underlying coverage.
- Umbrella policies may drop down to cover losses even if underlying coverage is not fully exhausted.





# Why Do It This Way?

## Different appetite for risk.

- Some insurers prefer to deal with more frequent, smaller claims.
- Some prefer fewer, larger claims.

## Different expertise and ability.

- Some insurers prefer control over investigation and defense.
- Some prefer to have other companies investigate and defend in the first instance.

## Different access to reinsurance.

Allowing carriers to segment risk, i.e., take only the part they are most comfortable handling, allows more companies to participate in the market, allows those companies to specialize in areas of expertise, and keeps premiums competitive for insureds.

# Sample Policy Language: Primary

We will pay those sums that the insured becomes legally obligated to pay as damages because of “bodily injury” or “property damage” to which this insurance applies. We will have the right and duty to defend the insured against any “suit” seeking those damages. However, we will have no duty to defend the insured against any “suit” seeking damages for “bodily injury” or “property damage” to which this insurance does not apply. We may, at our discretion, investigate any “occurrence” and settle any claim or “suit” that may result. But:

(1) The amount we will pay for damages is limited as described in Section III – Limits Of Insurance; and

2) Our right and duty to defend ends when we have used up the applicable limit of insurance in the payment of judgments or settlements under Coverages A or B or medical expenses under Coverage C.

No other obligation or liability to pay sums or perform acts or services is covered unless explicitly provided for under Supplementary Payments – Coverages A and B.

- First-dollar indemnity obligation
- Right to investigate potentially covered “occurrences.”
- Right to defend claims – so as to limit indemnity obligations.
- Obligation ends when limit has been used up in “payment of judgments or settlements.”
- In some policies, limits are also eroded by payment of defense costs.

# Sample Policy Language: Excess Follow-Form

*This Policy shall provide the Insured with insurance coverage for any claim, loss and/or occurrence in accordance with the same terms, conditions, exclusions and limitations of the Followed Policy referenced ... in the Declarations (except as regards the premium, Limits of Liability or any endorsements attached to this Policy) as they existed on the inception date of this Policy, except as otherwise provided herein.*

*Notwithstanding any other provision of this Policy, in no event shall this Policy grant broader coverage than that provided by the Followed Policy or any of the Underlying Policies.*

*The Insurer shall have the right, but not the duty, and shall be given the opportunity, to effectively associate with the Insured in the investigation, settlement or defense of any claim that is reasonably likely to involve the Limits of Liability of this Policy. The Insured shall not admit liability for, offer to settle or settle, any claim or incur any defense costs where the liability, settlement and/or defense costs are reasonably likely to involve the Limits of Liability of this Policy, without the Insurer's prior written consent.*

- Extends limits of underlying coverage.
- No underlying insurance, no coverage.
- Follows form: “In no event shall this policy grant broader coverage than would be provided by the Followed Policy or any of the Underlying Policies.”

# Sample Policy Language: Umbrella

*We will pay on behalf of the insured the “ultimate net loss” in excess of the “retained limit” because of “bodily injury” or “property damage” to which this insurance applies. We will have the right and duty to defend the insured against any “suit” seeking damages for such “bodily injury” or “property damage” when the “underlying insurance” does not provide coverage or the limits of “underlying insurance” have been exhausted.*

*“Ultimate net loss” means the total sum, after reduction for recoveries or salvages collectible, that the insured becomes legally obligated to pay as damages by reason of settlement or judgments or any arbitration or other alternate dispute method entered into with our consent or the “underlying insurer’s” consent.*

*“Retained limit” means the available limits of “underlying insurance” scheduled in the declarations or the “self-insured retention,” whichever applies.*

- Indemnity obligation above “retained limit” –  
    i.e., available limits of underlying insurance or self-insured retention.
- Defense obligation when underlying insurance is exhausted.
- Drops down when underlying insurance is unavailable or does not provide coverage.

# Sample Policy Language: “Other Insurance”

- Where several insurance companies provide concurrent coverage for the same risk at the same level, “other insurance” clauses may determine which is primary and which is excess.

*Where there is other insurance covering the same loss or damage that is covered:*

- a) Under this policy; and*
- b) Any other policy;*

*Then **this insurance will apply only as excess** and in no event as contributing insurance, and then only after all other insurance has been exhausted, whether or not such insurance is collectible.*

# Policy Language Disputes: *Forecast Homes*

- Developer (Forecast) purchased excess policy over self-insured retention.
- **Policy language: “It is a condition precedent to our liability that you make actual payment of all damages and `defense costs' for each `occurrence' or offense, until you have paid `self-insured retention' amounts and `defense costs' equal to the [p]er [o]ccurrence amount shown in the Schedule...”**
- Forecast tendered defense to subcontractors.
- Did defense costs paid by subcontractors exhaust the SIR?
- Held, no – “you” means Forecast, and only payments by Forecast lead to exhaustion.

*Forecast Homes v. Steadfast Ins. Co.*,  
181 Cal. App. 4<sup>th</sup> 1466 (2010)

# Policy Language Disputes: QAHS LLC

- Developer (QAHS) purchased AIG excess policy over indemnity-only SIR.
- AIG's excess duties triggered when "Retained Limit" of the Policy was satisfied by payment of \$1M in covered "Loss."
- "Loss" was defined as "sums **actually paid as judgments or settlements**" – i.e., not defense costs.
- QAHS became insolvent.
- To create "Loss" it "hatched a plan" with claimants.
- Settled some (not all) claims in exchange for \$1M promissory note.
- Had no assets. No hope of ever paying the note.
- Was promissory note "actual payment" – ?
- Yes – AIG owed duty to defend.

*Chartis Specialty Ins. Co. v. QAHS LLC*,  
867 F.Supp.2d 1111 (W.D. Wash. 2012)

# Exhaustion and Trigger

Certain large-loss scenarios involve continuous and progressive losses that span more than one policy period.

- Environmental
- Toxic Torts
- Asbestos

Controversies arise as to which policy year should respond – manifestation, exposure, etc.

Some courts allow the insured to trigger more than one policy year – pro rata vs. all sums.

How does excess coverage work in that context?

- Horizontal exhaustion
- Vertical exhaustion

# Today's Themes

## 1. Horizontal vs. Vertical Exhaustion

- Long-Tail Context
- Public Policy Implications

## 2. Additional Insureds

- "Other Insurance" Disputes
- Who Exhausts and How?
- Public Policy

## 3. Below-Limits Settlements

- *Zeig* and Its Progeny
- *Qualcomm, Comerica, Pfizer, Rohr*

# HORIZONTAL VS. VERTICAL EXHAUSTION OF INSURANCE COVERAGE

**Scott M. Seaman**  
**Hinshaw & Culbertson LLP**  
sseaman@hinshawlaw.com

**STRAFFORD**

**June 8, 2021**

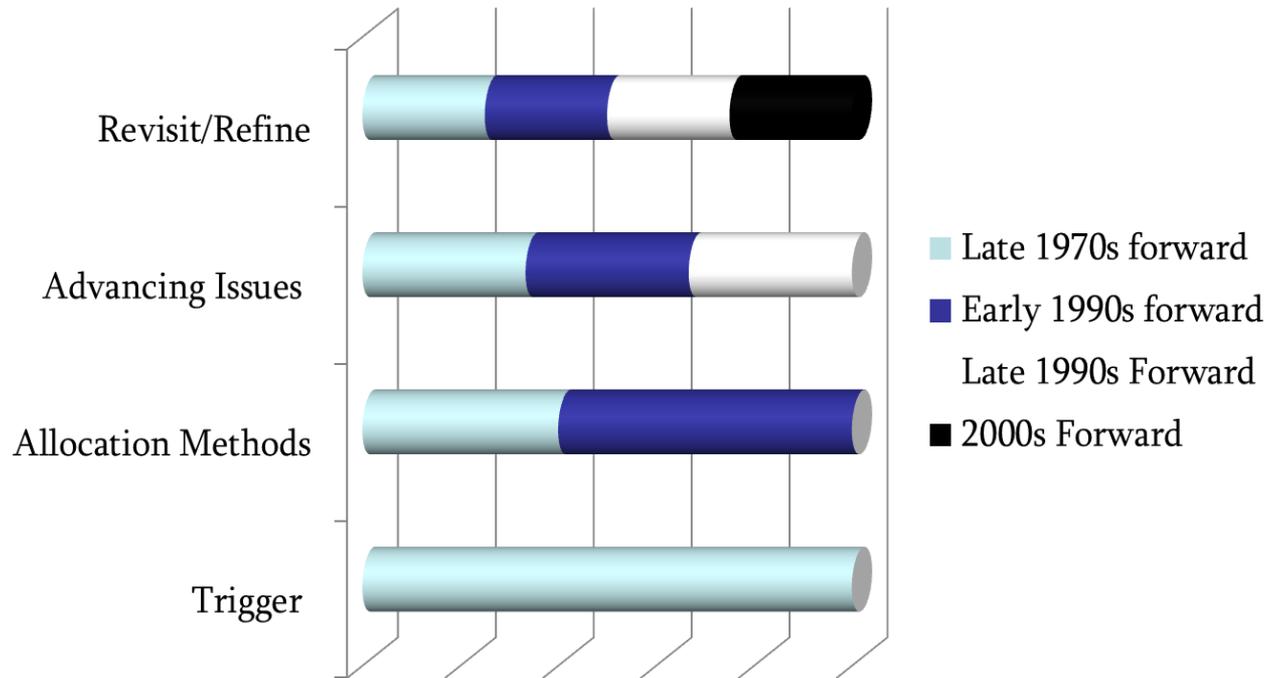


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**LONG TAIL CLAIMS:  
THE TRIGGER, ALLOCATION, &  
EXHAUSTION TRIFECTA**

# Allocation Mix Time Line



# Phase I: Trigger Of Coverage

- ❖ “Occurrence-based” policies
- ❖ Most occurrence-based policies limit coverage to bodily injury and property damage that take place during the policy period
- ❖ Some policies require that the act, event and/or damage take place during the policy period

## Four Basic Trigger Theories

- ❖ Exposure: policies on the risk between the first and last date that the claimant or property was exposed to harmful substance
- ❖ Manifestation/Discovery: policy on the risk when injury or damage is discovered
- ❖ Injury-in-fact: policies on the risk on date that property damage or bodily injury actually happens through actual proof that damage was sustained
- ❖ Continuous: policies on risk between first exposure and manifestation

# Trigger Trends

- ❖ In the early long-tail cases (asbestos and DES) the battle was between exposure and manifestation
- ❖ The current trend of decisions is to apply a continuous or injury-in-fact trigger, with occasional manifestation or exposure rulings
- ❖ Often the main distinction between the continuous trigger and injury-in-fact trigger is one of proof
- ❖ Most states with appreciable coverage decisions have developed case law on trigger

# Relationship Between Trigger And Allocation

- ❖ Losses can only be allocated to triggered policies
- ❖ The “trigger” selected may limit the allocation period (e.g., manifestation limits the beginning date and exposure limits the end date)
- ❖ The allocation method should be consistent with the trigger (joint and several liability is inconsistent with the injury-in-fact and continuous triggers)

## Phase II: Allocation Methodologies

- ❖ Methodology: “all sums” versus pro rata
- ❖ Impact of no insurance, self-insurance, or under insurance

# “All Sums,” Vertical Exhaustion, Or “Joint And Several” Liability

- ❖ Position usually advocated by policyholder
- ❖ The policyholder can collect from any triggered policy the full amount of indemnity that is due (subject to the policy limits)
- ❖ This methodology allows the policyholder to “pick and choose” which triggered policies will pay. The policyholder does not have to contribute its share for periods of self-insurance
- ❖ The policyholder can “spike” to reach target excess policy
- ❖ The policyholder maximizes its flexibility in settlement negotiations
- ❖ Maximizes recovery, but does not guarantee a full recovery

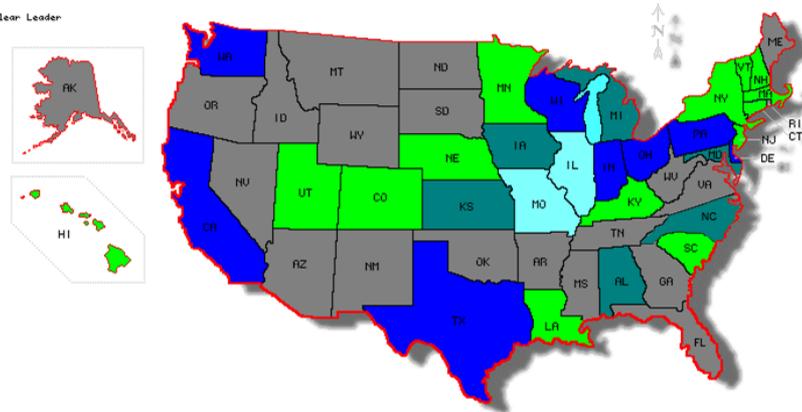
# Pro Rata Allocation Methodologies

- ❖ Each insurer is liable for its pro rata share of the loss. The insurer's liability is not “joint and several” – it is individual and proportionate
- ❖ Various pro rata methodologies. Most common are pro rata based on time on the risk and pro rata based on time on the risk x limits (O-I/C-W)
- ❖ Other methods
- ❖ Fact based allocation

# Pro Rata Allocation Is The Majority & Better Rule

## PRO RATA IS THE MAJORITY RULE

- - Presumptive JIS
- - Leaning JIS
- - Presumptive Pro Rata
- - Leaning Pro Rata
- - No Clear Leader



Source: dymaps.net (c)

# The Differences Between Joint & Several And Pro Rata Approaches

- ❖ SIR's and insolvencies
- ❖ Judicial inefficiencies (holding universe of insurers hostage in initial action and subsequent litigation to re-allocation through equitable contribution)
- ❖ Transaction costs of re-allocation
- ❖ The impact of “unavailability”
- ❖ Limited circumstances where re-allocation not permitted:
  - ❖ Selective/targeted tender decisions
  - ❖ Defense (minority of jurisdictions)
  - ❖ Allowed in Florida effective 1/1/2020
- ❖ Litigation Practicalities:
  - ❖ Generally insurers defer litigating cross-claims
  - ❖ Taking pro-policyholder positions

# Phase III: The Allocation Hydra

**Acceleration/UNR**

**SIRS/Deductibles**

**Targeted Tender**

**Impact of Unavailability**

**No More “All Sums” Language**

**Multi-Year Policies**

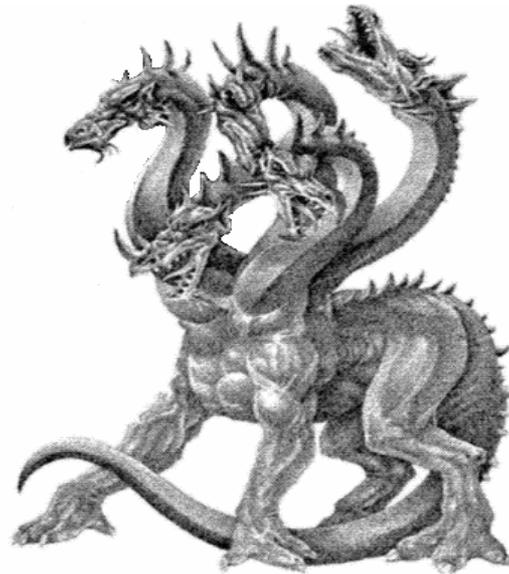
**Stubs & Extensions**

**Number Of Occurrences**

**Non-Cumulation**

**Vertical/Horizontal  
Exhaustion**

**Covered/Non-Covered  
Claims**



**Drop Down**

**Guarantee Funds**

**Defense vs. Indemnity**

**Reallocation (Equitable  
Subrogation/Contribution)**

**Set-Off/Settlement  
Credits Apportioned  
Share/Pro Tanto**

**Actual/Functional  
Exhaustion**

**Recoupment Of Defense Costs/Settlement Amounts  
Associated With Non-Covered Claims**

## Phase IV: Revisit, Revise, & Drill Down

- ❖ Phase 1 through 3 issues continue to be litigated
- ❖ Policyholders seeking to undo the natural consequences of a pro rata allocation through a so-called “unavailability of insurance” exception
- ❖ Parties arguing specific policy language trumps general default rules. For example, insurer arguing the change of “all sums” to “those sums” language requires pro rata allocation. See Thomson Inc. (Ind. App. 2014). The issue is before the Ohio Supreme Court in Lubrizol. Similarly, policyholders arguing “non-cumulation” clause requires an “all sums” allocation in a pro rata jurisdiction
- ❖ Drilling down on exhaustion

# “Unavailability Of Insurance”

- ❖ There is no “unavailability” exception in most pro rata jurisdictions
- ❖ The notion is contrary to the fundamental and logical consequences of a pro rata allocation.
- ❖ The issue of unavailability comes from language in the NJ Sup.Ct. decision in Owens-Illinois, Inc. v. United Ins. Co., 650 A.2d 974 (NJ 1994). NJ has held firm. Continental Ins. Co. v. Honeywell Int'l, Inc., 188 A.3d 297(NJ 2018)
- ❖ KeySpan put a fork in any notion of an “unavailability” exception under NY law. Keyspan Gas East Corp. v. Munich Reinsurance America, Inc., 96 N.E.3d 209 (NY 2018)
- ❖ Even where an “unavailability of insurance” exception exists, it limited typically limited to post 1985 and in the context of environmental or asbestos claims



# **DRILLING DOWN ON EXHAUSTION**

# The Fundamental Requirement Of Exhaustion

- ❖ Excess insurance is secondary insurance coverage that attaches only after a predetermined amount of primary insurance or self-insured retentions has been exhausted. Exhaustion is not only a matter of contract language, but also a function of the nature and role of excess insurance
- ❖ Important to note that the presence of an excess “other insurance” clause does not make a primary insurance policy an excess insurance policy. Lamorak Ins. Co. v. Kone, Inc. (Ill. App. 2018)
- ❖ Claims of premature exhaustion can arise under a variety of circumstances or relate to a variety of issues apart from settlement for less than policy limits
- ❖ Many times the policyholder is involved in the dispute and the issues are addressed in the coverage litigation through declaratory judgment claims and allocating the loss
- ❖ Other times the issue is presented in the context of insurer vs. insurer claims for declaratory judgment or equitable contribution/subrogation claims

# Legal Issues Concerning Exhaustion

- ❖ Horizontal/Vertical: One issue is whether only exhaustion of the limits of insurance contracts and retentions directly underlying the subject excess insurance contract must be exhausted (vertical exhaustion) or whether all underlying limits and retentions for all periods implicated by a loss must be exhausted (horizontal exhaustion) before an excess insurance contract is obligated to respond. There is general agreement that the attachment point of the excess contract must be reached before an excess contract is required to respond
- ❖ Functional Exhaustion: Dispute concerns whether the underlying exhaustion required to reach an excess contract can be satisfied solely by payment of claims by the underlying insurer(s) or whether some type of “functional” exhaustion will be accepted. These disputes exist with respect to both traditional and long tail claims. This is the biggest excess insurance issue over the past couple of decades and Eric will address this.
- ❖ CD Claims: Risks of loss commonly assigned in the construction documents. Construction documents and insurance policies not always consistent. Anna will address this.

# Exhaustion Of All Underlying Limits – Horizontal Exhaustion

- ❖ The doctrine of horizontal exhaustion is the majority rule. Horizontal exhaustion is the near universal rule in states applying a pro rata allocation methodology
- ❖ Even in states with some law permitting an “all sums” or “horizontal spike” the policyholder is required to exhaust the underlying coverage in the year it selects
- ❖ Even some states employing the “all sums” fiction recognize the distinction between primary and excess insurance.
  - ❖ For example, Illinois’ Targeted or Selective Tender Rule does not trump the requirement of horizontal exhaustion. Kajima Const. Services, Inc. v. St. Paul Fire & Marine Ins. Co., 858 N.E.2d 234 (Ill. 2006)

# California Supreme Court 2020 Decision In Montrose

- ❖ California Supreme Court had previously ruled that California is an “all sums” jurisdiction that permits stacking, absent contractual language requiring a different result
- ❖ Last year, the California Supreme Court reversed the appellate court and held that a policyholder is permitted to vertically exhaust coverage.
- ❖ Policyholder is permitted to seek indemnification under any excess policy once the underlying policies in the same year are exhausted
- ❖ Previously, conflicting decisions in California
- ❖ The Court expressly stated that the parties are free to write policies to provide for alternative exhaustion requirements
- ❖ It cited to “other insurance” clauses, insurance schedules, and language that the insurers argued required horizontal exhaustion, but it failed to adequately consider the language and differing language in policies

# Satisfaction Of Retentions

- ❖ Phoenix v. First State Ins. Co. (9th Cir. 2018)
- ❖ Policies provided that in the event any claim arising from an occurrence is “adjudicated prior to trial court judgment for a total amount not more than the retained limit, then no loss expenses or legal expenses shall be payable by the Company”

# Generally Excess Insurers Are Entitled To Challenge Exhaustion

- ❖ Exhaustion also requires examination of the claims and facts as well as the method required or permitted in the pertinent jurisdiction
- ❖ Numerous courts have allowed excess insurers to challenge payments and settlements of claims in which the excess insurers did not participate. See, e.g., Colony Nat. Ins. Co. v. Sorenson Medical Inc., 2011 WL 6740537 (E.D. Ky. Dec. 21, 2011) (applying Utah law); Goodyear Tire & Rubber Co. v. National Union Fire Ins. Co., 694 F.3d 781 (6th Cir. 2012) (applying Ohio law); American Ins. Co. v. St. Jude Medical, Inc., 2010 WL 3733009 (D. Minn. Sept. 20, 2010); Royal Indemnity Co. v. C.H. Robinson Worldwide Inc., 2009 WL 2149637 (Minn. Ct. App. 2009) (unpublished); D.R. Horton Inc. v. American Guar. & Liab. Ins. Co., 864 F.Supp.2d 541, 548 (N.D. Tex. 2012), appeal dismissed, (5th Cir. 2012)
- ❖ This comports with realities of excess insurance. Excess insurers generally do not have a duty to defend and usually are not involved in the claims handling and settlement process prior to their contacts being implicated

# The Ability To Challenge Exhaustion May Depend Upon . . .

- ❖ The law in the controlling jurisdiction
- ❖ The factual circumstances
- ❖ The issue being challenged
- ❖ The policy language

# Exhaustion Challenge Sustained

- ❖ Shy v. Ins. Co. of the State of Pa., (9th Cir. 2013)
- ❖ Excess insurer bound by policy provisions incorporated into its following form excess policy, but not bound by the primary insurers' determination there was coverage
- ❖ Under California law, the court properly looked to arbitration award to determine whether award/components were based upon actions/events that are covered
- ❖ Covered damages did not reach the \$2 million attachment point of the excess policy
- ❖ Policyholder's claim against the excess insurer was properly dismissed

# Exhaustion Challenge Not Sustained

- ❖ Northrop Grumman Corp. v Axis Re Co. (9th Cir. 2020)
- ❖ Excess insurer argued that underlying insurers paid an uncovered claim for ERISA violations, improperly eroding underlying limits in a prior suit. District court agreed, but Ninth Circuit reversed
- ❖ Excess insurer cannot challenge payment decisions of underlying insurers absent showing of fraud bad faith or specific reservation of such right in the insurance contract
- ❖ “Reasonable expectations”
- ❖ Distinguishes Shy as involving a single claim in which insurers took opposing views
- ❖ Concern with undermining of both insureds and insurers in the dependability of settlements and interposing inefficiencies into the process

# Legal/Practical Limits On Excess Insurer's Ability To Challenge Prior Payments

- ❖ In the IMO case, several of the insurers challenged the trial court's ruling that coverage issues could not be relitigated for each individual asbestos claim. The appellate court affirmed based upon language in the New Jersey Supreme Court's decision in Owens-Illinois, prohibiting the insurers from relitigating already settled claims after refusing to defend them
- ❖ The appellate court affirmed, stating: "It stands to reason that accommodating a challenge to coverage in tens of thousands of individual claims would not only prove daunting but would compromise the integrity of the framework Owens-Illinois offers for efficient and equitable allocation of losses among policies
- ❖ Presumably, even under New Jersey law, the result may be different where there were not reasonable procedures employed to settle claims, where the excess insurers were not provided with notice, where the files were not made available to the excess insurers, or where the claims universe did not involve thousands of underlying claims

# The Exhausting Examination

- ❖ The policyholder generally bears the burden of proving exhaustion of underlying coverage or SIRs
- ❖ Other determinations such as assignment of date of loss (trigger), allocation, treatment of number of occurrences, multi-year policies, etc. may be involved
- ❖ The determination of exhaustion often runs deeper than an understanding of the applicable legal principles (e.g., horizontal/ vertical and actual payment/functional exhaustion), involving review of the policies, facts, and items involved
- ❖ The mechanics may include a full audit, a review of a sample of claims, full file reviews, reviews of invoices, cancelled checks, or loss runs
- ❖ Practical considerations: costs/benefits; the extent to which policyholders and courts will permit review and challenges; no one-size-fits-all approach to evaluating underlying exhaustion

# Application Of Proper Limits

- ❖ A determination of proper exhaustion requires an understanding of the various limits of liability and a determination as to whether the claims/payments have been applied properly against the limits
- ❖ Indemnity limits: per occurrence, per claimant, per accident, per claim, and aggregate limits; apply separately to property damage, bodily injury, or personal injury or “combined single limits;” are there aggregate limits, do they apply to all losses under the contract or only to some types of losses such as operations, premises, or products/completed operations claims; do the aggregates apply on a policy basis or an annual basis; multi-year policy limits
- ❖ Asbestos products/non-products example

# Defense Verses Indemnity Costs

- ❖ Usually it is easy to identify whether costs are defense costs (e.g., counsel fees) or indemnity (e.g., settlement payments or payments made to satisfy a judgment against the policyholder)
- ❖ Other times, such as in the case of evaluating environmental remedial investigative and feasibility study costs, the answer requires reference to the law in the controlling jurisdiction as well as analysis of the costs themselves to determine whether they are defense costs or indemnity

## Review Of Specific Items

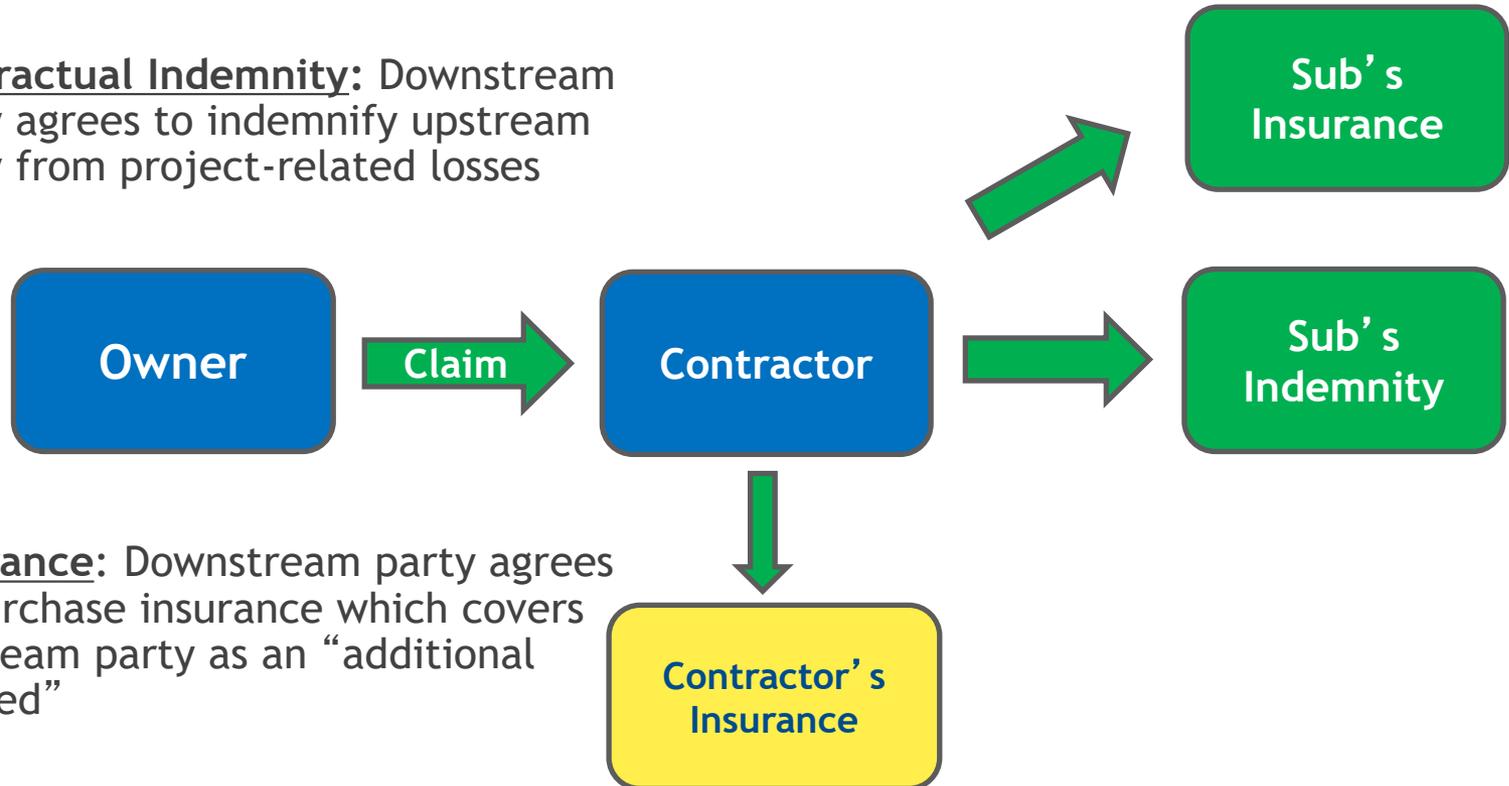
- ❖ The review of specific items may establish that some components of an otherwise covered claim are improperly included
- ❖ Many corporate policyholders are aggressive in the costs for which they seek recovery from their insurers and may include items that are not covered
- ❖ Costs of doing business, maintenance, regulatory compliance, economic loss, civil fines, and facility improvements, for example, may not be covered damages under third-party liability contracts
- ❖ Future cost issues

# Reasonableness Of Costs

- ❖ Defense costs (as opposed to indemnity, costs of prosecuting counter claims, business costs, internal costs, etc.)
- ❖ Defense costs as opposed to costs pursuing coverage
- ❖ Counsel rates
- ❖ Reasonable fees/costs
- ❖ Review of fees/invoices; legal fee audit; billing guidelines; reasonable controls; adequately documented; not otherwise reimbursed

# Risk Transfer Methods

**Contractual Indemnity:** Downstream party agrees to indemnify upstream party from project-related losses



**Insurance:** Downstream party agrees to purchase insurance which covers upstream party as an “additional insured”

# Which Policy Responds Second?

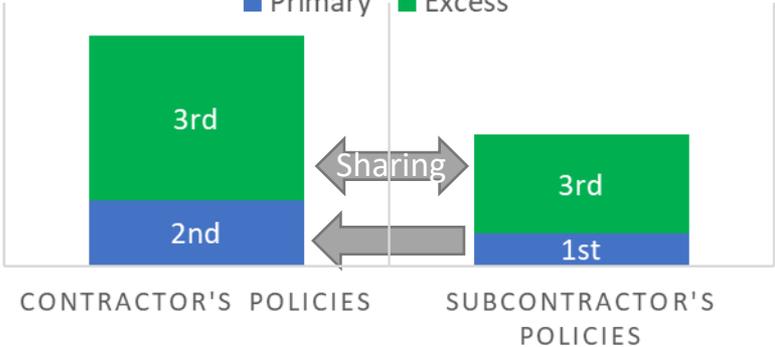
## VERTICAL EXHAUSTION

■ Primary ■ Excess



## HORIZONTAL EXHAUSTION

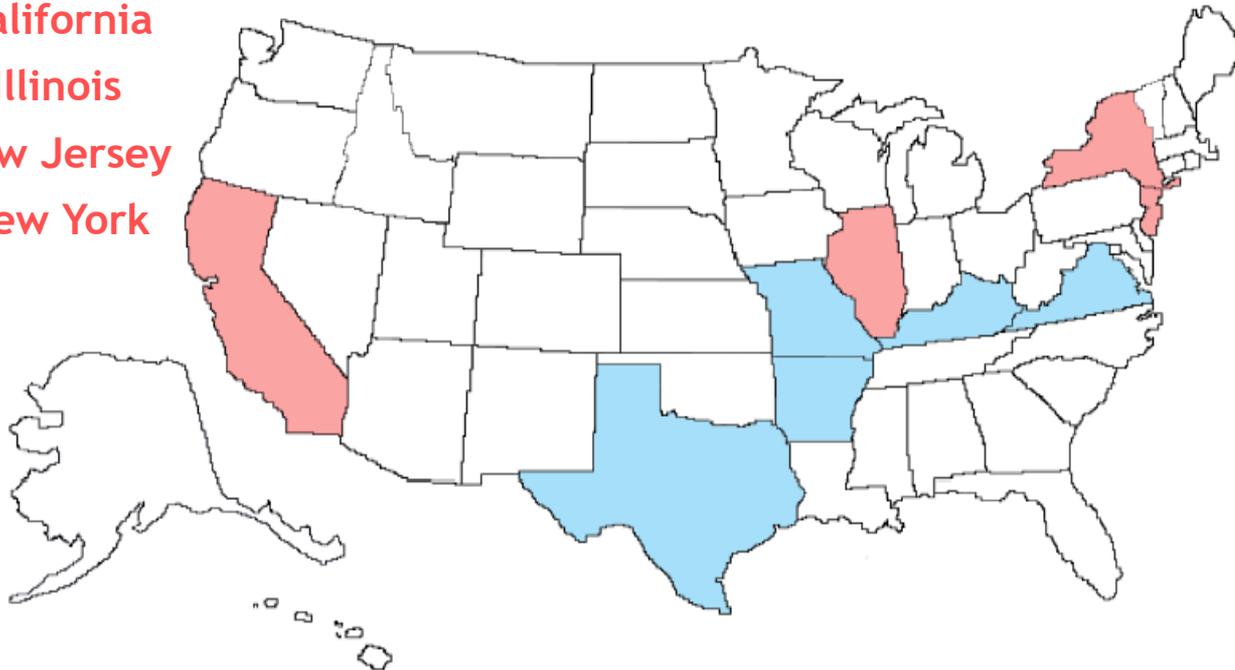
■ Primary ■ Excess



# Priority of Coverage: State by State

## Horizontal Exhaustion:

California  
Illinois  
New Jersey  
New York



## Vertical Exhaustion:

4<sup>th</sup> Cir. (Virginia)  
5<sup>th</sup> Cir. (Texas)  
8<sup>th</sup> Cir. (Arkansas)  
Kentucky  
Missouri

# Vertical Exhaustion



General Contractor

General Contractor sued

GC tenders to AI primary and AI excess

AI primary pays first, then AI excess carrier pays

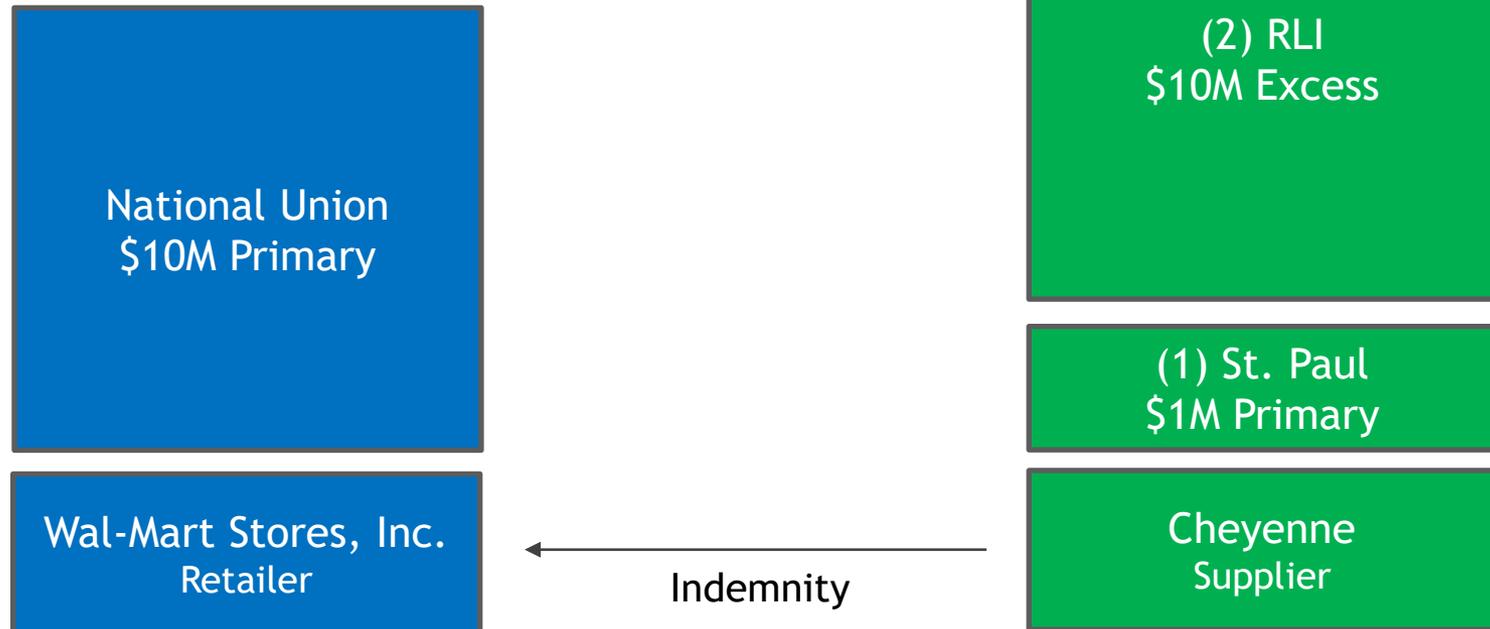


Subcontractor

# Vertical Exhaustion Example:

Wal-Mart Stores, Inc. v. RLI Ins. Co., 292 F.3d 583 (8<sup>th</sup> Cir. 2002)

- Contract required \$2M in liability insurance; Cheyenne obtained \$1M primary/\$10M excess
- \$11M settlement: paid by St. Paul (\$1M) and RLI (\$10M)
- Result: St. Paul paid first and RLI paid second; no contribution from Wal-Mart's insurer

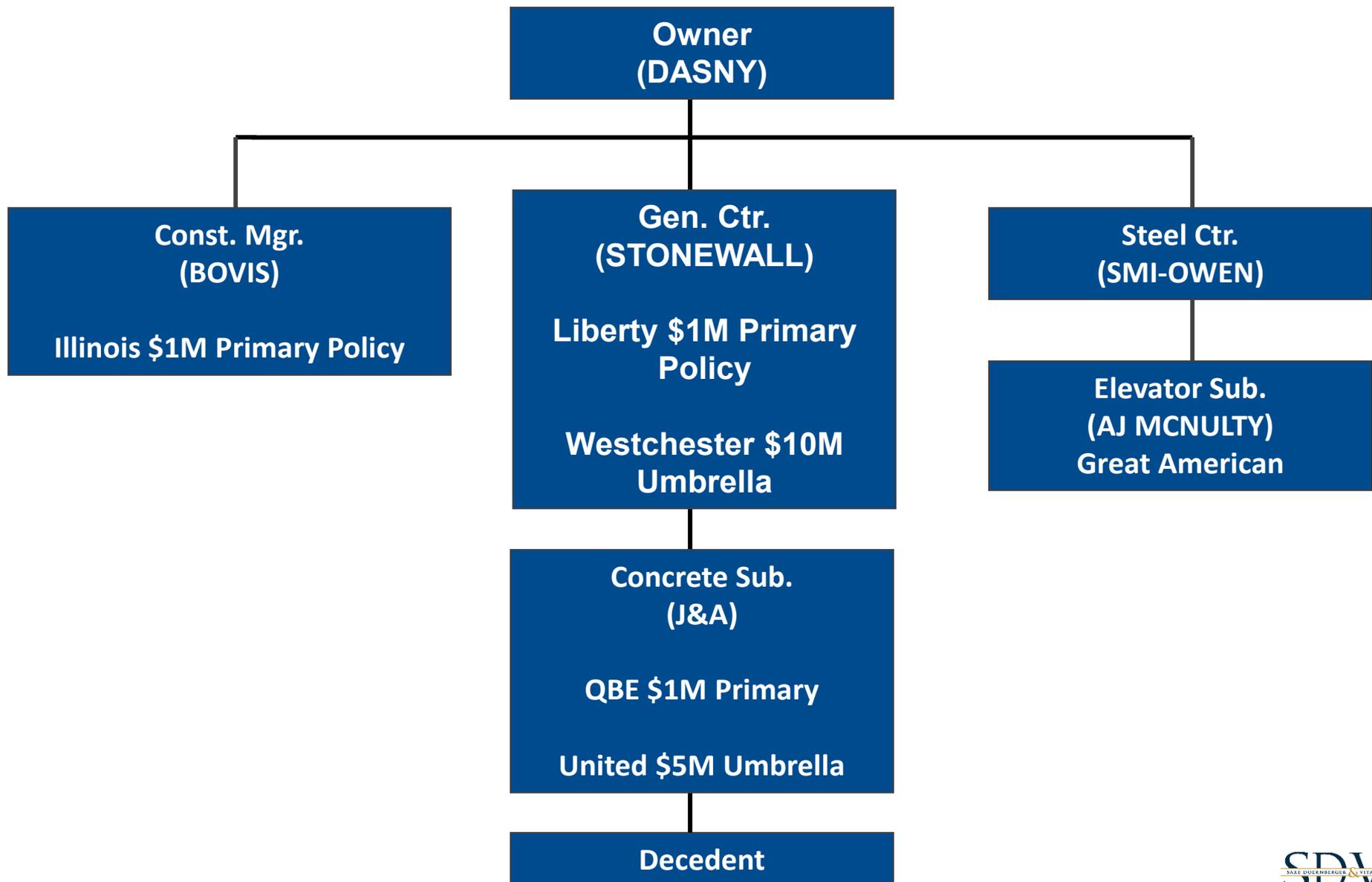


# Horizontal Exhaustion

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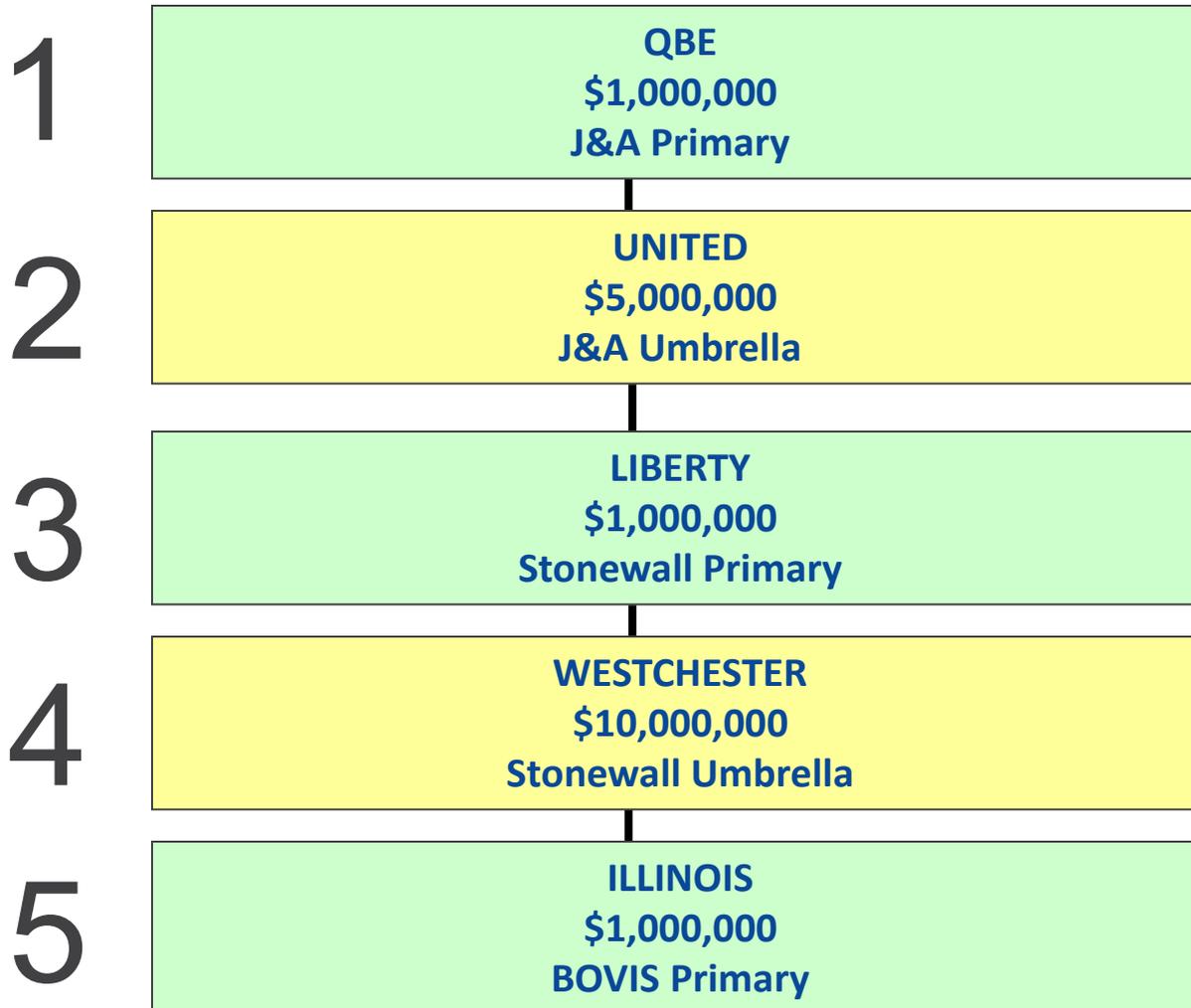
- All available primary policies must exhaust first
- Focus on policy language, not underlying contract
- Excess policy is a payer of last resort

# Horizontal Exhaustion: *Bovis v. Great American Ins. Co.*, 855 NYS 2d 459 (2008)



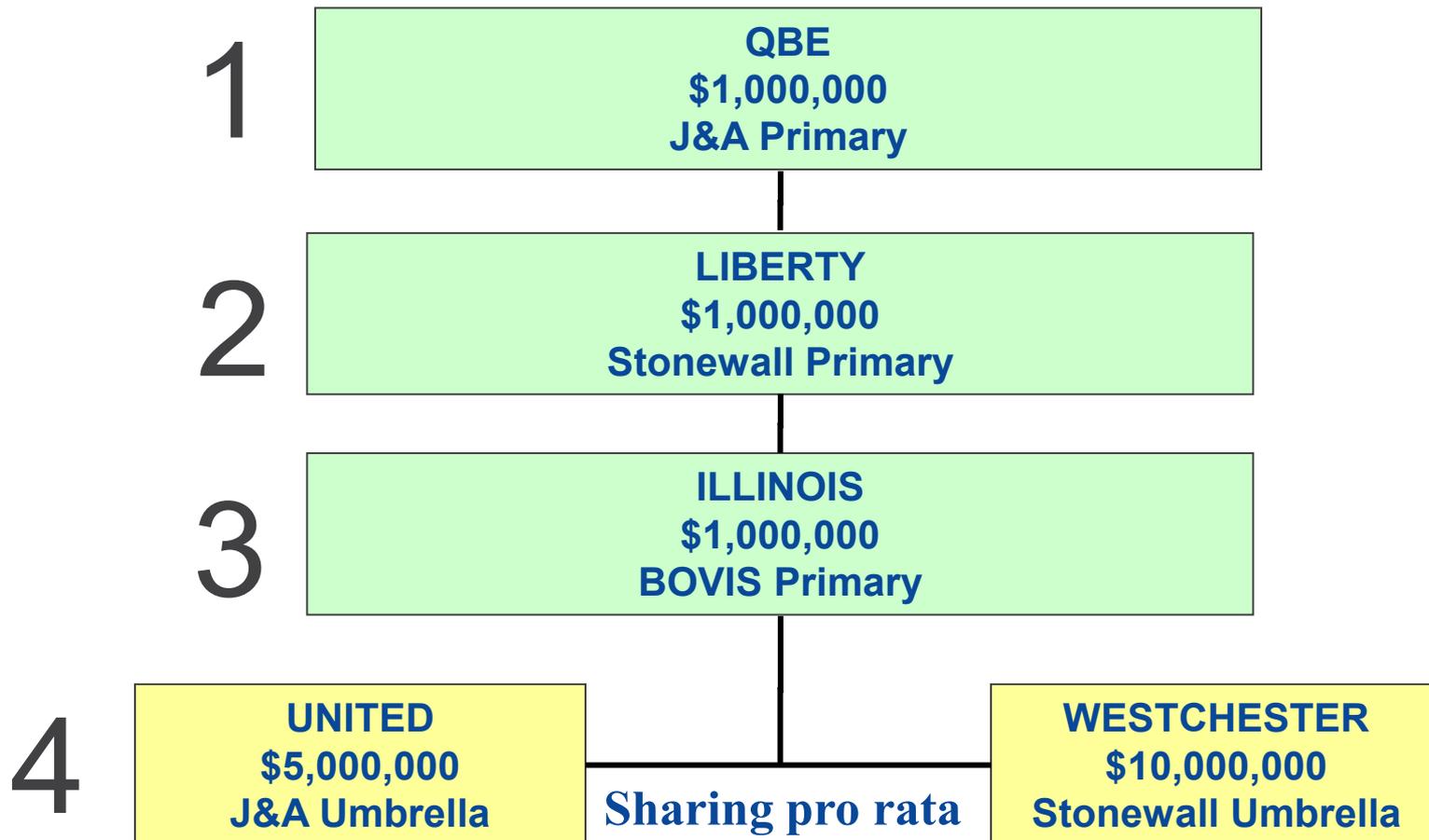
# Bovis: Trial Court Apportionment

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# Bovis: Appellate Court Apportionment

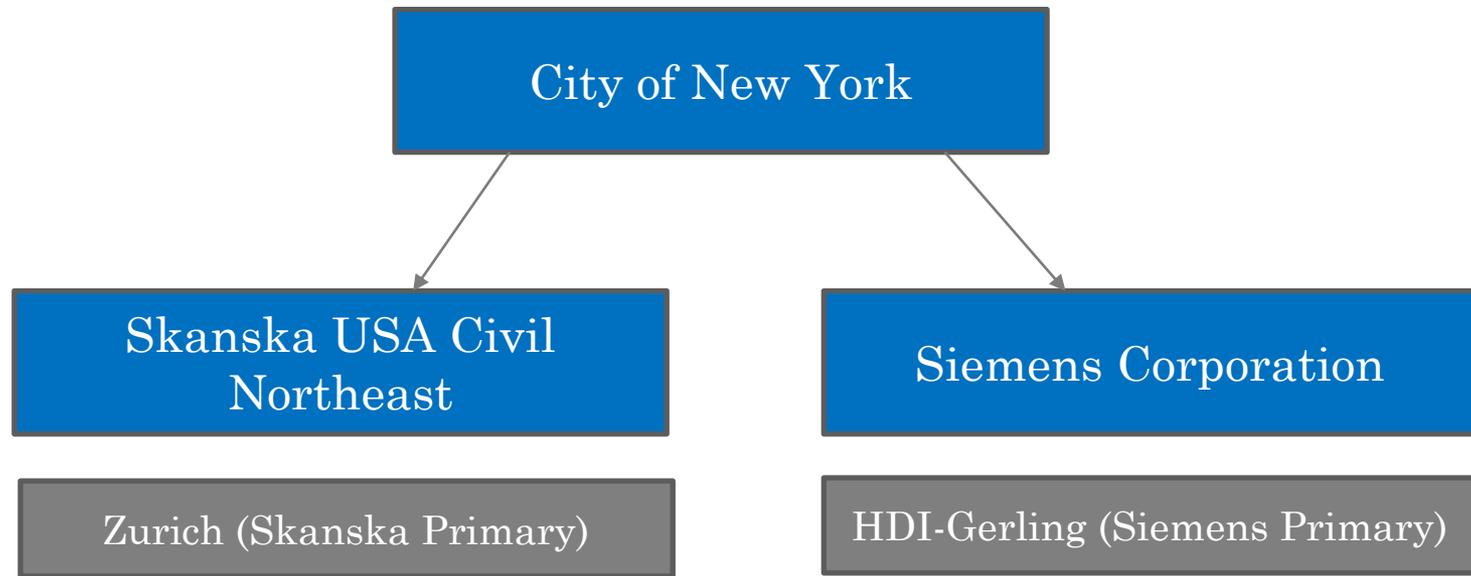
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# *HDI-Gerling Am. Ins. Co. v Zurich Am. Ins. Co.:*

2017 NY Slip Op 01955 [1st Dept Mar. 16, 2017]

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# *HDI-Gerling Am. Ins. Co. v Zurich Am. Ins. Co.,* Manuscript Endorsement

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## Zurich Policy

SECTION IV. COMMERCIAL GENERAL LIABILITY CONDITIONS, 4. **Other Insurance**, is amended per the following:

1. The following paragraph is added under **a. Primary Insurance**:

This insurance is primary insurance as respects our coverage to an additional insured person or organization, where the written contract or written agreement requires that this insurance be primary and non-contributory. In that event, we will not seek contribution from any other insurance policy available to the additional insured on which the additional insured person or organization is a Named Insured.

2. The following paragraph is added under **b. Excess Insurance**:

This insurance is excess over:

Any of the other insurance, whether primary, excess, contingent or on any other basis, available to an additional insured, in which the additional insured on our policy is also covered as an additional insured by attachment of an endorsement to another policy providing coverage for the same "occurrence", claim or "suit". This provision does not apply to any policy in which the additional insured is a Named Insured on such other policy and where our policy is required by written contract or written agreement to provide coverage to the additional insured on a primary and non-contributory basis.

Any provisions in this Coverage Part not changed by the terms and conditions of this endorsement continue to apply as written.

# Other Insurance Clauses

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- Endorsing the Primary General Liability Policy Is Not Enough
- Why Isn't Follow Form Coverage Sufficient?

# Primary CGL - CG 20 01 04 13

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The following is added to the **Other Insurance** Condition and supersedes any provision to the contrary:

## **Primary And Noncontributory Insurance**

This insurance is primary to and will not seek contribution from any other insurance available to an additional insured under your policy provided that:

- (1) The additional insured is a Named Insured under such other insurance; and
- (2) You have agreed in writing in a contract or agreement that this insurance would be primary and would not seek contribution from any other insurance available to the additional insured.

**Does endorsing  
primary policy  
really help?**

CG 20 01 04 13

# Non-Contributory Without Primary

Excess - CX 24 33 11 16

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Paragraph 8. of **Section III -- Conditions** is replaced by the following:

## 8. Other Insurance

a. This insurance is excess over, and shall not contribute with any of the other insurance, whether primary, excess, contingent or on any other basis. **However:**

**(1) This condition will not apply to other insurance specifically written as excess over this Coverage Part.**

**(2) The insurance provided under this Coverage Part will not seek contribution from any other insurance available to an additional insured, provided that:**

**(a) The additional insured is a Named Insured under such other insurance;**

**(b) The additional insured is shown in the Schedule; and**

**(c) You have agreed in writing in a contract or agreement that this insurance would not seek contribution from any other insurance available to the additional insured.**

When this insurance is excess, if no other insurer defends, we will undertake to do so, but we will be entitled to the insured's rights against all those other insurers.

**CX 24 33 11 16**

**Non-contributory  
doesn't quite get  
us there**

# Non-Contributory Without Primary

Umbrella - CU 24 78 11 16

Paragraph 5. of Section IV – Conditions is replaced by the following:

## 5. Other Insurance

a. This insurance is excess over, and shall not contribute with any of the other insurance, whether primary, excess, contingent or on any other basis. However,

(1) This condition will not apply to other insurance specifically written as excess over this Coverage Part.

(2) The insurance provided under this Coverage Part will not seek contribution from any other insurance available to an additional insured, provided that:

(a) The additional insured is a Named Insured under such other insurance;

(b) The additional insured is shown in the Schedule, and

(c) You have agreed in writing in a contract or agreement that this insurance would not seek contribution from any other insurance available to the additional insured

When this insurance is excess, we will have no duty under Coverages A or B to defend the insured against any "suit" if any other insurer has a duty to defend the insured against that "suit". If no other insurer defends, we will undertake to do so, but we will be entitled to the insured's rights against all those other insurers.

b. When this insurance is excess over other insurance, we will pay only our share of the "ultimate net loss" that exceeds the sum of:

(1) The total amount that all such other insurance would pay for the loss in the absence of the insurance provided under this Coverage Part; and

(2) The total of all deductible and self-insured amounts under all that other insurance.

Non-contributory  
doesn't quite get  
us there

CU 24 78 11 16

# Horizontal Exhaustion: Two-Part Solution

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1. Contractual Insurance Requirement
2. Ensuring the Policy Complies
  - Review subcontractor's primary and excess liability policies to ensure they provide primary/non-contributory coverage for additional insureds
  - Review base policy for and modifying endorsements

# Sample Excess Policy Endorsement

## EXCESS LIABILITY PRIMARY AND NON-CONTRIBUTORY COVERAGE

This endorsement modifies insurance provided under the following:

### EXCESS LIABILITY POLICY

Paragraph 9. OTHER INSURANCE in **SECTION IV- EXCESS POLICY CONDITIONS** is hereby amended by the addition of the following paragraph:

When the **controlling underlying policy** is required by an insured contract to provide coverage for an **event** on a primary and non-contributory basis, the insurance afforded by this policy is primary to, and on a non-contributory basis with, any other insurance available.

ALL OTHER TERMS, CONDITIONS AND EXCLUSIONS OF THIS POLICY REMAIN UNCHANGED.

# Sample Excess Policy Endorsement

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## **Endorsement – Excess Liability Policy Priority of Coverage**

**THIS ENDORSEMENT CHANGES THE POLICY. PLEASE READ IT CAREFULLY.**

Any entity qualifying as an additional insured on the insurance stated in the Schedule of Underlying Insurance shall be an additional insured on this policy.

This insurance shall apply immediately upon exhaustion of the insurance stated in the Schedule of Underlying Insurance as respects the coverage afforded to any additional insured. This insurance shall apply before any other insurance available to the additional insured, on which the additional insured is a named insured, whether such other insurance is primary, excess, contingent, or on any other basis, and we will not seek contribution from such insurance for defense or indemnity.

Where an entity qualifies as an additional insured on insurance stated in the Schedule of Underlying Insurance based on a written agreement to provide liability insurance, the limits of insurance provided by this policy shall not exceed the limits of insurance required by such written agreement.



# Horizontal/Vertical Exhaustion Checklist

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## Risk Management/Pre-Litigation

- ✓ Check applicable state's law regarding horizontal/vertical exhaustion
- ✓ Require additional insured coverage be provided on a primary and non-contributory basis on the general liability and all excess liability policies
- ✓ Check policies' "other insurance" provisions and endorsements regarding horizontal exhaustion (i.e., primary, non-contributory coverage)
- ✓ Ensure that indemnity agreement is broad and enforceable
- ✓ Consider whether a consolidated insurance (aka "wrap-up") program is cost-effective and otherwise appropriate for your project

# Zeig Issue: Tapping Excess After Primary Settlement

- Insured (Zeig) experienced burglary loss.
- Excess policy applied “after all other insurance herein [\$5000] ... shall have been exhausted in the payment of claims **to the full amount of the expressed limits.**”
- Three underlying policies totaled \$15,000.
- Zeig settled claims with underlying insurers for \$6,000 .
- Excess carrier argued that policy language required underlying carriers to make **actual payments of full policy limits** before coverage under the excess policy was triggered.
- Held: Full payment unnecessary.

*Zeig v. Massachusetts Bonding & Ins. Co.*  
23 F.3d 665 (2d Cir. 1928)

# Zeig Rationale: Excess After Primary Settlement

Zeig Rationale (1): Presumed lack of concern by excess carrier.

**“The defendant had no rational interest in whether the insured collected the full amount of the primary policies, so long as it was only called upon to pay such portion of the loss as was in excess of the limits of those policies.”**

True?

- Excess carriers rely on primary carriers to contest coverage.
- Settling primary carrier may not investigate or contest fully.
- Shifts responsibility to excess to investigate.
- Akin to a drop – down.

# *Zeig* Rationale: Excess After Primary Settlement

*Zeig* Rationale (2): Public policy.

**“To require an absolute collection of the primary insurance to its full limit would in many, if not most, cases involve delay, promote litigation, and prevent an adjustment of disputes which is both convenient and commendable.”**

True?

- Most excess policies follow form to primary.
- The dispute doesn't die – it simply moves up the chain.
- Except now the excess carrier has to litigate meaning of the primary carrier's policy language, i.e., the language it followed.

# Zeig Rationale: Excess After Primary Settlement

*Zeig Rationale (3): Contra proferentum.*

**“A result harmful to the insured, and of no rational advantage to the insurer, ought only to be reached when the terms of the contract demand it.”**

True?

- Excess policies are for companies facing large losses.
- Usually these are large (sophisticated) companies, advised by sophisticated brokers (Marsh, AON, etc.)
- Does *contra proferentum* make sense?

# Tapping Excess After Primary Settlement

- Top Insurance Brokers By Revenue (2019)

- Marsh & McLennan Cos. - \$17B
- Aon Plc - \$11B
- Willis Towers Watson - \$9.04B

Source: AM Best

- Top Commercial Lines Insurers – Direct Premiums Written

- Chubb - \$19B
- Travelers - \$18.8B
- Liberty Mutual - \$17.1B
- Zurich - \$13.3B
- AIG - \$11.8B

Source: Insurance Information Institute

# Erosion of *Zeig*: *Qualcomm*

- Policy language rationale.
- Excess carrier “shall be liable *only after* the insurers under each of the Underlying Policies *have paid or have been held liable to pay the full amount* of the Underlying Limit of Liability.”
- “[I]n our view, the phrase “have paid . . . the full amount [of the primary policy],” particularly when read in context of the entire excess policy and its function as arising upon exhaustion of primary insurance, **cannot have any other reasonable meaning than actual payment of no less than the [full] underlying limit.**”

*Qualcomm v. Certain Underwriters*,  
73 Cal. Rptr. 3d 770 (Cal. App. 2008)

# Erosion of *Zeig*: *Comerica*

- Policy language rationale.
- “The cases that follow *Zeig* generally rely on an ambiguity in the definition of ‘exhaustion’ or lack of specificity in the excess contracts as to how the primary insurance is to be discharged.”
- “A different result occurs when the policy language is more specific. Payments by the insured to fill the gap, settlements that extinguish liability up to the primary insurer’s limits, and agreements to give the excess insurer “credit” against a judgment or settlement up to the primary insurer’s liability limit are not the same as actual payment. “
- **“Zurich’s policy requires “actual payment of losses” by the underlying insurer ... That never happened in this case.”**

*Comerica Inc. v. Zurich Am. Ins. Co.*,  
498 F. Supp.2d 1019 (E.D. Mich. 2007)

# Erosion of *Zeig*: Other Relevant Cases

## No Functional Exhaustion

- *Rapid-American Corp. v. Travelers Casualty and Surety Co.*, No. 15-01095 (Bankr. S.D.N.Y. June 7, 2016).
- *Forest Labs, Inc. v. Arch Ina. Co.*, 953 N.Y.S.2d 460 (N.Y. Sup. 2012), *aff'd* 984 N.Y.S.2d 361 (N.Y. App. Div. 2014)
- *Ali v. Federal Insurance Co.*, 719 F.3d 83 (2d Cir. 2013)
- *Quellos Group LLC v. Federal Ins. Co.*, 312 P.3d 734 (Wash. App. 2013).
- *Goodyear Tire & Rubber Co. v. Nat'l Union Fire Ins. Co. of Pittsburgh*, 694 F.3d 781 (6th Cir. 2012).
- *Intel Corp. v. American Guarantee & Liability Insurance Co.*, 2012 Del. LEXIS 480 (September 7, 2012)
- *CitiGroup v. Federal Ins. Co.* 649 F.3d 367, 372 (5th Cir. 2011)
- *JP Morgan Chase & Co. v. Indian Harbor Ins. Co.*, 2012 N.Y. App. Div. LEXIS 4627 (N.Y. App. Div. June 12, 2012.)
- *Bally Total Fitness Holding Corp.*, No. 06 C 4554, 2010 WL 25452191 (N.D. Ill. June 22, 2010)
- *Trinity Homes LLC v. Ohio Cas. Ins. Co.*, 629 F.3d 653, 657–58 (7th Cir. 2010)

## Allowing Functional Exhaustion

- *Pfizer Inc. v. U.S. Specialty Insurance Company*, 2020 WL 5088075 (Del. Super. Aug. 28, 2020).
- *Maximus, Inc. v. Twin City Fire Insurance Company*, 856 F. Supp. 2d 797, 798 (E.D. Va. 2012)
- *Trinity Homes LLC v. Ohio Casualty Insurance Co.*, 629 F.3d 653 (7th Cir. 2010).
- *Fremont Reorganizing Corp. v. Fed. Ins. Co.*, 2010 WL 444718 (C.D. Cal. Feb. 1, 2010)
- *Mills Ltd. P'ship v. Liberty Mut. Ins. Co.*, 2010 Del. Super. LEXIS 563 (Nov. 5, 2010).

# Continued Erosion: *Rohr*

- Environmental coverage dispute (annualization of limits).
- Insured compromises with first excess carrier.
- Seeks coverage on *Zeig* theory from second and third excess carriers (“constructive exhaustion”)
- Federal policy language: coverage would “apply ... in excess of and after all underlying insurance... has been exhausted.”
  - No reference to “full payment” of primary limit.
  - No requirement of payment by primary carrier.
- Held: Functional exhaustion disallowed.  
Full payment required by underlying carrier, despite lack of controlling language.

*Continental Casualty Co. v. Rohr, Inc.*,  
2020 Conn. App. LEXIS 366 (Dec. 1, 2020)

Questions?