

The Subcontract

In the written subcontract agreement between Whitin Electrical Contractors, Inc. (the Subcontractor) and Spartan General Contractors, Inc. (the Contractor), Whitin has agreed to include Spartan as an additional insured on Whitin's liability policies (for more on this, see [Contractual Risk Transfer: Contractual Indemnification Versus Additional Insured](#)). The limit required of Whitin by Spartan for liability insurance is at least \$5 million, which may be satisfied by a combination of Commercial General Liability (CGL) coverage and excess or umbrella liability coverage.

Further, Spartan has made it clear to Whitin that *all \$5 million of Whitin's liability insurance* is to respond first (primary) to any claims against Spartan as an additional insured and that Whitin's liability insurance will not share (non-contributory)¹ with any insurance available to Spartan. Spartan's liability insurance (which includes a \$1 million each occurrence CGL and a \$25 million Umbrella) is to respond only *as excess* of the \$5 million of liability insurance available to Spartan as an additional insured on Whitin's policy.

Whitin's Insurance

Whitin has purchased a CGL policy with a \$1 million each occurrence limit as well as an umbrella policy with a \$5 million limit – both include Spartan as an additional insured. The CGL does this via an automatic or “blanket” additional insured endorsement. Whitin's umbrella expressly states that any insured in the underlying insurance will also be an insured in the umbrella, but the coverage provided to the insured in the umbrella will be no broader than the coverage provided to that insured in the underlying policy.

Joe's Injury

A longtime employee of Whitin, Joe is injured on the jobsite on which Spartan is the general contractor. Because Joe's injuries are severe, he brings a claim against Spartan, alleging in the lawsuit that Spartan failed to maintain a safe workplace. Spartan tenders the claim to Whitin's CGL insurer as an additional insured. Whitin's CGL insurer accepts the tender and begins to defend Spartan against Joe's claim. What becomes obvious almost immediately is that Spartan is likely partly at fault for Joe's injury and also that Joe's damages may far exceed the \$1 million limit provided by Spartan's CGL insurer (the case is valued at \$2 million).

Settlement

After a long legal battle, the case is settled with Joe for \$1.5 million in damages. Whitin's CGL policy pays its full limit on behalf of Spartan - \$1 million.² However, Whitin's umbrella insurer refuses to pay the additional \$500,000 on behalf of Spartan. Whitin's umbrella insurer points to its “Other Insurance” condition, which states that Whitin's umbrella is *excess of any other insurance available*, unless that insurance is *specifically* written to be excess of Whitin's umbrella policy. As Spartan's CGL exists as other liability available to Spartan *and* Spartan's CGL was not specifically written to be excess of Whitin's umbrella, Whitin's umbrella insurer is demanding that Spartan's CGL policy *respond next* and pay the balance of the settlement - \$500,000. Whitin's umbrella insurer contends that it applies only as *excess* of Spartan's own CGL policy.

Vertical and Horizontal Exhaustion

Whitin is quite disturbed by this turn of events as this is not what they have agreed upon with Spartan. Spartan's CGL was intended to apply only when all \$5 million of Whitin's liability insurance was exhausted. This arrangement is sometimes known as *vertical exhaustion*. Of course, this is not what is happening. The order of coverage now being imposed upon Spartan (and Whitin) is sometimes known as *horizontal exhaustion* – that is, all primary policies must be exhausted *before* any excess or umbrella policies will respond.

Legal Opinion

Because Whitin has not complied with the subcontract agreement as respects the order of coverage for Spartan, Whitin's attorney Sarah looks into whether Whitin's umbrella insurer is correctly interpreting the policy. She finds very little case law on the matter – and none that apply in her state. The case law she does find is mixed – some courts follow the wording of the umbrella policy (which is similar to Whitin's umbrella “other insurance” condition) and thus follow *horizontal* exhaustion. Other states look *outside* of the insurance policies to the indemnity agreement to determine the intent of the parties as to the order of coverage, and thus follow *vertical* exhaustion. Sarah cannot tell which would apply in her state but intends to litigate the matter, and the outcome is far from certain.

(continued on next page)

To learn more about how AmWINS can help you place coverage for your clients, reach out to your local AmWINS broker or marketing@amwins.com.

If you do not have a contact at AmWINS to help with your casualty risks, [click here for a list of brokers on our website](#).

Legal Disclaimer - Views expressed here do not constitute legal advice. The information contained herein is for general guidance of matter only and not for the purpose of providing legal advice. Accordingly, the information provided herein is provided with the understanding that the authors are not engaged in rendering legal advice. You should contact an attorney to obtain advice with respect to any particular issue or problem. Any views or opinions presented are solely those of the author. Discussion of insurance policy language is descriptive only. Coverage afforded under any insurance policy issued is subject to individual policy terms and conditions.

 AmWINS
Group, Inc.

AmWINS Group, Inc. is a leading wholesale distributor of specialty insurance products and services. AmWINS has expertise across a diversified mix of property, casualty and group benefits products. AmWINS also offers value-added services to support some of these products, including product development, underwriting, premium and claims administration and actuarial services. With over 2,300 employees located in 21 countries, AmWINS handles over \$7 billion in premium annually through our four divisions: Brokerage, Underwriting, Group Benefits and International.

Going Forward

Whitin's attorney Sarah does meet with Whitin's insurance broker Claire to discuss how this situation can be handled in the future. Claire makes inquiries and does find that some of her umbrella insurers will, on a select basis, change the umbrella's other insurance condition. These umbrella insurers will agree to expressly state that in situations such as these, the other insurance condition will be amended to state that it will apply to an additional insured (if agreed to in a written contract) *before* the additional insured's own primary CGL policy protecting it as a named insured.

Conclusion

While a written subcontract usually prescribes the order of coverage (i.e., *all* of the subcontractor's liability insurance is to be primary to *any* of the general contractor's liability insurance), it is likely that any such agreement will be contrary to the standard other insurance wording found in the subcontractor's umbrella or excess liability policy. Because most damage awards or settlement amounts still fall within CGL policy limits, this coverage issue often does not arise until a serious claim occurs. However, when it does, knowing how an umbrella or excess liability policy will respond (i.e., the order in which coverage applies) is very important. Simply presuming that all umbrella or excess policies would "follow form" of the other insurance condition of a CGL policy or that "vertical exhaustion" will be adhered to is risky at best and usually in error.

Steps taken to amend the subcontractor's umbrella or excess liability other insurance condition are highly recommended to eliminate or at least minimize the problems resulting from horizontal exhaustion being imposed when vertical exhaustion was expected.

The general contractor, in our illustration Spartan, also has a strong interest in having this coverage issue properly handled. General contractors might consider inserting wording in the subcontract that if a subcontractor chooses to use a combination of CGL and excess liability to build up to the required \$5 million limit, any excess or umbrella policy that is purchased should also be amended to *expressly* have the umbrella or excess policy respond *before* any insurance available to the additional insured (such as the general contractor's CGL and umbrella). Further, considering that some courts look to the indemnity agreement to determine the order in which coverage is intended to respond, a general contractor is also well advised to make certain the indemnity agreement in its subcontract is properly written and enforceable in the jurisdiction in which the subcontract will be enforced.

Editorial note: AmWINS has a dedicated construction practice with brokers who are well versed in the issues related to additional insured status and order of coverage. Agents should contact their AmWINS broker with any questions.

¹ For more on meaning and implications of primary and noncontributory, see the following <http://www.irmi.com/expert/articles/2012/stanovich03-cgl-general-liability-insurance.aspx>

² This payment by Whitin's CGL insurer presumes that the two CGL policies involved have been arranged so that Whitin's CGL insurer will provide coverage to Spartan as an additional insured *first* and that Spartan's own CGL (a CGL on which Spartan is a named insured) will respond to cover Spartan only as *excess* of Whitin's CGL.

About the Author – Craig F. Stanovich is co-founder and principal of Austin & Stanovich Risk Managers, LLC, a risk management and insurance advisory consulting firm specializing in all aspects of commercial insurance and risk management, providing risk management and insurance solutions, not insurance sales. Services include fee based risk management, expert witness and litigation support and technical/educational support to insurance companies, agents and brokers. Email at cstanovich@austinstanovich.com. Website www.austinstanovich.com