



## Horizontal Exhaustion Rule Exception

*Indemnity Ins. Co. of N. Am. V. St. Paul Mercury Ins. Co., 2010 N.Y. Slip. Op. 03254 (N.Y. App. Div. 1<sup>st</sup>. Dept. April 22, 2010)*

### Summary

The Indemnity Insurance decision arises from the settlement of a bodily injury claim brought by a worker injured on the Manhattan Bridge renovation project. The City of New York (“City”) hired Yonkers as the general contractor for the project. In its contract, Yonkers promised the City defense and indemnity, as well as additional insured coverage on its policies. Yonkers hired subcontractor Romano, who also promised defense, indemnity and additional insured coverage to the City and Yonkers.

Yonkers’ insurance included a \$1 MM primary general liability policy and a \$5 MM excess policy, both issued by St. Paul. Romano’s insurance included a \$1 MM primary general liability policy issued by Royal Insurance (“Royal”), and a \$10 MM excess policy issued by Indemnity Insurance Company of North America (“Indemnity Insurance”).

During the project, Flood, a Yonkers employee, was injured by a cable which Romano neglected to remove from the area where Flood was performing work. Flood sued the City and Romano on labor law and negligence theories. The City tendered its defense to St. Paul pursuant to its status as an additional insured, and St. Paul accepted defense. Romano tendered its defense to Royal, who also accepted. St. Paul later tendered the City’s defense to Romano/Royal based on Romano’s contractual indemnity obligation to City. Royal accepted the tender without any reservation. After the start of the trial, Royal tendered the defense of the City and Romano to Indemnity Insurance based on the potential for exposure in excess of its \$1 MM limit.

At trial, the court entered a directed verdict against the City, finding it vicariously liable as the owner of the bridge, pursuant to Labor Law 240(1). The case settled for \$3 MM after the close of plaintiff’s case. Royal paid \$1 MM and Indemnity Insurance paid \$2 MM. The settlement agreement specified that the money was paid on behalf of the City and Romano. Notably, St. Paul was not part of the negotiations or settlement.

Indemnity Insurance then commenced a declaratory action against Yonkers and St. Paul, seeking to recover the \$2 MM it had paid. The trial court ruled in favor of St. Paul and Yonkers on motions for summary judgment and Indemnity Insurance appealed.

- In its claim against St. Paul, Indemnity Insurance argued that the St. Paul policy of Yonkers was primary coverage for the City and should pay before Indemnity Insurance. The court rejected the claim on two grounds. First, the court found that because St. Paul was not involved in the settlement and never consented to it, St. Paul could not be forced to fund it. Second, the court found that “horizontal exhaustion” principles, as articulated in TISHMAN CONSTR. CORP. OF N.Y. V. GREAT AM. INS. CO., 53 A.D.3d 416 (N.Y. App. Div. 2<sup>ed</sup> Dept. 2008), did not apply because of Romano’s independent contractual indemnity obligation to the City. The court stated: “Even if St. Paul’s coverage of the City were primary to that of IICNA, the City’s liability still would pass through to Romano and its insurers, Royal and IICNA.” This principle is often referred to as “circuity of litigation”.
- Indemnity Insurance’s claim against Yonkers was based on subrogation on the theory that, since Yonkers had promised contractual indemnity to City, Indemnity Insurance could subrogate to the City’s rights against Yonkers. The court held that, because Yonkers was an additional insured on the Indemnity Insurance policy, the claim was barred by anti-subrogation principles.



## Commentary

Most trade contracts require the downstream party to provide additional insured coverage to the upstream party on a primary and non-contributory basis. Market realities often require trades to furnish the required coverage limits through a combination of primary and excess policies. New York courts have disregarded the trade contracts, and instead, held that all primary insurance available to an insured must pay before any excess insurance. Practically, this often means that an upstream party's primary insurer must pay before the downstream party's excess carrier.

In Bovis Lend Lease, LMB, Inc. v. Great Am. Ins. Co., 53 A.D. 3d. 140 (N.Y. App. Div. 1st. Dept. 2008), the court held that trade contracts do not bind insurance carriers unless the policies specifically reference or incorporate the contracts. Absent policy language directing an excess policy to act on a primary basis for an additional insured, all primary coverage available to the insured must be exhausted first. This rationale was later echoed in Tishman Indemnity Insurance is the first New York appellate decision to describe a limitation or exception to the horizontal exhaustion principle articulated in Bovis.

In many jurisdictions, the courts do not apply horizontal exhaustion where circuitry of litigation applies, i.e., in a situation where the named insured owes contractual indemnity for damages to an additional insured, the named insured's policies, both primary and excess, will be obligated to pay under the contractual indemnification provisions, and therefore, vertical exhaustion will apply. Indemnity Insurance is the first case addressing circuitry of litigation in New York. Circuitry of litigation was not raised in the Tishman case, and the decision is silent as to the contractual indemnity rights between the insureds. Although circuitry of litigation was raised in Bovis, the court addressed the issue of priority of coverage before resolution of the underlying case. In declining to consider the effect of circuitry of litigation, the Bovis court stated that the issues concerning contractual indemnification were not before it and might be resolved in later litigation. Thus, the Indemnity Insurance decision is not inconsistent with Bovis or Tishman, and presents an exception to the effect of horizontal exhaustion in New York.

In light of the Indemnity Insurance decision, the priority of coverage between insurers may not always be determined by the principle of horizontal exhaustion. Practically speaking, this decision may place pressure on excess insurers who want to take advantage of horizontal exhaustion to disclaim coverage, rather than pay first and then seek contribution as Indemnity Insurance did in this case.