The Subcontractors' Warranty Endorsement

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If you have clients who are construction companies, maintenance companies, or other companies who perform work through subcontractors, you may encounter the "Subcontractors' Warranty Endorsement" or similarly named endorsements[1] on your client's Commercial General Liability policy. The general intent of such an endorsement is to require your client to obtain additional insured status on the CGL policy of its subcontractor and to make your client's policy excess over the subcontractor's policy. Additionally, the endorsement may create drastic consequences for your client if the endorsement's requirements are not fulfilled.

The wording of the "Subcontractors' Warranty Endorsement will vary from insurer to insurer, but here are the principal terms, paraphrased, of an endorsement I recently encountered. First, there is the requirement to be made an additional insured on the subcontractor's policy:

> As a *condition precedent* to coverage for *any insured* under this policy for any suit arising out of or allegedly involving work performed on the insured's behalf by a subcontractor, the insured *warrants* that it shall require all subcontractors to maintain CGL insurance coverage underwritten by a company with at least an "A" rating from the A.M. Best Company, with minimum limits of $_____ Per Occurrence, $_____ General Aggregate, and $_____ Products-Completed Operations Aggregate. The insured further warrants that it will be named as an additional insured on all such subcontractors' CGL policies. (Emphasis added).

Note that the foregoing requirement (to be made an additional insured on the subcontractor's policy) is a condition precedent to any coverage that might also be available under your client's policy. Moreover, this requirement is not just a "best efforts" undertaking but a warranty that it will be done. Further, the requirement applies to all insureds under your client's policy, not just your client, the named insured. So, if your client (Company B) is a subcontractor to a general contractor (Company A) who has been made an additional insured on your client's policy, your client has to secure additional insured status for both itself and Company A on your client's subcontractor's (Company C's) policy.

In addition to requiring that your client obtain additional insured status on the subcontractor's policy, the endorsement may require that your client obtain an indemnity agreement from the subcontractor.

The endorsement continues:

> Furthermore, the insured *shall obtain all necessary documentation* to *ensure* that such coverage has been obtained by all subcontractors. The CGL coverage maintained by subcontractors shall be primary, *and this policy shall be excess*,

[1] Some examples are "Contractor's Warranty Endorsement" and "Contractor's Special Conditions Endorsement."

> notwithstanding the language of the Other Insurance provisions in the subcontractor‘s policy. (Emphasis added).

The necessary documentation that your client should obtain is not a worthless Certificate of Insurance but the actual endorsement on the subcontractor's policy that ensures your client has obtained additional insured status. The endorsement may name your client specifically, or it may be a blanket endorsement giving additional insured status to a class of persons. You or your client needs to be familiar with the possible endorsement forms.

The foregoing provision of the "Subcontractors' Warranty Endorsement" also attempts to make your client's policy excess over the subcontractor's policy. Whether that attempt succeeds may depend on language in the subcontractor's policy.

Now, consider the consequences of failing to fulfill the requirements of the "Subcontractors' Warranty Endorsement":

> If any insured has not obtained the insurance set forth above from a subcontractor and seeks defense or indemnity under this policy, *the insured seeking coverage* shall pay a self-insured retention as a condition precedent to any duty to defend or indemnify (*in addition to any other applicable deductible or retention*). The self-insured retention shall be the amount in the schedule shown above [$ _____] and it will apply *for each "subcontractor"* who failed to name the insured as an additional insured. We shall have no obligation for defense or indemnity of any insured for any "suit" arising out of or allegedly involving subcontractor(s), if all of the terms and warranties of this Endorsement are not satisfied and the self-insured retention(s) are not promptly paid by the insured. (Emphasis added).

Under this endorsement, the consequence for non-fulfillment is the imposition of a new self-insured retention in addition to any other retentions or deductibles otherwise existing under the policy. The new self-insured retention requirement will likely be substantial—perhaps commensurate with the subcontractor's limits or with your client's claim history. Note that the new self-insured retention applies to each insured seeking coverage, so it might apply to your client and to your client's general contractor (Company A), if Company A has been made an additional insured on your client's policy. Additionally, your client may need to satisfy the new self-insured retention several times, because it applies for each subcontractor that has not made your client an additional insured.

Rather than imposing a new self-insured retention, the "Subcontractors' Warranty Endorsement" might provide that, as a consequence of non-fulfillment of its requirements, your client's policy will provide no coverage whatsoever—not even coverage above an SIR. Such a provision might seem akin to an unenforceable "escape" clause, but some courts will look to the "condition precedent" language in the endorsement and allow the insurer to avoid coverage completely. See *Meridian Constr. v. Admiral Ins. Co.*, 105 F.Supp.3d 1331 (M.D. Fla., 2013); *Sasser v. Wintz*, 102 So.3d 842 (La. App., 2012); *North American Capacity Ins. Co. v. Claremont Liability Ins. Co.*, 177 Cal.App.4th 272, 99 Cal. Rptr. 3d 225 (Cal. App., 2009).

So what are you to do when your client has not fulfilled the "Subcontractors' Warranty Endorsement" and is looking at a substantial, new SIR or the voiding of coverage altogether? Find a way around the endorsement.

Is it necessarily true that the suit arises solely from the work of your client's subcontractor so as to be subject to the endorsement? Doesn't the suit contain some allegations that your client was at fault as well? It may well be the case that your client was blameless and that all the fault lies with the subcontractor, but your client needs a defense from its insurer, and the duty to defend turns on the allegations in the case (whether true or not) and on the potential for coverage under your client's policy, not on the ultimate merits. Consider the following cases where the insured (assume your client) avoided the "Subcontractors' Warranty Endorsement."

In *Evanston Ins. Co. v. American Safety Indemnity Co.*, 768 F.Supp.2d 1004 (N.D. Cal. 2011), Evanston Insurance Company sought equitable contribution from ASIC for the cost of defending their mutual insured, Northern Cal, a home developer, in connection with a suit against Northern Cal and its subcontractors for defective construction of some twenty-one homes over the course of several years. Evanston and ASIC had coverage on Northern Cal for different policy years. Northern Cal tendered its defense to both Evanston and ASIC. Evanston accepted, but ASIC responded that, pursuant to the subcontractor warranty endorsement on its policy, Northern Cal would have to pay over to ASIC a $50,000 SIR and demonstrate that it had been named as an additional insured under all its subcontractors' policies. Northern Cal objected, stating that "all damages and attorneys will ultimately be paid by subcontractor insurers. To the exten[t] they are not, Northern can and will pay up to $50,000 at the end of the settlement process." 768 F.Supp.2d at 1009. This did not satisfy ASIC, so it did not participate in Northern Cal's defense. After the underlying defective construction suit was resolved, Evanston sued ASIC for equitable contribution for the costs of defending Northern Cal. ASIC moved for summary judgment and argued, among other things, that it had no duty to defend Northern Cal because it had not satisfied the subcontractors warranty endorsement. The court examined the complaint in the underlying action and observed that the allegations of fault were not limited to the subcontractors. Some of the claimed damages were alleged to be Northern's fault. Moreover, the court noted that "Defendant [ASIC] does not point to any evidence that any or all of the damages alleged in the [underlying action] are attributable to Northern Cal's subcontractors." 768 F.Supp.2d at 1011. Consequently, there was a potential for coverage under the ASIC policy outside the subcontractors warranty endorsement, and ASIC had a duty to defend.

Similarly, in *Underwriters of Interest Subscribing to Policy No. A15274001 v. ProBuilders Specialty Ins. Co.*, 241 Cal.App.4th 721 (2015), Underwriters sought equitable contribution from Probuilders Specialty Insurance Company for its refusal to defend their mutual insured. Probuilders Specialty moved for summary judgment arguing, among other things, that it had no duty to defend because the insured had not satisfied the Contractors Special Conditions endorsement requiring the insured to obtain indemnity agreements and certificates of insurance from its subcontractors. Citing *Evanston Ins. Co. v. American Safety Indemnity Co.*, supra, the court found that the endorsement did not apply because the underlying case against the insured included allegations of the insured's own negligence. The court stated, "ProBuilders's showing below did not conclusively establish that all of the claims against Pacific Trades [the insured] in

the [underlying] lawsuit were limited to claims based on work performed by independent contractors." 241 Cal.App.4th at 734.

To the same effect is *Everest Nat. Ins. Co. v. Jeffrey Novak General Contractor, Inc.*, 16-cv-04814 (N.D. Cal. Jan. 2, 2018). In refusing to defend Novak in an underlying defective construction suit, the insurer, Everest, relied on its contractors warranty endorsement. Everest contended that all of the damage claimed in the underlying suit related to the work of Novak's independent contractors. But the underlying complaint belied Everest's contention because it expressly charged Novak itself with breaching the standard of care in the construction of the property. The court stated:

> The complaint clearly does not state, and Everest has not submitted any undisputed evidence to show, that the alleged injury in the underlying case was caused *only* by the work of Novak's independent contractors. There is a meaningful possibility that Novak has some responsibility and liability to plaintiffs in the underlying case, aside and apart from any work done by independent contractors. Even assuming that Everest is right about Novak's failure to satisfy the general contractors warranty endorsement, Everest still would not be entitled to a declaration that that failure "excludes any claim for coverage."

In these three cases, the insured avoided the "Subcontractors' Warranty Endorsement" or similarly named endorsements. However, the endorsement can be very dangerous. If you have the opportunity, make sure your client fully understands what is required by the endorsement in terms of subcontractor coverage, additional insured status, and indemnity agreements. If it's too late, your client did nothing, and a suit has arisen, you should parse the language of the endorsement carefully. Is the endorsement a condition precedent? What requirements of the endorsement were mandatory ("shall") as opposed to suggested ("should")? And, to get a defense from your client's insurer, look for an argument that the suit doesn't arise solely from the subcontractor's fault but potentially involves fault by your client as well.