Additional Insureds Beware: State Farm Policies Don't Satisfy Your Contractual Requirements

By Theresa A. Guertin

Recently a colleague and I published a whitepaper on New York Labor Laws and Action Over Exclusions, which has drawn some interesting follow-up questions. In particular, several individuals reached out to us about the short reference to State Farm's policy wording which we categorize as a labor law exclusion. I thought this would be a good opportunity to further expand on the problems we have seen with State Farm policies, especially in New York, since this insurer has become such a major player in the subcontractor insurance marketplace over the past few years.

State Farm Primary Policies

State Farm has several additional insured endorsements at its disposal on its New York placements, but all of them contain the following unusual limiting language:

Any insurance provided to the additional insured shall only apply with respect to a claim made or a "suit" brought for damages for which you are provided coverage.

This wording is unique to State Farm; it does not appear in an ISO endorsement, nor have I ever seen it on any other additional insured endorsement, manuscript or otherwise. Given the well-settled principle of insurance policy interpretation that all "unambiguous provisions must be given their plain and ordinary meaning," and that policies "should be construed so as to give full meaning and effect to all of their provisions," the limitation is serious cause for concern. [1]

Imagine the following extremely common scenario: an Owner and General Contractor are added as additional insureds to a State Farm policy issued to a Subcontractor. The Subcontractor's employee is injured on the project and brings a suit under Labor Law §§ 200, 240, and/or 241 against the Owner and General Contractor. The employee does not, of course, sue the Subcontractor (their employer)

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[1] U.S. Fid. & Guar. Co. v. Ashley Reed Trading, Inc., 43 F. Supp. 2d 271, 277 (S.D.N.Y. 2014), quoting Allianz Ins. Co. v. Lerner, 416 F.3d 109 (2d Cir. 2005), LaSalle Bank Nat'l Ass'n v. Nomura Asset Capital Corp., 424 F.3d 195 (2d Cir. 2005).

since they are precluded from doing so pursuant to the "exclusivity" provision of the state Workers' Compensation Law – the section of the law which states that worker's comp is the sole remedy for an employee vis-à-vis their employer. The Owner and General Contractor tender the claim to State Farm, seeking a defense and indemnity in the employee's case.[2]

State Farm, however, denies their AI tender, citing the language above. The named insured (the Subcontractor) does not have coverage for an employee bodily injury suit because of the employer's liability exclusion. Thus, it follows, the additional insureds likewise do not have coverage because of the unique limiting language State Farm has appended to its AI endorsements.

State Farm has made this argument before, albeit in an Indiana federal court. In State Farm Fire & Casualty Co. v. Vidal, State Farm used this language to deny coverage to an additional insured in a bodily injury dispute. The Named Insured, Mr. Vidal, was performing lawn maintenance work for Integra Bank when he fell into a hole on the property and injured himself. State Farm argued that Integra was not entitled to additional insured coverage under Mr. Vidal's policy because Mr. Vidal himself was the claimant – and he was prohibited from obtaining coverage under his own policy for injuries he himself sustained. Clearly, State Farm is aware that the language in its additional insured endorsements may be used to deny coverage whenever the Named Insured is not entitled to coverage under the policy – it is only a matter of time until they use the language to deny labor law-related AI tenders in New York.

What is the solution? An Owner or General Contractor could take the risk that State Farm will *not* apply the wording as predicted here. It is true that this has not been litigated in New York – although, in our view, there is a huge potential gap in coverage here that State Farm is sure to exploit if the stakes are high enough, as it did in the Vidal case. Alternatively, an Owner or General Contractor could require its State Farm-insured subcontractors to purchase an Owner Contractor Protective, or OCP, policy as a gap-filler. This coverage, also offered by State Farm, is often a less expensive solution for a subcontractor than a wholesale replacement of their coverage with a different carrier.

State Farm Excess Policies

Unfortunately, the problems with State Farm policies do not end there. State Farm's Commercial Liability Umbrella Coverage Form also lacks two critical provisions – a primary and non-contributory endorsement and a waiver of subrogation endorsement – which nearly all upstream parties contractually require of their subcontractors. This is not that surprising, as most base policy forms do not include these provisions on the excess level; but what sets State Farm apart is that it does not have *any* available endorsements to add these provisions to its policies.

I have heard many arguments as to why these endorsements are not required. Most commonly, brokers have told us that the policy is "follow form" and that, therefore, the endorsements are not necessary. However, the Bovis Lend Lease LMB, Inc. v. Great American Insurance Co.[3] case, which was handed down over a decade ago by the New York appellate level court, clearly demonstrates

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[2]Assume, for purposes of this hypothetical, that the Subcontractor also contributed in some material way to the injury such that the proximate causation requirement set forth in Burlington Ins. Co. v. NYC Transit Auth., 79 N.E.3d 477 (N.Y. 2017) is satisfied.

[3]53 A.D.3D 140 (1st Dep't. 2008).

the necessity of such endorsements on excess policies. In that case, the court applied the principle of "horizontal exhaustion" to find that a construction manager's primary coverage had to contribute to a judgment prior to subcontractor excess/umbrella policies because those policies clearly stated that coverage was excess over all other insurance. The fact that the trade contracts mandated that the limits provided by the excess policies apply on a primary and non-contributory basis was deemed irrelevant since the terms of the insurance policy itself controlled.

I have also been told that the endorsements are unnecessary because State Farm issued both the primary and the excess policies – although, to be fair, I have heard this in regard to other package policies issued by other insurers as well. Someone once told me that the Bovis case only relates to umbrella policies, not excess policies (or vice-versa). However, these arguments are clearly specious when you analyze the plain language of the policies.

Most excess/umbrella policy forms provide that the coverage follows form *except where it does not.* For example, AIG's excess policy form provides that "[c]overage under this policy will follow the terms, definitions, conditions, and exclusions of Scheduled Underlying Insurance, ***subject to*** the Policy Period, Limits of Insurance, premium, and ***all other terms, definitions, conditions and exclusions of this policy.***" Arch has a more pointed approach, stating that "[i]f any provision of the controlling underlying insurance conflicts with any provision of our insurance, then the provision of our insurance will apply." Clearly, follow form wording is not an absolute.

State Farm's Commercial Liability Umbrella Coverage Form does not contain any follow form wording applicable to the entirety of the policy. Indeed, the only place follow form wording appears is in certain exceptions to exclusions (e.g., the Employer's Liability exclusion). As such, there is no argument that the terms of the Umbrella policy apply on a follow form basis.

In any event, even if the policy form did contain follow form wording, the policy's conflicting provisions would control. State Farm's Umbrella form provides the following with respect to other insurance:

> **6. Other Insurance**
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> a. This insurance is excess over, and will not contribute with any of the other insurance, whether primary, excess, contingent or on any other basis. This condition will not apply to insurance specifically written as excess over this policy. . . .

This wording is almost precisely what the Bovis court determined mandated application of horizontal exhaustion. Similarly, the State Farm Umbrella form provides:

> **9. Transfer of Rights of Recovery Against Others To Us**
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> If the insured has rights to recover all or part of any payment we have made under this policy, those rights are transferred to us. The insured must do nothing after loss to impair them. . . .

This is the antithesis of a waiver of subrogation because it *retains* the carrier's right to subrogate against a third-party.

Conclusion

You may be reading this and wondering – what now? If you are an upstream party, there is a decent chance you have subcontractors insured by State Farm who are not providing you with the coverage you contractually require. The most conservative (and, admittedly, impractical) approach is to reject State Farm placements outright. A more realistic solution is to require an OCP policy from any subcontractor insured by State Farm to plug some of the gaps caused by their unique additional insured limitation.

On the excess level, State Farm representatives strenuously disagree with my analysis as far as I can tell. Several agents of the company have issued letters on State Farm letterhead warranting that the policy will apply on a primary and non-contributory basis excess of the underlying policy and that the policy waives subrogation in favor of the additional insureds. This sort of written affirmation should be compelling evidence if State Farm backpedals on its representations about its policy wording.

A better alternative would be for State Farm to offer the forms that everyone expects are on the policies in the first place. My hope in drafting this article is to get the attention of relevant decision-makers at the company and persuade them of the necessity of doing so. Until that time, Owners and General Contractors should take steps to protect themselves.

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