Additional Insureds: Manage the Added Risk

Business relationships are, without question, demanding. While many engineering firms aim to go above and beyond in the name of customer service or to build strong business partnerships, going too far can be detrimental to a company despite its best intentions.

Consider the practice of insuring clients under the firm’s insurance policy. Many companies are called upon to include various business associates as “Additional Insureds” under their general liability insurance and, in some instances, professional liability policies. Contract demands are typically the reasons behind adding another party to your insurance policy. When hiring a firm, many companies seek ways to transfer the risks of the project. Acquiring additional insurance coverage by requesting to be added as an Additional Insured to a contracted firm’s policy certainly does just that.

Problem Areas

While this may seem like a harmless practice, it certainly poses its problems. For one, although Additional Insureds pay no premium for the policy, they are offered some of the same rights under a policy. With certain language in an Additional Insured endorsement, a firm or owner with Additional Insured status may consume this coverage before his or her own insurance coverage is triggered. Adding another party to your insurance coverage also means that you are sharing liability limits and, therefore, you face the possibility that your Additional Insured could dilute your own policy limits, leaving little coverage for you in the end.

There is also the issue of a policy’s deductible. If a claim involves the Additional Insured, who is responsible to pay the deductible before additional expenses are paid by the insurance policy? If terms are not carefully defined as part of the Additional Insured endorsement, you, the policyholder, may be held responsible for paying the deductible before activating any additional protection from the policy. Additionally, such a claim or loss by an Additional Insured could have a long lasting effect on your own insurance coverage in the future, including the possibility of higher premiums.

A typical Additional Insured endorsement restricts coverage for the Additional Insured to situations where the liability arises out of work or operations performed by or on behalf of the Policyholder for the Additional Insured, thus protecting a client, owner or subcontractor from vicarious liability arising out of the Policyholder’s actions. These endorsements, however, have been broadly interpreted to afford the Additional Insured broader coverage than the primary Policyholder. In one instance, a Policyholder’s employee filed a claim for injury against a subcontractor — which was an Additional Insured. The insurance carrier denied the claim based on the exclusion of bodily injury. In court, however, the insurance carrier’s argument was rejected because a “Separation of Insureds” clause in the policy said that the insurance coverage is applied separately to each insured. Since the Additional Insured endorsement did not have any such exclusion for employee bodily injury, it was covered for that exposure, even though the Policyholder was not. (Erdo v. Torcon Construction 275 NJ Super. 117 (1994))

Therefore, there is the possibility that when naming an Additional Insured, the Policyholder can be providing unintended coverages, such as personal injury coverages. To avoid this, Additional Insured endorsements should contain clearly defined limitations and obligations on the coverage provided.

Most Additional Insured endorsements are added to general liability policies, although you may be faced with a contract demand to include a client or owner on your professional liability policy. A common argument for not granting Additional Insured status to an owner on a professional liability policy is that they have no insurable interest. A professional liability policy covers claims arising from an Insured rendering professional services to others. The policy is designed to pay out on behalf of the Policyholder, not to the Policyholder directly. Since an owner or client does not render the actual professional services, they have no insurable interest. Likewise, since the owner is frequently the one looking to recover damages from a contractor or design professional, this situation creates a real conflict of
interest. For these reasons, adding an Additional Insured to a professional liability policy is often not an available option. The one exception to this may be a project-specific professional liability policy. In this case, an owner, as an Additional Insured, would be protected for their vicarious liability as the project owner.

Conflicts of Interest

Handling the conflicts of interests that accompany Additional Insured agreements are particularly challenging. Consider the defense conflicts that may arise for your insurance company. When a claim arises, often the best defense for one business or party being sued is passing the blame on to another. If one insurer is charged with defending multiple insureds on one policy, the potential for conflict of interest can arise.

There is also the whole issue of a contract’s indemnity agreements. The intention of a contract’s indemnity agreements is to limit a company’s liability. Indemnity agreements offer important protection in the event of a loss or litigation. On the other hand, Additional Insured coverage creates exposure to liability that otherwise would be contractually or legally precluded by an indemnity agreement. By allowing another party Additional Insured status — often with whom you are entering into a contractual agreement — you are frequently bypassing some of the protective indemnifying language, which limits the responsibility of your company that you have placed in your contract. Basically, you could be providing your client with a means to claim damages directly under your insurance coverage even if the claim asserted was due to the sole negligence of the Additional Insured itself. This is a condition of “contractual liability” coverage that typically would be barred under your Commercial General Liability (CGL) policy and be limited by your contract’s indemnity agreement.

Therefore, your contract may have closed the “front door” to any direct claims for indemnification or for defense of such claims. However, by adding an Additional Insured to your policy, you have opened another door for your client to seek damages.

Taking Precautions

As more and more situations for adding Additional Insureds to policies arise, a firm is faced with evaluating this risk and possibly turning away from the business or opportunity. If walking away from the business opportunity is not the best decision, the language of the Additional Insured endorsement should be evaluated and contractual terms should be negotiated to effectively and fairly limit the Policyholder’s exposures to such an arrangement.

When posed with a client request to be added to your insurance policy, what are the options? What are the precautions to be taken if you decide to add another party to your insurance policy? When do you walk away from the deal because the risk is too great? No one can answer the latter but you, the firm that is accepting the risk.

However, there are steps that you can take. First, evaluate the firm. Secondly, language and terms are the best precautions to take if you decide to accept the risk. Just as you have a certain amount of control over your insurance "destiny," such as implementing programs to improve safety, control liabilities, identify problem areas, and properly train and educate employees to control insurance costs, so too should your potential Additional Insured. Remembering that when an additional party is added to your insurance, your control of the Additional Insured’s activities or procedures is very limited, if not non-existent. When considering adding an Additional Insured to an insurance policy, the policyholder should evaluate if the Additional Insured is a "good" risk. It is important to review their capabilities. What is their loss history? What is their financial viability? What hand will they play in the scope of work being performed? What are the qualifications of the Additional Insured’s personnel who may be overseeing or managing the project from their end? It is also important to obtain certificates of insurance to determine what coverage they already have in place.

If the risk is acceptable, terms and conditions should be clearly spelled out in both the insurance policy endorsement and the contractual agreement. The terms of the Additional Insured endorsement need to be carefully addressed. For instance, contractual arrangements should be made for how a deductible will be handled should the Additional Insured be filing the claim. The endorsement should specifically identify what coverages are included and/or excluded as part of this endorsement (e.g., personal injury, etc.). Many Additional Insured endorsements also have an “Other Insurance” clause that outlines how an insurance policy will respond when another insurance policy is available and would also cover the claim.

Finally, Additional Insured requirements typically provide little benefit to the company holding the policy. The reality is that customer demand often has to be met, unless your firm is willing to pass up projects where there are Additional Insured requirements. If faced with this situation, it is then wise to take all proper precautions to assure that your firm is not exposed to additional liabilities that may be posed by this situation. You, the insured, can now use this information to provide a comfort level to the insurance carrier when asking to add one of your clients, an additional risk
to your policy.