Additional Insured Coverage: Unveiling Myths & Reality Planning

Every company involved in the construction of a building and/or the on-going use of a commercial property knows that additional insured coverage is a required element for any contract or lease. Sometimes a party is giving additional insured coverage, other times the party is receiving the coverage.

Beyond this limited level of knowledge, most companies merely check the box to ensure that the words ‘insurance’ and ‘additional insured’ appear in the contract or lease and then give no further thought to how much coverage has been conferred or, indeed, whether the words in the contract are sufficient to confer any insurance rights at all.

Moreover, most companies fail to recognize that the words in the contract or lease are crucially important in terms of setting the parameters for the additional insured coverage provided. Additional insured coverage can be a slippery slope depending on whether coverage is being given or received.

Before entering into your next agreement, consider the following myths about additional insured coverage and best practice tips for establishing reasonable expectations vis-à-vis additional insured coverage:

Myth #1
A Certificate of Insurance is Sufficient to Establish Additional Insured Status.

This is a common misconception. A certificate of insurance is a pre-printed form that is usually prepared by the named insured’s insurance broker. A careful reading of the certificate reveals that, at face value, the certificate is being provided only for the purpose of demonstrating that the named insured has coverage with the insurance company identified, in the amounts identified, and during the policy period identified.

Some certificates of insurance even state (in the very fine print) that the recipient of the certificate has no rights at all under the policy. In order to obtain additional insured status, the certificate must explicitly identify the recipient’s company by name and designate it as an additional insured.

Alternatively, the company may have to review the named insured’s policy to determine whether it contains a broad form additional insured endorsement, which in essence establishes additional insured status for any party that has entered into an insured contract with the named insured. The broad form endorsement has become commonplace for companies engaged in construction activities.

Best Practices Tips:

Don’t find yourself, as many companies do, thinking about these issues only after a loss has occurred and you realize that the named insured has not complied with its insurance obligations under the contract.

Ask for the certificate of insurance. Read it to ensure that the certificate identifies your company by name and as an additional insured.

And lastly, keep a copy of the certificate in your files regarding the project because that is the first place you will look for it when the loss occurs.

Myth #2
Limits of Liability Identified in the Certificate will be Sufficient and Available to Cover Any Loss.

Most contracting parties include minimum insurance limits that must be carried while the contract remains in effect. Thereafter, the party receiving the insurance assurance sometimes requires production of the certificate of insurance to demonstrate compliance with the contract provision. However, many parties overlook three critical issues that often arise.

First, the limits will be available to both the named insured and the additional insured. Therefore, depending on the size of the project and the ultimate ensuing loss, the limits may be eroded quickly and patently insufficient.

Second, the limits identified in the certificate will be available to the named insured, and any additional insured party with which the named insured may contract, for other losses that may take place during the policy period.

In other words, regardless of the number of contracts that the named insured enters, regardless of the number of additional insured parties which may have rights under the policy, and regardless of the number of losses that may be experienced, the insurance company has contracted to provide only one aggregate limit that will be available during the policy period to all potentially covered parties.

Third, in some policy forms, defense costs paid on behalf of an additional insured may erode the policy limit. Again, depending on the nature and size of the loss, this provision may have a severe negative impact on the availability of overall limits in today’s climate of scorched-earth, expensive litigation.
**Best Practices Tips:**

To address these issues, companies that intend to rely on the insurance of a contracting party must: (a) develop minimum limit requirements that evaluate a realistic loss scenario; and (b) ask not only for the certificate of insurance, but also obtain representations regarding:

- the number of other additional insureds that may have access to the subject policy; and
- the level of limit erosion, if any, for the insurance policy that is being offered to comply with the insurance requirements of the contract.

Depending on the activities of the named insured, you may want to require increased limits to account for the many potential mouths to feed in the event of major and/or successive losses.

Conversely, the party supplying additional insured coverage must be sure that: (a) all defense costs are paid outside of the limits of liability; or (b) its defense obligation is capped at a reasonable amount. The last thing the named insured wants to do is pay for an insurance policy that is used largely, if not entirely, to defend someone else.

**Myth #3**

An Additional Insured Party Will Only Have Access to the Named Insured’s Policy for Vicarious Liability.

One of the goals of any contract is to establish that each party should be responsible for its own negligence, even if a court of law may impose vicarious liability against the innocent contracting party.

For example when a general contractor (GC) is bidding out work on the construction of a commercial building, the GC seeks to establish in its contract with each subcontractor that it will not be responsible for damages that are suffered as a result of the subcontractor’s work performed on the construction project.

One way for the GC to insulate itself from liability is to require the subcontractor to name the GC as an additional insured party on its policies. However, as many subcontractors have learned, courts do not always limit the scope of insurance available to the GC to those scenarios where a GC is being held vicariously liable for the conduct of the subcontractor.

Rather, many courts have allowed GCs to recover under the subcontractor’s policy where the loss ‘arises from’ the subcontractor’s work, even where the GC has in whole or in part...
caused the loss through its own negligence. Similar issues have arisen with respect to leases.

Importantly, when courts evaluate whether additional insured coverage should be limited to vicarious liability as opposed to contributory/sole negligence scenarios, the contract language establishing the insurance requirement becomes the linchpin of the analysis.

Courts routinely strive to fulfill the reasonable expectations of the contracting parties, and therefore, may broadly construe the insurance obligations unless the contract mandates a narrow scope of coverage.

**Best Practices Tips:**

The party required to supply additional insured coverage should take great care in the contract drafting stage to make clear that its insurance obligation is limited to loss that arises from the named insured’s negligence.

Alternatively, the party required to provide insurance may seek a cap of its overall indemnity obligation to account for its potentially limitless liability if the broader ‘arising from your work’ language is used in the contract. Conversely, the party receiving additional insured coverage should strive to keep the contract language as broad and ambiguous as possible.

**Conclusion**

As construction defect and commercial property litigation continues to rage, the importance of understanding the nature and scope of additional insured coverage cannot be overstated. Insurance companies are actively looking for ways to narrow their coverage obligations to additional insured parties.

The parties that are counting on the coverage to be available must be extremely diligent in the contract drafting process. Those parties that are required to provide additional insured coverage must proactively take steps to ensure that their compliance with the insurance requirements in the contract does not make them vulnerable to place their entire insurance program at risk.

These best practices tips should go a long way toward achieving both parties’ goals and establishing reasonable expectations with respect to additional insured coverage.

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