Certificates of insurance are not a foolproof way to ensure that you have the additional insured coverage you need. Here's what to ask for as proof of appropriate coverage.

"Certificates of Insurance" and "Additional Insured" Coverage: Maximize Value and Avoid Pitfalls

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Parties doing business together commonly request and receive "additional insured" protection, but rarely understand the full benefits and risks associated with the coverage. What's more, many companies are sitting on one or more certificates of insurance purportedly evidencing their "additional insured" protection, but certificates of insurance are not a foolproof way to ensure actual coverage. The following overview attempts to demystify some of the nuances of "additional insured" coverage and provides useful tips to help your company ensure that its "additional insured" procedures and practices are effective.

The Basics: Who Is an "Additional Insured"?

Starting with square one, it's important to understand who an "additional insured" is. It's not a "named insured." And it's not an "additional named insured." These are the entities to whom the policy is issued. Named insureds have the greatest responsibilities (e.g., premium payment) and rights (e.g., ability to negotiate terms) under the policy.

An "additional insured," in contrast, is generally a person or entity that is doing business with the named insured (or additional named insureds), such that it makes sense to add the other person or entity as an "additional insured" to the policy by endorsement or amendment. "Additional insureds" have fewer responsibilities and rights under the policy. They are not responsible for premiums, and they have no direct control over the maintenance or terms of the policy.

Additional insured coverage is commonly used to fund or reinforce the ability to pay an indemnity obligation between parties that do business together.

Why Seek Additional Insured Status?

There are several reasons why an entity would seek additional insured status:

1. to fund or reinforce an indemnity obligation;

   Additional insured coverage is commonly used to fund or reinforce the ability to pay an indemnity obligation between two parties that do business together. When coupled with an indemnity undertaking, it's a belt-and-suspenders approach to the risk transfer. That is to say, the scope of an indemnity agreement can be (and oftentimes is) very different from the scope of direct coverage under an additional insured endorsement. If the indemnity obligation is enforceable, the indemnitor may be able to respond to the risk by using its contractual liability coverage under its general liability policy. On the other hand, if the indemnity obligation is found to be unenforceable (e.g., some states prohibit sole-fault indemnification), then the risk transfer may nonetheless be completed by virtue of the direct coverage afforded to the additional insured (although some states prohibit the parties from doing through insurance what they cannot do through private agreement). In the end, the additional insured coverage provides some reassurance that the indemnitee may have protection even if the indemnitor is financially or legally unable to satisfy its contractual indemnity obligation.

2. to prohibit subrogation by the named insured's insurer against the additional insured for the additional insured's own fault or negligence;

   As a general matter, an insurer that pays a claim can subrogate to the rights of the insured to seek reimbursement from the party at fault for the underlying claim. There's an "antisubrogation rule," though, that applies to insureds under the policy, including additional insureds. Thus, by adding a business contact/indemnitee as an additional insured, you can decrease the likelihood that the named insured's insurer will pay a claim and then turn around and subrogate against the business contact/indemnitee for reimbursement of the paid claim if the businesss contact/indemnitee is at fault. This antisubrogation rule prevents insurers from passing the cost of a loss to its own insured (or additional insured) and also ensures that the insurer will not have an adverse incentive to provide less than a vigorous defense for the additional insured.

3. to directly pay defense costs of the additional insured;

   Another benefit — at least to the additional insured — is to have someone else's insurer foot the cost of defense up front. The duty to defend under a policy is broader than the duty to indemnify. So, as long as a claim even potentially falls within the scope of coverage, the insurer's duty to defend is triggered. As a result, it's to the advantage of the additional insured to have this broad defense provided at the cost of the named insured's insurer. Oftentimes, defense costs under the policy will be paid in addition to the policy limits, rather than erode the policy limits. Thus, the defense obligation is valuable.

4. to reduce impact on the loss history for the additional insured.

   The additional insured arrangement also benefits the additional insured because (if all goes as planned) the additional insured can avoid asserting the liability claim under its own policy. With a more favorable loss history, the additional insured can keep its premium rates low. Of course, as a corollary matter, repeated claims by additional insureds under the named insured's policy could have a negative impact on the named insured's future premiums.

What Are the Downsides of Being an Additional Insured?

Although there are a lot of advantages to using "additional insured" coverage, it's not without its potential disadvantages—depending on the perspective of the party involved.

1. Dilution of policy limits

Some insureds worry about dilution of policy limits when they start adding additional insureds to their coverage. That's because when more than one insured has access to a named insured's policy, all insureds must share the limits applicable to any one occurrence. The limits for that occurrence don't increase simply because more than one insured is involved. So, if one occurrence involves both a named insured and the additional named insured, there is still only one policy limit applicable, not two.

As a result, some commentators warn of the diluted policy limits for each insured under the policy. Of course, where the parties are using "additional insured" coverage to back up the named insured's contractual indemnity undertaking, the policy limits may nonetheless be eroded if the named insured's obligation constitutes a covered contractual liability under the policy. Either way, the claim gets paid and the policy limits are eroded. So, it's not really fair to say that dilution of policy limits is necessarily unique to the "additional insured" situation.

2. Defense conflicts

A more pressing disadvantage is the defense conflict that can occur when a lawsuit is filed against both the named insured and an additional insured and the best defense for one party is not the best defense for the other. It's difficult, if not impossible, for the insurer to fully defend both parties, who may be pointing their fingers at one another in an attempt to cast blame elsewhere. When this happens, the insurer's duty to defend is compromised because of the conflict of interest.

To resolve the conflict, the insurer usually has the obligation to obtain separate counsel for the two insureds, at its own expense. But if you have a policy where defense costs erode policy limits, the double defense can eat away those limits even more rapidly, which would be a distinct disadvantage to offering the additional insured coverage in the first place.

The company should procure an additional insured endorsement that specifically corresponds with the scope of risk transfer contemplated.

3. Overriding the indemnity provision

A third, potential disadvantage to the "named insured" in granting additional insured coverage is that the named insured may be accepting a greater risk transfer than it ever really intended. For example, a company may negotiate indemnity language with another party that is limited to liability arising out of the company's own negligence, but then turn around and have additional insured coverage for the other party on the company's policy that extends to the sole negligence of the insured. Although the policy is responding to the risk, rather than the indemnitor itself, the loss history under the policy may ultimately hike up the indemnitor's premium when it goes to purchase insurance in future years.

To avoid this result, the company should procure an additional insured endorsement that specifically corresponds with the scope of risk transfer contemplated by the bargained-for indemnity provision.

Only an additional insured endorsement can create additional insured rights under the policy.

4. Loss of defense control

Seeing the glass half full, the additional insured can be thankful to have its defense provided by another party's liability insurer. Seeing the glass half empty, the additional insured can complain because it doesn't have full control of its own defense when the insurer steps in to defend. As a practical matter, most additional insureds are willing to relinquish control in exchange for having the defense provided up front under another company's policy. Interestingly, the Texas Supreme Court recently recognized the "loss of defense control" problem in the opinion of *National Union Fire Insurance Company of Pittsburgh, PA, Appellant, v. Beatrice Crocker, Appellee*, No. 06-0868, wherein the court held that the insurer had no extra-contractual obligation to give the additional insured notice of its coverage, finding, in part, that National Union reasonably assumed the additional insured was concerned about controlling its own defense, and that's why the additional insured never tendered the claim to the insurer.

5. Increased chance of coverage disputes

Again, whether you see the glass half full or half empty, there is always the inherent risk of additional coverage disputes when multiple policies are triggered by the same loss. Whose policy pays first and whether certain policy exclusions apply to the additional insured coverage grant can be up for debate, and coverage disputes can easily ensue.

6. Potentially inadequate protection

Additional insureds should follow the tips identified in the following section to make sure that they're not lulled into a false sense of security. When a company seeks additional insured status, it usually thinks to specify a minimum level of insurance limits for the named insured, but that's not the whole picture. To get a more realistic picture of the named insured's coverage, and the potential benefits you're actually getting under the policy, the best practice is to solicit representations from the named insured regarding:

a) the number or scope of other additional insureds under the policy (who have equal access to the policy limits);

b) the extent to which the insurance policy limits have already been eroded by other claims; and

c) whether defense costs are paid outside the limits of liability under the policy or erode away the policy limits, potentially leaving the insureds with inadequate limits.

How to Obtain Additional Insured Coverage

This sounds like a simple matter, but it is an important one and, quite frankly, one that is frequently misunderstood. Additional insured status is obtained by a contractual agreement with the insurer reflected by a policy endorsement. Additional insured endorsements may be "blanket" in form or specific to a particular additional insured, but there won't be a contractual right to additional insured coverage unless you have an endorsement to the policy.

"But," the question is asked time and time again, "what about a certificate of insurance that shows my company as an additional insured to the policy? Doesn't that work, too?" The short answer is "No. Not necessarily."

The common practice is to contractually agree that the indemnitor/named insured will provide to the indemnitee/additional insured a certificate of insurance that specifically identifies the certificateholder as an additional insured. This practice, although common, can be problematic. With rare exceptions, certificates of insurance are issued for informational purposes only. It's conceivable that a certificateholder may be able to use equitable principles of estoppel and detrimental reliance to argue for coverage when a faulty certificate has been issued, but the certificate of insurance itself does not create a contractual right to coverage under the policy. Only an additional insured endorsement can create additional insured rights under the policy.

Tips to Avoid Certificate Problems

So, how can you make sure you've actually received the additional insured protection you bargained for?

- Don't rely solely on a certificate of insurance as proof of your additional insured coverage. Yes, you should request the certificate, and yes, you should ensure your company is listed as an additional insured, but the inquiry shouldn't stop there.

- When you receive a certificate, make sure it identifies the particular additional insured endorsement that was issued for the policy. Additional insured endorsements vary greatly and, depending on which version of which form is used, you may not receive the coverage that was contemplated by the parties. (Drafting nuances are plentiful and will have to be the subject of a follow-up article.) Also, by identifying the specific nature of the endorsement in the certificate, you're increasing the likelihood that the endorsement was actually issued.

- If an agent or broker issues the requested certificate, check to see if there's a paper trail showing that a copy of the issued certificate was forwarded to the insurer, such that the insurer would be on notice of any discrepancies or inaccuracies on the certificate.

- In addition to asking for the certificate, ask for a copy of the additional insured endorsement and policy itself. As a practical matter, you may not receive a copy, but by being denied access to a requested policy, you may bolster an estoppel argument down the road if it turns out you received a certificate that was either inaccurate or materially incomplete.

Of course, on the flip side of this equation, when you receive a copy of the requested policy and endorsement, it would behoove you to review it — or to have it reviewed by coverage counsel — to make sure that there aren't coverage problems lurking in the additional insured endorsement or some other exclusion in the policy. Otherwise, the table could turn, and the insurer could argue you are estopped from contesting coverage based on a policy term you should have understood.

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