

ADDITIONAL INSURED STATUS:

RECOGNIZING COVERAGE RISKS

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I. INTRODUCTION

Those with business relationships with an insured often seek to protect themselves from liability that arise out of the insured's activities. Such contracting parties have a long history of using additional insured coverage to spread and transfer risks. Frequently, making another additional insured under a liability policy is done in connection with indemnity agreements to provide the indemnitee with direct rights under the insurance policy. Those typically protected with additional insured status include owners on general contractors' policies, contractors on subcontractors' policies, and real estate owners on lessees' policies.

While insurance coverage may attach because of damage attributable to the insured's contractual liability, such coverage is not the same as additional insured status. The additional insured has direct rights under the insurance policy, and contractual liability coverage applies directly to the insured based on the indemnity provisions in the contract. If both additional insured and contractual liability coverage are available, the insurer cannot pick and choose which applies, but must provide all of the protection possible.

The Courts in most U.S. jurisdictions have generally interpreted the additional insured provisions liberally and in favor of coverage. Consequently, having additional insured status gives such benefits as the right to an immediate defense instead of later indemnification for defense costs incurred. Of course, an additional insured's rights against the insurer are governed by the policy, and

not by the provisions of any underlying indemnity contract. Thus, if the indemnity agreement is not valid, there is no obligation to pay for injury or damage, but additional insured status still gives the indemnitee rights under the policy notwithstanding an invalid indemnity agreement. Moreover, having additional insured status does not guarantee the same protections as the named insured because of exclusions and limitations that might be part of the additional insured endorsement.

This discussion will look briefly at three items that contracting parties and risk managers should consider in their overall use of additional insured coverage as a risk transfer tool:

1. An understanding of the coverage provided by the policy which provides the additional insured coverage.
2. An understanding of the interrelationship between the contractual requirement for additional insured coverage and the insurance policy requirements that are needed to trigger additional insured coverage;
3. The importance of planning, collection and preservation of the documents related to additional insured coverage.

II. THE POLICY PROVIDING ADDITIONAL INSURED COVERAGE

A comparison of the additional insured language in use in the mid-1980 - 1990s with the additional insured language found under one of the new ISO forms for additional insureds is instructive and illustrates some of the pitfalls for the unwary. In the past, insurers have provided fairly broad coverage to additional insureds generally at little or no cost to the named insured.

The following additional insured language is similar to the 1984 ISO form CG 20 10:

“ADDITIONAL INSURED - OWNERS, LESSEES OR CONTRACTORS (FORM B)

This endorsement modifies insurance provided under the following:

COMMERCIAL GENERAL LIABILITY COVERAGE PART.

SCHEDULE

Name of Person or Organization:

(If no entry appears above, information required to complete this endorsement will be shown in the Declarations as applicable to this endorsement.)

WHO IS AN INSURED (Section II) is amended to include as an insured the person or organization shown in the Schedule, but only with respect to liability arising out of “your work” for that insured by or for you.”

The coverage under this endorsement was broad in nature, in part, because it lacked any temporal limitations. Thus, the old coverage form provided that work done at any time would be covered indefinitely into the future under an occurrence policy. The form also used the phrase “your work” which most general liability policies define as:

“a. Work or operations performed by you or on your behalf; and

b. Materials, parts or equipment furnished in connection with such work or operations.

[“your work” also means]

a. Warranties or representations made at any time with respect to the fitness, quality, durability, performance or use of “your work”; and

b. The providing of or failure to provide warnings or instructions.”

As can be seen, “your work” does not differentiate ongoing from completed operations and is silent as to vicarious liability. Consequently, the named insured need not be negligent and this standard ISO endorsement permitted coverage for situations involving the additional insured’s sole fault.

The insurers have responded to the judiciary’s expansive interpretation of insurance policies by attempting to draft narrower coverage for additional insureds and/or by charging fees for the coverage. In 2004, ISO changed its forms, affecting the coverage the additional insured endorsement provided in contractual relationships, such as between owners and contractors. For example:

“This endorsement modifies insurance provided under the following:

COMMERCIAL GENERAL LIABILITY COVERAGE PART

SCHEDULE

Name of Additional Insured Person(s): Location(s) of Covered Operations:

Information required to complete this Schedule, if not shown above, will be shown in the Declarations.

A. *Section II – Who Is An Insured is amended to include as an additional insured any person(s) or organization(s) shown in the Schedule, but only with respect to liability for “bodily injury”, property damage” or “personal and advertising injury” caused, in whole or in part, by:*

- 1. *Your acts or omissions; or***
- 2. *The acts or omissions of those acting on your behalf;***

in the performance of your ongoing operations for the additional insured (s) at the locations designated above.

- B.** *With respect to the insurance afforded to these additional insureds, the following additional exclusions apply:*

This insurance does not apply to “bodily injury” or “property damage” occurring after:

- 1. All work, including materials, parts or equipment furnished in connection with such work, on the project (other than service, maintenance or repairs) to be performed by or on behalf of the additional insured(s) at the location of the covered operations has been completed; or*
- 2. That Portion of “your work” out of which the injury or damage arises has been put to its intended use by any person or organization other than another contractor or subcontractor engaged in performing operations for a principal as a part of the same project.”*

The changes in the additional insured coverage provisions of insurance policies must be considered in looking at the obligations of parties under both existing contracts and when negotiating new contracts. The new ISO form also has a clear time limit on the coverage. It excludes coverage for damages and injury occurring after work is completed or after the portion of your work issue has been put to its intended use. This time limit also seems to preclude coverage for warranty and representations which were clearly covered under the older additional insured language which incorporated coverage representations and warranty without time limitations.

As a result, contracting parties who are obligated to provide additional insured coverage, but continue to rely on the standard contract language regarding additional insured coverage and related indemnity provisions run several risks. There is also a risk of being under-insured or uninsured as additional insureds. Second, there is the risk of breaching a contract, thus potentially becoming the insurer of the other party when they are the party obligated to provide additional insured coverage.

It should also be noted that in July of last year, ISO issued other specialized additional insureds form: CG 20 10 07 04 Additional Insured-Owners, Lessees or Contractors - Scheduled

Personal Organization; CG 20 28 07 04 Additional Insured - Lessor Leased Equipment; CG 20 15 07 04 Additional Insured - Vendors; CG 20 26 07 04 Additional Insured - Designated Personal Organization; and CG 20 32 07 04 Additional Insured - Engineers, Architects, Surveyors.

The point to remember - your insurance coverage as an additional insured is only as good as the policy providing the additional insured coverage. Get a copy of the policy and review it.

III. UNDERSTANDING THE INTERACTION BETWEEN THE CONTRACT REQUIRING ADDITIONAL INSURED COVERAGE WITH THE INSURANCE POLICY

A review of the underlying contract requiring additional insured status is necessary to understand the coverage the named insured has agreed to provide and to ensure that the named insured's policy actually provides the contractually required additional insured coverage. Simply requiring the named insured to list you or your company as an additional insured may result in unexpected consequences when you review the policy, or worse yet, when you are sued and are seeking a defense or coverage.

Changing economic circumstances and increases in insurance costs have caused many insureds to go to higher and higher deductibles which have as a practical matter cause them to self-insure much of what was covered by primary policies in the past. The trend toward higher deductibles should be addressed by reviewing all contractual obligations and existing contracts written several years ago and should be considered when drafting contracts for current and future projects.

The following general contract language dealing with insurance requirements is fairly typical, but does not address many important issues:

“Contractor shall carry and maintain insurance of the types and coverages indicated below with insurance carriers satisfactory to owner, naming owner as an additional

insured as its interest may appear, and containing waivers of subrogation in favor of owner. The terms of coverage shall be evidence by certificates of insurance to be furnished to owner, with such certificates providing that at least thirty (30) days written notice shall be given to owner prior to cancellation, material modification, or expiration of the term of coverage of any policy.

<u>Types</u>	<u>Minimum Coverages</u>
<i>Workers' Compensation</i>	<i>Statutory</i>
<i>General Liability (including Contractual liability obligations)</i>	<i>\$5 million, combined single limit</i>
<i>Automobile</i>	<i>\$1 million"</i>

Under the above-referenced contract language, it is conceivable that the party responsible for providing additional insured coverage has purchased insurance with a million dollar deductible. The contract obligations have been met, but the party who is the additional insured will be in for an unpleasant surprise when a claim is made, *i.e.*, the additional insured will have no indemnity coverage for the first million dollars. Of a more immediate and practical significance, the additional insured may not have an insurer providing a defense until the million dollar self-deductible has been met.

It is possible that under other contract provisions the situation may be addressed in part by indemnification provisions which are generally coupled with a defense obligation. However, there are at least two problems in relying on any defense and indemnification language in a contract to cover high deductible gaps. First, the defense obligation contained in most contracts is generally not

as broad as a defense duty insurers provide. Insurers are typically obligated to defend all claims in a lawsuit if a single claim raised in the lawsuit would be covered. Generally, indemnification agreements only defend a party for claims that are also subject to indemnity. That difference could generate disputes between the contracting parties. Second, the financial ability of the contracting party who is obligated to provide additional insured coverage is often not strong enough to provide a meaningful defense (even under the limited situations where the party is willing to defend).

Further, the defending party is often a co-defendant who may in fact have adverse interests in the same lawsuit. These problems combined with the indemnitor's lack of financial resources often strip the protections sought by defense obligations under an indemnity agreement and often make such promises valueless as a practical matter. The following comprehensive sample insurance provision that addresses the high deductible problem as well as providing a road map for some of the additional insured coverage that should be considered.

AP shall maintain at its sole cost and expense insurance naming PL as an additional insured with respect to the PIPELINE and the Rights-of-Way. The insurance required hereunder shall provide coverage as required by Rights-of-Way Agreements provided such coverage shall not be less than:

*(i) Contractual and commercial general liability insurance against claims for bodily injury, death or property damage occurring on, in or about any of the AP PLANT, the PIPELINE and/or the Rights-of-Way, which insurance may be provided under primary and umbrella policies and shall be written on a so-called "occurrence basis," and shall provide aggregate minimum protection with a combined single limit in an amount not less than Ten Million Dollars (\$10,000,000) (or in such increased limits from time to time to reflect declines from the date hereof in the purchasing power of the dollar as PL may reasonably request) and coverage for premises-operations, completed operations-products, independent contractors, engineering and design defects, explosion, pollution, collapse and underground property damage hazards. The policies referenced in this subsection shall also be written without an insured versus insured exclusion or any exclusion that prevents coverage of a claim by one insured against another. **The parties agree that AP may self-insure the first \$_____ of the \$10,000,000.00 in coverage (or have a deductible in the amount of up to \$_____).** AP assumes the defense obligations of the insurer providing insurance pursuant to this subparagraph (i) for all*

lawsuits against PL. This defense obligation of AP shall begin immediately upon the filing of any suit or claim that would be defended by the insurance required hereunder and continue until such time as the self-insured retention (or deductible) has been met or the insurance required hereunder provides a defense to PL.

(ii) Workers compensation insurance covering all persons employed by AP or its contractors in connection with the PIPELINE and/or the Rights-of-Way, including coverage for occupational disease and employer's liability, with minimum limits of liability as follows:

(a) worker's compensation - statutory benefits

(b) employer's liability - \$1,000,000.

(iii) Casualty insurance covering the PIPELINE, which shall be written on a so-called "occurrence basis," and shall provide aggregate minimum protection with a combined single limit in an amount not less than Two Million Dollars (\$2,000,000) (or in such increased limits from time to time to reflect declines from the date hereof in the purchasing power of the dollar as PL may reasonably request). PL understands and agrees that the self-insured retention or deductible on the primary policy may exceed the amount of the insurance requirements under this provision.. The policy(s) shall name PL, and its subsidiaries and affiliated companies and lender as additional insureds with the right to approve settlements and to be paid proceeds directly as their interests may appear. The policy(s) shall provide contractual indemnity coverage consistent with the requirements of the provisions of this agreement.

1.16.2 Approved Insurers

The insurance required by Section 2.16 hereof shall be written by companies (a) acceptable to PL and LENDER (b) with a minimum A.M. Best rating of A-minus (or an equivalent rating from another recognized rating agency) and (c) authorized to do insurance business in the State of Louisiana.

2.16.3 Provisions of Policies

Each insurance policy referred to above shall, to the extent applicable, contain standard non-contributory mortgagee clauses in favor of LENDER. The policies referenced above and the certificate delivered by AP in respect of each such policy shall provide that the policy shall not expire until PL and LENDER shall receive a notice from the insurer to the effect that the policy will expire on a date which shall be thirty (30) days following the date of notice to PL and LENDER. Each policy required to be carried by AP shall also provide that any loss otherwise payable thereunder shall be payable notwithstanding (i) any act or omission of PL

or AP which might, absent such provision, result in a forfeiture of all or a part of such insurance payment, (ii) the occupation or use of any of the PIPELINE and/or the Rights-of-Way for purposes more hazardous than permitted by the provisions of such policy, (iii) any foreclosure or other action or proceeding taken by any LENDER pursuant to any provision of the MORTGAGE upon the happening of an event of default therein, or (iv) any change in title or ownership of any of the PIPELINE. All insurance policies shall be for a term of not less than one year. AP shall have no interest in any proceeds of PL's insurance against loss or damage to the PIPELINE.

2.16.4 Payment of Premiums

AP shall pay as they become due all premiums for the insurance required to be carried by it by this Section 2.16, and shall timely renew or replace each policy. In the event of AP's failure to comply with any of the foregoing requirements of this Section 2.16 within five (5) business days of written notice by PL, PL shall be entitled, but not obligated, to procure such insurance. Any sums expended by PL in procuring such insurance shall be repaid by AP to PL upon demand.

2.16.5 Blanket Policy

Anything in this Section 2.16 to the contrary notwithstanding, any insurance which AP is required to obtain may be carried under a "blanket" policy or policies covering other properties or liabilities of AP, provided that such "blanket" policy or policies otherwise comply with the provisions of this Section 2.16. In the event any such insurance is carried under a blanket policy, AP shall deliver to PL and LENDER a certified copy of the relevant provisions of the blanket policy, to evidence the issuance and effectiveness of the policy, the amount and character of the coverage and the presence in the policy of provisions of the character required in the provisions of this Section 2.16.

2.16.6 Subrogation

AP and PL shall obtain waivers of subrogation from its insurers in favor of the other, and its subsidiary and affiliated companies, under all policies of insurance, including (without limitation) those referred to above, maintained by or for the benefit of this project.. Each party waives its rights to recover against the other or the LENDER in subrogation or as subrogee for another party.

2.16.7 Policy Forms; Coverage

*The coverages referred to in Section 2.16 are set forth in full in the respective policy forms approved by the applicable state Department of Insurance, and the foregoing descriptions of such policies are not intended to be complete or to restrict such coverages in any manner. **Insurance required by this AGREEMENT to be carried by AP shall be primary to and shall not contribute with any insurance carried by PL. AP's obligations under this AGREEMENT shall not be limited by the insurance coverage maintained by or for the benefit of PL.***

2.16.8 Certificates of Insurance

*Before the EFFECTIVE DATE of this AGREEMENT, and at renewal or replacement of any policy of insurance required hereunder, AP shall furnish to PL and LENDER certificates of insurance making reference to this AGREEMENT and indicating (a) the types and amounts of insurance required by this AGREEMENT, (b) the names of the insurance companies providing said coverage, (c) the effective and expiration dates of said policies, (d) that thirty (30) days advance written notice will be given to PL and LENDER of any material change in or cancellation of any of said policies, (e) that PL, and its subsidiary and affiliated companies, and LENDER are additional insureds under the policies to the extent required by this AGREEMENT, and (f) that the insurers waive their rights of subrogation as provided in Section 2.16.6. PL and LENDER shall provide to AP the addresses to which any notice of a claim, occurrence, or accident are to be sent under said policies. Upon LENDER's request, **AP shall provide the lender with a copy of each policy under which it is an additional insured. Immediately upon AP's receipt of any policy referenced herein which is required to name PL as an additional insured, AP shall immediately provide PL with a copy of said policy.***

This sample insurance provision is more detailed than commonly found in many contracts being executed today. The sample provisions address many issues that should be considered and are offered as a checklist. It is unlikely that all of the provisions will be agreed to in a single contract.

The sample insurance provisions recognize the possibility of a high deductible, but obligates the party providing insurance to defend the additional insured during the self-insured provision as if insurance was in place. These provisions make it clear that the parties have specific obligations in the event of a lawsuit, but do not eliminate the impact of the financial uncertainty related to the defense obligation.

Another point illustrated by the sample insurance provision is a requirement that the additional insured receive actual copies of the insurance policy. It has become increasingly important for insureds and additional insureds to maintain copies of policies and insurers providing insurance coverage for many years. The litigation surrounding lost and incomplete policies which provide a coverage for 30, 40 or 50 years back has increased significantly. It is unlikely that insurers or brokers will maintain historical policy archives. Thus, receipt of an actual copy of the policy provides protection over long periods of time. Further, receipt of an actual policy allows the additional insured to verify that it has received the type of coverage required under the policy. Many jurisdictions in the United States do not recognize insurance certificates as equivalent to providing insurance coverage. Litigation involving insurance certificates and additional insured coverage is becoming more common.

The sample insurance provisions also require that the insurance provided by the party providing additional insured coverage shall make the additional insurance coverage primary. This provision should avoid some litigation issues that often arise in multi-party litigation as to which insurer has primary versus secondary liability. As a practical matter, this issue if resolved by contract, avoids a multitude of problems and should result in the additional insured receiving a defense early on in multi-party litigation.

Point to remember - you must make sure your contract with the party obligated to provide additional insured coverage is consistent with the policy providing additional insured coverage.

IV. ACQUISITIONS, COLLECTION AND PRESERVATION

Many lawyers and risk managers recognize, at least at some level, that it is important to negotiate additional insured requirements in contracts; and to get copies of certificates of insurance and the policies. After today's talk you will be in a group that is cognizant of the importance of

getting actual copies of insurance policies and matching contract requirements with the policy provisions. This is a good start in ensuring that you or your company will have additional insured coverage available in the ever more likely event a claim is made that is related to contracts that you will negotiate in the future. There are several other points that should be kept in mind to ensure the availability of additional insured protection.

Planning - Past, Present, and Future Agreements

You should not consider current and future contracts as your only source of additional insured coverage. Previously negotiated contracts and insurance or a lack of insurance in past, current, or future asset purchases, stock purchases, or mergers are also important components in future insurance coverage including additional insured coverages.

Acquisitions

Acquisitions of other companies and/or their assets may include acquisitions of liabilities related to occurrences in the past. With regard to acquisitions that have taken place in the past, it is important to maintain or reconstruct the insurance and contracts belonging to the companies that were the subject of mergers, takeovers, stock sales or asset purchases.

Old contracts and policies provide a history of your company's insurance coverage as well as potential liability and obligations to provide additional insured insurance to others. Without this information, significant insurance resources belonging to a company may not be realized.

Issues Related to Finding, Reconstructing, Current and Future Acquisitions, Insurance Asset

Many companies have realized the need to have coverage lawyers involved in the due diligence stages of the acquisitions. The structure of acquisitions and the provisions regarding insurance have become more important over time as courts have increasingly allowed large claims

stretching back for decades. Recognition of this fact makes it even more important for lawyers conducting mergers and acquisitions to protect the insurance assets of the parties to the deal or at least make sure that the merger and acquisition documents clearly reflect risk retention and insurance allocation. Specific attention should be directed to the assignment of third-party contracts and related additional insured coverage.

Recent caselaw dealing with the assignability of insurance and the rights of the successor companies to insurance assets have highlighted the need for merger and acquisition documents to clearly delineate allocation of insurance assets. Old assumptions that insurance policies generally follow the acquiring company without regard to insurers consent to assignment have been upset by a recent California Supreme Court decision *Henkel Corporation v. Hartford Accident & Indemnity*, 29 Cal. 4th 934, 62 P.3e 69, 129 Cal. Rptr. 2d 828 (2003). A complete understanding of the risks and complexity of issues related to insurance assignability is vital to any acquisition. While the *Henkel* case is currently only setting precedent in California, readers are reminded that many companies somewhere in their history may have predecessors with insurance policies controlled by California law. Thus, an assumption that the *Henkel* case will not affect a merger or acquisition can only be verified by a thorough understanding of the entire history of the acquired company or assets. It is also likely that insurers will seek to expand *Henkel* to jurisdiction outside of California.

Maintaining Policies

Verifying all acquisition documents, policies, and third-party contracts must be maintained. The value of a historical collection of insurance merger and acquisition documents third-party contracts and insurance policies for a company cannot be over estimated. Point to remember - even if you do everything right as an additional insured, you must be able to prove you are an additional

insured, with specific rights. If you don't maintain the documents you must rely on others (who will be asked to defend and indemnify you) for the proof.