How other people increase your insurance costs and what to do about it

The small print in contracts matters. Clauses requiring additional insured endorsements can be expensive in a way you may not realize. You could end up paying for others’ mistakes.

It is the purpose of this report to help you understand what you are agreeing to when you sign a contract requiring an additional insured endorsement, how it could increase your costs and what to do about it. Contractual provisions requiring additional insured endorsements vary from one contract to another. The differences can be important.

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Danger: Don’t sign contracts requiring additional insured endorsements without knowing what you are agreeing to. You may be substantially decreasing your coverage and increasing the price of your insurance.
What is an additional insured endorsement?

People who request an additional insured endorsement want you to pay for insurance that covers them. In its most basic form an additional insured endorsement is a part of your insurance policy that identifies a specific third party as being covered by your insurance for claims against them that you cause. Initially that seems fair and uncomplicated. However third parties often demand additional advantages which make it more complicated and expensive and perhaps unfair for you.

“Additional insured” and “named insured” are not the same. A “named insured” has the complete coverage provided by the policy along with responsibilities such as paying the premium and notifying the company of claims. An “additional insured” has coverage that is usually more limited and is defined by the endorsement.

Recognizing the contract language:

Here is an example of what a third party can ask for:

The coverage for the additional insured must be primary, noncontributory and there must be a waiver of subrogation.

What does that mean?

“Primary” means that your insurance pays for the defense and settlement of a claim first, before other insurance pays.

“Noncontributory” means the third party’s insurance doesn’t contribute toward payment of a claim. Your insurance pays it all up to the policy limits.

“Waiver of subrogation” means your insurance company can’t ask the third party or their insurance company to pay the part of a claim caused by the third-party.

Is it fair?

The initial idea seems fair enough. You pay for insurance that covers claims against the third-party that you cause. But what about claims that are caused both by you and the third-party? In some instances additional insureds even want to be covered by your policy for claims caused solely by the third-party. Shouldn’t the third-party or their insurance company pay for the part of the claim they caused?

3 Examples:

Here are three hypothetical examples which demonstrate how your insurance company could be asked to pay when others cause injury and they are additional insureds:

Foster child placement: Sometimes behavioral healthcare providers have agreements with a state to place children in foster homes. Typically the state will ask to be named as an additional insured. If the state does not disclose important information about a child and you place the child in an inappropriate home both you and the state could be sued for possible injuries. Your insurance company may have to pay the whole claim even if the state was partially at fault.

Rental Property: If you rent a building for use as a supervised apartment the landlord may ask to be named as an additional insured on your general liability policy. Assume for example that the stairs in the building are not in compliance with the building code because the height of the stairs is too short. The landlord may not tell you about the code violation and you might not recognize it. If someone falls on the stairs because of the short stair height you and the landlord are likely to be sued. The landlord is probably at least partly at fault. But your insurance company may have to pay the whole claim even though you may not have been negligent.

Leased Equipment: Copier companies often request to be named as additional insureds on general liability policies. The copier company might install a copier incorrectly and create an electrical hazard that you do not recognize. If someone is injured, your insurance company will likely be asked to pay.
How do additional insured requests make insurance more expensive for me?

Reducing your policy limits:
All insurance pays only up to a specified limit. For instance if you have a policy limit of $1 million and a claim for $1,200,000 the insurance company pays $1 million and you pay $200,000. Naming third parties as additional insureds can effectively reduce the policy limits available to you. For example assume a $1 million policy limit and a claim for $1,200,000 caused 50% by you and 50% by the additional insured with the additional insured coverage being primary, noncontributory and with a waiver of subrogation. Your insurance company, of course, pays $1 million and though you only caused $600,000 of the claim you will have to pay amounts in excess of the $1 million. Thus, naming the additional insured effectively reduced your coverage to $600,000 for that claim. And if you only have $1,000,000 coverage for the policy year you would have no insurance for the rest of the year.

Some policies provide that the cost of defense of a case, including such things as attorneys and expert witness fees that can be quite expensive, are in addition to the policy limits. However in some policies the cost of defense reduces the policy limits. Of course it is likely to be more expensive to defend two parties to a lawsuit than one. If the cost of defense reduces your limits, the cost of defending the additional insured reduces your limits further.

If the additional insured is a government entity entitled to sovereign immunity the cost of defense will probably be the same as defending any other party. Typically though sovereign immunity limits the amount of damages the government is liable to pay. Insurance companies only pay sums the insured is obligated to pay. Whatever amount is paid for the additional insured affects your available limits.

The impact on loss history and your insurance cost:
Insurance companies take your loss history into account when they decide how much to charge. If you have a negative loss history your premium can be more expensive. "Loss history" means the history of the losses paid on your policy whether paid for your benefit or for the benefit of an additional insured. Thus losses paid for an additional insured are part of your history and your premium for future insurance could be more expensive.

Some suggestions:
1. Read contract provisions about insurance carefully so that you understand the effect of what you are being asked to sign. If you need it, ask for professional help.
2. Negotiate the specifics of contract requirements about insurance and indemnification. You can appropriately point out that you are only asking for what is fair if you ask to omit requirements that additional insured coverage be primary and noncontributory with a waiver of subrogation.
3. Don't assume your insurance company will add an additional insured endorsement to your policy. Check with your company before you sign a contract. Insurance companies want to use their own policy language and do not want to provide additional insured coverage on a primary and noncontributory basis with a waiver of subrogation using someone else's wording. It is generally not a problem to obtain an additional insured endorsement if the company can use its basic wording that simply covers claims against the third party you cause.
Miscellaneous Issues

Is my contractual obligation to indemnify the other party capped by the additional insured coverage?

Contracts often have a separate clause requiring that one party indemnify the other. This means that if the other party is sued for your negligence you pay for the claim. Your obligation to "indemnify" the third-party normally extends to the whole amount of the claim whether you have insurance to cover it or not. Contracts usually do not have a provision that the obligation to indemnify is limited by the amount of additional insured coverage available.

Am I in compliance with the additional insured provision of my contract?

Contracts requiring that you name third parties as additional insureds vary. For example, some require that the additional insured coverage be primary and noncontributory and some do not. We suggest that you have a professional review that portion of your contract and your insurance policy to determine whether or not you are in compliance. If a claim is made against the additional insured and you have not secured the correct coverage you could be liable for breach of contract.

A Last Point

We hope this information is helpful. The Mental Health Risk Retention Group maintains a hotline for its insureds for risk management questions. Other risk management materials are available through the website at MHRRG.com.

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