Risk Allocation Through Insurance Arrangements

When an indemnification provision in the parties’ contract shifts some or all of the liability for third-party claims to a contracting party, the institution must confirm that the contracting party is able and willing to pay for the liability it has assumed. Institutions can accomplish this by requiring that the other party show proof of adequate insurance coverage and give the institution access to this coverage.

Institutions that adhere to the following four recommendations can ensure that they are covered by a contracting party’s insurance. (See also part two of the appendix for a description of actual claims involving other insurance missteps.)

1. **Require proof of insurance with adequate policy limits.**
   For proof that a contracting party has the finances to pay for losses, an institution should request a certificate of insurance. The certificate should reflect sufficient policy limits. Over the past 20 years, $1 million has been the standard policy limit required by most institutions, but nowadays $1 million does not go very far toward covering damages and defense costs related to claims. It is a good idea for institutions to reevaluate the policy limits they require of their contracting parties and, if necessary, consider increasing them. Certificates of insurance should also include the name of the insurance company, name and address of the insured, type of policy, policy period, the insurer’s A.M. Best rating, the policy’s coverage trigger (occurrence or claims made), a description of services to be provided under the parties’ contract, and the effective contract dates.

2. **Require an additional insured endorsement.**
   An additional insured endorsement fills many of the gaps left by a certificate of insurance. While a certificate is valuable in showing a party’s insurance coverage, it does not:
   - Entitle the certificate holder access to the listed policies and, therefore, does not give an institution the right to review specific terms contained in the insurance contract.
   - Provide coverage to guarantee that the certificate holder will be notified if there is a material change to the policy’s coverage or a policy cancellation. The certificate merely provides basic information about coverage that is available to the contracting party.
   - Provide information about whether the insurance policy’s limits have been exhausted by other claims. The certificate also is worthless if the policy has expired, been cancelled, or excludes the type of claim that has occurred.

To gain ready access to another party’s insurance policies, a certificate of insurance should include an endorsement that names the institution as an additional insured to the insurance policies listed (even excess policies, if necessary). The responsibility for keeping track of a certificate of insurance and an additional insured endorsement falls on the institution or party to which it was issued. Certificates of insurance typically are issued by a party’s insurance broker in accordance with policy terms and without notice to the insurance carrier. This means that carriers generally do not track certificates or additional insured endorsements.

If an institution is named as an additional insured on a certificate of insurance, it will gain these benefits:
• Access to insurance policies to review and to confirm the coverage that is available under the policy.
• Full rights to coverage under the listed insurance policies for those losses assumed by the other party under the risk allocation provision.
• Notification from the carrier of any material changes to, or cancellation of, the policy upon the institution’s request.

3. Review the other party’s insurance policies.
An additional insured endorsement is only as good as the coverage provided by the insurance policies to which the endorsement relates. If the other party’s insurance policy does not cover the risks that are most likely to occur under the contract, then the institution receives little to no insurance protection from other insurance. Consider this example:

A college enters into a written contract with 007 Security Services to provide security on its campus. Legal counsel reviews the contract’s risk allocation provision and determines that it lawfully transfers the risk of claims and losses arising out of the agreement to 007 Security Services. Furthermore, to ensure that 007 Security Services can pay for the claims that might arise and that the college is adequately protected, the college obtains a certificate of insurance, with an additional insured endorsement naming the college. During the contract’s performance, a female student alleges that a 007 Security Services’ guard sexually assaulted her. She files a lawsuit against the college. When the college attempts to obtain coverage under 007 Security Services’ insurance, they learn that the policy excludes coverage for sexual assault.

Institutions need copies of the actual policies listed in the endorsement to be sure of the coverage provisions, including exclusions and other coverage limitations. It is especially important to do so for long-term contracts and those that present severe risks of loss.

Institutions should also confirm the extent to which the aggregate limits of the policies listed on a certificate of insurance have been exhausted. This step will avoid situations in which an institution seeks coverage for a claim under a contracting party’s insurance policy only to be denied coverage because that policy’s limits have been exhausted.

4. Reinforce insurance requirements using the contract.
A contracting party’s insurer will only assume coverage for a claim brought against the institution if all of the following are true:

• The contracting party has assumed responsibility for the claim under an enforceable contract.
• The institution is named as an additional insured to the policy.
• The policy has not expired.
• The policy’s aggregate limits are not exhausted or impaired.
• The claim is covered by the policy.

Even when all these requirements are met, the contracting party’s insurance carrier can challenge its obligation to extend coverage to the institution. The underlying contract can fortify your claim to other insurance coverage if you do the following:
• **Require that the other party’s insurance be primary to the institution’s insurance**: By requiring that the contracting party’s insurance be primary to the institution’s insurance, an institution will eliminate any attempt by the contractor’s insurer to share coverage with the institution’s carrier when a third-party claim is made.

• **List the required lines of insurance in the contract**: Lines that are typically required include commercial general liability, auto, workers’ compensation, employers’ legal liability, professional liability, and property. However, the specific lines of insurance that are appropriate will depend on the subject matter of the contract and the risks involved.

• **Require quality and well-capitalized insurers**: If the other party’s insurers are financially stable, it is more likely that they will be solvent to cover third-party claims. Consider requiring that the other party’s insurers have a particular financial strength rating by a nationally recognized financial rating organization such as A.M. Best.

• **Require appropriate limits**: Set minimum policy limits for each line of insurance required and consider requiring excess insurance, too. These limits should reflect the potential risk of loss from the contract’s activities. Remember the price of a contract is not a good measure of the liability exposures presented by that contract.

• **Require advance notice of a policy’s cancellation or a material change to coverage**: As an additional insured under the contracting party’s insurance policy, an institution will want sufficient notice so that it can provide adequate time for the other party to secure substitute insurance coverage in accordance with the contract.