

# Certificate of Insurance— Notice of Cancellation Change

Challenges for upstream and downstream parties to a construction contract ... and their insurance brokers



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“The most common method to evidence liability in the industry is the use of ACORD 25—Certificate of Insurance form.”

Construction contracts often contain an indemnity provision that requires a downstream party to hold harmless and indemnify an upstream party. Examples of upstream–downstream relationships include Owner to General Contractor, General Contractor to Subcontractor and Subcontractor to Sub-Subcontractor. To assure the upstream party there will be enough assets available to back up the indemnity, upstream parties typically require the downstream party to maintain certain insurance coverages and evidence compliance with those insurance requirements via a certificate of insurance.

The most commonly used form to evidence liability insurance in the industry is the ACORD 25—Certificate of Liability. ACORD, which stands for Association of Cooperative Operations Research and Development, is a global, nonprofit organization that serves the insurance industry in the creation and filing of standardized forms.



The **ACORD Certificate of Liability Insurance** contains a disclaimer that reads:

THIS CERTIFICATE IS ISSUED AS A MATTER OF INFORMATION ONLY AND CONFERS NO RIGHTS UPON THE CERTIFICATE HOLDER. THIS CERTIFICATE DOES NOT AFFIRMATIVELY OR NEGATIVELY AMEND, EXTEND OR ALTER THE COVERAGE AFFORDED BY THE POLICIES BELOW. THIS CERTIFICATE OF INSURANCE DOES NOT CONSTITUTE A CONTRACT BETWEEN THE ISSUING INSURER(S), AUTHORIZED REPRESENTATIVE OR PRODUCER, AND THE CERTIFICATE HOLDER.

This wording serves as a disclaimer which has significant legal bearing. For purposes of contract law, a disclaimer stating that a certificate “does not amend, extend or alter” the underlying policy indicates that the parties must intend for the certificate to be a “snapshot” of the policy—providing information about coverage, but not changing policy forms.<sup>1</sup>

If there are no disclaimers on the certificate of insurance, it is possible the certificate could function as an endorsement. There are at least seven states that have case law that interpret a certificate of insurance without a disclaimer and containing additional coverage terms as a functional equivalent of an “endorsement” that changes the underlying policy.<sup>2,3</sup> If a certificate is perceived to provide a policy right different from that provided by the policy itself, then the certificate effectively purports to be a policy form.

In September 2009, ACORD introduced changes to eight of their certificate of insurance forms including ACORD 25.

According to Ann Henstand, ACORD Assistant Vice President of Forms & Industry and Government Affairs, the changes were driven by two reasons. First and foremost, the forms were revised to comply with changes in various state insurance regulations. ACORD constantly monitors changes in state laws and regulatory guidance from state insurance departments and makes changes necessary to ensure their copyrighted forms are in compliance. According to Ms. Henstand, “it is in law, it is required by law.” The secondary reason for these changes was to improve the formatting and the usability of the forms.<sup>4</sup>

The most significant and impactful change to ACORD 25—Certificate of Liability is the change to the Notice of Cancellation provision. The outgoing version of ACORD 25—Certificate of Liability edition (01/2009) contained the following wording:

### **CANCELLATION**

SHOULD ANY OF THE ABOVE DESCRIBED POLICIES BE CANCELLED BEFORE THE EXPIRATION DATE THEREOF, THE ISSUING INSURER WILL ENDEAVOR TO MAIL \_\_\_ DAYS WRITTEN NOTICE TO THE CERTIFICATE HOLDER NAMED TO THE LEFT, BUT FAILURE TO DO SO SHALL IMPOSE NO OBLIGATION OR LIABILITY OF ANY KIND UPON THE INSURER, ITS AGENTS OR REPRESENTATIVES.

When Ms. Henstand of ACORD states “it is in law,” she is referring to the majority of states that have addressed the issue of certificates of insurance explicitly. Many states have statutes, codes or regulations concerning the use of certificates



of insurance. Thirty-eight states have issued Bulletins (or other formal correspondence) stating their position regarding the treatment of certificates of insurance. A summary of each state's stance on certificates of insurance can be found in the appendix.

These state laws and bulletins share a common message. An excerpt from the State of Utah's Bulletin 2010-4 is representative of the state laws and bulletins that were reviewed.

*"The Department is aware, however, that some insurance producers, agencies and insurers have been asked to provide certificates that purport to amend, extend or alter the terms of the underlying policy, or inaccurately suggest the existence of certain contractual rights. Although the insurance industry may feel pressured or obligated to provide certificates that revise policy language or misrepresent the actual policy terms, they are in violation of Utah's Insurance Code when they do so. This also includes any customized certificate of insurance forms provided by a proposed certificate holder.*

*Insurers, agencies and producers are in violation of Utah Code Ann. 31A-23a-402 when they issue a certificate of insurance that obscures or misrepresents the insurance coverage or terms, the obligation of notice by an insurer, or other rights provided under an insurance policy and may be subject to administrative penalties and/or license suspension or revocation.*

*When an insurer or insurance producer executes a certificate of insurance or other evidence of coverage which extends beyond offering a mere synopsis of the policy, the insurer or producer risks modifying the policy's terms or coverages. In addition, if an insurer or its producer includes any statement in a certificate of insurance purporting to amend or extend coverage from the underlying policy, including references to construction contracts, service contracts or insurance requirements, the insurer or producer may be misrepresenting the policy terms. By issuing such a certificate, the insurer or producer is in violation of the above referenced Insurance Code prohibiting a producer or insurer from intentionally or materially misrepresenting the terms of an actual or proposed insurance contract."*



“ In short, any evidence of insurance that does not mirror the policy or which alters, amends, or extends coverage provided by a referenced insurance policy is a violation of insurance law in those particular states.”



In short, any evidence of insurance that does not mirror the policy or which alters, amends or extends coverage provided by a referenced insurance policy is a violation of law in those particular states.

Some upstream parties to a contract may request the old notice of cancellation wording coupled with the words “~~endeavor to mail~~” and “~~But failure to do so shall impose no obligation or liability of any kind upon the insurer, its agents or representative~~” “x’d out.” This creates a dilemma as to the whether the certificate is still a “snapshot” of the policy as opposed to a functional endorsement. In any case, a certificate that amends, extends or alters the policy would be considered a violation of applicable law in most states.

In addition to being a violation in the majority of states, “x-ing out” the words “~~endeavor to~~” and/or promising to provide 30 days notice to the certificate holder, ignores the standard policy provision that preserves the right of the insurance carrier to cancel upon ten (10) days notice in the event of nonpayment. It also ignores the possibility that the insured could cancel their insurance of good standing at any time. If the insured cancelled their insurance and chose not to comply with their construction contract terms of providing thirty (30) days notice to their certificate holders, then who would be responsible for paying the insurance for the remaining thirty days to allow for advance notice to be sent? The insurance carrier, the broker, the insured, the certificate holder or none of the above?

For these reasons and based on ACORD’s monitoring of states’ insurance departments, ACORD felt it necessary to change their copyrighted forms to be in compliance with regulatory directives. The new wording reads:

#### **CANCELLATION**

**SHOULD ANY OF THE ABOVE DESCRIBED POLICIES BE CANCELLED BEFORE THE EXPIRATION DATE THEREOF, NOTICE WILL BE DELIVERED IN ACCORDANCE WITH THE POLICY PROVISIONS.**

The significance of this wording is that the party responsible for delivering the notice must be stipulated in the insurance form. Insurance policies may have an endorsement providing additional days notice of cancellation (e.g., 60 days notice or 90 days notice), but these common enhancements are intended to address the insured’s right to receive notice of cancellation under the policy(s) and do not specify the certificate holder will be notified. Up until now, the only party to whom insurance companies are obligated to deliver notice of cancellation is the First Named Insured.

If the insurance policies evidenced on the certificate do not have an endorsement or provision specifying the certificate holder will receive notice of cancellation, any certificate containing different or additional wording representing the certificate holder will be notified is out of compliance with state statutory and/or regulatory directives. Carriers will not recognize the certificate as a functional endorsement. Some states view misrepresentation on the certificate of insurance

as a criminal offense while other states have the ability to impose monetary fines or penalties and/or restrict, suspend or revoke an agent's license.

An insurance agent's ability to take on the responsibility of notification is handcuffed by the lack of language in the policy. If it is not provided for in the policy, then it cannot be included in a certificate of insurance for the reasons stated above. States view notification as a "policy right" not a "broker service."<sup>25</sup> This clearly places the burden for any solution on the insurance carriers. Carriers are grappling with implementing a solution. Creating policy language is a fairly simple task; working out the logistics of how to notify potentially thousands of different certificate holders is a bit more daunting. Meanwhile, parties to construction contracts face challenges.

These challenges are bifurcated between upstream and downstream parties. Upstream parties have a real need to be notified if one of their downstream party's insurance is cancelled. How are upstream parties supposed to be apprised if a downstream party's insurance is cancelled? We have encountered some upstream parties reacting to the change in the following manner:

❖ **Requesting updated certificates every 30 days from downstream parties.** In essence, the upstream party is basically using the certificate of insurance as a notice of cancellation. Admittedly, this would increase the administrative work on behalf of the upstream party to track and monitor the additional certificate of insurance. But the upstream party would be assured every 30 days that insurance is still in force.

A variation of this response would be to only request certificates of insurance every thirty (30) days from those downstream parties that were identified in the pre-qualification process as having questionable financials.

❖ **Requesting updated certificates of insurance every time the downstream party asks for payment.** In addition to the initial certificate of insurance before coming onto the job site, the upstream party requests an additional updated certificate of insurance before a payment is made. This includes regular payments and payments for change orders. Another updated certificate of insurance is requested before paying retainage.

A variation of this response would be to request the initial certificate of insurance before coming onto the job site. Then request an updated certificate of insurance before paying retainage. This would minimize the

administrative burden but would allow for some gap of time in which the downstream party's insurance could be cancelled without notification.

❖ **Have downstream parties or their insurance agents sign proprietary forms or insurance checklists.** For many of the same reasons listed above, insurance agents are not in a position to evidence the certificate holder is going to receive advanced notification unless the provision is part of the policy. ACORD's change was intended to facilitate compliance with state regulations. Surely, there will be some insurance agents who either are not aware of the consequences or will choose to roll the dice with the insurance regulators and sign these documents.

❖ **Not relaxing their stance on the certificate of insurance notice of cancellation issue.** Some upstream parties are not aware of the changes and continue to contractually require and insist upon a certificate of insurance that indicates they will receive 30 days notice in the event of cancellation.

Other upstream parties who are aware of the changes continue to request 30 days notice of cancellation understanding that insurance brokers are not in a position to evidence it on the certificate. These upstream parties look at the requirement as a downstream party responsibility, and failure to notify the upstream party will constitute breach of contract.

How are downstream parties supposed to evidence compliance with the insurance requirements for notice of cancellation in the contract they signed sometimes two years ago? If they fail to do so, they could be in breach of





their contract, and some upstream parties could withhold payment until a valid certificate is provided. Examples of how some downstream parties are reacting include the following:

- ❖ **Demanding the carrier assume the responsibility of sending notice of cancellation to the certificate holders.** ACORD announced their changes a year ago. For whatever reason, insurance carriers are just now waking up to the fact that this is a carrier issue and not a broker issue, and some are currently evaluating this as a possible solution.
- ❖ **Demanding the broker provide a certificate of insurance with the old notice of cancellation provision.** This poses a real problem for all insurance brokers/agents, and the more sophisticated brokers will realize they are not in a position to comply with this request. One reason is that using the old forms would constitute a violation of ACORD's licensing agreement and/or federal copyright laws. The second reason has been mentioned several times before. Carriers have traditionally been unwilling to endorse the policy for notice of cancellation to certificate holders. There certainly have been exceptions, but these are usually scheduled on endorsement to the policy. If the policy does not contain the provision that the certificate holder will be notified, any evidencing to the contrary could be construed as false or a misrepresentation running the risk of incurring a variety of consequences for the agent/broker.

It is expected that there will be some insurance agents/brokers out there that are either not aware of the significance of the changes or who feel they don't have a choice but to comply with their client's request. This will send conflicting messages to certificate holders (i.e., "Well, I got a certificate from a broker the other day with the old wording; why can't you do it?"). The more sophisticated brokers will educate their clients and certificate holders and look for ways to solve the problem within the confines of the law.

- ❖ **Demand their insurance agents sign upstream proprietary forms or insurance checklists.** For many of the same reasons listed above, insurance agents are not in a position to evidence the certificate holder is going to receive advanced notification unless insurers agree to make the provision a part of the policy. Surely,

there will be some insurance agents who either are not aware of the consequences or will choose to roll the dice with the insurance regulators.

Proprietary forms do not solve the representation issue. Any form that represents a coverage condition that is not present in the policy risks being in violation of state insurance statutes. In addition, there are at least fourteen states, where these forms would need to be filed and approved to be utilized.

## JANUARY 2011 UPDATE

Lockton continues to work with both its construction insurance carriers and clients toward finding a solution that works for all parties. We are willing to do whatever we can within the bounds of applicable state laws and regulations to assist our clients in complying with their construction contract terms and conditions. Since November 2010, multiple carriers have developed proprietary forms to add a provision to the policy outlining the parameters in which third parties would be notified in the event of the policies being terminated before their natural expiration date.

After reviewing sixty-one (61) different carrier forms representing twenty-two (22) different insurance carriers, it is a safe observation insurance carrier forms are vastly different from one another as carriers adopt different philosophies in addressing the issue. The forms may or may not include notification for nonpayment, nonrenewal, or material change or reduction in insurance but will do so for cancellation. Some forms require each certificate holder to be specifically listed while other forms agree to provide on a blanket basis (usually with certificate holder information on file). Some forms agree to mail notice while others will simply e-mail. Some forms say they will endeavor to and will not explicitly agree to provide notice. Yet others tie notice where required by written contract. The various options and combination of these components make it important to read and understand the form to see if it will meet the insurance requirements of the construction contract.

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<sup>1</sup>"Legal Analysis of Certificates." Contractual Risk Transfer International Risk Management Institute (IRMI) July 1, 2010.

<sup>2</sup>"Legal Analysis of Certificates – No Disclaimers Present." Contractual Risk Transfer International Risk Management Institute (IRMI) July 1, 2010. p. 3.

<sup>3</sup>NY, GA, ID, IL, TX, MA, HI

<sup>4</sup>Westin, Tim and Ann Henstand. "ACORD Alert: Certificate Changes, New changes to 8 ACORD forms, known as certificates, explained." ACORD, 2010. [www.video.acord.org](http://www.video.acord.org)

<sup>5</sup>Wilson, Bill. "Certificates of Insurance and Notice of Cancellation." Independent Insurance Agents & Brokers of America (Big I) Virtual University. May 21, 2010. p.1.

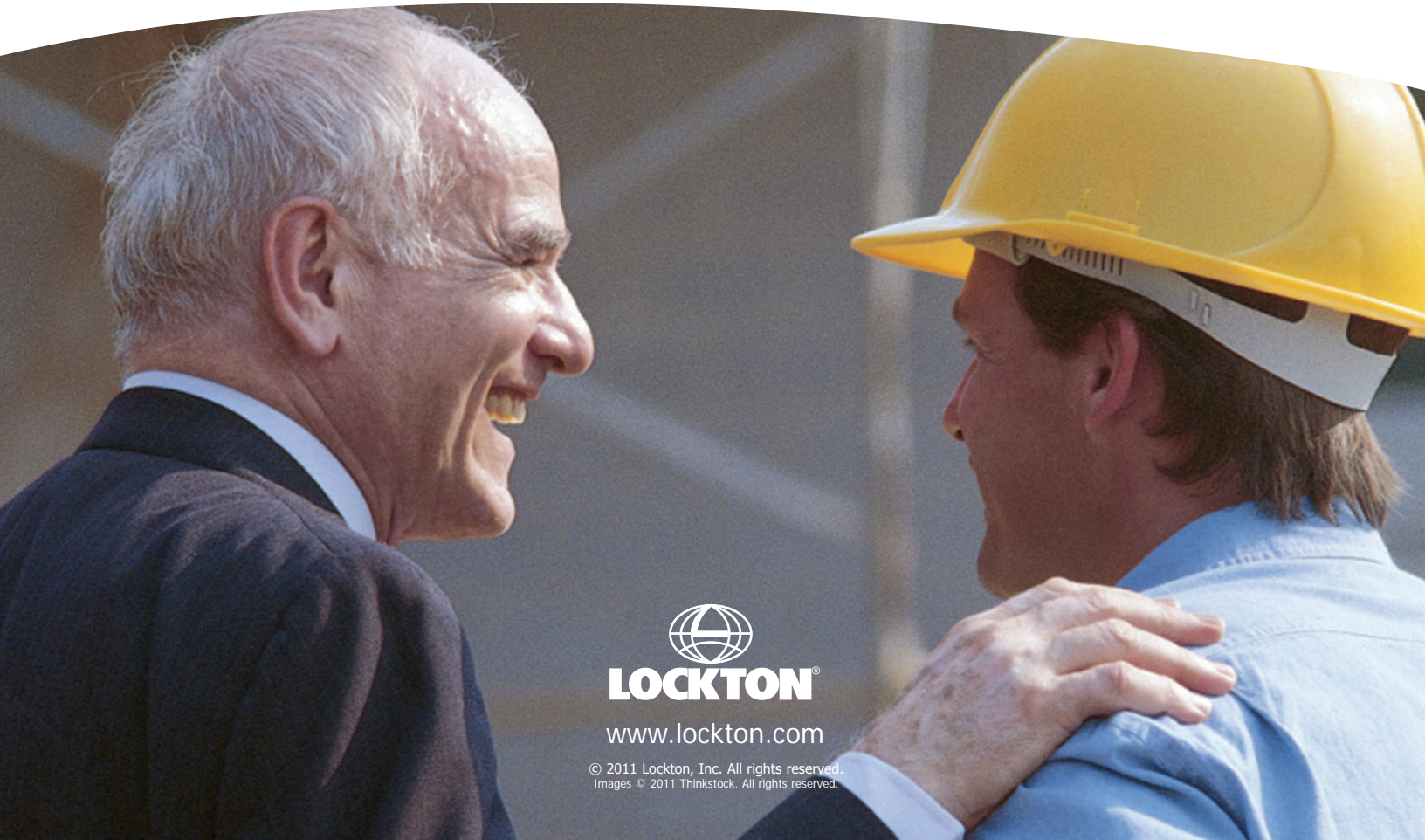
Lockton continues to work with both its construction insurance carriers and clients towards finding a solution that works for all parties.

## SUMMARY OF STATES' STANCE ON CERTIFICATES OF INSURANCE

Many states have statutes, codes or regulations concerning the use of certificates of insurance. Many states model their laws after the NAIC Model Fraud Law. The majority of states have issued Bulletins (or other formal correspondence) stating their position regarding the treatment of certificates of insurance. This is a summary based on a review of individual state bulletins where they could be identified. This list is as of January 31, 2011.

| State         | Advisory Opinion (A)<br>Statute (S)<br>Directive (D)<br>Bulletin (B)<br>Code (C)<br>Memorandum (M)<br>Circular Letter (L) | Modified<br>Certificates<br>That "Amends,<br>Extends or Alters"<br>Coverage Could Be<br>Considered a State<br>Violation | Certificates<br>Must Be Filed<br>and Approved<br>by the State | Possible<br>Criminal<br>Action for<br>Agent/Broker<br>for Violations | Directly<br>References<br>Proprietary<br>Forms or<br>Opinion<br>Letters |
|---------------|---|---|---|--|---|
| Alabama       | (S) 482-1-062   | √   | √   |  | √   |
| Alaska        |   |   |   |  |   |
| Arizona       | (B) 2011-01 (1) (1)   | √   |   | √  |   |
| Arkansas      | (B) 7-2010  | √   |   |  |   |
| California    | (C) Div 1, Part 1 Article1,<br>Section 384  | Must contain<br>disclaimer wording  |   |  |   |
| Colorado      | (B) B 5.21  | √   |   |  |   |
| Connecticut   | (B) S-14 (11-9-10)  |   |   |  |   |
| Delaware      |   |   |   |  |   |
| Florida       | (B) 94-104<br>(B) OIR-03-003M   | √   |   |  |   |
| Georgia       | (D) 88-R-1  | √   |   |  |   |
| Hawaii        | (M) 2009-3A   | √   |   | √  |   |
| Idaho         | (B) No 08.03  | √   | √—if amends<br>coverage                                       | √  |   |
| Illinois      | (M) dated 2-11-08   | √   |   |  | √   |
| Indiana       | (B) 170   | √   |   |  |   |
| Iowa          | (B) 10-04   | √   | √   |  |   |
| Kansas        | (S) KSA 40-955(b)   | √   | √   |  |   |
| Kentucky      | (S) KRS 304.14-120<br>(A) 2004-03   | √   | √   |  |   |
| Louisiana     | (B) 09-02<br>(S) 22.881.1   | √   | √   | √  |   |
| Maine         |   |   |   |  |   |
| Maryland      | (B) 08-34   | √   |   |  |   |
| Massachusetts |   |   |   |  |   |
| Michigan      | (B) 2008-11-INS   | √   |   |  |   |
| Minnesota     | (B) 2008-03   | √   |   |  |   |
| Mississippi   | (S) Reg 2009-1  | √   | √   |  | √   |
| Missouri      | (B) 10-02   | √   |   |  |   |
| Montana       |   |   |   |  |   |
| Nebraska      | (B) CB-118<br>Amended (12-7-10)   | √   |   |  |   |
| Nevada        |   |   |   |  |   |
| New Hampshire | (B) INS No. 09-048-AB   | √   |   |  |   |
| New Jersey    | (B) 98-5  | √   |   |  |   |
| New Mexico    | (B) 2011-001<br>(C) 59-A-18-2<br>(C) 59-A-18-12   | √   | √   |  | √   |
| New York      | (L) No. 8 June 8, 1995<br>(L) No 15 Jan. 27, 1998   | √   | √—if amends<br>coverage                                       |  |   |

| State          | Advisory Opinion (A)<br>Statute (S)<br>Directive (D)<br>Bulletin (B)<br>Code (C)<br>Memorandum (M)<br>Circular Letter (L) | Modified<br>Certificates<br>That "Amends,<br>Extends or Alters"<br>Coverage Could Be<br>Considered a State<br>Violation | Certificates<br>Must Be Filed<br>and Approved<br>by the State | Possible<br>Criminal<br>Action for<br>Agent/Broker<br>for Violations | Directly<br>References<br>Proprietary<br>Forms or<br>Opinion<br>Letters |
|----------------|---|---|---|--|---|
| North Carolina | (S) 58-3-150<br>(M) Sept. 15, 2006  | ✓   | ✓—if amends<br>coverage                                       |  | ✓   |
| North Dakota   | (B) 2010-1  |   | ✓   |  |   |
| Ohio           | (M) March 18, 2009  | ✓   |   |  |   |
| Oklahoma       | (B) PC 2008-01  | ✓   |   |  |   |
| Oregon         | (M) April 22, 2010  | ✓   | ✓—if amends<br>coverage                                       |  |   |
| Pennsylvania   | (S) 40 P.S. 477b<br>(B) 2009-02   | ✓   | ✓—if amends<br>coverage                                       |  |   |
| Rhode Island   |   |   |   |  |   |
| South Carolina |   |   |   |  |   |
| South Dakota   | (B) 06-02   | ✓   |   | ✓  |   |
| Tennessee      |   |   |   |  |   |
| Texas          | (B) B-0035-06   | ✓   |   |  |   |
| Utah           | (B) 2010 -4   | ✓   | ✓   |  |   |
| Vermont        |   |   |   |  |   |
| Virginia       |   |   |   |  |   |
| Washington     |   |   |   |  |   |
| West Virginia  | (L) No. 3   | ✓   | ✓   |  |   |
| Wisconsin      | (B) April 23, 2008  | ✓   |   |  |   |
| Wyoming        | (M) 01-2007   | ✓   |   |  | ✓   |



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