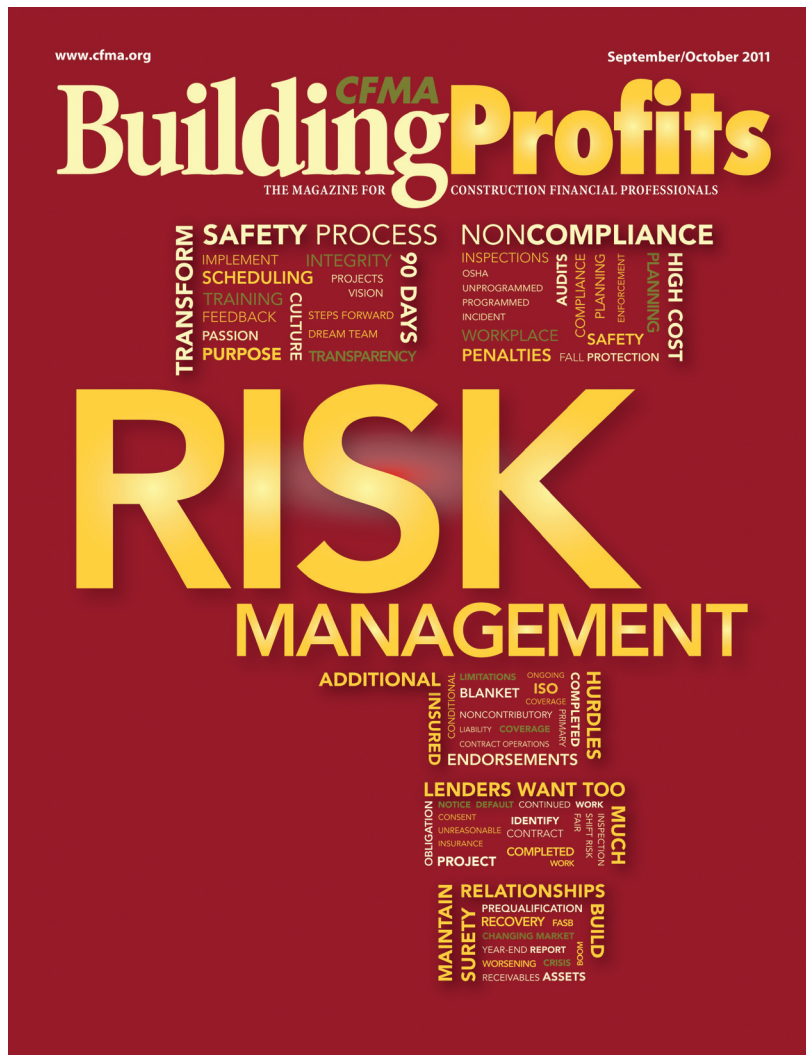


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BY SEAN H. BROGAN, A. PETER PRINSEN & RICHARD H. LOWE

Construction Challenges of the New ACORD 25

For the past 30 years, the construction industry has relied on standard certificates of insurance as the most timely and efficient way to verify the existence and terms of a project participant's insurance coverage before and during work on a construction project.

These certificates are produced by the Association for Cooperative Operations Research and Development (ACORD) and are so widely accepted that they have almost come to be viewed as operative legal documents that confer rights upon the certificate holder.

However, a certificate is only a snapshot of an insurance policy's existence and terms as of the issue date.

Certificate of Insurance Limitations

While a certificate of insurance plays an important role for informational purposes, there are limitations. First, it is not a full recount of a specific insurance policy's terms and conditions.

More importantly, a certificate of insurance does not alter the terms and conditions of the applicable insurance or confer any rights or responsibilities on the certificate holder. That is, a certificate of insurance does not amend, extend, or alter the coverage afforded by the insurance policy to which it pertains.

Construction contracts typically include obligations for one party to the contract (such as a GC or subcontractor) to maintain adequate insurance coverage, which often provides protection to the other party (e.g., additional insured coverage for the owner).

As a result, these contracts usually include a requirement that the party obligated to maintain the insurance coverage also provides advance notice to the other party before the coverage is cancelled or otherwise allowed to expire.

Notice of Cancellation

About two years ago, ACORD 25 – *Certificate of Liability Insurance* was changed to clarify a misconception regarding the certificate holder's right to receive advance notice of cancellation of an insurance policy.

The old ACORD 25 contained express language that stated a certificate holder would receive such notice:

“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.”¹

This provision suggested that the certificate holder was entitled to notice of cancellation of the insurance policy – even if the policy did not provide that right to the certificate holder.

The new ACORD 25 states that notice of cancellation is solely governed by the terms of the insurance policy – which, in most cases, does not contain a provision that grants such rights to the certificate holder. This change has caused a considerable stir in the construction industry for all project participants.

Old ACORD 25 Provision

ACORD included the provision quoted above in an effort to bring its certificates of insurance within the requirements of standard contractual provisions. In order for a certificate to comply with the terms of construction contracts, insurance producers would often insert 30 as the number of days for written notice.

There were two problems with this approach. First, a typical liability policy obligates an insurer to notify only the first named insured of a policy cancellation. For example, the standard commercial general liability policy issued by the Insurance Services Office, Inc. (ISO) provides that the only party entitled to receive notice of cancellation is the first named insured.²

The old ACORD 25 provision extended beyond the policy provisions regarding the right to receive notice of cancellation by purporting to create the right of a certificate holder to receive notice of cancellation.



Construction contract participants must work together to achieve a collaborative solution that properly addresses all respective contractual obligations and corresponding insurance coverage.

The second problem was that even if a certificate could be used to alter, expand, or modify the terms of the applicable policy, compliance with the requirement to provide a certificate holder with a 30-day notice of cancellation is often impossible. Many state insurance regulations allow an insurance carrier to cancel a policy with only a 10-day notice for failure to pay the required premium. Moreover, an insured can cancel its own policy at its discretion, which would be effective immediately.

Over the past few years, more than 30 state insurance departments have issued bulletins or regulations to address insurance certificates that do not accurately represent the terms or conditions of an insurance policy. In fact, several state insurance departments have focused on the notice of cancellation presented in the old ACORD 25 and concluded that the notice of cancellation is a policy right and, therefore, strictly governed by the policy.

New ACORD 25 Language

During the summer of 2009, ACORD's Certificates Forms Working Group reviewed its various certificates and recommended that the following text be substituted for the notice of cancellation language in the old ACORD 25:

"Should any of the above described policies be cancelled before the expiration date thereof, notice will be delivered in accordance with the policy provisions."³

The word "endeavor" was removed because "[p]olicy cancellation provisions generally don't use the phrase 'endeavor to'" and "[o]nly a policy can obligate an insurer to provide notice of cancellation." In other words, "[u]nless a policy's provisions explicitly provide for notice to a party also listed as the certificate holder on the certificate of insurance, the insurer is not obliged to notify that party."⁴

This proposed amendment was approved by ACORD's membership and a new version of ACORD 25 was published in October 2009, which incorporated new notice of cancellation language.

This new language clearly states that there is no duty on anyone's part to warn of the potential insurance policy cancellation, except as provided in the policy, which is usually only to the first named insured.

Industry Reactions

After the new ACORD 25 was published, at least three state insurance departments (Kansas, North Carolina, and South Dakota) issued directives to all interested parties that required them to only use the new version of ACORD 25.⁵ Despite these directives, the insurance and construction industries were not eager to embrace the new certificate.

Many insurance producers were in a difficult position because municipalities, large contractors, and other types of certificate holders refused to accept the new ACORD 25 due to the elimination of the old form's cancellation provision.

As a result, some insurance producers continued to issue the old version of the certificate through the end of 2009 and most of 2010 in order to comply with their clients' instructions.

Under ACORD's licensing agreement, the prior edition of superseded forms can only be used for one year after new forms are introduced. So, as of October 2010, licensed ACORD form users (i.e., the insurance producers who issue ACORD certificates) are required by the terms of their licensing agreement to use only the new version of ACORD 25.

Using the old version is now a violation of ACORD's licensing agreement and, therefore, an unlawful use of ACORD's copyrighted documents.

Since insurance producers are now prohibited from using old versions of ACORD's certificates, an interesting dynamic has occurred in the insurance and construction industries.

Some insurance carriers have developed endorsements that can be added to liability policies to comply with certificate holder notice requirements in construction contracts. By obtaining such an endorsement, insurance producers can

help their clients attempt to remain compliant with contractual obligations regarding cancellation notice provisions.

Other carriers have determined that the most logical solution to this problem is for the insurance producer to send notice of cancellation to all affected certificate holders.

A carrier may include such an express provision in its licensing agreement with the insurance producer, or may seek to add an endorsement to the insurance policy that memorializes the client's authorization for the insurance producer to send notice of cancellation or nonrenewal to a certificate holder or other third party.

Insurance carriers have different views of who is responsible for handling the notice of cancellation; this may leave insurance producers and insureds in an uncomfortable position.

An insured whose carrier wants to delegate the cancellation notice responsibility to the insurance producer will expect the producer to fulfill that role so that the insured remains compliant with cancellation notice obligations in its construction contract.

The insurance producer, however, may not be willing to undertake that role, because then it would be exposed to potential liability if a cancellation notice is accidentally overlooked and a claim occurs.

Therefore, insurance carriers, producers, and insureds must work together to develop a uniform way to address the disconnect between the notice of cancellation provisions in construction contracts, the corresponding provisions in insurance policies, and the new ACORD 25.

Contract Negotiation Options

The ideal opportunity to properly handle notice of cancellation is during the contract negotiation phase.

Instead of using standardized language found in construction contracts, parties must realize that there is often a major disconnect between their respective contractual obligations and the actual insurance coverage terms.

Failing to properly recognize this issue before a claim occurs often results in an uncovered breach of contract claim against the party obligated to provide insurance coverage, as well as inadequate coverage for the party expecting protection.

Parties to a construction contract should have their producer (or other insurance advisor) involved in the negotiation pro-

cess before the construction contract is signed. A producer can review the insurance-related provisions of the contract and advise its client of any areas in which the contract might conflict with specific insurance coverage.

The client can try to tailor the contract language to meet the terms and conditions of its own insurance coverage and reduce the risk of an uninsured loss.

At the very least, it can decide whether or not to enter into the contract with a full understanding of the potential risk.

Parties to a construction contract could also consider including a provision in the contract that requires the party obligated to obtain insurance coverage, in addition to its insurance carrier, to provide notice of cancellation of the coverage.

So, a party to a construction contract that suffers a loss occasioned by a failure to receive adequate notice of cancellation of the insured's coverage might be able to pursue an alternative remedy through a claim on the insured's performance bond, if one exists.

Depending on the circumstances of a particular construction project or a specific insured, parties to a construction contract could also consider a provision that requires certificates of insurance to be provided by an insured at intervals more often than once a year. By doing so, the other parties would gain a heightened sense of security that the requisite coverage remains in place.

Insurance Carrier Approaches

Insurance carriers have taken differing approaches to the notice of cancellation issue.

Shifts to Producer

Some insurance carriers have tried to place the responsibility on the producer.

For example, in response to the changes to the new ACORD 25, one insurance carrier released a proposed endorsement that unilaterally shifted the notice of cancellation responsibility to the producer.

This proposed endorsement included a representation that the insured and the producer agreed that the producer would take responsibility. However, it included a complete waiver of liability for both the insurance carrier and the producer if the notice of cancellation was not handled properly. Not surprisingly, many producers and insureds were not willing to accept this proposed endorsement.



Additional Endorsements

Other carriers have added endorsements to their policies, under certain circumstances whereby they take on the responsibility to provide written notice of cancellation to any person or organization listed in the endorsement.

In fact, the ISO issued a version of this type of endorsement in 2004, but it has only been adopted and approved for use in Texas.⁶ Based on all of the recent focus on this issue, it is possible that the ISO would take the necessary steps to have its version of this endorsement approved in all (or at least many) states.

Endorsement Limitations

While an endorsement is a positive development for insureds with contractual obligations to provide notice of cancellation to other parties, there are certain limitations with this approach.

First, insurance carriers are unable to provide these endorsements on a true “blanket” basis. If an insurance carrier is obligated to provide notice of cancellation to certain parties, then it must first be provided the identities of those parties so that it can send the notice. So, it’s really not a “blanket” endorsement, because the insured retains the administrative burden of properly informing the insurance carrier that is supposed to receive notice.

Similarly, a carrier may require that a new endorsement (that individually lists the name and address of each party that should receive notice of the cancellation) be issued and attached to the insured’s policy each time a new contract is signed. For insureds that execute a significant volume of contracts, both of these scenarios pose an increased risk of error.

Second, insurance carriers have indicated an unwillingness to issue these endorsements when construction contracts are bid, but rather when construction contracts have been awarded.

Carriers also have cautioned that they are not able to complete and issue the endorsements in one day, unlike producers often do for insurance certificates.

These limitations may result in difficulties for insureds in their usual course of operations.

Administrative Controls

Once construction contracts are signed and work begins, all parties must have the proper administrative controls in place

to ensure contractual obligations are fulfilled. This can be accomplished in several different ways regarding the notice of cancellation.

First, a rising trend in construction is an effort to verify the specific terms of an insured’s policy, as opposed to merely relying on the generalized language contained in a certificate of insurance. This trend is driven in large part by how the insurance industry handles additional insured endorsements.

As of 25 years ago, there were only a handful of standard ISO additional insured endorsements. Over time, these endorsements have been broadly interpreted by the courts and, in response, insurance carriers have worked to limit the coverage for additional insureds by significantly modifying or creating new endorsements.

As a result, there are currently more than 30 different ISO endorsements that pertain to additional insured coverage (all of which provide different levels of protection).

With the availability of all additional insured endorsements, some construction contract participants are not satisfied with a certificate of insurance that indicates additional insured coverage is provided by an insured’s policy.

Instead, they require a copy of the additional insured endorsement in order to verify the scope and terms of the coverage. Similarly, a copy of the notice of cancellation endorsement could be requested and reviewed to ensure that adequate notice will be provided in the event of cancellation.

Depending on the project or participant, a party to a construction contract could require another party to provide a certificate of insurance more often than the industry standard of once a year. The more frequent the intervals, the less likely that the insurance coverage will be cancelled and, therefore, lead to a problem.

However, with the increased sense of security comes a corresponding administrative burden of keeping on top of the review process.

The process of reviewing certificates of insurance can also be managed through specialized software or online resources. For example, software packages or Web-based applications allow certificates to be received via fax, e-mail, or postal service; scanned into a database; and stored as an image with other key contractual information.

Information included on certificates of insurance can then be tracked and specific reports can be generated, along with

correspondence required to address issues or concerns – including the notice of cancellation.

A more comprehensive approach to project administration is to outsource the entire insurance certificate review process. In this approach, the vendor is responsible for the necessary follow-up to ensure that parties to a construction contract are fulfilling their obligations to maintain and show evidence of required insurance coverage.

Conclusion

Despite the dissatisfaction of many of the players in the construction industry, the new ACORD 25 notice of cancellation language is here to stay.

Construction contract participants must work together to achieve a collaborative solution that properly addresses all respective contractual obligations and corresponding insurance coverage.

These parties must fully understand the contract terms relative to insurance requirements, the scope and limitations of their respective insurance policies, and the corresponding administrative burden involved in overseeing that contractual obligations are fulfilled. ■

Endnotes:

1. ACORD 25 – *Certificate of Liability Insurance* (2001/08).
2. CG 00 01 12 04, *Commercial General Liability Coverage Form*, Section IV, No. 9. ISO Properties, Inc., 2003.
3. ACORD 25 – *Certificate of Liability Insurance* (2001/05).
4. ACORD Certificates FAQs, July 20, 2010, www.acord.org/standards/forms/Documents/ACORDCertificatesFAQ_201004.pdf.
5. See, e.g., Kansas Insurance Department Bulletin 2010-2, August 30, 2010; North Carolina Department of Insurance Bulletin Number 10-B-01, February 1, 2010; and South Dakota Department of Revenue & Regulation Division of Insurance Bulletin 10-01, January 13, 2010.
6. CG 02 05 12 04, *Texas Changes – Amendment of Cancellation Provisions or Coverage Change*, ISO Properties, Inc., 2003.

SEAN H. BROGAN is an Attorney and Producer at The Graham Company in Philadelphia, PA.

Sean assists clients with the design and implementation of comprehensive insurance programs and risk management strategies. He has 10 years' experience as an insurance coverage litigator.

Sean holds a BA from Catholic University of America and a JD from Villanova University. The Graham Company has been a longtime member of CFMA.

Sean is also a member of the Philadelphia Bar Association and the American Bar Association.

Phone: 215-701-5260
E-Mail: sbrogan@grahamco.com
Website: www.grahamco.com

A. PETER PRINSEN, CPCU, RPLU, is Vice President, General Counsel, and member of the Board of Directors of The Graham Company in Philadelphia, PA.

Peter earned his JD from Villanova University and is a licensed Insurance Agent. He also has the Associate in Surplus Lines Insurance (ASLI) and Associate in Claims (AIC) designations awarded by the Insurance Institute of America.

Phone: 215-701-5284
E-Mail: pprinsen@grahamco.com
Website: www.grahamco.com

RICHARD H. LOWE is a Partner with Duane Morris LLP in Philadelphia, PA, where he concentrates his practice in commercial litigation and construction law.

He earned his JD from New York University and is a Fellow of the American College of Construction Lawyers and a Fellow of the Litigation Counsel of America.

A member of CFMA, Richard served as a Board Member of the Philadelphia Chapter from 1997 to 2001.

Phone: 215-979-1137
E-Mail: rhlowe@duanemorris.com
Website: www.duanemorris.com



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