

## HOUSE OF REPRESENTATIVES STAFF ANALYSIS

**BILL #:** HB 173 CS

Construction Contracts

**SPONSOR(S):** Ross

**TIED BILLS:**

**IDEN./SIM. BILLS:** SB 682

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REFERENCE	ACTION	ANALYST	STAFF DIRECTOR
1) Insurance Committee	19 Y, 0 N, w/CS	Callaway	Cooper
2) Business Regulation Committee	9 Y, 8 N, w/CS	Livingston	Liepshutz
3) Civil Justice Committee			
4) Commerce Council			
5) _____			

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### SUMMARY ANALYSIS

The bill addresses the issue of a subcontractor's failure to obtain insurance required by a construction contract between the general contractor and the subcontractor. There are currently no specific statutory provisions relating to this issue. Remedies under other statutory provisions, such as contract law or lien law, may apply generically.

The bill gives a general contractor three business days to reject, in writing, a certificate of insurance given to him by a subcontractor. If a general contractor does not reject the certificate of insurance within the three day window, he or she is deemed to accept it, except under specified circumstances. The general contractor can still reject the certificate of insurance at a later date as long as the rejection is in writing.

The bill also requires general contractors who accept a subcontractor's certificate of insurance or who have deemed acceptance of it to pay the subcontractor for the work done, except under specified circumstances.

The bill's provisions also apply to certificates of insurance required by construction contracts between general contractors, subcontractors, sub-subcontractors, and materialmen.

There does not appear to be a fiscal impact on state or local government.

## FULL ANALYSIS

### I. SUBSTANTIVE ANALYSIS

#### A. HOUSE PRINCIPLES ANALYSIS:

**Provide Limited Government:** The bill creates statutory provisions governing the actions of contractors who are parties to a construction contract relating to acceptance or rejection of certificates of insurance and the resulting payment for work done or materials supplied. There are currently no specific statutory provisions relating to this issue.

**Safeguard Individual Liberty:** The bill restricts when a general contractor can reject work done by a subcontractor or withhold payment for work done by a subcontractor due to the subcontractor not having insurance coverage required in the construction contract. The bill also provides a time limit when a general contractor must reject a certificate of insurance from a subcontractor. Noncompliance with the time limit provided results in a general contractor's deemed acceptance of the certificate of insurance.

#### B. EFFECT OF PROPOSED CHANGES:

##### **Background**

Most property owners, general contractors, and subcontractors carry numerous kinds of insurance, such as workers' compensation<sup>1</sup> and commercial liability. Insurance costs are factored into the contractors' bids on a construction project. Insurance requirements for a particular construction project are included in the resulting construction contracts between the owner and general contractor, the general contractor and subcontractor, and/or subcontractor and sub-subcontractor or materialman. For purposes of brevity, this analysis refers to the working relationship between a general contractor and a subcontractor. The same practices can occur when general contractors or subcontractors contract with sub-subcontractors or with materialmen and the sub-subcontractor or materialmen are required to provide policies or certificates of insurance as proof of insurance coverage.

Although there are no laws specifically addressing the practice, a general contractor or subcontractor may require, as a part of the construction contract, a certificate of insurance or an insurance policy to be submitted by a subcontractor as a condition of work. The certificate of insurance is evidence of insurance in lieu of an actual copy of an insurance policy. At some point upon signing a construction contract, sometimes before the work begins and sometimes after, the subcontractor provides a certificate of insurance to the general contractor listing the insurance provided by the subcontractor. Most times the general contractor reviews all documents required to be submitted under the construction contract, including the certificate of insurance, prior to paying the first invoice for each subcontractor. If an insurance policy or certificate of insurance is not submitted or if it does not meet the standards of the general contractor requiring the policy under the contract, the contractor may prohibit the other party from working on the construction project or may withhold payment for work already done until the proper insurance is obtained and proof is submitted.

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<sup>1</sup> Employers in the construction industry with one or more employee must provide workers' compensation coverage for its' employees. s. 440.02(17)(b)2., F.S. (2005). If a subcontractor does not have workers' compensation coverage, the general contractor must provide workers' compensation benefits for any injured employee of the subcontractor. This is true even if the subcontractor lied to the general contractor about his or her workers' compensation insurance coverage or gave the general contractor a fraudulent certificate of workers' compensation insurance coverage. John J. Dubreuil, *Florida Workers' Compensation Handbook*, 3-43 (2003 Edition, 2003).

According to proponents of the bill, a practice of misuse of certificates of insurance by general contractors has emerged that is of serious concern to the subcontractors and their insurance agents.<sup>2</sup> This practice involves a general contractor demanding their subcontractors supply them with certificates of insurance containing non-standard and sometimes unavailable coverage provisions, such as hold harmless agreements or waiver of subrogation rights.

Specifically, the subcontractor is told by the general contractor that in order to work on the construction project, the subcontractor must supply evidence of a liability policy with certain provisions. The subcontractor purchases an insurance policy and receives a certificate of insurance from his or her insurance agent which contains information about what type of insurance coverage the policyholder/subcontractor has in force. The subcontractor usually gives the certificate of insurance to the general contractor before starting work on the construction project. However, circumstances do exist where the documentation may be submitted after commencement of the subcontractors' portion of the project.

According to the bill's proponents, once the subcontractor's work is complete, the general contractor often refuses payment to the subcontractor for work completed because the subcontractor did not carry insurance containing the general contractor's required specifications, even though the general contractor had the certificate of insurance from the outset of the subcontractor's work. The general contractor refuses payment to the subcontractor until the subcontractor provides the general contractor with a certificate of insurance meeting the general contractor's specifications.

The problem is further complicated when the subcontractor asks his or her insurance agent to give him or her a new certificate of insurance with the appropriate specifications, to provide him or her with a retroactive insurance policy with corresponding certificate of insurance meeting the specifications, or to alter his or her existing certificate of insurance to reflect the appropriate specifications. Most agents refuse to alter the certificates of insurance as doing so potentially subjects them to license discipline and administrative fines.<sup>3</sup> Also, an agent doing so may incur an "errors and omission" problem.<sup>4</sup>

If an agent refuses to alter a certificate of insurance, the general contractor may ask the agent to issue a personal guarantee of the changes to the certificate of insurance the general contractor requires.<sup>5</sup> A personal guarantee by the agent may expose him or her to suit if the insurer will not honor the changes required by the general contractor and personally guaranteed by the agent.

### **Proposed Legislation**

The bill is designed to resolve the problem relating to certificates of insurance between contractors alleged by the bill's proponents. In that regard, the bill creates statutory provisions allowing a general contractor three business days to reject a certificate of insurance given to him by a subcontractor. The bill's provisions also apply to certificates of insurance required by construction contracts between general contractors, subcontractors, sub-subcontractors, and materialmen. The rejection must be in writing and must specify the reason(s) for rejection. The bill does not require the general contractor to allow the subcontractor time to cure any deficiency in the certificate of insurance causing rejection of it by the general contractor.

If a general contractor does not reject the certificate of insurance within the three day window, he or she automatically accepts it (i.e. deemed acceptance). The general contractor is still able to reject a certificate of insurance at a later date (after acceptance or automatic acceptance) as long as the

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<sup>2</sup> Florida Association of Insurance Agents, *300 Words (more or less) about Certificates of Insurance* (2006) (on file with the Insurance Committee).

<sup>3</sup> s. 626.9541(1)(a)1., F.S. (2005); s. 626.9521, F.S. (2005); Informational Memorandum OIR-03-003M, issued by the Office of Insurance Regulation on February 21, 2003 (on file with the Insurance Committee).

<sup>4</sup> Florida Association of Insurance Agents, *300 Words (more or less) about Certificates of Insurance* (2006) (on file with the Insurance Committee).

<sup>5</sup> Id.

rejection is in writing and specifies the reason(s) for rejection. However, the general contractor must pay the subcontractor for work done by the subcontractor up to the date of written rejection of the certificate of insurance by the general contractor.

The bill outlines circumstances where a general contractor can withhold payment or reject work that has been completed by a subcontractor despite the general contractor's acceptance or automatic acceptance of the certificate of insurance. These circumstances are:

- if the certificate of insurance does not comply with the insurance coverage limits specified in the construction contract;
- if the certificate of insurance was knowingly and fraudulently altered or reflects coverages not in the insurance policy; or
- if the insurance policy is cancelled, nonrenewed, or materially and adversely altered during the term of the construction contract.

The bill also requires general contractors who voluntarily accept a subcontractor's certificate of insurance at the outset or who automatically accept it by operation of law after the 3 day window to pay the subcontractor for work completed up to the time the general contractor rejects the insurance policy on the basis that it is nonconforming. The bill does not require the general contractor to pay the subcontractor for work done in the three day window allowed for rejection of the certificate of insurance. Thus, the subcontractor is at risk for not getting paid for work performed, if any, during this time period.

The bill outlines circumstances where a general contractor cannot be caused to automatically accept a certificate of insurance even if he or she does not reject during the three day rejection window. These circumstances are:

- if the certificate of insurance does not comply with the insurance coverage limits specified in the construction contract,
- if the certificate of insurance was knowingly and fraudulently altered, or
- if the certificate of insurance reflects coverages not in the insurance policy

#### C. SECTION DIRECTORY:

**Section 1.** Creates s. 627.442, F.S. providing provisions regarding acceptance and/or rejection of certificates of insurance by parties to a construction contract and payment on construction contracts.

**Section 2.** Provides an effective date of July 1, 2006.

## II. FISCAL ANALYSIS & ECONOMIC IMPACT STATEMENT

### A. FISCAL IMPACT ON STATE GOVERNMENT:

#### 1. Revenues:

None.

#### 2. Expenditures:

None.

### B. FISCAL IMPACT ON LOCAL GOVERNMENTS:

#### 1. Revenues:

None.

2. Expenditures:

None.

C. DIRECT ECONOMIC IMPACT ON PRIVATE SECTOR:

The bill may create costs to a general contractor or subcontractor when a subcontractor, sub-subcontractor, or materialman does not have the proper insurance. The increased costs may include costs associated with hiring a subcontractor, sub-subcontractor, or materialman that carries the required insurance. However, the bill's provisions precluding the general contractor or subcontractor from withholding payment for work completed by subcontractors, sub-subcontractors, or materialmen may have a positive financial impact on those parties by guaranteeing payment for services rendered.

D. FISCAL COMMENTS:

None.

### III. COMMENTS

A. CONSTITUTIONAL ISSUES:

1. Applicability of Municipality/County Mandates Provision:

This bill does not require counties or municipalities to take an action requiring the expenditure of funds, does not reduce the authority that counties or municipalities have to raise revenue in the aggregate, and does not reduce the percentage of state tax shared with counties or municipalities

2. Other:

None.

B. RULE-MAKING AUTHORITY:

NA.

C. DRAFTING ISSUES OR OTHER COMMENTS:

None.

### IV. AMENDMENTS/COMMITTEE SUBSTITUTE & COMBINED BILL CHANGES

On January 26, 2006, the Insurance Committee considered the bill, adopted a strike-all amendment, and reported the bill favorably with CS. The strike-all amendment made the following changes to the original text of the bill:

- specified the general contractor has 3 business days to reject a certificate of insurance, rather than 3 days as provided in the original bill text
- clarified that a subcontractor will be paid for work done before the certificate of insurance is accepted or deemed to be accepted
- clarified that a general contractor can reject a certificate of insurance even after he originally accepted it or was deemed to have accepted it
- created exceptions to the provision relating to deemed acceptance of a certificate of insurance by a general contractor. The exceptions are a policy or certificate “that does not comply with the insurance coverage limits specified in the construction contract, that was knowingly and

fraudulently altered, or that reflects coverages or conditions that are not contained in the underlying policy.”

- created exceptions to the provision requiring a general contractor to pay a subcontractor for work performed. The exceptions allow a general contractor to withhold payment or reject work completed by a subcontractor if the policy or certificate: “(a) Does not comply with the insurance coverage limits specified in the construction contract; (b) Was knowingly and fraudulently altered or reflects coverages or conditions that are not contained in the underlying policy; or (c) Is cancelled, nonrenewed, or materially and adversely altered during the term of the construction contract.”
- deleted the provision in the original bill making the construction contract provision requiring insurance unenforceable if the certificate of insurance is rejected.

On February 21, 2006, the Committee on Business Regulation considered the bill, adopted one amendment, and reported the bill favorably with CS. The CS includes a provision that specifies a contractor may not reject an insurance policy based on the fact that the insurer is not rated by a national rating service.