

## HOUSE OF REPRESENTATIVES STAFF ANALYSIS

**BILL #:** HB 173 CS                      Construction Contracts  
**SPONSOR(S):** Ross and others  
**TIED BILLS:** None                      **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	7 Y, 0 N, w/CS	Blalock	Bond
4) Commerce Council	10 Y, 0 N, w/CS	Callaway	Randle
5) _____	_____	_____	_____

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### SUMMARY ANALYSIS

There are currently no specific statutory provisions relating to insurance provisions in construction contracts. This bill addresses the issue of a subcontractor's failure to obtain the insurance coverage required by a construction contract between a contractor and a sub-contractor, and the general/prime contractor's failure to compensate the sub-contractor for past work that the subcontractor accomplished while the general/prime contractor reviewed the sub-contractor's insurance coverage.

This bill gives a general/prime contractor 30 business days for commercial construction projects and 7 business days for residential construction projects in which to reject a certificate of insurance given to the general/prime contractor by a subcontractor. If a general/prime contractor does not reject the certificate of insurance within the applicable 30 day or 7 day time period, then the general/prime contractor is deemed to accept it. The general/prime contractor can still reject the certificate of insurance at a later date as long as the rejection is in writing.

This bill also requires general/prime contractors who accept a subcontractor's certificate of insurance, or who have been deemed in acceptance of it, to pay the subcontractor for the work done, except under specified circumstances. Owners and lenders, if applicable, are also obligated to pay the subcontractor for the work done.

The bill specifies no lien or payment bond claim by a subcontractor exists after the subcontractor's insurance is rejected. Additionally, a lien or payment bond claim only exists after the subcontractor provides evidence the subcontractor's insurance conforms to the construction contract.

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

A general/prime contractor will not be required to follow the provisions of this bill if the general/prime contractor provides a sample of a certificate of insurance that reflects all of the insurance requirements that a subcontractor must have coverage for, and the insurance provided by the subcontractor does not comply with the construction contract.

The bill will only be applied to contracts entered into on or after October 1, 2006.

The bill does not appear to have a fiscal impact on state or local governments.

**This document does not reflect the intent or official position of the bill sponsor or House of Representatives.**

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## FULL ANALYSIS

### I. SUBSTANTIVE ANALYSIS

#### A. HOUSE PRINCIPLES ANALYSIS:

Provide Limited Government -- This 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 -- This 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.

## **Effect of Bill**

This 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/prime contractor 30 business days for commercial construction projects and 7 business days for residential construction projects in which to reject an insurance policy or a certificate of insurance given to the general/prime contractor by a subcontractor. The rejection must be in writing and must specify the reason(s) for rejection. If the general/prime contractor rejects the insurance policy or certificate of insurance within the applicable 7 or 30 day period, the general/prime contractor does not have to pay for work done by the subcontractor. Additionally, the subcontractor has no lien or payment bond claim against the general/prime contractor. A lien or payment bond claim by a subcontractor only exists after the subcontractor provides evidence the subcontractor's insurance conforms to the construction contract. This bill does not require the general/prime contractor to allow the subcontractor

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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.*

time to cure any deficiency in the certificate of insurance causing rejection of it by the general/prime contractor.

If a general/prime contractor does not reject the certificate of insurance within the applicable 7 day or 30 day time period, then the general/prime contractor automatically accepts it (i.e. deemed acceptance). The general/prime contractor can also voluntarily accept the subcontractor's insurance during the 7 or 30 day time period. Under either scenario, the general contractor, owner, or lender must pay the subcontractor for the work done whether or not the subcontractor has insurance conforming to that required by the construction contract.

The general/prime contractor is still able to reject a certificate of insurance at a later date (after acceptance or automatic acceptance) as long as the rejection is in writing and specifies the reason(s) for rejection. In such a case, no lien or payment bond claim exists after the subcontractor receives the rejection. Only after the subcontractor obtains insurance conforming to the construction contract and provides evidence of it to the general/prime contractor does a lien or payment bond claim exist. Additionally, in such a case, the subcontractor is only paid for work completed before the rejection by the general/prime contractor and can only be paid for work done after the rejection if the subcontractor provides the general/prime contractor with evidence he or she has obtained insurance meeting the requirements set forth in the construction contract.

Even if a subcontractor's certificate of insurance is not rejected by the general/prime contractor within the applicable 7 or 30 day time period and even if the insurance is rejected by a general contractor after initial acceptance of it or deemed acceptance of it, the general/prime contractor does not have to pay for work performed at any time by subcontractor if:

- the subcontractor's certificate of insurance does not reflect the insurance in force or
- the subcontractor's insurance is cancelled, nonrenewed, or altered so that it does not meet the requirements of insurance set out in the construction contract.

These two circumstances also preclude the subcontractor from obtaining a lien or payment bond claim.

The provisions of this bill will not apply if the general contractor provides a sample of a certificate of insurance that reflects all of the insurance requirements that a subcontractor must have coverage, and the insurance provided by the subcontractor does not comply with the construction contract.

The bill specifically provides nothing in it tolls the required time period within which a claim or lien or a claim against a payment bond must be filed.

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

The provisions of the bill only apply to contracts entered into on or after July 1, 2006.

#### 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 creates s. 627.443, F.S. prohibiting a party to a construction contract from requiring another party to the contract to obtain workers' compensation insurance from a rated insurer or self-insurance fund.

Section 3 provides an effective date of October 1, 2006.

## II. FISCAL ANALYSIS & ECONOMIC IMPACT STATEMENT

#### A. FISCAL IMPACT ON STATE GOVERNMENT:

STORAGE NAME: h0173g.CC.doc  
DATE: 4/24/2006

PAGE: 4

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:

None.

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, nor reduce the percentage of state tax shared with counties or municipalities

2. Other:

None.

B. RULE-MAKING AUTHORITY:

None.

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.

On April 4, 2006, the Civil Justice Committee adopted two amendments to this bill. The amendments provided that:

- A general contractor is allowed 30 business days for commercial construction projects and 7 business days for residential construction projects in which to reject a certificate of insurance given to him by a subcontractor.
- The above provisions will not apply if the general contractor provides a sample of a certificate of insurance that reflects all of the insurance requirements that a subcontractor must have coverage, and the insurance provided by the subcontractor does not comply with the construction contract.
- The bill is only applicable to contracts entered into on or after July 1, 2006.

The bill was then reported favorably with a committee substitute.

On April 20, 2006, the Commerce Council considered the bill, adopted a strike-all amendment, and reported the bill favorably with a Council Substitute. The strike-all amendment: maintained the overall concept of the bill but added clarifying language to avoid unintended consequences. The amendment:

- Clarified an owner or lender on a construction project cannot withhold payment to a subcontractor for improper insurance unless the insurance is properly rejected.
- Clarified a subcontractor has no lien rights against the owner or a claim against the general contractor’s payment bond if the general contractor rejects the subcontractor’s insurance coverage until the subcontractor obtains the required insurance.
- Clarified a subcontractor’s insurance coverage must remain in place for the period specified in the construction contract.

The staff analysis was updated to reflect the adoption of the strike-all amendment.