Insurance & Risk Management Update - Spring 2007

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CERTIFICATES OF INSURANCE: PERILS AND PITFALLS

Certificates of Insurance are a common currency in many business transactions. Business contracts typically have provisions requiring one party or both to procure and maintain certain types of insurance, such as commercial general liability, and set limits for that coverage. The parties often rely on Certificates of Insurance - usually an ACORD™ form - as proof that the insurance requirements have been met.

A typical Certificate of Insurance identifies the Producer (the agent or broker), the insured and the Certificate Holder. It also provides a summary of the type of insurance (General Liability, Auto, Excess/ Umbrella and Workers' Compensation), the name of the insurer for each policy and policy number, limits of coverage and coverage dates. There are basically two types of Certificates of Insurance. The most common type is informational in nature, showing the existence and limits for various types of coverage issued to the named insured. The second type sometimes indicates that a third-party - usually the Certificate Holder - has been added as an additional insured to the named insured's policy. Certificates of Insurance are an easy way for the Certificate Holder to get an overview of coverage. There are, however, several potential problems with Holders exclusively relying on such Certificates.

INFORMATIONAL CERTIFICATES

The Certificate is a summary of coverage. It does not reflect all the terms and conditions of coverage, such as exclusions, sub-limits, or other restrictions on coverage. Without knowing the details of coverage, the Certificate may give the Holder a false sense of security. Moreover, the Certificate typically contains a disclaimer that it does not "amend, extend or alter the coverage" afforded by the policies themselves. If there is a discrepancy between the Certificate and the actual policy, the Certificate Holder may be out of luck. The insurer is likely to argue that the disclaimer put the Holder on notice and that the Holder should have checked the actual policy.

The Certificate is typically issued by the agent, not the insurance company. The agent may not forward the Certificate to the insurer and, even if it does, the insurer may ignore the Certificate. In such situations, the insurer will likely contend that it is not bound by the agent's representations in the Certificate and the Holder

should have confirmed coverage with the insurer. There may be ways to overcome this problem, as for example when the agent is authorized to bind coverage on behalf of the insurer. As a practical matter, however, it is easier to confirm the representations in the Certificate.

The usual ACORD form identifies the policy expiration date. Sometimes the policy may be cancelled or terminated mid-term, as for example non-payment of premium. The ACORD form has a provision indicating that the insurer will "endeavor" to mail notice of cancellation to the Holder some set period of time (usually 30 days) in advance of the cancellation. This does not necessarily obligate the insurer to provide notice. The ACORD form states that the failure to send notice of cancellation "shall impose no obligation or liability of any kind upon the insurer or it representatives." Thus, the Certificate Holder may never know if the policy is cancelled.

ADDITIONAL INSURED CERTIFICATES

In many instances, one party to a business transaction will insist on being named as an additional insured on the other party's insurance. Under Minnesota law, a party is not an additional insured on a policy unless the named insured requests the party to be included and the insurer agrees to the request. The Certificate may in fact state that the Holder is an additional insured. The disclaimer on the reverse side of the form, however, states that if the Holder is identified as an additional insured the policy must be so endorsed and the Certificate itself "does not confer rights" on the Holder in lieu of endorsement. Some courts have held that an ACORD Certificate containing such language that erroneously represents a party as an additional insured is not binding unless the policy is actually amended. There are, however, several potential arguments for effectuating the parties' intent, such as reformation of contract or third-party beneficiary of the policy. Nevertheless, prudence dictates confirming that the Holder is named as an additional insured.

Even if the Holder is named an additional insured, the Certificate may not identify which particular additional insured form is being used. There are many varieties of additional insured endorsements, some of which are much more restrictive than others. Without actually seeing the additional insured endorsement to the policy, there is no way of knowing what coverage has been afforded.

Some courts have held that reliance on the Certificate alone is unreasonable. The prudent practice for the Certificate Holder is not to rely on the Certificate of Insurance, but to actually review the policy, including all endorsements.

ARE YOU COVERED FOR PUNITIVE DAMAGES?

One important question an insured should ask in purchasing liability coverages (e.g., Commercial General Liability, Directors & Officers, Employment Practices, etc.) is whether coverage is provided for punitive or exemplary damages. With only limited exceptions, Minnesota law generally prohibits insurance for punitive damages on public policy grounds. Wojciak v. Northern Package Corp., 310 N.W.2d 675 (Minn. 1981). See

Minn. Stat § 60A.06, subd. 4 (authorizing sale in Minnesota of insurance covering vicarious liability for punitive and exemplary damages); Perl v. St. Paul Fire & Marine Ins. Co., 345 N.W.2d 209, 216-17 (Minn. 1984) (finding coverage for law firm for vicarious liability for disgorgement of legal fees). In other states, like Wisconsin, there is no prohibition on insurability of punitive or exemplary damages. See Brown v. Maxey, 124 Wis.2d 426, 444-47, 369 N.W.2d 677, 686-88 (1985). This is representative of the general split of authority among American jurisdictions on insurability of punitive damages.

Because state laws differ on whether insurance for punitive damages violates public policy, availability of coverage for punitive damages may turn on the state substantive law that is applied to resolve the insurance coverage dispute. The applicable law will be determined based upon the "choice of law" rules adopted by the court in which the action is brought. Minnesota applies a "choice influencing considerations" approach to resolving conflict of laws issues. Milkovich v. Saari, 295 Minn. 155, 203 N.W.2d 408 (1973). These considerations include: (1) predictability of results; (2) maintenance of interstate and international order; (3) simplification of the judicial task; (4) advancement of the forum state's governmental interest; and (5) application of the better rule of law. Id. at 412.

Insureds can attempt to increase the likelihood of coverage for punitive damages is applied in several ways. First, the insured can purchase a policy expressly covering punitive damages and applying the law of "the most favorable venue" in deciding whether the coverage applies. The purpose of that language is to avoid laws of states like Minnesota, which bar coverage for punitive damages on "public policy" grounds. Some carriers will even agree to insert a "choice of law" provision in the policy specifying application of the law of a jurisdiction that allows coverage for punitive damages. At a minimum, the insured should insist that the policy cover punitive damages to the maximum extent allowed by law.

Second, the insured can attempt to influence the "choice of law" outcome by creating as many contacts as possible between the policy and a state that allows insurance for punitive damages. Such contacts include where the policy is negotiated and purchased, where the policy is delivered and where premiums are paid.

Third, in the event that a punitive damage claim is asserted against the insured, and the insurer denies coverage for that claim, the insured could also commence a preemptive declaratory judgment action in a state with favorable law on coverage for punitive damages. This approach, of course, would not guaranty application of that state's law. However, it is important to recognize that while the substantive law of one state may be favorable as to insurability of punitive damages, that may not be true for other coverage issues. Therefore, strategic decisions such as where to file a coverage action involving potential punitive damage claims should always be made on a case-by-case basis.

For More Information:

If you have additional questions on these or other insurance or risk management issues, please feel free to contact Nick Nierengarten or Rick Kubler.

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