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Broker-Verification Questionnaires: A Disturbing Trend Explained

by *Brian K. Stewart, Esq.*

I: The Problem with Broker Verifications

The use of broker-verification questionnaires has been a growing trend seen most commonly in the context of construction insurance. In attempting to secure a contract, it is becoming increasingly common for project owners to request that brokers complete questionnaires wherein the broker is asked to verify whether the client's policies meet the contractual requirements, contains specific exclusions, etc.

Historically, a broker has satisfied this requirement through the production of a certificate of insurance or, if necessary, a copy of the policies themselves which demonstrate that the insured had the applicable coverage. However, a number of project owners have recently been refusing to accept certificates alone and are requiring brokers to complete a questionnaire and verification, with the understanding that a failure to complete the questionnaire will cost the broker's client the job.

The increasingly frequent use of such broker-verification questionnaires raises a number of legal issues for the broker. The first issue deals with the broker's authority to interpret the underlying policy between the insurer and the insured and whether a broker has the authority to confirm in writing whether a specific policy meets the requirements, not of the contract between the Owner and the insured but rather the requirements contained in the broker-verification questionnaires. The second legal issue deals with the effect of a conflict between the underlying policy and the language of the questionnaire. Specifically, what is the legal consequence when a broker completes a questionnaire that potentially contains conflicting language from the actual policy? Finally, this opinion will analyze what risks and

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liabilities a broker is exposed to when completing a questionnaire that contains language that is in conflict with or amends, modifies, expands, etc. the underlying policy.

II: Principles of Contract

Insurance is a matter of contract governed by the rules of contract.¹ Unlike the ordinary commercial contract where the parties seek to ensure a commercial advantage for themselves, an insurance contract seeks to obtain some measure of financial security and protection against calamity for the insured.²

Being a voluntary contract, as long as the terms and conditions made therefor are not unreasonable or in violation of legal rules and requirements, the parties may make it on such terms, and incorporate such provisions and conditions as they would see fit to adopt.³ The rights and obligations of parties to an insurance contract are determined by the language of the contract and the insurance policy is the law between the parties unless the contractual provisions are contrary to public opinion or law.⁴

III: Role of the Broker

An insurance broker provides a professional service for the insured, its client and goes to the insurance market to determine what policy or policies best fit the needs of its clients.

Relevant distinctions exist between an insurance agent and an insurance broker. Whereas an agent generally represents a particular insurance company, an insurance broker generally represents only the insured.⁵ Consequently, an insurance broker owes a duty to the insured and not the insurer.⁶

1: Issue One: Brokers Authority to Interpret Policies

The first issue deals with the authority of brokers to interpret the underlying policy when completing broker verification questionnaires. As a general rule, the interpretation of an insurance policy is a question of law.⁷ Therefore, it is the court's responsibility to determine coverage issues.⁸ Courts have long recognized that in construing an insurance policy, the primary function of the court is to determine and enforce the intentions of the parties as expressed in the insurance contract.⁹

When faced with an interpretation question, courts first focus on whether the language of the policy is unambiguous. If the words contained in an insurance policy are "clear and unambiguous", a court will afford those terms their plain, ordinary and popular meaning and apply them strictly as written.¹⁰ However, where policy language is susceptible to more than one reasonable interpretation, the language will be deemed to be ambiguous and will be construed against the insurer as the drafter of the policy language.¹¹

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Based on the foregoing, it is clear that the interpretation of contractual provisions is a question of law and the determination of whether coverage is triggered by certain events is ultimately a duty of the court. In the typical insurance dispute, it is the insurance company that makes the initial determination, based on the language of the contract, whether certain actions trigger coverage under the policy. In making this decision, the insurance company will take into account all information and evidence available related to the event in question and conducts their analysis using the above-discussed principles of contract interpretation applied to the specific facts of each case.

In contrast, the relatively new phenomenon of requiring a broker verification questionnaire forces the broker to interpret whether the underlying policy will provide coverage for hypothetical, future events. This raises a number of legal issues for the broker being asked to complete such a questionnaire. First, as a contract between the insured and the insurer only, a broker is a third-party to such a policy. When a broker is required to complete a verification questionnaire, the broker is essentially being asked to interpret what the parties to the underlying contract intended and since the broker is neither the drafter of the insurance contract nor a court interpreting the contract, the broker has no legal authority to provide such an interpretation and if a broker should provide such an interpretation, it does so at great risk. Furthermore, it would not be proper for the insured's client to require the verification and if it did so require it, reliance on the verification would be misplaced.

2. Inevitable Conflict Between Language of Underlying Policy and Broker Verification Form

The second issue involves instances when a broker completes a questionnaire in which he or she verifies that certain coverage exists and meets the owner's contractual requirements. A legal issue will arise should a broker verify that the insured's policy meets certain requirements when in fact there is a conflict between the language of the policy and the language of the broker verification questionnaire.

The questionnaire may contain language or requirements that vary from the language contained in the underlying policy. At the risk of losing the contract, the insured may insist that his or her broker complete the questionnaire containing potentially conflicting terms, provisions, language, etc. Having completed the conflicting questionnaire, the issue becomes whether the insured's policy now conforms to the new language contained in the verification form. It does not. There is no way that a verification executed by a broker can reform the policy issued by the carrier.

Similar to certificates of insurance, courts have routinely held that in the event of conflicting provisions, the underlying policy prevails over any terms contained in a

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certificate.¹² As a third party to the contract, courts have held that brokers, absent the requisite express authority, may not bind the insurer by a modification of the policy or other insurance contract.¹³ In order for a modification to the contract language to be valid, there must be an agreement between both the insured and the insurer and neither party has a right to modify the contract without the consent of the other party.¹⁴ In this respect, any modification contained in a broker verification form would be ineffective unless the insured's broker was acting with the consent of both the insured and the insurer. By analogy, courts have held that neither the insurer nor the insured may modify the contract terms by issuing a certificate which conflicts with the terms of the agreed upon contract so a verification form will not modify a policy form either.¹⁵

While the verification will not modify terms of the policy form, in completing a broker verification questionnaire that contains conflicting language, the broker is creating an exposure to a professional liability claim by the client of the insured for making representations if they are not accurate regarding coverage, etc.

The increasingly widespread use of broker verification forms presents a serious legal threat to the brokers signing such documents. In general, a broker's duty runs only to its client—i.e., “the person or entity that contracts with the broker, communicates to the broker its insurance needs, reviews the quotes provided by the broker and decides what policy to purchase.”¹⁶ However, courts have held that a broker is required to exercise due care to protect third-parties even though no privity of contract exists between them.¹⁷ The court reasoned that despite the lack of privity between the broker and the third party, the third party was essentially an intended beneficiary of the transaction in placing the coverage. Thus, the broker owed duties to the third party even though it was not the broker's customer or a named insured. This is dangerous precedent and shines a bright light on why broker verification forms should not be executed by brokers. They cannot modify the coverage at issue and if they verify to the contrary, then the broker is exposed to the risk of loss.

III: New Statutory Responses to Problem

In response to the widespread problems regarding certificates of insurance, the National Conference of Insurance Legislators (NCOIL) drafted and passed the model Certificates of Insurance Act. The purpose of the Act is “to clarify limitations on the use of certificates of insurance in order to promote a transparent system that discourages fraud and misuse.” Namely, the Act is addressed to third parties who exploit their marketplace leverage to demand the issuance of certificates or verification forms that do not accurately reflect the underlying insurance policies.¹⁸

First, the Act requires certificates of insurance to be filed with state regulators prior to use. Further, state regulators are vested with the authority to disapprove forms

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that are unfair, misleading, deceptive or against public policy. Further, the Act only permits forms to be filed by or on behalf of an insurer. There is no mechanism under the Act for non-insurers or third parties to submit their own proposed certificate forms.

Second, the model Act prohibits any person from preparing or issuing a certificate of insurance that contains false or misleading information concerning the underlying policy or one that purports to alter, amend or extend coverage. A certificate also may not warrant that the policy referenced in the certificate complies with the insurance or indemnification requirements of a particular contract. In this respect, the end and the aim of the Act is to avoid exactly what is being attempted by the insistence of a broker verification form.

Third, in an effort to help eliminate or reduce requests for improper or misleading certificates, the model Act applies specific requirements and extends jurisdictional reach of state regulators to third parties who make such requests. Specifically, the Act prohibits a person from requesting or requiring the issuance of a certificate that contains false or misleading information concerning the underlying policy; purports to alter, amend or extend coverage; or is issued on a form not filed with the commissioner.

Finally, the Act confirms that a certificate is distinct from an insurance policy and codifies the principles that a certificate does not alter, amend, or extend coverage or independently confer rights. Lastly, the Act provides that any certificate issued in violation of the Act is null and void.

As of May 2014, NCOIL's model act has been adopted and enacted in the following states: CT, DE, GA, ID, IL, IN, LA, MA, MD, MN, MO, MT, NV, NH, NM, NC, ND, OK, RI, TX, UT, VA, WA, WY. Unfortunately, more states have not adopted it but it is hoped that more will adopt it moving forward.

CONCLUSION

The increasingly widespread use of broker verification questionnaires is a troubling development for brokers. When faced with a questionnaire, the broker may be urged by his client to complete the form, regardless of the conflicting provisions, or risk losing the job for their client. This type of pressure is unwarranted and will not promote an ethical and fair insurance marketplace or a level playing field for brokers acting as trusted advisors to their clients. While a number of states have enacted regulations governing the use of such forms, brokers may still be faced with such verified questionnaires in one form or another. This development raises a number of legal issues set forth in above. Simply put, broker verification forms that attempt to force brokers to opine as to coverage and other issues when the policies themselves are the best and only appropriate source for coverage details,

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should not be allowed in the insurance marketplace. They are not conducive to a fair and ethical insurance marketplace.

ENDNOTES

- ¹ *Fleming v. American Auto Ass'n, Inc.* (2000) 764 So.2d 274
- ² *State Farm Mut. Auto Ins. V. Kastner* (2003) 77 P.3d 1256
- ³ *Insurance Co. of North America v. John J Bordlee Contractors* (1982) 543 F.Supp. 597
- ⁴ *Cincinnati Ins. Co. v. Pro Enterprises, Inc.* (2005) 394 F.Supp.2d 1127
- ⁵ *Massachusetts Mut. Life Ins. Co. v. Leberis* (1984) 595 F.Supp. 157
- ⁶ *Founders Ins. Co. v. White* (2006) 856 N.E.2d 506
- ⁷ *Waller v. Truck Ins. Exch., Inc.* (1995) 11 Cal.4th 1, 18
- ⁸ Evidence Code §310(a); see also *Garcia v. Truck Ins. Exch.* (1984) 36 Cal.3d 426, 439
- ⁹ *Outboard Marine Corp. v. Liberty Mutual Ins. Co.* (1992) 607 N.E.2d 1204.
- ¹⁰ *Outboard Marine, supra*
- ¹¹ See *Travelers Ins. Co. v. Eljer Manufacturing Inc.* (2001) 757 N.E.2d 481
- ¹² See *Humphrey v. Equitable Life Assur. Soc. Of America* (1967) Cal.2d 527 (Holding that in contrast to the general rule and only applying to employee group insurance coverage, any conflict between the terms of the certificate and the master policy is likely to be resolved in favor of the certificate.)
- ¹³ See *Karp v. Western Life Ins. Co.* (1987) 356 S.E.2d 893 (Holding that an insurance agent who was not an officer of the insurer lacked authority to change the express terms of a policy on his own, and thus, his letter to an insured, which was not signed by an officer of the insurer, could not change the insurance policy).
- ¹⁴ *GenCorp. Inc. v. American Intern. Underwriters* (1999) 178 F.3d 804.
- ¹⁵ *J.M.P.H. Wetherell v. Sentry Reinsurance, Inc.* (1990) 743 F.Supp. 1157
- ¹⁶ *Pacific Rim Mechanical Contractors, Inc. v. Aon Risk Ins. Services West, Inc.* (2012) 203 Cal.App.4th 1278
- ¹⁷ *Business to Business Markets, Inc. v. Zurich Specialities* (2006) 135 Cal.App.4th 165
- ¹⁸ "NCOIL Passes Certificates of Insurance Act", Wes Bissett 29 Nov. 2012

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