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WHITE PAPER ALERT

Indemnity - Construction Contracts

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AMENDMENTS TO CIVIL CODE SECTION 2782

Existing law allows indemnity agreements in construction contracts so long as indemnity is not provided for the sole negligence or willful misconduct of a promisee. There has been a proliferation of indemnity agreements in construction contracts. Owners and general contractors have insisted on Type I indemnification agreements.

A Type I indemnity agreement is defined as “one which requires the promisor to assume liability for the promisee’s negligence.” Developers and general contractors required subcontractors to assume liability for the developers and general contractor’s negligence and to be liable for all expenses they incur in the defense of such actions, including attorneys fees. Because subcontractors perceived this requirement to obtain the contract to be unfair, and because they believed it was unnecessarily driving up their costs, a lobbying effort began in the Legislature to outlaw Type I indemnity agreements. Only one bill made it out of the Legislature to the Governor’s desk. That was AB 758 authored by Assembly Member Ronald Calderon. It was signed by Governor Schwarzenegger on September 29, 2005 This bill provides the following features:

1. It applies to residential construction contracts entered into after January 1, 2006.
2. It prohibits Type I indemnity agreements, which are defined as “indemnity agreements by a subcontractor to indemnify a builder against liability for claims that arise out of, pertain to, or relate to the negligence of the builder or the builder’s other agents, other servants, or other independent contractors who were directly responsible to the builder.” It further outlaws such agreements related to defects in design furnished by those persons, and claims that do not arise out of, pertain to, or relate to the scope of work in the written agreement between the parties.
3. It provides that this prohibition cannot be waived by the parties.
4. The bill does not prohibit a subcontractor and builder from agreeing to the timing or immediacy of the defense and provisions for reimbursement of defense fees and costs, so long as that agreement does not modify the provisions of this statute. Presumably, this relates to Type II indemnity agreements.
5. It does not alter the obligations of an insurance carrier under the holding of *Presley Homes, Inc. v. American States Insurance Company* (2001) 90 Cal. App. 4th 971. This case holds that an insurer providing additional insurance to another has a duty to defend the entire action, even if some claims are potentially not covered. The duty to indemnify will be controlled by the additional

insured endorsement. However, the duty to defend the entire action rests with each insurer providing coverage to the additional insured. This duty is allocated among these carriers on the basis of equitable considerations.

COMMENT:

The purported effect of this bill is to limit the burden placed on subcontractors by general contractors and developers in construction defect lawsuits and also to reduce their insurance costs. One of the stated arguments in favor of the bill was that subcontractor insurance rates have skyrocketed. While prohibiting Type I indemnity agreements, the bill does not prohibit additional insured endorsements. Presumably, a developer or general contractor could insist upon an additional insured endorsement similar in scope to a Type I indemnity agreement. However, whether such endorsements will be available to subcontractors in California remains to be seen. Furthermore, there will still be costs associated with providing a defense to the general contractor and developer where an additional insured endorsement has been issued.

Finally, any big change in the law, such as this, generates litigation. We expect developers and general contractors to attack the constitutionality of these provisions, the meaning of the code section and its application to various factual situations. The bill will become Civil Code Section 2782(c)and(d) effective January 1, 2006. It reads as follows:

“(c) For all construction contracts, and amendments thereto, entered into after January 1, 2006, for residential construction, as used in Title 7 (commencing with Section 895) of Part 2 of Division 2, all provisions, clauses, covenants, and agreements contained in, collateral to, or affecting any such construction contract, and amendments thereto, that purport to indemnify, including the cost to defend, the builder, as defined in Section 911, by a subcontractor against liability for claims of construction defects are unenforceable to the extent the claims arise out of, pertain to, or relate to the negligence of the builder or the builder’s other agents, other servants, or other independent contractors who are directly responsible to the builder, or for defects in design furnished by those persons, or to the extent the claims do not arise out of, pertain to, or relate to the scope of work in the written agreement between the parties. This section shall not be waived or modified by contractual agreement, act, or omission of the parties. Contractual provisions, clauses, covenants, or agreements not expressly prohibited herein are reserved to the agreement of the parties.

(d) Subdivision (c) does not prohibit a subcontractor and builder from mutually agreeing to the timing or immediacy of the defense and provisions for reimbursement of defense fees and costs, so long as that agreement, upon final resolution of the claims, does not waive or modify the provisions of subdivision(c). Subdivision (c) shall not affect the obligations of an insurance carrier under the holding of *Presley Homes v. American States Insurance Company* (2001) 90 Cal. App.4th 571. Subdivision (c) shall not affect the builder’s or subcontractor’s obligations pursuant to Chapter 4 (commencing with Section 910) of Title 7 of Part 2 of Division 2.”

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