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2008 Amendment to §2782

Special Issue by: Ray Coates
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The Legislature has made another attempt to try to correct the indemnification mess in the residential construction arena. This is its third attempt.

In 2005, the Legislature changed the framework for analysis of indemnity contracts entered into after December 31, 2005. Under that framework, clauses were analyzed as to whether they were a Type I, Type II or Type III clause, that is, whether they provided indemnity for the general contractor's active or passive negligence. The 2005 bill provided that residential construction contracts containing Type I and Type II indemnity clauses favoring builders against subcontractors entered into after January 1, 2006 were unenforceable. This meant subcontractors could not be compelled by contract to indemnify the contractor for construction defect claims arising out of the negligence of the builder, or the builders' agents or other independent contractors. The bill did preserve the defense obligations of subcontractors' insurers under additional insured endorsements.

In 2007, an amendment to the law was signed, providing that contracts entered into after January 1, 2008 which included any Type I or Type II indemnity agreement against a subcontractor and in favor of a general contractor not affiliated the builder were also unenforceable. This was an effort to outlaw an attempt to avoid the statute by simply hiring another general contractor to act in the builder's stead in making contracts with subcontractors.

The Legislature has now passed, and the Governor signed on September 27, 2008, amendments to §2782 of the Civil Code. The amendments delete the provisions applicable to construction contracts entered into after January 1, 2008, and amend the provisions applicable to contracts entered into after January 1, 2006 and now provides new rules for contracts entered into after January 1, 2009. It incorporates the prior two statutes and prohibits Type I or Type II indemnity contracts in favor of the builder, general contractor, or a contractor not affiliated with the builder. Again, specifically excepted from the provisions of the statute are insurers who

provide coverage to subcontractors. Further, indemnification for liability of the general contractor arising vicariously as a result of the acts of the subcontractor is not prohibited.

The law adds new provisions regarding defense. It provides that a subcontractor owes no defense or indemnity obligation to the builder or general contractor until a written tender of the claim is made. The statute prescribes what type of notice is required for a proper tender.

Once the subcontractor receives a tender of defense, he has two options. First, he can defend the claim with counsel of his own choice, with the right to maintain control over the defense. If the subcontractor decides to so proceed, there are written notices that must be provided.

The second option is to pay the builder or general contractor's "reasonable allocated share" of fees for defense of claims alleged to be caused by the work of the subcontractor. If the subcontractor refuses either option, the builder or general contractor can pursue a claim for indemnity against the subcontractor and recover compensatory damages, consequential damages and reasonable attorneys' fees. The subcontractor has a right to sue the builder or general contractor who fails to allocate defense fees to the subcontractor within thirty days following final resolution of the claim. This section also provides the subcontractor with the right to recover reasonable attorneys' fees in connection with such lawsuit.

There is a new section added, Civil Code §2782.9, that deals with wrap-up insurance. It imposes specific requirements for such insurance that provides coverage for a private residential work of improvement that commences after January 1, 2009. It requires an owner, builder, or general contractor obtaining such a policy to disclose the total amount or method of calculation of any credit or compensation for a premium required from a subcontractor or other participant for that policy or program. There is a similar disclosure requirement if the wrap-up policy is for a public work project.

CONCLUSION

It is unclear whether this is the last effort of the legislature to tinker with indemnity contracts. It is important to remember, however, that these provisions apply to residential construction, not commercial construction.

These provisions do not apply to personal injury lawsuits. They are specifically limited to claims for construction defects. Finally, the independent obligations of insurers as set forth in Presley Homes v. American States Ins. Co. (2001) 90 Cal.App.4th 571, remains unaltered. The provisions go into effect on January 1, 2009.