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New Legislation on Wrap-up Insurance And Indemnity Clauses

By Edward B. Lozowicki and James G. Higgins

Owners, developers and major general contractors are ramping up their use of wrap-up insurance policies on building and industrial projects. When sponsored by an Owner, wrap-ups are dubbed Owner-Controlled Insurance Program ("OCIPs"). If the general contractor sponsors the wrap-up, it is termed a Contractor Controlled Insurance Program ("CCIPs"). These policies offer significant cost savings to owners and generals. Traditionally, bid packages required the general contractor and its subcontractors each to carry liability insurance and to indemnify the Owner and name it as an additional insured. This arrangement has been criticized as requiring costly duplication of coverage, and causing needless litigation over indemnity rights. Wrap-ups seek to avoid these consequences by affording liability coverage to all participants on a project under a single policy. However there have been problems with wrap-ups such as inadequate policy limits and gaps in coverage. And the controversy over contractual indemnity clauses continues.

To address some of these problems California has enacted a new law, Assembly Bill ("AB") 2738, which affects wrap-up policies in residential, commercial, and public works construction. It also restricts indemnity clauses in residential projects. In light of the increased use of wrap-ups and continuing controversy over indemnity clauses, AB 2738 will likely have an immediate effect. AB 2738 is codified in California Civil Code sections 2782, 2782.9, 2782.95, and 2782.96.

On new *for-sale residential projects* which commence construction after January 1, 2009, AB 2738 places restrictions on self-insured retentions ("SIRs"); and requires disclosure of other policy terms. SIRs are limited to a “reasonable” amount but such term is not defined. No premium contribution or SIR allocation to contractors or subcontractors is permitted unless several disclosures are made, for example: the policy limits, the scope of policy coverage, the policy term, and the basis upon which the deductible or occurrence is triggered by the insurance carrier. Moreover, the party obtaining the wrap-up must disclose an estimate of the available limits remaining under the policy. However if the policy is a multi-project or "rolling" wrap,

such disclosure could prove difficult, if not impossible, to make accurately. Further, indemnity clauses between participants in the wrap-up on any residential project are unenforceable for claims covered by the policy.

Separate disclosures are required *for public works projects and non-residential projects* put out for bid after January 1, 2009. For wrap-up policies on these projects, the bid documents must clearly disclose the total amount or method of calculation for subcontractor premiums. The named insured shall also disclose policy limits, exclusions, and the length of the policy term.

In addition contractual indemnity provisions on *new for-sale residential construction contracts* executed after January 1, 2009 are restricted. Indemnification for reimbursement of insurance or defense costs for claims unrelated to a subcontractor's scope of work is unenforceable. In addition a subcontractor owes no defense or indemnity obligations until the builder or general contractor provides a written tender of the claim to the subcontractor. Upon tender arising from the subcontractor's scope of work, the subcontractor may either: (1) defend with counsel of its own choosing and maintain control over that portion of the claim against the builder or general contractor to which the indemnity applies. Written notice of this election must be made within a reasonable time and no later than 90 days after receipt of tender. (2) Alternately, a subcontractor can pay within 30 days of receipt of an invoice from the builder or general contractor, no more than a reasonable allocated share of the builder's or general contractor's defense fees and costs on an ongoing basis during the pendency of the claim. Ironically this defense-election provision may lead to higher litigation costs because multiple subcontractors, having cross-claims against one another, could also be paying for a portion of defending third-party claims against the builder / general contractor based on the latter's reasonable allocations.

AB 2738 may create some conflicts. For example, what is the scope of an insurer's defense obligation? The legislation states that it does not affect the holding of *Presley Homes, Inc. v. American States Insurance Company* (2001) 90 Cal.App.4th 571, which held that if the insurer has a duty to defend any portion of a claim, it is obligated to defend the entire claim. But the indemnity provisions of AB 2738 invalidate *for-sale residential* construction contracts that require the subcontractor to insure, indemnify, and defend the builder/general contractor for claims not arising from the subcontractor's scope of work. Will insurers be permitted to refuse a defense to an insured subcontractor which is sued for claims which it is not required to defend under AB 2738? This new law could well lead to more litigation over such issues.

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