FALL 2008

Lorber, Greenfield & Polito, LLP

PERSPECTIVES

Lorber, Greenfield & Polito, LLP is pleased to announce our new partner,

CHERRIE D. HARRIS

Cherrie's invaluable experience in the legal, building, and real estate industries as a negotiator, litigator, and general counsel for contractors, builders and developers including KB Home, as well as her experience as a general contractor, realtor, and business owner, are an asset to our firm.

(Continued on Page 4)

CRAWFORD v. WEATHER SHIELD: CALIFORNIA'S SUPREME COURT ENFORCES SUBCONTRACTOR'S DUTY TO DEFEND

by David B. Roper, Esq.

The California Supreme Court has finally issued its long-awaited decision in the case of *Kirk Crawford v. Weather Shield Manufacturing, Inc.* (2008) 44 Cal.4th 541, holding that under the terms of a standard residential construction contract, a subcontractor is required to defend its developer in lawsuits in which the plaintiff has alleged construction defects arising from the subcontractor's negligence. This decision upholds the right of the parties to a contract to allocate risk, reaffirms the fundamental rule of contract interpretation that words in a contract are to be given their ordinary meanings, and should be

(Continued on Next Page)

Inside this issue:

ARIZONA LEGISLATIVE ALERT: THE 'LAWSUIT ABUSE INITIATIVE'

by Jill Ann Herman, Esq.

Arizona's home-building industry is facing a devastating initiative, i.e., Prop 201, in this November's election. If passed, this measure will drastically change Arizona law by modifying our pre-litigation right to repair process, as well as changing, reversing, and/or extinguishing existing law relating to liability, affirmative defenses, attorney's fees, and costs recovery. Specifically, Prop 201:

- Forces homeowners to sue builders and subcontractors in court;
- Permits *prospective buyers* to sue;
- Forbids homebuilders or subcontractors from recovering attorney's fees or costs for frivolous claims or lawsuits;

(Continued on Page Four)

CRAWFORD v. WEATHER SHIELD . . .

(Continued from Front Page)

interpreted in the way that effectuates the intent of the parties, and provides definitive statutory and judicial authority for enforcement of the subcontractor's duty to defend against claims arising from its scope of work.

In *Crawford*, the plaintiff sought damages from the developer for, among other things, leaky windows, which had been manufactured by Weather Shield. The contract between the developer and Weather Shield contained a provision which stated that "Contractor does agree to indemnify and save Owner harmless against all claims for damages . . . growing out of the execution of the work, and at his own expense to defend any suit or action brought against Owner founded upon a claim of such damage or loss . . .". The developer had demanded that Weather Shield provide a defense to plaintiff's window-related claims. Weather Shield refused. At trial, the jury found that Weather Shield was not negligent with regard to plaintiff's window claims. Developer argued that Weather Shield owed it a defense, or since Weather Shield had refused, reimbursement for the costs of defense as against the window-related claims, despite the ultimate jury finding that Weather Shield was not negligent. Weather Shield argued that the jury's finding that it had not been negligent absolved it of any obligation to defend the developer, or to reimburse the developer for the costs of defending the window-related claims.

Prior decisions of the California Court of Appeals upheld the developer's argument. *Continental Heller Corp. v. Amtech Mechanical Services* (1977) 53 Cal.App.4th 500 and *Centex Golden Construction Co. v. Dale Tile Co.* (2000) 78 Cal.App.4th 992 both held that no rule precluded a developer and subcontractor from agreeing that the subcontractor would provide a defense to the developer against claims arising from the subcontractor's scope of work regardless of whether the subcontractor is ultimately found negligent. However, another line of cases including *Regan Roofing Co. v. Superior Court* (1994) 24 Cal.App.4th 425 contains language which, taken out of context, supports such a rule. The *Regan Roofing* line of cases interprets the subcontractor's "duty to defend" as the subcontractor's "duty to reimburse" the developer for the costs it incurs in providing its own defense, but only if the subcontractor is ultimately adjudicated to have been negligent.

The California Supreme Court began its discussion by noting that the agreement between the developer and subcontractor is construed under the same rules that govern the interpretation of other contracts: "Effect is to be given to the parties' mutual intent as ascertained from the contract's language if it is clear and explicit. Unless the parties have indicated a special meaning, the contract's words are to be understood in their ordinary and popular sense."

Next, the Supreme Court noted that California Civil Code Section 2778(3) provides that a promise of indemnity against claims "embraces the costs of defense against such claims . . .". Civil Code Section 2778(4) provides that "The person indemnifying is bound, on request of the person indemnified to defend actions brought . . . in respect to the matters embraced by the indemnity." Finally, Civil Code 2778(5) states that, if after request, a person indemnifying neglects to defend the person indemnified, "a recovery against the latter suffered in good faith is conclusive in favor of the person indemnified."

In light of these statutory provisions, the contractual duty to "defend" connotes an "obligation of active responsibility." The duty promised is "to render, or fund, the service of providing a defense . . . a duty that necessarily arises as soon as such claims are made . . . and may continue until they have been resolved." Therefore, the subcontractor's duty to defend the developer is different from an obligation to reimburse the developer, after the fact, for defense costs the developer has incurred in defending itself. Implicit in interpretation of the duty to defend is that the duty arises immediately upon a proper tender of defense and thus before the litigation to be defended has determined whether indemnity is actually owed. A subcontract which requires the subcontractor to defend against any "suit" or "action" does not require a final determination of the issue of the subcontractor's negligence before the subcontractor is required to provide a defense on the developer's behalf.

The Supreme Court disapproved *Regan Roofing* and other cases which had been interpreted to hold that the duty to defend could not arise until the negligence of the subcontractor had been adjudicated. The Supreme Court held that the

(Continue on Next Page)

CRAWFORD v. WEATHER SHIELD . . .

(Continued from Previous Page)

Regan Roofing court had erred in assuming that under Civil Code Section 2778(4) an indemnitor's duty to defend is not "free-standing" but extends only to claims as to which indemnity is actually owed.

Of course, the parties to a contract containing an indemnity provision can easily disclaim any responsibility to provide or pay for a defense. They can also specify that the sole defense obligation will be reimbursement for costs incurred in defending a particular claim, after the indemnitor's negligence has been adjudicated. Again, an important thrust of the Supreme Court's decision is that the contract should be interpreted in such a way as to give effect to the expressed intent of the parties to the contract.

It should be noted that as for contracts entered into after January 1, 2006, California Civil Code Section 2782 renders this traditional risk allocation agreement, to the extent it provides for indemnity by the subcontractor to the developer for claims which arise out of the negligence of, or relate to the negligence of, the developer or its other agents, unenforceable as to residential construction defect claims, but not as to claims arising from commercial construction.

Finally, as a practical approach to the implementation of the *Crawford* defense obligations, it may be very productive and cost-effective to include all insurance carriers for the subcontractors in the negotiation of a cost-sharing agreement with the "additional insured" carriers who have already committed to participation in the defense of the developer. ❖

WILL ARIZONA FOLLOW CRAWFORD v. WEATHERSHIELD?

by Danielle M. Gross, Esq.

The Arizona Court of Appeals has already established that an insurer has the duty to defend a suit alleging facts that, if true, would give rise to coverage, even if the allegations are not proven and there is ultimately no obligation to indemnify. *See Lennar Corp., et al. v. Auto-Owners Ins. Co., et al.,* 151 P.3d 538 (Ariz.Ct.App. 2007); and *Regal Homes, Inc. v. CNA Insurance,* 217 Ariz. 159; 171 P.3d 610 (Ariz.Ct.App. 2007). However, will Arizona follow the California Supreme Court of Appeals' recent *Crawford* decision and extend those recent holdings in the *noninsurance* context? The United States District Court in Arizona seems to think so.

In *Schrum v. The Burlington Northern Santa Fe Ry. Co., et al.,* 2007 U.S. Dist. LEXIS 38139 (D.Ariz., May 24, 2007) affirmed by *Schrum v. Burlington Northern Santa Fe Ry. Co.,* 2008 U.S. App. LEXIS 14947 (9th Cir. Ariz., July 10, 2008), the Arizona District Court, applying Arizona law, considered whether the granting of summary judgment in BNSF's favor on all claims against it which rendered the issue of indemnity moot also disposed of Chemical Lime Company's duty to defend BNSF.

The subcontract agreement between BNSF and Chemical Lime required Chemical Lime to indemnify and hold harmless BNSF, and to assume the defense of any lawsuit brought against BNSF relating to any matter covered by the agreement. Chemical Lime argued that because its obligations to defend arose under a contract as opposed to an insurance policy, it had no duty to defend unless it also had a duty to indemnify. Chemical Lime further argued that a finding requiring them to defend BNSF, without any proof of fault, would improperly place its obligations on par with that of an insurance company. However, relying on the established principals that the duty to indemnify and the duty to defend are separate and distinct, and that proof of causation is not necessarily required to establish a duty to defend, the District Court disagreed that the practical effect of Chemical Lime's contractual obligation was a valid reason to disregard the plain language of the Agreement, and granted summary judgment to BNSF on the issue of the duty to defend. Accordingly, Arizona is following the *Crawford* decision. ❖

FEATURED PARTNER . . .

Cherrie D. Harris was born in Texas and resides in San Diego, California. She received her J.D. from the University of San Diego School of Law in 1997 and was admitted to the California Bar in 1998. Her practice focuses on the representation of developers and general contractors in all construction matters with an emphasis in litigation. She joined the firm as a Partner in 2008, after serving as Associate Counsel for KB Home, where she directed litigation for Southern California, Colorado, and New Mexico. She has also represented clients in securing development agreements with municipalities throughout Southern California. Her experience as a licensed California General Contractor, former co-owner of a development/construction firm, and real estate agent bring an added dimension to the legal services she provides to her clients. ❖

ARIZONA LEGISLATIVE ALERT: THE 'LAWSUIT ABUSE INITIATIVE'

(Continued from Front Page)

- Prohibits mediation or arbitration;
- Provides for additional damages beyond the cost of repair, including consequential damages, time missed from work, and compensatory damages for the builder's or subcontractor's failure to repair, regardless of causation;
- Extends the existing statute of repose by two (2) years for all improvements, including residential, commercial, and industrial;
- Modifies the pre-litigation right to repair process to include any defect "known or should have been known" and prevents builders and subcontractors from making their own repairs; and
- Allows purchasers the right to cancel their contract for up to 100 days from the date of contract and receive 95% of their deposit back.

Under Prop 201, attorney's fees and costs for the entire home-building industry will be substantially increased and existing rights for home builders and subcontractors will be destroyed. For more information about Prop 201, log on to www.stoplawsuitabuseaz.com. ❖

QUICK CASE SUMMARIES IN CALIFORNIA

by David B. Roper, Esq.

Baker v. Osborne Development (2008) 159 Cal.App.4th 884: Plaintiffs claimed that the arbitration clause contained in a warranty booklet was unenforceable because the warranty booklet had not been provided at the time of purchase and execution of the sale agreement. The court held that the arbitration clause was unconscionable because it had not been made available to the purchaser at the time of sale. The court also held the arbitration clause to be unconscionable because it made only post-close of escrow claims subject to arbitration. Since such claims by the builder were unlikely, but claims by the purchaser whereas most claims by purchaser would be after close of escrow, the arbitration clause was unfair to the purchaser.

Treo @ Kettner Homeowners Assn. v. Superior Court (2008) 166 Cal.App.4th 1055: The CC&R's stated that all disputes between the developer and the Homeowners Association must be resolved by judicial reference pursuant to California Code of Civil Procedure Section 638 ("A referee may be appointed by the court upon the agreement of the parties filed with the clerk . . ."). The Court refused to enforce the mandatory reference clause, holding that a developer-written requirement in an association's CC&Rs that all disputes between owners and the developer and disputes between the association and the developer be decided by a general judicial reference is not a written contract as the Legislature contemplated the term in the context of Section 638. ❖

CALIFORNIA ASSEMBLY BILL 2738 TO PUSH BACK AGAINST RECENT AFFIRMATION OF SUBCONTRACTOR'S CONTRACTUAL DUTY TO DEFEND

by David B. Roper, Esq.

The California Professional Association of Specialty Contractors and other subcontractor groups have sponsored Assembly Bill 2738, to be codified as amendments to California Civil Code Sections 2782, *et. seq*., which have just recently been signed into law. The subcontractor's lobby describes AB 2738 as follows:

"This bill restricts a trade contractor's obligation to front the defense of a builder or general contractor to only those claims associated with that trade contractor's scope of work, and it mandates that the trade contractor rather than the builder maintain control of any such defense. In addition, the bill provides the critically important mandate that a trade contractor may not be required to indemnify or defend a builder or general contractor for claims that should have been paid by a wrap insurance policy."

AB 2738 will restrict the rights of developers and general contractors to allocate the risks associated with construction through the use of the very contractual provisions affirmed by the California Supreme Court in the recent decision in *Crawford v. Weather Shield* (2008) 44 Cal.4th 541.

Section 1 of AB 2738 states that as to all construction contracts entered into after January 1, 2009, AB 2738 renders unenforceable any provision that "purports to insure or indemnify, including the cost to defend the builder . . . against liability for claims or construction defects to the extent the claims arise out of, pertain to or relate to the negligence of the builder . . . or to defects in design . . . ." In other words, contrary to current law which upholds a contract that requires a subcontractor to defend and indemnify the builder for anything short of sole negligence or willful misconduct, AB 2738 states that subcontractors may be held responsible only for the *pro rata* portion of liability attributable to their own fault. Of particular concern is that by including the word "insure" in its text, AB 2738 appears to prohibit enforcement of an additional insured endorsement that covers the builder for any liability beyond the subcontractor's own negligence.

Section 1 of AB 2738 also states that upon written tender by the builder to the subcontractor, the subcontractor "Shall defend the claim *with counsel of its choice*, and the *subcontractor shall maintain control of the defense* for any claim or portion of claim to which the defense obligation applies." In the alternative, the subcontractor may choose to pay "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, subject to reallocation . . . upon final resolution of the claim, either by settlement or judgment." One can only imagine the difficulties which will arise in a large, multi-trade construction defect litigation with each subcontractor vying for control of its limited portion of the overall litigation, or the arguments which will arise regarding what constitutes "a reasonable allocated share" of the costs of defense.

Section 2 of AB 2738 relates to any construction project on which a "wrap-up insurance policy" is applicable. It makes unenforceable any provision that requires an enrolling subcontractor to "*indemnify, hold harmless or defend another* for any claim or action covered by that program." It does preserve the parties' rights to seek equitable indemnity, and permits the builder to require a reasonably allocated contribution from the subcontractor to satisfy any deductible or self-insured retention when such is incurred by the builder. It is further required that if a builder obtains a wrap-up policy and requires that the subcontractor provide a credit or compensation for the policy, the credit or compensation and the coverage provided and the length of time the policy remains in effect must be clearly delineated in the bid documents. The contractor may not require that the insured subcontractor under the wrap-up policy pay an amount greater than the amount the builder paid to provide the subcontractor coverage under the wrap. Given that wrap policies have traditionally not been broken down on a trade-by-trade basis, this allocation of the cost to each subcontractor will be difficult to implement.

In addition, AB 2738 mandates numerous additional disclosures regarding the total amount or method of calculation of any credit or compensation for premium required from a subcontractor, disclosure of policy limits, the scope of coverage, the

(Continued on Next Page)

CALIFORNIA ASSEMBLY BILL 2738 . . .

(Continued from Previous Page)

basis upon which the deductible or occurrence is triggered, the policy term, the number of units indicated on the application for the insurance policy if more than one, known exclusions, and a good faith estimate of the amount of limits remaining under the policy as of the date of the disclosure.

AB 2738 contains many provisions which, at this point, appear vague and ill-defined. As its terms become subject to court interpretation its more radical departures from current business practices may be tempered by economic reality, conflicts of interest, and the demands of proven litigation strategies.

In some ways, AB 2738 presents more questions than it answers. For instance, in construction defect lawsuits where as many as 40 or more subcontractors may be implicated, there are no provisions to address how so many different attorneys or law firms can "control" the defense of the litigation. There will be no central decision-maker to formulate an overall defense strategy against homeowner claims which may have little or no merit. There is also an inherent conflict of interest presented by the prospect of a subcontractor's attorney being faced with "controlling the defense" of a developer, while at the very same time, advocating that the developer shares some or all of the fault for the plaintiff's damages. Also, early settlement of complex construction defect suits will be very difficult in cases where many parties are struggling to properly allocate their respective shares of defense fees and costs. We will undoubtedly see subcontracts drafted in ways which will attempt to minimize these potential conflicts while still fulfilling the new requirements contained in AB 2738. Finally, of significant interest will be the issue of whether or not the "defending" subcontractor is actually capable of satisfying the vicarious liability of the developer or general contractor.

Many of the difficulties which may be encountered in the application of AB 2738 can be addressed through creative cooperation of the parties and their attorneys. A joint resolution approach between counsel for developers, counsel for the subcontractors, and their respective insurance carriers should be promptly undertaken in order to develop an efficient, cost-effective protocol which protects the rights of all parties while complying with the letter and spirit of AB 2738.

The ultimate economic results of AB 2738 will only be known after litigants and the Courts have had the opportunity to apply the new provisions when presented with the unique real-life situations presented in California construction disputes. Given the dearth of new construction in the current economic climate, and that by its own terms AB 2738 applies only to contracts entered into after January 1, 2009, the real impact of this new law will probably not be felt for another three to four years. However, it is apparent that, with AB 2738, subcontractors have achieved a comprehensive change in the way developers and general contractors have allocated the risks associated with large-scale construction projects. ❖

RECENT COURT DECISIONS IN ARIZONA

by Amy M. Wilkens, Esq.

In ***Highland Village Partners, L.L.C. v. Bradbury & Stamm Constr. Co.,*** 2008 Ariz. App. LEXIS 65 (Ariz. Ct. App. Apr. 8, 2008), the Arizona Court of Appeals (Division One) held that a subsequent purchaser of commercial property can sue for breach of the implied warranty of workmanship and habitability pursuant to an express assignment of that warranty by the original owner. The Court, in its opinion, stated the holding in *Hayden Business Center Condominiums Ass'n v. Pegasus Development Corp.*, 209 Ariz. 511, (App. 2005) requiring privity in the commercial property context did not preclude a suit by a subsequent purchaser of commercial property for breach of the implied warranty pursuant to an express assignment of the original owner's warranty rights. The Court relied on the general view in Arizona that parties are free to contract and are permitted to assign contractual rights, unless such rights are not assignable pursuant to the principles set forth in the Restatement (Second) of Contracts.

In ***Lofts at Fillmore Condo. Ass'n v. Reliance Commercial Constr., Inc.,*** 191 P.3d 733 (Ariz. 2008), Arizona's Supreme Court held that a homebuilder who is not also the vendor of the residence can be sued by a buyer for breach of implied warranty of workmanship and habitability. The Court concluded the absence of contractual privity does not bar such a suit. ❖

WHO WE ARE . . .

THE PARTNERS . . .

BRUCE W. LORBER
JOYIA Z. GREENFIELD
STEVEN M. POLITO
JILL ANN HERMAN
J.D. TURNER
THOMAS F. OLSEN
LISA M. CAPPELLUTI
HOLLY P. DAVIES
CHERRIE D. HARRIS

THE ASSOCIATES . . .

SEAN D. ALLEN
KELLY T. BORUSZEWSKI
ASHLEY BRITTAIN
TRAVIS R. CAMPBELL
MERWAN CHEHAB
SALLY J. CHO
ERIN K. CLANCY
LILY C. COMPTON
STUART L. EISLER
S. SAMMY ELMI
RENATA H. ELWARDANI
DAVID J. ESTES
IRENE Y. FUJII
MARYAM GILAK
DANIELLE M. GROSS
KEVIN GUPTA
JOSHUA J. K. HENDERSON
ANDREA A. HEWITT
LOUIS W. HOROWITZ
SARA H. IGDARI
ARTHUR Y. LIN
RON U. LUNSKI
SHANE D. McFETRIDGE
LEWIS A. MELFI
NORMA A. MORALES
DARRELL V. NGUYEN
LESLEE A. NOLAND
CHRISTINA E. QUAGLIERI
DEIRDRE E. RICHARDSON
MICHAEL E. ROGASKI
DAVID B. ROPER
SARAH M. SHARMA
SARAH E. SINGER
KRISTIN M. SMITH
WAKAKO URITANI
TODD E. VERBICK
JOY VERMA
ANDREW G. VERNE
DEANNA M. WALLACE
AMY M. WILKENS
BRIAN WOOLFALL

Lorber, Greenfield & Polito, LLP is a full-service civil litigation defense firm. The Firm was established in 1980 and is A-V rated with Martindale-Hubbell. Lorber, Greenfield & Polito, LLP handles a broad range of civil litigation matters. The primary emphasis of our practice has been and continues to be representation of developers and general contractors in complex construction defect claims. The Firm has had over twenty-five years of experience in representing developers and general contractors in some of the largest construction defect and civil litigation cases in the States of California and Arizona. Litigation matters are handled throughout California, Arizona, and New Mexico.

Southern California	Northern California	Arizona	New Mexico
13985 Stowe Drive	150 Post Street, Suite 700	8222 S. 48th St., Suite 230	4801 Lang NE, Suite 110
Poway, CA 92064	San Francisco, CA 94018	Phoenix, AZ 85044	Albuquerque, NM 87109
T: 858.513.1020	T: 415.986.0688	T: 602.437.4177	T: 505.798.2634
F: 858.513.1002	F: 415.986.1172	F: 602.437.4180	F: 505.796.9601

We welcome suggestions for future articles. Please contact our Editor, Jill Ann Herman, or our Legal Administrator, Julie Young, at Lorber, Greenfield & Polito, LLP, 13985 Stowe Drive, Poway, California, T: 858.513.1020; E: jherman@lorberlaw.com or jyoung@lorberlaw.com.

LORBER, GREENFIELD & POLITO, LLP
13985 Stowe Drive
Poway, California 92064
Telephone: 858-513-1020