

News & Views

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The Changing World Of Indemnification In California

This article discusses the progression of indemnification law in the State of California. It was written by John Duffy, a Partner with the firm of Gray•Duffy, LLP.

Fifty years ago, indemnification was predominately a contractual arrangement between two parties. The contract allowed the parties to define their relationship should a claim be made involving their transaction.

It was not until 1967 that the Legislature enacted legislation in order to set forth the public policy of this state, while still acknowledging that parties were entitled to enter into contractual indemnity agreements as they saw fit. It was declared that the public policy of the State of California, due to the increasing use of hold harmless agreements in construction contracts protecting the general contractors from liability, would be that contractual indemnity agreements would be honored except in situations where the indemnitee was solely negligent or engaged in willful misconduct.

In 2008, the California Legislature once again revisited the anti-indemnity provisions of California law codified in Civil Code § 2782. Civil Code § 2782 was amended in 2008 to change the anti-indemnity provisions for residential construction contracts. In Civil Code § 2782(d), the Legislature mandated that indemnification provisions in residential construction projects that provide indemnification for the negligence of the builder or general contractor are unenforceable. Essentially, the Legislature, for all practical purposes, eliminated “Type I” indemnity agreements.

In 2012, the California Legislature added Civil Code § 2782.05. California Civil Code § 2782.05 extends the provisions of California Civil Code § 2782 to any construction contract entered into on or after January 1, 2013, not just residential construction.

California Civil Code § 2783 defines a construction contract as follows:

Any agreement or understanding, written or oral, respecting the construction, surveying, design, specifications, alteration, repair, improvement, renovation, maintenance, removal of or demolition of any building, highway, road, parking facility, bridge, water line, sewer line, oil line, gas line, electric utility transmission or distribution line, railroad, airport, pier or dock, excavation or other structure, appurtenance, development or other improvement to real or personal property, or an agreement to perform any portion thereof or any act collateral thereto, or to perform any service reasonable related thereto, including, but not limited to, the erection of all structures or performance of work in connection therewith, electrical power line clearing, tree trimming, vegetation maintenance, the rental of all equipment, all incidental transportation, moving, lifting, crane and rigging service and other goods and services furnished in connection therewith.

Clearly, just about any contract involving some type of building process or remedial work would be considered a construction contract under California law. A crane lifting Endeavor onto a 747 airplane to transport it across the country, may not be considered a construction contract but just about anything related to creating something will probably qualify as a construction contract.

In Civil Code § 2782.05(a), the Legislature provides that any indemnification provisions “that purport to insure or indemnify, . . . against liability . . . are void and unenforceable to the extent the claims arise out of, pertain to, or relate to the active negligence or willful misconduct of that general contractor, construction manager, or other subcontractor, or their other agents, other servants, or other independent contractors who are responsible to the general contractor, construction manager, or other subcontractor.” The Legislature goes on to state that no party may waive or modify these provisions by contract. However, the Legislature does provide that “contractual provisions, clauses, covenants, or agreements not expressly prohibited herein are reserved to the agreement of the parties”. Essentially, the Legislature is providing that the parties may enter into certain types of

agreements, as long as the Indemnitee cannot avoid its obligations for its active negligence or willful misconduct. Passive negligence on the part of the general contractor is still subject to indemnity. The best example of passive negligence would be a failure to discover a dangerous condition.

Civil Code § 2782.05(b) sets forth 13 different scenarios to which the statute does not apply. Specifically, the Legislature indicates that Civil Code § 2782.05 does not apply to WRAP policies. Clearly, the Legislature is making known its preference for WRAP policies, by endorsing those policies in the delineation of their being excepted from the provisions of the statute.

The Legislature created a mechanism to trigger the obligations of the parties subject to an indemnification agreement. In Civil Code § 2782.05(e), the Legislature sets forth the basis upon which the indemnity provision shall be applicable to the Indemnitor. The Legislature, however, indicates that the parties may, through its contract, set forth in its agreement as to when the Indemnitor must respond to the request for indemnification by the Indemnitee. Civil Code § 2782.05(e) provides that “Subdivision (a) does not prohibit a subcontractor and a general contractor or construction manager from mutually agreeing to the timing or immediacy of the defense. . . .” It is this language that provides the parties with the ability to negotiate terms as to who is going to be responsible for the defense costs and when that responsibility triggers. In other words, the parties could agree that the Indemnitor is not responsible for defense costs unless there is a finding of negligence as to the work done by the Indemnitor. Naturally, a subcontractor would want such language in the indemnification provision. A general contractor, obviously, would not want such language; which demonstrates that such a provision would clearly be a negotiated term between the contracting parties.

The Legislature placed the onus on the party seeking indemnification to notify the Indemnitor of their demand for indemnity. Civil Code § 2782.05 provides that the subcontractor has no obligation to defend or indemnify the general contractor or construction manager until the general contractor or construction manager provides a written tender of the claim.

The Legislature has also placed another burden on the general contractor or construction

manager in the submission of their written tender of the claim to a subcontractor. The general contractor or construction manager must present a reasonable allocation of fees and costs. The general contractor or construction manager has the burden of providing, in writing, how the allocated share of fees and costs was determined.

Without some type of agreement as to the timing of the triggering of the obligation under the indemnification provision, Civil Code § 2782.05 provides the mechanism for the subcontractor to respond to an indemnification tender. The subcontractor has two choices under the statute. The subcontractor may defend the claim with counsel of its choice and thereby maintain control of the defense. However, the statute also makes it clear that the defense by the subcontractor shall be a complete defense of the claims against the subcontractor’s scope of work including claims of vicarious liability resulting from the subcontractor’s scope of work. The statute also makes it clear that the subcontractor is not responsible for defending claims against the scope of work of any other party, including the general contractor or construction manager. Needless to say, implementation of Civil Code § 2782.05(e)(1) could lead to very complex and conflicting positions taken by counsel retained by the subcontractor and counsel retained by the general contractor. As a practical matter, these conflicts may not be able to be worked out.

Civil Code § 2782.05 also gives the subcontractor the ability to prove, to the satisfaction of the general contractor or construction manager, that the subcontractor’s scope of work is not implicated or, at the very least, is a small portion of the claim. As such, it is of benefit to both the subcontractor by giving it the opportunity to set forth evidence showing it is not at fault and the general contractor or construction manager by obtaining information to help it defend against such allegations. Both sides have a vested interest in doing the work necessary to show that the scope of work of the subcontractor was implicated unjustly.

It is more likely that the statutory defense requirements of the subcontractor in construction actions will probably be triggered under Civil Code § 2782.05(e)(2). Civil Code § 2782.05(e)(2) requires that the subcontractor is responsible for a reasonable allocated share of the general contractor’s or construction manager’s defense

fees and costs. Of course, there will be disputes as to the “reasonable allocated share” as to each subcontractor. Under the terms of the statute, the general contractor or construction manager will be responsible to set forth the basis of its allocation. If the subcontractor is not satisfied with the general contractor’s allocation, then that dispute will probably have to be worked out after the case is resolved through subsequent litigation.

Civil Code § 2782.05(e)(2) requires the subcontractor who elects this option, to pay its percentage share of the fees and costs incurred by the general contractor or construction manager, within 30 days of receipt of an invoice from the general contractor or construction manager setting forth the subcontractor’s allocated share. This process is subject to reallocation throughout the pendency of the action. The general contractor or construction manager is also obligated to set forth the reasonable allocated share it attributes to its own actions. Additionally, each trade implicated in the case is to be allocated a reasonable share of the fees and costs, regardless of whether the general contractor or construction manager has tendered the claim to them or whether such subcontractor is participating in the defense. The statute explicitly indicates that if a subcontractor is not participating in the defense, the general contractor or construction manager may not collect that subcontractor’s share from the other subcontractors.

Civil Code § 2782.05(f) provides the basis for the general contractor or construction manager proceeding against a subcontractor who fails to perform its obligations under the statute. The statute allows for the general contractor or construction manager to recover its fees and costs incurred in pursuing the recalcitrant subcontractor. Additionally, a subcontractor may request a reallocation of defense fees and costs following final resolution of the case and may pursue a claim against the general contractor or construction manager contesting an improper reallocation.

The provisions regarding allocation is an area that can be addressed by the parties in an agreement entered into prior to starting the project. The subcontractors may also place a limit on the amount of indemnity the general contractor or construction manager may impose on the subcontractor. Naturally, these limits of

exposure to the subcontractor will have to be clear and unambiguous in any indemnification agreement. The courts will consider any indemnification agreement as limitless unless otherwise clearly stated in the contract.

Civil Code § 2782.05 begins the process of placing liability for damages on the party responsible for causing those damages. It can be anticipated that there will be fierce disputes as to which party is responsible for the damages to the injured party but at least now; all parties have a vested interest in conducting all of the operations in a safe and responsible manner. No party will be able to ignore their individual responsibilities based upon their right to indemnity from another party for their own actions.

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Cases & Decisions

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Builder’s Certification In Its Final Construction Draw Request That It Had No Liens Or Claims That May Result In Liens Against Property Was Insufficient To Comply With Requirements Set By Mechanics’ Lien Act For A Valid And Enforceable Waiver And Release Of Liens

LANE MYERS CONST., LLC v. COUNTRYWIDE HOME LOANS, INC., 2012 UT App 269, 287 P.3d 479 (UTAH Ct. App. 2012)

In February and May 2006, a home builder (“Builder”) entered into two separate construction agreements with a husband and wife (the “Buyers”) to build a residence in Oakley, Utah, (“Home 1”) and another in Park City, Utah