

**NEW LAW RESTRICTS SCOPE OF INDEMNITY CLAUSES IN
SUBCONTRACTS ON RESIDENTIAL CONSTRUCTION IN
CALIFORNIA**

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by Gregory R. Shaughnessy

A new law was recently enacted, signed by Governor Schwarzenegger on September 29, 2005, that limits the scope of indemnity clauses in subcontracts on residential construction projects in California. The law is important for developers, contractors and subcontractors who are involved, on even a part time basis, in the residential construction industry. This law will affect the way that indemnity clauses should be written in prime contracts on all residential construction in California. Because the terms of the indemnity clause are something that is negotiated in almost every significant prime contract or subcontract, it is important to have a thorough understanding of the terms and impact of the new statute.

Assembly Bill 758 amended the terms of Civil Code Section 2782, in particular sub-sections (c) and (d), which now provide 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, Inc. 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.

It is important to analyze what the new statute does, and does not, do. First, the statute applies to residential construction only, as defined in Civil Code Section 895, *et. seq.* Thus, it does not apply to commercial contracts, condominium conversions or apartment construction. Second, it only applies to contracts entered into after January 1, 2006. Third, the statute is limited to claims for construction defects.

The statute is clear that all contractual provisions that purport to require a subcontractor to

indemnify a builder, or the builder's other independent contractors, are unenforceable to the extent that the claims arise out of the negligence of parties performing other work on the Project.

The intent of this new language is apparently to prevent the enforceability of indemnity clauses that require the subcontractor to indemnify the "builder" for negligent acts of the builder or third parties. It appears to have achieved this purpose. But it does not appear to change the rule that a subcontractor may be required to indemnify a builder (or contractor), for all claims "arising out of" the subcontractor's work. Such clauses can require a subcontractor to indemnify a contractor even where the subcontractor was not negligent. *See Centex Golden Const. Co. v. Dale Tile Co.* (2000) 78 Cal. App. 4th 992.

The "builder" as defined in Civil Code Section 911 is the party who is in the business of selling the residential units. Any contracts between such a builder and a subcontractor would technically not be "subcontracts" (which require a prime contractor). However, the statute appears intended to capture subcontracts where a developer is also acting as a contractor and contracting directly with "subcontractors"

The limitation in the statute applies where a subcontractor enters into a subcontract with a prime contractor that contains an indemnity provision for claims against the owner. Even if the subcontract's indemnity clause requires the subcontractor to indemnify the owner and contractor, the indemnity obligations to the owner are limited by Section 2782.

An unsettled issue is whether prime contractors who do not qualify as "builders" under Section 911 can still impose broad indemnity obligations on subcontractors on residential construction projects. For example, assume a prime contract between an owner and a contractor, and a subcontract between the contractor and a subcontractor, and that the owner is sued for construction defects. The owner will sue the contractor for indemnity, and the contractor will

sue the subcontractor for indemnity. Will a broad indemnity clause in the subcontract still allow the contractor to be indemnified by the subcontractor for the contractor's negligence, or the negligence of other subcontractors?

Another issue is whether it is necessary for "builders" to amend the indemnity clauses in their form subcontracts for residential construction projects. It may be that the effect of the statute is to modify the subcontract clause. Since the statute is limited to construction defects, it makes sense to continue to use a broad indemnity clause in subcontracts, to allow for broad indemnity for claims for personal injury or wrongful death.

A related issue is whether general contractors should amend the indemnity clauses in their form subcontracts. The answer is probably not, for the reasons noted in the preceding paragraph.

General contractors on residential construction projects in California now need to be careful not to include an overly broad indemnity clause in the prime contract, since they may not be able to pass those broad indemnity obligations down stream to the subcontractors.

General contractors faced with an owner who is demanding an overly broad indemnity clause on a residential construction project may consider proposing instead to use a form of indemnity clause that contains broad indemnity provisions, but which then recites the language in Section 2782(c) to limit the indemnity obligations for construction defects.

Conclusion

The subcontractor industry associations that undoubtedly supported the passage of AB 758 obviously wanted to drastically reduce the scope of broad indemnity obligations by subcontractors. However, Section 2782 may not extend to reduce indemnity obligations to prime contractors (who are not also owners).

It remains to be seen whether remedial legislation will be introduced to broaden the scope of Section 2782, first to apply to subcontracts with prime contractors, then to non-residential construction projects. Now that the subcontractors have their “foot in the door,” so to speak, attempts to further expand the reach of the limitations in Section 2782.

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