

New Rules for Indemnity in Construction Contracts:

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SB 474 (Civ. Code §2782 et seq.) furthers the trend toward comparative equitable apportionment in construction contracts. Recently enacted SB 474 applies to construction contracts entered into after 1/1/13, effectively bringing contracts for construction of commercial properties into line with those for residential properties; i.e., a subcontractor cannot indemnify the general contractor for the general's own active negligence. Said another way, now in both residential and commercial construction, the parties only pay for what they did wrong. As a result of the enactment of SB 474, the following statutory restrictions apply to indemnity agreements in construction contracts:

- 1) Civil Code §2782(a) – cannot indemnify anyone for their sole negligence, willful misconduct, or defects in design
- 2) Civil Code §2782(b) – cannot indemnify public agencies for their active negligence
- 3) Civil Code §2782(c) – cannot indemnify a property owner who is not acting as a contractor or supplier, cannot indemnify owner for active negligence. (Does not apply to homeowner performing a home improvement on his or her own single-family home.)
- 4) Civil Code §2782(d) – in residential construction, cannot indemnify for negligence, design defects or claims beyond scope of work
- 5) Civil Code §2782.05(a) – in commercial construction, cannot indemnify for active negligence, design defects or claims beyond scope of work

Everyone who has dealt with construction contracts is familiar with the Type I, Type II, and Type III designations for written indemnity agreements. *MacDonald & Kruse, Inc. v San Jose Steel Co.* (1972) 29 Cal. App.3d 413,421. The MacDonald court came up with these designations as a shorthand way of describing the extent to which an indemnitor (one who gives) is required to indemnify the indemnitee (one who gets).

- Type I – Covers or includes the indemnitee's active negligence
- Type II – Covers or includes only the indemnitee's passive negligence
- Type III – Any negligence, active or passive, by the indemnitee bars indemnification.

Although a few recent decisions have expressed dissatisfaction with the Type I, II and III designations, courts and construction litigators continue to use them to describe risk-shifting agreements in construction defect cases.

With SB 474's enactment, Type I indemnity in California construction contracts has gone the way of the dinosaur and the dodo bird; a developer or contractor cannot receive indemnity

for its own active negligence. With the statutory limitations, a key issue in determining whether a contractor may receive indemnity often will turn on whether its conduct was "actively" or "passively" negligent:

"Whereas passive negligence involves 'mere nonfeasance, such as a failure to discover a dangerous condition or to perform a duty imposed by law,' active negligence involves 'an affirmative act', knowledge of or acquiescence in negligent conduct, or failure to perform specific duties." *Fritteli v. 350 North Canyon Drive, LP* (2011) 202 Cal.App.4th 35, 48, citing *Rossmoor Sanitation, Inc. v. Pylon, Inc.* (1975) 13 Cal.3d 622, 629.

Whether an act or omission is "actively" or "passively" negligent is a factual issue. With SB 474's enactment, more disputes regarding this question likely will come before the courts. In the coming years, the line between "active" and "passive" negligence should become more well-defined.

SB 474 also clarifies how an indemnitor can fulfill its defense obligation under the indemnity agreement. An indemnitor can either defend the indemnitee with counsel of the indemnitor's choice or pay a reasonable allocated share of the indemnitee's defense. (Civ. Code §2782.05(e).) If, after a case is resolved, a party brings a lawsuit to obtain reallocation of the defense fees or costs, it might be entitled to recover prevailing party attorney's fees. Such fees are available to both parties in the case of a residential project (Civ. Code §2782(f).), but only to the indemnitee in a commercial project. (Civ. Code §2782.05(f).) The statutory limitations raise an interesting question regarding when an indemnitor's defense obligation begins.

With SB 474's enactment, additional analysis is now required when presented with a construction contract with an indemnity provision. Who owes what to whom will often depend upon, among other things: the type of project (residential, commercial); the type of party involved (private owner, homeowner, public agency); and the contract date. In addition, gray areas remain regarding how the statute will apply in certain construction contexts, e.g., mixed-use projects.

For additional information on SB 474 and its impact on construction contracts, contact G. Geoffrey Wood, partner at the Oakland office of Ericksen Arbuthnot, T: 510.832.7770

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