

Reshaping Contractors' Duties

Recent court cases could erode hard-fought legislation.

By **Trish Drew**

Now that 2008 has officially been declared a recession year—with a sub-prime mortgage collapse and drying credit markets—residential homebuilders are certainly hoping 2009 sees a return to normalcy. Whatever the outcome of that may be, contractors and subcontractors will most likely be operating on a playing field that shifted in ways the media headlines didn't capture. An important court decision could have contractors re-evaluating their risk management practices: General contractors will need to ensure their insurance coverage is still adequate, and sub-contractors could see the erosion of some recently awarded protections.

The changes center around the assignment of responsibility and payment in construction defect claims. And it's an issue that is heating up. In a slumping real estate market, the number of construction defect claims often increases. In the last 12 months our office has seen an increase in claims compared with the previous 5 years for our construction clients.

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A common risk management practice is for a general contractor to require a subcontractor to sign a construction agreement that includes a duty to defend (or agreement to pay attorneys fees) and an indemnity agreement to cover defect claims against the general contractor.

Most disputes, however, never go to trial, and many insurance companies settle on behalf of subcontractors based on a presumption that the subcontractor could have some liability. This has left the subcontractor's responsibility to indemnify and his duty to defend untested in the courts. The drivers were purely economical—it was less expensive to contribute to the settlement than it was to take a case to trial.

But last July the California Supreme Court changed those contributions.

The court ruled in *Kirk Crawford et. al vs. Weather Shield Manufacturing Inc.* that even though a subcontractor was not found negligent (therefore, not liable for the developer's indemnity costs), he was still responsible for the defense for the general contractor.

This is a significant loss for the subcontractors and a source of uncertainty. In 2005, they fought for protection against paying indemnity costs, and they won that right through State Assembly Bill 758. Today, the new decision could erode those changes to the civil code the subcontractors hoped would create fewer claims and smaller premiums.

Now it's possible that the *Weather Shield* decision could chip away at that protection, because it is unclear how attorneys will mount defenses based on both the civil code and the *Weather Shield* ruling. It's always possible that the scope of the *Weather Shield* case could expand beyond the duty to defend and eliminate the subcontractor protections against indemnity.

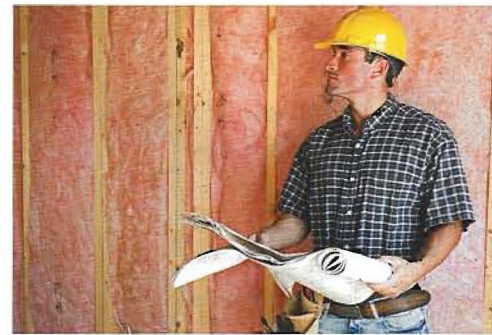
In the interim, however, both sides—the general contractor and the subcontractor—could take steps to ensure that their risk management practices (contracts, insurance requirements) take into account the possibility of new cases winding through the courts.

GENERAL CONTRACTORS

- Review construction agreements and make sure that they include the specific duty to defend (express obligation to defend) and indemnify. These are two distinct legal theories, and both should be included in the contract. The *Crawford v. Weather Shield* decision was based on the specific language of the contract between the parties, which required the subcontractor to defend based on claims arising out of the work.
- Remember that the contract is what transfers the obligation to defend and indemnify, but the Additional Insured endorsement under the subcontractor's policy is what funds that obligation.

Without the insurance, you are forced to obtain your defense directly from the subcontractor and his assets.

- Review the Additional Insured endorsements provided by your subcontractors. Be sure they don't stipulate that the coverage will extend to the builder/developer only if the subcontractor is at fault.



SUBCONTRACTORS

- The immediate concern is that you may now be asked to mount a defense for the developer as soon as a claim is filed, without delaying to determine if you are liable for the product and/or work. Be sure to notify your carriers right away of any potential and/or pending claims brought to you by the general contractor.
- You should also be concerned about the Additional Insured endorsement that your current and/or prospective insurance company is willing to offer. Make sure that it will pick up the defense of the general contractor at the onset of the claim or tender from the general contractor. If the endorsement is too restrictive you may have to mount the defense without the benefit of your insurance policy.

Ultimately, what *Crawford v. Weather Shield* provides is uncertainty on how some of these claims will be determined over the next few years. What is certain is that the courts will have subsequent rulings, and it will be impossible to say how these claims will ultimately settle. ■

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