



New California Law Will Require Major Changes in Construction Contracts

- Owners and General Contractors Can No Longer Rely on Subcontractors to Defend and Indemnify Them for Certain Losses on Residential Projects.
- New Rules on Wrap-Up Insurance Programs Will Require Disclosures on Both Residential and Commercial Projects, and Affect the Allocation of Deductibles.

A new law (Assembly Bill 2738), effective January 1, 2009, makes significant changes in two areas of construction contracting. First, the new law continues a recent trend by further limiting subcontractors' defense and indemnity obligations in residential construction. Second, it imposes disclosure obligations and limitations on parties utilizing wrap-up or consolidated insurance programs on both commercial and residential projects.

Limited Defense and Indemnity on Residential Projects

Commencing January 1, 2006, California Civil Code §2782 was changed to limit subcontractors' indemnity obligations on residential projects. Specifically, subcontractors' indemnity obligations were limited by the extent to which the claims arose out of, or related to that subcontractor's scope of work. These limitations applied only to owners and builders affiliated with the owner, but not to independent general contractors hired by an owner. Effective January 1, 2008, these limitations on subcontractor indemnities were expanded to apply to independent general contractors, as well as owners and affiliated builders. Under the new law, an indemnifying subcontractor can now elect to either: (1) defend a claim "to the extent alleged to be caused by the subcontractor" using counsel of the subcontractor's choice; or (2) pay the subcontractor's "reasonabl[y] allocated" share of the general contractor's or owner's total defense fees and costs. Because this change will likely result in disputes on how the general contractor's and owner's defense are split among multiple parties, owners and general contractors may need to rely more on their own insurance programs to cover the cost of defending lawsuits.

New Rules for Wrap-Up Insurance Programs on All Construction Projects

The new law also adds Civil Code §2782.95, which requires that owners and general contractors make certain disclosures in their contracts and subcontracts if the project uses a wrap-up or consolidated insurance program on either residential or commercial projects. Further, contract provisions requiring a subcontractor on a residential project to indemnify any party insured under a wrap-up insurance program

“for any claim or action covered by that program” are unenforceable. In addition, provisions requiring the subcontractor to contribute to a deductible or self insured retention are limited by the scope of the subcontractor’s work.

Effect on Risk Management and Construction Insurance

For construction contracts entered into after January 1, 2009, parties should modify any contracts which violate the new law. Owners and general contractors should update their contract forms and risk management programs to maximize legal protections and to assure sufficient insurance coverage for claims and losses. Further, these changes in law may expose subcontractors and trade contractors to new risks as well. For more information, please see our website at www.gglts.com, or contact partners Ted Senet or Steve Cuneo at (310) 552-3400.

Theodore L. Senet, Esq.
Steven R. Cuneo, Jr. Esq.
Gibbs, Giden, Locher, Turner & Senet LLP
(310) 552-3400
www.gglts.com