

IMPORTANT REMINDER

BAN ON “TYPE 1” INDEMNITY CLAUSES IN COMMERCIAL CONSTRUCTION CONTRACTS TAKES EFFECT IN CALIFORNIA

DECEMBER 2, 2012

A ban on “Type 1 Indemnity” clauses in commercial construction contracts in California will take effect upon contracts and amendments executed or entered into on and after January 1, 2013.

Effective on and after January 1, 2013:

General contractors can no longer contractually bind subcontractors to be legally and/or financially responsible for the active negligence or willful misconduct of others; including the GC, construction managers, other subcontractors or their other agents, or for defects in design furnished by those persons.

Public agencies can no longer contractually bind contractors or subcontractors to be legally and/or financially responsible for the active negligence or willful misconduct of others; including the GC, construction managers, or other subcontractors or supplier of goods or services, or relieve the public agency from, liability for the active negligence of the public agency.

Owners of privately owned real property* can no longer contractually bind contractors, subcontractors, or suppliers of goods or services to be legally or financially responsible for the active negligence of the owner, including that of its employees.

**Applies only when the owner is not acting as a contractor, construction manager, or supplier of materials or equipment to the work,*

**Does NOT apply to a homeowner performing improvement projects on his or her own single family dwelling.*

WHAT DOES THIS MEAN?

Any clause within a commercial or public works construction contract, entered into after January 1, 2013, that purports to impose on any subcontractor, or supplier of goods or

services liability for the active negligence of the GC, the public agency or the private owner (as qualified) is void and unenforceable.

WHAT DOES “EXECUTED” OR “ENTERED INTO” MEAN?

Generally, you entered into a contract when it becomes binding and legally enforceable. To have a binding and enforceable construction contract you need all the elements of a contract.

According to Jury instructions (BAJI 10.55 Contract Defined/Elements) a contract is an agreement between two or more persons to do or not to do a certain thing or things.

A [valid] contract requires:

1. Parties having legal capacity to contract;
2. Mutual consent;
3. A lawful objective; and
4. A sufficient consideration.

To form or enter into a contract you need those four elements. But before that occurs there has to be an offer into the contract and an unconditional acceptance of that offer.

IMPORTANT: *While the elements of a legally enforceable contract are clear; the facts in each exchange between parties can be different and subject to interpretation. You should consult your own attorney to determine whether or not you have entered into an enforceable contract based upon the facts in your particular circumstance.*

WHEN IS A CONSTRUCTION CONTRACT EXECUTED OR ENTERED INTO?

Q: Is it when the Request for Proposal was generated or dated?

A: *No. The RFP has simply been placed into the public domain by one party. The originator has not yet approved of the offer from the other party or the respondent. Thus, the two parties have not yet mutually agreed to the unconditional acceptance of the other party's offer.*

Q: Is it when the signatory parties execute the contract?

A: Yes.

Q: What if a contract is issued as part of the RFP and has the clause contained within?

A: *The contract is not consummated until both parties agree to the terms. In this case, the effective date would be when the originator of the RFP awards the job to the respondent party. If the contract is consummated after January 1, 2013, the Type 1 clause is unenforceable.*

Q: If a subcontractor is forced to execute a subcontract agreement that contains the Type 1 clause or risk losing the job, is the clause enforceable?

A: No.

***IMPORTANT:** While the elements of a legally enforceable contract are clear; the facts in each exchange between parties can be different and subject to interpretation. You should consult your own attorney to determine whether or not you have entered into an enforceable contract based upon the facts in your particular circumstance.*

WHAT IF A TYPE 1 CLAUSE IS FOUND IN A 2013 CONTRACT?

It is unenforceable. You should ask for it to be removed or modified to comply with the new law.

COULD EXISTING CONTRACTS BE AFFECTED BY THIS NEW LAW?

Perhaps. The bill also references amendments to a contract entered into on or after January 1, 2013. A change order for all intents and purposes is generally construed as an amendment to a construction contract. You should consult with your own attorney as to whether or not change orders entered into after January 1, 2013 to pre-existing contracts would trigger these new protections.

WHAT IS NOT AFFECTED BY THIS NEW LAW?

The bill would except certain contractual provisions and types of insurance from these provisions, including an agreement between a subcontractor and general contractor or construction manager as to the timing or immediacy of the defense and provisions for reimbursement of defense fees and costs, as specified.

WHAT SHOULD YOU DO GOING FORWARD?

1. Any contracts or amendments to those contracts you enter into after January 1, 2013 should have the indemnity clause modified so that it complies with the new law. You should speak with your attorney about specific changes.
2. You should review any Master Subcontract Agreements to ensure that the indemnity clauses are modified for work authorizations that are entered into after January 1, 2013.
3. You should review your insurance coverage and insurance policies to determine if they are compliant with the new law. You should also review new policies and

endorsements to determine if insurers are modifying their forms relative to their duties to defend a lawsuit and pay claims.

SUMMARY OF KEY LEGAL POINTS

The new law:

1. Prohibits construction contracts requiring indemnity, insurance, or defense obligations by a subcontractor for the active negligence or willful misconduct of a general contractor, his/her agents, or certain other subcontractors.
2. Provides that, unless otherwise prohibited, the parties to a construction contract can freely contract for other protections and obligations of each party, but allows numerous exemptions, including residential construction contracts, direct contracts with a public agency or owner, and insurance contracts for project wrap up and workers' compensation.
3. Requires an insurer to uphold their contractual obligations to additional insureds pursuant to *Presley Homes, Inc. v. American State Insurance Company* (2001) 90 Cal.App.4th 571.
4. Provides that an insurer maintains reimbursement rights from a general contractor or other subcontractor pursuant to the holding in *Buss v. Superior Court* (1997) 16 Cal.4th 35.
5. Provides a defense or settlement option for commercial construction contracts similar to existing law regarding residential construction contracts under which a subcontractor, after receiving claim information from the general contractor, has the option to defend the claim or pay its portion of the claim.
6. Provides that in the event a contractor fails to maintain its obligations to defend or pay its portion of the claim, the general contractor may make a claim for compensatory and consequential damages and reasonable attorney's fees.
7. Clarifies that a public agency is prohibited from shifting its liability for its active negligence to a contractor, subcontractor, or materials supplier.
8. Establishes that a project owner, not acting as a project manager, general contractor, or materials supplier, is prohibited from shifting liability for its active negligence to a contractor, subcontractor, or materials supplier.
9. Provides that these new rights and obligations shall be construed to affect the obligation, if any, of either a contractor or construction manager to indemnify, including defending or paying the costs to defend, a public agency against any claim arising from the alleged active negligence of the public agency under Civil Code

Section 2782(b) or to indemnify, including defending or paying the costs to defend, an owner of privately owned real property to be improved against any claim arising from the alleged active negligence of the owner under Civil Code Section 2782(c).

10. Provides that the foregoing changes shall not be construed to affect the obligation, if any, of either a contractor or construction manager to provide or maintain insurance covering the acts or omissions of the promisor, including additional insurance endorsements covering the acts or omissions of the promisor during ongoing and completed operations pursuant to a construction contract with a public agency under Civil Code Section 2782(b) or an owner of privately owned real property to be improved under Civil Code Section 2782(c).

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Please note that CAL SMACNA members made the elimination of Type 1 indemnity a top legislative priority in 2010 and worked to pass SB474.

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