

The Morrison Law Journal
December 2008
Volume III, Edition 12

A Minor (Unpublished) Win For Subcontractors: California Court Of Appeal, Second District, Rules That Holding In California Supreme Court Decision In Crawford v. Weather Shield Manufacturing, Inc. (2008) 44 Cal.4th 541 Does Not Extend To Indemnity Obligations Arising From Settlements Between Indemnites And Third Party Claimants, Even Where The Indemnitor Breached An Immediate Duty To Defend The Indemnitee

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As we reported in the July 2008 edition of *The Morrison Law Journal*, the California Supreme Court issued its decision on July 21, 2008 in the matter of Crawford v. Weather Shield Manufacturing, Inc. (2008) 44 Cal.4th 541 ("Crawford Decision") whereby it held that the duty to defend under a broad based indemnity agreement was immediate and did not depend on a determination as to whether the indemnitor (the party charged with the indemnity obligation) was ultimately found to be negligent in the first place.

In footnote 6 of the Crawford Decision, the California Supreme Court noted that if a contractual indemnitor declined the indemnitee's tender of defense of a third party claim against the latter, the third party's later judgment against the indemnitee may be conclusive evidence, as against the indemnitor, of the indemnitee's liability to the third party (including the amount thereof), while the indemnitee's good faith settlement of the third party claim may be presumptive evidence against the indemnitor on that issue, citing Isacson v. California Insurance Guarantee Association (1988) 44 Cal.3d 775 ("Isacson") and Peter Culley & Associates v. Superior Court (1992) 10 Cal.4 th 281 ("Peter Culley")¹.

¹ In so holding, the California Supreme Court cited California Civil Code section 2778(5) which deals with the repercussions resulting from the failure by the indemnitee to accept a demand for a defense. That statute provides, in pertinent part:

"If, after request, the person indemnifying neglects to defend the person indemnified, a recovery against the latter suffered by him in good faith, is conclusive in his favor against the former".

The footnote was somewhat curious in that the Isaacson and Peter Culley cases present different outcomes, if not different holdings. In Isaacson, a case involving an alleged failure to provide a defense to physician insureds from the California Insurance Guarantee Association (the physicians later settled for \$500,000 after being denied a defense), the Court ruled that if an insurer wrongfully failed to provide coverage or a defense and the insured then settles the claim, the insured is to be given the benefit of an evidentiary presumption as to that settlement. The Court went on to hold that in a later action against the insurer for reimbursement based on a breach of its contractual duty to defend the action, a reasonable settlement made by the insured to terminate the underlying claim against him may be used as presumptive evidence of the insured's liability on the underlying claim, and the amount of such liability citing Kershaw v. Maryland Casualty Company (1959) 172 Cal.App.2d 248, 256-257.

By contrast, the Peter Culley dealt with a developer of a condominium project which entered into a settlement with an architect and obtained an assignment of the architect's express indemnity rights against the structural engineer. Suit was filed by the developer against the structural engineer and the Court found the settlement amount (apportioned to the structural engineer) to be in good faith and also determined that the amount of the settlement was conclusive as against the structural engineer. On appeal, The Court of Appeal reversed and ruled that the settlement, even though found to be in good faith, was only presumptively valid and the indemnitor could still challenge the reasonableness of the settlement amount even though the duty to defend had been breached.

In October of this year, in the matter of Aerospace Dynamics International, Inc. v. Frize Corporation, Inc., ("Aerospace Dynamics International") the Court of Appeal, Second District was presented with the question (among other issues) as to whether, in the context of a noninsurance contract, an indemnitee could still challenge a settlement between the indemnitee and the third party claimant when:

- (i) an immediate duty to defend was owed;
- (ii) the indemnitor breached the immediate duty to defend;
- (iii) the indemnitee entered into a settlement agreement whereby an arbitrator issued an award which was only partially binding on the indemnitee (i.e. the indemnitee was only obligated to pay the award up to a certain amount); and
- (iv) the Court entered a judgment based on the arbitration award.

Aerospace Dynamics International dealt with a personal injury accident where a 17 year journeyman painter severely burned his hand after placing it on a buss bar in the crane stall of an aerospace facility. The project owner, Aerospace Dynamics International, Inc., tendered its defense to the general contractor, Frize Corporation, which had been working at the facility and which had hired the employer of the injured worker. The general contractor declined to provide a defense and the worker and the project owner went to an arbitration with an agreement that the project owner would only be responsible for the first \$300,000 of the arbitrator's award. The arbitrator awarded \$2,700,000 and the Court entered judgment in that amount. The project owner then assigned its rights to the injured worker who sued the general contractor to recoup the amount of the award.

At trial, the Court found that the general contractor had breached its obligation to defend the project owner but ruled that the \$2,700,000 amount was only presumptive as against the general contractor and the jury later found the amount was not reasonable. The injured worker then appealed arguing that the arbitration award should have been conclusive as against the general contractor. Prior to oral argument, the Crawford Decision was issued. Both parties argued that the Crawford Decision was on point, and favored their respective positions.

In an unpublished decision issued December 4, 2008 in Aerospace Dynamics International, Inc. v. Frize Corporation, Inc. (2008) Westlaw 5096982, the Court of Appeal held, in footnote 2 of the decision, that the Crawford Decision only applied to defense obligations and that the Crawford Decision did not impact the indemnity obligation which might arise from the settlement between the third party claimant and the indemnitee. Quoting the Court of Appeal:

“The Supreme Court issued Crawford v. Weather Shield Manufacturing Inc. (2008) 44 Cal.4th 541 after briefing in this case was complete and so we asked the parties to provide supplemental briefing on the effect of that opinion on this case. Having considered Crawford and the parties' letter briefs, we conclude that other than the statements of general indemnity law, Crawford is not on point. The issue here is whether Frize was required to indemnify ADI under the parties' agreement, the extent of the indemnity obligation, and whether and how any indemnity responsibility was affected by ADI's settlement with Mendoza, Jr. and the referee's award. By contrast, the Supreme Court in Crawford was presented with “no issue ... of the effect of [the indemnitee's] settlement with the [third party] on [the indemnitor's] indemnity liability.....” The issue in Crawford was

"the contractual duty to defend in a noninsurance context" (id. at p. 547, original italics omitted, italics added) and so that case is of limited value here."

The decision in Aerospace Dynamics International, although not published, does present a measure of comfort to indemnitees where an immediate duty to defend is found to have been owed and was not accepted at the time of tender. While Aerospace Dynamics International cannot be cited as a published case, it does present an analysis of the important question as to what impacts will occur as a result of a denial of a demand for a defense

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