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A Pressing Obligation: California Supreme Court Rules That Developer Defendant In Construction Defect Case Is Entitled To Defense From A Subcontractor Based On A Garden Variety Express Contractual Indemnity Clause Even Though The Subcontractor Was Found By The Jury To Be Not Negligent With Respect To Its Work

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In a stirring victory for developers and general contractors in construction defect cases, the California Supreme Court has ruled that the duty to defend arising from a standard construction subcontractor indemnity agreement triggers an immediate duty to defend under Civil Code section 2778(4) and remains in effect even where the subcontractor is later adjudicated to be not negligent by the trier of fact.

The California Supreme Court's decision was issued on July 21, 2008 in the matter of Crawford v. Weather Shield Manufacturing Inc. (2008) Westlaw 2789215 (herein, "Crawford" case). Given the ten year statute of limitations period for latent construction defects provided under Code of Civil Procedure section 337.15, the Crawford case will impact a broad array of existing and future cases even though, as discussed below, indemnity and defense obligations in favor of residential developers and general contractors have been limited by statute for developer construction contracts entered into after January 1, 2006 and general contractor construction contracts entered into after January 1, 2008 under recently amended Civil Code section 2782 . Therefore, the Court's holding in the Crawford case will be a necessary component in determining indemnity rights in construction defect cases for some time to come.

The Crawford case presented fairly routine facts. The case arose from a lawsuit by 220 homeowners of 122 finished homes in a residential project located in Huntington Beach, California. Suit was filed in 1999 by the homeowners against developer, builder and general contractor, J.M. Peters Co. ("JMP") as well as, among others, Weather Shield Manufacturing Inc. ("Weather Shield") and Darrow the Framing Corporation ("Darrow"). Weather Shield had contracted with JMP to manufacture and supply windows for the project. Darrow contracted to act as the framer. The construction subcontracts contained typical indemnity provisions whereby, in the case of Weather Shield, it promised to:

> (1) "to indemnify and save [JMP] harmless against all claims for damages...loss,...and/or theft...growing out of the execution of [Weather Shield's] work," and

(2) "at [its] own expense to defend any suit or action brought against [JMP] founded upon the claim of such damage[,]...loss or theft."

The plaintiffs' complaint alleged a variety of construction defects including improper design, manufacture and installation of windows. In 2000, JMP filed a cross-complaint against, among others, Weather Shield and Darrow. JMP and all of the subcontractors, except for Darrow and Weather Shield, settled before trial. As relevant here, the window leak and framing issues went to trial in 2002 and the jury returned a verdict in favor of Weather Shield but awarded the homeowners approximately $1,000,000 against Darrow, who later settled.

In 2003, JMP's cross-complaint against Weather Shield was tried separately to the Trial Court. The Trial Court ruled that the jury's finding of no liability against Weather Shield absolved it of any express contractual indemnity liability to JMP. However, the Court ruled that JMP was entitled to recover attorneys' fees against Weather Shield in spite of the fact that Weather Shield was found to be free of negligence. After apportioning attorneys' fees incurred by JMP, the Court awarded JMP $131,274 in damages against Weather Shield and another $46,734 in attorneys' fees incurred by JMP in prosecuting its cross-complaint against Weather Shield (presumably on the basis that it was a prevailing party under Civil Code section 1717).

As relevant here, Weather Shield appealed the declaratory relief judgment insofar as it required Weather Shield to reimburse JMP for the attorneys' fees it incurred in defending the construction defect case and in pursuing the JMP cross-complaint[1]. In a divided decision, the Court of Appeal affirmed the award of attorneys' fees in favor of JMP. In a dissenting opinion, Justice O'Leary stated that the award of attorneys' fees should not stand on the basis that the subject contract was not specific enough in its language to impose a defense obligation where the subcontractor was found to be not negligent, stressing that noninsurance indemnity contracts, unlike liability insurance policies, are construed to limit the obligations imposed on the indemnitor.

Weather Shield then sought review from the California Supreme Court. The California Supreme Court then granted limited review on the sole question of whether, in the context of a garden variety indemnity contract whereby the subcontractor agreed "to defend any suit or action" against a developer "founded upon" any claim "growing out of the execution of the work", the subcontractor is obligated to provide a defense to the developer even though it is found to be free of negligence.

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[1] Weather Shield also appealed the Trial Court's grant of a new trial to the plaintiff homeowners on a previously dismissed strict products liability cause of action. The Trial Court had dismissed the strict products liability cause of action before the jury trial on the basis of the decisions in Casey v. Overhead Door Corporation (1999) 74 Cal.App.4th 112 and La Jolla Village Homeowners' Association v. Superior Court (1989) 212 Cal.App.3d 1131, which decisions were superseded by the California Supreme Court decision in Jimenez v. Superior Court (2002) 29 Cal.4th 473.

In a unanimous decision, the Supreme Court affirmed the majority decision of the Court of Appeal. In its ruling, the California Supreme Court noted that Civil Code section 2778(4) and decisional case law construe an "immediate" duty to defend an indemnitee against all claims "embraced by the indemnity" agreement, see, Gribaldo, Jacobs, Jones & Associates v. Agrippina Versicherunges A.G. (1970) 3 Cal.3d 434, and commented that that the duty to defend, therefore, is distinct from the duty to indemnify, is broader than the duty to indemnify and cannot depend on the outcome of the litigation. In short, the California Supreme Court ruled that, unless the indemnity agreement provides otherwise[2], the statutorily described duty to defend under Civil Code section 2778(4) extends to any claims which allege facts which would give rise to a duty to indemnify, commences upon the tender of defense and will remain in effect even if the subcontractor is later found to be free of any negligence.

The California Supreme Court also distinguished the published opinions in Heppler v. J.M. Peters Co. (1999) 73 Cal.App.3d 497 (commenting that the plaintiffs in that matter did not contend that the duty of defense was broader than the duty to indemnify), Goldman v. Ecco-Phoenix Electrical Corporation (1964) 62 Cal.2d 40 (commenting that the Court only addressed the indemnitor's duties under the separate indemnity clause in that case) and Mel Clayton Ford v. Ford Motor Company (2002) 104 Cal.App.4th 46 ("Mel Clayton Ford") (commenting that the indemnity contract in that case specifically limited the indemnitor's obligations to claims caused solely by product defects). The California Supreme Court also overruled the decision in Regan Roofing Co. v. Superior Court (1994) 24 Cal.App.4th 425 ("Regan Roofing"). As for the Regan Roofing decision, the California Supreme Court acknowledged that the Court of Appeal in that case had ruled that the duty to defend could not be determined until there had been a finding of indemnity liability and held that the Court of Appeal in "Regan Roofing was therefore mistaken".

The California Supreme Court noted the potential injustice given the often unequal bargaining power of subcontractors but ruled that it would be left up to the subcontractor to include limiting language in its indemnity contracts. The California Supreme Court further noted that the legislature had recently amended Civil Code section 2782, which limits the scope of indemnity clauses in residential construction contracts so that developers may not impose indemnity (and defense) obligations on subcontractors beyond their scope of work for contracts entered into after January 1, 2006 and the same limitation for general contractors for contracts entered into after January 1, 2008. However, it should be noted that the ten year statute of limitations period under Code of Civil Procedure section 337.15 will mean that there will be many years of litigation before the benefits of

[2] The California Supreme Court noted that parties to an indemnity contract may disclaim responsibility for the indemnitee's defense or can specify that the indemnitor's sole defense obligation will be to reimburse the indemnitee for costs incurred for a particular type of claim, but the Weather Shield contract (which contained typical "arising out of" language), contained no such limitations.

amended Civil Code section 2782 will be felt by subcontractors (and that assumes no further changes in Civil Code section 2782). Also, it should be noted that even the amended version of Civil Code section 2782 will not modify the all encompassing duty to defend under an additional insured endorsement as provided under the decision in Presley Homes, Inc. v. American States Insurance Company (2001) 90 Cal.App.4th 571.

The Crawford case is certainly significant. It means that, for residential contracts between developers and subcontractors entered into before January 1, 2006 and residential contracts between general contractors and subcontractors entered into before January 1, 2008, mere allegations in a construction defect claim will trigger an immediate duty to defend, irrespective of the negligence of the subcontractor. The only limitation to this would be where there is a limitation in the indemnity contract itself to certain types of claims, such as in Mel Clayton Ford, or where there is a limitation in the defense clause. However, since such limitations clauses are quite rare in construction contracts, the foregoing reasoning will likely apply to most construction contracts entered into either before January 1, 2006 with developers and before January 1, 2008 with general contractors, placing significant administrative and legal costs on subcontractors and their insurers.

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