

### Assembly Bill 2738 Changes Subcontractor Indemnity and Defense Obligations

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Effective January 1, 2009, owners and contractors need to modify their subcontractor agreements to comply with new statutory requirements. Assembly Bill 2738 amends California Civil Code Section 2782 and adds three new statutes that limit a subcontractor's indemnity and defense obligations for residential construction and require certain disclosures relating to wrap-up insurance policies.

**Limits on Indemnity and Defense Obligations.** Under subdivision (c) of Section 2782, provisions that purport to require a subcontractor to insure, indemnify or defend the builder or contractor against liability for construction defects claims are unenforceable to the extent the claims relate to the negligence of the builder, contractor or other parties who are directly responsible to the builder, or to defects in design furnished by those persons, or to the extent the claims do not relate to the scope of work in the written subcontractor agreement. This limit applies to all construction contracts for residential construction, including amendments, entered into after January 1, 2009.

**Subcontractor's Obligation to Defend.** Subdivision (c) does not prohibit the parties from mutually agreeing to the timing or immediacy of the obligation to provide a defense and provisions for reimbursement of defense fees and costs, so long as that agreement does not waive or modify the provisions of subdivision (c). If a builder or general contractor properly tenders a construction defect claim to a subcontractor, the subcontractor must elect within a reasonable period (not to exceed 90 days) to either (i) defend the claim with counsel of its choice, in which case the subcontractor will maintain control of the defense, or (ii) pay a reasonably allocated share of the builder's or general contractor's defense fees and costs on an ongoing basis during the pendency of the claim, subject to reallocation upon final resolution of the claim. The builder or general contractor must allocate a share to itself and to each subcontractor to the extent a claim is alleged to be caused by each party's work, actions or omissions.

**No Indemnity for Claims Covered by Wrap-Up Policy.** California Civil Code Section 2782.9 has been added by AB 2738. This statute applies to all contracts, including any amendments, entered into after January 1, 2009, for residential construction projects that have a wrap-up insurance policy or other consolidated insurance program. Under Section 2782.9, all contracts for such projects that require an enrolled and participating subcontractor or other participant to indemnify, hold harmless or defend another for a claim or action covered by that insurance program are unenforceable. However, the parties may agree to require a reasonably allocated contribution from a subcontractor or other participant to the self insured retention or deductible required under such insurance program, if the maximum amount and method of collection of the participant's contribution is disclosed in the contract and the contribution is reasonably limited so that each participant may have some financial obligation in the event of a claim alleged to be caused by that participant's scope of work.

**Disclosures Required Regarding Wrap-Up Policies.** California Civil Code Sections 2782.95 and 2782.96 apply to residential and non-residential projects, respectively, and require the owner, builder or general contractor to make disclosures regarding any wrap-up insurance policy or other consolidated insurance program. If the owner, builder or general contractor fails to make the required disclosures, bids for a private residential work of improvement are not binding on the subcontractor unless the subcontractor has the right to increase its bid.

**Conclusion.** AB 2738 limits the ability to shift construction defect risk to subcontractors and limits the practical benefit of subcontractor defense obligations. Owners and contractors will need to modify their subcontractor agreements for all new projects and determine whether future amendments to existing subcontracts will trigger the new statutory requirements.

## Attorneys

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