

# Construction Industry Update – Senate Bill 474 – A change in Indemnity Laws Pertaining to Private Commercial Projects. . . A Boon for Subcontractors?

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Recent legislation (SB 474) was enacted which will significantly change the indemnification agreements that are allowable on private commercial construction projects. The new legislation applies to commercial construction signed on or after January 1, 2013.

Basically, the law makes Type I indemnities illegal. A Type I indemnity requires the Downstream Party to indemnify the Upstream Party for everything except the Upstream Party's sole negligence or willful misconduct. The new law now makes it illegal for the Upstream Party to contractually transfer its active negligence to the Downstream Party as well. Note that you can still contractually transfer your passive negligence to another (this is called a Type II indemnity). SB 474 represents a major shift in the way risk is transferred on Commercial Construction Projects. Historically, developers and general contractors have regularly used Type I indemnities and since "sole negligence" is rarely established, the contractual transfer of risk from an Upstream to a Downstream Party was almost absolute.

In addition to prohibiting construction contracts requiring indemnities for active negligence or willful misconduct, the new law makes it clear that a subcontractor cannot be held responsible for the design of others or problems outside the subcontractor's scope of work. The bill also clarifies that a public agency is prohibited from shifting its active negligence to a contractor, subcontractor, or materials supplier, with design professionals or projects insured by an Owner Controlled Insurance Program or similar project-specific policies. It also does not affect Additional Insured obligations.

This last issue is a big one. Even though contractually a Subcontractor (Downstream Party) is no longer responsible to indemnify the General Contractor (Upstream Party) for the General Contractor's active negligence, the Subcontractor's general liability insurer can still end up paying for it if the General Contractor is included as an Additional Insured (AI) on the Sub's General Liability policy. Most Additional Insured endorsements provide broad protection to the AI. A typical endorsement\* extends coverage to an Additional Insured so long as the problem is "caused, in whole or in part, by" the Named Insured. In other words, if the Named Insured is partially at fault, then the Additional Insured has coverage even if the Additional Insured was actively negligent. In a perfect world, the Downstream Party would tailor the Additional Insured Endorsement to track with the indemnification agreement. Unfortunately, most developers or general contractors will not accept this.

A Downstream Party's defense obligations have changed, as well. The Upstream Party must now submit a written tender to the Downstream Party. This tender must outline information relating to claims caused by the Downstream Party. At this point, the Downstream Party has the option of paying the claim or defending it. If the Downstream Party elects to pay the claim, they must do so within 30 days of receiving an invoice from the Upstream Party. If they choose to defend it, they must notice the Upstream Party within 90 days.

Unfortunately, legislation like SB 474 is rarely black and white. The new law could lead to an increase in litigation costs as various parties sue others to determine what the law really says. There is also some

question as to whether or not the new defense provisions may conflict with the *Crawford*\*\* case, which dealt with defense issues in construction contracts.

The good news is SB 474 will make it more difficult for the Upstream Party to require the Downstream Party to be responsible for the Upstream Party's active negligence, or to make the Downstream Party pay for problems caused by the work of others. At the end of the day, everyone should be responsible for their own negligence, active as well as passive. SB 474, while not perfect legislation, is definitely a step in the right direction.