California Supreme Court Ruling Approves Contractual Risk Transfer

By Jeff Dennis

At a time when the California State Legislature is actively curtailing businesses' rights to contractually assign indemnity and defense obligations, the California Supreme Court has once again backed developers' ability to do so. The Court's 2008 ruling in Crawford v. Weather Shield Mfr, Inc. is a victory for California developers and any other California businesses that reach arm's length agreements to transfer defense-risk indemnity in the event of litigation. Although *Crawford* specifically arose in the residential construction defect arena, the Supreme Court's review of historic, and general, indemnity case law suggests that the ruling would apply not only to residential construction, but also to commercial litigation and beyond. Of course, additional interpretations and challenges to the *Crawford* holding can be anticipated.

The *Crawford* court affirmed that under typical defense and indemnity provisions in a subcontract agreement, a subcontractor's duty to defend a developer arises immediately upon the tender of a claim, **even if it is later determined that the subcontractor was not negligent**. This decision will not only preserve the intent of parties to the defense and indemnity agreement, it will also help keep the focus in construction defect cases where it belongs – on the parties that performed the work at issue.

The *Crawford* case arose from a typical construction defect action, in which a group of homeowners brought suit against a developer and a number of subcontractors for a variety of alleged defects, including faulty windows. The trial court found that the window manufacturer, Weather Shield, was not negligent. The trial court also found that while the manufacturer did not owe indemnity to the developer, the subcontractor was obligated to pay for the developer's defense costs because of the subcontract's requirements.

Crawford was appealed to the fourth appellate circuit which upheld the lower court's rulings on both the indemnity and duty-to-defend issues, and Newmeyer & Dillion filed an amicus brief in the California Supreme Court case on behalf of several homebuilders.

In upholding both the trial court and appellate court, the California Supreme Court conducted an exhaustive review of the history of contractual duties in California, and found a repeated distinction between a party's duty to indemnify and a duty to defend. While a subcontractor's duty to indemnify is intimately tied to its culpability, a contractual promise to defend "clearly connotes an obligation of active responsibility, from the outset, for the promisee's defense against such claims."

The Supreme Court also rejected Weather Shield's interpretation of *Civil Code* section 2778, which sets forth general rules of indemnity contract interpretation. The Court concluded that the defense duty which appears in subdivision 4 of section 2778 "arises immediately upon a proper tender of defense by the indemnitee, and thus before the litigation to be defended has determined whether indemnity is actually owed." Following this interpretation, the Supreme Court held that a duty to defend "cannot depend on the outcome of that litigation," but rather must commence upon tender.

Although the ruling should be applicable to residential, multi-family and commercial construction, the *Crawford* holding may have limitations which curtail its significance. Specifically, the Court does indicate that its review was limited to a consideration of pre-2006 residential construction subcontracts. However, the Court's subsequent analysis of case law goes well beyond cases involving residential construction, and focuses on general contractual principles. The methodology behind the *Crawford* holding suggests that this ruling would apply far beyond the pre-2006 residential construction.

The *Crawford* holding begs the question – how can an aggrieved party enforce an immediate duty to defend in the non-insurance sector? Fortunately, the Court foresaw this question and provides a clear answer. Rather than waiting for the conclusion of protracted litigation, a developer can establish a subcontractor's affirmative duty to immediately defend the developer, regardless of eventual liability or fault. To ensure that the subcontractors fully understand the immediate nature of their duty to defend, the Supreme Court went to great lengths in footnote 12 of the decision to explain exactly how a builder might establish the duty to defend. The exemplar footnote 12 protocol begins with a party (the developer) bringing a motion for summary judgment or summary adjudication with respect to the duty to defend. The Supreme Court indicates that a trial court can rule on "whether any of the contracts at issue include a duty to defend, and, if so, whether the underlying suit or proceeding as to which a defense is sought falls within the scope of any of the parties' contractual duty to defend." The Court continued by stating that the litigation can continue following this determination, "subject to a later determination of how damages for breach of the duty to defend should be apportioned among the breaching parties." This roadmap provides an invaluable tool for trial courts attempting to properly utilize the *Crawford* decision.

Finally, early indications from the subcontractor bar suggests that specialty trade contractors will attempt to turn the *Crawford* ruling around in their favor, arguing that the Crawford ruling provides an opportunity for a subcontractor to assume the defense of a particular issue for not only itself, but also the developer. From the outset, this concept contains inherent and problematic conflict issues for both subcontractor and developer counsel. It is doubtful that the *Crawford* court intended to further complicate complex construction litigation. Rather, the Court appears to be attempting to simplify the defense process in finding that such a defense obligation arises immediately upon tender, and allowing the parties an opportunity to determine its resolution. In fact, while the Court notes in footnote 13 that subcontractors may <u>prefer</u> to assume control of the defense of suits, the Court does not state that such action is appropriate.

The *Crawford* ruling provides further support for builders forced to defend themselves in lawsuits arising out of trade contractor errors, particularly where the subcontracts contain appropriate contractual defense and indemnification language. Since not all contractual indemnity provisions may be the same, it is prudent to conduct a review of such language in light of the *Crawford* ruling.

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