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California Law Update

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SUBCONTRACTOR'S DUTY TO DEFEND

The recent California Supreme Court decision in Crawford v.Weather Shield Mfg. Co. Inc. (7/21/08), holding that a subcontractor's duty to defend is immediate under an appropriate express indemnity contract, creates some very serious problems for a subcontractor and its carriers in a multi-party construction defect case. The questions that must be answered are how should the subcontractor fulfill its indemnification obligation, and what are the risks in failing to do so.

The California Supreme Court relied heavily on Civil Code Section 2778 in finding the duty to defend under an express indemnity contract is immediate and based on the "claim", and not whether the subcontractor ultimately owes indemnity. That same Code section provides:

> 5. 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 Supreme Court did not need to address that subsection of Civil Code Section 2778 as the case came to it after judgment. If, however, a subcontractor fails to defend the contractor, we have no difficulty in anticipating some form of stipulated and/or collusive settlement which then will be pursued against the subcontractor, pursuant to subsection 5.

From an insurance standpoint, an indemnity contract is an "insured contract" and although the insurer should still be able to raise its policy defenses in the case of a stipulated or collusive judgment, the difficulty in doing so is well known.

Section 2778, subsection 4 states:

> The person indemnifying is bound upon the request of the person indemnified to defend actions or proceedings brought against the latter in respect to the matters embraced by the indemnity, but the person indemnified has the right to conduct such defenses, if he chooses to do so.

The above subsection may give subcontractors and their insurers a road map. Unlike the duty to defend under an insurance policy, the defense owed under indemnity is only to the extent of "…the matters embraced by the indemnity". Accordingly, we believe it appropriate for the subcontractor to offer to install an attorney to defend the general contractor on the limited issues raised by the indemnity agreement. Such a defense need not be much more costly than the defense that would have been offered to the subcontractor, who presumably now can passively defend the claim.

Without a stipulation, it is unlikely that the same attorney could defend the claim for the general and the subcontractor, and that issue obviously becomes complicated when the issue of insurance is injected.

Subcontractors and their carriers can no longer, without significant risk, wait until the end of the case to address the defense issue. On the bright side, insurers with additional insured obligations can now count on help toward defense costs from co-insurers and insurers of other subcontractors which do not have additional insured obligations.

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