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CALIFORNIA SB 474 UPDATE – RISK MANAGEMENT CONSIDERATIONS

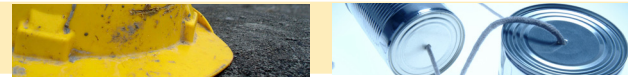
Senate Bill 474 was signed in to law by Governor Brown on October 9, 2011. This new law will become effective January 1, 2013. SB 474 restricts the inclusion of Type I indemnity provisions in construction contracts for commercial projects and for any contracts with public entities. In short, Type I indemnity provisions will not allow indemnity for a party's **active** negligence. Similar restrictions on direct contracts with public entities and residential projects have been in effect since January 1, 2006, (Assembly Bill 758). SB 474 can be viewed as an extension of these restrictions to commercial projects.

SB 474 amends California Civil Code Sections 2782 and 2783 and adds Section 2782.05. Section 2782.05 now provides that construction agreements with a subcontractor that are executed or amended on or after January 1, 2013, that purport to indemnify a general contractor, construction manager, public entity or other subcontractor for liability claims (including the defense fees and costs) will be unenforceable to the extent that the indemnitee is **actively** negligent or if there is **willful** misconduct by the indemnitee. Our Interpretation of "amended" includes change orders on or after January 1, 2013.

This prohibition also applies to defects in design furnished by those persons or to the extent the claims do not arise out of the scope of work by the subcontractor.

NOTABLE CHANGES IN THE STATUTE ARE:

- The obligations to Public Owners do not change. The duty to defend allegations which may include the active negligence of the Owner still exist and the timing and immediacy of defense provisions included in the statute do not change for Public or Private Owners.
- Section 2782.05(e) of the statute establishes certain protocols for the "timing and immediacy of defense" and sets forth the manner in which defense must be tendered. Once a claim has been properly tendered, the lower tiered subcontractor has the option of (1) defending the claim with counsel of their choice no later than 30 days following receipt of the tender or (2) paying within 30 days of receipt of an invoice the reasonably allocated cost of the General Contractor or higher tiered Subcontractor's defense costs.
- The "timing and immediacy of defense" does provide for a reallocation of defense costs upon resolution and settlement and includes penalties where either party fails to meet the obligations of the statute (Section 2782.05(e)(2)&(f)).
- This legislation does not impact insurance contracts or other insurance endorsements. An insurer's obligation under their insurance contracts and additional insured endorsements to provide defense do not change (see Section 2782.05(a)).
- Choice of law provisions to use another state's law to settle disputes will not be recognized. If the construction project is in California it is subject to California law irrespective of a prior choice of law provision between the parties.
- The legislation is effective January 1, 2013, and applies not only to new construction contracts but also would apply to work performed under change orders issued after January 1, 2013, where the underlying contract was signed prior to.
- SB 474 does not apply to Contracts with Design Professionals.



RISK MANAGEMENT CONSIDERATIONS:

Indemnity Provisions

- We recommend that you introduce some reference to "...California Civil Code Section 2782, et seq..." in your existing indemnification provisions. You should consult your legal counsel for their input but it is our recommendation that simple reference to the statute should be included as a minimum.
- Once this legislation is effective we do not believe that any further modification of the indemnification provision should be warranted. Any suggestion to do so should not be considered without careful due diligence.
- A detailed review of existing practices for tendering claims should be conducted so that any necessary modifications required by Section 2782 are incorporated.

Insurance Requirements

- No changes to your existing insurance requirements should be necessary as a result of this legislation. You should continue to be diligent in reviewing Additional Insured endorsements and other endorsements attached to Certificates of Insurance evidencing insurance coverage.
- You should be on the lookout for possible changes in endorsements where Insurers see an opportunity to avoid providing defense and/or indemnification. Woodruff-Sawyer stands ready to assist in those reviews and will keep you informed should we see any changes trending through the insurance industry.

Negligence issues that could prevent indemnity.

Active negligence may be found if:

- An indemnitee has personally participated in an affirmative act of negligence.
- The indemnitee was connected with negligent acts or omissions by knowledge or acquiescence.
- The indemnitee failed to perform a precise duty that the indemnitee had agreed to perform.
- Willful misconduct (meaning conscious or intentional disregard of the rights or safety of others).

Whether you are an owner, general contractor or subcontractor it is important that the contracts you negotiate maintain indemnity and insurance provisions which are consistent with the new legislation. We recommend you consult with your legal counsel for further review and guidance. Of course should you have any questions or would like to discuss this new legislation in more detail please give us a call.

Follow this link to the enrolled (final) bill:

http://www.leginfo.ca.gov/pub/11-12/bill/sen/sb_0451-0500/sb_474_bill_20110912_enrolled.pdf

Contact Us

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