S141541

IN THE
SUPREME COURT OF CALIFORNIA

KIRK CRAWFORD Et Al.,

Plaintiffs & Respondents,

vs.

WEATHER SHIELD MFG., INC.,

Defendant & Appellant.

APPLICATION FOR LEAVE TO FILE AMICUS CURIAE BRIEF IN SUPPORT OF APPELLANT WEATHER SHIELD MFG., INC.

From a Decision of the Court of Appeal of the State of California
Fourth Appellate District, Division Three, Case No. G032301

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INTRODUCTION

Pursuant to California Rules of Court, rule 29.1(f), American Subcontractors Association, Inc. ("ASA") respectfully requests leave to file the attached brief of *Amicus Curiae* in support of defendant-appellant Weather Shield Mfg. Inc. This application is timely made within 30 days after the filing of the reply brief on the merits.

THE AMICUS CURIAE

ASA is a non-profit corporation supported by the membership dues paid by its approximately 5000 member businesses trading as construction subcontractors and suppliers throughout the country. More than 400 subcontractor firms located in California are members of one of ASA's five chapters in the state. The opinion of the Court of Appeal, if permitted to stand, will have significant adverse consequences for subcontractors who do business in California and on the California public at large.

INTEREST OF AMICUS CURIAE

The primary purpose of ASA is to promote the equitable treatment of subcontractors in the construction industry. In this regard, ASA is actively involved in the promotion of legislative action across the nation and has regularly intervened in legal actions that affect the construction industry at large. ASA's applications for leave to submit *Amicus Curiae* briefs have been approved in many jurisdictions, including California in *Vandenberg v. Superior Court* (1999) 21 Cal.4th 818.

ASA has participated as *Amicus Curiae* in many jurisdictions with regard to proper interpretation of construction anti-indemnification statutes, of which California Civil Code Section 2782 is one. *See Barton-Malow v. Grunau,* 835 So.2d 1164 (Fla.App. 2d Dist. 2002) (duty to defend not severable from duty to indemnify where hold harmless clause was void under Florida's anti-indemnity statute); *Walsh Construction v. Mutual of Enumclaw,* 104 P.3d 1146 (Or. 2005) (application of anti-indemnity statute to "additional insured" requirements); *Chrysler Corp v. Merrell & Garaguso, Inc.,* 796 A.2d 648 (Del. 2002) (anti-indemnification statute "may, under certain circumstances," bar remedy for breach of "additional insured" requirements); *Star Electrical Contractors v. Stone Building Company,* 863 So.2d 1071 (Ala. 2003) (electrical subcontractor entitled to a trial to determine whether it must hold general contractor harmless against lawsuit by injured employee of drywall subcontractor), *clarifying* 796 So.2d 1076.

The *Amicus Curiae* have a substantial interest in the present matter. The issues presented in this case implicate public safety and inherent fairness in the construction industry. The lower court found a subcontractor responsible for a developer's defense costs even though the subcontractor was determined to be non-negligent and found to have no underlying liability. This ruling has a direct and profound impact on the *Amicus Curiae* members' subcontracting businesses and, more importantly, on public safety in the California construction industry as a whole. In holding that developers/general contractors are entitled to have their defense costs paid by their subcontractors for claims

arising from the developers'/general contractors' sole negligence, the ruling violates public policy, and indeed violates the very purpose for the California legislature's enactment of California Civil Code Section 2782.

ASA is concerned the ruling will lead developers and general contractors to require subcontractors to agree to pay their defense costs even where the developers or general contractors are themselves the sole negligent party. General contractors and developers are ultimately in charge of maintaining the safety of construction sites and are responsible for ensuring the quality of the finished product. The lower court's ruling endangers the California public by removing an important incentive for maintaining safe jobsites and for ensuring quality final products. Additionally, the ruling permits general contractors and developers to receive a windfall by forcing subcontractors to provide a defense where they have no responsibility for the alleged damage.

NEED FOR FURTHER BRIEFING

ASA is familiar with the issues before this Court and the scope of their presentation. ASA's position is that Civil Code Section 2782, California's anti-indemnity statute, precludes the recovery of defense costs incurred by a responsible developer or general contractor against a non-negligent subcontractor. The *Amicus Curiae* believes that further briefing is necessary to address matters not fully addressed by the parties' briefs and to take into account the strong interest of the *Amicus Curiae* on this issue. Moreover, the Court of Appeal's decision will significantly undermine California's strong public policy of safety in the construction industry embodied in Civil Code Section 2782.

E. Scott Holbrook, Jr, who has drafted the brief, has reviewed the lower court opinion and the briefs in this Court and is familiar with the issues presented in this case.

CONCLUSION

For the foregoing reasons, the *Amicus Curiae* respectfully requests that this Court accept the accompanying brief for filing in this case.

Dated: November 28, 2006

Respectfully submitted,
LAW OFFICES OF
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____

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ISSUE TO BE BRIEFED

This Court has limited its review to the following issue: Did a contract under which a subcontractor agreed "to defend any suit or action" against a developer "founded upon" any claim "growing out of the execution of the work" require the subcontractor to provide a defense to a suit against the developer even if the subcontractor was not negligent?

The answer is no; such a requirement contravenes California's public policy and violates the expectations of the parties to the contract.

INTRODUCTION

American Subcontractors Association, Inc. ("ASA"), the *Amicus Curiae* submitting this brief, is a national non-profit corporation supported by the membership dues paid by its approximately 5000 member businesses trading as construction subcontractors and suppliers throughout the country. More than 400 subcontractor firms located in California are members of one of ASA's five California chapters. The primary purpose of ASA is to promote the equitable treatment of subcontractors in the construction industry. In this regard, ASA is actively involved in the promotion of legislative action across the nation and has regularly intervened in legal actions that affect the construction industry at large.

ASA supports defendant-appellant Weather Shield Mfg, Inc. in its appeal to the ruling of the Court of Appeal, Fourth Appellate District, Division Three, which held that a subcontractor was required to provide a defense to a developer even though the subcontractor was not negligent. The decision of the Court of Appeal implicates the California legislature's determination on safety and fairness in the construction industry embodied in Civil Code section 2782. This Court's decision will have a direct and profound impact on the safety and quality of work in California's construction industry and on the ability of ASA's members to conduct their subcontracting businesses. ASA's position, as argued in this brief, is that

Civil Code section 2782, California's anti-indemnity statute, precludes the recovery of defense costs incurred by a responsible general contractor or developer against its non-negligent subcontractor.

If the lower court ruling is permitted to stand, ASA is concerned that general contractors and developers will require blameless subcontractors to pay their defense costs in situations where the general contractor or developer was the sole negligent party. The ruling harms the interests of the California public in the construction industry by removing a critical incentive for general contractors and developers to ensure the safety and quality of their work. Moreover, it permits general contractors and developers to receive a windfall by forcing subcontractors to provide a defense where they have no responsibility for the alleged damage.

STATEMENT OF THE CASE

To conserve the Court's resources, the *Amicus Curiae* opts to omit this section and instead rely upon the statement of the case as set forth in the opening brief of defendant-appellant Weather Shield Mfg, Inc.

ARGUMENT

Requiring a non-negligent subcontractor to defend a responsible general contractor or developer violates California's anti-indemnity statute. Moreover, in finding such a duty to defend, the Court of Appeal incorrectly applied the standard for interpretation of insurance agreements to the indemnity agreement in this case.

I. Requiring a Subcontractor to Defend a General Contractor or Developer Where the Subcontractor Has No Obligation to Indemnify Violates California's Anti-Indemnity Statute

A subcontractor's agreement to defend a general contractor or developer cannot be enforced where there is no underlying duty to indemnify. Requiring such a defense would allow responsible general contractors and developers to unfairly pass on to blameless subcontractors

indemnity costs for which they have no liability in violation of Civil Code section 2782, California's anti-indemnity statute.

Civil Code section 2782 provides that, "provisions, clauses, covenants, or agreements contained in, collateral to, or affecting any construction contract, and that ***purport to indemnify*** the promisee against liability for damages for death or bodily injury to person, injury to property, or any other loss, damage or expense arising from the ***sole negligence*** or willful misconduct of the promisee ... are ***against public policy and are void and unenforceable*** ..." (emphasis added.)

Anti-indemnity statutes exist to discourage unfair risk-shifting. (American Subcontractors Association and Richard B. Usher, A Guide for Dealing with Insurance and the Risk Allocation Dilemma (2001) 1 (hereafter "ASA and Usher").) They counteract the "moral hazard problem" that arises when economic actors are not financially responsible for their own negligent conduct. (*Id.*) Including California, thirty-eight (38) states have enacted laws prohibiting construction businesses from contractually transferring the consequences of their own negligence to others. (See Subcontractors Chart of Anti-Indemnity Statutes, American Subcontractors Association (2005) available at http://www.asaonline.com/pdfs/antiindemnitychart.2005.04.20.pdf) The effect of these laws is to void, as contrary to public policy, agreements in construction contracts that attempt to indemnify a person, such as a general contractor or developer, against the consequences of its own negligence. (Matthew Bender & Company, Inc. (2006) 4-13 Construction Law § 13.17[2] (hereafter "Construction Law").)

Anti-indemnity statutes preserve financial incentives for businesses in the construction industry to discourage defective construction and protect public and worker safety. Construction and demolition operations, by their very nature, carry the potential for both tremendous public benefit and

individual, catastrophic harm. For example, according to the U.S. Bureau of Labor Statistics, the construction industry accounts for 5% of employment in the United States, but accounts for 20% of workplace fatalities. (Census of Fatal Occupational Injuries Summary, 2005, available at http://www.bls.gov/news.release/cfoi.nr0.htm) Defective construction can also result in tremendous financial burdens for individual businesses and families. (See e.g., *American Family Mutual Insurance v. American Girl* (Wis. 2004) 652 N.W.2d 65 [damage to warehouse valued at $4.1 million to $5.9 million]; *Lamar Homes, Inc. v. Mid-Continent Casualty Company* (5th Cir. 2005) 428 F.3d 193 [family home with defective foundation].)

If non-negligent subcontractors are forced to pay for the defense of responsible general contractors and developers, the intent of California's anti-indemnification statute would be undermined to the detriment of the California public and to the detriment of subcontractors who are in weaker bargaining positions *vis a vis* general contractors and developers. Civil Code section 2782 was enacted to avoid just these results.

A. A Subcontractor Has No Obligation to Defend a General Contractor or Developer Where the Underlying Indemnity is Unenforceable as a Matter of Law

In enacting Civil Code section 2782, California's legislature recognized the problem in the construction industry of contractors passing liability for their sole negligence on to non-negligent parties. "The manifest purpose of the Legislature in enacting section 2782 was to prevent one party to a construction contract from shifting the ultimate responsibility for its negligence to a nonnegligent party." (*Southern Pacific Transportation Co. v. Sandyland Protective Assn.* (1990) 224 Cal.App.3d 1494, 1498.)

The legislature has further recognized the general principle that an indemnity defense obligation is encompassed within the broader indemnity obligation. Civil Code section 2778 sets forth the general rules for interpreting agreements of indemnity. Section 2778(3) states that "***an indemnity*** against claims, or demands, or liability, expressly, or in other equivalent terms, ***embraces the costs of defense*** against such claims, demands, or liability incurred in good faith, and in the exercise of a reasonable discretion." (emphasis added.) Further, Civil Code section 2778(4) states that ***"[t]he person indemnifying is bound***, on request of the person indemnified, ***to defend*** actions or proceedings brought against the latter ***in respect to matters embraced by the indemnity*** ..." (emphasis added.) While section 2778 provides that these rules can be overridden if a contrary intent by the parties is present, they demonstrate the general principle that a requirement to defend a claim for indemnity is part of the indemnity obligation itself.

A requirement to defend for the sole negligence of another violates Civil Code section 2782 just as a requirement to indemnify for the sole negligence of another violates the statute. Re-characterization of the indemnity obligation as a defense obligation should not allow a general contractor or developer to benefit from what is otherwise an illegal indemnity. Moreover, if, despite the prohibition of Civil Code section 2782, contractors and developers can nevertheless pursue non-negligent subcontractors for costly legal fees, the public policies underlying California's anti-indemnity statute will be circumvented.

B. It is Bad Public Policy to Allow General Contractors and Developers to Pass On Their Responsibility for Construction Oversight to Non-Negligent Subcontractors

Nationally, courts recognize several public policy objectives served by anti-indemnity statutes. First, the statutes ensure that players in the

construction industry maintain an incentive to provide a safe workplace. (4-13 Construction Law, *supra*, at § 13.17[2b]; see also *Guy F. Atkinson Co. v. Shatz* (1980) 102 Cal.App.3d 351, 355; *Martindale v. Getty Ref. & Mktg. Co.* (D. Del. 1981) 510 F.Supp. 188.) In this regard, allowing a contractor to contractually free itself from liability for its own negligence reduces its incentive to safely operate the workplace. (4-13 Construction Law, *supra*, at § 13.17[2b].) Second, the statutes combat overreaching by general contractors and developers in the construction industry where small subcontractors and suppliers are often powerless to negotiate an allocation of risk through indemnity agreements. (4-13 Construction Law, *supra*, at § 13.17[2b]; see also *Berardi v. Getty Refining & Marketing Co.* (1980) 435 N.Y.S.2d 212.) These "public policy goals of enhancing safety and eliminating 'unconscionable' contract provisions outweigh the normal right of private individuals to contract as they see fit." (4-13 Construction Law, *supra*, at § 13.17[2b].)

ASA, the *Amicus Curiae* herein, represents a constituency whose businesses implicate both of these considerations. The norm in the construction industry is that general contractors (or in some cases developers) are responsible for overseeing the construction work and maintaining order and safety on the jobsite. Individual subcontractors, often just one of many subcontractors working concurrently on the same project, are not in the position of the general contractor to oversee the job due to the limited and specialized nature of their trade. Subcontractors are focused on perfecting their discreet area of work and, as much as possible, staying out of the way of other contractors on the project.

The ruling of the Court of Appeal removes an important incentive for general contractors and developers to take their oversight and safety obligations seriously. Under the court's ruling, if something goes wrong on a project, a subcontractor can be forced to defend a general contractor or

developer from liability, even though the subcontractor has performed its work without fault. This runs contrary to the goal of anti-indemnity legislation, whereby the "risk of loss should be borne by the party who can control the risk at the least cost." (ASA & Usher, *supra*, at p. 1.) "The cost of mistakes should be paid by the party best able to avoid the mistakes in the first place." [*Id.*] In the vast majority of cases, the party best able to control the risks associated with construction is the general contractor or developer.

California courts have recognized this purpose in Civil Code section 2782. Section 2782 is a "statutory prohibition against allowing an indemnitor to hold harmless an indemnitee for the indemnitee's sole negligence in construction contracts. It is against California public policy for a general contractor to use its economic clout to preemptively transfer the risks of its own sole negligence to fault-free subcontractors. Such indemnity ... increase[s] the risk of accidents by removing the general contractor's incentive to undertake accident-prevention measures involving its own negligence to avoid a risk of harm to third parties." (*National Union Fire Ins. Co. v. Nationwide Ins. Co.* (1999) 69 Cal.App.4th 709, 717.) Other states have similarly recognized that anti-indemnity statutes correct the disincentive indemnity agreements otherwise create for indemnitees to exercise due care. (See e.g., *Braye v. Archer-Daniels-Midland Co.* (Ill. 1997) 676 N.E.2d 1295 [Illinois]; *Kemmeter v. McDaniel Backhoe Serv.* (Ohio. 2000) 732 N.E.2d 385, 388 [Ohio]; *Barton-Malow v. Grunau* (2002) 835 So.2d 1164, 1167 [Florida].) Illinois, for example, determined that the purpose of the state's anti-indemnity statute was "to protect the construction worker and the general public from suffering construction-related injuries by encouraging accident-prevention measures." (*Bosio v. Branigar Organization, Inc.* (1987) 154 Ill.App.3d 611, 613.)

If general contractors are allowed to pass their defense costs to their non-negligent subcontractors as the Court of Appeal has held, this policy will be undermined. Legal costs in defending construction defect cases are very high. J.M. Peters' defense costs in this case, just through trial, were $375,069, of which Window Shield was ordered to pay $131,274. (*Crawford v. Weather Shield Mfg., Inc.* (2006) 136 Cal.App.4th 304, 317.) The potential for paying such fees in litigation is an important incentive for developers and contractors such as J.M. Peters' to ensure the safety and quality of the jobs over which they have control. The option to preemptively pass the risk of such costs to subcontractors in construction contracts critically undermines this incentive.

Moreover, subcontractors are usually in the weaker bargaining position in construction contract negotiations. They are often faced with the decision to sign an entire subcontract, full of onerous terms, or lose the job. (See e.g., *Berardi, supra.*, 435 N.Y.S.2d 212 [(recognizing that small contractors and suppliers are often powerless to truly negotiate an allocation of risk in construction contracts].) The extent of the defense obligation the majority rule would burden a subcontractor with goes well beyond what a reasonable subcontractor would anticipate when entering into a subcontract. In his dissent in *Crawford,* Judge O'Leary addressed the problems with requiring non-negligent subcontractors to defend responsible developers or general contractors. He observed that under the majority's rule, a subcontractor would be bound to defend "as long as there is merely a preliminary indication the claim is founded on the subcontractor's own work. Consequently, there will always be a foreseeable risk the subcontractor will end up paying a portion (or all) of the defense costs for damages ultimately found not to be based on its work." (*Crawford, supra* 136 Cal.App.4th at p. 844, O'Leary, J., concurring and dissenting.) This

goes well beyond the reasonable expectations of subcontractors when they contract to perform construction work.

Requiring a subcontractor to defend a general contractor or developer where there is no underlying obligation to indemnify, i.e. where the subcontractor is non-negligent, is contrary to public policy and violates Civil Code section 2782. This Court should, therefore, reverse the decision of the Court of Appeal.

II. The Court of Appeal Incorrectly Applied the Insurance Law Presumption in Favor of Coverage to the Indemnity Provision in this Case

ASA's position, as set forth above, is that regardless of the language of the indemnity agreement, California's anti-indemnity statute precludes enforcement of a subcontractor's defense obligation where it has no underlying duty to indemnify the general contractor or developer. However, even if such a contract provision were permissible, under the applicable presumptions for interpretation of indemnity agreements under California law, an indemnity provision requiring a subcontractor to undertake such a duty to defend must be set out clearly in the contract. It is an onerous (and ASA submits, illegal) proposition for subcontractors to agree to defend negligence that is the sole responsibility of others. The decision of the Court of Appeal lowers the threshold for interpreting indemnity agreements to the much more liberal standard found in insurance law.

The presumptions for interpreting insurance contracts and for interpreting indemnity agreements run in opposite directions. While insuring clauses are broadly construed in favor of coverage and include claims that are potentially covered (*Buss v. Superior Court* (1997) 16 Cal.4th 35, 46.), indemnity agreements are strictly construed against the indemnitee. (*Goldman v. Echo-Phoenix Elec. Corp.* (1964) 62 Cal.2d 40,

49; *Heppler v. J.M. Peters Co.* (1999) 73 Cal.App.4th 1265, 1277 n.8.) Moreover, insurers have a "distinct and free-standing duty to defend their insureds." (*Mel Clayton Ford v. Ford Motor Co.* (2002) 104 Cal.App.4th 46, 57.) In contrast, an indemnitors' duty to defend is not triggered until it is determined that the proceeding against the indemnitee is "embraced by the indemnity." (Civ. Code, § 2778(4); *Heppler*, *supra*, 73 Cal.App.4th at p. 1282; see also *Regan Roofing Co. v. Superior Court* (1994) 24 Cal.App.4th 425, 436-37 [duty to defend does not arise until there is a finding of liability against the indemnitor].)

Though the Court of Appeal purported to distinguish the situation at bar with the insurance context, the court relied heavily on cases dealing with an insurer's duty to defend as independent of its duty to insure. (*Crawford, supra*, 136 Cal.App.4th at pp. 330-32, 339.) For example, the Court of Appeal cited to a passage from *Gray v. Zurich Ins. Co.* (1966) 65 Cal.2d 263, a case dealing with the scope of an insurance company's duty to defend an insured, which it said "absolutely demolishes the idea that any 'defense' obligation can be made dependent on a later determination of a duty to 'indemnify'..." (*Crawford, supra*, 136 Cal.App.4th at p. 339.) Despite recognizing the difference between indemnity and insurance presumptions, the Court of Appeal applied the insurance interpretive standard to the indemnity provision in this case by broadly construing the provision in favor of finding an expansive duty to defend.

The error in the Court of Appeal's interpretation of the indemnity agreement is further demonstrated by the fact that the identical J.M. Peters Co. indemnity provision was previously litigated and decided in *Heppler v. J.M. Peters Co., Inc.* (1999) 73 Cal.App.4th 1265. The Court of Appeal in *Heppler*, however, arrived at the opposite conclusion. In *Heppler*, the court of appeal found, under the indemnity language, that actual negligence on the part of the subcontractor was required before the subcontractor's

obligation to defend and indemnify the general contractor arose. (*Id.* at pp. 1277-78.) The *Heppler* court concluded that there was no specific contractual language in the contract providing for an indemnity obligation in the absence of the subcontractor's negligence. (*Id.* at p. 1278.) In the absence of such language, "the notion there was a meeting of minds that these subcontractors would be liable if they were not negligent does not pass scrutiny. Rather, it is much more credible the parties intended the subcontractors' indemnity obligation to arise only if the subcontractors performed negligently and caused damage. Contracts should be read in a manner that renders them reasonable and capable of being put into effect." (*Id.* at p. 1278.)

The *Heppler* court applied the indemnity presumption against the indemnitee, while in the present case the Court of Appeal applied the insurance presumption in favor of coverage. The indemnity presumption against the indemnitee is important in the construction industry due to the unequal bargaining position between subcontractors and developers/general contractors in contract negotiations. The *Heppler* court recognized the danger of subcontractors being saddled with unanticipated liability in contravention of "public policy and decisional law, which imposes vastly different responsibility on a developer versus a subcontractor. In a case such as this, plaintiffs' position would have the effect of transferring Peters' strict liability as a developer to the subcontractors, without the use of specific contractual language that unambiguously manifested this intent." (*Id.* at pp. 1278-79.)

The Court of Appeal decision incorrectly lowers the threshold for indemnity interpretation to the insurance contract level. Even if an indemnity provision requiring a non-negligent subcontractor to defend a general contractor or developer were enforceable, which ASA strongly disputes, the language creating the obligation would have to be clear

enough to put the subcontractor on notice of the extent of the risk it is undertaking. The indemnity provision in this case does not meet this standard. Therefore, the strict presumption against indemnity must apply.

CONCLUSION

Civil Code section 2782 bars general contractors and developers from requiring their non-negligent subcontractors to defend them in litigation. Plaintiffs'-Respondents' attempt to enforce such a defense violates section 2782's proscription against receiving indemnity for one's sole negligence. Moreover, allowing general contractors and developers to pass on responsibility for maintaining the safety and quality of construction projects to blameless subcontractors violates California public policy. The legislature has seen fit to invalidate such contractual "agreements" for the benefit of the public. This is the Court's opportunity to make clear to contractors that they cannot circumvent California's anti-indemnity law by characterizing defense as separate from the underlying indemnity obligation. ASA, on behalf of its members and as *Amicus Curiae* herein, respectfully requests that this Court reverse the decision of the Court of Appeal.

Dated: November 28, 2006

Respectfully submitted,
LAW OFFICES OF
CRAWFORD & BANGS, LLP

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CERTIFICATION OF WORD COUNT

Pursuant to California Rules of Court, Rule 14(c), I certify that the text of this brief consists of 3,338 words as counted by the Microsoft Word 2003 word-processing program used to generate the brief.

I declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct. Executed in Covina, California on November 28, 2006.

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E. Scott Holbrook, Jr.