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Restrictions On Indemnity In Construction Contracts

One of the key risk management tools for contractors is the use of indemnity provisions in contracts. The laws surrounding indemnity, however, are constantly evolving, most recently with the California Legislature's enactment of Civil Code Section 2782.05.

Section 2782.05 prohibits construction contracts that require a subcontractor to indemnify a contractor for the "active negligence" of the contractor or the contractor's agents or independent contractors. Under prior law, indemnity agreements that purported to indemnify a contractor for that contractor's own sole negligence or willful misconduct were already void in California. In addition, since 2009, residential construction contracts could only require a subcontractor to indemnify the contractor to the extent of the subcontractor's negligence—commonly known as Type III indemnity. Section 2782.05 effectively expands these limitations.

As a result, for all construction contracts entered into after January 1, 2013, a contractor can no longer seek indemnity from a subcontractor for any active negligence or willful misconduct of the contractor. Active negligence is not defined in the statute, and while it is often determined on a case-by-case basis, active negligence has generally been defined in case law as "an affirmative act of negligence" where a contractor "has failed to perform a precise duty for which [it] had agreed to perform."

In addition, the statute sets forth procedures a contractor must follow to perfect a defense demand to a subcontractor. Under Section 2782.05(e), a contractor's tender must now include an itemization of the claims caused by the subcontractor's scope of work as well as an explanation of how defense fees and costs will be allocated. Upon receipt of this tender, the subcontractor has two options to defend the contractor: defend the claims with counsel of its choosing (and maintain control of the defense) or pay its allocated share of the contractor's defense costs. Section 2872.05, however, does not alter any defense obligations a subcontractor's insurer may owe to a contractor as an additional insured.

Finally, there are expanded limitations on indemnity provisions in public works contracts. Public entities cannot require contractors to provide indemnity for the public entities' active negligence and contractors, in turn, cannot seek such indemnity from their subcontractors in public works projects.

Given the importance of having a strong, enforceable indemnity provision, it is critical to ensure continued compliance with evolving indemnity laws. If you have any questions regarding indemnity provisions in any of your existing or potential contracts, please contact Jordan Nager in LGC's San Diego office.

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New Case Clarifies Insurer's Duty To Settle

In *Reid v. Mercury Insurance Company*, (2013) 220 Cal.App.4th 262, the Court of Appeal held that an insurance company may, under some circumstances, not have a duty to initiate settlement discussions to ensure settlement within policy limits.

In the case, Mercury's insured ran a red light and stuck another vehicle, causing serious injuries to Paul Reid. Mercury disclosed the $100,000 policy limits to Mr. Reid's attorney, but indicated it needed medical records and a statement from Mr. Reid before it could settle the case. Mr. Reid's attorney did not formally demand the policy limits at that time because he felt it would be pointless given Mercury's insistence on more information.

Mr. Reid filed suit against Mercury's insured several months later. Mercury then offered the policy limits, which was declined. Mr. Reid ultimately obtained a $5.9 million verdict, and, after receiving an assignment from the insured, initiated an action against Mercury for the excess verdict.

The trial court granted Mercury's Motion for Summary Judgment, and the Court of Appeal affirmed. (Continued on Page 4)

LGC Client Obtains Victory In Ongoing Stop Notice Action

In *National Financial Lending v. Superior Court*, (2013) 222 Cal.App.4th 262, long-time LGC client Brady Company obtained an appellate victory in its long-standing stop notice case. The case arises out of the development of a condominium project in San Diego known as Mi Arbolito. Brady and other contractors and material suppliers performed work at the project but were not paid.

Brady and the other contractors originally sued the developer, Mi Arbolito, LLC, and the construction lender, Point Center Financial, Inc. ("PCF"). Unlike most of the unpaid contractors, Brady served a stop notice on PCF, instructing PCF to withhold loan distributions pending payment to Brady. Thus, when Mi Arbolito, LLC filed for bankruptcy, Brady was still able to pursue PCF for failing to abide by the stop notice.

After a trial led by LGC partner Ted Cercos and associate Paul James, Brady, along with the other stop notice claimants, obtained a $2.7 million judgment against PCF. Brady and the other judgment creditors then proceeded with collection efforts.

Those collection efforts ultimately led to the appointment of a limited receiver, as well as a motion against National Financial Lending, LLC ("NFL"), a third-party entity wholly controlled by the judgment debtor, to recover funds wrongfully transferred to the judgment debtor after NFL was served with a levy.

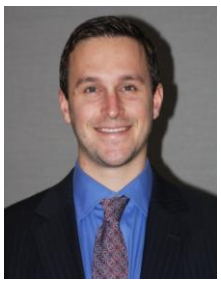
In response to the motion to enforce the levy, counsel for NFL filed a peremptory challenge to disqualify the trial judge, who awarded the judgment and appointed the limited receiver, on grounds of bias. After the peremptory challenge was denied, NFL filed a petition for writ of mandate requesting the Court of Appeal to reverse the ruling on the grounds that the motion to enforce the levy constituted a special proceeding independent of the main action, which entitled NFL to challenge the judge.

Working with appellate attorney David Niddrie, Brady and the judgment creditors prevailed against NFL's writ. In denying NFL's writ, the Court of Appeal held that the judgment creditors' motion to enforce the levy against NFL did not constitute a separate "special proceeding" independent of the underlying action. Furthermore, even if the motion to enforce the levy qualified as a special proceeding, the Court held that the ruling on the motion was based substantially on the same facts as the earlier motion for appointment of a receiver, and thus was merely a continuation of that post-judgment proceeding.

Brady's ongoing case emphasizes two important issues for contractors and judgment creditors. First and foremost, the case demonstrates the importance of properly serving a stop notice. Without that stop notice, Brady and the other judgment creditors would not have been able to obtain their initial $2.7 million judgment. Second, this case demonstrates the broad power of some of the collection tools at the disposal of judgment creditors, including receivers and levies.

For more information about the case, stop notices, or collection issues, please contact Paul James in LGC's San Diego office.

S.D. Office Welcomes New Associates


Phil Simpler


Patrick Klingborg

LGC's San Diego office welcomes the addition of new associates Patrick Klingborg and Phil Simpler. Patrick and Phil began as second-year summer law clerks with LGC's San Diego office while attending University of San Diego School of Law. After graduating from USD in 2013, Phil and Patrick passed the July bar exam and were admitted to practice in December.

Originally from Northern California, Patrick attended U.C. San Diego and obtained a B.A. in political science with a concentration in public law. While at USD Law School, Patrick was the Chair of the Appellate Moot Court Board and competed nationally in moot court competitions. Since joining LGC, Patrick has worked on a variety of civil litigation matters, including personal injury claims, contract disputes, and product liability claims.

Phil, meanwhile, is originally from Virginia and attended the College of Charleston where he earned his B.A., magna cum laude, in economics with a minor in business administration. At LGC, Phil is representing clients in personal injury, estate planning, construction defect, and intellectual property matters.

Phil and Patrick also maintained a notable streak in the history of LGC: no summer clerk in LGC's San Diego office has ever failed the California bar exam.

Congratulations to Phil and Patrick.

LGC Hosts Successful Small Business Seminar

Last month, LGC presented an educational seminar to small business owners that focused on a variety of legal issues relating to their business. The free seminar, which took place at the Mission Bay Yacht Club, was well-attended by a broad spectrum of local businesses.

After a short "meet and greet" and continental breakfast, the LGC attorneys got down to business and went through a host of pertinent topics that confront small business owners. The seminar began with a discussion of the pros and cons of different types of business entities, from sole proprietorships to corporations. Next, there was an in-depth discussion on employment-related issues with practical advice on how to deal with a variety of situations and new laws affecting employers. Finally, there was a discussion on ways to protect your business, ranging from indemnity language to insurance to protective contract language.

After the presentation, time was reserved for questions and answers, and all attendees were given a packet of information on the topics that were covered. Special thanks to Randy Gustafson, Teresa Beck, Jill Dickerson, Paul James, Darcie Colihan and moderator Tom Lincoln for all their efforts.

LGC is committed to helping small businesses. It will be putting on these free seminars from time to time so that the owners of these businesses can get access to lawyers in an informal setting where they can ask questions and discuss their issues. LGC is thankful for the opportunity and ability to help and wants to give back to the community as best it can.

S.D. Superior Court Completes Civil Case Consolidation

Effective January 13, 2014, Hon. Eddie Sturgeon moved from the East County Division of the San Diego Superior Court to the Central Division. Judge Sturgeon was the only remaining judge of a civil department in the Eastern Division of the San Diego Superior Court.

The move marks the end of a one-year effort to consolidate most civil operations of the San Diego Superior Court to the Central Division, located downtown. As described in a statement issued by the Superior Court, the consolidation and reduction was taken "to meet the unprecedented $33 million in budget reductions it has faced over several fiscal years." In September of 2012, the Court announced the closure of civil operations in both the East County Division (located in El Cajon) and the South County Division (located in Chula Vista).

As a result of the closures, the only departments hearing civil cases in San Diego Superior Court are located in the Central Division and the North County Division (located in Vista). All cases formerly pending in the Eastern and Southern Divisions have been transferred to the Central Division.

For future cases, any civil suit that would have otherwise been filed in the Eastern or Southern Divisions must now be filed in the Central Division.

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Upcoming Partner Presentation

Partners Teresa Beck and Jill Dickerson will be speaking at the Annual Conference of the Claims & Litigation Management Alliance ("CLM") in Boca Raton, Florida. The CLM Annual Conference features more than 80 collaborative educational sessions and keynote presentations designed by industry professionals to help attendees gain the knowledge they need to be on the forefront of the industry. Teresa will be presenting "The Jury Speaks: 2013 Jury Verdicts & What We Can Learn From Them." Jill will be presenting "How To Spot The Reptile Effect Before It's Too Late." For more information, click here or contact Teresa or Jill.

Insurance Appellate Decision

(cont. from page 1)

The Court held that an insurer can only be liable for bad faith failure to settle within policy limits when (1) the injured party communicated an interest in settlement to the insurer; (2) the insurer knew that settlement within policy limits was feasible; or (3) the insurer's conduct actively foreclosed the possibility of a settlement. None of these circumstances were present in this case, so the Court affirmed.

While Mercury prevailed in this case, insurers should nonetheless take care to actively attempt to resolve claims within policy limits. Given the broad factors listed by the Court, there may be a duty in some circumstances to settle even without a formal demand.

Please contact partner Chris Schmitthenner with any questions about the case.

Statute Of Limitations Issues In California With Dissolved Foreign Entities

Many states have statutes of limitations applicable to lawsuits against dissolved corporations. California, however, does not. Rather, California Corporations Code Section 2010, commonly referred to as California's "survival statute," states that "a corporation which is dissolved nevertheless continues to exist for the purpose of…prosecuting and defending actions by or against it." In other words, a California corporation can still be sued in California at any time after it has been dissolved, provided no other statutes of limitation apply to the particular causes of action at issue.

Under Corporations Code Section 2011(a), a California court can enforce an action against a dissolved corporation "to the extent of its undistributed assets, including, without limitation, any insurance assets held by the corporation that may be available to satisfy claims." Therefore, because there is no statute of limitations on actions against California corporations, insurance carriers can be held responsible for indemnifying dissolved California corporations long after they dissolve.

In February of 2013, however, the California Supreme Court crafted an exception to this general rule in *Greb v. Diamond International Corporation*, (2013) 56 Cal.4th 243, holding that California's survival statute does not apply to corporations that were incorporated in other states. Such corporations are referred to as foreign corporations. Under *Greb*, a dissolved foreign corporation is subject to its *home state's* statute of limitations on suits against dissolved corporations. Based on this finding, the *Greb* court dismissed a California lawsuit against a Delaware corporation because Delaware's three-year statute of limitations on suits against dissolved corporations had expired.

The *Greb* decision has been particularly significant in the context of construction defect cases because many contracting corporations dissolved during the economic downturn. Prior to *Greb*, general contractors could seek indemnity from dissolved foreign subcontractors long after the subcontractors dissolved, and the subcontractors' insurance carriers often provided coverage.

Now, under the current law, dissolved foreign subcontractors are protected by their home states' statutes of limitations on actions against dissolved corporations – limitations that are often much shorter than California's 10-year statute of limitations in construction defect cases. The *Greb* decision can therefore make it much more difficult to settle construction defect cases by reducing the number of parties and insurance carriers available to contribute funds toward a settlement.

If you have any questions about the *Greb* case, please contact Rich Reese in LGC's San Diego office.