Point/Counter-Point: May a General Contractor Require Subcontractors to Provide Insurance Covering General Contractor’s Active Negligence after January 1, 2013?

SB 474 became effective on January 1, 2013. That section does not particularly identify any additional insured endorsement ("AIE") that is no longer allowed by law. Indeed, some question whether SB 474 affects insurance requirements, whatsoever. In this point/counterpoint article, Daniel F. McLennon and Craig Wallace of McLennon Law Corporation debate whether general contractors may still require the CG 2010 11/85 “gold standard” AIE, which provides insurance covering the active fault of the general contractor.

Dan McLennon:

By my reading of SB 474, the legislature plainly intended to prevent general contractors from obtaining coverage for their own active fault by requiring additional insured status on their subcontractors’ insurance. In my role as Government Relations Chairman for the American Subcontractors’ Association of California, I had the pleasure of speaking with Senator Evans’ staff about this very issue, and staff confirmed adamantly the Senator’s intent that SB 474 not only prevents indemnity requirements, but also insurance requirements that would protect the general contractor from its own active negligence.

Notwithstanding the opinions and intentions of the author and the author’s staff, how is a court likely to rule? My sense is that a court will probably hold that general contractors may no longer require subcontractors to provide CG 2010 11/85 endorsements.

Legislative History

Let’s start with SB 474’s stated intent:

First, section one declares a broad legislative intent that parties to a construction contract be responsible for their own fault and damages they cause:

SECTION 1. The Legislature finds and declares that it is in the best interests of this state and its citizens and consumers to ensure that every construction business in the state is responsible for losses that it, as a business, may cause.

If a general contractor is to be made responsible for its own active fault, it should feel this responsibility in its pocketbook. It does not feel the pain if the subcontractor’s insurance policy pays for the general contractor’s active fault, because the subcontractor, and not the general contractor, pays the premium increases that result from any losses.

Moreover, the legislative intent as recorded in the very first of ten paragraphs of the bill analysis states this bill:

1. Prohibits construction contracts requiring indemnity, insurance, or defense obligations by a subcontractor for the active negligence or willful misconduct of a general contractor, his/her agents, or other subcontractors, as specified. http://www.leginfo.ca.gov/pub/11-12/bill/sen/sb_0451-0500/sb_474_cfa_20110907_133912_sen_floor.html

The Statute’s Plain Language

Moving on to the new law, Section 2782.05 (a) provides, paraphrased, that except as provided in subdivision (b), provisions, clauses, covenants and agreements contained in, collateral to, or affecting any construction contract entered after January 1, 2013 that purport to insure or indemnify, including the cost to defend a general contractor from claims for damage to person or property are void an unenforceable to the extent that they arise out of the active negligence or willful misconduct
of the general contractor.

By this language, I believe the Legislature must have intended to prevent general contractors from obtaining insurance from subcontractors for the general contractor’s active fault, because insurance is specifically referenced here. Also, I believe that additional insured endorsements (which are amendments to insurance policies that trigger insured status for the additional insured) are “collateral to” the construction contracts that require them.

For example, with respect to AIEs for public agencies, Insurance Code section 11580.04, which has been part of the law since 1997, acknowledges that additional insured endorsements may be “collateral to” construction contracts, and it specifically outlaws AIEs that would provide indemnity for the additional insured public agency’s active negligence:

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Any additional insured endorsement issued by an admitted or nonadmitted insurer for the benefit of a public agency in connection with, collateral to, or affecting any construction contract to which the provisions of subdivision (b) of Section 2782 of the Civil Code apply, shall not provide any duty of indemnity coverage for the active negligence of the additional insured in any case where an agreement to indemnify the additional insured would be invalid under subdivision (b) of Section 2782 of the Civil Code.
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Some believe that the reference in section 2782.05 to *Presley Homes, Inc. vs. American States Insurance Company* (2001) 90 Cal.App.4th 571 suggests that the Legislature meant to exempt insurance policies from SB 474. I do not read the reference to *Presley Homes* that way. Rather, *Presley Homes* held that an additional insured is entitled to a complete defense, same as the named insured. The developer in *Presley Homes* was entitled to defense for its own active fault, even though it did not have the right to indemnity coverage for its own fault. It happened that the additional insured endorsement was not limited in *Presley Homes*, and therefore, the defense obligation of the carrier was similarly not limited.

I agree that if a carrier does issue a CG 2010 11/85 endorsement after SB 474, that endorsement may be enforceable (some argue opposite). However, if a subcontractor refuses to supply such an endorsement, the subcontractor would not be liable for breach of a subcontract that required it to provide the CG 2010 11/85 endorsement, because that requirement would be unenforceable.

**Only Limited AIE Allowed**

Further support for this position is found in subsection (b)(6). Section 2782.05, subdivision (b) states specifically that the prohibitions found in subdivision (a) do not apply to subdivision (b). Subsection (b)(6) provides that a construction contract may require a subcontractor to purchase or maintain AIEs covering the actions or omissions of the promisor, the subcontractor, during ongoing and completed operations. In other words, subdivision (b) carves out from the general prohibition in subsection (a) AIEs that cover the actions or omissions of the subcontractor. It does not carve out an AIE that would provide coverage for the acts or omissions of the promisee, the general contractor, so those remain prohibited under section (a). A CG 2010 11/85, if provided, would provide coverage for the active negligence of the general contractor by the subcontractor’s insurer. Since there is no exception in subdivision (b) to allow an AIE in favor of the general contractor to protect it from its own active fault, a subcontract requirement for such an endorsement would remain prohibited under SB 474, subdivision (a).

**Conclusion**

I believe the courts would not enforce a clause in a subcontract requiring a subcontractor to provide a CG 2010 11/85 additional insured endorsement, because the statute plainly prohibits requiring a subcontractor to provide an insurance policy collateral to a construction contract.

**Craig Wallace:**

Dan makes an appealing argument, but a closer look at the context and language of the statute reveals it did not accomplish what Dan contends the Legislature intended. A careful look at the bill’s history and the statute’s language reveal that it applies only to a construction contract and not
at all to an insurance policy.

**Legislative History**

I disagree that the bill’s “Section I” preface suggests that the statute affects insurance. This preface is not in the statute itself, but the bill. In addition, it does not use the word “insurance” anywhere. This preface does not does not provide that a business is responsible for its “own” fault and damages as Dan urges. Instead, it declares that it is a good thing that all businesses are responsible for the losses they may cause. When a general contractor requires its subcontractors to indemnify it and provide insurance, it is making sure that it, a as business, is responsible for losses it may cause to its clients or third parties. Indeed, the preface could be argued as supporting the requirement for comprehensive insurance. While that may be overreaching, I think arguing that the preface demonstrates an intent to apply to and limit insurance is also overreaching.

**Earlier Case Law Separates Contracts from Policies**

Argument similar to Dan’s was considered and rejected regarding the old law that SB 474 supplements:

> By its express terms, section 2782 limits the scope of potential indemnity promises in construction contracts . . . What these arguments ignore is that we do not have before us a dispute about the enforcement of an indemnity provision in a construction contract. The dispute presented in this case involves the enforcement of the additional insured endorsement to a liability policy issued by American. That insurance policy is an entirely separate contract and its enforcement is expressly not limited by section 2782. American Cas. Co. of Reading, PA. v. General Star Indem. Co. (2005) 125 Cal.App.4th 1510, 1523-1524.

**Statute’s Plain Language Applies to Contracts, Not Policies**

Section 2782.05(a), by its terms, applies only to “construction contracts.” As Dan suggests (citing “staff” hearsay), while the Legislature may well have intended to preclude a contractor from having the benefit offered through the broad CG 2010 11/85 type additional insured endorsement (“AIE”), it did not accomplish this with the current section 2782.05. Moreover, the Legislature knows the difference between a contract and insurance. If the Legislature intended to have this law reach insurance, there was certainly an easier, clearer, and more direct way to do it, i.e., just add the phrase “and including insurance contracts.”

Turning to the statute, the phrase, “that purport to insure or indemnify, including the cost to defend” in section 2782.05(a) is limited to the “construction contract” itself and does not have the intent of making this section reach all separate insurance contracts. Subsections 2782(a), 2782(b)(1) and (2), and (c)(1) were amended as part of SB 474 also. They are each markedly similar and consistent with 2782.05 in that they purport to preclude a contractual requirement for Type I indemnity. They only differ in which party is affected and what indemnity is precluded. They preclude indemnity by a contractor for an owner’s sole or willful negligence, of a public agency’s active negligence, or a non-contractor owner’s active negligence, whereas 2782.05 precludes such indemnity by a subcontractor for a general contractor’s or project manager’s active negligence. The 2782 subsections do not include the phrase in 2782.05, above.

If the addition of the phrase “purport to insure or indemnify” makes 2782.05 applicable to insurance policies, then, the omission of the phrase in subsections 2782(a), 2782(b)(1) and (2), and (c)(1) necessarily means those sections do not prohibit a contractual requirement to provide insurance for such active negligence. It would not make sense for the Legislature to intentionally preclude Type I indemnity via the subsections in 2782, but nonetheless intentionally (via omission of the phrase) permit such entities to require those working for them to provide insurance coverage for the active negligence of those entities. Accordingly, it would not make sense to conclude that the phrase reaches beyond a construction contract to an insurance policy.

Moreover, that section 2782 is limited to the “construction contract” is driven home by the phrase, in 2782(a), “this section shall not affect the validity of any insurance contract . . . .” (emphasis added.) Subsection 2782.05(i) has similar language (“[t]his section shall not affect the validity of any existing insurance contract or agreement . . . .”). These references in the statutes demonstrate the
Legislature knows what an insurance contract is and how to describe it. That they specifically addressed an insurance contract in one part of the statute means it was not just an oversight that they did not address an insurance policy in another section. So, again, Dan’s interpretation would mean the Legislature specifically intended to preclude Type I indemnity yet specifically intended to allow a contractual requirement for an insurance policy to provide the same Type I indemnity protection for everyone except subcontractors. That the Legislature intended this divergent result would not make sense.

Other language in section 2782 demonstrates this section was not intended to apply to insurance at all. Subsection 2782(c)(1) provides, “[a construction contract cannot] purport to impose on any contractor, subcontractor, or supplier of goods or services, or relieve the owner from, liability” for the private property owner’s active negligence. It is apparent that “construction contract” does not include an insurance policy because a contractual requirement requiring one to provide insurance for the owner would not “impose” any “liability” on any of the listed entities. Indemnity clauses, and not insurance policies, do purport to impose liability on another; subsection (c)(1) is directed at an indemnity clause in a construction contract. Also, if any liability is imposed by an insurance requirement, it is imposed upon the insurer, not one of the listed entities.

Well Craig, you ask, if your analysis is correct, why the differing language between 2782 and 2782.05? Glad you asked. As I posit, based on the analysis above, it does not appear section 2782 was intended to effect insurance policies, but only construction contracts. If we look at a subsection of 2782, specifically 2782(d), we find the phrase which Dan suggests made 2782.05 applicable to insurance policies, “that purport to insure or indemnify, including the cost to defend.” Subsection 2782(d) pre-existed section 2782.05(a) and, due to the drafting similarities of the two subsections, it appears the drafters of 2782.05(a) simply borrowed the pre-existing language for their new statute. This is not new language added for purpose of making 2782.05(a) reach beyond “construction contracts” to also apply to a subcontractor’s insurance policy. As I noted before, if that was the intent, there was certainly an easier, clearer, and more direct way to do it, i.e., just add the phrase “and including insurance contracts”. It appears more likely the Legislature was addressing only “construction contracts” and what those contracts could or could not require, and in so doing, cast a wide net to preclude efforts to merely circumvent or draft around the statutory language.

The Legislature must have recognized that AIEs were not clearly prohibited by 2782, because the Legislature added section 11580.04, which Dan quotes, to make clear that in limited instances AIE coverage is precluded. Tellingly, the Legislature did not add a section similar to 11580.04 to prohibit AIE coverage for general contractors’ active negligence.

AIEs Not “Collateral To”

Dan argues that an insurance policy may be “collateral to” a construction contract. Dan construes the phrase broader than I do. The statute should be viewed as a whole. It applies to “provisions, clauses, covenants, or agreements” in, collateral to, or affecting a construction contract. An insurance contract is not a “provision,” “clause,” or “covenant” within a construction contract. Nor is it an “agreement” “in” or “affecting” a construction contract. I say it does not “affect” the contract because the insurance policy has no bearing on the terms and conditions within the contract – they exist separate from one another – the insurance policy does not “affect” the contract. The insurance policy exists because the contractor wants insurance, not because of the “construction contract.”

I believe “collateral to” is included to preclude the crafty lawyer from making a separate contract, which is not the “construction contract” itself, but which a separate agreement that only addresses, for example, indemnity. “Collateral to” was not intended to be interpreted so broadly that it reaches every other agreement that the contractor might enter into to run his or her construction business, such as an insurance contract, a 401k agreement, an HR contract, a union CBA, or an office equipment lease contract. Once again, if the Legislature intended this to apply to insurance policies, it would have been as easy as adding, “and including insurance contracts.”

In addition, other parts of this statutory language weigh against its application to insurance. Paraphrased, it reads, clauses or agreements in (or collateral to) a construction contract that purport to “insure or indemnify, including the cost of defense,” a general contractor “by a
subcontractor against liability for claims” are void. The text prohibits an agreement to insure “by the subcontractor.” It does not prohibit insuring by an insurance company, but “by the subcontractor.” A subcontractor never “insures” a contractor, but is contractually required to provide insurance which will provide coverage to the contractor. Considered in context, this supports the notion that the Legislature used “insure” and “indemnity” to drive home protections for subcontractors, but not their insurance carriers.

AIE’s Not Limited

Dan finds support for his position in subsection (b)(6), the carve out for AIEs. Dan argues that because it carves out the allowance of an AIE for a subcontractor (“promisor”) for its own acts, it precludes such an AIE for the contractor (“promisee”). I say this subsection is silent as to an AIE providing insurance for the promisee so has no effect at all, and I note that subsection 2782.05(a) provides “[c]ontractual provisions, clauses, covenants, or agreements not expressly prohibited herein are reserved to the agreement of the parties.”

Conclusion

So, in short, it would not make sense for the Legislature to treat subcontractors (in 2782.05) differently than contractors (in 2782). To interpret section 2782.05 to apply to insurance policies as “collateral to” a construction contract suggests section 2782 is not applicable to insurance policies, and that this was done intentionally. That does not make sense. It is more likely the Legislature was focusing only on construction contracts, and not insurance policies, because if it was seeking to address insurance policies, it could have done so much simpler and clearer.

—Daniel F. McLennon

—Craig Wallace

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