



# Personal Insurance Federation of California

California's Personal Lines Trade Association

REPRESENTING THE LEADING AUTOMOBILE AND HOMEOWNERS INSURERS  
State Farm • Farmers • 21st Century Insurance Group • SAFECO • Progressive

## MEMORANDUM

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Date: April 23, 2004

To: The Honorable Ellen Corbett, Chair  
Members, Assembly Judiciary Committee

From: Dan C. Dunmoyer, President  
G. Diane Colborn, Vice President of Legislative and Regulatory Affairs  
Michael A. Gunning, Senior Legislative Advocate

RE: AB 2804 (Calderon): Construction Defects  
Assembly Judiciary Committee Hearing: May 4, 2004  
**PIFC Position: Support**

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The Personal Insurance Federation of California (PIFC), which represents insurers who provide construction dispute resolution insurance to subcontractors throughout the state of California, **supports AB 2804** by Assembly Member Calderon.

AB 2804 (Calderon), among other things, would provide that all agreements affecting any residential construction contract that purports to indemnify against liability for *all* actual defects claims are against public policy, void, and unenforceable. Furthermore, the bill provides that any insurance contract for residential construction dispute resolution that names an additional insured limits the duty to defend the additional insured to only those claims and causes of action that arise out of the named insured's construction contract.

PIFC represents insurance companies that offer insurance to subcontractors throughout the state of California. Currently, the cost of general liability insurance for subcontractors is skyrocketing out of control. Insurance costs are escalating for subcontractors due in large part to two factors: Type I indemnity agreements between subcontractors and developers; and the recent Court of Appeals decision in *Presley Homes, Inc v. American States Insurance Company* (90 Cal.App4th571).

### Type I Indemnity

In the construction arena, developers are currently forcing subcontractors to contractually indemnify the developers for losses where the subcontractor is less than 100% negligent. In the case of what is known as a "Type I indemnity agreement," the subcontractor must sign a contract agreeing to indemnify the developer for losses arising out of the negligence or willful misconduct of the developer. Under these contractual agreements, the only losses for which the subcontractor is not responsible are those resulting from the sole and exclusive negligence and/or willful misconduct of the developer. In other words, if the developer is 99% negligent and the subcontractor is 1% negligent, the subcontractor must indemnify the developer for the entire loss. If the subcontractor does not agree to such a contract, the developer will simply look for another subcontractor, essentially shopping for a willful participant.

As a result of Type I indemnity agreements, subcontractors are typically required to procure “Additional Insured Endorsements” (AIEs) which essentially amend the subcontractor’s insurance policy to name the builder as an additional insured. Contributing to the increasing risk and loss of the subcontractor insurance market is Civil Code Section 2782, which effectively prevents an insurance company from confining the scope of their liability specifically to damages directly caused by the insured subcontractor.

### **Court of Appeals Decision**

In the recent *Presley Homes, Inc.* decision (90 Cal.App4th 571), the Court of Appeals held that the insurance company which issued the subcontractor’s AIE must defend the developer for all claims regardless of whether those claims are related to the subcontractor’s work. As a result of this decision, subcontractor insurance carriers are forced to incur defense costs for defective work that the subcontractor did not perform. Thus, the liability for subcontractor insurance carriers has been expanded to the point where the insurance carrier is liable for work that the insured subcontractor did not perform at all.

By declaring Type I indemnity agreements void and unenforceable, as contrary to public policy, and repealing the unfair shift of liability resulting from the *Presley* decision, AB 2804 will provide relief to the general liability insurance market by confirming liability specifically to damages caused by an insured subcontractor. PIFC is well aware that there needs to be balance brought to this area in California law. Although current law has certainly shifted the balance unfairly against subcontractors and those who insure subcontractors, it is very important that any law constructed to address this issue take into account that subcontractors do generate defective material from time to time. As a result, subcontractors, as well as those who insure subcontractors, need to be held responsible for the defects which they have caused. Put more simply, balance needs to be brought back to the system but it needs to be brought back in such a way that it does not unfairly shift the burden to the contractors or other subcontractors.

PIFC is committed to working with all parties involved-- contractors, subcontractors, trial lawyers, labor trades and other important affected parties -- to ensure that balance can be brought back to the construction dispute resolution process to ensure that all parties are fairly treated, that responsible parties pay for the damages or problems they have caused, and that parties who hold no responsibility for damages caused have minimal or no costs associated with the construction dispute resolution process.

For the reasons stated above, **PIFC supports AB 2804 and urges your yes vote.** If you have any questions regarding our position on this measure, please contact Dan Dunmoyer at (916) 442-6646.

cc: Assembly Member Calderon, Author  
Consultant, Assembly Judiciary Committee  
Mark Redmond, Assembly Republican Caucus  
Cynthia Bryant, Office of the Governor  
Scott Reid, Office of the Insurance Advisor