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# Construction Update

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## When The Solution Becomes the Problem

In this issue of the Lewis Brisbois Bisgaard & Smith Construction Law Newsletter, we address some of the biggest issues facing our clients and attorneys, both inside the insurance industry and in the construction arena.

In an effort to streamline the dispute resolution process, the Nevada Legislature passed a series of statutes providing for a pre-filing process. This was meant to promote the resolution of construction defect disputes before they bloomed into full fledged lawsuits. As our Las Vegas partner, Jeffrey Ballin, highlights, the cure has now become the problem.

The California Court of Appeals Fourth District's finding that parties to a construction contract can, and do, contract separately for indemnity and defense of claims arising out of a subcontractor's work is also discussed in detail by Bridget Childs, of our San Francisco Office. Only time will tell the extent to which this decision will affect other areas of law.

As always, Lewis Brisbois Bisgaard & Smith strives to keep its clients current on the most recent developments and changes in relevant areas of law. We actively solicit your ideas on any topic you would like to see addressed in this newsletter.

*Karl R. Loureiro  
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## NRS 40.600 ET SEQ. - The Nevada Bulldozer

By: Jeffrey H. Ballin, Esq.

A frequently asked question, among attorneys, contractors/subcontractors, and insurance professionals, is, "Why don't construction defect cases in Nevada settle amid the NRS 40.600, et seq. process?"

NRS 40.600 to NRS 40.695, inclusive, are the collection of, confusing and confounding, statutes that govern construction defect litigation in Nevada. Although envisioned as a vehicle by which contractors/subcontractors could repair their handiwork and avert litigation, it is, in reality, a "bulldozer" that has crushed the construction and insurance industries in Nevada.

Key points include:

1. Before a claimant can commence a construction defect suit, the contractor must be put on notice of the defects. If the contractor is out of business, the claimant may put the subcontractors, suppliers and design professionals on notice.
2. If the notice involves multiple claimants in a development, the notice must contain an expert opinion based on a valid and reliable representative sample of the common defects.
3. Within 30 days after the contractor receives notice of a claim, the contractor must put its subcontractors, suppliers and design professionals on notice. If contractor fails to give the requisite notice, its claim against the subcontractors, suppliers and design professionals is waived.
4. Before an action can be commenced, the claimant must give the contractor, subcontractor, supplier or design professional a reasonable opportunity to inspect and repair the defects.
5. Within 90 days after the contractor, subcontractor, supplier or design professional receive notice of the defects, it must state, in writing, whether it intends to (a) repair the defects, (b) make a monetary offer, or (c) disclaim liability.
6. If the contractor, subcontractor, supplier or design professional fail to respond, the claimant may commence an action.
7. Contractors, subcontractors, suppliers, and design professionals have between 105 and 150 days to effectuate repairs (depending on the number of named and unnamed claimants involved).
8. The time frames espoused in NRS 40.600, et seq. can be expanded by stipulation of the parties.
9. The claimant is not required to give a release to the contractor, subcontractor, supplier or design professional that effectuates repairs.

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10. Insurers must treat NRS 40.600, et seq. claims the same way they treat civil actions.
11. The claimant is entitled to collect repair costs, relocation expenses, incidental expenses, attorney's fees, and expert costs.
12. If the claimant unreasonably rejects a settlement offer, the court may deny the claimant its attorney's fees and expert costs, and award the contractor, subcontractor, supplier or design professional its attorney's fees and expert costs.
13. If the contractor, subcontractor, supplier or design professional fails to comply with NRS 40.600, et seq., the limitations on damages and defenses set forth in NRS 40.600, et seq. do not apply.
14. Mediation is mandatory.
15. Insurance professionals can be compelled to attend settlement conferences and can be sanctioned if they fail to appear or negotiate in good faith.

The "bulldozer" has a self-perpetuating fuel source in that: (1) the time frames for inspecting/repairing are unrealistic for large projects, (2) the "valid and reliable representative sample of common defects" for multiple claimants is swathed in subjectivity, (3) the claimant that accepts repairs is not obligated to give the contractor/subcontractor a full release, and (4) the claimant's ability to collect attorney's fees and expert expenses, over and above repair costs, forces a sweetened offer of repair that the contractor/subcontractor can rarely digest.

Inasmuch as there is scant case law interpreting NRS 40.600, et seq., the war story is the best tool for illustration. In September 2002, I took on the representation of a roofer in a single family home case in which the claimant alleged roof leaks and mold. Attached to the NRS 40.645 Notice to Contractor was an architectural report that asserted, per a visual inspection, that the roofer had failed to properly repair a leak condition at the eaves, and an industrial hygienist's report that asserted, per clearance testing, that the house was contaminated. In response, my architectural expert agreed that the eave condition needed a tweak and espied a leak condition at the windows, and my industrial hygienist conducted clearance testing which did not reveal contamination.

In November 2002, the carrier for the (out of business) roofer offered, in accordance with NRS 40.645 the following: (1) to repair the condition at the eaves and remove/replace stained dry-wall, and (2) to pay a reasonable stipend for attorney's fees and costs (i.e. 50% of the cost of repair).

In January 2003, claimant's attorney summarily rejected the offer, asserting, without proof, that as a result of the roof leaks the entire house needed to be gutted, remediated, and put back together. Needless to say, intransigence and greed, facilitated by the potholes in NRS 40.600, et seq., caused the case, in June 2003, to go into suit. Now, nearly 2 ½ years and thousands of dollars later, the case is set to go to trial.

Clearly NRS 40.600 to NRS 40.695 have done nothing more than to "muddy up" the already turbulent construction defect waters in Nevada.



Jeff Ballin

# Off The Hook For Indemnity, On The Hook For The Cost Of Defense - The California Subcontractor's Catch 22

By: Bridget Childs

Your plumber client (insured) has agreed to 'indemnify' the general contractor she contracted with on construction of a private school 'from all claims for damages to persons or personal or real property arising out of its work' and 'to defend any suit or action brought against' the general contractor 'on the basis of such damage.' The subcontract includes a separate provision for recovery of attorneys' fees arising out of disputes regarding the subcontract.

Owner has sued general contractor who in turn has brought your client (and all the other subcontractors) into the circular firing squad known as a construction defect action.

What is your client's potential exposure to an obligation to defend the general? To indemnify the general? To pay attorneys' fees for the privilege of defending and indemnifying the general?

In *Crawford v. Weather Shield* (2006) 136 Cal.App.4th 304, the Fourth District Court of Appeals has provided construction counsel with a helpful (though lengthy) roadmap through the pitfalls of a subcontractor's express agreement to *defend* and *indemnify* developer general contractor.<sup>1/</sup> The Court focused on the obligation to *defend* – when negligence is a prerequisite to indemnity and the subcontractor is found not negligent and therefore does not owe indemnity, the subcontractor may still be on the hook for some or all of the general contractor's defense costs, depending on the subcontract's language and the number of parties to whom the defense of a particular defect or issue can be allocated. The Court provided a useful summary of relevant principles of express indemnity interpretation and jurisprudence. Lastly, the Court upheld the trial court's award of attorneys fees to the developer/general contractor, under the attorneys' fees provision in the subcontract, for prevailing on its prosecution of the contractual defense obligation against the non-negligent window manufacturer.

## Analysis A: The subcontractor's obligation to defend

In *Crawford*, 200 homeowners sued a subdivision developer over window leaks and fogging.<sup>2/</sup> Developer cross-complained against subcontractor window installer and subcontractor window manufacturer under an indemnity provision that provided that the subcontractor(s) agreed to:

defend and save [Developer] harmless against all claims for damages . . . and . . . loss . . . growing out of the execution of the work, and at his own expense to defend any suit or action brought against [Developer] founded upon the claim of such damage . . . .

At trial, the window installer was found negligent; the window manufacturer was found not negligent. On the basis of the 'no negligence' finding, the window manufacturer argued that it was not obligated to reimburse the general contractor for its costs of defense. The trial court ruled against the window manufacturer and the Court of Appeal upheld the trial court's ruling.

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<sup>1/</sup> For purposes of this article the distinctions between developers and general contractors will be ignored and the developer will be treated as a general contractor.

<sup>2/</sup> Of course, they sued over other issues too, but the only issues that went to trial were the window issues.

The focus of *Crawford* is on the obligation to defend, but the Court also reminds us of the significant principles that ground the analysis of an indemnity contract: (1) the parties' intention as expressed in the agreement controls their indemnity (and defense) obligations<sup>3/</sup> (2) the subcontractor's obligation to indemnify (and to defend) must be as narrowly construed as is permissible under the ordinary and plain meaning of the contract language,<sup>4/</sup> and (3) any obligation to *indemnify* (as distinct from an obligation to *defend*) requires a finding of negligence unless the contract has clear, explicit language to the contrary.<sup>5/</sup>

But in *Crawford*, the Court reasoned that the contractual obligations (1) to indemnify, and (2) to defend are legally distinct, and if set forth distinctly in the contract, must be distinctly analyzed. Therefore, depending on the language of the indemnity agreement and the facts of the case, a subcontractor might owe the general contractor the costs of the general contractor's defense (duty to defend), *and* some or all of the damages assessed against the general contractor by the trier of fact who finds for the plaintiff owner (indemnity). However, consistent with interpretation of indemnity contracts, "the *scope* of the duty to defend undertaken by the subcontractor will be the narrowest possible consistent with the contract language."<sup>6/</sup> A subcontractor's agreement to defend is *not* an agreement to reimburse defense costs only after it is found negligent – unless the subcontract says so.<sup>7/</sup>

Following *Continental Heller*<sup>8/</sup> and *Centex Golden Construction*<sup>9/</sup> on the issue of a subcontractor's duty to defend the contractor for claims *arising out of its work*, the Court held that under *these* facts and *this* indemnity agreement, the window manufacturer, Weather Shield, owed a duty of defense to the general contractor – because plaintiffs' claims of window fogging and leaks were claims relating to and growing out of the window manufacturer's work.

Under this contract, the obligations to defend and to indemnify were distinct, both under the obvious contractual language by which the subcontractor contracted to "defend and save [Developer] harmless against all claims for damages . . . growing out of the execution of the work" and (separately) "at his own expense to defend any suit or action brought against [Developer] founded upon the claim of such damage . . .". To indemnify someone is to compensate them for the money they paid out – "make good a loss or damage another has incurred" – because of the equities or because of one's contractual promise to do so.<sup>10/</sup> Utilizing a definition from the insurance coverage arena, *Crawford*

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<sup>3/</sup> *Rossmoor Sanitation, Inc. v. Pylon, Inc.* (1975) 13 Cal.3d 622, 633. In the construction context in California, the subcontractor's indemnity is limited by statute – the subcontractor (promisor) cannot be liable for damages arising out of the sole negligence of the contractor (promisee), or resulting from designs provided by the promisee or its agents or independent contractors. Civil Code section 2782, subd. (a).

<sup>4/</sup> E.g., *Goldman v. Ecco-Phoenix Elec. Corp.* (1964) 62 Cal.2d 40, 49. The *Goldman* Court understood that since the general contractor typically takes bids from competing subs, it occupies the better bargaining position. Thus, the subcontractors' obligations to indemnify the general contractor must be narrowly construed.

<sup>5/</sup> *Heppler v. J.M. Peters Co.* (1999) 73 Cal.App.4th 1265, 1278.

<sup>6/</sup> *Crawford v. Weathershield* (2006) 136 Cal.App.4th 304, 330.

<sup>7/</sup> *Id.* at 332.

<sup>8/</sup> *Continental Heller Corp. v. Amtech Mechanical Services, Inc.* (1997) 53 Cal.App.4th 500.

<sup>9/</sup> *Centex Golden Construction Co. v. Dale Tile Co.* (2000) 78 Cal.App.4th 992.

<sup>10/</sup> Civil Code section 2772.

reasoned that “to defend” means to “mount and fund a defense so as to avoid or minimize liability.”<sup>11/</sup> Unlike the duty to indemnify, which only arises when the indemnitee suffers a loss,<sup>12/</sup> the duty to defend accrues as soon as the request for it is made.<sup>13/</sup> The obligation to defend a claim ‘growing out of execution of the work’ anticipates that such a claim might be false, but requires the subcontractor to defend it, if it arises from his execution of the work<sup>14/</sup> and because it obliges the subcontractor to ‘defend any suit or action’ does not require a finding of negligence before the obligation to defend accrues.<sup>15/</sup> Based on this contract, the window manufacturer owed the developer a defense obligation when it was requested so long as it arose out of claims against the manufacturer’s work. As with any indemnity contract, the scope of the indemnitor’s obligation must be as narrowly construed as the language of the contract will allow.<sup>16/</sup>

Based on the language of the contract at issue here, the Court of Appeals upheld the trial court’s finding that the non-negligent window manufacturer owed a duty of defense to the developer. This Court specifically stated that it was not considering any claims of unconscionability, noting that the manufacturer and developer were reasonably sophisticated and could have negotiated the indemnity and defense terms.

### **Analysis B: The subcontractor’s obligation to indemnify**

In rendering its analysis of the subcontractor’s defense obligations, the Court reiterated the relevant rules of contractual indemnity analysis. Our analysis includes three areas of potential subcontractor exposure (that you may have to analyze, report or defend). Thus, the ‘negligence trigger’ applicable to contractual indemnity agreements is relevant. The rules are as follows: if the agreement is completely silent about whether negligence is required as a basis for indemnity, *it is*. If the agreement includes language to the effect that the indemnitor’s or the indemnitee’s conduct or fault or negligence is of no consequence in determining the obligation to indemnify, the indemnification obligation will trigger, without a finding of negligence.<sup>17/</sup> (Unless the construction indemnitee is *solely* negligent.)

Modifying our example at the beginning of this article: if the plumber has agreed to ‘indemnify’ the general contractor ‘from all claims for damages to persons or personal or real property arising out of its work’, she will have to be found negligent before her indemnity obligation triggers, because the language is *silent* on the issue of negligence. If the plumber has agreed to ‘indemnify’ the general contractor ‘from all claims for damages to persons or property arising out of its work, **regardless of responsibility for negligence** (or other similar language), the plumber is facing a stringent *Continental Heller/Dale Tile* indemnity clause requiring her to indemnify the general contractor for claims for damage arising out of her work, *regardless of whether she is found negligent*. Unless she can successfully argue that the contract is void, e.g. unconscionability, or because it requires her to indemnify the general for its sole negligence, or for designs it provided, she is on the hook for indemnity, even if her work was perfect.

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<sup>11/</sup> *Buss v. Superior Court* (1997) 16 Cal.4th 35, 46.

<sup>12/</sup> Civil Code sections 2778 subd. (1) and (2); *Crawford, id.* at 330.

<sup>13/</sup> Civil Code section 2778 subd. (4); *Crawford, id.* at 331.

<sup>14/</sup> *Crawford.*, at 341.

<sup>15/</sup> *Id.*, at 342.

<sup>16/</sup> *Id.*, at 342.

<sup>17/</sup> *Heppler v J.M. Peters, supra*, 73 Cal.App.4th, at 1278

## Analysis C: Recovering/facing attorneys' fees on the breach of contract for failure to provide a defense.

If the subcontract includes a separate provision for attorneys' fees, the subcontractor may face a third area of exposure, an award of attorneys' fees against it because the general contractor recovered its contractual indemnity judgment and/or its contractual defense costs.

In the *Crawford* case, the subcontract included a separate provision for attorneys' fees. Window manufacturer won on the indemnity question, but lost on the defense question to the tune of \$131,000, and the trial court found the developer to be the prevailing party. On that basis, the trial court awarded the developer \$47,000 in attorneys' fees.<sup>18/</sup> The Court of Appeal upheld the trial court's decision reasoning that 'a prevailing party is entitled to its costs in any action'<sup>19/</sup> including its attorneys' fees if authorized by contract.<sup>20/</sup> If Civil Code sections 1032(b) and 1033.5 were the only considerations, the developer would be entitled to its attorneys' fees for winning on its cost of defense argument, no question, 'since \$131,000 beats zero any day.' However, contractual attorney fee contests implicate Civil Code section 1717, which 'ensure[s] mutuality of remedy for attorney fee claims under contractual attorney fee provisions'<sup>21/</sup> Under Civil Code section 1717(b)(1) the 'party prevailing on the contract shall be the party who *recovered greater relief* in the action on the contract.' Window manufacturer argued that based on a comparison of relief sought by developer (\$1 million) versus its recovery of a mere \$131,000, it should be considered the prevailing party under 1717(b)(1). While this argument might prevail in other cases, the Court of Appeal was not swayed and ruled that this trial court acted within its discretion in finding the developer to be the prevailing party and awarding it attorneys' fees.

The moral of this long tale: Counsel defending or prosecuting the subcontractor, and claims professionals analyzing and reporting to carriers, need to carefully review the subcontractors' indemnity agreements to determine the potential for (1) an indemnity exposure; (2) a defense obligation exposure; and (3) attorneys' fees exposure. Based on contracts typically found in the construction arena today, an entirely non-negligent subcontractor who has no exposure to indemnity may nonetheless be exposed to defense costs and attorneys' fees for failing to defend the claim against its work.



*Crawford v. Weather Shield* is pending before the California Supreme Court (and therefore cannot be cited as precedent). An update will follow the Supreme Court's decision.



Bridget Childs

<sup>18/</sup> Practice Pointer: Do you have an argument that the contractual attorneys' fees are included in the cost of defense and represent a 'double recovery'? Raise it or you waive it. Why not raise it as an affirmative defense?

<sup>19/</sup> Civil Code section 1032(b)

<sup>20/</sup> Civil Code section 1033.5(a)(10)(A)

<sup>21/</sup> *Santisas v. Goodin* (1998) 17 Cal.4th 599, 610



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