

When An Insurer May Recover Defense Costs Based Upon Equitable Subrogation: Court Of Appeal Rules That Costs Incurred In Defense of General Contractor In Construction Defect Action Arising From Subcontractors Work Constituted Loss For Which Subcontractors Were Each Partly Liable In Subrogation

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In California construction defect actions, many insurers which have assumed the defense of the general contractor or developer, often under an additional insured endorsement, later seek to recoup the defense costs they expended from other subcontractors and/or other subcontractors' insurers which did not participate in the defense of the general contractor or developer. Various arguments have been raised as to what are the rights of the insurer seeking to recoup defense costs.

In the matter of Pulte Home Corporation v. CBR Electric, Inc. (2020) Westlaw 3072241 ("CBR Electric case"), the California Court of Appeal has provided further guidance. The facts of the CBR Electric case are routine in nature. After defending the general contractor in two construction defect actions, general liability insurer St. Paul Mercury Insurance Company ("St. Paul") sought reimbursement of defense costs under an equitable subrogation theory against six subcontractors that had worked on the underlying construction projects and whose contracts required them to defend the general contractor in suits involving allegations related to their work. After a bench trial, the court denied St. Paul's claim. Relying on Patent Scaffolding Co. v. William Simpson Constr. Co. (1967) 256 Cal.App.2d 506, the trial court concluded St. Paul had not demonstrated it was fair to shift all of the defense costs to the defendants because their failure to defend the general contractor had not caused the homeowners to bring the construction defect actions in the first place.

St. Paul appealed arguing the trial court's ruling misconstrued the law governing equitable subrogation. The Court of Appeal agreed and reversed. In its opinion, the Court of Appeal identified two errors in the trial court's ruling. First, the Court of Appeal held that the trial court incorrectly concluded that a cause of action based in subrogation required a shift of the entire amount of defense costs incurred in the construction defect actions to the defendants, on a joint and several basis. The Court of Appeal acknowledged that, if that were the rule, it would be unfair to burden only a small subset of the subcontractors that worked on a project with the entire cost of defending a construction defect action alleging defects in every trade. However, the Court of Appeal noted that a cause of action based on equitable subrogation allows an insurer to step into the shoes of its insured but it can only recover what the general contractor would be entitled to recover from the defendants citing to Rossmoor Sanitation, Inc. v. Pylon, Inc. (1975) 13 Cal.3d 622, 633-634. Under the principles articulated in Crawford v. Weather

Shield Mfg., Inc. (2008) 44 Cal.4th 541, and the subcontracts at issue, the Court of Appeal held that the defendants' duty to defend the general contractor arose when the general contractor tendered its defense to them, and that duty covered the cost of defending claims related to their work. Because the general contractor could not recover the full amount of defense costs from any one of its subcontractors involved in the construction defect actions (based on their scope of work), neither could St. Paul and there was no need to shift all defense costs to the defendant subcontractors. Second, the Court determined that the trial court employed a flawed causation analysis when balancing the equities, finding the appropriate inquiry to be whether the defendants' failure to defend the general contractor caused St. Paul to incur the defense costs, not whether that failure caused the underlying lawsuits citing to Interstate Fire & Casualty Ins. Co. v. Cleveland Wrecking Co. (2010) 182 Cal.App.4th 23 and Valley Crest Landscape Development, Inc. v. Mission Pools of Escondido, Inc. (2015) 238 Cal.App.4th 468.

The CBR Electric case will have major impacts. First, when pursuing a non participating subcontractor (i.e. one that has not paid the general contractor or the developer's defense costs), the insurer seeking subrogation may recoup defense costs relevant to that subcontractor. In addition, and related to that, the CBR Electric case will make it more difficult to pursue subcontractors with minor scopes of work (such as a vinyl fence contractor) as it may be difficult to demonstrate what defense costs were incurred based on the subcontractor's work.

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