

NC Anti-Indemnity Statute Update, New Changes Now in Effect

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On July 8, 2019, Governor Roy Cooper signed into law HB 871, significantly altering North Carolina's anti-indemnity statute, N.C. Gen. Stat § 22B-1 ('Anti-Indemnity Statute'), particularly as it relates to indemnity agreements in design professional contracts.

Indemnity

In general terms, an indemnity agreement is an agreement to make good and save another harmless from loss on some obligation which he or she has incurred or is about to incur to a third-party. The indemnity agreement obligates the promisor to reimburse his or her promisee for loss suffered or to save him or her harmless from liability. The indemnity obligation typically applies if a third-party makes a claim against the promisee that was caused by the promisor. While the indemnity obligation is not fully triggered until the third-party's claim prevails, the obligation to indemnify is often coupled with a duty to defend the promisee from the third-party claim.

The Duty to Defend

Many indemnity agreements in design professional contracts provide that the promisor shall "defend" the promisee in the event of a third-party claim arising out of the promisor's negligent acts or omissions. By way of example, a typical agreement might provide that an engineer shall defend, indemnify, and hold harmless a project owner from any third-party claims arising out of the engineer's negligent acts or omissions. The duty to defend differs from the obligation to indemnify in that the duty arises when a third-party claim is made. In other words, if there is a third-party claim against the project owner that allegedly is a result of the engineer's negligence, the engineer must assume the defense of the project owner from the claim. Typically this requires retaining an attorney to defend the project owner from the claim. The duty to defend arises long before an arbitrator, judge, or jury determines whether the engineer was at fault. The engineer may be required to pay to defend the project owner, based on the allegations alone, even if the trier of fact later determines the engineer was not at fault. Until now, such duty to defend clauses in professional design contracts generally have been found valid and enforceable in North Carolina provided they did not run afoul of the existing anti-indemnity prohibitions of N.C. Gen. State § 22B-1, which declares void and against public policy construction contract indemnity agreements requiring a party to be indemnified for that party's own negligence.

Duty to Defend Requirements Revised for Design Professionals

Under subsection (c) of the new Anti-Indemnity Statute, any such duty to defend in an agreement that includes design professional services is now against public policy, void, and unenforceable. This new subsection (c) provides:

Provisions in, or in connection with, a construction agreement that includes design professional services or a design professional agreement purporting to require a design professional to defend a promisee, the promisee's independent contractors, agents, or employees, the promisee's indemnitees, or any other person or entity against liability or claims for damages or expenses, including attorney's fees, proximately caused or allegedly caused by the professional negligence, in whole or in part, of the promisor, the promisee, or their derivative parties, whether the claim is alleged or brought in tort or contract, is against public policy, void, and unenforceable.

The new law became effective August 1, 2019, and applies to contracts entered into, amended, or renewed on or after that date. While it remains to be seen how Courts will interpret the new law, it seems reasonably clear that any provision in an agreement that purports to require a design professional to defend the other contracting party from third-party claims will be found void and unenforceable. On its face, the statute applies only to certain listed design professionals including architects, landscape architects, engineers, land surveyors, geologists, and soil scientists. The new prohibition also applies not just to design professional agreements but to any construction agreement that includes design professional services. Thus, the revised statute could have wide-ranging implications in design-build contracts, which are project delivery systems in which both the design and construction of a project are contracted by a single entity.

The Exception to the New Rule

While the revised statute clearly prohibits duty to defend clauses in contracts involving professional design services, it does not prohibit the recovery of attorney fees altogether. A design professional may still be contractually required to pay a promisee's attorney fees as part of its duty to indemnify the promisee from losses caused by the design professional. For example, if a third-party brings a claim against a project owner that is alleged to arise out of the engineer's negligence, the engineer will not have to provide the project owner with a defense of the claim. Rather, the project owner will proceed to defend itself from the third-party claim and will incur attorney fees in doing so. Practically speaking, this means that the project owner will have to pay to defend itself and then try to recover those costs later from the engineer. If it is ultimately found that the third-party claim against the project owner was, in fact, caused by the engineer's negligence, the engineer's indemnification owed to the project owner may include the attorneys' fees and expenses the project owner incurred in defending the third-party claim. If it is found that the third-party claim was not caused by the engineer, the project owner will not be able to recover its attorney fees from the engineer.

Expansion of Existing Anti-Indemnity Statute

The new subsection (b) to the Statute also arguably expands the scope of the existing anti-indemnity protection, or at least codifies existing norms. The new subsection (b) applies to both construction and design professional agreements. It provides that an indemnity clause is void and unenforceable unless the fault of the promisor is a proximate cause of the loss, damage, or expense. This means that for an indemnity agreement to be valid, the fault of the person making the promise to indemnify (or its derivative parties) must have actually caused the loss or damage, at least in part. The revisions also apply to all loss, damage, or expenses (*e.g.*, economic losses) and are not limited to liability for bodily injury or property damage. It has been understood by many practitioners that fault was always an underlying requirement to an obligation to indemnify.

Indeed, I am unaware of any reported decisions in the construction or design field in which a party was required to indemnify another when the party providing the indemnity was not at fault. That said, some indemnity provisions in construction and design contracts are broad enough to arguably require indemnity even if the party giving the indemnity was not at fault. For instance, a clause requiring a contractor to "indemnify a project owner for all claims, losses, or damages related to the Project" could arguably be interpreted to require the contractor to indemnify the project owner for any loss related to the Project even if the contractor didn't cause the loss. This new section seems to codify the common understanding in the construction field that the promisor must have actually caused a loss to trigger its indemnity obligation. While it might not change much in terms of existing law, the revision should provide a useful tool in contract negotiations when faced with a very broad indemnity clause.

Conclusion

The revisions to the Anti-Indemnity Statute significantly change indemnity provisions that are common in construction and design contracts. These changes should prompt contractors, subcontractors, designers, and engineers to review their standard form contracts to ensure compliance with the revised Statute. They should also provide a useful tool in future contract negotiations when faced with either a duty to defend or a broad indemnity clause.

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