Coates' Canons Blog: New Law Modifies Construction Indemnification and Prohibits Duty-to-Defend in Design Professional Contracts

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For those not familiar with Chapter 22B of the North Carolina General Statutes, this Chapter prohibits certain contract provisions by making those provisions void and unenforceable as a matter of public policy. The restrictions in Chapter 22B apply to all contracts, including those with a governmental entity as well as those between private parties. Within Chapter 22B is a statute that prohibits what can be described as “self-indemnification” in construction contracts. GS 22B-1 prohibits any provision in a construction contract that requires one party to indemnify another party against the other party’s negligence. Simply put, this means that a contractor cannot require a local government to indemnify the contractor, for the contractor’s own negligence and vice versa. This does not mean that the local government cannot require the contractor to indemnify it for the contractor’s negligence and vice versa, which can be described as “cross-indemnification” (as opposed to self-indemnification). Cross-indemnification provisions are permissible and common in contracts, including those entered into by local governments.

GS 22B-1 was amended by House Bill 871 (S.L. 2019-92) to add five new subsections (b)-(f) that (1) revise the scope of cross-indemnification provisions in construction and design services contracts; (2) prohibit duty-to-defend provisions in design services contracts; (3) preserve certain indemnification obligations; (4) exempt certain agreements from the requirements of the statute; and (5) define terms used in the statute. These changes became effective August 1, 2019, and apply to all contracts entered into, amended, or renewed on or after that date. This blog post describes these new statutory provisions.

Revised Indemnification (new 22B-1(b))

Subsection (b): This new provision makes cross-indemnification provisions in construction and design services contracts void and unenforceable unless fault on the part of the the promisor (the party that agreed to indemnify and hold harmless the other party) is a proximate cause of the loss, damage, or expense suffered by the promisee (the other party to the contract) that is indemnified under the contract. This provision applies to the promisor and its derivative parties, which include subcontractors, agents, employees or other individuals or entities, for which the promisor may be responsible as a result of any statutory, tort, or contractual duty. Fault on the part of the promisor is defined as a breach of contract; negligent, reckless, or intentional acts or omissions that constitute a tort under statutory or common law; or violations of applicable statutes or regulations.

What does this mean? The new statutory language does not prohibit cross-indemnification provisions in construction and design services contracts. However, such provisions are not enforceable unless fault by the promisor or its derivative parties is a proximate cause of the loss, damage, or expense suffered by the other party to the contract. In other words, an indemnification or hold-harmless provision in a construction or design services contract cannot require a contractor or design professional to indemnify a local government unless fault on the part of the contractor or design professional is a proximate cause of damages or losses suffered by the local government. Similarly, an indemnification or hold-harmless provision in a construction or design services contract cannot require a local government to indemnify a contractor or design professional unless fault on the part of the local government is a proximate cause of the damages suffered by the contractor or design professional.

The revision to the indemnification provisions applies to all contracts for construction and repair work as well as contracts with design professionals. For purposes of GS 22B-1, a design professional is defined as persons or entities that hold

licenses as architects (Chapter 83A), landscape architects (Chapter 89A), engineers and land surveyors (Chapter 89C), geologists (Chapter 89E), and soil scientists (Chapter 89F). A contract with any of these design professionals to provide services for which licensure is required is now subject to the new indemnification revision.

Local governments should consult with their attorneys and review indemnification and hold-harmless provisions in their construction and design contracts to ensure those provisions are compliant with the new law.

Duty-To-Defend Prohibited in Design Services Contracts (new GS 22B-1(c))

Subsection (c): This new provision prohibits duty-to-defend provisions in contracts with design professionals or construction contracts that include design services. A duty-to-defend provision requires one party to defend another party in a legal challenge brought by a third party such as a lawsuit, mediation, or arbitration. For example, if an architect and a local government are named in a lawsuit involving the design of a public facility, a duty-to-defend provision in the architect's contract would require the architect to provide legal defense for himself as well as the local government. Under the new statutory provision, the contract with the architect cannot require him to provide legal representation for the local government; the local government must provide its own legal defense.

The duty-to-defend prohibition applies to all contracts with design professionals for any work that requires licensure for that design profession. As with the indemnification revision discussed above, design professionals are defined for purposes of GS 22B-1 as persons or entities that hold licenses as architects (Chapter 83A), landscape architects (Chapter 89A), engineers and land surveyors (Chapter 89C), geologists (Chapter 89E), and soil scientists (Chapter 89F). A contract with any of these design professionals to provide services for which licensure is required are now subject to the duty-to-defend prohibition.

The prohibition also applies to construction contracts that include design professional services. These contracts include design-build contracts (GS 143-128.1A), design-build bridging contracts (GS 143-129.1B), and public private partnership contracts (GS 143-128.1C). The prohibition does not apply to construction contracts that do not include design services as part of the construction contract, which is the case with most regular construction contracts, and it does not apply to construction management at-risk contracts (GS 143-128.1) since the local government, not the CMR, contracts directly with the project designer.

Local governments should consult with their attorneys and review their contracts with design professionals (note the description above of who is a design professional under the new statutory language) and modify their contracts to comply with the new law. It is important to note that the duty-to-defend prohibition became effective August 1, 2019, and applies all contracts entered into, amended, or renewed on or after that date. If a contract with a design professional was entered into prior to August 1, 2019 and is amended or renewed on or after that date, the prohibition is triggered and any duty-to-defend provisions in the contract is now void.

Indemnification Obligations Preserved (new GS 22B-1(d))

Subsection (d): This new provision preserves indemnity obligations where fault is found. Despite the revisions to indemnification provisions and the prohibition against duty-to-defend in design services contracts, if fault by a contractor or designer is found to be a proximate cause of the damages or losses suffered by a local government that is a party to the contract, an indemnification or hold harmless provision can still require the contractor or designer to pay attorney fees, litigation or arbitration expenses, and court costs as well as actual damaged suffered. For example, if a city and its architect are sued, the city cannot require the architect to defend it but must defend itself; however, if fault by the architect is found to be a proximate cause of the damages or losses suffered by the city, the city may pursue recovery of the legal expenses and costs it incurred if the indemnification provision in its contract with the architect provides for this.

Local governments should consult with their attorneys and review indemnification and hold harmless provisions in their contracts to ensure that their opportunity to recover legal expenses and costs (as well as damages) in the event of fault by the contractor or designer is preserved in the language of the contract provision.

Insurance Contracts, Workers' Comp, Liens, and Bonds Exempted (new GS 22B-1(e))

Subsection (e): This new provision (which modifies existing language in the statute) exempts from the provisions of GS 22B-1 the following types of agreements and claims: insurance contracts, workers' compensation, other agreements issued by an insurer, and lien and bond claims brought under Chapter 44A of the General Statutes. While liens cannot be filed against units of government, local governments may bring performance bond claims and subcontractors may bring payment bond claims under Article 3 of Chapter 44A.

Definitions (new GS 22B-1(f))

Subsection (f): This provision contains definitions of the terms used in the statute as referred to above.

Links

- www.ncleg.gov/EnactedLegislation/Statutes/HTML/ByChapter/Chapter_22B.html
- www.ncleg.gov/EnactedLegislation/Statutes/PDF/BySection/Chapter_22B/GS_22B-1.pdf
- www.ncleg.gov/Sessions/2019/Bills/House/PDF/H871v4.pdf
- www.ncleg.gov/EnactedLegislation/Statutes/PDF/ByArticle/Chapter_44A/Article_3.pdf