

State Construction Conference

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Proposed Legislative Revisions to North Carolina Lien and Bond Law

NORTH CAROLINA
STATE CONSTRUCTION CONFERENCE
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Presented By:
Bonnie Keith Green

Creation of the Lien and Bond Law Revision Committee

The N.C. Bar Association's Construction Law Section created a Lien and Bond Revision Committee in the summer of 2009 comprised of approximately twenty practicing construction lawyers throughout North Carolina to consider potential revisions to North Carolina's lien and bond laws.

Goal: CONSENSUS

- To develop the key concepts of a lien law proposal to address the issues and concerns of various segments of the construction industry
- A neutral bill with industry-wide support
- Avoid a cram down legislation by 1 section of the industry
- Functionality for lawyers, as well as non-lawyers/industry members
- Balanced sharing of the risks
- Reward industry due diligence with statutory protection of interests

Historical Perspective

- Article X, Section 3 of the NC Constitution:
 - *The General Assembly shall provide by proper legislation for giving to mechanics and laborers an adequate lien on the subject matter of their labor...*
- Last complete overhaul of the lien & bond laws in NC was in 1970
- 40 years of “band-aids”
 - Bonding-off liens, Notices of Contract & Subcontract, etc.

Why Revise NOW???

- Economy
 - Impact on title insurance companies (which led to SB 803)
 - Failure of lending institutions
- 40 years of “band-aids” has resulted in 40 years of case law
 - Swain, O&M, Boardwalk, Clark-Langley, etc.
- Recent bankruptcy decisions in NC
 - Has led to confusion and inconsistencies across NC
- Changes in construction industry
 - “Spec-houses”, Public-private partnerships, Owner-builders, Condominiums, Townhouses and Mixed-use developments

Interested & Engaged Parties

- Title Insurance Companies / Owners
 - Inchoate / Hidden Liens
- Banking Institutions
 - Hidden Liens / Priority / Subordination
- Architects, Designers & Engineers
 - Early Priority / Status

Interested & Engaged Parties

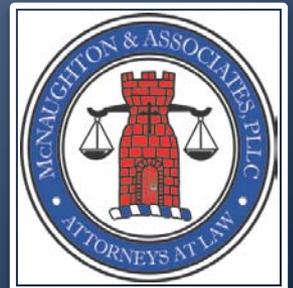
- General Contractors
 - Double Payments
- Subcontractors & Suppliers
 - Relation Back / Preserving Lien Rights
- Attorneys
 - Clearer Attorney Fees Provision

REASONS FOR CHANGE: HISTORY AND RECENT JUDICIAL DECISIONS



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STATE CONSTITUTION

- “The General Assembly shall provide by proper legislation for giving to mechanics and laborers an adequate lien on the subject-matter of their labor.”



- N.C. Constitution,
Art. X, 3 (1868)



ORIGINAL PURPOSE



- Whitaker v. Smith, 81 NC 340 (1879):
- A very large proportion of the laboring population of the State had just recently been released from thralldom and thrown upon their own resources perfectly ignorant of the common business transactions of social life and this provision of the Constitution and the acts passed to carry it into effect were intended to give protection to that class of persons who were totally dependent upon their manual labor for subsistence.



PURPOSE OF LIEN STATUTES

- The purpose of this lien statute is to protect the interest of the contractor, laborer, or materialman.

[Embree Constr. Group, Inc. v. Rafcor, Inc.](#), 330 N.C. 487 (1992)

- The lien statute is remedial in that it seeks to protect the interests of those who supply labor and materials to improve the value of the owner's property.

[Elec. Supply Co. of Durham](#),
328 N.C. 651 (1991)



PURPOSE OF BOND STATUTES

- The purpose of the bond statute is to create “a substantial equivalent” to lien rights on public projects, with the surety on the bond being, “for practical purposes, the substitute for the lien.’

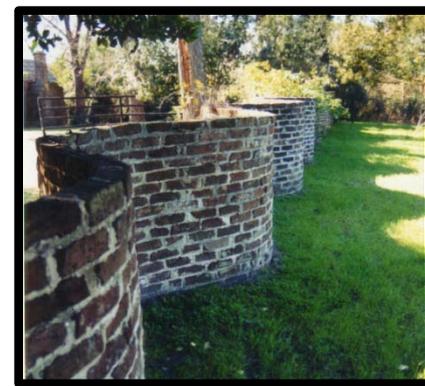
[Carolina Builders Corp. v. Dry Wall, Inc.](#), 43 N.C. 444 (1979).

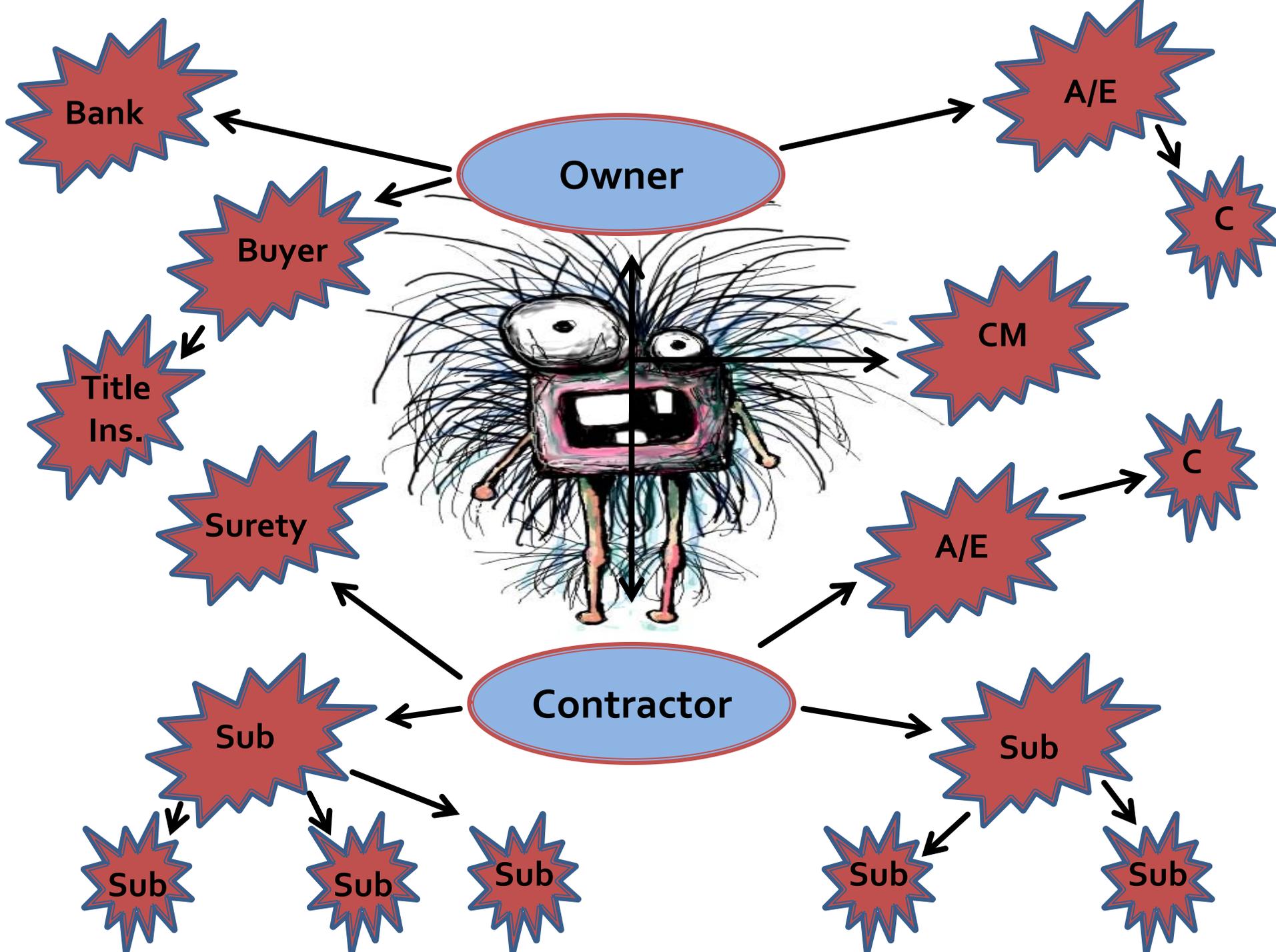


Owner



Contractor





TIME LIMITS

Must be filed within **30 days** after the performance & completion

1869

6 months

1881

12 months,
but lost if action thereon is not begun in 6 months after filing

1905

120 days from date of last work, lawsuit within 180 days of date of last work

1971

1877

60 days



1883

12 months

1923

6 months to file, must initiate action to enforce within 6 months after filing



STATE CASES

- **2006**: A \$1.00 Notice of Claim of Lien upon Funds shuts down a \$1 million dollar project.
- **2008**: No Action = Action. A default judgment against GC may not cut off subcontractors liens.

O&M Industries v. Smith Engineering Company, 360 N.C. App. 263 (2006)

Carolina Building Servs. Windows & Doors, Inc. v. Boardwalk, LLC, 362 N.C. 262 (2008)



McNaughton & Associates, PLLC



STATE CASES



2010: A partial lien waiver may reset the date of 1st work.

Wachovia Bank Nat'l Ass'n v. Superior Constr. Corp., 07 CVS 21256, 2010 WL 1655494, N.C. Business Court, April 23, 2010



PRIOR LEGISLATION ATTEMPT

SB 803 (2009) "An Act to Address Hidden Liens..."

- Land Title Association proposed making claims of lien on real property ineffective against owners "whose interest has been registered after the date of first furnishing, [but] prior in time to the filing of the claim of lien."
- Became a study bill after push-back from GC's and Subcontractors.



BANKRUPTCY CASES

- **2009:** A Subcontractor cannot serve a claim of lien upon funds after bankruptcy petition.

In Re Shearin Family Investments, LLC, Case No. 08-07082-8-JRL (Bankr. E.D.N.C. April 17, 2009)



- **2009:** A Subcontractor can not file claim of lien on real property after bankruptcy petition.

In Re Harrelson Util., Inc., Case No. 09-02815-8-ATS (Bankr. E.D.N.C. July 30, 2009);

In Re Mammoth Grading, Inc., Case No. 09-01286-8-ATS (Bankr. E.D.N.C. July 31, 2009)

- Lien established as a Constitutional Right after end of slavery;
- Last major revision 40 years ago (1971 - Richard Nixon);
- Recent reinterpretations of lien laws by State Courts;
- Bill to eliminate “Hidden Liens” shot down;
- Recent reinterpretations of lien laws by Bankruptcy Court.

SUMMARY



Proposed Lien Law Revisions

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“Hidden” Mechanic’s Liens

- Addresses the issue and concern of “hidden” (or not yet filed) mechanic’s liens
- Requires the filing and posting of a Notice of Commencement (owner and general contractor)
- Requires the filing and service of a Notice to Owner (subcontractor).
- Envisions a single court file number under the Notice of Commencement for all future recordings including all applicable Notice to Owner.

Double liability / Double Payment

- Protects general contractors from incurring double liability / double payment under payment bonds on public projects
- Requires subcontractors to serve the contractor with notice that they are furnishing labor or materials on the project.

Effects of Bankruptcy

- Intended to protect subcontractor lien rights and addresses bankruptcy court rulings that prevent subcontractors from perfecting and enforcing mechanic's liens after a bankruptcy is filed.

O&M Case

- Addresses the O&M decision
- Prevents projects from being shut down since construction funding is not entirely frozen
- Benefits all parties by authorizing withholding of funds subject to a lien while permitting other funds to continue to be used for project purposes

Statutory Forms / Lien Waivers

- Creates statutory forms for partial and final lien waivers.
- Protects subcontractors from waiving their lien rights unconditioned upon actual receipt of payment for which the lien waiver is provided.
- Addresses concerns created by the Business Court's recent decision in Wachovia v. Superior Construction whereby a partial lien waiver could change a contractor's first date of furnishing.

Priority Date

- Provides all contractors (prime contractors and subcontractors) who furnish work on a project and comply with the statutory provisions the same mechanics' lien priority date (the date the Notice of Commencement was filed).

“Savings Clause” for Subcontractors

- Provides a savings clause for subcontractors who fail to timely file and serve their Notice to Owner within thirty (30) days from their first date of furnishing.
- Relates back to the Notice of Commencement but the late Notice to Owner will only capture monies owed for work performed by the subcontractor within the last thirty (30) days.

Residential Carve Out

- Provides for a Residential Carve-Out for owner-builder projects involving 1-4 unit residential structures. The Carve-Out will allow owner-builders to file just one Project notice that would create a single court file number for all future recordings. The trade contractors normally viewed as subcontractors but who are actually prime contractors would have to file a Notice of Commencement under the file number established by the owner-builder project notice. This will prevent the unmanageable burden imposed on title examiners having to sort through large number of Notices of Commencement which would involve the same residential dwelling, but otherwise would not be indexed under the same file number.

Statutory Framework for Lienholders

- The lien structure remains essentially the same in that contractors who deal directly with the owner still have a direct lien on the property. Subcontractors, who deal with entities other than the owner, maintain their lien on funds, their land/ personal liability as a result of violating the lien on funds, and their lien on land by virtue of being directly subrogated to the lien of the general contractor.

QUESTIONS?

