Recent Changes to North Carolina Mechanics Lien & Payment Bond Law

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During the 2012 legislative session, the N.C. General Assembly revised mechanics’ lien and payment law by enacting Senate Bill 42 and House Bill 1052. In addition to adding new notice requirements for lien and bond claimants, these bills also resolve confusion regarding the treatment of subcontractor lien claims in bankruptcy arising after the Shearin, Mammoth, Harrelson, and Construction Supervision Services decisions. See In re Shearin Family Investments, LLC, Case No. 08-07082-8-JRL, 2009 WL 1076818 (Bankr. E.D.N.C. April 17, 2009); In re Harrelson Utilities, Inc., 2009 WL 2382570 (Bankr. E.D.N.C. July 30, 2009); In re Mammoth Grading, Inc., No. 09-01286-8-ATS (Bankr. E.D.N.C. July 31, 2009); In re Construction Supervision Services, Inc., 2012 WL 892217, Case No. 12-00569-RDD, Docket No. 175
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Overview of Lien and Bond Law Changes

The payment rights and obligations of everyone involved in a construction project will be impacted as the changes take effect this year. In short, parties now should act when they begin work to protect their real property lien and bond claim rights, or risk losing them. Subcontractors maintain the right to assert both a lien upon funds and a lien on real property. Other than the clarification concerning when liens upon funds arise, the statutory changes primarily affect liens on real property.

New Requirements for Liens on Real Property on Private/Non-Government Projects

New sections 44A-11.1 and 44A-11.2 require the use of a “lien agent,” a company whose duty is to track information concerning parties who may have potential real property lien rights. The idea behind the lien agent is to create an easy and early way to identify potential lien claimants and avoid the risk of unknown claims arising after the property is sold or refinanced. Parties with lien rights have to give notice to the lien agent, and failure to give timely and full notice may result in the loss of lien rights. The law now requires:

- Property/Project Owners: Pursuant to 44A-11.1(a), for any project with a contract price greater than $30,000 (except a single-family home renovation where the home is the owner’s residence), the property owner must appoint a title insurance company, who is a registered lien agent with the Department of Insurance, as a lien agent before entering into the first contract concerning the improvements to the property. The owner must provide the lien agent with specific information concerning the project as set forth in 44A-11.1(a). The owner must also notify others of the lien agent’s contact information by posting it at the project site, and, if anyone makes a written request for it, the owner must provide it within seven days of the request. (effective April 1, 2013)

- Contractors and Subcontractors: To preserve their lien rights, contractors and subcontractors should provide written notice to the lien agent within 15 days of first furnishing labor or materials, though failsafe measures in N.C.G.S. § 44A-11.2(k) allow lien claimants to protect lien rights as long as notice is given prior to transfer or refinancing of the property. Exceptions exist for single-family home builders if the identity of the lien agent is included in the construction contract. N.C.G.S. § 44A-11.2(g). Contractors and subcontractors must also provide the lien agent’s contact information to any subcontractors who are not required to furnish labor at the project site within three days of entering into such subcontracts. N.C.G.S. § 44A-11.2(c). Failure to provide this notice exposes contractors and subcontractors to potential claims for damages. (effective April 1, 2013)

- Subcontractors: In certain circumstances, to properly perfect its rights to a claim of lien, the revisions to section 44A-11 require a subcontractor to serve its claim of lien on both the owner and the contractor. Of particular note for practitioners assessing priority of claims, in completing the claim of lien, revised section 44A-23(a) allows the subcontractor to use either its first and last date of furnishing labor or materials, or that of the contractor. (effective Jan. 1, 2013)

- Design Professionals: To be safe, architects, engineers, and surveyors should provide notice to the lien agent within 15 days of first work. However, section 44A-11.2(g1) includes a limited exception in circumstances when the owner does not include the identity of the lien agent in the design contract. If the design contract does not identify the lien agent, then the designer is deemed to have given notice at the time the owner appoints the lien agent. (effective April 1, 2013)

New Requirements for Payment Bond Claims on Public/Government Projects

Similarly, the law now provides for advance notice of potential payment bond claims on public projects. Subcontractors who do not provide the required notice risk losing the right to recover the full amount of their claim from the bond. Payment bonds are generally required on public projects because liens cannot be asserted against publicly-owned property. The law now requires:

- Contractors: Pursuant to revised section 44A-27(b), contractors must provide a copy of the payment bond within seven days of receiving a written request from a subcontractor or supplier on a public project. Under section 44A-27(f), contractors must also prepare a “contractor’s project statement” (including details about the project, owner, contractor, bond surety, and the contractor’s agent designated to receive notices required by the statute) and furnish it to each of their subcontractors at the time they enter into each respective subcontract. (effective January 1, 2013)

- First-tier Subcontractors: At the time of contracting, first-tier subcontractors must provide their subcontractors with a copy of the “contractor’s project statement.” N.C.G.S. § 44A-27(f)(2), (3). (effective January 1, 2013)

- Lower-tier Subcontractors: To secure the right to assert a bond claim for the full amount being claimed, subcontractors who are "sec-
ond-tier” and lower must provide to the general contractor’s designated agent a “notice of public subcontract.” This notice must include details about the project, the labor or materials provided, and the parties in the contract chain. The statute does not specify when the notice must be provided; however, bond claims are limited to labor or materials provided by the subcontractor within the 75-day period before service of the notice of public subcontract. N.C.G.S. § 44A-27(b).

Therefore, the notice should be provided as close as possible to when labor or materials are first provided to the project. An exception exists allowing subcontractors to assert bond claims of $20,000 or less even if they have not served notices of public subcontract. N.C.G.S. § 44A-27(e). (effective Jan. 1, 2013)

Effect of Lien Waivers

Revisions to section 44A-20(d) make explicit what many construction practitioners considered implicit under prior law: execution of a lien waiver by the general contractor can cut off the subcontractor’s subrogation lien rights against the real property, but cannot cut off a subcontractor’s right to a lien on funds or a subsequent direct lien right on property that may arise by operation of law if the recipient of the lien on funds pays over the lien on funds without holding back adequate money to satisfy the lien on funds. (effective January 1, 2013)

Subcontractor/Supplier Claims of Lien Upon Funds in Bankruptcy

New N.C.G.S. § 44A-18(f), effective January 1, 2013, provides that a lien upon funds owed on a project “arises, attaches, and is effective immediately upon the [subcontractor’s] first furnishing of labor, materials, or rental equipment.” This new language removes the statutory underpinning for the Courts’ analysis in the Shearin, Mammoth, and Harrelson decisions. These cases interpreted the prior statutory language – that a lien upon funds “is perfected upon the giving of notice” – to mean that a lien on funds did not give rise to any interest in the funds until it had been properly served. Since these opinions concluded that no interest arose prior to service, post-petition service of a notice of claim of lien upon funds violated the automatic stay, did not fall within the 11 U.S.C. § 362(b)(3) exception for pre-petition interests that were merely perfected post-petition, and thus was void and ineffective to perfect the lien upon funds. In Construction Supervision Services, Judge Doub reached a different conclusion finding that the post-petition service of a notice of claim of lien upon funds is a permitted exception to the automatic stay pursuant to section 362(b)(3). (The Construction Supervision Services opinion was appealed by a secured creditor in the case. As of the date of this article, no order has been entered resolving the issues on appeal.) These conflicting results gave rise to a split of authority in the Eastern District of North Carolina.

The amended statute should resolve this split of authority. It provides that the lien claimant’s interest arises at the first furnishing of labor or materials. As such, service of a claim of lien upon funds to perfect the lien claimant’s interest post-petition falls within the exceptions to the automatic stay provided in section 362(b)(3). (To avoid confusion concerning use of funds during construction, new N.C.G.S. § 44A-18(g) states that, until the lien upon funds is served, the funds against which the lien attaches can be used in the ordinary course of business without limitation.) In effect, the change concerning liens upon funds clearly preserves a subcontractor’s right to pursue a lien upon funds against project-related proceeds, even after a party higher in the contract chain files for bankruptcy protection.

Conclusion

Practitioners would be well-advised to familiarize themselves and their clients regarding the new lien and bond laws that require earlier action to preserve lien and bond claim rights. Given the scope and nature of the changes, it will take time—and the development of case law from North Carolina’s state and federal courts—to fully understand the impact of the new laws, but certainly the landscape has shifted. •

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