



Changes to North Carolina's Mechanic's Lien and Payment Bond Laws

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The economic downturn in the past few years brought to light deficiencies in North Carolina's mechanic's lien and payment bond laws. Given the "rob Peter to pay Paul" syndrome that evolved as contractors and subcontractors struggled to survive, the title companies found themselves buried in an avalanche of lien claims in properties conveyed during the downturn, and general contractors (simply referred to as "contractors" under the statutes) found that due to subcontractors not passing payments made down the chain, they were at risk of paying for the same work or materials twice, either to get paid by the owner on private jobs, or under their master surety agreements with their bonding companies on public jobs when the surety was liable for payment under the bond. This session, the General Assembly has attempted to fix many of these issues.

Changes for Private Projects: Effective April 1, 2013

The Basics of the New Rules:

Owners must designate a "lien agent" at the time of contracting from a list of approved lien agents and serve the agent with notice of the designation.

Contractors must: (1) provide the "lien agent" information in the building permit application and, if the lien agent information is not included in the permit, attach the lien agent information to the permit or post it separately on the job site, and, for off-site subcontractors, serve them the lien agent information with 3 days of contracting; (2) serve a new document termed a "Notice To Lien Agent" *within 15 days of first furnishing*, which substantially tracks the statutory form; and (3) serve any subsequently filed Claim of Lien on the lien agent and owner.

Subcontractors must: (1) provide the lien agent information to their off-site subcontractors within 3 days of contracting; (2) serve their own "Notice To Lien Agent" *within 15 days of their first furnishing*, and (3) include the lien agent in any service of a Notice of Claim of Lien On Funds.

The Details:

The new legislation introduces a new player to the lien process, the "Lien Agent." The Department of Insurance is charged with creating and maintaining a list of authorized lien agents. Presumably, these will be title companies. G.S. § 44A-7.

For projects in excess of \$30,000, that are not an improvement to an existing single family owner-occupied residence, the owner must designate a lien agent *at the time it first enters into a contract* to improve the property. The owner is then required to serve its notice of designation on the lien agent, together with the details of the project: street address, tax map and lot and block number, reference to recorded instrument or other designation of the property. G.S. § 44A-11.1. If the project is a single family residence, the owner must also include in the notice of designation the contractor's information. Within three (3) business days of receipt of an owner's designation, the lien agent must acknowledge the designation to the owner. Within seven (7) days of a request, an owner will provide the contact information for the lien agent to the requesting party. G.S. § 44A-11.2.

The new law requires that the lien agent information be posted on the property. It assures this by requiring that the lien agent information be given to the inspections department as part of the building permit application and, in addition, by providing that a sign disclosing the lien agent information be posted on-site, if it is not included in the building permit. For a failure to provide this information, liability is imposed on the contractor for losses incurred by any subcontractor who would otherwise have had notice of the lien agent. For single family residences, a contractor is compliant if the owner complies by including the contractor's name in the notice of designation.

Since off-site subcontractors cannot be expected to look at the building permits or job site postings, the new scheme requires that a contractor or subcontractor who contracts with a lower tier subcontractor *that is not required to furnish labor at the site*, give such subcontractor written notice of the lien agent's contact information within (3) business days of contracting with such lower tier subcontractor. This can be accomplished by including the information in the contract or purchase order. Failure to provide the information exposes the contractor or subcontractor to liability for damages incurred by a subcontractor that does not receive the information. G.S. § 44A-11.2(c).

The lien agent serves as a central repository for lien claimants and claims information. The lien agent receives notices from all contractors and subcontractors on the job that they are in fact on the project, together with the basics of their contracts. To protect its lien rights, a lien claimant, which is defined so broadly as to include the contractor, subcontractors and suppliers, must serve their "Notice to Lien Agent" on the lien agent within **15 days of first furnishing**. This notice states the potential claimant's name, the party it contracted with, the property description, and notice of a right to subsequently pursue a claim of lien. This document is NOT filed. G.S. § 44A-11.2. Within three (3) business days of receipt of a "Notice to Lien Agent" by a potential lien claimant, the lien agent must confirm receipt to the claimant. Thereafter, the lien agent is charged with maintaining a record of all notices it receives. Thus, under the scheme, with some exceptions, all contractors and subcontractors should end up serving a "Notice to Lien Agent" such that, by the end of the job, the lien agent will have a list of all potential lien claimants.

In addition to receiving the Notices to Lien Agent, the lien agent is responsible for providing this information to the other players on the project upon request. Within one (1) business day of receipt of a request by an owner, title company, potential lien claimant, purchaser, or closing attorney, the lien agent must provide the requesting party with notice of the potential lien claimants who have served him with a "Notice to Lien Agent." If the lien agent also received notice from the owner regarding a general contractor on a single family residence, it shall also include the contractor information in its response. G.S. § 58-26-41. Only if specifically requested must the lien agent provide copies of any notices of lien served on him. Closing attorneys must request copies of notices received by the lien agent to avoid professional negligence claims - not more than five (5) business days before closing. G.S. § 44A-11.1(f).

Serving the lien agent with the Notice to Lien Agent, or requesting the list of lien claimants from the lien agent, is not the end of the process. A lien claimant must still go through the process of serving and/or filing the traditional Notice of Claim of Lien on Funds and Claim of Lien Upon Real Property. The statutory changes will make the new lien process a bit more complex.

A contractor seeking a lien on the real property must now: (1) serve its Notice to Lien Agent within 15

days of its first furnishing; (2) file its Claim of Lien within 120 days of last work; (3) serve the Claim of Lien on the Owner and the Lien Agent [the Claim of Lien form must now expressly state that the lien agent was served]; and (4) file an enforcement action within 180 days of last work. A new provision to the statute provides that an owner can demand a lawsuit be filed to perfect a filed lien, and if a suit is not filed within 30 days, the lien is discharged.

A subcontractor seeking a lien on the funds must: (1) serve its Notice to Lien Agent within 15 days of its first furnishing; and (2) serve its Notice of Claim of Lien on Funds on the owner, the contractor, subcontractors above it in the chain, and on the Lien Agent while monies are still owed.

A subcontractor seeking to enforce the contractor's lien on real property by right of subrogation under G.S. §44A-23 must: (1) serve its Notice to Lien Agent within 15 days of its first furnishing; (2) serve its Notice of Claim of Lien on Funds on the Owner and all above it in the construction chain as well as on the lien agent; (3) serve the Subrogated Claim of Lien on the contractor, the owner, all above it in the construction chain and the lien agent, in addition to filing the same; and (4) file the lien enforcement action within 180 days of last work by the contractor. The statute has been clarified to provide that a contractor can cut off the subrogated claim by cancelling its contractor's lien rights before a lien enforcement action is filed, but this does not affect the subcontractor's lien on funds. The amendments clarify that, for these subrogated liens, the subcontractor may use either the subcontractor's dates or the contractor's. The amendments also make clear that second and third tier subcontractors cannot assert a subrogated lien if the owner, within 30 days of the contract award, posts and files a Notice of Contract, and there is no service by the second or third tier subcontractor of a Notice of Subcontract.

The new scheme seeks to limit claims against the property in the hands of new owners. A Claim of Lien can be perfected against a new purchaser only if: (a.) the lien agent received notice from the claimant not later than **15 days after its first furnishing; and (b) either** the lien agent received the notice from the lien claimant prior to the date on which a deed to a bona fide purchaser is recorded; **or** the Claim of Lien is filed prior to the deed being recorded. Even if the Claim of Lien attaches to the new property, if the Claim of Lien is filed **AFTER** a deed of trust is recorded, it will be subordinate to the new deed of trust unless: (a) the Lien Agent received notice within **15 days of first furnishing;** and (b) the Lien Agent received notice prior to the recordation of the deed of trust.

Changes were also made to avoid involving in the litigation parties without payment obligations. Former owners are no longer a necessary party in a lawsuit to perfect a lien if no monies are sought from them. Also, if a lien is discharged by a bond or cash deposit, a subsequent purchaser and lender need no longer be joined as a party to the lawsuit after the suit is filed.

Due to a question in the bankruptcy courts on the right to serve a Notice of Claim of Lien On Funds after a bankruptcy filing, the statute has been modified to provide that a lien on funds exists immediately, only to be perfected by service of the Notice of Claim of Lien On Funds. This will avoid a bankruptcy prohibiting the right to obtain the lien on funds by service of a notice after the bankruptcy is filed.

Changes for Public Projects: Effective January 1, 2013

The Basics Of The New Rules:

Contractors must provide a "contractor's project statement" to their subcontractors.

Subcontractors must provide the "contractor's project statement" to their subcontractors, and subcontractors below the first tier must serve a "Notice of Public Contract" on the contractor, as soon as possible.

The Details:

A risk of double payment arises on public jobs where the contractor has posted a payment bond, pays the first tier subcontractor for its work - in full - but the first tier subcontractor fails to pay down the line to the second tier subcontractor/supplier. Under the law, the unpaid lower tier subcontractors still have a claim on the bond. Since the bonding company is liable, the contractor is in turn liable on its master surety agreement to the surety. The new legislation attempts to limit this risk.

The new changes require that, where a bond is required by law, a contractor shall provide each subcontractor with the following information: name of the project, address, name of contracting body, name of contractor, agent for service, name and address of principal place of business of surety. This is termed the "contractor's project statement." In turn, each subcontractor shall provide each subcontractor it engages with a copy of the contractor's project statement.

After receiving the "contractor's project statement," a subcontractor should serve a "Notice of Public Subcontract" on the contractor stating: Name and address, property description, description of subcontract, description of labor or materials. [Not applicable to claim of \$20,000 or less.]. By doing so the subcontractor protects its right to recover on the bond. If he fails to do so, the subcontractor is at risk if a contractor complies with its obligations. A contractor must now provide a copy of the bond within seven (7) days of receiving a request, instead of 10 days. If the contractor complies, a subcontractor is limited to recovering for work or material within 75 days prior to giving notice of public subcontract. G.S. § 44A-27. The sooner the Notice of Public Contract is given, the further back in time the recovery right extends.

A subcontractor below the first tier on a public project (i.e. any subcontractor that does not have a direct contract with the contractor) must still give written notice to the contractor of a claim on a payment bond within 120 days of its last furnishing to have a claim on that payment bond.

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