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ABOUT THE AUTHORS



[Byron Saintsing](#) leads a practice group focused on matters involving [construction law](#), commercial and business litigation, representation of [equipment lessors](#), charter schools, and education law, and commercial creditor bankruptcy. Byron has written and lectured on many topics pertaining to construction and equipment leasing, including editing materials on North Carolina's adoption of Article 2A of the Uniform Commercial Code.



[John Sperati](#) is a partner in the firm and member of the firm's Creditors' Rights Practice group. He concentrates his practice in commercial creditor bankruptcy, foreclosure and real estate litigation, structured settlement transfer, judgment domestication and enforcement, construction litigation, commercial litigation, equipment leasing and finance and creditors' rights. John is listed as a Rising Star in North Carolina Super Lawyers® that recognizes

Possible Impact on North Carolina Lien Waivers

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In North Carolina, a mechanic's and material man's lien relates back to his/her first date of furnishing for the purposes of establishing priority of liens on real property. However, a recent decision by the North Carolina Business Court may seriously erode those lien rights for contractors and subcontractors on construction projects in NC. The North Carolina Business Court's ruling in *Wachovia Bank, N.A. v. Superior Construction Corporation, et al.* may substantially impact the determination of priority between the lending institution providing the construction financing and the general contractor or subcontractor when the contract's first date of furnishing pre-dates the filing of the lender's deed of trust.

Background of the Case

Intercoastal Living, LLC ("Owner") contracted with Superior Construction Corporation ("Superior") to be the general contractor on a condominium project in Brunswick County ("the Project"). Superior began construction on the Project on April 22, 2005. Wachovia Bank, N.A., made a construction loan to the Owner and secured it with a deed of trust recorded on May 19, 2005 in the county where the Project was being constructed. As part of Superior's payment application process, Superior executed partial waivers of lien conditional upon payment. Superior's partial lien waivers specifically stated that by signing the waivers it did in fact "waive, relinquish, surrender, and release any and all liens, claims, or right to lien on the above said described project and premises, arising under and by virtue of the mechanic's lien laws of the State of North Carolina on account of any labor performed or the furnishing of any material to the above described project and premises up to and including [the date of the lien waiver.]"

Eventually, a payment dispute arose between the Owner and Superior and Superior filed a claim of lien on the Project. The Owner defaulted on its construction loan payments and Wachovia began foreclosure proceedings. When Wachovia discovered Superior was claiming a priority position on the real property encompassing the Project, Wachovia filed suit and asked the court to determine the priority of the respective liens, arguing that the partial lien waivers executed by Superior caused them to lose their priority position.

accomplished, young attorneys.

Superior argued that when it signed the lien waivers and accepted partial payment, it only reduced the amount payable under the lien and did not affect in any way the priority of its lien or its first date of furnishing of labor and materials.

The Business Court looked at the language of the lien waiver and determined that it was broadly written. Further, language like “release any and all lien” was taken to mean that Superior was waiving all rights to liens, including the date of first furnishing of materials. Prior to this decision, the Courts of North Carolina have consistently interpreted the partial lien waiver to only modify the possible amount of the lien, if a payment issue arises later. The Business Court interpreted the partial lien waiver in this case as a waiver of all rights up until the date specified in the lien waiver, which would serve to push back Superior’s first date of furnishing to be that first provision of labor or materials after the date of the provided lien waiver.

How Does This Decision Possibly Impact Lien Waivers Going Forward?

The possible impact of this ruling on North Carolina lien waivers can be illustrated in the following scenario. ABC Contractors starts work on Project X on January 1, 2010. For the purposes of asserting a lien, January 1, 2010 is the first date of furnishing for ABC. Bank A provides construction financing to the owner of Project X on January 20, 2010 and records its deed of trust in the proper county. At this point and time, if there was a dispute on the Project X regarding priority, ABC’s lien would have priority over Bank A’s deed of trust and ABC would get paid first in the event there was a foreclosure sale, assuming Bank A had no other defenses. On January 31, 2010, ABC executes a partial lien waiver as part of its payment application process, waiving its lien rights for the work it completed during January using similar language to that above. ABC then gets paid based on the January payment application. At this point, under the Business Court’s new decision, ABC’s “new” date of first furnishing for determining the priority on Project X is February 1, 2010 and Bank A then becomes the priority lien holder on Project X and will be entitled to be paid first if there is a foreclosure action/sale.

While this decision is a written opinion of a single North Carolina Superior Court and, as such, is not binding authority on other superior courts, prudence dictates taking precautionary action to change the language of any lien waivers that may create the same exposure. Of concern is that other courts may agree with the logic of this decision and adopt its reasoning. Superior is attempting to have this decision overturned by Court of Appeals; however it may be several years before any ruling is issued. In the meantime, here are a few things to note in light of this ruling as it stands.

Keep in mind that this ruling will have no impact in a situation where the deed of trust was recorded before the contractor or subcontractor’s first date of furnishing of materials. In this instance, there is no question that the financing bank maintains priority. Should priority be at issue, however, the Court noted that in order to avoid similar unintended consequences, the lien waivers should be written more narrowly. For example, inserting a sentence that states that “this interim partial lien waiver is intended solely to waive any and all lien rights with regard to the sums actually paid and received contemporaneously herewith, and is expressly not intended, nor may it be construed, to

alter, amend, modify, or revise the date upon which labor or materials were first furnished (or last furnished) for any purposes of Chapter 44A of the North Carolina General Statutes, including, but not limited to, determining priority of interests in the real property being improved.” Such clarity of language would better avoid an issue such as the one that arose in the recent business court decision.

If you have any questions or concerns regarding this article, please feel free to contact John Sperati at (919) 250-2122 or jsperati@smithdebnamlaw.com or contact Byron Saintsing (919) 250-2118 or bsaintsing@smithdebnamlaw.com in our firm’s [Construction Law](#) department.

CONTACT US

919.250.2000
mail@smithdebnamlaw.com

RALEIGH OFFICE

The Landmark Center
4601 Six Forks Road, Suite 400
Raleigh, NC 27609

Phone: 919.250.2000
Fax: 919.250.2100

CHARLESTON OFFICE

171 Church Street
Suite 120C
Charleston, SC 29401

Phone: 843.714.2530
Fax: 843.714.2541