

# SPECIAL BULLETIN: North Carolina's New Mechanic's Lien Law - The Ground Has Shifted

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On July 12, 2012, North Carolina Session Laws 2012-158 and 2012-175 became law. These laws significantly change North Carolina's mechanic's lien and public project bond statutes. In order to continue to receive the rights and protections provided by these statutes, anyone engaged in the construction process will need to understand – and strictly comply with – these new provisions.

## **The Existing Mechanic's Lien Law and the Perceived**

### **Need for Change**

A "mechanic's lien," sometimes referred to as a "contractor's lien," is a secured interest in real property or funds benefitting contractors and subcontractors<sup>[1]</sup> who improve a parcel of real property located in North Carolina ("Real Property"), but who are not paid for those improvements as required by their contract with the owner of the Real Property or another contractor or subcontractor. If the lien claimant contracted directly with the owner of the Real Property, then the lien claimant is a "general contractor" or, in the terminology of the statute, a "contractor," and has a secured interest in the Real Property that the contractor improved. If, on the other hand, the lien claimant contracted with a contractor or a subcontractor of a contractor, then the claimant is considered a "subcontractor" and is entitled to assert a lien upon funds in the hands of upper-tier subcontractors, the contractor, and the owner where such funds are owed "downward" to the claimant, but is not entitled to assert a lien directly on the title to the improved Real Property.

The existing system for asserting a lien is relatively simple. A contractor who is not paid for its work on a project by the owner of the Real Property can file, within 120 days after the date it last furnished labor or materials to the Real Property (commonly called the "last furnishing"), a "Claim of Lien on Real Property" with the Clerk of Court of the county where the Real Property is located. The contractor is then required to file a lawsuit against the owner to enforce the lien within 180 days after the contractor's last furnishing. The priority of the contractor's lien on the Real Property relates back to the first date the contractor furnished labor or materials to the Real Property (commonly called the "first furnishing").

On the other hand, a subcontractor who is not paid timely cannot file a "direct" lien on the Real Property, but can serve upon its upper-tier subcontractors (if any), the contractor, and the owner a "Notice of Claim of Lien Upon Funds." If money is owed "downward" from the owner to the contractor, from the contractor to the intervening subcontractors (if any), and then on to the subcontractor-claimant, then service of the Notice of Claim of Lien Upon Funds creates a secured interest in favor of the subcontractor-lien claimant against that

owed money. If any party higher in the chain of funds disbursement then ignores the claimant's Notice and pays another party instead or, as it is sometimes stated, "pays over" the lien claimant's lien upon funds (that is, makes a payment without insuring that the lien claimant's claim is satisfied or sufficient funds are withheld to satisfy the claim), then that party becomes directly liable to the lien claimant to the extent of the wrongful payment. Furthermore, to the extent the subcontractor has a valid lien upon funds held by the owner, the subcontractor can "step into the shoes" (a legal concept called "subrogation") of the contractor and thereby assert against the owner any lien on Real Property available to the contractor.

The primary driving force behind the 2012 changes to the lien and bond statutes was the fact that since the liens can "relate back" in time, they constitute "hidden" liens on the Real Property which do not appear on the public record so that a lender or buyer can protect against them. Because the contractor's lien on Real Property becomes effective as of the date on which labor, materials, or services are first provided to improve the Real Property and there was no formal public record of when this may have occurred, there was no certain way for a buyer or lender to determine whether there was a possible lien, when it might have become effective, and whether it might take priority over other interests in the Real Property.

### **The Lien Agent Amendment - Session Law 2012-158**

The key component of Session Law 2012-158, commonly called the "Lien Agent Amendment," is the creation of a very important new player in the construction process: the Lien Agent. The Lien Agent Amendment applies in situations where the first furnishing of labor or materials to the Real Property occurs on or after April 1, 2013. The Lien Agent Amendment does not apply to jobs where the cost of the improvement is projected to be less than \$30,000 at the time the building permit is issued or to additions or improvements to an existing single-family residential dwelling that is also used as the owner's residence.

The Lien Agent Amendment requires that, for any construction project to which it applies, the owner of the Real Property must designate a Lien Agent no later than when the owner first contracts with any person or entity to improve the Real Property. A list of available Lien Agents will be maintained by the North Carolina Department of Insurance. The owner will designate the Lien Agent by giving the designated Lien Agent written notice of the Agent's selection, which will include a description of the Real Property to be improved. The owner will also be required to identify the Lien Agent to any potential claimant who requests such information within seven days after the request.

An owner or contractor will not be able to obtain a building permit unless the Lien Agent's contact information is provided to the issuing inspections department. Further, the Lien Agent's contact information must be a conspicuous part of the building permit, and must be conspicuously posted on the Real Property for the duration of the project.

Contractors and subcontractors will be required to provide lower-tier subcontractors who are furnishing labor or materials to be used in improving the Real Property, but who will not actually perform the services on, or deliver the materials to, the Real Property, (for example, material suppliers) with the Lien Agent's contact information within three business days after contracting with the lower-tier subcontractor. The best tactic will be to put the Lien Agent's contact information in the contracts and subcontracts applicable to the project at issue.

In order to preserve lien rights directly against the Real Property, every potential lien claimant will be required to provide to the Lien Agent a "Notice to Lien Agent" which contains the following information:

- The potential lien claimant's name, mailing address, telephone number, fax number, and email address;
- Identification of the party with whom the potential lien claimant contracted to improve the Real

Property;

- A description of the Real Property improved in sufficient detail to identify it; and,
- Notice of the potential claimant's right to subsequently pursue a Claim of Lien on Real Property.

The Notice to Lien Agent may be submitted prior to, during, or subsequent to the performance of the work or delivery of the materials in question. However, to preserve and assert a lien against the Real Property (as opposed to a lien against pending funds), one of the following must occur:

- The Notice to Lien Agent must be served on the Lien Agent no later than 15 days after the first furnishing of labor or materials to the Real Property by the potential lien claimant; or,
- The Lien Agent must be served with the Notice to Lien Agent prior to a conveyance of the Real Property; or,
- The potential lien claimant must file a Claim of Lien on Real Property with the Clerk of Court of the county where the Real Property is located prior to a conveyance of the Real Property.

Furthermore, the lien cannot relate back and have priority over a deed of trust encumbering the Real Property unless:

- The Notice to Lien Agent is served upon the Lien Agent within 15 days after the first furnishing of labor or materials by the lien claimant; or,
- The Notice to Lien Agent is served on the Lien Agent prior to the recording of the deed of trust at issue.

Thus, if a potential lien claimant fails to serve the Notice to Lien Agent within 15 days after commencing work, then the claimant will risk either losing its lien claim altogether or, at a minimum, losing the priority of its lien claim as to deeds of trust recorded after the start of the project.

The requirement that a Claim of Lien on Real Property be filed with the Clerk of Court within 120 days after a lien claimant's last furnishing of labor or materials to the Real Property remains unchanged. Likewise, the requirement that a lawsuit to enforce the lien be filed within 180 days after the lien claimant's last furnishing of labor or materials also remains unchanged. These requirements continue to apply to both contractors asserting direct liens against the Real Property and subcontractors asserting subrogation liens against the Real Property. Similarly, a subcontractor's lien upon funds and the manner in which it is asserted will not be affected by the Lien Agent Amendment. However, a subcontractor's ability to assert, through subrogation, a contractor's lien directly against the Real Property will be affected by whether and when the subcontractor has served a Notice to Lien Agent on the Lien Agent.

The purpose of requiring notice of potential lien claims to be served on the Lien Agent at the start of the project or as soon as the contractor or subcontractor is hired to either perform services or provide materials to the Real Property is so that the Lien Agent can act as a clearing house for lien claims, thereby making potential lien claims public information and no longer "hidden."

### **The Secondary Amendment - Session Law 2012-175**

Session Law 2012-175, commonly called the "Secondary Amendment," makes a number of changes to the exercise of lien rights. All of the provisions of the Secondary Amendment described below go into effect on January 1, 2013.

*First*, Claims of Lien on Real Property will be required not only to be filed with the Clerk of Court, but also to be served upon the owner of the Real Property and, if it is a subcontractor's subrogation lien, the contractor. Failure to serve the correct parties with the Claim of Lien on Real Property can cause the lien to fail altogether.

*Second*, the following new, additional information must be included in the Claim of Lien on Real Property:

- If the lien is asserted by a subcontractor, the name of the contractor through whom the subcontractor is asserting the lien; and,
- A certification by the lien claimant that the required parties have been served with the Claim of Lien on Real Property.

*Third*, it will be clarified that a subcontractor's lien upon funds "arises" upon the first furnishing of labor or materials to the Real Property by the subcontractor, and that the service of a Notice of Claim of Lien Upon Funds only "perfects" the lien, thus making it legally enforceable. This change avoids a problem with the potential loss of rights that might occur when an upper-tier party files bankruptcy.

*Fourth*, it will also be made clear that to establish priority, a subcontractor asserting a lien against the Real Property by way of subrogation to a contractor's right may use either its own first and last furnishing dates, or the contractor's first and last furnishing dates.

*Finally*, there will be increased penalties that can be assessed against parties for making false statements in lien waivers:

- The applicable licensing board for the contractor or subcontractor making the false statement may pursue revocation of the party's license; and,
- The penalties applicable to making a false statement will also be made applicable to public, bonded jobs.

### **Changes to North Carolina's Public Project Bond Statute - the "Little Miller Act"**

The Secondary Amendment also includes several changes to North Carolina's public project bond statute (also known as the "Little Miller Act").

*First*, a contractor on a construction project where the owner of the Real Property is the State of North Carolina or one of its subdivisions will be obligated to provide a copy of the statutorily required bond to a subcontractor within seven days after a request from that subcontractor.

*Second*, all subcontractors, regardless of the party with whom they contract (whether it be a contractor or any other subcontractor), will be required to provide a "Notice of Public Subcontract" to the contractor. The contents of the Notice of Public Subcontract will be as follows:

- The name and address of the subcontractor giving notice;
- A general description of the Real Property;
- A general description of the subcontractor's contract; and,
- A general description of the labor and materials furnished.

The Notice of Public Subcontract should be provided no later than 75 days after the subcontractor's first furnishing of labor or materials. If the Notice of Public Subcontract is sent later or not at all, there is a substantial risk that the subcontractor will lose its ability to recover from the project's payment bond some or all of the amounts it may ultimately be owed.

*Finally*, the contractor on a public construction project is now required to pass down to its subcontractors a "Contractor's Project Statement" which must include the following:

- The name of the project;
- The physical address of the project;

- The name of the owner of the Real Property;
- The name of the contractor;
- The name, phone number, and mailing address of the contractor's registered agent; and,
- The name and address of the principal place of business of the surety issuing the payment bond.

Subcontractors are required to pass down to their subcontractors copies of the Contractor's Project Statement.

## **Conclusion**

The changes to North Carolina's mechanic's lien and public project bond statutes are significant. Unless those who are in the construction process understand – and comply with – these changes, they may lose valuable rights and protections that are provided by these statutes.

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[1] "Subcontractor" as used in this Bulletin includes material suppliers.

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