

# SMITH ANDERSON

# Client Alert

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July 2012

## Changes to North Carolina Lien and Bond Law – What You Need to Know

A number of significant changes to North Carolina's lien and bond statutes were just signed into law. In part, these changes are in reaction to concerns from the title insurance industry about so-called "hidden" liens, the risk to contractors of "double payment" to subcontractors, and recent bankruptcy court decisions which adversely affected subcontractor/supplier lien rights. The changes will affect the payment rights and obligations of everyone involved in a construction project. Among the changes, parties will now have to take early steps to protect their lien and bond claim rights or risk losing them. The following overview highlights the most critical changes in the law. The changes phase in at different times – some become effective immediately, and some on January 1, 2013 or April 1, 2013. In all cases, the law applies to improvements made to real property on or after those dates.

### *Private/Non-Government Projects – New Requirements*

The new lien laws now require the use of a "lien agent," a company whose duty is to track information concerning parties who may have potential 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:

- **Owners:** 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. 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)
- **Contractors/Subcontractors:** To preserve their lien rights, contractors and subcontractors must provide written notice to the lien agent within 15 days of first furnishing labor or materials (exceptions apply for single-family home builders). 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. Failure to provide this notice exposes contractors and subcontractors to potential claims for damages. (effective April 1)

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- **Subcontractors:** In certain circumstances, to properly perfect its rights to a claim of lien on real property, a subcontractor must serve its claim of lien on real property on both the owner and the contractor. In completing the claim of lien on real property, the subcontractor may either use its first and last date of furnishing labor or materials, or that of the contractor. (effective January 1)
- **Design Professionals:** To be safe, architects, engineers, and surveyors should provide notice to the lien agent within 15 days of first work. However, the statute includes a limited exception where 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)

### ***Public/Government Projects – New Requirements***

Similarly, the law now provides for advance notice of potential 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 payment bond. Payment bonds are generally required on public projects because liens cannot be asserted against publicly-owned property. The law now requires:

- **Contractors:** 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. 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 all of their subcontractors at the time they enter into the subcontract. (effective January 1)
- **First-tier Subcontractors:** At the time of contracting, first-tier subcontractors must provide their subcontractors with a copy of the “contractor’s project statement.” (effective January 1)
- **Lower-tier Subcontractors/Suppliers:** In order to secure the right to assert a bond claim for the full amount being claimed, subcontractors and suppliers who are “second-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 or supplier within the 75-day period before service of the notice of public subcontract. 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 and suppliers to assert bond claims of \$20,000 or less even if they have not served notices of public subcontract. (effective January 1)

### ***Notice of Claim of Lien Upon Funds***

The statute now makes it clear that a lien upon funds owed on a project (as distinguished from a lien on the real property) arises, attaches, and is effective immediately upon the subcontractor’s/supplier’s first furnishing of labor or materials. This change preserves the right to pursue a lien upon funds against project-related proceeds, even after a bankruptcy filing by a party higher in the contract chain. This lien is perfected by serving the notice of claim of lien upon funds in a manner and form as previously provided for under the law. Until the notice of claim of lien upon funds is served, the funds against which the lien attaches can be used in the ordinary course of business without limitation. (effective January 1)

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The general contractor's execution of a lien waiver can cut off the subcontractor's lien rights against the real property, but cannot cut off a subcontractor's right to a lien upon funds so long as the subcontractor has served the notice now required by the statute. (effective January 1)

### ***False Lien Waiver Penalties Expanded***

In an effort to further deter the incidents of false lien waivers, signing or compelling others to provide a false lien waiver remains a criminal offense (Class 1 misdemeanor). The new law also provides for potential disciplinary action by the appropriate licensing board against those who either sign, or compel others to sign, a false lien waiver, including the imposition of restrictions on the license, suspension, or revocation in a timely manner. (effective January 1)

### ***Conclusion***

These new changes in the lien and bond laws came about after significant debate. Given the scope and nature of the changes, it will take time—and rulings from North Carolina's appellate courts—to fully understand the impact of the new laws. Further legislative action is expected in order to provide for technical corrections, remove inconsistencies, and clarify the new requirements in these laws.

While there is time before most of the changes take effect, the changes will require doing business differently and a greater diligence on the part of all involved in the construction project. Therefore, it is important that parties fully educate all members of their team concerning these changes and promptly implement new practices and procedures to account for the notice requirements. It is also advisable that parties evaluate their current form contracts and lien-related forms to determine whether those documents are consistent with the changes in the law and to revise them accordingly.

### **About Our Real Estate Development Group**

The Smith Anderson Construction law team is a subgroup within our firm's Real Estate Development (RED) group. The team counsels owners, general contractors, subcontractors, sureties, and design professionals during all stages of a project. Services include bidding, contract and development issues, claims avoidance and administration, pre-litigation planning and strategies, and the resolution of construction-related disputes and the bond, lien, and insurance claims that are often involved. The team's experience includes involvement in some of the largest public and private projects in the state and region.

Our RED group comprises more than 20 lawyers, making it one of the largest of its kind in our marketplace. We are a dedicated, collaborative team of finance, real estate and construction law professionals with an eye for efficient and effective solutions. Our clients view us as vital extension of their team, often involving us at every stage of a project, from conception to completion. Our RED group features many of the area's top legal professionals from each of our five related practice groups: Commercial Real Estate, Construction, Environmental, Health & Safety, Land Use & Zoning, and Real Estate Litigation.