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February 19, 2014

1. **Issue**:

As currently worded, North Carolina's Mechanics Lien statutes do not protect the interests of those who supply labor and materials that improve the value of real property, when the general contractor is in privity not with the actual owner of the property, but only a tenant. In his concurring opinion in Pete Wall Plumbing Co. v. Sandra Anderson Builders, Inc., 215 N.C. App. 220, 721 S.E.2d 663, (2011), Judge Steelman rightly posited:

> I am concerned that the present state of our law does not provide adequate protection to suppliers of labor and materials as envisioned by Article X, section 3 of the North Carolina Constitution. In addition, the increasingly complex real estate arrangements now being used make it virtually impossible for a supplier of labor or materials to protect themselves under our lien laws.

Conceding that the holding in Pete Wall Plumbing was technically correct under the current statutes and caselaw, Judge Steelman observed: "I believe that such a holding does not provide suppliers of labor and materials with 'an adequate lien' as mandated by our Constitution" and suggested that the Supreme Court reconsider its previous holdings and the General Assembly "consider revising the provisions of Chapter 44A to prevent this unjust result." Pete Wall Plumbing, 215 N.C. App. at 234, 721 S.E.2d at ___.

Two years ago, via a written warning that they would "curtail[] mechanics' and materialmen's lien coverage" on all policies issued in North Carolina, the major title insurance companies convinced the legislature to remedy the recently recognized, 140-year-old 'hidden lien' problem. Title insurance companies get paid to take risks. Contractors and Subcontractors take risks to get paid. It is now time to correct the equally insidious and harmful "Hidden Owner" issue.

2. **History**:

In North Carolina, a Contractor's, Subcontractor's or Supplier's lien is a Constitutional right: "The General Assembly shall provide by proper legislation for giving to mechanics and laborers an adequate lien on the subject-matter of their labor." N.C. Constitution, Art. X, § 3 (1868.) In 1879, North Carolina Supreme Court Judge Thomas Ashe explained the genesis of this Constitutional right:

> A very large proportion of the laboring population of the State had just recently been released from thraldom and thrown upon their own resources perfectly ignorant of the common business transactions of social life and this provision of the Constitution and the acts passed to carry it into effect were intended to give protection to that class of persons who were totally dependent upon their manual labor for subsistence.

Whitaker v. Smith, 81 NC 340 (1879).[1]

The current statutes intended to satisfy this Constitutional mandate are codified in Chapter 44A of the General Statutes. O & M Indus. v. Smith Eng'r Co., 360 N.C. 263 (2006). Specifically, N.C. Gen. Stat. § 44A-8 states:

> Any person who performs or furnishes labor or professional design or surveying services or furnishes materials or furnishes rental equipment pursuant to a contract, either express or implied, with the owner of real property for the making of an improvement thereon shall, upon complying with the provisions of this Article, have a right to file a claim of lien on real property… to secure payment of all debts owing… pursuant to the contract.

N.C. Gen. Stat. § 44A-8. The courts have consistently recognized that the purpose of these lien statutes is to protect the interest of the contractor, laborer or materialman. Embree Constr. Group, Inc. v. Rafcor, Inc., 330 N.C. 487,492, 324 S.E.2d 626, 629 (1992) ("the materialman, rather than the mortgagee, should have the benefit of materials

[1] As such, the original statutes enacting North Carolina's Constitutional mechanics lien rights may have been the earliest Civil Rights laws in this State.

that go into the property and give it value."); Carolina Builders Corp. v. Howard Veasey Homes, Inc., 72 N.C. App. 224, 229, 324 S.E.2d 626, __ (1984) ("the materialman . . . should have the benefit of materials that go into the property and give it value."), disc. review denied, 313 N.C. 597, 330 S.E.2d 606 (1985); Elec. Supply Co. of Durham, 328 N.C. 651 (1991) ("The materialman's lien statute is remedial in that it seeks to protect the interests of those who supply labor and materials that improve the value of the owner's property").

The problem, as noted by Judge Steelman, is the current express statutory limitation of lien rights to only the labor, materials, services, or equipment furnished pursuant to contracts with the owner of real property. As such, by treating a tenant as a non-owner of the real property itself, the Constitutional lien rights usually are "illusory" and "effectively eviscerate the constitutionally protected lien rights of laborers and materialmen." Pete Wall Plumbing, 215 N.C. App. at 234-235, 721 S.E.2d at __.

140 years ago, construction contracts were simpler agreements between the owner and the contractor, and most contractors performed all of the work themselves. This is no longer true. While 140 years ago third parties, such as lenders, had an interest in the improvements, there was not the plethora of interested parties that we see today: multi-state general contractors, construction managers, multiple tiers of subcontractors and specialty trade contractors, multi-state material suppliers, equipment rental companies, third-party labor providers, labor unions, etc. In fact much of the work is required to be performed by a licensed specialty contractor, such as electrical or plumbing work. As such, many general contractors today act more as brokers and managers than actual builders, and are no longer the ones directly performing the labor or furnishing the materials.

Recognizing the evolving sophistication of construction practices, the legislature passed in 1880 "An Act to Give Subcontractors, Laborers and Materialmen a Lien for Their Just Dues." That revision, as stated by our Supreme Court, was "intended to extend the remedy to those who work or furnish materials from which the owner derives a benefit in the improvement of his property, even where there are no contract relations between them

and the owner…" Morganton Mfg. & Trading Co v. Anderson, 165 N.C. 285, 293, 81 S.E. 418, ___ (1914). Yet, the contractor's side of the equation is not the only one to have evolved since 1868 – for example, 140 years ago there were no multi-tenant shopping malls or property management companies. Up until now, however, the Constitutional remedy has only been extended to parties whose 'privity' is derived from that of the contractor. It is now time to extend the remedy to the corresponding parties whose privity is derived from the contracting 'owner.'

3. **Leaseholds**:

N.C. Gen. Stat. § 44A-7(6) defines "Owner" as: "A person who has an interest in the real property improved and for whom an improvement is made and who ordered the improvement to be made. 'Owner' includes successors in interest of the owner and agents of the owner acting within their authority." N.C. Gen. Stat. § 44A-7(7) defines "Real Property" as: "The real estate that is improved, including lands, leaseholds, tenements and hereditaments, and improvements placed thereon." Despite the fact that the mechanics' lien statutes are remedial, and as such should be interpreted in favor of those who are the statutes intended beneficiaries, the past interpretation of these two definitions has been that while recognizing a tenant as an 'owner,' the only real estate that a tenant can cause to be liened is his leasehold interest and the lien does not reach to the actual real property.

To claim that these improvements do not add to the value of the real property is disingenuous. The OED defines improve as:

> 2.b. To turn land to profit, to enclose and cultivate (waste land); hence to make land more valuable by such means.
> ***
> 3. To enhance in monetary value; to raise the price or amount of.
> ***
> 5. To advance or raise to a better quality or condition; to bring into a more profitable or desirable state; to increase the value or excellence of; to make better; to better, ameliorate.

THE OXFORD ENGLISH DICTIONARY, Vol. VII, 750 (2nd ed. 1991). Thus, if the labor or materials furnished add any value to, or better the quality or condition of, the real

property itself, the legal owner of the real property's interest, as well as any intervening landlord's or property manager's interest, has likewise been improved.

The landlords' recognition of the value of tenant initiated improvements is empirically evidenced by the frequent inclusion of clauses securing title to tenant improvements upon termination of a tenant's leasehold interest. For example, both the standard residential and commercial leases published by the North Carolina Association of Realtors expressly transfer such improvements to the landlord. See North Carolina Association of Realtors, Standard Form 410-T (Residential Lease) (Section 13: "All alterations, additions, and improvements upon the Premises, made by either the Landlord or Tenant, shall become the property of the Landlord and shall remain upon and become a part of the Premises at the end of the tenancy hereby created"); and North Carolina Association of Realtors, Standard Form 592-T (Commercial Lease) (Section 13: "All alterations, additions and improvements which Landlord has not required Tenant to remove shall become Landlord's property and shall be surrendered to Landlord upon the termination of this Lease, ...").

These standard clauses in the lease agreements expressly make the Landlord a successor in interest to the tenant in the improvements. Under a plain reading of the statue itself, a Landlord falls squarely within N.C. Gen. Stat. § 44A-7(6)'s definition of "Owner" as including "successors in interest of the owner and agents of the owner acting within their authority." As a successor in interest to the owner-tenant, the owner-landlord is an "owner [who] derives a benefit in the improvement of his property, even where there are no contract relations between them and the [contractor]." Morganton Mfg. & Trading Co., 165 N.C. at 293, 81 S.E. at ___. As such, the mechanic's lien should extend to the owner-landlord's interest in the real property as well.

4. **Proposed Solution**:

Similar to the protection recently granted to the title insurance companies and owners against 'hidden liens,' the North Carolina Subcontractors Alliance recommends that the statutes be changed to protect those who supply labor and materials from "hidden owners" and affirmatively extend the rights of contractors, subcontractors, and suppliers

to be paid for the furnishing of labor, materials, rental equipment, and/or professional design or surveying services under a contract with the tenant who holds a leasehold interest in the improved real property to the property itself. NCSA also recommends, in order to prevent "hidden owners" from being unfairly liable for improvements of which they may be unaware, that the statutes be modified to include reasonable notice to owner requirements for all improvements in excess of $ 10,000, and a mechanism whereby an owner may protect its real property from potential lien claims in a manner similar to the existing use of payment bonds. As such, NCSA recommends the following:

1. Change N.C. Gen. Stat. § 44A7(6) to read: **Owner.** -- The record owner of the real property claimed to be subject to the claim of lien on real property at the time the claim of lien on real property is filed, and a~~A~~ person who has an interest in the real property improved and for whom an improvement is made and who ordered the improvement to be made. "Owner" includes successors in interest of the owner and agents of the owner acting within their authority.

2. Add a new subsection 44A-12(2a) to read: Name and address of the party for whom the improvement was made and who ordered the improvement to be made, if the claim of lien on real property is being asserted pursuant to contract with a party other than the record owner of the real property.

3. Add a new section to Chapter 44A, Article 2, requiring a potential lien claimant improving real property pursuant to contract with a party other than the record owner of the real property where the cost of the potential lien claimant's contract is ten thousand dollars ($ 10,000) or more, either at the time that the original building permit is issued or, in cases in which no building permit is required, at the time the potential claimant entered into said contract, to serve written notice of said contract to the record owner in order to preserve its lien rights on the real property itself.

4. Add a new section to Chapter 44A, Article 2, allowing an owner to prospectively discharge any liens filed or subsequently filed upon real property by procuring and maintaining a payment bond executed by one or more surety companies legally authorized to do business in the State of North Carolina, in a sum equal to one and

one-fourth times the costs of the undertaking either at the time that the original building permit is issued or, in cases in which no building permit is required, at the time the contract for the improvements is entered into with the owner.

These changes would correct the "hidden owner" problem, and better align the mechanics lien statutes with both the letter and intent of the right mandated by our Constitution.

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