

NORTH CAROLINA COURT OF APPEALS

PRESERVE HOLDINGS, LLC,)
)
 Plaintiff-Appellee,)
)
 v.)
)
 SUPERIOR CONSTRUCTION)
 CORPORATION and)
 WESTERN SURETY COMPANY,)
)
 Defendants-Appellants,)
)
 and)
)
 GEORGE ROUNTREE III, Receiver)
 FOR Intracoastal Living, LLC,)
 and COASTAL SASH & DOOR,)
)
 Defendants.)

From Mecklenburg County
 Civil Action No. 07-CVS-21256
 Before the North Carolina
 Business Court

AMICUS CURIAE BRIEF OF AMERICAN SUBCONTRACTORS ASSOCIATION, INC.
AND AMERICAN SUBCONTRACTORS ASSOCIATION OF THE CAROLINAS

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AMICUS CURIAE BRIEF OF AMERICAN SUBCONTRACTORS ASSOCIATION, INC.
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ISSUES PRESENTED

- I. DOES THE TRIAL COURT'S DECISION IMPAIR SUBCONTRACTORS' LIEN RIGHTS BY IMPROPERLY IGNORING THE RELATION BACK DOCTRINE?
- II. DOES THE PARTIAL WAIVER OF LIEN CONTAIN LANGUAGE ALTERING THE RELATION BACK OF SUPERIOR'S LIEN TO ITS FIRST FURNISH DATE?
- III. DOES THE PARTIAL WAIVER OF LIEN CONTAIN LANGUAGE OF SUBORDINATION?
- IV. DID THE BANK RECEIVE THE BENEFIT OF ITS BARGAIN WITHOUT ALTERING SUPERIOR'S FIRST FURNISH DATE?

VI. WILL THE TRIAL COURT'S DECISION CREATE CONFUSION AND LITIGATION?

STATEMENT OF THE CASE

The American Subcontractors Association, Inc. ("ASA") and the American Subcontractors Association of the Carolinas ("ASAC") adopt by reference the Statement of the Case in the Brief of Appellants Superior Construction Corp. ("Superior") and Western Surety Company as if fully set forth herein. As an additional Statement, ASA and ASAC filed a Motion for Leave to File Amicus Curiae Brief on 15 October 2010. This Court granted the Motion by Order dated 19 October 2010. ASA and ASAC submit this Brief to urge reversal of the Trial Court's decision.

STATEMENT OF THE GROUNDS FOR APPELLATE REVIEW

This is an appeal from a final judgment of the Trial Court, granting a declaratory judgment in favor of the Plaintiff-Appellee. Appeal to this Court lies of right pursuant to N.C. Gen. Stat. § 7A-27(b).

STATEMENT OF THE FACTS

ASA is a national organization that represents the interests of approximately 5,000 subcontractor members who provide labor and materials on construction projects throughout the country. ASAC is an organization that represents the interests of approximately 234 subcontractor members throughout North and South Carolina. ASA's and ASAC's primary focus is the

equitable treatment of subcontractors in the construction industry. ASA and ASAC act in the interest of all subcontractors by promoting education and legislative action and by participating in significant legal actions that affect the industry. ASA and ASAC adopt by reference the Statement of the Facts in the Brief of Appellants Superior Construction Corp. and Western Surety Company as if fully set forth herein.

ARGUMENT

I. THE TRIAL COURT'S DECISION IMPAIRS SUBCONTRACTORS' LIEN RIGHTS BY IMPROPERLY IGNORING THE RELATION BACK DOCTRINE.

The protections afforded contractors, subcontractors, and suppliers through mechanics' and laborers' liens are essential to the survival of the construction industry. "An adequate lien is necessary to encourage responsible extensions of credit, which are necessary to the health of the construction industry" because contractors and subcontractors typically are not paid until after their work is complete and so must purchase their labor and materials on credit. O & M Indus. v. Smith Eng'g Co., 360 N.C. 263, 266, 624 S.E.2d 345, 347 (2006) (quoting Electric Supply Co. of Durham, Inc. v. Swain Elec. Co., 328 N.C. 651, 659, 403 S.E.2d 291, 296 (1991)).

The lien statutes are remedial in nature, and courts should further the legislative intent when interpreting the statutes. Carolina Builders Corp. v. Howard-Veasey Homes, Inc., 72 N.C.

App. 224, 229, 324 S.E.2d 626, 630 (1985). "The materialmen, rather than the mortgagee, should have the benefit of materials that go into the property and give it value." Id. at 229, 324 S.E.2d at 629.

A claim of lien "relate[s] to and take[s] effect from the time of first furnishing of labor or materials at the site of the improvement." N.C. Gen. Stat. § 44A-10. Justice Samuel J. Ervin, Jr. observed how weak the lien statutes would be without the "relation back doctrine":

The doctrine is inherent in the very statutes which give the contractor the lien upon the property improved by his labor or materials...; for it is plain that unless the contractor's lien when filed relates back to the time at which the contractor commenced the performance of the work or the furnishing of the materials, the object of the statutes can be defeated at the will of the owner of the property, by his selling or encumbering his estate. To hold that the doctrine of relation back is not inherent in these statutes would be to 'keep the word of promise to our ear, and break it to our hope.'

Equitable Life Assurance v. Basnight, 234 N.C. 347, 351, 67 S.E.2d 390, 394 (1951).

The relation back doctrine protects the contractor's lien by deeming it prior to any lien or encumbrance that attaches to the property after the contractor's first furnish date. Frank H. Conner Co. v. Spanish Inns Charlotte, Ltd., 294 N.C. 661, 667, 242 S.E.2d 785, 789 (1978). Thus, a claim of lien by a contractor whose first furnish date precedes the filing of a

lender's deed of trust takes priority over that deed of trust. Id. at 666, 242 S.E.2d at 788.

The Trial Court's decision shoots an arrow through the heart of the relation back doctrine and breaks the "word of promise" to subcontractors and contractors. The decision holds that an interim lien waiver given in exchange for a single progress payment forever changes the lien priority of the contractor (and all its subcontractors) for later performed work, even though the waiver contains no language altering the first furnish date or waiving the relation back doctrine. The Trial Court's holding misapprehends the relation back doctrine, misreads the lien waiver, and ignores the effect of waivers on subcontractors.

The Trial Court's decision, if not reversed, will have a particularly severe and unnecessarily harsh impact on the very subcontractors the lien statutes are designed to protect. A subcontractor's primary right to lien a project is by way of subrogation to the contractor's right to lien the project, and the first furnishing date for a subcontractor's lien is the date of the first furnishing of the contractor. Electric Supply Co. of Durham, Inc. v. Swain Elec. Co., Inc., 328 N.C. 651, 667, 403 S.E.2d 291, 297 (1991). Thus, a contractor's lien waiver releases a subcontractor's right to lien the project. See N.C. Gen. Stat. § 44A-23 (limiting the effect of a contractor's

waiver).

Subcontractors are at the mercy of contractors as to lien waivers. They have no practical way to stop a contractor from signing a lien waiver. They have no practical way to know when or whether the contractor signs a lien waiver. They have no practical way to participate in the drafting of a lien waiver.

The Trial Court's decision infers a waiver of the relation back doctrine when no such waiver is present. Inferring waiver of the relation back doctrine devastates subcontractors' lien rights and places the consequences of poor drafting on subcontractors who have no means to manage that risk. This Court should reject the Trial Court's decision.

II. THE PARTIAL WAIVER OF LIEN DOES NOT CONTAIN LANGUAGE ALTERING THE RELATION BACK OF THE LIEN TO SUPERIOR'S FIRST FURNISH DATE.

The Trial Court's opinion relies upon a sentence in two Partial Waivers of Lien. The relevant language states that Superior did:

waive, relinquish, surrender and release any and all lien, claim, 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 31st day of May, 2005.

(R pp 20, 248) (emphasis added).

The structure and grammar of the waiver show that the "up

to and including the 31st day of May" clause describes the "labor performed or the furnishing of any material." This meaning is clear from (1) the placement of the "up to" clause immediately behind the "on account of" clause and (2) the inclusion of a comma after the "waive . . . and release any and all lien" clause and the omission of a comma between the "on account of" clause and the "up to and including" clause. See Huffman v. Occidental Life Ins. Co., 264 N.C. 335, 338, 141 S.E.2d 496, 498 (1965) (using commas to determine meaning). The first sentence of Paragraph 47 of the Trial Court's opinion shows the trial court's agreement with this analysis. (R p 248).

Correctly read, the quoted sentence from the Partial Lien Waiver states only that Superior waived the right to file a lien on account of labor or materials furnished before 31 May 2005. It does not state that Superior waived its right to file a lien on account of labor or materials furnished after 31 May 2005.

Because nothing in the Partial Waiver of Lien prevents Superior from filing a lien for labor or materials furnished after 31 May 2005, the question becomes whether any language in the Partial Waiver of Lien addresses the priority of Superior's lien. Section 44A-10 provides that the priority of the lien relates back to Superior's first furnish date. N.C. Gen. Stat. § 44A-10. Nothing in the Partial Waiver of Lien suggests that the relation back doctrine no longer applies or justifies the

Trial Court's disregard of the relation back of the lien. Superior's rights with respect to labor or materials furnished after 31 May 2005 are unaffected by the Partial Waiver of Lien and N.C. Gen. Stat. § 44A-10 mandates that Superior's lien relate back to 22 April 2005, Superior's first furnish date.

Only a few states have lien laws comparable to North Carolina's lien laws. Counsel for ASA and ASAC are aware of only two relevant opinions from outside North Carolina. Metropolitan Fed. Bank v. Allen Mech. Contractors, Inc., 477 N.W.2d 668 (Iowa 1991); Duckett v. Olsen, 699 P.2d 734 (Utah 1985). Each case involved (1) a priority dispute between a contractor and a bank and (2) the interaction of a relation-back statute and a partial lien waiver substantially similar to the statute and waiver in the present case. Metropolitan, 477 N.W.2d at 672-73; Duckett, 699 P.2d at 735-36. Each opinion held that the contractor's lien remained superior to the bank's deed of trust. Metropolitan, 477 N.W.2d at 675; Duckett, 699 P.2d at 737. Each opinion based that result on the fact that nothing in the lien waiver affected the contractor's lien on later-performed work or on the relation back doctrine. Metropolitan, 477 N.W.2d at 673-74; Duckett, 699 P.2d at 737.

The Court should reach the same result in the present case. Here, the Partial Waiver of Lien did not waive rights with respect to work performed after 31 May 2005. One right of that

work is its priority relates back to the first furnish date. N.C. Gen. Stat. § 44A-10. Nothing in the Partial Waiver of Lien suggests that Superior agreed to change its first furnish date. Nothing in Chapter 44A suggests that the first furnish date is subject to change by agreement of the parties. The first furnish date does not change just because a contractor releases part of its lien.

The present case is no different from a contractor who accepts payment for all labor and materials through a date after the recording of a deed of trust. In that case, the priority of the lien relates back to the contractor's first furnish date even though the contractor's lien relates only to labor and materials furnished after the payment. EDMUND T. URBAN, NORTH CAROLINA REAL PROPERTY MECHANICS' LIENS, FUTURE ADVANCES, & EQUITY LINES §§ 8-2(a), 54-14 (2d ed. 1998) (Form Lien Subordination Agreement of Stewart Title Co. containing instructions to this effect) (App pp 2-4, 7-8). The result should be the same here because the Partial Waiver of Lien waived only Superior's right to lien on account of labor and materials furnished through 31 May 2005.

III. THE PARTIAL WAIVER OF LIEN DOES NOT CONTAIN LANGUAGE OF SUBORDINATION.

Section 44A-12(f) makes clear that the terms "subordination" and "release" are not synonymous. Section 44A-12(f) provides that it "does not prohibit subordination or

release of a lien.” N.C. Gen. Stat. § 44A-12(f) (emphasis added). Use of the conjunction “or” shows that the terms as having different meanings. Liens can be subordinated; liens can be released. One can be done without the other. A partial “release” of a lien does not necessarily include “subordination” of that lien.

The real estate industry provides a mechanism through which lenders can obtain priority over the lien of a contractor who began work before the lender could record its deed of trust.¹ That mechanism is the Subordination Agreement. Examples of language commonly used in the real estate industry to subordinate a lien to a deed of trust are presented in the Appendix to this Brief. (App pp 12-24).

Title insurance companies require the execution of an appropriate document relating to liens before they provide coverage for a lender without exception. 2 EDMUND T. URBAN ET AL., NORTH CAROLINA REAL ESTATE WITH FORMS § 27:6 (2d ed. 2009) (App pp 11). The North Carolina Land Title Association (“NCLTA”) has promulgated three form documents to deal with mechanics’ liens. Id. & App pp 12, 14, 20.

One such form, the “Owner/Contractor Affidavit, Indemnity

¹The real estate industry acknowledges that payments to a contractor through the date of the recording of a deed of trust do not change the relation back of the lien to the contractor’s first furnish date. See NORTH CAROLINA REAL PROPERTY, supra, § 54-14, Stewart Title Guaranty Co. Lien Subordination Agreement, Instructions (App p 8).

and Lien Subordination Agreement" contains language that shows how a bank can protect itself from liens like Superior's. (App p 20). The relevant language is in the third paragraph of Section

2. Id. That language provides:

Each undersigned Contractor hereby subordinates to the lien of the [bank's] Deed of Trust such Contractor's right and that of anyone claiming by, through, or under such Contractor to file a lien for Labor, Services or Materials on the Property. Each Contractor agrees that the [bank's] Deed of Trust shall constitute a superior and paramount lien for all amounts which have been or may hereafter be advanced under the Deed of Trust.

Id.

In the present case, the Partial Waiver of Lien does not contain language subordinating Superior's lien rights to the bank's deed of trust. The bank knew that Superior had already started work when the bank recorded its deed of trust. (R p 10 ¶ 18). The bank could have required a Subordination Agreement before it ever agreed to lend money to Intracoastal. The record does not reveal why the bank chose not to do so.

Interestingly, a formal subordination agreement would have subordinated Superior's lien only to the bank's deed of trust. The Trial Court's decision, however, does not subordinate Superior's lien just to the deed of trust of the bank that elected not to get a subordination agreement. By changing Superior's first furnish date, the Trial Court's decision

effectively subordinates the contractor's lien to any lien that arises between the first furnish date and 31 May 2005. The Trial Court's reasoning would subordinate the contractor's lien to the lien of a judgment creditor who gets a judgment between 22 April 2005 and 31 May 2005. Allowing a Partial Waiver of Lien that contains no express language of subordination to have a broader effect on the priority of the contractor's lien than a formal Subordination Agreement is bad policy.

IV. THE BANK RECEIVED THE BENEFIT OF ITS BARGAIN WITHOUT CHANGING SUPERIOR'S FIRST FURNISH DATE.

The correct reading of the Partial Waiver of Lien is that it reduces Superior's lien rights by the amount of the payment and that it prevents Superior from filing a lien for labor or materials furnished through 31 May 2005. It does not affect later work, including the relation back of Superior's lien rights to its first furnish date.

The bank does not need the court to change the contractor's lien priority in order for the bank to benefit from the Partial Waiver of Lien. The bank benefits because the Partial Waiver of Lien reduces the amount of Superior's lien by the amount of the progress payment. That improves the bank's junior position to the extent of its payment. The bank also benefited from Superior continuing to work on the project, enhancing the value of the bank's collateral. The bank has received the benefit of

its bargain without changing Superior's first furnish date.

V. THE TRIAL COURT'S DECISION WILL CREATE CONFUSION AND LITIGATION.

The priority of a lien relates back to the date of first visible commencement of work on the project. Frank H. Conner Co. v. Spanish Inns Charlotte, Ltd., 294 N.C. 661, 671-72, 242 S.E.2d 785, 791-92 (1978). The priority of a deed of trust starts at the date of recording. See Equitable Life Assurance Soc'y of U.S. v. Basnight, 234 N.C. 347, 350, 67 S.E.2d 390, 393 (1951) (holding that a mechanic's lien had priority over a deed of trust).

Both the contractor's first furnish date and the date of recording of the deed of trust are verifiable. The first furnish date is verifiable from observation of the property and from building permits or inspections by local government officials. The date the deed of trust is recorded is available from the register of deeds. That verifiability creates certainty, which is a foundation of the North Carolina system. D. Christopher Osborn, *N.C. Business Court Ventures Into Construction Lien Law*, CHANGE ORDER (N.C. Bar Ass'n Constr. Law Section, Cary, N.C.), June 2010, at 4 (App p 31).

The Trial Court's decision destroys the certainty that comes from verifiable facts. Partial lien waivers get buried in files and are not easily verifiable by anyone other than the

parties to them. No longer could subcontractors, suppliers, property buyers, third party lenders, creditors, or anyone else have any confidence in priorities based on public information.

The Trial Court's decision has many unintended consequences and leaves many unanswered questions, including:

- If a contractor wants to file a lien for work performed after it signs a partial waiver of lien, what does it write in the claim of lien for its "first furnish date"? Is the contractor supposed to use the actual first furnish date or the "revised" first furnish date?
- Is a subcontractor's claim of lien invalid if it uses the actual first furnish date instead of the "revised" first furnish date?
- If a second-tier subcontractor files a lien and lien perfection lawsuit before the contractor gives a partial lien waiver, is the second-tier subcontractor earlier in priority than the contractor and all subcontractors who did not file a lien, including the first tier subcontractors with whom the second-tier subcontractor dealt?
- How can subcontractors protect themselves?

By allowing each partial lien waiver to alter the contractor's first furnish date, the Trial Court's decision creates an ever changing "first furnish" date and dismantles the structure of the lien statutes.

CONCLUSION

For the foregoing reasons, ASA and ASAC urge this Court to reverse the Trial Court's Order granting Plaintiff-Appellee's Motion for Judgment on the Pleadings.

Respectfully submitted, this the 28th day of October, 2010.

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CERTIFICATE OF SERVICE

The undersigned hereby certifies that a true and accurate copy of the foregoing AMICUS CURIAE BRIEF OF AMERICAN SUBCONTRACTORS ASSOCIATION, INC. AND AMERICAN SUBCONTRACTORS ASSOCIATION OF THE CAROLINAS has been served upon each of the parties listed below by putting the same in a properly addressed, postage prepaid envelope, and placing said envelope in an official depository under the exclusive care, custody, and control of the United States Postal Service, addressed as follows:

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