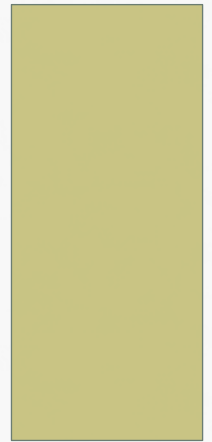


LIENS ON LEASEHOLD INTERESTS

CURRENT LAW AND RECENT APPELLATE DECISIONS



CONSTITUTIONAL PROVISION

- Article X, section 3 of the North Carolina Constitution:

“The General Assembly shall provide by proper legislation for giving to mechanics and laborers an adequate lien on the subject matter of their labor. The provisions of Sections 1 and 2 of this Article shall not be so construed as to prevent a laborer's lien for work done and performed for the person claiming the exemption or a mechanic's lien for work done on the premises.”

STATUTORY PROVISION

§ 44A-9. Extent of claim of lien on real property.

“A claim of lien on real property authorized under this Article shall extend to the improvement and to the lot or tract on which the improvement is situated, to the extent of the interest of the owner. . . .”

§ 44A-7. Definitions.

“(6) Owner. – 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. SUPREME COURT OPINION

To secure a lien on the fee simple, a materialman [or laborer] must “exercise that degree of diligence which would enable them to ascertain the status of the title to the land upon which the [improvement is] to be erected and to obtain the approval or procurement of the owners.” *Brown v. Ward*, 221 N.C. 344, ___, 20 S.E.2d 324, 327 (1942).

SO WHAT ABOUT LIENS ON LEASEHOLD INTERESTS?

Short Answer:

- Where a materialman [or laborer] contracts with a leaseholder and not the owner of the real property, the materialman's lien only extends to that leasehold interest *unless* the materialman can prove that the leaseholder was acting as an agent for the owner.
- Where the lien exists only on the leasehold interest, enforcement of the lien must be completed before the leasehold interest terminates.

RECENT CASES

- *Pete Wall Plumbing Co., Inc. v. Sandra Anderson Builders, Inc.*, __ N.C. App. __, 721 S.E.2d 663 (2011).
- *Pegram-West, Inc. v. Sandra Anderson Builders, Inc.*, 210 N.C. App. 491, 716 S.E.2d 88 (2011) (unpublished).

PETE WALL - FACTUAL BACKGROUND

- Pete Wall Plumbing Co., Inc. (plaintiff) delivered plumbing supplies and services for the construction of six homes in a residential subdivision located in Greensboro, North Carolina. The ownership of these properties involved a complex transaction of leases, subleases, foreclosures, and sales.

PETE WALL - FACTUAL BACKGROUND

- The properties were owned by the Housing Authority of the City of Greensboro (the Housing Authority).
- The Housing Authority entered into a ground lease with Willow Oaks Development (Willow Oaks) covering the six properties.
- Willow Oaks entered into a ground sublease with Sandra Anderson Builders (SAB). SAB was required to make improvements on the land - construct single family homes.

PETE WALL - FACTUAL BACKGROUND

- Under the terms of the lease, SAB was the owner of the improvements during the lease term. However, upon completion of a home on any lot, SAB was required to convey the home to a homebuyer. At the end of the lease term, SAB was required to surrender the properties (presumably the ones that did not sell before the end of the lease term) in “as-is” condition.
- SAB had no right to bind any interest of Willow Oaks to any lien or other security interest.
- The subleases were recorded with the Guilford County Register of Deeds.

PETE WALL - FACTUAL BACKGROUND

- Construction of the homes was financed by Carolina Bank. The Housing Authority, Willow Oaks, SAB, and Carolina Bank entered into a multiparty agreement for each of the properties whereby the Housing Authority and Willow Oaks agreed to subordinate their interests in the properties to Carolina Bank's deeds of trust in SAB's subleased interests.

PETE WALL - FACTUAL BACKGROUND

- Plaintiff provided plumbing, labor, and materials during the construction of the six homes between January and April 2008. Plaintiff was not paid and subsequently filed six “Notices of Claims of Lien” on each of the six properties in July 2008. These forms were an amalgamation of the “claim of lien” form (G.S. 44A-12) and the “notice of claim of lien upon funds” form (G.S. 44A-19). It appears that the attorney chose this method of filing because SAB was technically an owner and a contractor.

PETE WALL - FACTUAL BACKGROUND

- At the time plaintiff filed its notices, four of the six properties had already been conveyed by general warranty deed from the Housing Authority and SAB to individual buyers. The deeds stated that the ground lease, ground sublease, and the multiparty agreements were terminated.
- The other two properties were foreclosed upon by Carolina Bank (Carolina Bank subsequently purchased these two properties) before SAB even furnished labor or materials.
- In August 2008, plaintiff brought an action to enforce the liens against SAB; the Housing Authority; Willow Oaks; Carolina Bank; the homebuyers; and the owner of SAB, Sandra B. Anderson.

PETE WALL - PROCEDURAL HISTORY

- The procedural history in the trial court is extensive. In essence, all of plaintiff's claims were dismissed against the various parties except the claim against SAB. In June 2009, a consent order for summary judgment was entered against SAB for \$49,913.11.
- Plaintiff argued on appeal that the trial court erred by dismissing its claims against the individuals who purchased four of the six properties, and the claims against Carolina Bank who took two of the properties through foreclosure.

PETE WALL - APPELLATE HOLDING

I) Four Properties Sold To Individual Buyers

- With regard to the claim of lien on the four properties, the private owners argued that any liens filed against their properties were invalid because they each received general warranty deeds that cancelled the interests of SAB in their properties before plaintiff's filings were made. The Court agreed.
- The Court acknowledged that judicial enforcement of a materialman's lien on a leasehold interest is permissible; however, the lien is only valid to the extent of the interest of the owner. With regard to the four lots sold, the lien was not enforced until after SAB's ownership interest in the lots and sublease had been extinguished by the deed conveyances.

PETE WALL - APPELLATE HOLDING

The Court reasoned:

“Since our statutes only provide plaintiff with a claim of lien to the extent of an owner's interest in a property, plaintiff possessed no statutory protection in the private owners' properties after SAB's interest in each property was terminated. . . . As the facts of the instant case demonstrate, the combination of the time limited nature of a leasehold interest and the time required to judicially enforce a materialman's lien effectively makes the protections of a claim of lien against a leasehold interest almost theoretical for shorter-termed leases. However, this result is necessitated by previous decisions of our Supreme Court and by the language of Chapter 44A of our General Statutes. It was ultimately plaintiff's decision to furnish materials to an entity with only a time-limited interest in the properties. The extent and terms of SAB's interest in the properties were filed with the Register of Deeds and were thus a matter of public record, readily ascertainable by plaintiff.”

PETE WALL - APPELLATE HOLDING

With regard to the claim of lien on funds, the Court held that the sale of the land to the private owners also extinguished this lien. The Court explained that a lien on funds does not attach to any funds until after it is received by an obligor pursuant to G.S. 44A-20(a). At the time plaintiff provided labor and materials, only SAB qualified as the obligor under G.S. 44A-17(3) (repealed effective January 1, 2013) since it was the owner of the improvements at that time. Carolina Bank held a deed of trust, but it was not an obligor. Therefore, the trial court correctly discharged the claim of lien on funds against Carolina Bank on all the properties sold to individual buyers. The Court did not address whether plaintiff had a valid claim of lien on funds paid by SAB since SAB had already entered into a consent judgment.

PETE WALL - APPELLATE HOLDING

II) Two Properties Foreclosed on, and Later Purchased, by Carolina Bank

With regard to the claim of lien on the two properties, the Court held that since Carolina Bank recorded deeds of trust on the two lots before plaintiff provided labor or materials to them, Carolina Bank's deeds of trust were senior to plaintiff's claims of lien pursuant to G.S. 44A-10. The Court held that with regard to the claim of lien on funds, the foreclosure on the two properties had no effect on the lien since the lien does not attach to real property; however, the Court did not address whether the discharge of any lien on funds against SAB was erroneous.

PETE WALL - CONCURRENCE

Judge Steelman wrote a concurring opinion in which he stated:

“In a lease situation, such as that before this Court, the lien protection of the supplier of labor and materials is illusory. The lien can only attach to the extent of the sublessee's interest, and this evaporates upon expiration of the lease. I agree that this result is mandated by the Supreme Court decision in *Brown v. Ward*[.] However, I believe that such a holding does not provide suppliers of labor and materials with ‘an adequate lien’ as mandated by our Constitution. The Supreme Court should reconsider its holding in *Brown* and the General Assembly should consider revising the provisions of Chapter 44A to prevent this unjust result.”

PETE WALL - CONCURRENCE

Judge Steelman proffered the following:

“Where it is clear that the principal purpose of the agreements was the construction of improvements upon real estate to the joint benefit of the owner, the lessee, and the sublessee, those parties should be deemed to be joint venturers, and the clauses in the leases prohibiting the lessee and sublessee from causing any lien to attach to the lots be declared void as against public policy.

If such provisions in leases and subleases are enforced by the courts, then they will effectively eviscerate the constitutionally protected lien rights of laborers and materialmen.”