STATE OF NORTH CAROLINA CONSTRUCTION LAW COMPENDIUM

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I. Breach of Contract

In North Carolina, claims on a construction project primarily involve claims for breach of contract. In order to properly plead a claim for breach of contract, the complainant should allege: 1) the existence of a contract, 2) the specific provisions breached, 3) the facts and circumstances constituting the breach, and 4) the amount of resulting damages. *Cantrell v. Woodhill Enterprises, Inc.*, 273 N.C. 490, 160 S.E.2d 476 (1968). "[W]here the cause of action is a failure to construct in a workmanlike manner and with the material contracted for, plaintiff's pleading should allege wherein the workmanship was faulty or the material furnished by defendant was not such as the contract required." *Id*. at 497, 160 S.E.2d at 481. A party may also breach the contract by repudiation. A party repudiates a contract when, by his words or conduct, he expresses an unequivocal and absolute refusal or inability to perform. *Messer v. Laurel Hill Assoc.*, 93 N.C. App. 439, 378 S.E.2d 220 (1989); *Profile Invs. No. 25, LLC v. Ammons East Corp.*, 207 N.C. App. 232, 700 S.E.2d 232 (2010). A lien granted pursuant to Chapter 44A of the General Statutes cannot be premised on a contract implied in law. *Waters Edge Builders, LLC v. Longa*, 214 N.C. App. 350, 715 S.E.2d 193 (2011).

II. Negligence

Negligence is the failure to exercise the appropriate standard of care under the given circumstances, whether that standard be imposed by statute or common law. In North Carolina, in order to establish a claim for negligence, a party must prove: 1) a duty imposed by law to conform to a certain standard of care; 2) a failure to conform to that standard; 3) a causal nexus between the failure to conform to the standard and the resulting injury or damage; and 4) actual damages or injury. *Sasser v. Beck*, 65 N.C. App. 170, 308 S.E.2d 722 (1983).

Violations of the North Carolina Building Code constitute negligence per se. *Oates v. JAG, Inc.,* 314 N.C. 276, 333 S.E.2d 222 (1985).

While North Carolina does recognize a claim for negligent construction, it should be noted that North Carolina has also long held that "[o]rdinarily, a breach of contract does not give rise to a tort action by the promisee against the promisor." *N.C. State Ports Authority v. Lloyd A. Fry Roofing Co.*, 294 N.C. 73, 81 (1978); *see, e.g. Supplee v. Miller-Motte Bus. College, Inc.*, 239 N.C. App. 208, 768 S.E.2d 582 (2015); *see e.g. Hardin v. York Mem'l Park*, 221 N.C. App. 317, 730 S.E.2d 768 (2012). Commonly known as the economic loss rule, the law is well-settled in North Carolina that there is no recovery in tort for purely economic losses. Similarly, "[A] tort action does not lie against a party to a contract who simply fails to properly perform the terms of the contract, even if that failure to properly perform was due to the negligent or intentional conduct of that party, when the injury resulting from the breach is damage to the subject matter of the contract. It is the law of contract and not the law of negligence which defines the obligations and remedies of the parties in such a situation." *Kaleel Builders, Inc. v. Ashby*, 161 N.C. App. 34, 43, 587 S.E.2d 470 (2003). The owner of a general contracting company may be held personally liable for negligent construction of a building if the owner personally supervised or performed the construction. *White v. Collins Bldg., Inc*., 209 N.C. App. 48, 704 S.E.2d 307 (2011).

In order to prevail on a claim for willful and wanton negligence, a party must prove a deliberate purpose to not fulfill some duty imposed by law necessary for the safety of persons or protection of the property of others. *Akzona, Inc. v. Southern R. Co.*, 314 N.C. 488, 334 S.E.2d 759 (1985). To be entitled to punitive damages, a party must prove willful or wanton conduct. N.C. Gen. Stat. § 1D-15. "'Willful or wanton conduct' means the conscious and intentional disregard of and indifference to the rights and safety of others, which the defendant knows or should know is reasonably likely to result in injury, damage or other harm. 'Willful or wanton conduct' means more than gross negligence." N.C. Gen. Stat § 1D-5(7) (2016).

North Carolina remains in the discrete minority of states that recognizes the defense of contributory negligence as a complete bar to a negligence claim. Under North Carolina law, if a party asserting a claim based on negligence is found to have contributed, even the slightest amount – i.e. 1% negligent, to its own injuries, the finding bars the party's right to recovery. "With contributory negligence, a plaintiff's actual behavior is compared to that of a reasonable person under similar circumstances." *Draughon v. Evening Star Holiness Church of Dunn*, 374 N.C. 479, 484, 843 S.E.2d 72, 77 (2020).

III. <u>Breach of Warranty</u>

A. Express Warranties

In the construction industry, warranties are generally defined as promises, or guarantees of the quality, quantity, or duration of a product or certain construction work performed. There are two types of warranties or guarantees involved in construction contracts. The first is the "express warranty," which is a warranty specifically agreed to by the parties and embodied in their construction contract. See *Coates v. Niblock Dev. Corp.*, 161 N.C. App. 515, 588 S.E. 2d 492 (2003). These provisions within the contract specify the duties of the parties and the time limits involved. The most common warranty of this type is the contractor's promise regarding the quality of his work often found in the contract's "General Conditions." This warranty usually promises the contractor's work will be of good quality, free from defects, and performed in accordance with the contract documents.

The UCC express warranty provision (N.C. Gen. Stat. § 25-2-313) has also been applied to construction projects. *See Westover Products, Inc. v. Gateway Roofing, Inc.*, 94 NC App. 63, 380 S.E.2d, 369 (1989); *See also Russell v. Baity*, 95 NC App. 422, 383 S.E.2d 217 (1989). There are four elements required of a successful claim for a breach of express warranty under the UCC: (1) a contract between the seller and buyer of goods; (2) a promise by the seller to the buyer relating to the goods, or a description of the goods, or showing a sample or model to the buyer, which is made part of the basis of the bargain; (3) breach of the warranty; and (4) damages caused by the breach. *See Russell v. Baity*, *supra*; *Westover Products, Inc. v. Gateway Roofing Company*, *supra*; *Salem Towne Apartments, Inc. v. McDaniel & Sons Roofing Co.*, 330 F. Supp. 906 (E.D.N.C. 1970).

B. Implied Warranties

The second type of warranty is the "implied warranty", which arises by operation of law from the nature of a particular transaction. In the construction context, there are a number of implied warranties which can arise under North Carolina law.

The most important implied warranty between an owner and a contractor is the one by which the owner warrants to the contractor the plans and specifications furnished by or on behalf of the owner are accurate and adequate for the contractor's performance of the work. If the plans and specifications are defective, the contractor is entitled to recover any additional costs incurred in attempting to perform in accordance with the defective plans or in making corrections required because of the defective plans. *Gilbert Engineering Co. v. Asheville*, 74 NC App. 350, 328 S.E.2d 849, *disc. rev. denied*, 314 NC 329, 333 S.E.2d 485 (1985); *Greensboro Housing Authority v. Kirkpatrick & Assoc.*, 56 NC App. 400, 289 S.E.2d 115 (1982).

A second example of an implied warranty is the mutual promise by the parties to a construction contract that neither will delay or impede the other's performance. See *Raleigh Paint & Wallpaper Co. v. James T. Rogers Builders, Inc.,* 73 NC App. 648, 327 S.E.2d 36 (1985)(where general contractor prevented subcontractor from completing performance of the contract, general contractor was precluded from using subcontractor's failure either as defense or counterclaim). A claim for breach of warranty not to delay or hinder usually derives from the contractor seeking to recover damages when it has been forced to perform work in an inefficient or out-of-sequence manner by virtue of some act or omission for which the owner is responsible.

Yet another example of implied warranty is the implied warranty of workmanlike construction. *Lumsden v. Lawing*, 107 N.C. App. 493, 421 S.E. 2d 594 (1992). This warranty guarantees the quality of work performed by the contractor. *Cantrell v. Woodhill Enterprises, Inc.,* 273 NC 490, 160 S.E.2d 476 (1968).

An implied warranty which is sometimes utilized in construction is the warranty of livability. This warranty does not apply to commercial buildings, only residential dwellings. *See Dawson Industries, Inc. v. Godley Constr. Co.*, 29 NC App. 270, 224 S.E.2d 266, *disc. rev. den.*, 290 NC 551, 226 S.E.2d 509 (1976). The warranty relates to substantial defects in a dwelling which renders the dwelling unfit for human habitation. The warranty does not apply to visible or "patent" defects and only requires that the construction be of sufficient quality to withstand reasonable conditions of use. *Hartley v. Ballou*, 286 NC 51, 209 S.E.2d 776 (1974). This warranty is not limited to the initial purchaser of a residence but provides a subsequent purchaser a cause of action based upon negligence against the builder. *Gaito v. Auman*, 313 NC 243, 327 S.E.2d 870 (1985).

IV. Misrepresentation and Fraud

Contracts exist in virtually every aspect of construction and carry with them an implied obligation of "good faith and fair dealing." *SunTrust Bank v. Bryant/Sutphin Prop.*, LLC, 222 N.C. App. 821, 833, 732 S.E.2d 594, 603 (2012) (quoting *Bicycle Transit Auth. v. Bell*, 314 N.C. 219, 228

(1985)). When a party to a contract fails in that respect, a simple breach of contract action arises. In order to sustain an action for fraud or misrepresentation, substantial aggravating circumstances or egregious conduct must be present. The economic loss doctrine does not bar a fraud claim. *Bradley Woodcraft, Inc. v. Bodden*, 251N.C. App.27, 795 S.E.2d 253 (2016).

A. Common Law Fraud

In order to establish a claim for common law fraud in North Carolina, the plaintiff must show: "(1) a false representation or concealment of a material fact, (2) reasonably calculated to deceive, (3) made with intent to deceive, (4) which does in fact deceive, (5) resulting in damage to the injured party." *Myers & Chapman, Inc. v. Thomas G. Evans, Inc*., 89 N.C. App. 41, 365 S.E.2d 202*, affirmed, in part, rev'd in part & remanded,* 323 N.C. 569, 374 S.E. 2d 385, 391 (1988). To prove common law fraud, one must demonstrate a misrepresentation made knowingly, reasonable reliance, and resulting harm. Punitive damages are available for a successful common law fraud claim.

Fraud can also be established where a party has a duty to speak but fails to do so. A duty to speak may arise (1) in the context of a fiduciary duty, (2) where one party has taken affirmative steps to conceal material facts from the other party, or (3) where one party has knowledge of a latent defect in the subject matter of the negotiations about which the other party is both ignorant and unable to discover through reasonable diligence. *Harton v. Harton*, 81 N.C. App. 295, 344 S.E.2d 117 (1986).

B. Unfair and Deceptive Trade Practices

N.C. Gen. Stat. § 75-1.1, governing unfair and deceptive trade practices, is a statutory cause of action for a party injured by fraud and, in some circumstances, misrepresentation. Proof of fraud is a *per se* violation of N.C. Gen. Stat. § 75-1.1. However, in pursuing a violation of § 75-1.1, knowing misrepresentation is not a necessary element and willfulness is not a prerequisite. In fact, good faith is not a defense. Pursuing a remedy under this statute is made more attractive by the fact that treble damages are automatically awarded for § 75-1.1 violations, and attorneys' fees are also available in the discretion of the trial court. Typically, a plaintiff will allege both a common law claim and a violation of N.C. Gen. Stat. § 75-1.1, but the plaintiff must ultimately choose his or her course of action. Note, a party may not recover both punitive damages and treble damages under Chapter 75. The prevailing party must make an election prior to entry of judgment. *Ellis v. Northern Star Company*, 326 N.C. 219, 388 S.E.2d 127 (1990).

Fact patterns that have been held to constitute fraud and, consequently, unfair and deceptive trade practices include: misrepresentations by developers of oceanfront property regarding material aspects of the project and false promises made to purchasers, a general partner's misrepresentations to contractors about the amount of money remaining on a construction loan, false representations about work that had been performed on a condominium in order to consummate a sale, and securing services and materials with no intent to pay.

C. Misrepresentation

Deception, to a lesser degree than fraud, can be actionable and also qualify as a violation of N.C. Gen. Stat. § 75-1.1. The key distinction is the absence of the element of intent. Negligent misrepresentation occurs when in the course of a business or other transaction in which an individual has a pecuniary interest, he or she supplies false information for the guidance of others in a business transaction, without exercising reasonable care in obtaining or communicating the information. Intent to deceive or knowledge of a statement's falsity is not required, as it is when fraud is alleged. Unlike fraud, negligent misrepresentation does not give rise to an award of punitive damages. Contributory negligence is a defense to negligent misrepresentation in tort actions, however it is not a defense in unfair and deceptive trade practice actions.

In *Marshall v. Miller*, the North Carolina Supreme Court held that in order for misrepresentation to form the basis for an unfair and deceptive trade practices claim, a party's words or conduct must possess the tendency or capacity to mislead or create the likelihood of deception. 47 N.C. App. 530, 268 S.E.2d 97 (1980), modified & aff'd 302 N.C. 539, 276 S.E.2d 397 (1981). Several actions on the part of a partner and contractor involved in the construction of an apartment complex were found to have been misrepresentations constituting unfair trade practices. These included obtaining funds to pay subcontractors and material suppliers and then failing to pay them, and providing misleading information about the status of construction, expected date of completion, and quality of the construction. However, in determining whether a representation is deceptive under N.C. Gen. Stat. § 75-1.1, the effect on the average consumer is considered. If the average person would not be deceived by a misrepresentation, then no violation of the statute would be found. In a business context, its effect on the "average businessperson" is the test. In the construction context, for example, courts have noted that projected completion dates are commonly missed for multiple reasons. Those facts alone would not rise to a level of conduct which would result in a violation of § 75-1.1.

For a breach of contract claim to support a § 75-1.1 violation, substantial aggravating circumstances must be present in relation to the breach. A mere breach of contract, even if intentional, cannot support an unfair trade practice claim. *Branch Banking & Trust Co. v.* Thompson, 107 N.C. App. 53, 418 S.E.2d 694 (1992). Some aspect of fraud, deception, or other unfairness needs to be present to sustain such a claim, and it must rise to a level greater than the general unfairness that accompanies a contract breach. Determining whether a mere breach of contract has occurred, or whether fraud or misrepresentation in violation of the unfair trade practice statute can be supported, will depend upon the facts evidencing the presence of requisite additional aggravating circumstances.

V. Strict Liability

North Carolina recognizes strict liability for ultra-hazardous activities, such as blasting. *Guilford Realty and Insurance Co. v. Blythe Brothers Co.*, 260 N.C. 69, 131 S.E.2d 900 (1963). North

Carolina courts also impose strict liability on builder-vendors for any breach of the implied warranty of habitability, which occurs when a structure is not sufficiently free from major structural defects or not constructed in a workmanlike manner so as to meet the standard of workmanlike quality prevailing at the time and place of construction. *Becker v. Graber Builders, Inc.*, 149 N.C. App. 787, 561 S.E.2d 905 (2002).

VI. Arbitration Provisions

North Carolina adopted the Revised Uniform Arbitration Act, N.C. Gen. Stat. § 1-569 *et seq.* When one party claims a dispute is covered by an agreement to arbitrate and the other party denies there is such an agreement, the trial court must determine whether an arbitration agreement exists. *Moose v. Versailles Condo. Ass'n.*, 171 N.C. App. 377, 381, 614 S.E.2d 418, 422 (2005); N.C. Gen. Stat. § 1-569.6(b). In its analysis, the court must ascertain: "1) whether the parties had a valid agreement to arbitrate and also 2) whether the specific dispute falls within the substantive scope of the that agreement." *Moose*, 171 N.C. App. at 381, 614 S.E. 2d at 422. The party seeking arbitration must show that the parties mutually agreed to arbitrate. *Routh v. Snap-On Tools Corp.*, 108 N.C. App. 268, 271-72, 423 S.E.2d 791, 794 (1992).

Finding the existence of an arbitration agreement is conclusive on appeal where supported by competent evidence. *Sciolino v. TD Waterhouse Investor Servs., Inc.* 149 N.C. App. 642, 645, 562 SE.2d 64, 66 (2002). However, the determination of whether the dispute is subject to arbitration is reviewable *de novo*. *Moose* at 382, 614 S.E.2d 422. An order denying a motion to compel arbitration is immediately appealable under N.C. Gen. Stat. § 1-569.28, but the grant of a motion to compel arbitration is interlocutory and is not immediately appealable because it does not affect a substantial right since courts are able to vacate, modify or correct an arbitration award. *C. Terry Hunt Indus. V. Klausner Lumber Two, LLC,* 255N.C. App. 8, 803 S.E.2d 679 (2017).

A right to arbitrate may be waived either by the express terms of the parties' contract or impliedly by delay that is prejudicial to the other party. *T.M.C.S., Inc. v. Marco Contractors, Inc.*, 780 S.E.2d 588 (2015). Prejudice may include causing the non-moving party to unnecessarily incur legal fees. *Town of Belville v. Urban Smart Growth, LLC,* 252 N.C. App. 72, 796 S.E.2d 817, (2017).

VII. Damages

In North Carolina, the general rules governing the measure of contract damages apply to the breach of a construction contract. One's actual damages must arise as the natural and proximate result to the breach of contract. The general rule for determining the quantum of damages for the breach of an express contract is that the non-breaching party should be placed in the same position had the contract been fully performed by the other party. *Meares v. Nixon Constr. Co.*, 7 N.C. App. 614, 173 S.E. 2d 593 (1970). Where there is an implied contract, damages may be based on *quantum meruit*, i.e. the reasonable value of the services rendered and accepted by the other party. *Booe v. Shadrick*, 322 N.C. 567, 369 S.E. 2d 554 (1988).

A. Compensatory (Direct) Damages

North Carolina courts have developed three different rules for calculating compensatory damages depending upon the timing of the breach of contract, which are not always consistently applied; (i) If the contractor has fully completed its work, the damages recoverable would be the full contract price plus interest; (ii) If the contractor has "substantially completed" its work, the measure of damages is the difference between full performance and what the owner has actually received, i.e. the reasonable cost of correcting and completing the contractor's work; *Meares, supra;* but (iii) Where a contractor has not substantially completed its work the measure of damages is the contractor's earned but unpaid portion of the contract price which had been earned, plus lost profits on the remaining work, if any, determined by taking the contract price and subtracting what it would have cost the contractor to complete the contract. *Meares, supra*. In the event defects in construction may not be corrected without destruction of a substantial portion of the work beneficial to the owner then the measure of damages is the diminution in value attributable to the contractor's breach ("Economic Loss Rule"). *Moss v. Best Knitting Mills*, 190 N.C. 644, 130 S.E. 635 (1925).

The North Carolina Court of Appeals approved of and enforced an engineering firm's "risk allocation" provision, which provided that the firm's liability for all claims, damages and expenses would not exceed $50,000 or the amount of the firm's fee, whichever was greater. *Blaylock Grading Company, LLP v. Smith*, 189 N.C. App. 508, 658 S.E.2d 680 (2008).

B. Special (Indirect) Damages — Lost Profits

Special proof is required to recover lost profits as they constitute a form of special damages in North Carolina. The first requirement is that lost profits must have been within the contemplation of the parties when the contract was made. *See Weyerhaeuser Co. v. Godwin Bldg. Supply Co.*, 292 N.C. 557, 234 S.E. 2d 605 (1977). The second requirement is that the special damages must be ascertainable with reasonable certainty, i.e. not speculative or uncertain. *See Gurney Industries, Inc. v. St. Paul Fire and Marine Ins. Co.*, 467 F 2d 588 (4th Cir. N.C. 1972).

C. Delay Damages

Damages flowing from a delay in a construction project are recoverable in certain situations. In North Carolina, there are two kinds of delays. The first type of delay is an excusable delay and the second is an inexcusable/compensable delay. Generally, excusable delays are unforeseeable, involve forces over which neither party has any control and are not due to either party's fault. Because of this, excusable delays do not give rise to damages although a contractor maybe entitled to an extension of time within which to complete its work. Excusable delays include unforeseen weather conditions, labor problems, and similar matters over which a party may not have control. It should be noted, however, that weather conditions causing delays must be unusually severe, and it is generally held that a contractor should anticipate some type of weather delays during any project. Additionally, although generally not an issue in North Carolina, labor disturbances constitute an excusable delay if they were unanticipated at the time

of contracting. A contractor should pay careful attention to any notice requirements contained in its contract since these may set out a given time period during which contractor must seek an extension of time to complete its work. If it does not do so, its request may be denied summarily.

An inexcusable/compensable delay is one which is caused by a party on the project which impacts another party which then becomes entitled to be compensated for resulting damages. Unlike an excusable delay, an inexcusable delay is a breach of contract so that the other party may be entitled to both damages and an extension of time. Some general examples of compensable delays include an owner's failure to provide sufficient access to a project; an owner's supply of defective materials causing delay; an owner's failure to deliver materials during the time required by the contract; and delays resulting from the owner's failure to coordinate the work with others on the project (when the owner is charged with that duty).

Where both parties to a construction contract contribute to the delay, neither can recover damages unless there is proof of clear apportionment of the delay and expense attributable to each party. In proving delay damages, North Carolina courts favor a direct actual cost method of quantifying the actual losses resulting from a delay, although these are not always easy to measure. A modified total cost method which seeks the difference between a contractor's total costs in performing the contract and its bid price is disfavored and is accepted only when there is no other way to compute damages. *Biemann & Rowell Co. v. Donohoe Cos.*, 147 N.C. App. 239, 556 S.E. 2d 1 (2001). In order to recover under the total cost method, the plaintiff must show: (1) the impracticability of proving actual costs directly; (2) the reasonableness of its bid; (3) the reasonableness of its actual costs; and (4) the lack of responsibility for the added costs. *Id*.

North Carolina courts prefer evidence that establishes actual damages; namely those that arise as a natural and proximate result of party's breach of contract. *Federal Paper Bd. Co. v. Kamyr, Inc.*, 328 N.C. 570, 403 S.E. 2d 510 (1991). Direct damages would include such things as excess labor, material, and equipment costs. Indirect damages would include items such as (1) extended jobsite and home office overhead, (2) anticipated or lost profits; (3) additional insurance for bond premiums and (4) damages due to lost restricted bonding capacity. *See Olivetti Corp. v. Ames Bus. Sys., Inc.*, 319 N.C. 534, 356 S.E.2d 578 (1987) (proof of damages must be made with reasonable degree of certainty). However, it has been held that home office overhead cannot be recovered on a public project unless that recovery was expressly contemplated by the parties in their contract. *Davidson and Jones, Inc. v. North Carolina Dep't of Admin.*, 315 N.C. 144, 337 S.E. 2d 463 (1985). No North Carolina courts have addressed the issue of whether the "*Eichleay"* formula calculation largely utilized as a method of calculating home office overhead damages in construction delay cases may be used to calculate overhead costs as damages.

In North Carolina, no-damages-for-delay clauses are generally enforceable on non-public projects. These clauses, however, are closely scrutinized and there are exceptions to enforcement for delay caused by fraud, misrepresentation, bad faith, active interference, gross negligence, and unreasonable delay constituting abandonment of the contract. Moreover, if an owner fails to grant an extension of time for delays caused by that owner, North Carolina courts

may award damages for breach of contract even though the contract contains a no-damages-for-delay clause.

D. Liquidated Damages

Liquidated damages clauses are frequently used in construction contracts in North Carolina following the general rule that parties to a contract may agree as to the amount of damages at the outset of their agreement. Because of the difficulty of proof of actual damages on a construction project, liquidated damages clauses are routinely upheld provided that the provision is not deemed a penalty and is a reasonable estimate of damages. A valid liquidated damages clause requires: (1) the damages must be of such a nature that they would be difficult to ascertain if there were a breach; and (2) the amount stipulated must either be a reasonable estimate of the probable damages if there were a breach or be reasonably proportionate to the damages actually caused by the breach. *Ledbetter Bros., Inc. v. N.C. Dep't of Transp.*, 68 N.C. App. 97, 314 S.E.2d 761 (1984). If a court finds a liquidated damages clause unenforceable, it will deem the clause to operate as an upper limit on the amount of damages that may be recovered for the breach. *Kinston v. Suddreth*, 266 N.C. 618, 146 S.E. 2d 660 (1966).

E. Interest on Contract Damages

N.C. Gen. Stat. § 24-5 provides that an amount due under a contract bears interest from the date on which it was due and N.C. Gen. Stat. § 24-1 provides that in the absence of an express agreement, the legal rate of interest is eight percent (8%) per annum. A court may award interest at a rate significantly higher than the statutory rate of eight percent pursuant to an agreement between the parties, even where the evidence of such an agreement is one party's failure to deny the interest agreement in response to a request for admissions. *J.M. Parker & Sons, Inc. v. William Barber, Inc*., 208 N.C. App. 682, 704 S.E.2d 64 (2010).

F. Attorney's Fees

Historically, contractual provisions for attorney fees for any type of action were not enforced by North Carolina courts unless specifically authorized by statute. *Stillwell Enter., Inc. v. Interstate Equip. Co.*, 300 N.C. 286, 266 S.E. 2d 812 (1980). In *Stillwell*, the Court allowed the recovery of attorney's fees in a dispute involving the lease of construction equipment because it interpreted the lease as "evidence of indebtedness" under N.C. Gen. Stat. § 6-21.2 which allowed recovery on an attorney's fees provision in such a document. The legislature has enacted several statutes since *Stillwell* to allow for the recovery of attorney's fees including:

1. Business Contracts (N.C. Gen. Stat. § 6-21.6)

Reciprocal attorneys' fees provisions in business contracts are valid and enforceable for the recovery of reasonable attorneys' fees and expenses if all parties to the contract sign the contract (which includes electronic signature). However, the award of attorneys' fees may not exceed the amount in controversy. A business contract is defined as a contract entered into

primarily for business purposes and does not include consumer contracts, employment contracts, or contracts in which a government or governmental agency is a party.

2. Lien Enforcement Actions (N.C. Gen. Stat. § 44A-35)

This statute allows a "prevailing party" to recover reasonable attorneys' fees in a lien-enforcement action upon a finding by the presiding judge that the losing party unreasonably refused to resolve the matter which constituted the basis of the suit or defense. "Prevailing party" is defined as (i) one who obtains judgment of at least 50% of the monetary amount sought or (ii) one who defends a lien-enforcement action that results in a judgment of less than 50% of the monetary amount sought by the claimant.

3. Unfair and Deceptive Trade Practice (N.C. Gen. Stat. § 75-16.1)

In any suit in which it is alleged that a party violated N.C. Gen. Stat. 75-1.1, which allows treble damages, the presiding judge may award *reasonable* attorney fees to the prevailing party, to be taxed as part of the court costs upon a finding by the presiding judge that (i) the party charged with the violation, willfully engaged in such conduct and there was an unwarranted refusal to fully resolve the matter which constitutes the basis of the suit; or (ii) the party instituting the action knew or should have known, the action was frivolous and malicious.

G. Mitigation of Damages

When a contract has been breached by a party the other party is under a common law duty to mitigate its damages due to the breach, provided he or she is aware of the breach. *Tillinghast v. Providence Cotton Mills,* 143 N.C. 268, 55 S.E. 2d 621 (1906). However, the duty to mitigate requires only reasonable diligence and ordinary care and is not obligated to incur extraordinary expense to minimize his or her damage *T.C. Bateson Constr. Co. v. United States,* 319 F.2d 135 (Ct. Cl. 1963).

VIII. Economic Loss Doctrine

North Carolina has adopted the economic loss doctrine, and consequently a party cannot recover for purely economic losses through a tort action. *Moore v. Coachmen Industries, Inc.,* 129 N.C. App. 389, 499 S.E.2d 772 (1998) (where doctrine prevented plaintiffs from recovering on their negligence claim against defendants for the loss of their recreational vehicle). The term "economic losses" has been construed to include damages to a product itself. See N.C. State *Ports Authority v. Lloyd A. Fry Roofing Co.,* 294 N.C. 73, 240 S.E.2d 345 (1978) (where the plaintiff contracted with a general contractor who subcontracted the work and the plaintiff's claim of negligence against the subcontractor for the faulty roof work was barred due to the economic loss doctrine). *See also Crescent Univ. City Venture, LLC v. Trussway Mfg., Inc.*, 376 N.C. 54, 852 S.E.2d 98 (2020) (reaffirming *N.C. State Ports Authority* and concluding that North Carolina courts have consistently applied the economic loss rule to hold that purely economic losses are not recoverable under tort law, particularly in the context of commercial transactions).

"The rationale for the economic loss rule is that the sale of goods is accomplished by contract and the parties are free to include, or exclude, provisions as to the parties' respective rights and remedies, should the product prove to be defective." *Moore,* 129 N.C. App. at 401-402, 499 S.E.2d at 780. To allow a remedy in tort, where the defect in a product damages the actual product, would let the aggrieved party ignore the rights and remedies imposed by the contract for sale of the product. *Id.* at 402, 499 S.E.2d at 780.

Only where a defective product causes damage to property *other* than the defective product is the loss attributable to the defective product and recoverable in tort. *Id.* Otherwise, recovery is in a contract action. In *Higginbotham v. Dryvit Systems, Inc.,* 2003 U.S.Dist. LEXIS 4530 (M.D.N.C. 2003), the plaintiffs contended that their losses were not "economic losses" because the product involved, defendant's Fastrak 4000, damaged not only itself, but also plaintiffs' house. The *Higginbotham* court, relying on a similar holding in *Wilson v. Dryvit Systems, Inc.* 206 F. Supp. 2d 749, 753 (E.D.N.C. 2002), held that such damage was not considered damage to other property. "'[W]hen a component part of a product or a system injures the rest of the product or the system, only economic loss has occurred.'" *Higginbotham* at 10 (*quoting Wilson* at 753).

IX. Indemnity and Contribution

A. Indemnity

In North Carolina, indemnification from a contractor or other entity involved on a construction project may only be had in three circumstances: 1) when a written contract for indemnification exists between the parties; 2) when a contract implied-in-fact exists; or 3) when equitable concepts arising from the tort theory of indemnity exist, which are also called a contract "implied-in-law." *Kaleel Builders, Inc. v. Ashby*, 161 N.C. App. 34, 587 S.E.2d 470 (2003). *Kaleel* is the leading case on indemnification, and it places strict limits on a contractor's right to recover indemnity damages from someone such as a subcontractor.

In most cases, it is clear whether or not an express contract for indemnification exists. If one does exist, then the entity seeking indemnification may generally recover it. If no such contract exists, then the only way to recover indemnification is to argue that a contract implied in fact or one implied in law exists. This will generally be difficult to prove.

A contract implied in fact "stems from the existence of a binding contract between two parties that necessarily implies the right." *Kaleel*, 161 N.C. App. at 38, 587 S.E.2d at 474. Thus, unless there is a contract between the person seeking indemnity and the person against whom the claim is asserted, there can be no indemnification. Additionally, even if there were such a contract, the right to indemnity arises only in master-servant or principal-agency contractual arrangements, and in the typical construction context, a contractor will not have this type of relationship with another contracting entity. *Kaleel*, 161 N.C. App. at 40, 587 S.E.2d at 474-75.

As for a contract implied in law, this is an equitable right existing when one defendant is passively negligent but is exposed to liability for another's active negligence, or one party is derivatively liable for the negligence of another. Both scenarios require negligence as the underlying claim, which is generally prohibited in construction cases, as the remedies will be determined by contract. *Kaleel*, 161 N.C. App. at 41-42, 587 S.E.2d at 475-76.

Therefore, under *Kaleel*, absent a written contract for it, indemnification generally may not be recovered on a construction project. However, contractors still maintain the right to recover for breach of contract from any entity with whom they contracted.

B. Contribution

The only right to contribution in North Carolina is the right that exists between joint tortfeasors. N.C. Gen. Stat. § 1B-1. As tort claims are generally prohibited in construction cases, given that the remedies are to be judged by the contracts existing between the parties, there can be no joint tortfeasors. Thus, there is generally no right to contribution. *See Kaleel*, 161 N.C. App. at 43, 587 S.E.2d at 476.

X. Statutes of Repose and Limitations

In North Carolina, actions for breach of contract, breach of warranty, and negligence have a three-year statute of limitations. N.C. Gen. Stat. § 1-52. The limitations period begins to run on the date of breach or negligent act. However, where the action is one for personal injury or property damage, the period does not begin to run until the injury is, or should reasonably have been, discovered. N.C. Gen. Stat. § 1-52. The discovery rule is subject to a statute of repose, however, no actions for an unsafe or defective improvement to real property may be brought after six years from the later of substantial completion or the last act or omission giving rise to the claim. N.C. Gen. Stat. § 1-50. The six-year statute of repose was called into question in December of 2014 when freedom of contract principles prevailed in the North Carolina Supreme Court's decision in *Christie v. Hartley Constr., Inc.*, 367 N.C. 534, 766 S.E.2d 283,(2014). The Court determined that a manufacturer waived application of North Carolina's 6-year statute of repose by extending an express 20-year warranty of its product. The decision restores confidence that an express warranty can be relied on for its full stated term. The 10-year statute of limitations applicable to instruments under seal applies to both actions on the instrument itself and counterclaims based on the instrument. *McGuire v. Dixon*, 207 N.C. App. 330, 700 S.E.2d 71 (2010).

XI. Pay When Paid Clauses (N.C. Gen. Stat. § 22C-2)

Pay when paid clauses are against public policy in North Carolina and are unenforceable.

XII. Prompt Payment Act. (N.C. Gen. Stat. § 22C-1)

When a subcontractor has performed in accordance with the provisions of his contract, the contractor is required to pay the subcontractor the full amount the contractor receives for the subcontractor's work within seven days of receipt of the payment. Delay in making this payment entitles the subcontractor to interest on the unpaid amounts at one percent (1%) per month.

XIII. Insurance Coverage

A. Builder's Risk Insurance

Builder's Risk Insurance usually covers the subject building while under construction as well as other structures, equipment, and materials related to the construction which are actually located on the jobsite. Normally, all parties participating in the construction of the project are co-insureds under the typical policy. The policy is an "all risk" policy so that generally coverage terms are construed broadly and exclusions are construed very narrowly. The policies do not cover business interruption losses or loss of use, although endorsements can be purchased covering these kinds of losses. The policy generally terminates when the project is accepted by the owner or when it terminates by its own terms. Many Builder's Risk policies exclude damages caused by faulty or defective workmanship or materials.

B. Commercial General Liability ("CGL") Policies

CGL policies cover the insured for claims arising out of bodily injury or property damages caused by an occurrence. This coverage does not apply to Workers' Compensation claims but only to claims by third parties that the insured caused bodily injury or property damage to them. CGL policies are written both on an occurrence and claims-made basis. Originally, CGL policies excluded coverage for work product since the policies were not issued as a guarantee of an insured's quality of work. Later on, endorsements to some the CGL policies provided that work performed by a general contractor's subcontractor did come within the coverage provisions, but work by the general contractor itself did not. In addition, much litigation has taken place over whether a given event constitutes an "occurrence" under the terms of the policy. See *Builders Mutual Insurance Co. v. Mitchell*, 207 N.C. App. 330, 709 S.E.2d 528 (2011).

C. Other Coverages

In addition to the above coverage, Owner's and Contractor's protective liability policies provide insurance to protect an owner from liability for work performed by the contractor on behalf of the owner, but these policies generally do not cover the owner's sole negligence which causes damage.

Project Management Professional Liability Insurance covers the architect or engineer, owner, and general contractor for management related work during the construction project. Again, the policy only covers claims arising while the work is in progress.

A Wrap-up policy is a single insurance policy covering the construction risks of the owner, construction manager, general contractor, and subcontractors. Generally, it provides the same coverage as separate policies purchased by the parties. These policies are generally only seen on very large projects.

In addition to the above, pollution liability policies and umbrella or excess liability insurance policies are also available.

Finally, in the context of design professionals there is professional liability insurance, project specific insurance covering all design professionals on a given project, and design-build insurance. Design-build policies cover those projects where an owner contracts with a single entity which provides both design and construction services.

XIV. Performance and Payment Bonds – State and Local Public Projects

A public entity must require a payment and performance bond from each contractor with a contract more than $50,000 if the total value of the construction project exceeds $300,000. N.C. Gen. Stat. § 44A-26. Within 75 days of first furnishing subcontractors or material suppliers who do not have a direct contract with the general contractor one must serve a Notice of Public Subcontract on the general contractor in order to preserve a payment bond claim under the general contractor's payment bond. N.C. Gen. Stat. § 44A-27. The requirements of the Notice of Public Subcontract are set forth in N.C. Gen. Stat. § 44A-27(d).

Any action on a payment bond must be brought within the longer of one year from the last date that labor or materials were provided to the project or the date that the public entity makes final settlement with the contractor. If a subcontractor or supplier does not have a direct contract with the entity that posted the payment bond, the subcontractor or supplier must also provide written notice of the amounts claimed and to whom the labor or materials were provided within 120 days of the last date that labor or materials were provided to the project. This notice must be sent by certified mail, sheriff, or overnight delivery. Suits to enforce claims against performance or payment bonds must be brought in the county where the project is located. N.C. Gen. Stat. §§ 44A-27, 44A-28. A court may award a reasonable attorney's fee to the prevailing party upon a finding that there was an unreasonable refusal by the losing party to fully resolve the matter which constitutes the basis of the suit or defense.

XV. Requirement that General Contractors Be Licensed

Any person, firm, or corporation who bids, constructs, superintends, or manages the construction of any building, highway, public utility, or improvement where the cost of improvement is more than $30,000 is deemed a "general contractor" engaged in the business of general contracting and, therefore, must be licensed by the State Licensing Board for General Contractors. N.C. Gen. Stat. §§ 87-1(a), 87-2. A contractor must be licensed to recover from the owner for breach of contract or on theory of quantum meruit. *Mill-Power Supply Co. v. CVS Assocs.*, 85 N.C. App. 455, 355 S.E.2d 245 (1987).

However, there are limits to the scope of the "unlicensed contractor defense." *Wright Constr. Servs., Inc. v. Hard Art Studio, PLLC*, 853 S.E.2d 500, 504 (N.C. Ct. App. 2020)(holding that licensure defense did not bar negligence claims by an unlicensed general contractor against architects or engineers who breached their duty of care in their professional work on a construction project.)

XVI. Mechanic's Lien Laws

In North Carolina, an individual, corporation, or other entity that provides: (1) materials or services; (2) for the purpose of making an improvement on real property; (3) pursuant to an express contract with the owner of the real property, is entitled to a mechanic's lien. The lien attaches to the improvements to the property, and to the lot on which the improvement is situated, but only to the extent of the owner's interest in the property. N.C. Gen. Stat. § 44A-8. However, a contractor is not entitled to a construction lien for materials and labor provided pursuant to a joint venture agreement with the landowner. *Lake Colony Construction, Inc. v. Boyd*, 212 N.C. App. 300; 711 S.E.2d 742 (2011).

A. Lien Agent Requirement

1. Designation of Lien Agent- North Carolina requires that owners designate a lien agent on all private projects where the total cost of the project exceeds $30,000. N.C. Gen. Stat. § 44A-11.1. The building permit is required to list the lien agent, and if it does not, any potential lien claimant may make a written request to the owner, who is required to respond within 7 days with the name and contact information of the lien agent. Contractors and subcontractors are required to provide written notice of the name and contact information of the lien agent to a material supplier or subcontractor within 3 days of contracting with the supplier or subcontractor. A contractor or subcontractor who fails to provide the lien agent information within 3 days of contracting, will be liable for any actual damages suffered as a result of failure to give notice.

2. Notice to Lien Agent- In order to preserve priority, potential lien claimants must serve notice on the designated lien agent within 15 days of first furnishing or before the owner conveys an interest in the property. N.C. Gen. Stat. § 44A-11.2.

3. Through an online system (www.Liensnc.com) an owner may appoint a lien agent, a potential claimant may determine the lien agent for a project and provide notice to the lien agent, and anyone can search for information about the project.

B. General Contractor's Lien

There are two steps to perfecting a general contractor's mechanic's lien. First, a Claim of Lien on Real Property must be filed with the Clerk of Court within 120 days after the contractor last furnished labor and/or materials to the property and served on the record owner of the property. N.C. Gen. Stat. § 44A-12. A Lien on Real Property is served when it is deposited; proof

of receipt is not required. The lien "relates back" to the first date that the contractor provided any labor or materials to the property. Interim lien waivers signed by a general contractor do not re-set the date of the general contractor's first furnishing of labor, material, and equipment to the project for purposes of calculating the effective date of the general contractor's lien. . *Wachovia Bank Nat. Ass'n v. Superior Const. Corp.,* 213 N.C. App. 341, 718 S.E.2d 160 (2011). Second, a lawsuit must be filed to enforce the lien within 180 days of the last furnishing of labor and/or materials to the property. N.C. Gen. Stat. § 44A-13. These deadlines are strictly enforced. Forms for the liens are contained in the North Carolina General Statutes.

C. Subcontractor's and Supplier's Liens

Subcontractors and suppliers have three different types of liens: (1) lien on funds (N.C. Gen. Stat. § 44A-18); (2) wrongful payment lien (N.C. Gen. Stat. § 44A-20); and (3) subrogation lien (N.C. Gen. Stat. § 44A-23).

1. Lien on Funds. Most subcontractors and suppliers have a lien upon any funds owed to the contractor with whom the subcontractor or supplier dealt. A subcontractor may also have a lien on funds owed to other parties in the contractual chain by subrogation. The lien on funds is perfected by serving a Notice of Claim of Lien Upon Funds on all parties in the contractual chain by certified mail, overnight delivery or sheriff. The Notice of Claim of Lien Upon Funds should also be attached to any Claim of Lien on Real Property filed with the court. The lien on funds must be perfected by filing suit to enforce the lien.

2. Wrongful Payment Lien. A party that receives a Notice of Claim of Lien Upon Funds is under a duty to withhold payment of any funds subject to the lien on funds referenced in the Notice of Claim of Lien Upon Funds. If any party wrongfully pays funds that are subject to the lien, that party becomes personally liable up to the amount of the wrongful payment. If the owner of the property makes the wrongful payment, the owner's personal liability for the wrongful payment also becomes a direct lien on the property in favor of the subcontractor.

3. Subrogation Lien. First, second, or third tier subcontractors can enforce the general contractor's lien against the owner by subrogation. The subcontractor must serve a Notice of Claim of Lien Upon Funds, file and serve a Claim of Lien on Real Property with the Notice of Claim of Lien Upon Funds attached, and perfect the lien by filing suit. A subrogation lien must be filed within 120 days of the last date the general contractor performed work on the project and must be perfected by suit brought within 180 days. These subrogation lien rights can be limited if a general contractor posts a "Notice of Contract" on the job site and files it in the courthouse and the subcontractor fails to respond with the appropriate documents. A contractor can also compromise the subcontractor's subrogation lien rights by waiver until the suit is filed to enforce the subrogation lien.

In any mechanic's lien action, a court may award a reasonable attorney's fee to the prevailing party upon a finding that there was an unreasonable refusal by the losing party to fully resolve the matter which constitutes the basis of the suit or defense.

About the Authors

Poyner Spruill LLP is a multidisciplinary North Carolina law firm, providing a comprehensive range of business and litigation legal services. The firm has a reputation for professional excellence and client service throughout the Southeast. Poyner Spruill, one of the largest firms in North Carolina, has more than 100 attorneys with offices in Charlotte, Raleigh, Rocky Mount, and Southern Pines.

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