

## N.C. COURT OF APPEALS EXTENDS APPLICATION OF LIEN ON FUNDS TO CONSTRUCTION LENDER

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In *Pete Wall Plumbing Co., Inc. v. Sandra Anderson Builders*, issued on March 15, 2011, the N.C. Court of Appeals addressed the application of North Carolina's lien law to construction lenders. Specifically, the Court addressed the issue of whether a construction lender with a primary deed of trust qualifies as an "obligor" subject to liability for loan distributions or "draws" made after receipt of a subcontractor's Notice of Claim of Lien on Funds.

Under a complicated set of facts, the Court found that a construction lender with a primary deed of trust satisfies the statutory definition of "obligor" by virtue of its status as legal owner of the property. This conclusion appears to turn on North Carolina's status as a so-called "title theory" state, meaning mortgages in North Carolina are accomplished by deed of trust, which is technically a transfer of title to the mortgage holder, as opposed to a mere lien on the mortgaged property.

Ostensibly, the Court's conclusion in *Pete Wall* means that loan distributions made after receipt of a Notice of Claim of Lien on Funds are in contravention of a subcontractor's lien rights, rendering the lender directly liable to the subcontractor for amounts disbursed. This conclusion, however, constitutes a departure from prior precedent and the Court's holding in *Con Co., Inc. v. Wilson Acres Apartments, Ltd.*, 56 N.C. App. 661, 289 S.E.2d 633 (1982) (holding that a lender fell outside the statutory definition of "owner" under the lien scheme, and thus outside the definition of "obligor").

Given what appears to be a contradiction in the case law, we expect this will not be the last word on the subject. But for now, lenders should proceed cautiously after receipt of a subcontractor's Notice of Claim of Lien on Funds or face the prospect of being forced to pay a like distribution to the subcontractor.