NO. COA05-1030

NORTH CAROLINA COURT OF APPEALS

Filed: 18 July 2006

CAROLINA BUILDING SERVICES WINDOWS & DOORS, INC.,

Plaintiff,

v.

Iredell County
No. 02 CVS 0989

BOARDWALK, LLC; MILLER BUILDING CORPORATION; DEBORAH C. LEE; SHANNON W. MYERS; JOHN C. CZERWINSKI and Wife, JEANETTE M. CZERWINSKI; MANISH G. PATEL; ALLEN H. VAN DYKE and Wife, PERRY G. VAN DYKE; GEORGE CORNELSON and Wife, KIMBERLYE F. CORNELSON; AFSHIN GHAZI; and CHARLES H. HUNTLEY,

Defendants.

Appeal by plaintiff from orders entered 28 March 2005 by Judge Larry Ford in Iredell County Superior Court. Heard in the Court of Appeals 22 February 2006.

Erwin and Eleazer, P.A., by L. Holmes Eleazer, Jr., Fenton T. Erwin, Jr., and Peter F. Morgan, for plaintiff-appellant.

Johnston, Allison & Hord, P.A., by Greg C. Ahlum and Martin L. White, for defendant-appellee Boardwalk.

Horack, Talley, Pharr & Lowndes, by D. Christopher Osborn, for individual defendant-appellee home owners.

ELMORE, Judge.

This appeal presents the question of whether first tier subcontractor's liens can be extinguished by a default judgment entered in an action between the contractor and landowner that establishes the contractor's breach and the fact that no money is owed to the contractor. The trial court answered affirmatively, granting summary judgment in favor of the landowner and against the subcontractor. The subcontractor appealed to this Court.

Prior to September 2001 Boardwalk, L.L.C. (Boardwalk or landowner) entered into a contract with Miller Building Corporation (Miller or contractor) to develop property in Mooresville, North Carolina. Pursuant to this contract, and in consideration of over three million dollars, Miller agreed to serve as the general contractor for Boardwalk's condominium project. But in February 2002 Miller removed its personnel and equipment from the job site, well before completion of the project. And, although being periodically paid by the landowner before defaulting, the contractor failed to fully pay its subcontractors, including Carolina Building Services' Windows and Doors, Inc. (Carolina Building or subcontractor).

Accordingly, on 22 February 2002 Carolina Building gave notice to Boardwalk of a lien on funds and filed a subrogation lien on Boardwalk's property on 25 February 2002. In April of that same year, Carolina Building filed suit against Boardwalk and Miller; its claims were based on the liens, breach of contract against Miller, and *quantum meruit*. There is no dispute Carolina Building entered into a contract with Miller, pursuant to which it furnished

Miller with nearly $189,704.41 worth of materials, and Miller failed to pay. In accord with that contract claim, and the fact that Miller failed to respond in the litigation, in June 2002 Carolina Building obtained an entry of default and later a default judgment against Miller.

Then, on 28 June 2004, over two years after the subcontractor obtained its entry of default against the contractor, the landowner filed a crossclaim against the contractor alleging that Miller breached its contract to finish the project and pay all necessary parties. Similar to the subcontractor's action against it, Miller never answered the crossclaim or appeared at any stage of the litigation. The landowner, therefore, sought and obtained an entry of default against the contractor on 26 January 2005. Although the landowner also sought a default judgment in the amount of $185,420.38 against the contractor, the subcontractor intervened and objected to the entry of that judgment. This issue was consolidated with the parties' cross-motions for summary judgment and heard on 28 February 2005.

The trial court concluded that the subcontractor did not have standing to object to a default judgment in an action between the landowner and the contractor pursuant to *Johnson v. Amethyst Corp.*, 120 N.C. App. 529, 463 S.E.2d 397 (1995). Therefore, with no action by the contractor and in conjunction with the entry of default, the trial court entered a default judgment against the contractor on the landowner's crossclaim in the amount of $172,265.63. This amount marked the difference between the

contract price and the excess cost to complete the project. Given that outcome, on the summary judgment motions in the lien action between the landowner and the subcontractor, the trial court determined that:

> as shown by Miller's admissions of the substantive allegations of Boardwalk's Crossclaim against it [due to the entry of default], there are no funds owing from Boardwalk to Miller, and Boardwalk has been damaged as a result of Miller's breach of contract. [Carolina Building] is not entitled to a mechanics' lien against real property or against funds owed to Miller by Boardwalk, since there are no funds owed to Miller by Boardwalk.

I.

Carolina Building first argues the trial court erred by ruling it had no standing to object to the default judgment entered on a crossclaim between two defendants in its lien action. The subcontractor states it should have been granted standing to object since it "had a tremendous personal stake in whether a default judgment was entered against [the contractor] upon [the land owner's] cross claim, because such judgment might be (and eventually in fact was) given preclusive effect as to [its] lien claims." In rebuttal, Boardwalk argues that the subcontractor cannot appear and litigate on behalf of the contractor, regardless of their intertwined interests. We agree; the cases of *Johnson v. Amethyst Corp.*, 120 N.C. App. 529, 463 S.E.2d 397 (1995), *disc. rev. allowed*, 342 N.C. 655, 467 S.E.2d 713, *disc. rev. withdrawn*, 343 N.C. 122, 471 S.E.2d 65 (1996), and *Dunkley v. Shoemate*, 350

N.C. 573, 551 S.E.2d 442 (1999), are quite persuasive on this point.

In *Amethyst*, the plaintiff sued an employee of a rehabilitation clinic, and the clinic itself, alleging that she was sexually assaulted by the employee while in the clinic's care. The employee failed to appear in the action and the plaintiff was awarded an entry of default. *Amethyst*, 120 N.C. App. at 532, 463 S.E.2d at 399-400. An attorney retained by the clinic's insurance carrier then filed a motion to set aside the entry of default achieved against the employee. The trial court allowed the motion. *Id.* at 532, 463 S.E.2d at 400. On appeal, this Court reversed.

> No person has the right to appear as another's attorney without the authority to do so, granted by the party for which he is appearing. *Pueblo of Santa Rosa v. Fall*, 273 U.S. 315, 319, 47 S. Ct. 361, 362, 71 L. Ed. 658 (1927). North Carolina law has long recognized that an attorney-client relationship is based upon principles of agency. *See State v. Ali*, 329 N.C. 394, 403, 407 S.E.2d 183, 189 (1991). Two factors are essential in establishing an agency relationship: (1) The agent must be authorized to act for the principal; and (2) The principal must exercise control over the agent. *Vaughn v. North Carolina Dep't of Human Resources*, 37 N.C. App. 86, 91, 245 S.E.2d 892, 895 (1978), *aff'd* 296 N.C. 683, 252 S.E.2d 792 (1979).

Id. at 532-33, 463 S.E.2d at 400. The Court noted that despite the carrier's interest in defending an action in which it would be vicariously liable, no relationship was created between the employee and the carrier's attorney and, therefore, the attorney could not appear for the employee.

This holding was reinforced several years later in *Dunkley*. There, the plaintiff was suing a health care provider for allowing a rape to occur by one of its agents. The employee-agent was sued, and the health care provider's insurance carrier retained counsel to defend on behalf of the employee, who had vanished (upon the discovery that he fraudulently created documentation to obtain residency at the hospital). *Dunkley*, 350 N.C. at 575, 515 S.E.2d at 443. Despite having no contact with the employee, after the trial court granted the firm's motion for limited appearance pursuant to Rule 16, the carrier's counsel filed an answer in the case on behalf of the employee. *Id.* at 576, 515 S.E.2d at 444. Our Supreme Court, quoting *Amethyst*, determined the trial court erred in allowing the motion to appear and subsequently accepting the answer due to the lack of agency. Characterizing the flawed situation in *Dunkley*, the Court said, "All we have is a motion by a law firm asking to represent, in a limited capacity, a party to whom attorneys at the law firm have never spoken and who has not authorized the law firm to represent him." *Dunkley*, 350 N.C. at 576, 515 S.E.2d at 444.

Those circumstances are generally what we have in this case: the subcontractor's attorney directly objected to the entry of the default judgment against the general contractor without any evidence that the subcontractor had the authority of the contractor to represent its interests. Just as our appellate courts in *Amethyst* and *Dunkley* did not allow the parties to circumvent the rules of civil procedure or the laws of agency, despite the

"tremendous" intertwined interests of the carriers, neither do we; the trial court did not err by denying Carolina Building's objection to the entry of a default judgment against Miller.

Since we have determined that Carolina Building had no authority to object on behalf of Miller, it is axiomatic that Carolina Building does not possess the ability to appeal that order either. Therefore, those issues presented by the subcontractor dealing with the alleged error in the order for default judgment are not properly before us and will not be reviewed. Notably though, that order's adjudicated effect on the subcontractor's lien action against the landowner *is* squarely before us.

II.

The trial court determined that since a default judgment was entered in favor of the landowner against the contractor, which settled that any amount owed to the contractor would be offset to zero by the amount of damages due from the contractor's breach, then there were no funds (or no debt owed) to which the subcontractor's lien(s) could attach. The subcontractor argues that the trial court erred by allowing the default judgment to have a preclusive effect on the lien action. Resolving that issue requires an understanding of each type of subcontractor's lien and the timing of when "funds" or "debt" owed should be calculated.

In North Carolina, mechanics and laborers enjoy a constitutional right to an "adequate lien on the subject-matter of their labor," one that exceeds even the exemptions to which other creditors are bound. *See* N.C. Const. art X, § 3. Article Two of

Chapter 44A provides the mechanism by which laborers can perfect that adequate lien. *See* N.C. Gen. Stat. § 44A-7 *et seq.* (2003)[1]; *Mace v. Construction Corp.*, 48 N.C. App. 297, 302, 269 S.E.2d 191, 194 (1980). First tier subcontractors, such as Carolina Building, generally have two types of liens available to them. Foremost available is a lien on any "funds which are owed to the contractor" by an "obligor," typically a landowner or developer. *See* N.C. Gen. Stat. § 44A-18(1) (2003); N.C. Gen. Stat. § 44A-17(3) (2003) (defining obligor). There is also a mechanism for obtaining a lien on the landowner's property. *See* N.C. Gen. Stat. § 44A-23 (2003).

A. Subcontractor's Lien on Funds

While section 44A-18(1) provides the basis for a first tier subcontractor's right to funds owed, it is section 44A-20 that provides the operational effect of that lien.

> (a) Upon receipt of the notice provided for in this Article the obligor shall be under a duty to retain any funds subject to the lien or liens under this Article up to the total amount of such liens as to which notice has been received.
>
> (b) If, after the receipt of the notice to the obligor, the obligor shall make further payments to a contractor or subcontractor against whose interest the lien or liens are claimed, the lien shall continue upon the funds in the hands of the contractor or subcontractor who received the payment, and in addition the obligor shall be personally liable to the person or persons entitled to liens up to the amount of such wrongful payments, not exceeding the total claims with

[1] As of 1 October 2005 provisions of these lien statutes were amended or revised. 2005 N.C. Sess. Laws ch. 229, §§ 1 and 2. Since the liens in this case arose before then, we apply the prior statutory language.

> respect to which the notice was received prior to payment.
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> (c) If an obligor shall make a payment after receipt of notice and incur personal liability therefor, the obligor shall be entitled to reimbursement and indemnification from the party receiving such payment.
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> (d) If the obligor is an owner of the property being improved, the lien claimant shall be entitled to a claim of lien upon the interest of the obligor in the real property to the extent of the owner's personal liability under subsection (b), which lien shall be enforced only in the manner set forth in G.S. 44A-7 through G.S. 44A-16 and which lien shall be entitled to the same priorities and subject to the same filing requirements and periods of limitation applicable to the contractor. The lien is perfected as of the time set forth in G.S. 44A-10 upon the filing of claim of lien pursuant to G.S. 44A-12. The claim of lien shall be in the form set out in G.S. 44A-12(c) and shall contain, in addition, a copy of the notice given pursuant to G.S. 44A-19 as an exhibit together with proof of service thereof by affidavit, and shall state the grounds the lien claimant has to believe that the obligor is personally liable for the debt under subsection (b).

N.C. Gen. Stat. § 44A-20(a)-(d) (2003).

The plain language of this section speaks in terms of timing: the pivotal time being receipt of the notice of the claim of lien on funds. *See O & M Indus. v. Smith Eng'r. Co.*, 360 N.C. 263, 270, 624 S.E.2d 345, 350 (2006). After the obligor has proper notice of the lien on funds it is guided by two symbiotic interests: one, completing the project efficiently, and two, avoiding personal liability.

The landowner must first retain sufficient funds to satisfy the lien. This may typically mean the landowner withholds a

payment (or portion thereof) otherwise marked for the contractor in order to directly pay the subcontractor or, alternatively, coax the contractor into paying the subcontractor.

> When notice is served, the risk [of non-payment] shifts [from the subcontractor] to the obligor to the extent that the obligor is holding funds. With this notice the burden of assuring payment of the subcontractor's lien shifts to the obligor who owns the project, is receiving construction funds, and receives the benefit of the subcontractor's labor and materials. The owner is, thus, put on notice of a general contractor's potential breach and is apprised of the need to take precautions necessary to protect the project and to ensure that subcontractors remain on the job.

Id. at 269, 624 S.E.2d at 349.

If, however, payments are made to the contractor in contravention of the notice, the landowner becomes personally liable for the payment. N.C. Gen. Stat. § 44A-20(b) (2003). And the subcontractor can obtain a lien on the landowner's property to secure the liability of the funds owed. N.C. Gen. Stat. § 44A-20(d) (2003). This provision is a manner of expediting and prioritizing what would otherwise be akin to a judgment lien on a defendant's real property.

B. Subcontractor's Subrogated Lien on Real Property

The lien on funds, however, is entirely separate from the lien rights afforded to the subcontractor under section 44A-23, *see Mace*, 48 N.C. App. at 304, 269 S.E.2d at 195, although each shares similar processes for notice, filing, and collection.

> A first tier subcontractor, who gives notice as provided in this Article, may, to the extent of this claim, enforce the claim of lien on real property of the contractor

> created by Part 1 of Article 2 of this Chapter. The manner of such enforcement shall be as provided by G.S. 44A-7 through 44A-16. The lien is perfected as of the time set forth in G.S. 44A-10 upon filing of the claim of lien pursuant to G.S. 44A-12. Upon the filing of the notice and claim of lien and the commencement of the action, no action of the contractor shall be effective to prejudice the rights of the subcontractor without his written consent.

N.C. Gen. Stat. § 44A-23(a) (2003). "This statute grants to a first tier subcontractor a lien upon improved real property based upon a right of subrogation to the direct lien of the general contractor on the improved real property as provided for in G.S. 44A-8." *Mace*, 48 N.C. App. at 303, 269 S.E.2d at 194. Accordingly then, section 44A-23 allows the subcontractor to step into the shoes of the contractor, enjoying the same right to a lien that its contractor does. *See id.* at 303, 269 S.E.2d at 194-95. That right is to "have a lien on such real property to secure payment of all debts owing for labor done . . . pursuant to the contract." N.C. Gen. Stat. § 44A-8 (2003). Notably, the contract referenced is not that of the subcontractor's, but rather that of the contractor with the landowner.

Therefore, the subcontractor's lien will always be limited by any of the landowner's contractual defenses against the contractor, *see Watson Elec. Const. Co. v. Summit Cos.*, 160 N.C. App. 647, 650-51, 587 S.E.2d 87, 91 (2003), with one exception. That exception is if the defense arises after the subcontractor has commenced an action on the lien (*e.g.* after subcontractor's filing, the contractor enters into an amended contract with the landowner

waiving its rights to a lien). As of the subcontractor's proper filing, actions by the contractor cannot divest the subcontractor's rights. *See* N.C. Gen. Stat. § 44A-23(a) (2003) ("Upon the filing of the notice and claim of lien and the commencement of the action, no action of the contractor shall be effective to prejudice the rights of the subcontractor without his written consent."). Further, since the subcontractor's rights are subrogated to that of the contractor, the subcontractor may not acquire a lien for a sum exceeding that owed to the contractor. *See* N.C. Gen. Stat. § 44A-23(a) (2003); *Watson Elec.*, 160 N.C. App. at 650-51, 587 S.E.2d at 91.

III.

With those principles in mind, we see a vital difference in the General Assembly's use of "*funds* which are owed the contractor," when dealing with a subcontractor's lien on funds, and "*debts* owing . . . pursuant to contract," when dealing with contractors. Each phrase bears out a different point in time for calculating the amount owed under each type of lien, and thus, a potentially different impact regarding a determination that no money is owed the contractor.

When dealing with a lien on funds, pursuant to section 44A-18, our Supreme Court has said, "[t]he critical time for determining whether an amount is owed for purposes of N.C.G.S. § 44A-18(1) is when the obligor receives the notice of lien." *O & M Indus.*, 360

N.C. at 270, 624 S.E.2d at 350.[2] In other words, the lien attaches to "*funds* which are owed to the contractor," N.C. Gen. Stat. § 44A-18 (2003), at the time the obligor receives the notice, *O & M Indus.*, 360 N.C. at 270, 624 S.E.2d at 350. By its plain usage, a "fund" means "[a] sum of money or other liquid assets established for a specific purpose." *Black's Law Dictionary*, 696 (8th ed. 2004). In accord with these two principles, the necessary determination under section 44A-18 and 44A-20 is whether a "sum of money" is owed to the contractor at the specific point the obligor receives proper notice. If so, the lien attaches to those funds or that specific obligation to pay. Whether that sum or obligation is still the same amount at the completion of the project is of little consequence to this type of lien, so long as when the obligor was noticed, there were funds owed at the time or funds were paid to the contractor after that point.

Pursuant to these rules, Boardwalk's default judgment against Miller (which determined the contractor was owed no money pursuant to final contract calculations) should not have had a bearing on the lien on funds since it occurred after Boardwalk had notice of Carolina Building's lien. The key issue here then is whether, as

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[2] In *O & M Industries*, the Supreme Court stated that it was distinguishing this Court's opinion in *Builders Supply v. Bedros*, 32 N.C. App. 209, 212, 231 S.E.2d 199, 201 (1977), in which the Court held "[t]he amount owed by owner to the contractor [pursuant to a lien on funds] at any particular time must be determined in the light of existing circumstances and the contract between owner and contractor." We see no way to reconcile this Court's statement in *Builders Supply* with the Supreme Court's statement in *O & M Industries*. To the extent they are irreconcilable, *O & M Industries* controls.

a matter of law, on 22 February 2002 (the date Boardwalk received notice of the lien on funds) did Boardwalk owe Miller any sum of money. Despite disagreements on end project calculations and Boardwalk's damages, both parties agree the answer to this specific question is no. Both parties also agree that after receiving Carolina Building's notice, Boardwalk paid no funds to Miller. Thus, there are no funds owed to the contractor that a lien under section 44A-18 could attach to and Boardwalk, by making no payments after receipt of the notice, has incurred no personal liability. The trial court did not err in ordering summary judgment in favor of Boardwalk on Carolina Building's lien on funds.

As alluded to earlier however, when dealing with a subcontractor's subrogated lien on real property pursuant to section 44A-23, the same timing rules do not apply. A contractor, and thus the subcontractor in this case, has the right to a lien on the property in order "to secure payment of all debts owing . . . pursuant to the contract." N.C. Gen. Stat. § 44A-8 (2003). "Debt," as opposed to "funds," is an obligation to pay pursuant to an agreement between the parties. *See* Black's Law Dictionary 432 (8th ed. 2004) ("Liability on a claim; a specific sum of money due by agreement or otherwise . . . ."). When assessing "debts owing" under 44A-23 and 44A-8, previous courts have not looked to a specific point during construction as the point of reference, but rather a final determination of parties' contractual relationship—which may include litigation of that contract. *See Watson*, 160 N.C. App. at 651, 587 S.E.2d at 91 (subcontractor's

lien under 44A-23 cut off after arbitrator determined there was no debt owed to contractor pursuant to its contract with the landowner); *Dail Plumbing, Inc. v. Roger Baker & Assoc.*, 78 N.C. App. 664, 667, ___ S.E.2d ___, ___ (1986) (calculating "debts owing" as solely the outstanding amount owed the contractor after payments pursuant to contract are considered).

Here then, the default judgment has the same effect on a subcontractor's lien under section 44A-23(1) as a situation in which the contractor, due to a breach, was determined to owe money to the landowner. Both situations reduce the recovery available to subcontractors under 44A-23; the only difference is that the contractor did not litigate its own rights. This outcome, although perhaps unique, is consistent with the statutory scheme protecting subcontractor's rights. The statutes do not protect each laborer equally, and under no circumstance elevate the position of a subcontractor above that of its contractor. Allowing Carolina Building to maintain an action against Boardwalk despite the contractor, at this point, being unable to, would disrupt the hierarchy created by N.C. Gen. Stat. § 44A-7 *et seq.* and ignore the Rules of Civil Procedure.

Carolina Building has achieved a default judgment against Miller, similar to that of Boardwalk. If funds were to be paid at the time Boardwalk received notice of the lien on funds, it would be entitled to them. But the General Assembly has stated subcontractors cannot achieve a lien on real property superior to that of their contractor. When that contractor does not litigate

its own rights, breaches its contract, or takes some other limiting action, the risk lies with the subcontractor—not the landowner.

Affirmed.

Judges STEELMAN and JACKSON concur.

Report per Rule 30(e).