



# 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 normally 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 Associates*, 93 N.C. App. 439, 378 S.E.2d 220 (1989).

## **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 (1983).

Violations of the North Carolina Building Code constitute negligence per se. *Oates v. JAG, Inc.*, 314 N.C. 276 (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.” *Ports Authority v. Roofing Co.*, 294 N.C. 73, 81 (1978). Commonly known as the economic loss rule, there is no recovery under North Carolina law 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 (2003).

In order to prevail on a claim for willful and wanton negligence, a party must prove a deliberate purpose to not to fulfill some duty imposed by law necessary for the safety of persons or property of others. *Akzona, Inc. v. Southern Ry. Co.*, 314 N.C. 488 (1985). “An act is willful if the defendant intentionally fails to carry out some legal duty imposed by law or contract which is necessary to protect the safety of the person or property to which it is owed. An act is wanton if the defendant intentionally fails to carry out some duty imposed by law or contract which is necessary acts in conscious or reckless disregard for the rights and safety of others.” N.C.P.I. Civil 102.86.

To be entitled to punitive damages, a party must prove willful or wanton conduct, which by definition under North Carolina's punitive damages statutes is more than gross negligence. N.C. Gen. Stat. §§ 1D-5, 1D-15 (2003).

North Carolina remains in the discrete minority of states that recognizes the defense of contributory negligence. Under North Carolina law, if a party asserting a claim based on negligence is found to have contributed, even the slightest amount, to its own injuries, the finding bars the party's right to recovery. "A plaintiff is contributorily negligent when he fails to exercise such care as an ordinary prudent person would exercise under the circumstances in order to avoid injury." *Newton v. New Hanover County Bd. of Educ.*, 342 N.C. 554, 564 (1996).

### **III. Breach of Warranty**

#### **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 contracting. 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 Development 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 Company*, 94 NC App. 63, 380 S.E.2d, 369 (1989); and *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 expressed 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*; and *Salem Towne Apartments, Inc. v. McDaniel and Son's Roofing Company*, 330 Fed. 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. There are a number of implied warranties which can arise under North Carolina law relating to construction.

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 Company v. City of 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 and Associates*, 56 NC App. 400, 289 S.E.2d 115 (1982); and *Bert County Public Schools Board of Education v. Juno Construction Corporation*, 50 NC App. 238, 273 S.E.2d 504, app dis, 304 NC 187, 282 S.E.2d 778 (1981).

Another 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 and Wallpaper Company v. James T. Rogers Builders, Inc.*, 73 NC App. 648, 327 S.E.2d 36 (1985). 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. *Lunsden 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 (1978).

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 Construction Company*, 29 NC App. 270, 224 S.E.2d 266, discr 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. Amman*, 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 obligation of "good faith and fair dealing". 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.

##### **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 a common law fraud action, one must demonstrate knowing misrepresentation, reasonable reliance and resulting harm. Punitive damages are available under common law fraud.

N.C. General 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. General 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 automatic for § 75-1.1 violations, and attorneys' fees are also available. Typically a plaintiff will allege both a common law claim and a violation of N.C. General Stat. 75-1.1, but the plaintiff must ultimately choose his or her course of action.

There are numerous examples of cases that have held that actions or practices of a party constitute fraud and, consequently, unfair and deceptive trade practices. These 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.

#### B. Misrepresentation

Deception, to a lesser degree than fraud, can be actionable and also qualify as a violation of N.C. General Stat. § 75-1.1. 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 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*, 47 N.C. App. 530, 268 S.E.2d 97 (1980), *modified & aff'd* 302 N.C. 539, 276 S.E.2d 397 (1981), the North Carolina Supreme Court held that in order for misrepresentation to form the basis for an unfair and deceptive practices claim, a party's words or conduct must possess the tendency or capacity to mislead or create the likelihood of deception. 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. General 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 breach of contract to become a N.C. General Stat. § 75-1.1 violation, substantial aggravating circumstances must be present in relation to the breach. 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 occurs in a contract breach. Clearly 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 generally recognizes strict liability for ultrahazardous 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 of 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. Recoverable Damages**

In North Carolina the general rules governing the measure of contract damages also 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 *Mears v. Nixon Constr. Co.*, 7 N.C. App. 614, 173 S.E. 2d 593 (1970). Where there is an implied contract a recovery of 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 (3) 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; *Mears, 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 *Mears, 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).

In a recent case, 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 since lost profits are a form of special damage. The first requirement is that lost profits must have been within the contemplation of the parties when the contract was made *Weyerhauser 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 *Gurney Industries, Inc. v. St. Paul Fire and Marine Ins. Co.*, 457 F 2d 588 (4<sup>th</sup> Cir. 1972).

#### C. Delay Damages

Damages flowing from a delay in a given project are recoverable in certain situations. In North Carolina, there are two different kinds of delays. The first type of delay is an excusable delay and the second is an unexcusable/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. However, it should be noted 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. In addition, 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 unexcusable/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 unexcusable 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. Moreover, a total cost method which seeks the difference between a contractor's total costs in performing the contract and its bid price is frowned upon and is condoned only when there is no other way to compute damages. *Biemann & Rowell Co. v. Donohoe Companies, Inc.* 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.*

As noted, North Carolina courts prefer evidence which establishes actual damages which are those which arise as a natural and proximate result of party's breach of contract. *Federal Paper Board Co., Inc. v. Kanup, 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. *Olivetti Corp. v. American Business System, Inc.*, 81 N.C. App.1, 344 S.E. 2d 82 (1986). 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 Department of Administration*, 315 N.C. 144, 337 S.E. 2d 463 (1986). No North Carolina courts have addressed the issue of whether the *Eichleay* formula may be used to calculate overhead costs as damages.

In North Carolina, no-damages-for-delay clauses are generally enforceable on non-public projects. However, the clauses 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 Brothers, Inc. v. N.C. Department of Transportation*, 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. *City of Kinston v. Suddreth*, 266 N.C. 618, 146 S.E. 2d 660 (1966).

E. Interest on Contract Damages.

North Carolina Gen. Statute (N.C. Gen. Stat.) § 24-5 provides that an amount due under contract bears interest from the date on which 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.

F. Attorney's Fees.

Contractual provisions for attorney fees for any type of action were not enforced by North Carolina courts unless specifically authorized by statute until *Stillwell Enterprises, Inc. v. Interstate Equipment Co.*, 330 N.C. 282, 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 fees provision in such a document. In a subsequent case, the court has indicated that a construction contract was an "evidence of indebtedness" but that dicta has not been followed. Recent cases suggest that there must be a statutory basis for attorney fees and the legislature has enacted several such statutes since the *Stillwell* case some of which are as follows:

1. Lien Enforcement Action (N.C. Gen. Stat. § 44A-35).

This recent 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.

2. 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.

3. Claim for Punitive Damages (N.C. Gen. Stat. § 1D-45).

Punitive damages may not be awarded merely for breach of contract and are limited in amount to three times the compensatory damages or \$250,000.00. However, punitive damages may be awarded upon proof of one of the aggravating factors of fraud, malice; or willful and wanton conduct in connection with a tort action. If a claimant fails to prevail on a punitive damage claim, the other party may recover reasonable attorney fees if "the claimant knows or should have know the claim to be frivolous or malicious". Finally, the statute requires the

claimant to choose, prior to judgment between punitive damages and treble damages under the Unfair and Deceptive Trade Practices Statute.

#### 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. *Tillinghart v. 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).

### **VII. 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 *Ports Authority v. 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).

“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).

## **VIII. 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 even 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. Therefore, 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*, indemnification, absent a written contract for it, may generally 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 can generally be no right to contribution. *Kaleel*, 161 N.C. App. at 43, 587 S.E.2d at 476.

## **IX. 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, in that 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.

## **X. Paid When Paid Clauses (N.C. Gen. Stat. § 22C-2)**

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

## **XI. 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.

## **XII. 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.

### 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.

### **XIII. 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). 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.

### **XIV. 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 or implied 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.G.S. § 44A-8).

#### General Contractor 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. (N.C.G.S. § 44A-12). The lien "relates back" to the first date that the contractor provided any labor or materials to the property. 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.G.S. § 44A-13). These deadlines are strictly enforced. Forms for most of liens are contained in the North Carolina General Statutes.

#### Subcontractor and Supplier Liens.

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

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.

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 for 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.

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 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.

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Poyner Spruill LLP is a large, 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 over 100 attorneys with offices in Charlotte, Raleigh, Rocky Mount and Southern Pines.

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