Judicial Activism Constructs Lenders' Nightmare - Embree Construction Group, Inc. v. Rafcor, Inc. and United Carolina Bank

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INTRODUCTION

In North Carolina, contractors can recover amounts earned from delinquent owners through the use of a "mechanic's lien." A mechanic's lien is a statutorily created lien right that applies in the construction industry to laborers, materialmen, and others who have rendered goods or services for improvement of the owner's real property. A properly filed and perfected mechanic's lien secures for the lien holder priority of payment of the price or value of work performed and materials furnished in constructing the project. Where corporate bankruptcy is commonplace, a lien holder's priority of payment often means the commercial contractor gets paid where other creditors do not.

Prior to the decision in Embree Construction Group, Inc. v. Rafcor, Inc., the mechanics' lien statute provided a contractor's sole remedy should payment for his goods and services not be voluntarily forthcoming. North Carolina's courts would typically provide no equitable relief for contractors, relying almost solely on the provisions contained in this state's applicable mechanics' lien statutes.

Thus, under North Carolina law as it existed prior to the case Embree v. Rafcor, a contractor in privity with an insolvent owner had only one remedy: the statutory mechanic's lien. Even though the lender received all the security it had bargained for in the form

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2. N.C. GEN. STAT. § 44A-8 to 13 (1989). In this Note, the terms "mechanic's lien," "lien statute," and "Chapter 44A" shall be used interchangeably.
3. Id.
5. Note that "attachment" relief may be granted in conjunction with a lien judgment. See JAMES A. WEBSTER, JR., WEBSTER'S REAL ESTATE LAW IN NORTH CAROLINA § 424(b) (Patrick K. Hetrick & James B. McLaughlin, Jr., eds., 3d ed. 1988) (hereinafter Webster).
of a completed building and even if there remained funds in the construction account with which to compensate unpaid builders, the contractor could generally not compel payment from the construction loan funds held by the lender.\footnote{Id. at 786-87. In that case the Court stated that "[w]hatever rights, therefore, in respect to a lien upon the property in construction of which, or furnishing materials or performing labor thereof, said creditors may have, if any, is dependent upon the statutes of this state." In effect, the Court stated that the only remedies available were those arising from the state's statutes.} Since a lien does not necessarily insure payment of an outstanding debt, strict application of the policy that the applicable mechanics' lien statute provides a builders sole remedy could, in instances such as in \textit{Embree v. Rafcor}, result in apparent injustice.

In the typical commercial construction scenario, the real property owner, which is quite frequently a corporation, will borrow funds for construction of a commercial facility. The lender requires the borrower/real property owner to give a priority mortgage on the real property and any attachments to that real property. Typically, only after the lender has secured its mortgage will it disburse the monies necessary to allow construction to begin. Due to the high costs of commercial construction, real property owners rarely begin construction before the loan is approved and the mortgage has been given. Accordingly, upon perfection, the lender's mortgage will take priority over any subsequently arising rising mechanic's lien. In instances where the real property owner becomes insolvent during construction of the commercial facility, the lender receives payment first. Only after the lender receives full payment may the contractor receive payment. In bankruptcy, assets often may be dissipated before all lenders receive full payment. The contractor, after considerable expense, time and effort could very well leave empty-handed.

In 1992 the North Carolina Court of Appeals faced just such a dilemma in the case of \textit{Embree Construction Group, Inc. v. Rafcor, Inc.} The court chose to grant an equitable mechanic's lien after reaching the conclusion that a strict application of the scheme underlying the North Carolina statutory mechanic's lien could lead to an unjust result. The injustice of the strict application of the mechanic's lien statute lay in the fact that whereas a contractor might recover nothing after incurring considerable expense to complete the construction of a commercial facility, other entities could
and often did recover at least partial repayment of monies expended for the completion of the same project.

While North Carolina courts do grant equitable relief in certain situations, it is rare for them to grant equitable relief in the form of an equitable lien. Black's Law Dictionary defines an equitable lien as

[a] right, not existing at law, to have specific property applied in whole or in part to payment of a particular debt or class of debts. . . . An equitable lien arises either from a written contract which shows an intention to charge some particular property with a debt or obligation or is implied and declared by a court of equity out of general considerations of right and justice as applied to relations of the parties and circumstances of their dealings."

Even following the decision in Embree, an equitable lien will still not arise where (a) the construction is incomplete or (b) the lender disburses all the loan funds to the borrower, who diverts the funds to purposes other than paying the contractor. However, in certain situations where previously the contractor would have been unable to collect monies owed for work on a project, Embree may now enable contractors to collect in spite of the owner's insolvency and prior encumbrances on the owner's property.

This Note will offer a brief history of the case law developed prior to Embree and will analyze the rationale used by the North Carolina Supreme Court in order to make their determination to grant an equitable remedy in this particular case. Next, this Note will examine the holding in Embree and will advance the proposition that the holding in that case is a departure from pre-existing law and cannot be easily reconciled with the case law developed in earlier North Carolina decisions and decisions of Federal Courts applying North Carolina law. Finally, this Note will outline the potential problems in litigation that may arise as a result of the decision in Embree, and will conclude with suggestions for attorneys to consider in light of the new development in North Carolina law from the standpoint of helping assemble construction loan packages.

10. BLACK'S LAW DICTIONARY 539 (6TH ED. 1990).
11. Embree at 495-96, 411 S.E.2d at 922-23 n.3.
THE CASE

On October 20, 1987, the plaintiff/contractor, Embree Construction Group, Inc., ("Embee Construction"), contracted with defendant/owner, Rafcor, Inc., ("Rafcor"), to construct a restaurant building for Rafcor. Rafcor mortgaged the property to co-defendant/lender, United Carolina Bank, ("UCB"), for a construction loan of $942,500. Embree Construction applied to Rafcor for periodic progress payments during the entire course of construction. Rafcor would send this application to UCB who would then disburse the funds from the loan amount. Embree Construction completed the construction in March of 1988. Embree Construction then applied to Rafcor for its final two payments. Even though $70,000 remained in the loan fund, UCB did not honor Embree Construction's direct requests. While Embree Construction properly filed its Notice of Claim of Lien, it did not pursue an action to enforce the lien. Since Embree Construction failed to meet the statute's enforcement requirement, its lien on the real property expired.

On November 17, 1988, Embree Construction brought action

12. Id. at 489, 411 S.E.2d at 919.
14. Id.
15. Id.
16. Id.
17. Id.
19. Id.
20. Id. at 491, 411 S.E.2d at 920 n.1, which states in pertinent part, "In its brief UCB argues that plaintiff [Embee Construction Company] filed a claim of lien on 1 July 1988 but failed to perfect the lien within 180 days. Had plaintiff perfected its claim, it could have forced a sale of the improved property and thus 'would have been protected to the extent intended by Chapter 44A.' Plaintiff responds that because UCB's mortgage interest was superior to plaintiff's lien, plaintiff's interest was cut off, virtually obliterating any likelihood plaintiff would collect either the $110,383 it was owed or the $70,000 remaining in the loan fund. UCB did in fact foreclose on the property on 30 December 1988, effectively cutting off any subordinate liens. In addition, the contract between plaintiff and Rafcor stated final payment would not become due until all liens arising out of the contract were released."
21. N.C. GEN. STAT. § 44A-13 (1989). The statute requires a lien judgment in order to direct the sale of the real property and for the proceeds to be applied against the lien amount.
against Rafcor and UCB (together, "Defendants"). Embree Construction alleged that Defendants owed it $110,383 for the completed construction project. Embree Construction argued that since UCB received all the security for which it bargained - a completed building - yet did not disburse the remaining $70,000 in the loan fund, UCB was unjustly enriched at Embree Construction's expense. Therefore, Embree Construction argued that an equitable lien existed on the loan fund.

The Superior Court granted Defendants' 12(b)(6) motion to dismiss reasoning that Embree Construction's remedies were limited to those provided by the lien statute. The lien statute requires a lien holder to file an enforcement action in order to enforce its lien. The lien statute does not expressly provide any remedy where a lien holder fails to meet all the requirements in filing and perfecting its lien. Since Embree failed to file an enforcement action, Embree's lien expired. Since Embree's lien expired and the statute does not expressly provide for any other remedy beyond the statutory lien, the Superior Court held that Embree Construction failed to state a claim upon which relief could be granted.

On appeal, Embree Construction argued that North Carolina's lien statute was not to the exclusion of all other remedies, but rather in addition to other remedies. The majority of a divided Court of Appeals reversed the lower court. The Court of Appeals held that, even where the contractor is not in privity with the lender, the contractor has an equitable lien against construction loan funds held by the lender. The majority for the Court of Ap-

22. Plaintiff also sued Anthony J. Sapienza, Ronald Thomas Tedesco and Frederick Anthony Occhino, directors of Rafcor, Inc., and as against them included a claim of tortious interference with a contract. This Note will not address the merits of this claim.

23. See supra text accompanying notes 17 and 18. The amount of $110,383 included $32,973 for extra work performed and costs of delay.

24. Id.
25. Id. at 491, 411 S.E.2d at 920.
26. Id. at 490, 411 S.E.2d at 919.
27. Id.
28. Id. at 492-93, 411 S.E.2d at 921.
29. Id. at 490, 411 S.E.2d at 919.
peals reasoned that there were instances where the legal remedy proved insufficient. In such instances, unless the legislature explicitly provides to the contrary, North Carolina's courts should continue to grant equitable relief in the interest of justice.

Defendants appealed, arguing that North Carolina's lien procedures were created expressly for this type of situation, that the mechanic's lien was Embree Construction's sole remedy, and since Embree Construction failed to undertake the necessary steps to enforce the lien, Embree Construction's claims should be dismissed. The North Carolina Supreme Court affirmed the Court of Appeals' decision to grant an equitable lien on the undisbursed loan funds. The Supreme Court ruled that the mechanics' lien statute did not expressly exclude equitable remedies. Therefore, Embree Construction stated a claim upon which relief could be granted and equity could require that the defendants give restitution to Embree Construction. Since the defendant, UCB, unjustly enriched itself at Embree Construction's expense, Embree Construction could be entitled to an equitable lien on the undisbursed construction loan funds held by UCB.

BACKGROUND
STATUTORY REQUIREMENTS OF CHAPTER 44A LIEN

The statutory scheme of Chapter 44A protects the interests of builders and materialmen. In order to recover under the lien statute, contractors must meet five basic filing and enforcement requirements. First, the contractor must render goods or services

31. Id.
32. Id.
33. See supra text accompanying notes 3 and 4.
34. Id.
35. See supra text accompanying note 20.
36. Id. Embree Construction did file a claim of lien but did not pursue an enforcement action; thus, Embree Construction's claim of lien against Rafcor's property expired.
38. Id. at 492, 411 S.E.2d at 921.
39. Id. at 497, 411 S.E.2d at 923.
40. Id.
41. The term "contractors" shall be used to generically refer to those "builders" and "materialmen" protected under Chapter 44A's Lien Statute.
42. WEBSTER, supra note 5, at § 418 to 24.
pursuant to an express or implied contract with the owner of the real property.\textsuperscript{43} The contract need not be in writing.\textsuperscript{44} Second, the contractor’s performance must be for the improvement of the owner’s real property.\textsuperscript{46} Third, a Claim of Lien must be filed “not later than 120 days from the last furnishing of labor or materials at the site of the improvement” by the lien claimant.\textsuperscript{48} This “Claim of Lien” must be filed with the Office of the Clerk of Superior Court in the county where the real property subject to the claim is located.\textsuperscript{47} Fourth, an action to enforce the lien must be “[commenced within] 180 days after the last furnishing of labor or materials at the site of the improvement” by the lien claimant.\textsuperscript{49} This “enforcement action” may be instituted in any county wherein the “Claim of Lien” was filed.\textsuperscript{50} Where the lien claimant fails to file an enforcement action within this period, the lien expires.\textsuperscript{51} Fifth, the law requires a judgment to be entered for the amount recoverable. The judgment amount may not to exceed the amount stated in the lien. The judgment should direct “a sale of the real property subject to the lien.”\textsuperscript{52} In order for the judgment to be in proper, enforceable form, the court must render a judgment amount and order the sale of the real property to satisfy that amount.\textsuperscript{53} The judgment amount cannot exceed the amount claimed in the “Claim of Lien.”\textsuperscript{54} Whether or not the construction is complete or the funds are due, the lien secures the lien claimant’s rights to amounts earned.\textsuperscript{64} Where the contractor is in privity

\begin{enumerate}
\item[44.] Id.
\item[45.] Webster, supra note 4, § 421, at 547-48. The authors state that North Carolina’s Legislature has defined “improvement” in N.C. Gen. Stat. § 44A-7 (1989).
\item[47.] N.C. Gen. Stat. § 44A-12(a) (1989). The statute requires “substantial compliance” with the suggested Claim of Lien form that is found in N.C. Gen. Stat. § 44A-12(c) (1989). See also Webster, supra note 5, at § 423(c).
\item[49.] Id.
\item[50.] Webster, supra note 5, at § 424(b). Also note that N.C. Gen. Stat. § 44A-15 (1989) allows “attachment of the property subject to the lien” where the owner of the real property removes, attempts to remove, or threatens to remove an improvement from the real property subject to the lien without the lien claimant’s written consent.
\item[51.] N.C. Gen. Stat. § 44A-13(b) (1989).
\item[52.] Webster, supra note 4, § 424(e) at 558-60.
\item[53.] Id.
\end{enumerate}
with the insolvent owner, but not the lender, and the contractor seeks payment from the loan funds held by the lender, Chapter 44A offers no relief. This is because there exists no contract between the lender and the contractor; such a contract is a key element in a Chapter 44A lien.

REALITIES OF COMMERCIAL PRACTICE

Since the real property owner of a commercial site often owes the contractor large sums of money, commercial contractors generally file claim of liens in the ordinary course of business. Where necessary, the contractor will continue with an enforcement action and eventually obtain a judgment demanding the sale of the property to satisfy the outstanding judgment amount. Typically, in the commercial construction setting, there are several lien claimants and creditors who await payment. In order to ensure that laborers and materialmen get paid, the statute declares that the lien claimant’s right to the judgment amount “relates back” to the first day of furnishing labor or materials. Due to the “relation back” doctrine, the lien claimant, in this case Embree Construction, often has priority over creditors. Thus, when the owner’s property is sold, the lien claimant in this situation generally receives payment first. Then, if any money remains after payment of the lien claimants, other creditors are paid.

However, there are some instances where, in spite of the operation of the “relation back” doctrine, a lien claimant will not be paid. This is so even where judgment is properly rendered in the lien claimant’s favor. For example, where a lender extends a con-

58. Id.
59. Id.
60. N.C. GEN. STAT. § 44A-10 (1989).
61. WEBSTER, supra note 5, at § 425.
62. Id.
63. Id.
65. Id.
struction loan to the owner and simultaneously records a mortgage deed of trust on the owner’s real property, a contractor’s lien will be subordinate to the lender’s deed of trust, unless the contractor provided labor or materials to the site prior to the recordation of the deed of trust.66 This was the situation in Embree.67 Since commercial construction costs are high, real property owners will frequently not begin construction without first obtaining a construction loan.68 Thus, commercial contractors’ liens are often subordinate to the lenders’ deeds of trust.69 Should the owner become insolvent during the project, the commercial contractor may find that outstanding debts are unrecoverable in spite of his or her lien judgment.70

**Embree Construction’s Predicament**

As the Court aptly noted, a statutory lien is of minimal value where the owner is insolvent and the contractor’s lien is subordinate to prior encumbrances.71 In Embree v. Rafcor, UCB had a prior recorded construction loan mortgage which would take precedence over the contractor’s lien.72 Applying the statutory remedy to the case at hand, only after the bank had foreclosed and received the full value of its mortgage would the contractor be entitled to any remaining funds73 Additionally, even though the contractor Embree did file his lien, he never perfected it.74 While Rafcor’s loan fund at UCB contained $70,000, Rafcor still owed UCB $110,383. Embree Construction quickly recognized that once the bank foreclosed its note there would be no money remaining for Embree Construction. Therefore, perfection of the Lien by Embree Construction would have been of little advantage or value to them, this in addition to the expense of time and money required to do so. Under these circumstances, Embree Construction’s nonperfection of the lien could be seen as an understandable business decision.

Embree’s situation was made all the more difficult given the

66. Webster, supra note 4, § 428, at 565-66.
67. See supra note 18.
68. Higgins, supra note 64, at 953.
69. Id.
70. Id.
71. Embree at 493, 411 S.E.2d at 921.
72. See supra note 18.
73. Id.
74. Id.
fact that generally, a court will not render equitable relief where there is or was a "full and complete remedy at law." 75 In a similar previous case, Jones Cooling & Heating, Inc. v. Booth, 76 North Carolina's Court of Appeals did not afford the plaintiff subcontractor the equitable remedy of restitution on its claim of unjust enrichment as against the owner of the property. That court denied equitable relief on the basis that, had the subcontractor utilized his Chapter 44A remedy, he would have been given adequate relief. 77 It was thus apparent that Embree faced substantial uncertainties as to whether or not it could anticipate payment for the work performed on this project.

Status of the Law as it Existed Prior to Embree

A. Federal Cases Applying North Carolina Law

Although North Carolina's state courts have not squarely addressed the viability of a contractor's claim for an equitable lien on funds held by a lender, Federal Courts applying and interpreting North Carolina law had consistently rejected such claims for equitable relief. In the early case of Pratt Lumber Co., Inc. v. T.H. Gill Co., 78 the court determined that an unjust enrichment theory would not entitle the contractor to equitable relief as against the lender or provider of funds for the project. In that case, the court stated that materialmens' equitable assignment claims also failed. 79 Thus, Pratt Lumber indicated that theories of unjust enrichment or equitable assignment would not entitle a contractor-claimant to a lien on funds held by a lender. 80 In later federal cases applying North Carolina law, the courts have further repeatedly rejected contractors' claims based upon equitable lien theories which attempted to attach funds held by lenders. In 1975, in Urban Systems Development Corp. v. NCNB Mortg. Corp., 81 the court entered summary judgment for the lender after dismissing the

77. Id. at 760, 394 S.E.2d at 294.
78. 278 F. 783 (E.D.N.C. 1922).
79. Id. at 792.
80. Id. at 789-790.
81. 513 F.2d 1304 (4th Cir. 1975).
contractor's "trust fund" theory.\textsuperscript{82}

The only decision in which a federal court, applying North Carolina law, granted a contractor's request for equitable relief came in \textit{G.L. Wilson Bldg. Co. v. Leatherwood}.\textsuperscript{83} The facts in \textit{Wilson}, however, are distinguishable from those in \textit{Embree v. Rafcor}. In \textit{Wilson} the contractor completed the project only after meeting with the lender and receiving repeated direct assurances from the lender that full payment would be forthcoming upon the project's completion.\textsuperscript{84} In \textit{Wilson} the contractor received equitable relief based upon his reliance on the lender's repeated assurances over several meetings.\textsuperscript{85} In \textit{Embree v. Rafcor}, however, the lender made no such assurances to the contractor concerning payment for the project.

In short, federal case law developed upon interpretation of governing North Carolina law has repeatedly held that when no assurances of payment to the contractor by the lender are made and the contractor lacks privity with the lender, there should be no recovery beyond that offered under Chapter 44A. Accordingly, had the Court in \textit{Embree} adhered to the principles established in applicable federal interpretations of North Carolina law, equitable relief would have been denied in this case.\textsuperscript{86}

\textbf{NORTH CAROLINA CASE LAW}

While North Carolina's state courts have not directly addressed the issue of whether a contractor may state a cause of action in seeking an equitable lien against a commercial lender, the North Carolina Court of Appeals did address a closely-related issue in \textit{Suffolk Lumber Co., Inc. v. White}.\textsuperscript{87} In that case the Court of Appeals held that a first-tier subcontractor was not entitled to a claim of lien on the owner's real property.\textsuperscript{88} There the lien claimant based his right of recovery upon a third-party beneficiary theory. The court held that Chapter 44A did not provide an exception to the principle that "where there is a contract between persons for

\textsuperscript{82} \textit{Id.} at 1307.
\textsuperscript{83} \textit{268 F. Supp.} 609 (W.D.N.C. 1967).
\textsuperscript{84} \textit{Id.} at 614.
\textsuperscript{85} \textit{Id.} at 619.
\textsuperscript{86} These decisions have come from federal courts applying North Carolina law. While these holdings have persuasive authority, they are not considered controlling authority within North Carolina's State court system.
\textsuperscript{87} \textit{12 N.C. App.} 27, 182 S.E.2d 215 (1971).
\textsuperscript{88} \textit{Id.}
the furnishing of services or goods to a third person, that third person is not liable on an implied contract simply because he received such goods or services." Suffolk Lumber is similar to Embree v. Rafcor in that the plaintiffs in both cases lack privity of contract with third-party beneficiaries. Thus, under the Suffolk Lumber rationale, Embree Construction could not use Chapter 44A's lien remedy against UCB to attach the construction loan fund under an equitable lien theory. Likewise, under the principles enunciated in Suffolk Lumber, Defendants' motion to dismiss under Rule 12(b)(6) would have been proper and could have been granted.

SUMMATION OF STATUS OF THE LAW PRIOR TO EMBREE V. RAFCOR, INC.

As shown above, in the few instances where courts, either state or federal, have addressed this issue, the courts have routinely denied equitable relief to lien claimants. Prior to Embree v. Rafcor, a contractor, not in privity with the lender, had only Chapter 44A's relief to recover his cost of goods and services rendered to an owner.

ANALYSIS: EMBREE V. RAFCOR, INC.

In Embree v. Rafcor, the contractor, Embree Construction, asked the court for relief beyond that provided in Chapter 44A. The contractor based its request for equitable relief upon an unjust enrichment theory. The lender, UCB, correctly argued that North Carolina's federal courts had already determined that a contractor's Chapter 44A remedies should not be augmented by granting equitable relief. However, the North Carolina Supreme Court transcended the language of the mechanics' lien statute and extended equitable relief to Embree Construction. In holding for the contractor and granting equitable relief, the North Carolina Supreme Court has perhaps opened the door to a construction litigation quagmire similar to that which California has recently

89. Id. at 29, 182 S.E.2d at 216.
90. See supra text accompanying notes 78 to 89.
91. Embree at 489, 411 S.E.2d at 918.
92. Id.
93. Id.
94. Id. at 487, 411 S.E.2d at 923.
The Court held that, where a lender has received the security it bargained for— in this case, a completed building— and refuses to disburse to the contractor monies remaining in the construction loan fund, that money being rightfully owed to the contractor, the lender has been unjustly enriched at the contractor's expense. When one is unjustly enriched at the expense of another, he must make restitution to the other. The court may then determine what equitable remedy is most appropriate. Here, the Court determined that equity supported Embree's right to an equitable lien upon the undisbursed construction loan funds held by UCB. To the extent of Rafcor's outstanding construction debt to Embree, Embree held an equitable lien on the monies in the construction loan fund held by UCB.

The central issue in Embree v. Rafcor is whether a contractor who is not in privity with the lender is entitled to an equitable lien upon the undisbursed construction loan funds held by the lender to the extent of the outstanding debt owed by the property owner where the construction is complete. Should the court decide that a contractor is entitled to equitable relief where the construction project is complete, a secondary, more troublesome, issue arises. The secondary issue for the court to determine is what constitutes "completed construction." The Court dealt with these issues in the following sequence.

The Court stated that as a general rule a contractor is limited to Chapter 44A's relief and that there are no North Carolina state...
cases affording equitable relief. However, the Court noted that where the owner is insolvent and there are prior encumbrances, Chapter 44A's remedy is in reality worthless.

The Court also stated that in other jurisdictions, attempts to reach construction loan funds have proven unsuccessful when based on equitable assignment, third-party beneficiary, or trust fund theories. Where contractors sued as third-party beneficiaries of building loan agreements insured by HUD, the Court noted that several federal courts granted equitable relief to contractors. Although it is apparent that HUD-insured loans should be treated differently than loans issued through private lenders, the Court did not make this distinction.

Further, the Court focused on California and Florida's treatment of equitable lien claims based on theories of detrimental reliance and unjust enrichment. The Court put forth California's treatment of equitable lien claims as an appropriate way to address this issue. While focusing on California law and even noting the unique "stop-notice" statutory provision within California's lien

102. Id. at 491-93, 411 S.E.2d at 920-22.

103. Higgins, supra note 62, at 952-55. Typically a lender will record its mortgage deed of trust contemporaneously with the extension of the loan to the owner. Since the owner will perhaps not contract for the construction until he is assured that there will be sufficient funds for payment for the services, the contractor's Chapter 44A lien can become subordinate to the lender's deed of trust. In the event that the owner becomes insolvent or otherwise delinquent on his loan, the lender may foreclose on the property and retain the loan funds and any sales proceeds from the foreclosure sale. Sometimes there are insufficient funds remaining to satisfy the owner's outstanding debt to the contractor. See also supra note 20.

104. Embree at 493, 411 S.E.2d at 921.

105. Id. at 493, 411 S.E.2d at 921 (quoting Higgins, supra note 62 at 954 n. 12).

106. Embree at 493, 411 S.E.2d at 921-922. HUD stands for Department of Housing and Urban Development.


108. See supra note 106 where courts openly discuss the potential for a different outcome should the lender in question be a private lender rather than a federal governmental lending agency.


110. Id. at 494, 411 S.E.2d at 922.
The Court skirted the difficult question which arises in this issue: whether North Carolina's legislature intended equitable remedies to be allowed in addition to the remedies found in Chapter 44A. California's lien statute is worded differently than North Carolina's. Also, the legislative history of the California lien statute indicates that California's legislature determined that equitable remedies should not be granted in addition to the statutory lien remedies. The Court in effect ignored North Carolina's lien statute. Instead, the Court interpreted California's old statute. This decision might well be viewed as one best left for legislative action. As Judge Greene thoughtfully articulated in his dissenting opinion, "[o]ur Legislature has provided for liens to protect builders (N.C.G.S. §§ 44A-7 et seq. (1989)), and I perceive no good reason for the courts to judicially legislate additional security for the builder." Thus, it may be opined that the Court went beyond a mere interpretation of our State's lien statute and that the decision in Embree amounts to something quite more than that; perhaps an inadvertent judicial override of legislative intent.

Finally, the Court may have insufficiently addressed an important point in the appellant's argument with regard to what constitutes "completed construction." The appellant argued that, under this new equitable lien, litigation will focus not only on the elements necessary for equitable relief, but also on whether a jobsite is "completed construction." Thus, this new form of relief, an equitable lien upon a construction loan fund, litigation must first focus on whether a jobsite is "completed construction." Then, if it is determined that a jobsite is in fact "completed construction," the court will turn its attention to the issues involved in whether an equitable lien is available. Unfortunately, the Court here may have underestimated the significance of the appellant's argu-

111. Id. at 493-94, 411 S.E.2d at 921 n. 2.
112. Cal. Civ. Code § 3264 (West 1974), which was amended due to excessive litigation costs on the construction and lending industries, now expressly bars any equitable remedies not enumerated in either the contract or the statute. Also, Cal. Civ. Code § 3156 to 3172 embodies California's unique "stop-notice" procedures. North Carolina's lien statute does not have this language.
114. Id.
116. Id. at 495, 411 S.E.2d 922-23.
The question of what is "completed construction" should have been addressed by this court. However, the Court merely stated that only on "completed construction" projects would equitable relief be granted. In bypassing the appellant's valid question of the definition of "completed construction," the Court may have opened a Pandora's Box of construction litigation concerning the sub-issue of whether a project is "complete." Since the Court failed to clearly define "completed construction," many contractors may well sue for an equitable lien as a standard procedure in the quest for assurance of obtaining payment. Additionally, contractors might now file suit anytime construction is arguably "complete" and when there is some doubt as to whether payment from the lender's account will be immediately forthcoming. In the end, our court system will be subjected to the additional burden of being forced to resolve two separate issues with regard to the same construction site. The first issue to be resolved will be the determination of whether the construction is "complete" thereby determining whether an equitable lien will perhaps be available. The second issue to be resolved will be the determination of whether an equitable lien should attach to undisbursed construction loan funds held by the lender. Like California and Florida, our courts will hear construction cases where the outcome hinges upon whether a jobsite is "completed construction." Due to the Court's failure to properly define this term, lower courts will have to muddle through the issue of "what is 'completed construction'" on their own. There can be little doubt that the introduction of this ambiguity will only serve to further burden the lending and construction industries and introduce another element of uncertainty in dealings between contractors, owners and lenders.

120. This situation is illustrative of the types of problems faced by California courts in the wake of judicial decisions to create remedies beyond those outlined in their applicable mechanic's-lien statutes, and which eventually helped cause California's legislature to revise their State's lien statute to disallow equitable liens. See generally supra note 119.
CONCLUSION

In Embree v. Rafcor, North Carolina's Supreme Court judicially legislated an additional means of relief for builders. Chapter 44A's lien is no longer a builder's exclusive remedy. Now a contractor may recover under Chapter 44A's mechanic lien or seek an equitable lien. In relying upon decisions from other jurisdictions, notably California, the Court failed to grapple with the differences between California and North Carolina's lien statutes and did not acknowledge the recent changes in California's laws regarding construction liens. The Court further failed to adequately outline what should constitute a "completed construction" project for the purpose of making this new remedy available.

Prior to this case, builders were sufficiently protected by the lien statute and could easily contract for more security from the owner where necessary. With Embree v. Rafcor, the North Carolina Supreme Court failed to recognize the careful balance that our Legislature provided in North Carolina's lien statute. With the lien statute as a builder's sole remedy, North Carolina's construction and lending industries have flourished. While California and Florida lenders may decline to extend marginal loans due to potential litigation costs, North Carolina lenders have been able to extend loans at competitive interest rates. These loans create new construction and help support our state's economy. Our Legislature recognized that, while California's lending costs have skyrocketed due to construction litigation costs, North Carolina's lending costs are minimized by maintaining Chapter 44A's lien as a builder's exclusive remedy. Due to the holding in Embree v. Rafcor, North Carolina lenders will tighten their lines of construction loan credit. Where a marginal loan risk would have been granted, lenders may now deny credit to a property owner in the face of the added uncertainties created in the wake of this decision. This could well cause an appreciable decrease in construction projects. In that case, the holding in Embree v. Rafcor could mean

122. See supra note 114.
that lenders, owners, and builders alike will be adversely affected. Just as in California, our Legislature may be compelled to correct this ripple effect through revisions of long accepted statutory frameworks.

**DRAFTING SUGGESTIONS FOR LENDERS**

A lender may be able to lessen potential liability under this new "equitable lien on undisbursed construction loan funds" by following some simple steps. In the mortgage agreement, the lender should consider adding the following language:

1. In the "security clause" state that the lender's security interest runs to both the improved real property AND the undisbursed loan proceeds.

2. In the "default clause" state that "default may include situations where the lender, in good faith, deems that the owner may default or shows signs of inability to fulfill its obligations in this agreement."

3. Have the owner state that he/she will require all contractors to enter into a contract whereby the contractor agrees to waive any rights to legal or equitable liens on the improved real property, the undisbursed construction loan funds, or proceeds from the sale of this real property.\(^{124}\) If this is unacceptable to the contractor, the owner may wish to have the contractor limit himself to the legal remedies provided in 44A, and forego any additional equitable remedies in an attempt to limit the application of the principles enunciated in *Embree*.

4. In the mortgage agreement, the lender should clearly define "completed construction" in favorable terms and have the owner agree to have contractor/owner contract recite the same definition for "completed construction."

These additional measures could aid in reducing a lender's potential liability under the *Embree v. Rafcor* holding. Since the Court seemed to focus on (a) what the lender bargained for as security interest, and (b) that the owner was not in default when the contractor requested final payment, changing the language in the

\(^{124}\) See American Jurisprudence Legal Forms 2d Edition (1990) § 173:106, at 489, for an excellent sample of a Form Agreement between the prospective contractor and owner whereby the contractor agrees to not assert a mechanic's lien. By adding language which asserts that the contractor further agrees to waive any and all equitable liens to the undisbursed construction loan fund, the lender substantially improves his position should litigation follow.
mortgage agreement and the owner/contractor’s contract may eliminate any “equitable lien” liability.

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