CONSTRUCTION LAW - DAMAGE CALCULATIONS

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Not uncommonly during the course of any major construction project, disputes will arise concerning payment. Typically, the dispute will involve questions about the scope of work contracted to be performed or changes to the scope of work subsequently made after the original agreement between the parties. Further, parties involved with a construction project who experience difficulties (time delays, cost overruns, etc.) will either become dissatisfied with another party's performance or find themselves the target of breach of contract allegations. This paper identifies the basic concepts involved with claims for damages in the context of construction law from the perspective of the owner, the general contractor and the subcontractor.

It is important to keep in mind with regards to any discussion of claims for damages that the goal of the law of damages is not to punish or reward any party. Rather, the goal of an award of damages is to place the party injured by the breach, as near as may be possible, in the position which he would have occupied had the contract been performed. *See* Meares v. Nixon Constr. Co., 7 N.C. App. 614, 623, 173 S.E.2d 593 (1970); citing Harris and Harris Constr. Co. v. Crain and Denbo, Inc., 256 N.C. 110, 123 S.E.2d 590 (1962). As in non-construction cases, the plaintiff (whether the owner, contractor or subcontractor) has the burden of proving that he has been injured and is entitled to damages as a result of the breaching party's actions or inaction in violation of the construction contract.

A. Basic Measure of Damages Available to the Owner

If the contractor has abandoned the project, the owner has terminated the contractor, or the contractor has otherwise failed to complete the work in accordance with the contract, the owner may be entitled to seek the recovery of damages. As with any suit arising from a contract, the starting point for determining the prospective rights of the parties begins with a review of the contract documents. Not surprisingly, the contract documents are often drafted by the owner or the owner's agent and will likely contain favorable remedies for the owner. Some contracts contain a liquidated damages clause in which the owner and the contractor have pre-determined the monetary value associated with the contractor's default. In the absence of a liquidated damages provision or other applicable contractual remedy[1], North Carolina courts will apply either the "cost of completion or repair method" or "diminution in value method" to enable the owner to retain the benefit of his bargain and plac[e] him in the same position he would have occupied had the breach not occurred. *See* City of Charlotte v. Skidmore, Owings & Merrill, 103 N.C.App. 667, 407 S.E.2d. 571 (1991); see also Robbins

[1]The American Institute of Architects (AIA) standard form contract contains a cost of completion or repair clause which states that after termination the owner is entitled to the difference between the contract price and the cost to complete including any additional architect/engineering fees made necessary as a result of the default. (p. 14.2.2).

v. C. W. Myers Trading Post, Inc., 251 N.C. 663, 111 S.E.2d 884 (1960) (comparing the "cost of completion method" to the "diminution in value method"). As discussed below, the choice in application of the two methods will depend on the level of performance of the contractor in complying with the contract.

1. Liquidated damages clause as the measure of owner's damages

In the typical construction related liquidated damages clause, the owner and contractor have by contract established a per diem dollar amount representing an approximation of the actual damages the owner will suffer if the contractor fails to complete his contractual obligations in the manner prescribed in the contract. Such a liquidated damages clause will be enforced provided that: (1) the damages which the parties reasonably anticipate are difficult to ascertain because of their indefiniteness or uncertainty at the time of the making of the contract and (2) the amount stipulated is either a reasonable estimate of the damages which would probably be caused by a breach or is reasonably proportionate to the damages which have actually been caused by the breach**.** Knutton v. Cofield, 273 N.C. 355, 361-362, 160 S.E.2d 29, 34 (1968). Liquidated damages are appropriate where the nature of the project dictates that the owner's damages at the time of the contractor's breach will be difficult to calculate with precision.

North Carolina courts will generally enforce liquidated damages clauses as described above. However, the courts will not enforce the provision if it operates as a penalty, the threat of which is to prevent breach by the other party rather than as a pre-estimate of probable actual damages. Green Park Inn, Inc. v. Moore, 149 N.C.App. 531, 538, 562 S.E.2d 53, 58 (2002) (upholding the validity of a $500,000.00 liquidated damages clause for breach of a lease agreement where the parties specifically identified at the time of contracting the uncertainty of damages in the event of a breach). Hence, documentation that the parties contemplated the possible damages in the event of a breach prior to drafting the liquidated damages clause will ultimately aid in the enforcement of the provision.

2. Cost of completion or repair method to calculate the owner's damages

The "cost of completion or repair" method determines the cost of labor and materials necessary to complete the project where the defects or omissions are of such a character as to be capable of being remediated. Leggette v. Pittman, 268 N.C. 292, 150 S.E.2d 420 (1966); Durham Lumber Co. v. Wrenn-Wilson Constr. Co., 247 N.C. 680, 107 S.E.2d 538 (1959). While conceptually simple, the owner contemplating this method should organize and account for each item of expense incurred in completing the project. Since the cost to complete or repair will almost certainly be more expensive than the defaulting contractor's estimate (due to premiums placed on projects by replacement contractors), proper records must evidence not only what the contractor actually spent to complete the project, but, where possible, the reasonableness of the costs incurred by the owner, preferably through multiple estimates. Additionally, any change in the original scope of the contract and expenses incurred as a result must be carefully documented for to defend against the defaulting contractor asserting that the

project, as completed by the owner, exceeded the scope of work in either quantity or quality than that which the original contractor was obligated to provide.

The following checklist identifies areas of concern the owner should consider in preparation for proving damages based on the cost of completion or repair method when confronted with finishing a project after the original contractor default:

*How complete is the work (_____ %)?
*How much of the contract amount has been paid (_____)?
*Is the contract balance adequate to fund the completion of the work?
*Prepare a photographic/video record of contract work performed and work in progress.
*Prepare a photographic record of stored materials, equipment and tools on site.
*Make a photographic record of site conditions as of the termination date (document the need for clean-up, the absence of damage to other trade work.)
*Identify records and documentation which may be critical to the completion of the work.
*Prepare documentation of the contractor's failure to perform after notice of performance failures.
*Establish that cost records are adequate to segregate and calculate the consequences of the contractor default.
*Establish cost codes for additional costs directly attributable to the contractor default. (Identified as a significant reason that projects lose money)

See Rash, Eugene F., et. al., Termination-The Contractor/Subcontractor Perspective (2002).

3. Diminution of value method to calculate the owner's damages

North Carolina courts generally follow the cost of completion or repair method, described above, to ensure the owner has received the full benefit of his bargain. Lapierre v. Samco Development Corporation, 103 N.C.App 551, 560, 406 S.E.2d 646, 650 (1991). However, the diminution in value method recognizes an exception to the general rule and applies if two conditions exist: (1) the completed project substantially conforms to the contract requirements with only minor defects which do not substantially lower the value of the structure, and (2) the repair method would require a significant portion of the work to be reconstructed or demolished to enable the structure to fully conform. See Skidmore at 682, 407 S.E.2d at 580. Under these conditions the owner's damages will be established by the diminution in the value of the project as contemplated in the contract documents compared to the project as actually constructed. Robbins, supra.

The policy underlying this method of valuation recognizes the need to avoid economic waste and undue hardship to the defendant contractor when the building substantially conforms to the contract. Kenny v. Medlin Construction and Realty Co., 68 N.C. App. 339, 344-45, 315 S.E.2d 311, 314-15 (1984); But see Lapierre, supra (allowing cost of repair method despite the fact garage cost $4500 to build and $21,472.24 to repair). Interestingly, at least one North Carolina court appears to have drawn a distinction between economic waste as it relates to a particular line item in a construction project as compared to the project as a whole. The court in

Skidmore upheld an award of $2,127,000.00 to replace defective sidewalks noting that although substantial work to the sidewalks would have to be destroyed, replacement of the sidewalks would not result in economic loss to the entire project. Id. The impact of the Skidmore decision is uncertain, however, as the court had previously noted significant non-conformity in construction of the sidewalks.

A plaintiff seeking to utilize the cost of completion or repair damage calculation will need professional accounting including an expert appraiser familiar with standards of construction and applicable building codes to determine the relative value of the work as completed as compared to the value of the project if it had been built in accordance with the contract. See id.; see generally J.G. Robbins, supra.

B. The Basic Measure of Damages Available to the Contractor

In a best case scenario, the contractor has fully completed and performed every aspect of his original written contract in a timely manner with no changes to the original scope of work. An owner's refusal to pay under these conditions merits a simple collection action. Unfortunately, realities are rarely this simple. Typically, the refusal of the owner to pay the contractor on a completed project will stem from poorly documented change orders. Further, problems arise when the owner wrongfully terminates the contractor under allegations of incomplete or improper performance or when significant delays by the owner have caused the contractor to experience cost overruns. These pervasive problems faced by contractors are addressed below.

1. The Change Order - How to avoid litigation

Although not typically discussed in the context of damages, a properly documented change order is the contractor's best tool to ensure payment for the work actually completed on a construction project and further avoid the necessity of assessing damages at the end of the project. A change order, issued after work commences is a written order to the contractor signed by the owner and the architect authorizing a change in the work or an adjustment in the contract sum or contract time.[2] The change order allows the contractor and owner to effectively handle construction projects that are inevitably plagued by unforseen conditions arising out of design flaws, project site conditions, labor problems, weather concerns and the like.

Invariably, the contractor cannot wait for a written change order to be issued and will proceed with the work, usually upon the oral assurances of an owner's representative. At the end of the project the contractor invoices the owner and is met with a refusal to pay for the

[2]The "changes" clause contained in Article 7.3.1 of the AIA A201 General Conditions states, "The Owner may by Construction Change Directive, without invalidating the Contract, order changes in the Work within the general scope of the Contract consisting of additions, deletions or other revision, the Contract Sum and the Contract Time being adjusted accordingly."

additional work because no change order was issued. Routinely, the owner will defend non-payment by pointing to a provision in the contract which states:

> Claims by either party must be made within 21 days after occurrence of the event giving rise to such Claim or within 21 days after the claimant first recognizes the condition giving rise to the Claim, whichever is later. **Claims must be made by written notice**. An additional Claim made after the initial Claim has been implemented by Change Order will not be considered unless submitted in a timely manner.
>
> If the Contractor wishes to make a Claim for an increase in the Contract Sum, written notice as provided herein shall be given before proceeding to execute the Work.

AIA Document A201 Sections 4.3.3 and 4.3.7 (1987) (emphasis added)

To avoid this problem, the better practice is to wait for a written and signed change order before performing any changed or added work. If the project must go forward the contractor, before beginning work, should notify the owner:

1. He considers the work to be a change to the contract;
2. He will perform the changed work but expects additional compensation because the scope of the contract has been changed; and
3. If the owner does not agree that the work constitutes a change or does not intend to pay for the change, the owner should notify the contractor immediately.

Burchette, Robert L., et. al., Construction Claims, North Carolina Construction Law Deskbook, I-4
(Peter J. Marino, ed. 2000).

All too often the contractor seeks payment for extra work at the end of the project when the time for written notice has expired. Fortunately for the dilatory contractor, North Carolina courts have specifically held, "provisions of a written contract may be modified or waived by a subsequent parol agreement, or by conduct which naturally and justly leads the other party to believe the provisions of the contract are modified or waived . . . This principle has been sustained even where the instrument provides for any modification of the contract to be in writing." W.E. Garrison Grading Company v. Piracci Construction Co., Inc., 27 N.C.App. 725, 221 S.E.2d 512 (1975). The contractor seeking compensation for additional work should detail the following in its request for payment assuming the request is made after the expiration of the time for change orders:

1. A record of what extra work was performed;

2. A copy of the original Scope of Work, if possible, to demonstrate that the extra work was not contemplated by the contract;
3. The facts upon which the contractor relied showing that the owner had knowledge of or directed the extra work to be performed;
4. The facts regarding the apparent or actual authority of the representative who directed the extra work to be performed
5. Allegations that the owner ratified its representatives' directions; and
6. Allegations showing that the owner had actual knowledge that the contractor claimed the work to be extra work prior to the contractor performing.

See Burchette, pp. 6-7.

2. Contractor claims against the owner after substantial performance - now what?

If the owner's breach occurred prior to the contractor's completion of the work and prevented the contractor from completing the work, the contractor will be entitled to recover from the owner not only that portion of the contract balance earned by the contractor prior to the breach, but also the contractor's lost or anticipated profits. Recovery of the completed portion of the contract appears to present few problems of proof as it entails invoicing the owner as in the regular course of business. Addressing the latter element, a claim for lost profits asserts that but for the owner's breach preventing the completion of the contract, the contractor would have earned prospective profits. Gouger & Veno, Inc. v. Diamondhead Corporation, 29 N.C.App. 366, 369, 224 S.E.2d 278, 280 (1976). North Carolina courts have stated that the measure of lost profits is the difference between the contract price and what it would have cost plaintiff to complete the work under the contract. Meares at 623, 173 S.E.2d at 599. Hence, the successful contractor must demonstrate:

(1) that it is reasonably certain that such profits would have been realized except for the breach of the contract;
(2) that such profits can be ascertained and measured with reasonable certainty; and
(3) that such profits may be reasonably supposed to have been within the contemplation of the parties, when the contract was made, as the probable result of a breach.

Id.; citing Perkins V. Langdon, 237 N.C. 159, 171, 74 S.E.2d 634, 644 (1953).

To recover lost profits the contractor must establish the damages with reasonable certainty. A plaintiff has an obligation to prove such facts which will furnish a basis for the calculation of damages. See Steele Company v. Goodman, 82 N.C. App. 692, 698, 348 S.E.2d 153, 157 (1986), disc. rev. denied, 318 N.C. 693, 351 S.E.2d 745 (1987). Otherwise, lost profits

will not be recoverable. See e.g. Weyerhauser Co. v. Godwin Bldg. Supply Co., 292 N.C. 557, 234 S.E.2d 605 (1977); Catoe v. Helms Construction & Concrete Co., 91 N.C. App. 492, 372 S.E.2d 331 (1998). While the concept of lost profits appears simple, litigants have experienced significant difficulties presenting sufficient evidence to sustain an award.

Upon a claim for damages, North Carolina courts will award lost profits that are specifically provided for in the contract. Harris and Harris Construction Company, Inc. v. Crain and Denbo, Inc., 256 N.C. 110, 126, 123 S.E.2d 590, 602 (1962) (holding that where the contract contemplated a 4% profit based on the total project amount, plaintiff was entitled to recover lost profits as a result of breach in the amount of 4% of the total project). However, the Meares court rejected the plaintiff's claim for lost profits stating, "the testimony of plaintiff that his anticipated profit was 20% of the contract price does not provide an adequate factual basis for the jury to ascertain the measure of damages under the standard of certainty established by the decision of our Supreme Court." Id. The Catoe court found equally unpersuasive the plaintiff's claim for lost profits in the completion of seven concrete projects where the plaintiff demonstrated only the cost (out-of-pocket expenses) incurred in some of the projects and proceeds received from most of the jobs but failed to correlate cost with proceeds to demonstrate the profits with reasonable certainty. Catoe at 497, 372 S.E.2d at 335.

In Gouger, the court also denied lost profits to the plaintiff electrical subcontractor replaced or the project. The plaintiff presented evidence of profits on its specific account with the defendant for the four months prior to the breach in an attempt to establish future profits. The plaintiff's evidence as to future profitability as summarized by the Court was as follows:

> Plaintiff determined its profits on its account with defendant for four months of 1973 as follows: In February the total bill was $4,152.10; plaintiff expense for labor and 'other costs' amounted to $3.615.00 leaving a profit of $537.10. In March the total bill was $3,806.00 with a profit of $842.00. In April the total bill was $12,104.16 with a profit of $4,582.16. In May the total bill was $10,225.12 with a net profit of $4,194.12.

Id. In declining to award lost profits, the court found the plaintiff had failed to present sufficient evidence for the jury to determine with reasonable certainty an amount plaintiff should recover for lost profits. Id. at 368, 224 S.E.2d at 280. While the plaintiff in Gouger demonstrated the general, historical profitability of the contract, the court found it lacked the legal certainty to support an award of damages stating:

> . . .Plaintiff presented no evidence tending to show what its wage scale for the remaining months of 1973 would have been and how it would have compared with the four preceding months; how its 'other costs' in determining profits for the remainder of 1973 would have compared with the four previous months; and how many employees plaintiff could have counted on to perform work during the remainder of the year. Had the jury attempted to project

> profits on a percentage basis, they would have found no solid pattern as the profit for February was approximately 13 percent of the gross, for March approximately 22 percent, for April approximately 38 percent, and for May approximately 41 percent.

The Gouger decision suggests that a successful litigant in a case for lost profits will either demonstrate that expenses to be incurred in completing the project will be less than the project amount or that evidence of the general profitability of the enterprise is sufficiently certain and consistent to allow a jury to consider the lost profits on a prospective basis.

3. Recovery by the contractor for delay damages

Delays are inherent on a construction project and may stem from any number of factors including weather, labor problems, design problems, scheduling problems, etc. Where a delay is attributable to one of the parties, the non-breaching party may be entitled to compensation under the rule that every party to a construction project has an implied obligation to not delay, hinder, or interfere with the performance of another party. Brown v. East Carolina Railroad Company, 154 N.C. 300 (1911). Lengthy delays are financially devastating to contractor causing increased duration related costs. These cost are rarely capable of direct proof making the recovery of duration related costs difficult.

a. Actual Cost Accounting

Undoubtedly the best proof of delay damages is the actual cost incurred by the non-breaching party as a result of the delays caused by the breaching party. This proof will consist of information taken from the company's accounting books and records and accumulated in such a way that the damage calculation documents a direct cost for each item of delay. Barry B. Bramble and Michael T. Callahan, Construction Delay Claims 12-7 (2000). As noted by Bramble and Callahan, this type of detailed information is rarely available for delay claims as workers in the field may experience delay while waiting for material or directions after a change but rarely have a cost code to which they can assign the time delay. Id. Ideally, a vigilant project manager experiencing delays will document the amount and identify the cause of each delay.

It is clear that North Carolina courts will not award damages based on delay unless the plaintiff can demonstrate that delays caused by the defendant negatively affected plaintiff's work performance. Biemann and Rowell Company v. Donohoe Companies, Inc., 147 N.C. App 239, 244, 556 S.E.2d 1, 5 (2001). In Biemann, the plaintiff presented evidence consisting of a chart of instances of delay allegedly attributable to the plaintiff and anecdotal testimony about those delays. The court, however, considered such evidence insufficient noting that the plaintiff failed to take into account delays attributable to other causes. Id. Even though the plaintiff in Biemann kept a daily log book of labor overruns throughout the project, they failed to tie the extra labor costs to any specific delay. Id. at 246, 556 S.E.2d at 6.

The contractor plaintiff in Davidson and Jones, Inc. v. North Carolina Department of Administration, 315 N.C. 144, 337 S.E.2d 463 (1985), successfully documented evidence of

duration-related costs through presentation of actual cost associated with the owner's actions. The trial court found the following sufficient:

1. The plaintiff introduced the originals of its cost records for the duration- related expenses;
2. The records were made contemporaneously in the regular course of business;
3. The records were made by someone with personal knowledge of the events and amounts recorded;
4. Plaintiff required periodic checks and used various other methods to insure accuracy; and
5. The contractor presented evidence that the owner was the sole cause of delays.

Id. at 151-152, 337 S.E.2d at 467. Given the plaintiff contractor's success in Davidson & Jones, Inc. and their failure in Biemann, the above-numerated factors should be carefully considered when presenting delay damages using actual cost accounting.

b. Total Cost Method

Under a total cost method, a contractor seeks the difference between its total costs incurred in performance of the contract and its bid price. Id. at 245, 556 S.E.2d at 5; citing Youngsdale & Sons Construction Co., Inc. v. United States, 27 Fed. C.L. 516, 541 (1993). North Carolina courts have been critical of this method and condone its use only when no other way to compute damages is feasible. Specifically, the courts have questioned the total cost method "because it blandly assumes ... that every penny of the plaintiff's cost are prima facie reasonable, that the bid was accurately and reasonably computed, and that plaintiff is not responsible for any increase in cost." Id.; (citing Urban Plumbing & Heating Company v. United States, 187 Ct. Cl. 15 408 F2d 382, 394 (1969)). A plaintiff must satisfy the conjunctive four-part test for recovery under the total cost method:

1. The impracticability of proving actual losses directly;
2. The reasonableness of its bid;
3. The reasonableness of its actual cost; and
4. The lack of responsibility for the added cost.

Id. at 245, 556 S.E.2d at 5. Prong two and three may be satisfied by producing comparative bids for the work bid upon and actually performed by the plaintiff. However, prong four appears to require the plaintiff to isolate the nature and extent of specific delays and connect them to an act or omission by defendant. See generally Biemann at 246, 556 S.E.2d at 6.

The difficulty in presenting delay damages with the total cost method was well illustrated in Huber, Hunt, Nichols v. Moore, 67 Cal.App 3d 278, 136 Cal. Rptr. 603 (1977). The contractor sought $752,521.00 from the architect in delay damages and attempted to place into evidence a computer printout detailing all the additional costs as compared to the original bid.

The court noted that the printout failed to make a causal connection between the cost incurred and the alleged negligence of the defendant. Illustrating the point, the court examined one of the cost overruns - drinking water - which was bid at $1000 but actually cost $2,293 for a cost overrun of $1,193. In examining the fallacy of plaintiff's proof under the total cost method the court stated the jury would have to assume:

1. That the contractor's original estimate of $1000 for drinking water was accurate;
2. That the overrun of $1,293 in the cost of drinking water was proximately caused by errors and omissions in the architects' plans and specifications;
3. That said errors and omissions in the architects' plans and specifications were proximately caused by the architects' negligence; and
4. That the overrun of $1,293 was not due to other delays caused by change orders, inclement weather, or strikes (of which there were several).

Bramble and Callahan at 12-14.

These cases illustrate that in order to utilize the total cost method, a contractor must maintain a reasonable system of cost accumulation that could define extra costs if the delay damage had not been so continuous and pervasive. The contractor must also employ an accounting system that separates and defines specific costs of extra work. See Davidson, supra. A system that does not attempt to segregate extra work from contract items is not sufficient. See Biemann, supra.

c. Modified Total Cost Method

Courts have taken a modified approach aptly named the "modified total cost method" which generally follows the total cost method but makes adjustments for any deficiency in plaintiff's ability to satisfy the four requirements. Specifically, the modified approach assumes the elements of a total cost method claim have been established, but uses that amount as the starting point from which the court will make adjustments downward to reflect the plaintiff's inability to satisfy the test. Biemann at 245, 556 S.E.2d at 6. While the Biemann court acknowledged the modified total cost method it apparently made no effort to apply it to the facts. Accordingly, it is not clear how the court might determine the extent or applicability of any downward adjustments.

4. Specific delay claims available to the contractor

One of the most costly damages incurred by delay on a project site are the duration related expenses the contractor incurs when the contractor is required to maintain personnel, equipment and services at the project site after the originally scheduled completion date. Davidson at 151, 337 S.E.2d at 468. Common duration-related expenses include the following: (1) personnel costs for project managers and other similar project administrative personnel; (2) cost of additional utility charges for heat, light, sewer and water; (3) additional costs for maintenance and cleanup; (4) additional costs for facilities such as temporary storage facilities, dumpsters, or

office trailer; (5) communications charges; and (6) additional security charges. Bramble and Callahan p. 12-24. The most frequently used method to calculate these costs is to establish the actual cost of the general conditions for the entire performance period, divide this amount by the days in the actual period of performance, then multiply this daily rate by the number of delay days. Id. at 12-25. Duration- related expenses have been expressly recognized as recoverable in North Carolina. Davidson, supra.

Another prevalent expense the delayed contractor will incur as a result of delays is the increased cost of home office overhead associated with the particular project. North Carolina courts will recognize claims for home office overhead as allocated to delays on a construction site if they can be shown to be related to costs incurred, but only if contemplated in the contract. See Davidson at 156, 337 S.E.2d at 470; See Crain, supra (contractor awarded profit percentage contemplated in contract but denied recovery of home office overhead reasoning that the profit provision incorporated overhead costs).

Finally, the contractor experiencing delays attributable to the owner may be able to recover interest costs. Generally, there are two types of interest incurred due to delay on a construction project. The first is the business cost on the use of capital required to complete performance due to delay. Typically this claim for interest arises where the contractor must borrow additional funds to meet current expenses (labor, equipment, materials, office overhead, etc.) incurred due to unanticipated delays. Bramble and Callahan p.12-81.

The second type of interest award, commonly referred to as pre-judgment interest, seeks to compensate the non-breaching party for the loss of the use of funds as a result of the breach. North Carolina Gen. Stat. §24-5 specifically authorizes pre-judgment interest stating:

> In an action for breach of contract, except an action for a penal bond, the amount awarded on the contract bears interest from the date of breach. The fact finder in an action for breach of contract shall distinguish the principal from the interest in the award, and the judgment shall provide that the principal amount bears interest until the judgment is satisfied.

C. Specific Concerns for Subcontractors

In general, the damage calculations utilized by the contractor in an action against the owner will be applicable in action by a subcontractor against the contractor. However, subcontractors have been afforded additional protections and remedies at law. Among these are the North Carolina Prompt Pay Act (North Carolina Gen. Stat. § 22C) and the lien on funds (North Carolina Gen. Stat. §44A-18(1)). Pertinent provisions of the North Carolina Prompt Pay Act include:

> Performance by a subcontractor in accordance with the provisions of its contract shall entitle it to payment from the party with whom it contracts. Payments by the owner to a contractor is not a

> condition precedent for payment to subcontractor . . . and an agreement to the contrary is unenforceable. N.C.G.S §22C-2
>
> When a subcontractor has performed in accordance with the provisions of his contract, the contractor shall pay to his subcontractor . . . within seven days of receipt by the contractor . . . of each periodic or final payment, the full amount received for such subcontractor's work and materials . . . N.C.G.S. §22C-3
>
> Should any periodic or final payment to a subcontractor be delayed by more than seven days after receipt . . . by the contractor . . . the contractor . . . shall pay his subcontractor interest . . . at the rate of one percent per month. . .N.C.G.S. §22-5

An additional tool available to the subcontractor to procure payment is the lien on funds. Generally, the lien on funds asserted by the subcontractor attaches to funds owed to the person with whom the subcontractor dealt. N.C.G.S. § 44A-18(1). In the classic example, the subcontractor who is not paid by the general contractor asserts a lien on funds in the hands of the owner. Since the owner will hold the general contractor's funds, the general contractor has a meaningful incentive to make prompt payments to his subcontractors.

In order to be entitled to assert a lien on funds, a subcontractor must (1) have a contract (2) to improve real property, and (3) furnish labor or materials at the site of the improvement. Rowe, Eric C., Mechanics' Liens and Construction, North Carolina Construction Law Deskbook p. 20 (Peter J. Marino, ed. 2000). The critical concept in a lien on funds is the understanding that the lien can only attach if the obligor (the owner in the previous example) owes any money. If no money is owed to the person the subcontractor contracted with, than the lien is worthless. Hence, it is extremely important to assert a lien on funds as soon as possible,

D. Owner, Contractor and Subcontractor - Recovery of Attorney's Fees

North Carolina courts have expressly held that an attorney's fees provision in a construction contract is enforceable pursuant to North Carolina Gen. Stat. § 6-21.2. In G. L. Wilson Building Co. v. Thorneburg Hosiery Co., 85 N.C. App. 684, 688, 355 S.E.2d 815, 818 (1987) the Court held that a construction contract which recited, "the owner will pay reasonable attorney's fees incurred by Contractor for the collection of any defaulted payment due to the Contractor by the Owner as a result of this contract" was an "evidence of indebtedness" as that term is defined within North Carolina Gen. Stat. §6-21.2. The Court therefore held the contractor was entitled to recover attorney's fees in the statutory amount of 15% of the outstanding balance owed. Id.; see also Bromhal v. Stott, 341 N.C. 702, 462 S.E.2d 219 (1995)(noting that attorneys' fees provisions have been previously approved in "commercial construction contract(s)"). Hence, attorney's fees are likely to be collectible under N.C.G.S. Sec. 6-21.2 in a dispute involving a construction contract, provided such contract contains an express provision for the payment of attorney's fees.

A party to a construction contract dispute may also recover attorney's fees under North Carolina Gen. Stat. §44A-35. This provision of the lien laws allows recovery by the "prevailing party" of a reasonable attorney's fee in a lien-enforcement lawsuit 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. The "prevailing party" is defined in the statute as one who (a) obtains a judgment in such an action of at least 50% of the monetary amount sought, or (b) defends against a lien-enforcement lawsuit that results in a judgment of less than 50% of the amount sought by the claimant. The award of attorney's fees under this statute is discretionary with the trial judge.