NORTH CAROLINA

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§ 1.0 PUBLIC PAYMENT BONDS

A. Requirements for Bond

Like most states, North Carolina has a codified Little Miller Act (the "Act"). *See* N.C. Gen. Stat. §§ 44A-25 through 35. The public-works projects covered by the Act are identified in N.C. Gen. Stat. § 44A-26. North Carolina's Little Miller Act, among other requirements, mandates the payment bond form on North Carolina public projects. N.C. Gen. Stat § 44A-33(b). In addition to projects identified in § 44A-26, Department of Transportation projects also require Act-compliant bonds, and the relevant Department of Transportation statutes should be consulted for potential additional bond requirements. *See* N.C. Gen. Stat. § 136-18(46).

When the total amount of prime construction contracts for any *single* project exceeds $300,000, the contracting body must require Act-compliant performance and payment bonds. N.C. Gen. Stat. § 44A-26(a). If there is more than one prime contractor or construction manager at risk whose prime contract exceeds $50,000 on such project, that contractor or manager at risk must supply Act-compliant performance and payment bonds. *Id*. There is an exception, however, for projects for North Carolina State agencies, North Carolina State departments, and the University of North Carolina and its "constituent institutions," which requires Act-compliant bonds only if the single project exceeds $500,000. *Id.* All public projects with amounts less than those above, the contracting body has *discretion* to require bonds, but they are not mandatory. *Id.*

Act-compliant bonds must be 100% of the construction contract amount. N.C. Gen. Stat. § 44A-26(a)(1) & (2). The payment bond "shall be solely for the protection of the persons furnishing materials or performing labor for which a contractor, subcontractor, or construction manager at risk is liable." N.C. Gen. Stat. § 44A-26(a)(2).

B. Tiers Covered

While second-tier and lower payment bond claimants have additional notice duties than first-tier claimants, North Carolina's Little Miller Act does not limit civil actions to recover on a payment bond to any particular tier subcontractor or supplier. The Act provides that "any claimant who has performed labor or furnished materials in the prosecution of the work required by any contract for which a payment bond has been given pursuant to the provisions of this Article …, may bring an action on such payment bond in his own name …." N.C. Gen. Stat. § 44A-27(a). In other words, third-tier and lower subcontractor/suppliers appear to have rights under the Act. No North Carolina case, however, has addressed this issue. Note that in this regard North Carolina's Little Miller Act departs from the federal Miller Act, which limits recovery to subcontractor/suppliers who contracted with a prime contractor or a first-tier subcontractor/supplier. *See* 40 U.S.C. §§ 3131 *et seq*.

C. Notice Required

1. Contractor's Project Statement

The bonded prime contractor must provide to each first-tier subcontractor/supplier a "contractor's project statement," which includes the project name, physical address, the public contracting body (the project "owner"), the prime contractor's name, the contact information for the prime contractor's service-of-process agent, and the name, address, and principal place of business of the payment bond surety. N.C. Gen. Stat. § 44A-27(f). Each subcontractor/supplier (regardless of tier) must also provide a copy of the contractor's project statement to each lower-tier subcontractor/supplier that it engages to supply labor or material for the bonded project. *Id.* No contractor or subcontractor/supplier may enforce its agreement with a lower-tier subcontractor/supplier until it provides a copy of the contractor's project statement to the lower-tier party. *Id.*

2. First-Tier Subcontractor/Suppliers

Claimants who have a direct contractual relationship with a bonded prime contractor—that is, first-tier subcontractor/suppliers—may assert a payment bond civil action 90 days after the claimant's last day of furnishing labor or materials to the project. *Id.* There are no other notice conditions. *Id.*

3. Lower-Tier Subcontractor/Suppliers, the Notice of Public Subcontract, and Copies of the Payment Bond

Claimants who lack contractual privity with a bonded prime contractor—that is, second-tier and lower subcontractor/suppliers—have a complex set of rules regarding notice and potential limits on what they may recover. Accordingly, counsel must carefully consult N.C. Gen. Stat. § 44A-27. Like their first-tier counterparts, second-tier and lower claimants may also institute a civil action to enforce their payment bond claim 90 days after the claimant's last day of furnishing labor or materials to the project. *Id.* But these remote claimants must also provide *written notice* of nonpayment to the bonded prime contractor within 120 days of last furnishing labor or materials to the project. N.C. Gen. Stat. § 44A-27(b). This 120-day notice must also state "with substantial accuracy the amount claimed and the name of the person for whom the work was performed or to whom the material was furnished" and is referred to as a "Notice of Public Subcontract." *Id.* The Act provides a model Notice of Public Subcontract at § 44A-27(d).

Within seven days of receiving this notice, the bonded prime contractor must send a copy of the Act-compliant payment bond to the claimant. N.C. Gen. Stat. § 44A-27(b). It is at this point in the process that a second-tier or lower claimant may fall victim to a "gotcha" provision in the Act. Specifically, if the bonded prime contractor sends the payment bond to the claimant within the seven days, then the claimant may recover for only labor and materials furnished *within the prior 75 days* of the claimant's sending notice to the prime contractor. *Id.* This provision encourages second-tier and lower subcontractor/suppliers to promptly provide notice to the prime contractor and may punish claimants who wait between 75 and 120 days to send their Notice of Public Subcontract. There is also a partial exception to the 75-day recovery limit. Specifically, claims for $20,000 or less are not subject to the 75-day limit. N.C. Gen. Stat. § 44A-27(e). And if

the claim is for over $20,000 and is covered by the 75-day limit, the first $20,000 of such claim is *not* subject to the 75-limit. *Id.*

The Notice of Public Subcontract and the prime contractor's sending the payment bond to the claimant must be accomplished by: (1) certified mail; (2) US mail, postage prepaid, with signature confirmation as required by the U.S. Postal Service; or (3) any manner allowed by North Carolina law for service of a summons. N.C. Gen. Stat. § 44A-27(c). Service must be addressed to "such contractor at any place where his office is regularly maintained for the transaction of business or to such agent identified in the contractor's project statement" as required in section 44A-27(f). *Id.*

In addition to providing the payment bond to potential claimants under § 44A-27 as noted above, the Act requires that the public owner/contracting body provide payment bond copies to anyone who is entitled to bring a claim under the payment bond and who requests a copy. N.C. Gen. Stat. § 44A-31(a).

D. Time for Suit and the One-Year Statute of Repose

The civil actions of all payment bond claimants—regardless of tier—are limited by the Act's one-year statute of repose. Specifically, "no action on a [Little Miller Act] payment bond shall be commenced after the expiration of the longer period of one year from the day on which the last of the labor was performed or material was furnished by the claimant, or one year from the day on which final settlement was made with the [bonded prime] contractor." N.C. Gen. Stat. § 44A-28(b). This limitation is one of repose, and not a statute of limitation. *Tipton & Young Constr. Co. v. Blue Ridge Structure Co.*, 116 N.C. App. 115, 118–19, 446 S.E.2d 603, 605 (1994) [Lexis]. As such, a claimant must specifically plead compliance with the statute of repose. *Id.*

"Final settlement" under the statute of repose means the time when the contracting body (public owner) has "administratively fixed" the amount it is bound to pay the prime contractor. *Cencomp, Inc. v. Webcon, Inc.*, 157 N.C. App. 501, 505, 579 S.E.2d 482, 485 (2003) [Lexis]. Theoretically, this occurs when the prime contractor and the contracting body make their last change to the contract price via change order or as otherwise required by the prime contract.

Parties to a payment bond are generally "free to contract for any reasonable limitations period they choose." *Town of Pineville v. Atkinson/Dyer/Watson Architects, P.A.*, 114 N.C. App. 497, 499–500, 442 S.E.2d 73, 74 (1994) [Lexis]. But bond language that *shortens* the Little Miller Act one-year statute of repose is *not* enforceable. *Id.* at 499, 442 S.E.2d at 74.

E. Venue

All actions on a North Carolina Little Miller Act payment bond must be in a court of "appropriate jurisdiction" in the North Carolina county "where the construction contract or any part thereof is to be or has been performed." N.C. Gen. Stat. § 44A-28(a). Reference to the "construction contract" means the prime contract, and not the subcontract. Accordingly, the trial court properly transferred a payment bond civil action to the county where the prime contract was performed when the payment bond claimant brought suit in a different county where the claimant had performed part of its subcontract. *McClure Estimating Co. v. H.G. Reynolds Co.*, 136 N.C. App. 176, 179, 523 S.E.2d 144, 146–47 (1999) [Lexis]. North Carolina courts generally prefer to order transfer of a matter as a consequence of an improper venue rather than dismissal. *Id.* at 183, 523 S.E.2d at 149.

Occasionally, a party in a payment bond action might argue that a non-North Carolina forum-selection clause in either the prime contract or a subcontract should control. But provisions in contracts to improve real property *within* North Carolina that call for exclusive venue *outside* of North Carolina are void under N.C. Gen. Stat. § 22B-2. *See Price and Price Mech'l of N.C., Inc. v. Miken Corp.*, 191 N.C. App. 177, 179, 661 S.E.2d 775, 777 (2008) [Lexis].

F. Coverage

Like its federal big brother, the North Carolina Little Miller Act exists to protect "subcontractors and other persons suppling labor and materials for [a public] project." *Syro Steel Co. v. Hubbell Highway Signs, Inc.*, 108 N.C. App. 529, 534, 424 S.E.2d 208, 211 (1993) [Lexis]. As North Carolina's Little Miller Act is based on the federal Miller Act, North Carolina uses federal case law to interpret its Little Miller Act. *Id*. Further, since there is "little or no distinction" between private payment bonds and Little Miller Act payment bonds, both types of payment bonds are to be "construed liberally" for the benefit and protection of "laborers and materialmen." *Symons Corp. v. Ins. Co. of N. Am.*, 94 N.C. App. 541, 543–44, 380 S.E.2d 550, 552 (1989) [Lexis].

1. Labor

a. Professional Services

Little Miller Act payment bonds exist "solely for the protection of the persons furnishing materials or performing labor for which a contractor, subcontractor, or construction manager at risk is liable." *S. Seating Serv., Inc. v. W.C. English, Inc.*, 217 N.C. App. 300, 307, 719 S.E.2d 211, 217 (2011) [Lexis]. Moreover, the Act itself defines a proper Little Miller Act bond claimant as "any individual, firm, partnership, association or corporation entitled to maintain an action on a bond described in this Article and shall include the 'contracting body' in a suit to enforce the performance bond." N.C. Gen. Stat. § 44A-25(1). The Act defines a "subcontractor" as "any person who is contracted to furnish labor or materials to, or who has performed labor for, a contractor or another subcontractor in connection with a construction contract." N.C. Gen. Stat. § 44A-25(6). And the Act defines "labor or materials" as "all materials furnished or labor performed *in the prosecution of the work* called for by the construction contract regardless of whether or not the labor or materials enter into or become a component part of the public improvement, and further shall include gas, power, light, heat, oil, gasoline, telephone services and rental equipment or the reasonable value of the use of equipment directly utilized in the performance of the work called for in the construction contract." N.C. Gen. Stat § 44A-25(5) (emphasis added). No cases have interpreted the Act as allowing professionals, such as architects, to make Little Miller Act payment bond claims. Note however, that certain professional activities may permit a claimant to file a mechanics' lien. *See, e.g.*, N.C. Gen. Stat. § 44A-7(3) (permitting certain professional or skilled services such as "architects, engineers, land surveyors, and landscape architects" to file mechanics' liens). But there is no authority suggesting that the same professionals have payment bond rights under the Act.

b. Union Benefits

There are no North Carolina authorities determining whether union benefits are considered "labor or material" under a Little Miller Act payment bond. As noted above, however, North Carolina courts look to federal opinions for guidance if there is no North Carolina case law.

2. Material

North Carolina liberally construes a subcontractor/supplier's right to recover under a Little Miller Act payment bond for supplying materials. So long as a claimant can show that it sold or supplied materials to a higher-tier subcontractor or the prime contractor "in good faith" and under a "reasonable belief that the materials were for ultimate use in the prime contract," the claimant may recover. *Syro Steel Co. v. Hubbell Highway Signs, Inc.*, 108 N.C. App. 529, 535, 424 S.E.2d 208, 212 (1993) [Lexis]. Accordingly, there is no requirement that material be actually delivered to the job site or incorporated into the project improvement.

3. Equipment

a. Repair and Rentals

In a seminal case determining a supplier's right to collect from the surety under a Little Miller Act payment bond, the North Carolina Supreme Court in *Interstate Equipment Co. v. Smith*, held that the Act permitted recovery for not only equipment rental, but also repairs that were necessary over and above normal wear and tear. 292 N.C. 592, 600, 234 S.E.2d 599, 603–04 (1977) [Lexis]. The ability to recover for rentals and repairs, however, depends on the subcontractor/supplier's agreement. In other words, if the agreement allows for the claimant to recover those items then they are recoverable under the Little Miller Act bond. *Id*. (holding that "we are of the opinion that the claims of Interstate [an equipment lessor] for repairs to the machinery, in excess of ordinary wear and tear, and for 'abnormal' tire wear are as much a part of the lease agreement on which Great American is surety as are the rental payments [and accordingly], Great American may be held liable for these charges.").

4. Co-Prime Contractors

Although the issue has not been definitively decided in North Carolina, there is persuasive authority that a co-prime contractor in a multi-prime public project may not recover against another co-prime's payment bond. In *Pennsylvania National Mutual Casualty Insurance Co. v. Wayne J. Griffin Electric, Inc.*, the U.S. District Court for the Eastern District of North Carolina held that a co-prime contractor does not have the right to assert a claim against another co-prime's performance or payment bond. Case No. 5:00-CV-910-BR(3) (E.D.N.C. June 6, 2002) (unpublished Order and Judgment).

5. Other

a. Attorneys' Fees

Under the federal Miller Act, a claimant's recovery of attorneys' fees from the payment bond surety is a gray area. For a time, there seemed to be uncontroverted U.S. Supreme Court authority explaining that the claimant's attorneys' fees do not constitute "sums justly due" under the Miller Act. *F.D. Rich v. U.S. ex rel. Indus. Lumber Co.*, 417 U.S. 116 (1974) [Lexis]. Note that the U.S. Supreme Court decided *F.D. Rich* when the federal Miller Act codification at that time—40 U.S.C. §§ 270a *et seq.*—allowed recovery for "sums justly due." The Miller Act's current codification—40 U.S.C. §§ 3131 *et seq*.—permits payment bond claimants to recover the "amount unpaid" and may bring a claim for the "amount due." 40 U.S.C. § 3133(b)(1). *F.D. Rich* plainly held that a payment bond claimant's attorneys' fees are *not* part of "sums justly due". 417 U.S. at 127–131. The high Court held that state law plays no part in deciding whether a Miller Act claimant may recover attorneys' fees, and since attorneys' fees are not mentioned in the Miller Act, there is no reasons to deviate from the "American Rule" that each party bears its own attorneys' fees. *Id.*

But ever since *F.D. Rich*, lower federal courts have chipped away at its holding. And when the Miller Act was recodified, lower courts have used that as an opportunity to revisit the attorneys' fees issue and find ways to award them to successful payment bond claimants. *See, e.g., U.S. ex rel. Maddux Supply Co. v. St. Paul Fire & Marine Ins.*, 86 F.3d 332, 336 (4th Cir. 1996) [Lexis]; *U.S. ex rel. SCCB, Inc. v. P. Browne & Assocs., Inc.*, 751 F. Supp. 2d 813 (M.D.N.C. 2010) [Lexis].

Recovery of attorneys' fees is not mandatory under North Carolina's Little Miller Act, but they are recoverable in some cases. *See* N.C. Gen. Stat. § 44A-35. Here, trial courts have discretion to award attorneys' fees to the "prevailing party" if "there was an unreasonable refusal by the losing party to fully resolve the matter." *Barrett Kays & Assocs., P.A. v. Colonial Bldg. Co.*, 129 N.C. App. 525, 530, 500 S.E.2d 108, 112 (1998) [Lexis] (citing to N.C. Gen. Stat. § 44A-35). Under the Act, a "prevailing party" is a claimant "who obtains a judgment of at least fifty percent (50%) of the monetary amount sought in a claim[.]" N.C. Gen. Stat. § 44A-35. If the party is a defendant, it is considered a prevailing party if the judgment achieved is "less than fifty percent (50%) of the amount sought in the claim defended." *Id*. North Carolina also allows parties to make "offers of judgment" under Rule 68 of the North Carolina Rules of Civil Procedure. If there has been a Rule 68 offer of judgment then a "prevailing party" is an "offeree who obtains judgment in an amount more favorable than the last offer or is an offeror against whom judgment is rendered in an amount less favorable than the last offer." *Id.*

b. Interest

In the seminal case *Interstate Equipment Co. v. Smith*, addressed above in Section 1.0(F)(3)(a) ("Rental and Repairs"), the court also found that payment bond claimants may recover interest against the surety. 292 N.C. 592, 601, 234 S.E.2d 599, 605 (1977) [Lexis]. As in all other breach-of-contract cases, interest would begin to run from the date that the surety breached the bond. *Id.* The *Interstate Equipment* case remains good law in North Carolina. But since then, there is an interim quirky decision from the North Carolina Court of Appeals suggesting that if the surety is liable for interest, interest cannot begin to run until *judgment* against the surety and not the surety's breach of the bond. *See Synovus Bank v. County of Henderson*, Case No. C0A111601,

2012 WL 3192688, *8, 2012 N.C. App. LEXIS 967 (N.C. Ct. App. Aug. 7, 2012) [Lexis]. In the *Synovus Bank* decision, the court found that the word "penal sum" in a bond means an amount awarded as a "penalty." *Id.* And by extension, a bond that contains a penal sum is a "penal bond." *Id.* And while interest generally runs from the date a contract is breached, under North Carolina's interest statute, N.C. Gen. Stat. § 24-5(a)(1), interest on *penal bonds* does not run until there has been a judgment against the surety. While at first glance this may seem helpful to sureties because it saves them having to pay interest from the time of breach, alerting a court to the *Synovus Bank* decision has potential drawbacks. By the court's assertion that a bond with a penal sum is equivalent to a penal bond, the court may have inadvertently indicated that payment bonds (which is a bond with a penal sum) are really *forfeiture* bonds. There are many common-law cases in other jurisdictions noting that a penal bond is synonymous with a forfeiture bond. And a forfeiture bond means that once a claimant proves entitlement to a recovery under the bond, the surety must surrender the entire penal sum of the bond to the claimant. That is certainly not the intent of a payment bond, which is a *liability* bond, not a forfeiture bond.

Though the payment bond surety may be liable for interest, generally liability for pre-judgment interest cannot exceed the penal-sum cap. Sureties have long attested that the penal sum is sacred and cannot be exceeded. Indeed the Act attempts to shield the surety from liability above the penal sum. *See* N.C. Gen. Stat. § 44A-29 (providing that "[n]o surety shall be liable under a payment bond for a total greater than the face amount of the payment bond."). But this statutory language may apply only to *pre*-judgment interest. *See Robinson Mfg. Co. v. Blaylock*, 192 N.C. 407, 135 S.E. 136, 140–41 (1926) [Lexis]. In *Blaylock*, the court held that a surety's liability generally cannot exceed the bond's penal sum "until judgment has been rendered against the surety." *Id.* After judgment, however, the surety may be liable for statutory post-judgment interest. *Id.* This means that once judgment has been rendered against the surety, *post*-judgment interest begins to accrue at the statutory rate of 8% (N.C. Gen. Stat. § 24-1), and if a surety fails to satisfy its judgment, post-judgment interest accrues and can exceed the penal sum.

c. Financing Charges

There is no specific state authority addressing whether a claimant may recover finance charges to the extent that such charges are different from interest. Under the federal Miller Act, however, the Fourth Circuit Court of Appeals allowed a payment bond claimant to recover service charges imposed by the subcontractor/supplier's credit agreement. *U.S. ex rel. Maddux Supply Co. v. St. Paul Fire & Marine Ins. Co.*, 86 F.3d 332, 334 (4th Cir. 1996) [Lexis]. Again, where there is no controlling state authority, North Carolina courts would look to the federal Miller Act and related decisions for guidance.

d. Insurance Premiums

There is no North Carolina authority addressing whether a payment bond claimant can recover its insurance premiums under the Act. Though the definition of "labor and materials" under the North Carolina Little Miller Act is broad, it likely is not broad enough to include insurance premiums. *See* N.C. Gen. Stat. § 44A-25.

e. Loans

There is no North Carolina authority addressing a claimant's recovery for loaning funds to another contractor to purchase labor or materials.

f. Delay Damages

There is no North Carolina authority addressing whether a Little Miller Act payment bond claimant can recover expressly for "delay damages." These damages are not enumerated in any cases or in the Act itself as falling within the definition of "labor or materials."

g. Profits

There is no North Carolina authority addressing whether a payment bond claimant's lost profits are recoverable under the Act.

h. Extracontractual Damages and Bad Faith

North Carolina law is generally surety-friendly when it comes to recovering bad faith or extracontractual damages against a surety. There are no North Carolina binding precedents finding a surety liable to a payment or performance bond claimant for bad faith, unfair and deceptive trade practices under Chapter 75 of the North Carolina General Statutes, or violations of North Carolina's Insurance Code, which is Chapter 58 of the North Carolina General Statutes. The underlying reasoning that protects sureties from these types of claims is that suretyship is distinguished from insurance. The North Carolina Court of Appeals undertook a lengthy analysis of this distinction in *Henry Angelo & Sons, Inc. v. Property Development Corp.*, 63 N.C. App. 569, 574–77, 306 S.E.2d 162, 165–67 (1983) [Lexis], noting the lack of support for bad faith claims against sureties. Subsequently, the federal court, interpreting North Carolina law in *Cincinnati Insurance Co. v. Centech Building Corp.*, declined to find an extracontractual or bad-faith claim against a surety. 286 F. Supp. 2d 669, 691 (M.D.N.C. 2003) [Lexis]. The court noted that "the duty of good-faith and fair-dealing required to sustain a common law bad-faith claim [and a claim under Chapter 75 for unfair-trade practices] is a concept of insurance law and attaches because of the special relationship between insureds and insurers …" *Id.* at 688–91.

G. Contracts Excluded

As noted earlier in Section 1.0(A) above, public contracts of $300,000 or less—or public contracts for North Carolina State Departments, State agencies, and the University of North Carolina and its constituent institutions under $500,000—do not require Little Miller Act payment bonds. These excluded contracts, however, may in the discretion of the contracting body, still require a payment bond, but such bonds are not mandatory.

H. Procedural Issues

a. Insurance Code Generally Inapplicable

Litigants often confuse contracts of suretyship with contracts of insurance. As noted earlier, the *Henry Angelo & Sons* case described the differences at length and added that although sureties are similar to insurers in some respects, "this, of course, no more justifies the conclusion that sureties are insurers and performance bonds are contracts of insurance than does the commonly known fact that sheep are somewhat like goats justify the conclusion that sheep are goats." 63 N.C. App. 569, 578, 306 S.E.2d 162, 168 [Lexis]. But because of the confusion, litigants sometimes try to apply statutes from North Carolina's Insurance Code [Chapter 58] in lawsuits against sureties. Although there may be discrete portions of Chapter 58 that mention sureties and their bonds, for the most part the courts consistently hold that Chapter 58 terminology, requirements, and causes of action are not cognizable in cases under performance and payment bonds. *See, e.g.*, the authorities noted in Section 1.0(F)(5)(h) above; *see also Beachcrete, Inc. v. Water Street Ctr. Assocs.*, 172 N.C. App. 156, 160, 615 S.E.2d 719, 722 (2005) [Lexis] (explaining that a "payment bond is a contract of suretyship, not insurance" and that the "statutory provisions that control and regulate insurance in this state are contained in Chapter 58 of the General Statutes entitled: 'Insurance'; those that regulate suretyship in Chapter 26 entitled: 'Suretyship.'").

b. Service of Process

In North Carolina, a non-North Carolina insurance company must agree that in order to receive permission to do business in North Carolina the company must appoint the North Carolina Commissioner of Insurance as a legal agent for service of process. *Biggs v. Mut. Reserve Fund Life Ass'n*, 128 N.C. 5, 27 S.E. 955 (1901) [Lexis]; *see also* N.C. Gen. Stat. § 58-16-5(10) and § 58-16-30. As most sureties under public payment bonds are also insurance companies, sureties can be served through the North Carolina Insurance Commissioner. Service is not exclusive via the Commissioner. All service of process options under Rule 4 of the North Carolina Rules of Civil Procedure are also available. N.C. Gen. Stat. § 58-16-30.

I. Case Annotations

Effect of Conditional Payment Clause and Prompt Payment Act

Many, if not most, subcontracts contain language that the subcontractor will not be paid until the general contractor is paid. These are often referred to as "pay-when-paid" or "pay-if-paid" clauses. Despite their ubiquity, by statute, such clauses are unenforceable in North Carolina. N.C. Gen. Stat. § 22C-2.

Chapter 22C, which outlaws pay-when-paid and pay-if-paid clauses, comprises North Carolina's Prompt Payment Act. The Prompt Payment Act also includes penalties for contractors and higher-tier subcontractors who fail to pay their lower-tier subcontractors promptly. The Act provides that when a contractor or subcontractor receives payment, it must pay its lower-tier subcontractor/supplier "within seven days of receipt by the contractor or subcontractor of each periodic or final payment, the full amount received for such subcontractor's work and materials based on work completed or service provided under the subcontract." N.C. Gen. Stat. § 22C-3.

The Prompt Payment Act makes clear that the payee's entitlement to prompt payment is conditioned on the payee's substantial performance of its subcontract. *See* N.C. Gen. Stat. § 22C-4. If a payor fails to make prompt payment within the seven days, the payment due the payee begins to earn interest "on the eighth day, at the rate of one percent (1%) per month or a fraction thereof on such unpaid balance as may be due." N.C. Gen. Stat. § 22C-5.

Equitable Subrogation

North Carolina law has long held that a performing surety enjoys equitable subrogation rights. *See, e.g.*, *Keeble v. Fid. & Deposit Co. of Baltimore*, 192 N.C. 416, 135 S.E. 141 (1926) [Lexis] (holding that a surety who paid payment bond claims on a state highway project enjoyed rights in the contract balance that were superior to the principal's bankruptcy trustee); *see also Lacy v. Md. Cas. Co.*, 32 F.2d 48, 51 (4th Cir. 1929) [Lexis] (recognizing that it is a "well settled" rule that a "surety on a contractor's bond, who completes the contract on default of the principal, is subrogated to the rights of the obligee, and, to the extent necessary to reimburse himself, has an equity in the funds due the contractor, which is superior to that of a mere assignee."). Quoting U.S. Supreme Court authority from *Henningsen v. United States Fidelity & Guaranty Co.*, 208 U.S. 404 (1908) [Lexis], the *Lacy* court explained that when a surety pays the claims of laborers and materialmen (who should have been paid by the defaulting principal general contractor), the surety is equitably subrogated to the rights of not only the obligee but also the principal. 32 F.2d at 52. As such, the surety is equitably subrogated to funds that the obligee owed to the principal. *Id.* Many federal cases have descended from *Henningsen*, including the classic equitable subrogation decision of the United States Supreme Court, *Pearlman v. Reliance Insurance Co.*, 371 U.S. 132 (1962) [Lexis], where the high Court held that a performing surety is subrogated to the rights of the obligee, the principal, and the subcontractors who are paid under a payment bond.

§ 2.0 PRIVATE PAYMENT BONDS

A. Rules of Construction

A surety is not liable on a bond until there has been a default by its principal. *RGK, Inc. v. U.S. Fid. & Guar. Co.*, 292 N.C. 668, 678, 235 S.E.2d 234, 240 (1977) [Lexis].

Sureties may stand on all of the bonded contract terms, and the surety's liability must be found within the terms of the bonded contract. *Ingram v. Bank of Warsaw*, 195 N.C. 357, 142 S.E. 231, 233 (1928) [Lexis]. Stated differently, the extent of a surety's liability is coextensive with that of its principal under the terms of the principal's bonded contract. *Interstate Equip. Co. v. Smith*, 292 N.C. 592, 596, 234 S.E.2d 599, 601 (1977) [Lexis].

Surety bonds are construed under the same rules of construction as ordinary contracts. *First Union Nat'l Bank v. King*, 63 N.C. App. 757, 759, 306 S.E.2d 508, 509 (1983) [Lexis]. And as in non-surety contract cases, contract ambiguities are generally construed against the drafter, which in the case of a payment bond is usually the surety. *See, e.g.*, *Town of Scotland Neck v. W. Sur. Co.*, 301 N.C. 331, 335, 271 S.E.2d 501, 503 (1980) [Lexis].

In North Carolina, as in most all jurisdictions, a surety is entitled to all defenses that its bonded principal has. *Jarratt v. Martin*, 70 N.C. 459 (1874) [Lexis]; *Chozen Confections v. Johnson*, 218 N.C. 500, 11 S.E.2d 472, 473 (1940) [Lexis].

B. Other Statutory Bonds in the Private Construction Context

A real property owner or bond obligee can discharge and remove a subcontractor's mechanics' lien on real property by posting with the Clerk of Superior Court a lien-discharge bond. N.C. Gen. Stat. § 44A-16(6). The bond penal sum for a lien-discharge bond must be 125% of the amount claimed in the mechanics' lien. *Id.* The mechanics' lien claimant who has had its bond discharged under this statute has three years to file an action to recover against the lien discharge bond. *George v. Hartford Accident & Indem. Co.*, 330 N.C. 755, 412 S.E.2d 43 (1992) [Lexis].

C. Time for Suit

North Carolina's statute of limitation for bringing a breach-of-contract action is three years from the date of breach. N.C. Gen. Stat. § 1-52(1). The cause of action accrues and the limitations period begins to run whenever the contract is breached, and it does not matter that the harmful consequences of the breach were not known or discoverable at the time the breach occurred. *Brantley v. Dunstan*, 10 N.C. App. 706, 708, 179 S.E.2d 878, 880 (1971) [Lexis].

Parties to a private payment bond, however, may contract for a shorter limitations period, and a one-year limitations period in a payment bond for a private construction project has been upheld. *Beachcrete, Inc. v. Water Street Ctr. Assocs., LLC*, 172 N.C. App. 156, 159–60, 615 S.E.2d 719, 721–22 (2005) [Lexis]. In *Beachcrete*, the Court of Appeals upheld summary judgment against the payment bond claimant who brought an action more than one year after the owner's final payment, even though the subcontractor–claimant did not learn of the payment bond's existence until after one year and five months from the owner's final payment. *Id.* at 158–60, 615 S.E.2d 721–22.