LEGAL FOUNDATIONS

HSLC

Protecting Your Rights: Equipment Suppliers Tips

By: Nan E. Hannah

Did you ever consider the challenges which can arise when the equipment you supply has wheels or tracks and is mobile? For rental equipment suppliers, the provisions of Articles 2 and 3 of North Carolina General Statutes Chapter 44A and the case law interpreting those statutes create interesting challenges.

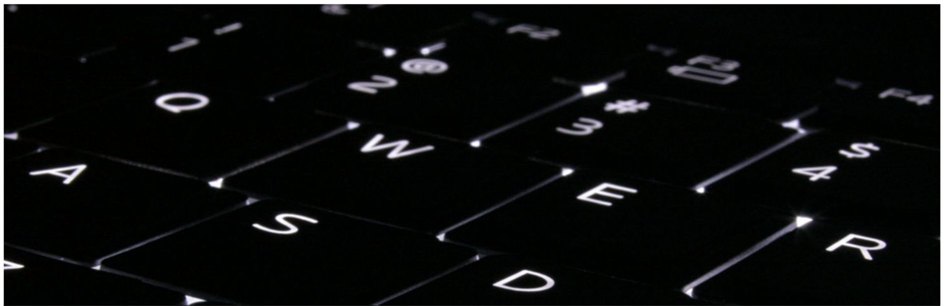
Years ago the General Assembly cleaned up a mess created by a court opinion when Chapter 44A was amended to specifically include rental equipment used to improve real property as a "equipment" for which a lien could be asserted or a bond claim made. There is no question that so long as the equipment was used for the improvement of real property pursuant to a contract, a claim may be asserted. That then raises the issue of what proof is necessary to enforce such a claim.

Presumably, those who rent equipment are aware that, to preserve a claim, some form of pre-notice is now required. For liens, a Notice to Lien Agent is advisable because if a closing beats your lien filing, the value of the lien essentially will be extinguished – translation: relation back is preserved by issuance of timely notice to the lien agent. On state public projects, failure to provide Notice of Public Subcontract limits your potential recovery to a maximum of $20,000.00.

For both lien and bond claims, it is essential that the claimant be able to establish that in some manner the equipment improved the real property. Because of its mobility, portability, and usefulness on multiple projects, questions can arise as to whether the equipment was continuously on the subject project or whether it was moved around to various projects. Therefore, rental equipment companies are finding GPS data useful in proving where equipment was located at any given time. When in doubt, maintain a daily location log.

Similarly, questions can arise as to the amount of time a piece of equipment was actually used on a particular project. Most, if not all, equipment comes with an hours of use monitor for maintenance purposes. Some owners and contractors try to use that data to reduce claims. How many hours an equipment is in use on a project is not a question **—Cont. on Page 3—**

In This Issue



Business Law

Who Owes the Debt? North Carolina Guaranties and Suretyship

By: Cody R. Loughridge

Confusion often exists as to the differences between the multiple types of guaranty agreements and suretyship agreements in North Carolina. Although subtle differences can dictate when the liability of a party may be triggered, they do share some initial similarities. Broadly speaking, both types of guaranty agreements and surety agreements are comprised of 3 parties: the Creditor, the Principal Debtor, and the Guarantor/Surety. In those common scenarios, the Guarantor or Surety is potentially liable to the Creditor for the debt owed by the Principal Debtor to the Creditor.

In drawing the distinction between a guaranty and a surety agreement, one must first examine the types of guaranties in North Carolina. Generally speaking, there are two types of guaranty agreements: Guaranty of Payment and Guaranty of Collection. In each case, the Guarantor is potentially liable for the debt of the Principal Debtor and, to the extent the Guarantor pays the underlying debt, is entitled to reimbursement from the Principal Debtor. However, there is a significant difference between a Guarantor of Payment and a Guarantor of Collection. Namely, a Creditor may pursue the Guarantor of Collection for payment of the debt only *after* the Creditor exhausts his remedies against the Principal Debtor or if the Principal Debtor is no longer available to pursue. A Guarantor of Payment, however, may be pursued directly without the Creditor first having pursued the Principal Debtor. From a Creditor's standpoint, a Guarantor of Payment is thus preferred to a Guarantor of Collection. As such, it is important that the guaranty agreement clearly state that the guaranty is one for "payment" and not one for "collection".

A Surety, much like a Guarantor of Payment, may be directly liable to the Creditor without the Creditor first having exhausted its efforts against the Principal Debtor. As such, a Surety and Guarantor of Payment (as opposed to a Guarantor of Collection) are remarkably similar. The difference being that, in North Carolina, any words of guaranty in a negotiable instrument (i.e. a Promissory Note) operate to waive presentment and notice of dishonor. The implicit waiver of presentment and notice of dishonor is not found within the suretyship context. Thus, a Guarantor of Payment and a Surety are treated the same, as both being directly liable to the Creditor, but the method of "calling in the debt" may be different. The liability of a Guarantor of Collection, on the other hand, is not triggered until the Creditor has exhausted its remedies against the Principal Debtor.

The North Carolina Statute of Frauds requires that agreements where one party is answering for the debt of other, such as a guaranty or surety agreement, be in writing. Said differently: oral guaranty agreements or surety agreements in North Carolina will not be enforced by the Courts. Moreover, North Carolina requires that Guarantor's signature on the agreement be separate and distinct from the Principal Debtor's signature even where the Guarantor is the same individual who executed the underlying contract on behalf of the Principal Debtor. This is often seen in the following commercial context: Company A wishes to receive materials from Supplier Z on credit. In order for Supplier Z to extend credit to Company A, Company A must sign the purchase agreement and Company A's President must sign a personal guaranty. Even though Company A's President is executing the purchase agreement on Company A's behalf, he must also sign separately, as guarantor, in order to establish an effective guaranty. In other words, the President must sign twice: once on behalf of Company A and once in his individual capacity. A single signature, regardless of the contractual language, would be insufficient to bind both Company A and the President. Thus, Supplier Z would be left to pursue Company A without recourse against President.

Guaranty and Suretyship Agreements are invaluable tools for Creditors. However, be advised that the nuances of these types of agreements can dramatically effect the recourse available to the Creditor. If you have additional questions relating to Guaranty Agreement or Suretyship, please contact our office.

HSLC Celebrates One Year!

Hannah Sheridan recently celebrated its one year anniversary with a Pullen Park BBQ lunch for firm clients, family, and friends. We had a great time seeing everyone!

We would once again like to extend our sincere gratitude for all who have supported HSLC over the past year. Together, we have laid a strong foundation for the future. We look forward to building upon that foundation alongside you for years and years to come.

Tips Cont.

which needs to be answered. However, keeping track of delivery and pick-up request dates is essential. And prompt pick up of equipment is truly key. Lien claims relying upon a last date which has been extended because the rental equipment provider was tardy in picking up the equipment after a request from a customer can be difficult to win.

The biggest challenge for the rental industry may well be long-term rentals. A requirement in asserting a lien or bond claim is a good faith belief by the supplier that its equipment was intended for use on the specific project. Being able to backtrack and discover where the equipment was used does not provide the requisite good faith belief that the equipment was being rented for the purpose of improving that specific project. Whether a process within the rental agreement can be created whereby the rental equipment company is put on notice of each project before the equipment is transported by the renter to that project is subject to debate.

If Customer rents a bulldozer for one year for use in its grading business, then the chances of preserving lien or bond claim rights for the rental company are pretty thin. The argument follows the "stream of commerce" limitation on other materials. By way of example, if a manufacturer sells cases of door locks to Supplier A which go into the stock of Supplier A, the fact that one box of those locks ends up in project B does not equate to lien rights for the manufacturer. Manufacturer simply put them in the stream of commerce with no realistic expectations of being able to identify any specific project improved by the lock.

So what is the take-away from this article – whether you supply the largest bulldozer or a small portable generator, if you expect to need the protection afforded by the lien/bond statutes, you need to be able to track your equipment, you need to know where it is being used, when it is being used, and whether it is being moved around. And, you must do your pre-notice.

Contract Law

Utilizing Contract Negotiation and Formation

By: Paul A. Sheridan

This article represents part three of a continuing series of articles identifying and explaining important risk shifting contractual clauses. In previous articles we've explored the importance of identifying and assessing risk shifting clauses, including "no damage for delay" and "exculpatory Contractor review of documents" clauses. Here are a few more clauses that deserve attention and review during the negotiation process.

INDEMNITY CLAUSE: Often contracts contain clauses reading something to the effect of: "Each party shall indemnify, defend, and hold the other party harmless from and against any and all claims, actions, suits, demands, or judgments asserted, and any and all losses, liabilities, damages, costs, and expenses, including, attorneys' fees alleged or incurred arising out of or relating to any operations, acts, or omissions of the indemnifying party." Indemnify means to protect against future damage, loss, or injury. This provision means that the indemnifying party will pay the damages, claims, expenses and other types of payments listed in this provision if the indemnified party, incurs damages as a result of something the indemnifying party does related to the agreement. The indemnifying parties actions or omissions which could result in liability to the indemnified party are listed at the end of the provision. This provision requires that the indemnified party promptly notify the indemnifying party of a claim and allow that party to control the defense or settlement of the claim. An indemnification provision addresses the risk that your company might be liable for damages resulting from something the other party does related to the contract. Indemnity clauses can also address the actions or omissions of third parties, so review these provisions with great care.

OBLIGATION TO CONTINUE WORK: One of the biggest risk shifting clauses in any construction contract relates to the obligation of the supplier, subcontractor, or general contractor (in an owner/contractor dispute) when a dispute arises during the progress of a project. A situation where a contracting party is forced to work and complete a project when there is a known dispute can quickly lead to a soured relationship fraught with additional disputes or financial ruin. From an owner's perspective, the owner will want to have a clause obligating the contractor to continue working notwithstanding the existence of disputes. From the owner's point of view these disputed generally center around workmanship, scheduling or other performance type issues. From a contractor's point of view, they will want a clause granting them a right to stop work in the event of untimely or non-payment. If no clause exists, either the contractor or owner may have the right to terminate for default, or cause, which equates to a material breach of the underlying contract. Without clarification within the terms of the contract, whether a default constitutes a material breach is often a question for the jury to decide after-the-fact. Unfortunately, all parties can become losers when litigation comes into play.

In the next article, we will look at "termination for cause" and "termination for convenience" clauses.

Express and Implied Warranties

By: Chad J. Cochran

Construction Law

This is a common story: Supplier provides building material to Contractor. Contractor installs material without any complaints. Owner later holds back money from Contractor, claiming improper construction: "My building is not suitable for its intended purpose and violates your warranties." Contractor shifts blame, claiming that Supplier provided faulty material. Supplier claims it provided exactly the material Contractor ordered. Contractor claims, "Your warranties suggest otherwise." Here comes the court system.

Nearly every large construction lawsuit in North Carolina touches upon warranties in one way or another. Accordingly, a basic understanding of warranties is paramount. Two types of warranties (a promise that the work sold is as represented) exist in North Carolina, express and implied.

Express warranties are simple. These warranties are set forth in the contract documents themselves and almost always set forth the specific assurances and time limits associated with the work performed. For instance, an electrical supplier's contract documents might specifically warrant that a high end electrical breaker will operate normally for ten years when installed in accordance with the electrical code.

Implied warranties are work assurances, which are presumed to apply regardless of whether the actual terms of the contract spell them out specifically. Unless specifically disclaimed by the contract itself, implied warranties often apply. Parties to a North Carolina construction contract should consider the following types of North Carolina implied warranties: (i) **Warranty of Habitability** — substantial defects in a residential dwelling (i.e., not commercial) which render the building unsuitable for a personal resident; (ii) **Warranty of Plans and Specifications**— an owner who provides construction plans to a contractor warrants to the contractor that the plans and associated specifications are suitable for the contractor's performance of the work; (iii) **Warranty Not to Delay or Hinder**—an implied warranty that neither party to a contract will impede the other's contractual performance; (iv) **Warranty of Workmanship**— this difficult to pinpoint warranty provides an implied assurance that the person performing work or supplying material is guaranteeing that the work/material is performed to a commercially reasonable standard.; and (v) **Warranty for a Particular Purpose—** a warranty applying to goods which requires that those goods comply with the purpose for which they are sold where the seller had reason to know of that purpose.

HSLC

Hannah, Sheridan,
Loughridge & Cochran, LLP

1011 Schaub Dr., Suite 104, Raleigh, NC 27606

PLACE
STAMP
HERE