

Recovering Attorneys' Fees: A New Day Dawns in North Carolina

For businesses in North Carolina long frustrated at the inability to recover attorneys' fees in contract disputes that go to court, a new day has dawned. A recently-enacted North Carolina statute broadly expands the opportunity to recover attorneys' fees incurred in business contract litigation. North Carolina's new law may dramatically alter the costs of litigating contract disputes and affect decisions to either litigate or settle.

How does the new law work?

The new law (Senate Bill 414) applies to all "business contracts" that are entered into on or after October 1, 2011. The statute gives a judge or arbitrator the discretion to award attorneys' fees if the business contract at issue contains a "reciprocal attorneys' fees provision." The statute does not require an attorneys' fees provision, but if the parties elect to put such a provision into their business contract, it must state that each party agrees to pay the other party's attorneys' fees and expenses that were incurred by reason of any suit, action, proceeding or arbitration involving the business contract. Although attorneys' fees provisions are commonly inserted into business contracts, prior to this new law such a provision typically could not be enforced in North Carolina unless the contract qualified as an "evidence of indebtedness" (e.g., a promissory note) under another statute (General Statutes § 6-21.2).

Under the new law, the judge or the arbitrator has the discretion whether to award attorney fees at all, and the amount of fees to award. Decisions to award fees are to be based on "all relevant factors." The new law provides a list of thirteen non-exclusive factors, such as the extent to which the party asking for attorneys' fees prevailed in the action, the amount in controversy, the amount of damages awarded, the reasonableness of the amount of fees requested, the relative economic circumstances of the parties, and the timing and amount of settlement offers. Interestingly, it is not an absolute requirement that a party win the case in order to recover its attorneys' fees. Although the terms of the contract are another factor for the judge or arbitrator to consider, the statute is not clear on whether the



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parties have the freedom of contract to insist that only a prevailing party may recover attorneys' fees.

What types of contracts are subject to the recovery of attorneys' fees?

The new law applies to "a contract entered into primarily for business or commercial purposes." Certain types of agreements are explicitly excluded from the scope of the statute. Consumer contracts (involving individuals and which are primarily for personal, family and household purposes) are outside the statute. Also excluded are employment contracts, which are defined as personal services agreements made with an individual who performs services, either as an employee or independent contractor. Business contracts also do not include contracts made with the State or with any State agency.

Given the broad sweep of what constitutes a business contract, many types of agreements will now be subject to an award of attorneys' fees if they contain a reciprocal attorneys' fees provision. These will include contracts between businesses for services, for the sale or lease of goods (products and equipment), commercial real estate contracts and leases, construction contracts, asset purchase agreements, stock agreements, corporate shareholder agreements and operating agreements for limited liability companies.

How will the new law affect businesses that are in a contract dispute?

After October 1, 2011, if parties enter into a business contract that includes a reciprocal attorneys' fees provision and later have a contract dispute that goes to court or arbitration, the parties will realize rather quickly that the stakes have been raised. Litigation and settlement strategies will need to evaluate the exposure to (or opportunity to recover) attorneys' fees, as well as the possibility that the new law may influence the opponent's litigation strategy. The new law places an even greater premium on careful case evaluation as early as possible once a dispute arises. Decisions to litigate or settle will be affected if the plaintiff has a meritorious claim and believes that its recovery of damages will not be reduced by the amount it spends on the litigation. Likewise, the defendant who is at a significant risk for paying damages will understand that its overall liability could be significantly higher if it is required to pay the attorneys' fees the plaintiff incurred in prosecuting the claim. Conversely, a plaintiff who has a case of doubtful merit runs the risk of not only losing the case but paying the defendants' attorneys' fees as well as its own. Therefore, depending on the relative merits of each claim and defense, the new statute may encourage some plaintiffs to file suit, may deter other plaintiffs from suing, and may put pressure on some defendants to settle early on to limit their exposure.

How is the new law different than an earlier statute?

For a business contract that contains a reciprocal attorneys' fees provision, all parties to the business contract will have the potential to recover attorneys' fees. This is a significant expansion of North Carolina law. Under an already existing statute (General Statutes § 6-21.2), certain types of contracts can allow for the recovery of attorneys' fees. This earlier statute has not been repealed and remains a viable alternative for recovering attorneys' fees if the contract qualifies as an "evidence

of indebtedness” and provides for the recovery of attorneys’ fees. Promissory notes and commercial leases qualify as evidences of indebtedness, but the recovery of attorneys’ fees is not reciprocal. For example, in a case involving the breach of a commercial lease, under the existing statute only the landlord may recover attorneys’ fees; a tenant may not.

By contrast, because of the new law’s explicit requirement of mutuality, all parties to a business contract that contains a reciprocal attorneys’ fees provision will be entitled to seek attorneys’ fees.

What amount of attorneys’ fees can be recovered?

The amount of attorneys’ fees that can be recovered is not specified in the new law. For example, under the earlier statute, attorneys’ fees can be based on a fixed percentage of 15% of the amount owed under the “evidence of indebtedness.” By contrast, the new law prohibits recovery of fees based on any stated percentage. The only limit on fees is that, if the case involves primarily a claim for money damages (as opposed to an injunction), the amount that a court or arbitrator awards cannot exceed the amount of money damages that are awarded.

What are the advantages and disadvantages of the new law?

The new law has some quirks to it. Most notably, the statute says that the business contract must be “signed by hand” by all the parties to it. Consequently, it appears that an informal business contract that is entered into through an exchange of emails could not be the basis for recovering attorneys’ fees even if the emails contained the necessary reciprocal attorneys’ fees language. Even a formal electronic contract containing electronic signatures would prevent the parties from recovering attorneys’ fees. The intent behind this provision is to prevent unfairness and surprise in “click accept” contracts—*i.e.*, contracts that are formed electronically by one party clicking onto a website button that requires consent to the other party’s terms and conditions. The effect of this requirement of a handwritten signature is problematic; for more than a decade, by statute North Carolina has made electronic contracts and electronic signatures valid. The new law appears to undercut existing law regarding electronic contracting.

When compared to the earlier attorneys’ fees statute limited to “evidences of indebtedness,” the new law involves some trade-offs. The new law is much broader and will allow for recovery of attorneys’ fees where no such recovery was permitted under the earlier statute. However, because there is no fixed percentage that can be awarded (as under the earlier statute), and because of the multiple factors that can be considered by a judge or arbitrator, a business seeking to recover attorneys’ fees will not have a clear idea in advance as to the amount of fees that might be recovered or have to be paid. It will likely take several years operating under the new statute for attorneys and businesses to get a good sense for how the courts are applying the new statute.

Certain businesses will not have to worry about trade-offs in the new law. Because the new law does not repeal the earlier statute, if the business contract at issue also qualifies as an “evidence of indebtedness” under the earlier statute, the new law expressly gives a party entitled to recover

attorneys' fees under either statute the option to choose which statute to proceed under. In some cases it might be more certain and more valuable to seek attorneys' fees under the earlier statute and recover fees based on 15% of the amount owed. For commercial lenders preparing promissory notes and other evidences of indebtedness, they can continue to rely exclusively on the earlier statute and thereby avoid reciprocal attorneys' fees provisions in their business contracts with borrowers.

Conclusion

Although the courts have not yet been called on to apply and enforce the new law, the language of the statute suggests that clients should carefully consider the following when drafting a business contract that contains a reciprocal attorneys' fees provision:

- If there is a dispute over the business contract, how expensive will litigation of that dispute likely be?
- How will the cost of litigation compare to the amount of damages that will likely be at issue?
- What is the company's risk tolerance for paying damages, its own attorneys' fees and the attorneys' fees of its opponent?
- Is reciprocity desirable? If the contract is likely to qualify as an evidence of indebtedness under the earlier statute, does the company give up its leverage if it agrees to a reciprocal attorneys' fees provision under the new law?
- Because the new law makes the terms of the contract a factor for a judge or arbitrator to consider when awarding attorneys' fees, businesses should consider including provisions to clarify the circumstances under which the parties intend attorneys' fees to be recoverable. Such provisions could include language that makes clear that only a prevailing party may recover attorneys' fees, and that a successful defense of a claim will entitle the defendant to recover its reasonable attorneys' fees.

As these points suggest, the new law hands businesses a powerful tool that may affect whether and how contract disputes are resolved. For this reason, new business contracts should be evaluated and drafted with this new law in mind to either limit exposure or create greater leverage for resolving disputes that may arise. Businesses should also carefully consider the impact of the new attorneys' fees statute on their existing standard form contracts and revise them accordingly.

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