Forum Selection and Attorneys' Fees Clauses in Contracts

Not Worth the Paper They're Written On?

By Clifton L. Brinson

They are two of the most common provisions in a commercial contract. And, as a general rule, in North Carolina they have no legal significance whatsoever. By statute, a provision in a North Carolina contract specifying an out-of-state forum for contract disputes is void and unenforceable. Similarly, for reasons of public policy, North Carolina courts will not enforce most contractual provisions allowing a non-breaching party to recover attorneys' fees in the event of a breach. While space does not permit a full discussion of the law on each of these points, the following is an overview of North Carolina law governing forum selection clauses and attorneys' fees provisions.

Forum Selection Clauses

Forum selection clauses purport to require that any lawsuit arising out of a contract must be brought in a particular forum. The specified forum might be a specific court (e.g., the United States District Court for the Southern District of New York), the courts of a particular state (e.g., the federal or state courts of Illinois), or even the courts of a foreign country.

In 1992, in the case of **Perkins v. CCH Computax, Inc.,**[1] the North Carolina Supreme Court held that forum selection clauses are valid, except where enforcement would be unfair or unreasonable or the clause was procured by fraud or unequal bargaining power. In response, the General Assembly enacted N.C.G.S. Section 22B-3, which states in full:

> Except as otherwise provided in this section, any provision in a contract entered into in North Carolina that requires the prosecution of any action or the arbitration of any dispute that arises from the contract to be instituted or heard in another state is against public policy and is void and unenforceable. This prohibition shall not apply to non-consumer loan transactions or to any action or arbitration of a dispute that is commenced in another state pursuant to a forum selection provision with the consent of all parties to the contract at the time that the dispute arises.

The statute applies to any contract "entered into in North Carolina." Under contract law principles, this means that the last act necessary for the contract to be formed took place in North Carolina. If so, the forum selection clause is void and unenforceable. If the contract was made in another state, North Carolina courts will look to the other state's law to determine whether the forum selection clause is enforceable.[2]

The statute applies only to forum selection clauses specifying an out-of-state forum, so clauses requiring that a lawsuit be brought in a North Carolina court are not affected. North Carolina courts will not, however, enforce a provision that specifies a particular county within North Carolina as the required forum for suit. (This is not based on Section 22B-3, but rather on the courts' reasoning that a clause specifying a particular county is inconsistent with the venue statutes.[3])

The statute by its terms includes out-of-state arbitration clauses. In general, however, this portion of the statute is preempted by the Federal Arbitration Act, which states that contractual agreements to arbitrate "shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract."[4] The Federal Arbitration Act applies only to contracts "evidencing a transaction involving commerce."[5] In the absence of a connection to interstate commerce, Section 22B-3 still governs and a provision requiring out-of-state arbitration would be void.

The two statutory exceptions are relatively narrow. The first is an exception for "non-consumer loan transactions," which has been defined by the courts as a loan that is "not extended to a natural person and not used for family, household, personal, or agricultural purposes."[6] The second exception says in essence that if the parties still want to litigate in the chosen forum in the face of an actual dispute under the contract, they can ratify an otherwise void forum selection provision.

Forum selection clauses are distinct from consent-to-jurisdiction clauses, in which a party merely agrees to submit itself to jurisdiction in a particular forum (thereby waiving any objection to personal jurisdiction or venue) without agreeing that suit be brought exclusively in that forum. Forum selection clauses are also distinct from choice-of-law provisions, which designate the law to govern a dispute but do not specify the forum in which the suit must be brought. These types of clauses are generally enforceable in North Carolina.[7]

Attorneys' Fees Provisions

Although the exact wording and requirements of these provisions vary, contractual attorneys' fees provisions generally require that in the event of litigation arising under the contract, the breaching party has to pay the non-breaching party's legal costs. Such provisions are unenforceable under North Carolina law except in the narrow instance where they are specifically authorized by statute. As the North Carolina Supreme Court said in a 1980 case: "Even in the face of a carefully drafted contractual provision indemnifying a party for such attorneys' fees as may be necessitated by a successful action on the contract itself, our courts have consistently refused to sustain such an award absent statutory authority therefore."[8] This rule applies even where the parties are sophisticated commercial entities, and even where there is no question as to the parties' awareness of and consent to the attorneys' fees provision.

The prohibition on attorneys' fees provisions is a creature of the common law. As far back as 1892, the North Carolina Supreme Court refused to enforce a provision in a promissory note allowing for recovery of a "collection fee" in the event of a lawsuit to collect on the note. Among other justifications, the Court stated that such provisions "are not only in the nature of penalties, but . . . are contrary to public policy and tend to encourage litigation."[9]

Although its origins are of old, the rule remains alive and well. A number of recent cases have reaffirmed the prohibition on enforcement of attorneys' fees provisions. Within the past five years alone, the North Carolina Court of Appeals has refused to enforce attorneys' fees provisions in the restrictive covenants of a residential subdivision,[10] in a consent judgment,[11] in a contract for the sale of real estate,[12] and in a contract for the sale of a business.[13]

There is one significant statutory exception to

the general rule. In 1967, the General Assembly enacted N.C.G.S. Section 6-21.2, which states, "Obligations to pay attorneys' fees upon any note, conditional sale contract, or other evidence of indebtedness . . . shall be valid and enforceable." The statute limits recovery of attorneys' fees to 15 percent of the outstanding balance of the note. The statute requires that the lender give written notice to the debtor of his intent to pursue a claim for attorneys' fees; if the debtor pays the outstanding balance within five days of the mailing of such notice, the lender is then prevented from seeking any attorneys' fees. The term "other evidence of indebtedness" in the statute has been interpreted to mean a "printed or written instrument, signed or otherwise executed by the obligor(s), which evidences on its face a legally enforceable obligation to pay money."[14] This includes instruments such as commercial leases[15] and open account credit agreements.[16]

There is also a judicially developed exception for attorneys' fees provisions in marital separation agreements. The basis for this exception is to ensure that provisions for support of children and dependent spouses will, as a practical matter, be enforceable. In setting forth this exception, however, the North Carolina Supreme Court made clear that its decision was based on the idea that separation agreements are different from other kinds of contracts, distinguishing such agreements from commercial contracts for which attorneys' provisions are unenforceable.[17]

The courts' refusal to enforce attorneys' fees provisions applies only to contracts governed by North Carolina law. If the contract law of a state other than North Carolina applies, then the other state's law will determine whether an attorneys' fees provision is enforceable.[18]

Conclusion

It has been my experience and the experience of others at my firm that many North Carolina attorneys, including experienced litigators, are unaware of our state's significant limitations on the enforceability of attorneys' fees provisions and forum selection clauses. This may be in part because North Carolina law in these areas differs substantially from the law of most other jurisdictions. Knowing these wrinkles may, in the right case, save you from making an unfounded motion to dismiss for improper venue based on a forum selection clause or motion for attorneys' fees based on a contract provision, or give you a defense should opposing counsel make such a motion. ■

BRINSON IS A MEMBER OF THE LITIGATION DEPARTMENT FOR SMITH ANDERSON IN RALEIGH.

Endnotes

1. 333 N.C. 140, 423 S.E.2d 780 (1992).

2. *See, e.g.,* **Szymczyk v. Signs Now Corp.,** 168 N.C. App. 182, 606 S.E.2d 728 (2005).

3. *See* **Perkins v. CCH Computax, Inc.,** 333 N.C. 140, 142-43, 423 S.E.2d 780, 782 (1992).

4. 9 U.S.C. § 2; *accord* **Boynton v. ESC Medical System, Inc.,** 152 N.C. App. 103 (2002).

5. 9 U.S.C. § 2.

6. **L.C. Williams Oil Co. v. NAFCO Capital Corp.,** 130 N.C. App. 286,290, 502 S.E.2d 415, 418 (1998).

7. *See* **MRI/Sales Consultants of Asheville, Inc. v. Edwards Publications, Inc.,** 156 N.C. App. 590, 577 S.E.2d 393 (2003) (consent-to-jurisdiction clauses); **Cable Tel Services, Inc. v. Overland Contracting, Inc.,** 154 N.C. App. 639, 574 S.E.2d 31 (2002) (choice-of-law clauses).

8. **Stillwell Enterprises, Inc. v. Interstate Equipment Co.,** 300 N.C. 286, 289, 266 S.E.2d 812, 814-15 (1980).

9. **Tinsley v. Hoskins,** 111 N.C. 340, 341, 16 S.E. 325, 325 (1892).

10. *See* **Walters v. Nicolas,** 162 N.C. App. 182, 590 S.E.2d 333 (2004) (unpublished).

11. *See* **Potter v. Hilemn Laboratories, Inc.,** 150 N.C. App. 326, 564 S.E.2d 259 (2002).

12. *See* **Lake Mary Ltd. Partnership v. Johnston,** 145 N.C. App. 525, 551 S.E.2d 546 (2001).

13. *See* **Lee Cycle Ctr., Inc. v. Wilson Cycle Ctr., Inc.,** 143 N.C. App. 1, 545 S.E.2d 745 (2001).

14. **Stillwell Enterprises, Inc. v. Interstate Equipment Co.,** 300 N.C. 286, 292, 266 S.E.2d 812, 816 (1980).

15. *See* **RC Associates v. Regency Ventures, Inc.,** 111 N.C. App. 367, 432 S.E.2d 394 (1993).

16. *See* **Hedgecock Builders Supply Co. v. White,** 92 N.C. App. 535, 375 S.E.2d 164 (1989).

17. *See* **Bromhal v. Stott,** 341 N.C. 702, 462 S.E.2d 219 (1995).

18. *See* **Tolaram Fibers, Inc. v. Tandy Corp.,** 92 N.C. App. 713, 375 S.E.2d 673 (1989).