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THE NORTH CAROLINA GENERAL ASSEMBLY NEARS PASSAGE OF SIGNIFICANT LEGISLATION AFFECTING BUSINESS

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The North Carolina General Assembly is working on significant legislation affecting the state's business legal climate. The Legislature is one vote away from adopting **Senate Bill 853** (SB 853)[1], which is intended to improve the predictability of litigation in the Business Court and enhance the ability of North Carolina companies to manage their risks and efficiently resolve their disputes in the State. Similarly, **Senate Bill 648** (SB 648)[2], which contains the "Abusive Patent Assertions Act," is one vote away from being presented to the Governor for signature. SB 648 will make North Carolina the national leader in protecting the integrity of the intellectual property of the innovation community against frivolous attacks by "Patent Trolls."

Both bills, if passed, should have a significant positive impact on the State's business climate.

SB 853 "The Business Court Modernization Act"

Modernizing the Business Court

Legislators addressed the need to clarify issues around Business Court jurisdiction. For example, formerly, Internet cases were within the Court's jurisdiction. The term Internet was not defined in the statute and raised concerns that cases that did not require special Business Court expertise could be filed in the Business Court. Disputes regarding the Internet alone will not qualify for Business Court jurisdiction under the new legislation, but only if they involve other covered matters such as technology licensing issues. The legislation makes a number of other adjustments including giving the Business Court jurisdiction over certain high value contract disputes.

SB 853 also establishes direct appeal for Business Court cases to the Supreme Court. Now, instead of an appeal first being heard by a randomly assigned three-judge panel of the Court of Appeals, litigants can seek review directly to the Supreme Court, with review by the full panel of seven justices. This procedure is expected to expedite resolution of business disputes and add predictability to decisions involving important business issues.

Simplifying Holding Company Reorganizations

A holding company reorganization is a transaction whereby a new parent corporation (the holding company) becomes the sole shareholder of an existing corporation (the constituent corporation) either through a merger or a share exchange. Following a holding company reorganization, the shareholders of the constituent corporation become the shareholders of the holding company and the directors of the constituent corporation become (or remain) the directors of the holding company. Holding company structures are employed for a variety of reasons, including segregating the liabilities of separate lines of business, allowing for structured leverage and facilitating dispositions of assets. Holding company structures are often used by publicly traded companies, particularly

ones in heavily regulated industries.

Historically, in North Carolina, an existing operating company has been required to engage in either a merger or a share exchange transaction that would require a shareholder vote and, with respect to nonpublic corporations, generally trigger statutory appraisal rights. A number of states, led by Delaware, have enacted statutes that permit holding company reorganizations without shareholder approval and without appraisal rights. New Section 55-11-11 of the North Carolina Business Corporation Act (the Holding Company Statute) is based on Delaware law and will allow holding company reorganizations in North Carolina without shareholder approval or appraisal rights if certain statutory requirements are satisfied. The requirements protect shareholders of the constituent corporation so that they have substantially identical ownership and rights in the holding company following the merger.

The Holding Company Statute will reduce the cost and time required by North Carolina corporations to form a holding company by removing the requirement for a shareholder vote, eliminating appraisal rights in connection with the holding company reorganization and facilitating compliance with federal securities laws and regulations. Corporations that desire to adopt a holding company structure should carefully consider availing themselves of the benefits of the Holding Company Statute once it becomes effective.

Risk Management through Exclusive Venue Provisions

The new law would also allow a North Carolina corporation to include a provision in its bylaws or articles of incorporation designating North Carolina venue as the exclusive forum for internal corporate litigation. For example, a company could require shareholder derivative actions, cases alleging a breach of fiduciary duty by the company's directors and cases arising under the Business Corporation Act to be brought in North Carolina state courts. (Any such cases would be subject to the jurisdiction of the North Carolina Business Court.)

Such a provision would avoid the substantial expense of fighting litigation in multiple states simultaneously and ensure that internal corporate litigation is handled by a court familiar with the governing law and convenient for the company and employees. Absent an enabling statute, however, such provisions have been a subject of litigation, with different courts reaching different results. By enacting this law, the General Assembly will provide certainty to North Carolina companies and give them a valuable tool to manage risks associated with internal corporate disputes.

SB 648 “Abusive Patent Assertions Act”

Nationally, there is significant attention to the negative effects that patent trolls have on the American economy and innovation. A patent troll does not research, develop technology or products related to its patents, or perform any technology transfer function. Instead, patent trolls acquire patents solely for the purpose of obtaining licensing fees from alleged infringers. Patent trolls often employ aggressive litigation tactics in the hopes that a target will pay a licensing fee rather than undertake expensive litigation.

A June 2013 White House report (entitled Patent Assertion and U.S. Innovation) states that suits by patent trolls tripled in 2011 and 2012, to an astounding **62%** of all patent infringement suits filed. One study cited by the White House found that patent trolls received \$29 billion from defendants and licensees in 2011, an increase of 400% over 2005, with less than 25% of those funds flowing back into innovation.

While the U.S. House of Representatives passed an anti-patent troll bill, legislation stalled in the U.S. Senate. But our General Assembly is one vote from sending a clear message, i.e., a patent troll threatens a North Carolina business at its own peril.

The North Carolina Senate's version of the bill is the most recent. The Senate's bill creates a cause of action in favor of North Carolina companies who are targets of a bad-faith assertion of patent infringement. The bill gives jurisdiction to a North Carolina court over any person or entity that sends a patent infringement demand letter to a North Carolina company. If the demand is found to be in bad faith, the bill provides for equitable relief, monetary damages, costs and reasonable attorneys' fees, as well as "exemplary damages" of either \$50,000 or triple the total damages, costs and fees, whichever is greater.

In patent troll litigation, a real frustration is that there usually is no recourse against the troll, because trolls are thinly capitalized. The real power of the proposed legislation is that it enables joinder of an interested party, i.e., a controlling stakeholder in the patent troll itself. Subject to the court making certain legal findings, if the defendant troll is not able to pay an award, the court could hold the interested parties jointly and severally liable and make them pay. That potential exposure to liability could provide a healthy deterrent to meritless litigation.

CONCLUSION

In debate on the Business Court Modernization Act, legislators were clear that they hope these changes will improve North Carolina's business legal climate, such that businesses and shareholders can feel confident incorporating in North Carolina (as opposed to another state such as Delaware) and having their legal matters resolved by North Carolina courts. Similarly, the Anti-Patent Troll legislation will make North Carolina a still better location for those working on the innovations that create jobs and our State's future.

For *Business Court and Venue Provision* questions, please contact **Christopher Smith**. For *Holding Company Statute* questions, please contact **Heyward Armstrong**. For *Abusive Patent Act* questions, please contact **Robert Joseph Morris**.

[1] Senate Bill 853 (Fifth Edition), 2013-2014 Sess. (N.C. 2014), available at <http://www.ncleg.net/Sessions/2013/Bills/Senate/HTML/S853v5.html>.

[2] Senate Bill 648 (Sixth Edition), 2013-2014 Sess. (N.C. 2014), available at <http://www.ncleg.net/Sessions/2013/Bills/Senate/PDF/S648v6.pdf>.

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