

# Incorporating N.C.G.S. Section 6-21.6 into Case Evaluations and Strategy

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Prior to Oct. 1, 2011, it was very difficult to recover attorneys' fees in a business contract case. There were narrow exceptions, including exceptions for cases involving the North Carolina Unfair or Deceptive Trade Practices Act or collections under an "evidence of indebtedness," such as a Note or Conditional Sales Contract. See N.C.G.S. §§ 75-16.1 and 6-21.2, respectively. The general public policy of North Carolina, however, did not allow for the recovery of fees by a prevailing party. That changed with the passage of Section 6-21.6 of the North Carolina General Statutes (the "Statute") in June of 2011. Subject to many conditions and requirements, the Statute makes reciprocal attorneys' fees provisions enforceable in business contracts executed after Oct. 1, 2011.

While the Statute fits the basic mold of previous narrow statutory exceptions to the general public policy of North Carolina disfavoring the recovery of attorneys' fees, the Statute has broad application and will most certainly have a profound effect on commercial litigation. This broad application, taken together with the often onerous expense associated with commercial litigation, means that attorneys should consider the Statute not only when evaluating and valuing their business litigation cases early in a dispute, but also throughout the litigation process to verdict or judgment. Luckily, the Statute provides a framework for crafting this analysis, and this article will explore ways to incorporate the statutory framework into an analysis spanning the life of a business contract litigation case.

## **Nature of Awards Pursuant to the Statute**

The most important characteristic of the Statute is that awards of attorneys' fees under its provisions are discretionary, not mandatory. This applies to the award itself and to the amount of any award. In fact, the Statute prohibits basing an award of attorneys' fees on any term of the business contract that sets a specific amount of reasonable attorneys' fees to be awarded. N.C.G.S. § 6-21.6(d). This separates it from other North Carolina attorneys' fees statutes, particularly Section 6-21.2, which established the commonly-known rule that "reasonable attorneys' fees" language in a contract governed by its provisions equals 15 percent of the outstanding balance due under the contract. N.C.G.S. § 6-21.2(2). Rather, the Statute allows judges or arbitrators to "consider all relevant facts and circumstances" in using their discretion to decide whether to award attorneys' fees and in what amount. *Id.*; see also Ann M. Anderson, "Attorney Fee Provisions in North Carolina Contracts," *Admin. Just. Bull.*, Sept. 2011, at 12.

To help guide judges and arbitrators in their consideration of "all relevant facts and circumstances," the Statute sets forth a non-exclusive list of 13 factors for them to use in determining the amount of the attorneys' fees award, if any. This non-exclusive list of factors is as follows:

- The amount in controversy and the results obtained.
- The reasonableness of the time and labor expended, and the billing rates charged, by the attorneys.
- The novelty and difficulty of the questions raised in the action.

- The skill required to perform properly the legal services rendered.
- The relative economic circumstances of the parties.
- Settlement offers made prior to the institution of the action.
- Offers of judgment pursuant to Rule 68 of the North Carolina Rules of Civil Procedure and whether judgment finally obtained was more favorable than such offers.
- Whether a party unjustly exercised superior economic bargaining power in the conduct of the action.
- The timing of settlement offers.
- The amounts of settlement offers as compared to the verdict.
- The extent to which the party seeking attorneys' fees prevailed in the action.
- The amount of attorneys' fees awarded in similar cases.
- The terms of the business contract.

N.C.G.S. § 6-21.6(c).

It is important to remember that the list of statutory factors above is non-exclusive, so there very well may be other factors that judges or arbitrators use to determine the award in specific cases. Thus, while these listed factors provide a good starting point for predicting the amount and impact of potential attorneys' fees awards under the Statute and for incorporating that prediction into litigation strategy, it is important for attorneys to brainstorm additional relevant factors that might stem from those mentioned in the Statute in the context of their particular transaction or litigation.

The statutory factors listed above generally focus on the position and conduct of the parties to a lawsuit, from contract formation, to pre-litigation disputes, to conduct of the parties during litigation, to the final outcome. The Statute has relevance at each stage, and a failure to incorporate an analysis of the Statute at each of these stages would be unwise. The remainder of this article will move through each of these stages and will highlight how the Statute is relevant and should be analyzed at each stage.

### **Utilizing the Statute Throughout the Case**

Contract Formation | If an attorney is so lucky as to be involved in the formation stage of the business contract, it is worthwhile to consider the utility and potential effect of including a reciprocal attorneys' fees provision in the contract. Prior to the Statute, this provision was of limited utility and was often included to serve only as a deterrent to controversy, especially lawsuits. Now, this provision can be useful in several contexts, from equalizing the parties' potential exposure to liability for attorneys' fees, to providing a meaningful incentive for early resolution of disputes.

However, a party looking for the deterrent effect should understand that this provision is now enforceable, and, since the provision must be reciprocal to be enforceable, the effort to deter controversy has the ability to backfire in the event that party is the one who is later found to have breached the contract. Removing the reciprocal nature of the clause is obviously not a solution because reciprocity is required to make the clause enforceable. N.C.G.S. §§ 6-21.6(a)(4) and (b). Perhaps the same deterrent effect can be achieved with a one-sided clause, as has always been the case, but the party considering the inclusion of a non-reciprocal attorneys' fee provision must understand that it will not be enforceable under the Statute.

Furthermore, an attorney involved at the contract-drafting stage must keep in mind that the terms of the contract itself will be considered in determining the amount of any award, although this is limited by the restriction against percentage awards. See N.C.G.S. § 6-21.6(d). A creative attorney should seek to develop contractual terms that may later increase or limit the amount of an award of attorneys' fees, depending on the circumstances.

In addition to drafting considerations, attorneys should consider the positions of the parties in looking ahead to a possible award of attorneys' fees. The Statute provides that the "relative economic circumstances of the parties" is a factor for the judges or arbitrators to consider. N.C.G.S. § 6-21.6(c)(5). This factor can be interpreted to mean that the judges or arbitrators can use the Statute to equalize the relative economic positions of the parties.

Imagine that a large corporation and a small business enter into a business contract containing a reciprocal attorneys' fees provision. If the large corporation breaches the contract and the small business prevails in litigation, the judge or arbitrator might read the Statute as authorizing a large award of fees against the large corporation based (at least in part) on the economic circumstances of the parties. In the reverse situation, where the small business breaches the contract and loses the case, the judge or arbitrator might read the Statute as authorizing the attorneys' fees award against the small business to be reduced or even declined because of the same circumstances. Attorneys should also consider the probable amount in controversy under the contract. See N.C.G.S. § 6-21.6(c)(1).

In a case where the recovery of monetary damages is sought, the total amount of the attorneys' fees award cannot exceed the amount of damages actually awarded or in controversy. N.C.G.S. §§ 6-21.6(b) and (f). Therefore, if the total value of the contract is \$25,000, then the potential exposure under a reciprocal attorneys' fees provision is limited to something equal to, or less than, that amount. Knowing the real value of a contract up front will help an attorney forecast the limitations on a possible attorneys' fee dispute, which in turn will assist the attorney with positioning during pre-litigation disputes.

**Pre-Litigation Disputes** | One of the most important implications of the Statute is that it has made certain aspects of settlement negotiations between the parties relevant in determining an award of attorneys' fees. Therefore, it is prudent to incorporate an analysis of the Statute into the strategic planning for handling a pre-litigation dispute.

The factors in the Statute pertaining to settlement negotiations center on the reasonableness of the parties' conduct. N.C.G.S. §§ 6-21.6(c)(6), (9), and (10). In other words, it is important to calculate reasonable settlement offers in terms of both timing and delivery. For example, if a party refuses to make any offers of settlement, that fact could mitigate against an award of attorneys' fees if that party becomes the prevailing party, or it could exacerbate an award against that party if that party does not ultimately prevail in the litigation.

Likewise, the amount of the settlement offers made must be reasonable. See N.C.G.S. §§ 6-21.6(c)(10). For example, if a settlement offer of \$75,000 is made, but refused, but the verdict at trial for the party rejecting the offer is \$60,000, then a judge or arbitrator is not likely to look favorably upon a request by the prevailing party for a substantial award of attorneys' fees. This factor can also be used offensively in the calculation of settlement offers. Here, a party that is able to accurately value potential monetary exposure and deliver settlement offers that have a rational relationship to that exposure may be able to either limit or increase (whichever is needed and relevant) a future award of attorneys' fees by delivering that offer.

**Conduct and Strategy During Litigation** | Of course, the timing and reasonableness of settlement offers has application both in pre-litigation disputes and in litigation itself. But, other conduct of the parties during litigation also is relevant, along with the ways that the attorneys tackle the various tasks in the case.

Under the Statute, judges or arbitrators are allowed to consider whether one party unfairly used an economic advantage it had over another party during the case. N.C.G.S. §§ 6-21.6(c)(8). This consideration invokes images of the classic example of a more economically-advantaged business "burying" another less economically-advantaged business in litigation to force a "surrender" unrelated to the merits of a claim. If an

enforceable reciprocal clause is present, such strategies should now be considered with caution.

A very interesting "conduct in litigation" factor, which mirrors the logic of the factors pertaining to settlement offers, is the factor concerning offers of judgment under Rule 68 of the North Carolina Rules of Civil Procedure set forth in Section 6-21.6(c)(7). In the past, Rule 68 offers of judgment were underused. In order for the offer of judgment to be effective, it had to be of an amount that reflected an accurate valuation of the case. However, in conveying that amount, a party also was potentially giving up arguments as to alternate or lower valuations. And, because the only tangible benefit of a successful offer of judgment was the recovery of costs (which were limited in North Carolina), it often did not make sense to utilize the tool. That situation has changed somewhat by the inclusion of the Rule 68 factor in Section 6-21.6(c)(7). Now, if a party makes an offer of judgment, which is then refused, and the resulting verdict is lower than the offer, the offering party will be in a much better position to argue against an award of attorneys' fees.

Conclusion of the Case | Two sets of factors pertain to the outcome obtained in the case. The analysis guided by these factors is focused not only on which party prevailed and the amount of the verdict, but also on the nature of the legal services provided to achieve the outcome. See N.C.G.S. §§ 6-21.6(c)(1)-(4), (10)-(12).

The first set of factors, reminiscent of the factors set forth in Rule 1.5 of the Rules of Professional Conduct of the North Carolina State Bar, relates to the legal services provided. In sum, the judges or arbitrators are allowed to consider the complexity of the case and the price and efficiency of the attorneys. Obviously, this is something for each attorney to consider throughout the course of a case up to, and through, litigation, but it bears special mention regarding its relation to the conclusion of the case. At that stage, the attorney is able to review the expenses of the case and not only have a realistic conversation with the client about a possible attorneys' fee award, but also begin to craft arguments as to why the expenses were justified.

The second set of factors relates to the results obtained in the litigation. These factors dovetail with the settlement factors and the upper limits on awards by incorporating the amount of verdict or judgment into the analysis. The amount of the award may be directly variable with the amount of the verdict or judgment, or with the amount of settlement offers as these offers relate to the final verdict or award. This is very important, as it may change the way attorneys approach decisions with regard to early settlement and even the propriety of appeals.

## **Conclusion**

This article simply scratches the surface of the many factors that judges or arbitrators must now review in determining whether an award of attorneys' fees is appropriate under the Statute. Numerous undefined other factors exist beyond those listed in the Statute, and each case will present unique circumstances that will alter the relevance of all of the possible factors. But, if nothing else, it is hoped that this article highlights the need for each attorney facing or considering the use of a reciprocal attorneys' fees provision to think deeply about the role of the provision in the specific circumstances of the transaction or case at hand and how possible awards could either benefit or harm the attorney's client.

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