SENATE BILL 648: NC Commerce Protection Act of 2014

2013-2014 General Assembly

Committee:	Senate Judiciary I	**Date:**	May 20, 2014
Introduced by:	Sens. B. Jackson, Meredith, J. Davis	**Prepared by:**	Peter Ledford
Analysis of:	PCS to Second Edition S648-CSTP-68		Staff Attorney

***SUMMARY:* The PCS to Senate Bill 648 would make various changes to statutes governing commerce in the State, including provisions to create transparency in contingency fee contracts between the State agencies and private attorneys, to create transparency in claims against asbestos and silica trusts, to amend the laws governing products liability actions, to prevent the abuse of patents, and to enforce exclusive forum provisions assented to by shareholders in derivative actions.**

PART I. CREATE TRANSPARENCY IN CONTRACTS BETWEEN THE ATTORNEY GENERAL AND PRIVATE ATTORNEYS

CURRENT LAW: Under G.S. 114-2.3, any state agency that is authorized to retain private counsel must obtain written permission from the Attorney General prior to employing private counsel.

BILL ANALYSIS: Section 1 of the bill would create procedures governing contingency fee agreements between the State and private attorneys.

Before granting a State agency permission to retain private counsel using a contingency fee contract, Section 1 of the bill would require the Attorney General to issue a written determination that such representation is both cost-effective and in the public interest. Section 1 would also exempt requests for contingent fee representation proposals from private attorneys from State purchasing and contracting requirements under Article 3, Chapter 143, and all proposals received would be deemed not to be public records under Chapter 132 until the conclusion of the proceeding for which the services of the private attorney were sought. Private attorneys submitting proposals would be required to pay a $50 fee that would go toward maintenance of the Attorney General's website.

The following documents related to contingency fee contracts must be provided to the State Auditor for oversight purposes, upon request:

- The Attorney General's written determination that a State agency should utilize the services of a private attorney.
- The proposals received by the Attorney General from private attorneys.
- The executed contingency fee contract.
- Documentation of all expenses incurred by the private attorney and the time records maintained by the private attorney.

Section 1 would cap the permitted contingency fee under a contract approved by the Attorney General at 22.5%, exclusive of reasonable costs and expenses, and would grant courts discretion to reduce the fee after a settlement or award in the proceeding. The fee could not be based on penalties or civil fines awarded. The State agency would retain exclusive authority over decisions regarding case disposition in consultation with a government attorney.

Additionally, Section 1 would require the Attorney General to report annually to the President Pro Tempore and Speaker describing the use of contingency fee contracts with private attorneys.

Section 2 of the bill would amend G.S. 114-2.3 to apply the provisions enacted in Section 1 of the bill to all contracts to retain private counsel authorized by the Attorney General.

EFFECTIVE DATE: Sections 1 and 2 of this act are effective when they become law and apply to any contract to retain private counsel authorized by the Attorney General entered into on or after that date.

PART II. CREATE TRANSPARENCY IN CLAIMS AGAINST ASBESTOS AND SILICA INJURY TRUSTS

CURRENT LAW: Under federal bankruptcy law, as a part of a reorganization plan under Chapter 11 of the Bankruptcy Code a debtor with outstanding liability in personal injury, wrongful death, or property-damage actions allegedly caused by the presence of or exposure to asbestos may establish a trust that will fund present and future settlements of claims and lawsuits. 11 U.S.C. 524(g). Once a company emerges from bankruptcy protection having established a bankruptcy trust, all liabilities for asbestos exposure are assigned to the trust. As of 2011, 56 such bankruptcy trusts have been created.[1] As of 2008, the largest 26 of these trusts had paid $10.9 billion on 2.4 million claims.[2] In 2012, the combined assets of all bankruptcy trusts were estimated to be between $35 and $60 billion.[3]

Most settlements between an injured party and a bankruptcy trust contain a confidentiality provision. Further, many bankruptcy trusts allow an injured party to delay claims against the bankruptcy trust until they have recovered from solvent defendants in the tort system. As a result of asbestos manufacturers filing for bankruptcy and creating bankruptcy trusts, there are fewer available defendants for an injured party to pursue, and because of confidentiality provisions and delayed claims, it is difficult for solvent defendants to prove inconsistencies in the claims of an injured party.[4]

In a recent bankruptcy proceeding, the court ordered the debtor and representatives of potential claimants to estimate the liability of the debtor for purposes of establishing a bankruptcy trust. *In re Garlock Sealing Technologies, LLC*, 504 B.R. 71 (W.D.N.C. 2014). Using different approaches, the two groups estimated the liability at very different amounts; the debtor estimated liability at $125 million while the representatives of potential claimants estimated liability to be as much as $1.3 billion. In ordering the trust be funded with the lesser amount, the judge noted that plaintiffs in prior lawsuits had failed numerous times to disclose claims of plaintiffs against other defendants and bankruptcy trusts, which had resulted in the plaintiff recovering more than the value of the injury and the debtor paying more than its share of the recovery.

BILL ANALYSIS: Section 4 of this act would enact the Asbestos or Silica Trust Claims Transparency Act, which would apply to all claims against bankruptcy trusts established for the purpose of settling claims against a debtor based on asbestos or silica exposure. The act would require a plaintiff to file a sworn statement with the court within 30 days after the effective date of this act or within 30 days of filing a claim identifying all claims against asbestos and silica trusts that have been filed or that potentially could be filed against an asbestos or silica bankruptcy trust. Once filed, the court could not schedule a trial until at least 180 days after this disclosure. Not less than 75 days before trial, a defendant would be permitted to move the court for an order to require the plaintiff to file a claim

[1] Lee Blanton Ziffer, Bankruptcy Trusts and Asbestos Litigation, American Bar Association Section of Litigation, June 11, 2012.
[2] Ziffer, Bankruptcy Trusts and Asbestos Litigation.
[3] Ziffer, Bankruptcy Trusts and Asbestos Litigation.
[4] Ziffer, Bankruptcy Trusts and Asbestos Litigation.

against an asbestos or silica trust not identified by the plaintiff that the defendant reasonably believes the plaintiff can file. Within 10 days of such a motion, the plaintiff must respond by either filing the claim or filing a response with the court setting forth why there is insufficient evidence to file the claim. If the court determines that there a sufficient basis for the plaintiff to file the claim, the court would be required to order the plaintiff to do so. If trial in the immediate action occurs before a claim by the plaintiff against a trust is resolved, there would be a rebuttable presumption that the plaintiff is entitled to and will receive the compensation specified in the trust governance document. In any award against the defendant, the defendant would be entitled to a setoff or credit in the amount of any prior recovery by the plaintiff from a trust plus the amount of the compensation specified in the trust governance document for any unresolved claims against trusts.

EFFECTIVE DATE: Section 4 of this act becomes effective July 1, 2014.

PART III. AMEND THE LAWS GOVERNING PRODUCTS LIABILITY ACTIONS

CURRENT LAW: Under current law, compliance with regulatory provisions does not constitute an absolute defense to a product liability action. In determining whether a manufacturer is liable for inadequate design or formulation of a product, however, G.S. 99B-6 requires the following factors, among others, to be considered:

- The extent to which the design or formulation conformed to any applicable government standard that was in effect when the product left the control of its manufacturer[5]
- The extent to which the labeling for a prescription or nonprescription drug approved by the United States Food and Drug Administration conformed to any applicable government or private standard that was in effect when the product left the control of its manufacturer[6]

BILL ANALYSIS: Sections 6 and 7 provide immunity from liability in any product liability action if:

- the product was designed, manufactured, packaged, labeled, sold, or represented in compliance with regulatory requirements or governmental approval, license or similar determination relevant to the event or risk allegedly causing the harm
- at the time the product left the control of the manufacturer or seller, the product was in compliance with a State or federal statute, standard, rule, regulation, or order relevant to the event or risk allegedly causing the harm
- the transaction forming the basis of the claim involves contract provisions or other practices authorized by or in compliance with rules, regulations, standards, or orders of a government agency.

This immunity does not apply if:

- the product was sold after an order of a government agency to withdraw the product or service from the market, to withdraw its approval, or to substantially alter the terms of approval in a manner that would have avoided the alleged injury
- the manufacturer intentionally and in violation of applicable regulations withheld from or misrepresented to the government agency information material to approval and relevant to the harm allegedly suffered by the claimant

[5] G.S. 99B-6(b)(3).
[6] G.S. 99B-6(b)(4).

- the manufacturer bribed a government official to obtain approval of the product

EFFECTIVE DATE: Sections 6 and 7 of this act become effective October 1, 2014, and apply to actions commenced on or after that date.[7]

PART IV. PREVENT THE ABUSE OF PATENTS

CURRENT LAW: Patent law is primarily governed by and preempted by federal law, which limits state regulation of patentable subject matter. In 1999, the U.S. Court of Appeals for the Federal Circuit held that patent law does not preempt allegations of state-law unfair competition requiring a showing of bad faith. *Zenith Elecs. Corp. v. Exzec, Inc.*, 182 F.3d 1340 (Fed. Cir. 1999). In 2004, the court clarified that, to survive federal preemption, the allegedly bad-faith patent assertion "must be objectively baseless in the sense that no reasonable litigant could realistically expect success on the merits. If an objective litigant could conclude that the suit is reasonably calculated to elicit a favorable outcome, the suit is immunized." *Globetrotter Software, Inc. v. Elan Computer Group. Inc.*, 362 F.3d 1367 (Fed. Cir. 2004). The objective baselessness standard is not the basis of the state court action contemplated by the bill; therefore, the legislation could be attacked on the grounds that it allows for application in instances that would result in federal preemption; the proposed statute might withstand scrutiny if it is enforced with precision only against persons asserting claims that are objectively baseless.

BILL ANALYSIS: Section 9 of the bill would make bad faith assertions of patent infringement an unfair and deceptive trade practice. The actionable assertion would involve communicating that patent infringement has occurred or that certain entities need to license a patent. The "target," or entity to which the communication is made, can be the person receiving the demand or assertion of patent infringement, a person threatened with or made the defendant in patent litigation, or a person with customers who have received a demand asserting patent infringement.

To aid the court in determining whether actions are taken in good or bad faith, the bill sets forth a number of non-exclusive factors the court can weigh. Factors indicating bad faith include:

- The demand does not contain the patent number/patent application number, name and address of patent owner/s and assignee/s, specific identification of areas of infringement, and an explanation of why the person making the assertion has standing (where they are not identified as the patent owner). An additional factor includes failing to respond to a request for this same information within a reasonable time.
- The person making the assertion did not analyze the claims in the patent to the alleged infringing device or activity.
- The person making the assertion demands licensing or response within an unreasonably short period of time.
- The person making the assertion offers to license the patent for an amount unrelated to the reasonable estimate of the value of the license or bases the license fee on the cost of litigation.
- The claim of infringement is meritless and the person making the assertion knew or should have known it was meritless. Alternatively, the factor is satisfied if a claimant bases an

[7] Because our appellate courts have held that an accrued cause of action is a property right, application of Sections 6 and 7 to actions arising prior to their effective date may lead to a constitutional challenge based on the argument that such retroactive application destroys vested rights. Bolick v. American Barmag Corp., 306 N.C. 354, 371 (1986). That challenge could be avoided by making Sections 6 and 7 applicable to actions arising on or after the effective date.

assertion on a patent interpretation disclaimed during prosecution and knew or should have known about the disclaimer or would have known upon review of prosecution history.

- The assertion is deceptive.
- The person making the assertion has previously/concurrently filed/threatened to file other lawsuits based on the same/similar claim of patent infringement without the information required above or there has been a previous attempt to enforce the claim where the claim was found to be meritless.
- The person making the assertion has made substantially the same claim against multiple recipients against a wide variety of products without reflecting the differences in a reasonable manner in the various demands.
- The person making the assertion identifies but does not disclose any post-grand finding of invalidity or unpatentability involving the patent.
- The person making the assertion seeks an injunction that is objectively unreasonably under the law.
- Any other factor the court finds relevant.

Factors indicating good faith on the part of the person making the assertion:

- The demand contains the information described above or timely responds with the information upon demand.
- The person engages in a good faith effort to establish the target has infringed the patent and to negotiate an appropriate remedy.
- The person substantially invests in the use of the patent, which involves active practice and not licensing alone.
- The person is (i) the inventor/joint inventor or the original assignee or (ii) an institution of higher education/a technology transfer organization owned/affiliated with an institution of higher education.
- The person has demonstrated good faith business practices in previous efforts to enforce the patent/substantially similar patent or has successfully enforced the patent/substantially similar patent.
- Any other factor the court finds relevant.

Specifically exempted from the purview of the new statute are assertions of patent infringement concerning drugs and biological products regulated under the Food, Drug, and Cosmetic Act.

If the court determines there is a reasonable likelihood of bad faith patent assertion, the court must require the person making the assertion to post a bond estimated to equal the costs and fees to litigate the claim and the amount likely to be recovered by the target due to the state claim created by the act. An exception to the bond mandate occurs where the person asserting the claim has assets equal to the amount of the proposed bond or good cause exists. The bond would be conditioned on a determination of an amount being finally determined to be due to the target and is capped at $500,000. The bond does not insulate the person making a bad faith assertion from liability above the bond amount.

Other provisions of the civil cause of action include:

- The Attorney General is empowered to make rules, conduct investigations, bring civil actions, or enter assurances of discontinuance provided in Chapter 75 of the General Statutes.
- Damages authorized to be awarded to a target include equitable relief, damages, costs and fees, and exemplary damages equal to the greater of $50,000 or three times the total of damages, costs, and fees.
- The court is permitted to join interested parties if the person asserting infringement has no substantial interest in the patent other than the assertion. Joined parties may be held jointly and severally liable if the party making the assertion is unable to pay amounts awarded.
- Making a demand to a North Carolina target subjects the person to the jurisdiction of North Carolina courts.

Section 10 of the bill would enlarge the criminal offence of extortion to include intentionally obtaining or attempting to obtain property by making or threatening an abusive patent assertion under G.S. 75-139. Extortion is a class F felony.

EFFECTIVE DATE: Section 9 of the bill creating the civil cause of action is effective when it becomes law and applies to causes of actions commenced on or after that date and demands made on or after that date. Section 10 of the bill enlarging the criminal offense of extortion becomes effective December 1, 2014, and applies to offenses committed on or after that date.

BACKGROUND: According to recent studies, people or companies that misuse patents as a business strategy ("patent trolling") has jumped by nearly 250%, rising from 29% of infringement suits to 62% of infringement suits in 2 years. As a result, the federal government has taken, is taking, or is contemplating the following courses of action:

- The DOJ Antitrust Division and FTC are jointly working towards modifying modern patent law to account for trolling practices. The FTC is actively investigating trolling activity and has stated its intention to use statutory authority, such as Section 5 of the FTC Act to prevent unfair and deceptive acts such as those typically employed by patent trolls.
- There have been federal legislation proposals that range from disclosure/transparency requirements to filing of written offers to settle + payment of offeror's costs/expenses where the ultimate result is less favorable than the offer).
- The President has ordered the PTO to adopt rules requiring patent applicants and owners involved in PTO proceedings to disclose real-party-in-interest information and creating a national, searchable database of patent infringement letters coupled with enabling the PTO or the district courts to impose sanctions for non-compliance.

The AIA modified the patent system to allow for challenging business method patents via inter partes review, which replaced the old reexamination process, in order to be speedier.

PART V. SHAREHOLDER ASSENT TO EXCLUSIVE FORUM

CURRENT LAW: In response to shareholder litigation in multiple forums, some corporations have begun specifying an exclusive forum for shareholder lawsuits. Under North Carolina law, such a provision can be adopted by the board of directors without shareholder approval for inclusion in the bylaws of a corporation (G.S. 55-10-20) or can be included in the articles of incorporation of a corporation, either during the initial formation of the corporation (G.S. 55-2-02) or by amending existing articles of incorporation with the approval of shareholders (G.S. 55-10-03). However, initial court

rulings regarding exclusive forum provisions that were adopted by the board of directors without shareholder approval have been varied in their outcomes. See *Galaviz v. Berg*, 763 F.Supp.2d 1170 (N.D. Cal. 2011) refusing to enforce such a provision and *Boilermakers Local 154 Ret. v. Chevron Corp.*, 73 A.3d 934 (Del. Ch. 2013) enforcing such a provision.

BILL ANALYSIS: Section 12 of the bill would provide that a provision in the articles of incorporation providing that the state courts of the State of North Carolina shall be the exclusive forum for a derivative shareholder lawsuit is effective and enforceable against any shareholder who voted in favor of an amendment to include the provision and any shareholder who purchased shares after the inclusion of the provision.

EFFECTIVE DATE: Section 12 of this act is effective when it becomes law and applies to all articles of incorporation and all amendments to articles of incorporation adopted on or after that date.

Shelly DeAdder, counsel to Senate Rules, Bill Patterson, counsel to Senate Judiciary I, and Dan Ettefagh, counsel to the Joint Legislative Economic Development and Global Engagement Oversight Committee substantially contributed to this summary.