



# THE STATE BAR OF CALIFORNIA

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## – COMMITTEE ON ALTERNATIVE DISPUTE RESOLUTION

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### ADR – 2005 – 09

**TO:** Larry Doyle, Chief Legislative Counsel, State Bar of California

**FROM:** State Bar's Committee on Alternative Dispute Resolution

**RE:** Proposal to add new Code of Civil Procedure Section 1281.12, which would toll a contractual arbitration "statute of limitations" provision requiring that arbitration of a controversy be demanded or initiated within a specified period of time, if a party commenced an action in court based upon that controversy within that period of time.

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### DIGEST:

Under existing law, where an agreement to submit a controversy to arbitration contains a contractual arbitration "statute of limitations" provision – i.e., a clause requiring that arbitration

be demanded or initiated within a specified period of time – as a general rule, the time period continues to run unless and until the party actually demands or initiates arbitration. The proposed statutory amendment would provide that the time period to demand or initiate arbitration of a controversy, as set forth in the arbitration agreement, is tolled from the time that a party commences an action in court based upon that controversy, until 30 days after a final determination is made by the court as to whether the controversy is required to be submitted to arbitration under the contractual agreement, or until 30 days after the final termination of the action that initiated the tolling, whichever occurs first.

**PURPOSE:**

A “contractual requirement that a party’s demand for arbitration must be made within a certain time is a condition precedent to the right to arbitration. In the absence of a legal excuse or subsequent modification of the parties’ agreement, the failure to submit the dispute to arbitration within the agreed time precludes judicial enforcement of the right to arbitrate.” *Platt Pacific, Inc. v. Andelson* (1993) 6 Cal.4th 307, 319.

When a party to an arbitration agreement files a *lawsuit* relating to a claim that is subject to the arbitration agreement, filing the lawsuit does not meet a contractual condition requiring a demand or initiation of *arbitration* by a certain point in time, i.e., it does not toll or satisfy the contractual statute of limitations for initiating arbitration governing that claim.

If a party to the arbitration agreement sues on a claim instead of demanding or initiating arbitration, and the defendant contends that the claim is subject to arbitration, the proceedings in court to resolve such issues may extend beyond the expiration of the arbitration statute of limitation period set forth in the arbitration agreement, i.e., beyond the time limit for demanding arbitration. If the court in that situation rules in favor of the defendant, finding that the claim is subject to arbitration, the plaintiff will be left without a remedy. That is, plaintiff will not be able to pursue the claim in court because it is subject to the arbitration agreement, but plaintiff will no longer be able to arbitrate the claim because it is too late to demand arbitration under the terms of the arbitration agreement. *See 24 Hour Fitness, Inc. v. Superior Court* (1998) 66 Cal.App.4th 1199, 1215-1216 and fn. 12.

There are many reasons why a plaintiff might file a lawsuit in court, rather than demanding or pursuing arbitration, including the following: (1) the plaintiff may believe the claims are not subject to arbitration because the arbitration agreement is unenforceable on grounds of unconscionability or similar concepts; (2) there may be a dispute about whether the particular claims at issue do or do not fall within the scope of an arbitration agreement; (3) the plaintiff may contend that one or more of the statutory grounds for denying a petition to compel arbitration set forth in Code of Civil Procedure section 1281.2 exist, assuming the defendant does

file a petition to compel arbitration in response to the plaintiff's filing of the lawsuit;\* (4) the plaintiff may prefer a court trial or jury trial and simply be hopeful that the defendant will not assert any right to arbitrate the claims, for whatever reason; and (5) the plaintiff might not even be aware that there is an arbitration agreement governing the controversy.

If a party wishes to challenge enforceability of an arbitration agreement, disputes that the claims at issue are governed by an arbitration agreement, or claims for some other reason that the controversy is properly pursued in court, the proposed statutory amendment would permit the party to go directly to court for a determination, without risking the loss of the claims entirely by lapse of time while the court decides the issue, in the event the court ultimately determines that the claims *are* governed by an enforceable arbitration agreement and must be arbitrated.

To avoid the potential problem under existing law, some plaintiffs demand arbitration at the same time they bring suit, to preserve both the contractual arbitration limitations period and the statutory lawsuit limitations period. As discussed above, filing the lawsuit will not, by itself, satisfy the contractual arbitration statute of limitations. In addition, initiating the arbitration will not, by itself, satisfy the various statutory lawsuit limitations periods, which govern the time within which an "action" must be "commenced," and apply to proceedings in court. *See* Code Civ. Proc. § 312 ("Civil actions, without exception, can only be commenced within the periods prescribed in this title, after the cause of action shall have accrued . . . "); Code Civ. Proc. § 22 ("An action is an ordinary proceeding in a court of justice by which one party prosecutes another for the declaration, enforcement, or protection of a right, the redress or prevention of a wrong, or the punishment of a public offense"); Code Civ. Proc. § 411.10 ("A civil action is commenced by filing a complaint with the court.")

For a plaintiff in the two-proceeding situation to make a demand for arbitration might be unfairly problematic for plaintiff, because it might be interpreted to contradict or detract from plaintiff's position that the claim is not subject to arbitration. Moreover, even if that two-proceeding strategy is used under existing law, and the court ultimately determines, *after* the statute of limitations period set forth in the arbitration agreement has expired, that the dispute must be arbitrated, there is no clear answer in the law on whether plaintiff would thereafter be barred from pursuing arbitration because plaintiff did not pursue the arbitration diligently after demanding it, and the answer may vary, depending upon the particular contractual language at issue. The proposed statute would avoid the need for a party to initiate duplicate proceedings on the same claims, which is inefficient and more costly, and would assure that plaintiff would not be barred from arbitration on the grounds that the contractual arbitration statute of limitations has run. The proposed statute would also provide protection in cases where the plaintiff is not aware

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\* Code of Civil Procedure section 1281.2 provides, in part, that on petition of a party seeking to compel arbitration, the court shall order arbitration of the controversy if it determines that an agreement to arbitrate the controversy exists, unless it determines that "(a) The right to compel arbitration has been waived by the petitioner; or (b) Grounds exist for the revocation of the agreement. (c) A party to the arbitration agreement is also a party to a pending court action or special proceeding with a third party, arising out of the same transaction or series of related transactions and there is a possibility of conflicting rulings on a common issue of law or fact. . . . If the court determines that there are other issues between the petitioner and the respondent which are not subject to arbitration and which are the subject of a pending action or special proceeding between the petitioner and the respondent and that a determination of such issues may make the arbitration unnecessary, the court may delay its order to arbitrate until the determination of such other issues or until such earlier time as the court specifies."

that there is an arbitration agreement governing the controversy, and therefore files a lawsuit in court only.

The proposed legislation is limited in scope. It is *not* intended to extend the period of time within which the plaintiff must assert his or her claims, but relates only to the forum in which those claims could be asserted, i.e., in court as opposed to an arbitration proceeding. Under the proposed statute, the plaintiff would still need to assert the claims within the *contractual* arbitration statute of limitations period in order for that period to be tolled. The difference made in the statute is that the plaintiff could do so by demanding arbitration *or* by initiating a lawsuit.

This proposed legislation is not intended to have a bearing on the substantive issue of whether a party would ultimately succeed in keeping the case in court or compelling arbitration, but simply deals with the *timing* on the demand for arbitration.

This proposal is only intended to provide assurance on the running of the statute of limitations, and is *not* intended to alter the law governing other consequences that may flow from a party's decision to file and otherwise pursue a claim in court as opposed to initiating arbitration, such as the possible waiver or forfeiture of contractual arbitration rights that may arise as a result of the plaintiff's conduct. Those questions would continue to be governed by the law that has developed in that area. *See, e.g., Saint Agnes Medical Center v. PacifiCare of California* (2003) 31 Cal. 4th 1187 (discussing legal issues relating to repudiation, waiver, and other consequences that participating in litigation may have on the right to arbitrate); *Omar v. Ralphs Grocery Co.* (2004) 118 Cal.App.4th 955, 961-965 (discussing whether it is proper for the court rather than the arbitrator to determine the issue of waiver, and the legal significance of litigation conduct as opposed to non-litigation conduct).

### **ILLUSTRATIONS:**

The case of *24 Hour Fitness, Inc. v. Superior Court* (1998) 66 Cal.App.4th 1199 does not deal with the exact situation addressed by the proposed legislation, but does have illustrative value. In that case, the plaintiff alleged she was constructively discharged from her employment. Her written arbitration agreement with her employer provided that “[t]o start the arbitration process, either party must submit a written arbitration request to the other, within one (1) year of the date the dispute first arose or within one (1) year of the termination of your employment, whichever occurs first. . . .” *Id.* at 1205. The plaintiff did not initiate arbitration within one year, and instead filed a lawsuit. In a letter sent to defendant's counsel after filing the lawsuit, plaintiff's attorney “expressly repudiated the arbitration agreement” [stating] ‘plaintiffs [*sic*] are knowingly waiving their right to arbitrate, and are not reversing their positions.’” *Id.* at 1206.

The Court of Appeal held that the parties' dispute was subject to their arbitration agreement and that summary judgment should have been granted in favor of defendants. In so ruling, the court noted: “We recognize the result of our decision here is that [plaintiff] has no avenue for recourse against [defendants]. This consequence flows from her decision to repudiate the arbitration agreement.” *Id.* at 1216, fn. 12.

*24 Hour Fitness* illustrates how it is possible for a plaintiff to be left without a remedy, but differs from the situation contemplated by the proposed legislation, which does not contemplate an express repudiation of the right to arbitrate. Instead, the proposed legislation contemplates preservation of the right to arbitrate by a party in the event the court ultimately finds that the party's claims are, in fact, governed by an arbitration agreement.

### **DOCUMENTATION:**

The ADR Committee is not aware of any documentary evidence (e.g., studies, reports, or statistics) that supports the conclusion that there is a problem.

### **HISTORY:**

The ADR Committee is not aware of any similar bills that have been introduced.

### **PENDING LITIGATION:**

This legislation, if enacted, could conceivably have an impact on *Ynzunza v 24-Hour Fitness USA, Inc.* and *Levine v. 24-Hour Fitness USA, Inc.*, both pending in Orange County Superior Court. Counsel for plaintiffs in these cases is the law firm of the Vice Chair (2003-2004)/Chair (2004-2005) of the ADR Committee. There may be other similar cases. In theory, any case could be affected in which a party challenges arbitrability, and a final decision in favor of arbitrability occurs after the time limit to demand or initiate arbitration has passed.

### **LIKELY SUPPORT & OPPOSITION:**

The plaintiffs' bar may support the proposed legislation because it would prevent the potential loss of claims. In cases where plaintiff is aware that the controversy may be governed by an arbitration agreement, the proposal would avoid the need to initiate duplicate proceedings in arbitration and in court in order to preserve the statute of limitations. The proposed statute would also preserve the statute of limitations in cases where the plaintiff is not aware that an arbitration agreement governing the controversy exists.

The defense bar may oppose the proposed legislation, arguing that contractual language in arbitration agreements should be applied as a strict matter of contract, and that a party should be required to initiate arbitration within a certain period of time, if that is what the contract says. The proposed statute would provide an opportunity for a plaintiff to initiate proceedings in a different forum (the court) to determine that the claims are not subject to an arbitration agreement. Defense counsel may contend that a plaintiff should be bound by whatever consequences may flow from the filing of an action in court, even if that results in a plaintiff's claims being barred by the statute of limitations. Defense counsel may also argue that arbitration should be encouraged and not delayed – a possible result of the proposed statute – although it is unusual for a plaintiff to wish to delay resolution of the plaintiff's claims.

A more neutral argument that might be made in support of the proposed statute is the proposed statute would have no bearing on whether a plaintiff or any party would ultimately

succeed in keeping the case in court – it is not intended to have any bearing on the substance of the court's decision on a motion to compel arbitration – but would simply toll the time to demand arbitration. Even under current law, a plaintiff could file a lawsuit in court based on a claim that is or might be subject to an arbitration clause, subject to any defenses or arguments the defendant may assert relating to the arbitration clause. A party should not be put to choice of either accepting an arbitration agreement that is of questionable enforceability or applicability, or risk losing the claim entirely by initiating a lawsuit in court. This would apply to any party, not just a plaintiff (e.g., a defendant asserting a cross-complaint, or possibly a party against whom arbitration has been demanded but who wishes to challenge arbitrability in court but not lose all rights to assert cross-claims the party may have).

**FISCAL IMPACT:**

None expected.

**GERMANENESS:**

The proposed legislation would preserve access to courts, access to arbitration, and access to justice. Parties to arbitration clauses would be able to have access to judicial review of arbitration clauses, without risk of losing the claim because of a contractual statute of limitations provision. The proposed legislation would preserve access in cases where the plaintiff is not aware that there is an arbitration agreement governing the controversy. The proposed legislation would preserve access to justice through arbitration in the event the court finds that the claims in question are subject to the arbitration agreement. The problem is a technical one, which may not be readily recognized by persons other than lawyers familiar with litigation and the law of arbitration.

**TEXT OF PROPOSAL:**

Section 1281.12 is added to the Code of Civil Procedure, to read:

“1281.12. If an arbitration agreement requires that arbitration of a controversy be demanded or initiated by a party to the arbitration agreement within a period of time, the commencement of a civil action by that party based upon that controversy, within that period of time, shall toll the applicable time limitations contained in the arbitration agreement with respect to that controversy, from the date the civil action is commenced until 30 days after a final determination by the court that the party is required to arbitrate the controversy, or 30 days after the final termination of the civil action that was commenced and initiated the tolling, whichever date occurs first.”