

The Resource

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Arbitration: Have You Thought About the Consequences? Statutes of Limitation and Arbitration: The Antagonistic Interplay

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Introduction

All states have statutes of limitations that require lawsuits be brought within a certain period of time. They purportedly are instituted to address and redress certain instances of perceived unfairness in defending actions after a substantial period of time has elapsed. The general consensus is that the passage of time causes memories to fade, documents to be lost, and serves as a modality of injustice without adequate reason for delay. In short, the law favors stability. But, do statutes of limitations apply in arbitration proceedings?

Arbitration, Not Such an Attractive Alternative?

Arbitration arises out of an agreement between two, or conceivably more, parties in an effort to resolve mutual differences in a more informal and efficient manner. Its purpose is to facilitate the prompt settlement of claims with dispatch and efficiency. Simply stated, arbitration attempts to avoid the formality, expense, and delay usually associated with a trial. In so doing, litigants substitute one form of tribunal, a district or superior court, with a tribunal of their choosing, a neutral arbitrator.

Assume for purposes of this article that an arbitration agreement was entered into which included a provision that each party preserves all rights and remedies in law or in equity in this arbitration proceeding. Assume further that a defense to the claim arbitrated was the statute of limitations. A logical conclusion, therefore, may be that the contractual preservation of rights and remedies within the arbitration proceeding entitles the defendant to assert that the plaintiff's claim falls outside the applicable statute of limitations, and, accordingly, the arbitrator, if finding sufficient factual support, would render an appropriate award in favor of the defendant. There is a possibility, however, that the arbitrator rules the defense could not be raised in the arbitration proceeding. The arbitrator's support: the North Carolina statute pertaining to statutes of limitations refers to an "action," of which arbitration is not, and, as such, the defense does not apply in an arbitration proceeding. That's right, arbitration is not an action as defined by North Carolina statute to which a defense of the statute of limitations is applicable. As such, the defendant's reservation of all rights and remedies in law or in equity in this arbitration proceeding is essentially useless, an effort to settle a dispute in an efficient and cheap manner is thwarted, and the seeming fundamental philosophy underlying arbitration is maligned.

The defendant is left with few avenues of recourse: either petition the court in an attempt to set aside the ruling of the arbitrator as being outside the confines of the arbitration agreement, or abide by the ruling of the arbitrator and attempt to defend the action without an essential defense. Either course is less than desirable, fraught with issues, and either course is conceivably not in keeping with your client's intentions in agreeing to arbitration initially, e.g., a quick and legally

proper resolution to this controversy without the need of a lengthy court proceeding. With this context in mind, and in order to fully understand the rationale and implications of this scenario, it proves beneficial to understand the differing interpretations of “action.”

Arbitration is not a Legal Action?

In deciding whether a particular statute of limitations applies, the fundamental assumption is that one has an “action” to attribute to that particular statute of limitations. That is because North Carolina provides that “[t]he periods prescribed for the commencement of actions, other than for the recovery of real property, are as set forth in this Article.” G.S. § 1-46. Thus, this assumption begs the elementary question of what constitutes an action for which a statute of limitations can apply.

North Carolina General Statute Section 1-2 defines “action” as “an ordinary proceeding in a court of justice, by which a party prosecutes another party for the enforcement or protection of a right, the redress or prevention of a wrong, or the punishment or prevention of a public offense.” G.S. § 1-2 (emphasis added). Other statutes in North Carolina, similarly, link an “action” to a “judicial proceeding.” See G.S. §§ 25-1-201(1), 25-2-725; In re: Cameron, 91 N.C. App. 164, 370 S.E.2d 704 (1988). Black’s Law Dictionary, moreover, defines action as “a criminal or civil judicial proceeding.” And “judicial proceeding” is defined by Black’s Law Dictionary as “any court proceeding.”

This conceptual framework is seemingly consistent with pronouncements from other state courts. For instance, in *Har-Mar Incorporated v. Thorsen & Thorshov, Inc.*, 218 N.W.2d 751 (Minn. 1974), a developer sued to enjoin an arbitration proceeding instituted by an architectural firm based upon the fact that the dispute was barred by the applicable statute of limitations. In determining whether to apply the statute of limitations to the dispute, the Minnesota Supreme Court stated that:

Based upon the special nature of arbitration proceedings and both the statutory and common-law meaning of the term “action,” we feel compelled to hold that [the statute of limitations] was not intended to bar arbitration of [the] . . . dispute solely because such claim would be barred if asserted in an action in court.

Id. at 755. Similarly, the court in *Son Shipping Co. v. De Fossee & Tanghe*, 199 F.2d 687 (2d Cir. 1952), held that the statute of limitations did not bar arbitration “because arbitration is not within the term ‘suit’ as used in that statute. Instead, it is the performance of a contract providing for the resolution of controversy without suit.” Id. at 689.

In these aforementioned contexts arbitration is, consistent with the ruling of the fictitious arbitrator, an extra-judicial proceeding rooted in contract and devoid of the obligations, rules and regulations which are attributed to proceedings in courts of law.

Is Arbitration that Attractive – What are the Implications?

Back to our fictitious arbitrator – he has ruled, based upon the above analysis, that an arbitration proceeding is not an action under North Carolina law in which an applicable statute of limitations defense could be maintained. This ruling and its potential implications should be seen as terribly troubling for counsel. The implications of this ruling, for instance, could extend to any

affirmative defense in North Carolina which may be asserted in an “action.” And in so doing, this ruling has seemingly undermined the traditional notion of arbitration. That is, if one defines arbitration as the honoring of a contractual agreement to resolve a mutual dispute, then how does one reconcile this definition with the ability of an arbitrator to unilaterally prevent a party from asserting rights specifically reserved under the contract which he agreed to enforce? The rub is this: if an arbitrator is chosen to decide the legal consequences of a transaction, then should not the arbitrator utilize all applicable rules that our legislative system has promulgated as applicable to the transaction. If not, is the arbitrator not acting as his own legislature in adopting which rules he sees fit to apply, and his own judiciary in applying the rules he has decided are applicable?

This predicament has potential broad reaching implications. As various sister states have ruled above, arbitration does not impute the preservation of all legal defenses available to a defendant, even when such defenses were purportedly specifically preserved. It raises the stakes for corporate defendants in entering into contracts with an arbitration provision. Does a corporation want the pros of arbitration, e.g., efficient resolution, when the cons, e.g., abrogation of substantive rights, may hamper its attempt at an efficient resolution? We suggest that counsel give great scrutiny to the mandatory arbitration provisions which are contained in many contracts, for such a provision may, in the end, serve as an impediment to assertion of a substantive defense.

The answer to the predicament raised herein may be that counsel include language in the arbitration agreement specifically adopting the applicable state statute of limitation, or set out a contractual statute of limitation for enforcing the contract at issue. Counsel, however, must also be cognizant of other defenses which apply to “actions” and which also must be specifically delineated in the contract and arbitration provision, lest their failure to be specifically included may lead to their inapplicability in the arbitration.

Conclusion

Alternative dispute resolution has become steadily more desirable in our legal system. It is a means to help alleviate the increasing burden that our judicial system faces. If arbitrators fail to honor the rights and remedies that a litigant would be entitled to in a court of law and/or equity, however, the desirability of arbitration may substantially diminish. It is incumbent upon arbitrators to consider all rights and remedies that a litigant may have in a court. Without such perspective, arbitration becomes a means of piecemeal resolution based upon technical distinctions in the law and without resort to the rights of litigants as promulgated by the legislature. It is also incumbent upon counsel to consider the issues presented here when entering into their next contract with an arbitration provision.

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