# U.S. Court of Appeals Illustrates Obsolescence of Law that Allows Court to Consider Timeliness Challenge to Arbitrable Claim

**Kluwer Arbitration Blog**
July 7, 2011

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*Please refer to this post as: Gary Born, 'U.S. Court of Appeals Illustrates Obsolescence of Law that Allows Court to Consider Timeliness Challenge to Arbitrable Claim', Kluwer Arbitration Blog, July 7 2011,*
*http://arbitrationblog.kluwerarbitration.com/2011/07/07/u-s-court-of-appeals-illustrates-obsolescence-of-law-that-allows-court-to-consider-timeliness-challenge-to-arbitrable-claim/*

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On March 22, the United States Court of Appeals for the Second Circuit held in *Bechtel do Brasil Construções Ltda. v. UEG Araucária Ltda.*, 638 F.3d 150, that the question whether a claim subject to arbitration was time-barred was for the arbitrator, not the district court, to decide, notwithstanding a New York state law that permits an arbitral party to assert a limitations defense in court. Above all, the *Bechtel* decision illustrates the obsolescence of laws like this New York provision, whose usefulness is highly questionable and whose application is effectively limited to situations where it is unnecessary in the first place.

In 2000, UEG Araucária, a Brazilian energy company, entered into a series of agreements with several Bechtel entities for the engineering and construction of a $210 million power plant in Araucária, Brazil. Three of the contracts contained identical arbitration and choice of law clauses. The arbitration clause provided that "[a]ny dispute, controversy, or claim arising out of or relating to the Contract, or the breach, termination or validity thereof . . . shall be finally settled by arbitration" under the ICC rules, "except as these rules may be modified herein." Each of the contracts also had multiple New York choice-of-law clauses, one of which provided that "[t]he law governing the procedure and administration of any arbitration instituted pursuant to [the arbitration clause] is the law of the State of New York."

In January 2008, the power plant's steam-turbine generator failed. That September, UEG Araucária submitted a Request for Arbitration to the ICC, claiming breach of contract, negligence, and fraud by Bechtel.

Bechtel responded by filing an action in the New York state court seeking to stay the arbitration and dismiss the claims, claiming that UEG Araucária's claims were time-barred under New York and Brazilian law. Notwithstanding the arbitration agreement between the parties, as a basis for the state court's jurisdiction, Bechtel cited section 7502(b) of the New York Civil Practice Law and Rules, which states:

"If, at the time that a demand for arbitration was made or notice of intention to arbitrate was served, the claim sought to be arbitrated would have been barred by limitation of time had it been asserted in

a court of the state, a party may assert the limitation as a bar to the arbitration on an application to the court."

UEG Araucária removed the action to federal district court and filed a counter-application to compel arbitration of the timeliness question. The district court denied UEG Araucária's motion to compel, finding that the contracts between UEG Araucária and Bechtel evidenced "the parties' clear intent to select New York law for arbitration procedure . . . including the rule limiting the power of arbitrators to hear preliminary questions of timeliness." The district court found the claims were indeed time-barred and granted Bechtel's request for a permanent stay of the arbitration.

UEG Araucária appealed the ruling to the Second Circuit, which reversed the district court's decision while acknowledging that "the question is a close one." The court said its task was "to divine whether the parties intended at the time of contracting to have issues of timeliness determined by the arbitrator." Its analysis would also be informed by the requirement under the Federal Arbitration Act to "construe the parties' intentions 'generously' in favor of arbitrability."

The appellate court acknowledged an apparent tension between the arbitration clause and the choice-of-law clauses in the contracts between the parties. The arbitration provision "tends to support the view that any disagreements about the contract—which would include disputes about whether a relevant statute of limitations bars arbitration, as well as disputes about who should decide the statute of limitations issues—shall be decided by arbitration." However, the choice-of-law provisions "cut the other way, suggesting that, because, under New York law, a party can assert a statute of limitations in court as a bar to arbitration, . . . a party is permitted to have a court decide timeliness issues."

The panel concluded that "the contracts in this case are at least ambiguous as to whether Bechtel and UEGA agreed to permit recourse to C.P.L.R. 7502(b)." As opposed to the broad arbitration clause, the choice-of-law provisions "make no mention of timeliness disputes or of any right of the parties to resort to the courts in any circumstances." Moreover, as the U.S. Supreme Court recognized in *Mastrobuono v. Shearson Lehman Hutton, Inc.*, "general choice-of-law clauses . . . may be read to address only 'substantive rights and obligations, and not the State's allocation of power between alternative tribunals.'" The court concluded that the contracts between UEG Araucária and Bechtel evidenced "no clear statement that a statute of limitations defense should be withheld from the arbitrator." Lacking such clear intent, the panel resolved the ambiguity in favor of arbitration, and held that the arbitrator, not the district court, should decide the timeliness issue.

The *Bechtel* decision illustrates how laws like New York's C.P.L.R. 7502(b), which carve out a particular role for courts in otherwise arbitrable disputes, are of very limited use given the capabilities of arbitrators and the expansive pro-arbitration reach of the FAA. In purporting to provide for an initial judicial role in arbitrable disputes, New York's § 7502(b) is reminiscent of a former provision in the English Arbitration Act that allowed a claimant that had entered into an arbitration agreement to nonetheless obtain summary judgment *in court* before the matter was referred to arbitration. That provision, which created an unnecessary judicial barrier to resolution of claims through arbitration, was sensibly deleted in the 1996 revision of the Act. Likewise, it is unclear why a law like § 7502(b) should carve out the particular question of timeliness for a court to review, when a claim as a whole is subject to arbitration. Arbitrators are no less capable of addressing whether a claim is time-barred than they are of resolving any other legal issue.

Moreover, under the FAA as interpreted by the Second Circuit, the applicability of § 7502(b) is so narrow as to render it virtually meaningless. If any choice-of-law provision would seem to allow for application of § 7502(b), the one between Bechtel and UEG Araucária would be it: the agreements provided that New York law would govern not only the parties' substantive legal rights, but also "the

procedure and administration of any arbitration" between the parties. But the court still found that because there was no clear statement that a court should be able to resolve the timeliness issue in particular, the issue was for only the arbitrator to decide.

The *Bechtel* panel's reasoning thus raises the question of what, exactly, is left for laws like § 7502(b) to do if even choice-of-law provisions that apply to the arbitral process itself do not allow for resort to them. According to the Second Circuit, for § 7502(b) to apply, the contracts would have had to provide expressly that a court could resolve a limitations question. However, if a contract had such an explicit provision, then § 7502(b) likely would not be necessary at all. After all, even if § 7502(b) did not exist, parties could still draft contractual language that generally provides for arbitration of disputes, but expressly allows a court to resolve any timeliness questions. If parties to an otherwise broad arbitration agreement really want to allow a court to resolve limitations questions, nothing is stopping them from writing that into the agreement without reference to § 7502(b). Thus, laws like § 7502(b) add little; *Bechtel*'s narrow construal of when § 7502(b) applies effectively limits its application to instances where its existence is unnecessary. This is probably just as well, as any broader application of such a provision might well run afoul of the FAA (although New York state courts have held in the past that § 7502(b) is not facially preempted by the FAA).

More broadly, the *Bechtel* decision implicates the question whether certain aspects of an arbitration agreement can broaden the judicial role in a dispute. The Second Circuit's assessment of whether § 7502(b) applied in the dispute between UEG Araucária and Bechtel is something of a mirror image to the question before the U.S. Supreme Court in its 2008 decision in *Hall Street Associates, L.L.C. v. Mattel, Inc.* In *Hall Street*, the Court addressed whether parties can agree to expand the scope of *post*-award judicial review beyond that expressly permitted by the FAA (the answer was no); *Bechtel* addressed whether a court may adjudicate certain aspects of a claim *before* the arbitration commences if the governing law of the arbitration agreement provides for it. In both instances, the courts limited the scope of the judicial role considerably, although not to the same degree. Unlike in *Hall Street*, the *Bechtel* panel found that parties *could*, theoretically, agree to have a court adjudicate part of a claim before it is referred to arbitration. This is because federal law does not restrict pre-award adjudications by courts where the underlying arbitral agreements allow for it – unlike the way the FAA, under *Hall Street*, does confine the bases on which courts may review final arbitral awards, even if the governing arbitration expressly purports to expand such grounds.

*Bechtel* illustrates that, although the scope of pre-award adjudication is not nonexistent, it is very narrow and requires clear intent by the parties. As *Bechtel* confirmed, a law like § 7502(b) is only applicable where it is expressly invoked in an agreement; it otherwise is not enforceable as a default rule under a particular governing law. Parties that do want to allow for the possibility of judicial involvement in certain aspects of disputes otherwise subject to arbitration would be well advised to make their particular intentions extremely clear in their agreements.

Finally, the *Bechtel* panel's rejection of the application of § 7502(b) could also cause certain observers to sigh with relief. Because of New York's economic importance and its well developed commercial law, a New York choice-of-law clause is a very common feature of international commercial agreements. When parties draft agreements that contain both New York choice-of-law clauses and arbitration clauses, it is unlikely that they are cognizant of § 7502(b) in particular. It is even less likely that many of them expect and want to supplant the arbitrator's jurisdiction if timeliness issues ever come up in a dispute between the parties. A contrary ruling in *Bechtel* might have caused corporate contract drafters to think twice before reflexively choosing New York's as the governing law of the contract. Thus, the *Bechtel* panel, in rendering a particular provision of New York law virtually nugatory, might ironically have been doing a favor to New York law more generally.

By Gary Born and Adam Raviv