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The Supreme Court Hears Argument on Whether Courts or Arbitrators Should Decide if a Precondition to Arbitration Has Been Satisfied in the Context of Investment Treaty Arbitrations

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The Supreme Court heard oral argument yesterday in *BG Group PLC v. Republic of Argentina*, a case in which the Court will address the question of “who” — a court or an arbitrator — should decide whether a precondition to arbitration has been satisfied in disputes involving a multi-staged dispute resolution process. The case is significant because it represents the first time that the Court will consider this issue in the context of an investor-state arbitration under a bilateral investment treaty — one of thousands of such treaties entered into in recent decades between states, which seek to promote foreign direct investment by conferring protections on investments and providing for arbitration of claims brought by investors of one state against the other state.

BACKGROUND AND ARBITRAL AWARD

Under the Federal Arbitration Act, 9 U.S.C. § 10(a), federal courts have the authority to vacate arbitral awards “where the arbitrators exceed[] their powers.” This provision encompasses situations where — as Argentina asserts is the case here — the arbitral tribunal lacked jurisdiction to hear a dispute.

Argentina challenges an arbitration award rendered by a tribunal constituted under the Arbitration Rules of the United Nations Commission on International Trade Law (UNCITRAL) pursuant to the terms of the bilateral investment treaty between the United Kingdom and Argentina (“Treaty”). The tribunal issued an award in favor of BG Group, a British company that had acquired a large stake in MetroGAS — an entity spun off during the privatization of Argentina’s natural gas sector in the early 1990s.

Argentina took several measures in response to its economic crisis of 1999–2002, including enacting legislation and promulgating decrees that renounced the existing one peso-to-one dollar fixed exchange rate, converted BG Group’s dollar-based gas tariffs into peso-based tariffs at the rate of one-to-one, and established a process for contract renegotiation, which excluded from that process any licensee who sought relief through either the courts or arbitration.

Article 8(1) of the Treaty provides that any “[d]isputes with regard to an investment which arise within the terms of this Agreement between an investor of one

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Contracting Party and the other Contracting Party . . . shall be submitted, at the request of one of the Parties to the dispute, to the decision of the competent tribunal of the Contracting Party in whose territory the investment was made" – in this case, Argentina. Article 8(2) further specifies that such "disputes shall be submitted to international arbitration . . . (a) if one of the parties so requests . . . (i) where, after a period of eighteen months has elapsed from the moment when the dispute was submitted to the competent tribunal of the Contracting Party in whose territory the investment was made, the said tribunal has not given its final decision; (ii) where the final decision of the aforementioned tribunal has been made but the Parties are still in dispute; (b) where the Contracting Party and the investor of the other Contracting Party have so agreed."

BG Group filed a notice of arbitration in 2003 without bringing a court action in Argentina. Following arbitration proceedings in the United States, the arbitral tribunal issued its final award in 2007. It determined that it had jurisdiction to hear the dispute based on the UNCITRAL Arbitration Rules. The arbitral tribunal found that Argentina's measures hindering recourse to domestic courts and excluding from contract renegotiations any licensees who brought grievances to court would have made it "absurd and unreasonable" to enforce the eighteen-month clause requiring litigation in an Argentine court. Finding against Argentina on the merits of the dispute, the arbitral tribunal awarded BG Group \$185 million in damages.

DECISIONS OF THE LOWER COURTS

The U.S. District Court for the D.C. District reviewed the arbitral tribunal's decision to assume jurisdiction deferentially, holding that it was "without authority to disturb the panel's conclusions" because the latter relied upon a "colorable, if not reasonable" interpretation of the Treaty and international law.

In 2012, a unanimous panel of the D.C. Circuit reversed the district court's decision and vacated the award. It stated that "[t]he 'gateway' question in this appeal is arbitrability: when the United Kingdom and Argentina executed the Treaty, did they, as contracting parties, intend that an investor under the Treaty could seek arbitration without first fulfilling Article 8(1)'s requirement that recourse initially be sought in a court of the contracting party where the investment was made? That question raises the antecedent question of whether the contracting parties intended the answer to be provided by a court or an arbitrator."

In addressing this threshold question, the D.C. Circuit looked to *First Options of Chicago, Inc. v. Kaplan*, in which the Supreme Court held that, for such a question of arbitrability to be referred to an arbitrator, there must be "clear and unmistakable evidence" of the parties' intent to this effect. Under *First Options*, if clear and unmistakable evidence exists, the arbitral tribunal's determination of arbitrability is entitled to "considerable leeway"; where the parties did not agree to submit the arbitrability question to arbitration, courts should decide that question independently.

The D.C. Circuit acknowledged that the applicable UNCITRAL Arbitration Rules grant arbitrators authority to rule on their own jurisdiction. Nonetheless, the Court found that the Treaty's incorporation of the Rules has a temporal limitation, namely that the Rules were not "triggered" until BG Group had first complied with the Treaty requirement to litigate for eighteen months in an Argentine court. The D.C. Circuit held that, because going to court is "a precondition to arbitration of an investor's claim" and "the Treaty is silent on who decides arbitrability when that precondition is disregarded," "the question of arbitrability is an independent question of law for the court to decide."

Accordingly, the D.C. Circuit found that the district court—by failing to determine whether the requisite intent existed in circumstances where the Treaty's litigation condition had not been satisfied—had erred as a matter of law.

THE PARTIES' ARGUMENTS

BG Group seeks reversal of the D.C. Circuit's decision and enforcement of the arbitral award, asserting that the same standard of review applies to arbitral awards issued under a bilateral investment treaty as to those rendered under a commercial contract. BG Group argues that the Treaty's exhaustion of local remedies requirement represents a procedural precondition, which is not the type of "gateway matter [that] present[s] a 'question of arbitrability' triggering the presumption of judicial determination." In *Howsam v. Dean Witter Reynolds, Inc.*, the Supreme Court ruled that the phrase "question of arbitrability" used in *First Options* is not applicable to "any potentially dispositive gateway question." Instead, it "has a far more limited scope" and is "applicable in the kind of narrow circumstance where contracting parties would likely have expected a court to have decided the gateway matter." This "narrow circumstance" includes "issues of substantive arbitrability," whereas "issues of procedural arbitrability, i.e., whether prerequisites such as time limits, notice, laches, estoppel, and other conditions precedent to an obligation to arbitrate have been met, are for the arbitrators to decide."

BG Group maintains that the parties clearly and unmistakably consented to arbitration under the Treaty pursuant to which final authority to settle disputes between investors and states rests solely with arbitrators—not courts. Article 8(2) enables any party dissatisfied with a court's judgment (or inaction) to seek further relief in arbitration. As BG Group explains, "[i]n resolving the dispute, the arbitral tribunal is not directed to defer to, let alone give effect to, any judgment of the local court. Nor may the local court review the arbitrators' decision. Instead, the 'arbitration decision shall be final and binding on both Parties.'" "Moreover," writes BG Group, "by expressly agreeing that the decisions of the arbitrators would be 'final and binding,' the parties eliminated any lingering doubts as to the effect of the incorporation of the UNCITRAL rules. Not only did the arbitrators get the first bite at the apple, they were intended to have the only bite."

Argentina advocates that the D.C. Circuit's decision be affirmed. Argentina contends that the exhaustion of local remedies requirement was a precondition to its very consent to arbitrate and that the arbitral tribunal lacked jurisdiction because no agreement to arbitrate was ever formed: having failed to comply with the Treaty's litigation requirement, "BG [Group] at best made a counter-offer [to arbitrate], which Argentina rejected." Argentina seeks affirmance of the D.C. Circuit's conclusion that the UNCITRAL Rules were not triggered until after the litigation requirement was satisfied. Accordingly, under *First Options*, *de novo* review by the district court and vacatur of the arbitral award would have been appropriate. In Argentina's view, this outcome is consistent not only with the practice of the United States and other states in investor-state disputes, but also with background principles regarding arbitrators' presumptive but not final power to determine their own jurisdiction ("competence-competence").

The Solicitor General's *amicus* brief takes a different approach, recommending vacatur and remand for further consideration in light of the principles governing treaty interpretation. The Solicitor General distinguishes the situation before the Court from the circumstances of prior cases, all of which involved private, commercial arbitration not

involving States. "An investment treaty typically sets forth a state's standing offer to arbitrate certain categories of disputes with covered investors, and it generally permits investors a choice of multiple arbitral rules . . . which preclude judicial review. As a result, while treaty parties generally contemplate, consistent with the UNCITRAL or applicable arbitral rules, that the arbitral tribunal will adjudicate objections to arbitration in the first instance, they do not usually have a specific agreement, in the *First Options* sense, as to whether the arbitral tribunal or any reviewing court has authority to finally resolve such disputes across the board. Applying the *First Options* and *Howsam* presumptions wholesale to investment treaties would graft onto those treaties default provisions that the treaty parties did not anticipate." "It is therefore appropriate to review independently," or *de novo*, "an arbitral tribunal's ruling on a party's threshold objection that no arbitration agreement exists." The Solicitor General notes, however, that "[c]ourts should deferentially review rulings on other threshold objections that do not call into question the existence of an investor-state arbitration agreement, including those often referred to in international arbitration as 'jurisdictional' objections, unless the treaty provides that the arbitral tribunal's authority to rule on such matters is limited."

HIGHLIGHTS FROM THE ORAL ARGUMENT

The Court's questioning during the oral argument focused on two related questions, namely, whether the Treaty's litigation requirement constitutes a precondition to Argentina's "consent" to arbitrate, such that a judge and not an arbitrator would decide the issue, and whether *First Options* and *Howsam* principles should apply in the case of a dispute under a bilateral investment treaty.

Several Justices raised the question of whether the litigation requirement is a condition on Argentina's consent to arbitrate a dispute. BG Group responded that the local litigation provision amounts to a requirement to "go wait in the Argentine courts" and cannot determine Argentina's consent to arbitration. Chief Justice Roberts asked if the structure of the Treaty—and, in particular, the fact that Article 8(1) says nothing about arbitration, but refers disputes "to the decision of" the Argentine courts—was problematic to BG Group's position. BG Group contended that "there is consent to arbitration when [as here] the investor is guaranteed that their claim can ultimately be decided by [an arbitrator] . . . and the State can't force it to ultimately be decided by a court." BG Group argued that "[n]o one would ever agree to these treaties if they didn't know that the decisionmaker would be the neutral, expert arbitrators . . ." Argentina, however, argued that "the clear language of the text and the implications to be drawn from it clearly show that the sovereign is not willing to arbitrate absent the 18-months' recourse to its courts," and the Court "should view that as a condition precedent to a unilateral contract that must be accepted by action. And the action is to bring this suit in the local court and wait 18 months."

A number of Justices expressed difficulty in understanding where Argentina wanted to draw the line between procedural prerequisites and conditions on consent to arbitrate. Chief Justice Roberts asked counsel for Argentina, "[i]t all gets down to the question, how do we tell . . . the contract formation from the blue paper, right? [I]f it says, you know, we agree to arbitrate and [the] rules say you have to have it on blue paper and it's not on blue paper, they say, oh, we didn't agree to have it not on blue paper. How do we distinguish between those two scenarios?"

Similarly, in response to the Assistant Solicitor General's argument that states in investment treaties agree to "conditions on consent that limit the terms on which the

state may be subject to arbitration," several Justices inquired about how to determine what does and does not constitute a consent-based objection to arbitration. Justice Kagan stated that she "would be more open about [the Solicitor General's position] if [it] had at least suggested how we should go about deciding that question[.]" Justice Breyer expressed concern that, even with "something that is as purely procedural as I can imagine," "under [the Solicitor General's] rule, you're going to say that the judges decide that and not the arbitrators, and that is what is bothering me about your rule."

The Court inquired whether BG Group could still commence litigation in Argentina, wait eighteen months, and then pursue arbitration. Chief Justice Roberts noted that "[t]here are numerous statutory regimes where Congress has decided, for example, it's valuable to give people a period of time to negotiate or discuss before you can go into . . . court [Y]ou can understand Argentina or any other country saying, look, before we're going to arbitrate . . . try our courts" However, several Justices expressed skepticism about the value of going to an Argentine court in this case. Justice Alito stated that "I don't see what [the litigation requirement] accomplishes. . . . You have a party who doesn't want to litigate . . . in the courts of Argentina. It doesn't think it's going to get a fair shake there. What is the point of requiring this . . . if it's not very important, if it isn't going to achieve anything, that seems to me to weigh against the conclusion . . . that it is a condition of consent." Argentina responded that, in addition to the possibility of achieving settlement, "you want to have the local court have the first look at construing it, just as you would construe a statute before you reach a constitutional question. The local court can illuminate the dispute . . . by saying what does our law actually mean[.]"

Noting that issues relating to preconditions to arbitration "typically, under *First Options* and *Howsam* [are] for the arbitrator," Chief Justice Roberts asked "what makes it distinct in [this] case . . . is it something special about a sovereign's agreement." Justice Sotomayor inquired "why isn't the *First Options* *Howsam* divide the one that we should follow in this setting?" The Assistant Solicitor General contended that "in the treaty context, the states parties are not agreeing, and they don't have expectations with respect to the allocation of authority between the court and the arbitrator," and that "applying the domestic law presumptions that are set forth in *Howsam* to this type of investor-state arbitration . . . would not be appropriate."

BG Group, however, argued that the applicability of *First Options* and *Howsam* principles should not be in question because Argentina—by participating in an arbitration in the United States—knew that the reviewing court's domestic arbitration law would apply, and that when Argentina "points to decisions [of the courts of other jurisdictions] in which a court reviews *de novo* a jurisdictional ruling of an arbitral tribunal, none of those decisions [is] unique in any way to the fact that it was an international arbitration or an international treaty arbitration."

A decision is expected in this case by June 2014.

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