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# The Supreme Court Holds That Arbitrators Have Authority to Determine the Meaning and Application of a Local Litigation Requirement in a Bilateral Investment Treaty

***March 7, 2014***

This week, in *BG Group PLC v. Republic of Argentina*, the Supreme Court confronted the question of "who"—a court or an arbitrator—should primarily interpret and apply the requirement that a party submit a dispute to a court for a certain period of time before referring that dispute to arbitration. The case is significant because it represents the first time that the Court has decided this issue in the context of an investor-State arbitration under a bilateral investment treaty between States—one of thousands of such treaties entered into in recent decades, 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. In a 7-2 opinion, the Court determined that its previous decisions on "who" should decide this question, which were rendered in the context of ordinary commercial contracts, should apply with equal force to a dispute arising out of a bilateral investment treaty containing an arbitration provision between the United Kingdom and Argentina. In reaching this conclusion, the majority decided that treaties and contracts do not require different treatment because "a treaty is a contract, though between two nations." Applying the presumptions used when interpreting threshold provisions concerning arbitration in ordinary contracts, the majority concluded that the arbitrators properly decided the threshold issue themselves.

## 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 asserted was the case here—an arbitral tribunal lacked jurisdiction to hear a dispute.

Argentina challenged 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.

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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 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.

## LOWER DECISIONS AND SUPREME COURT ARGUMENTS

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.

BG Group sought reversal of the D.C. Circuit's decision and enforcement of the arbitral award, asserting that the same standard of review should apply to arbitral awards issued under a bilateral investment treaty as to those rendered under a commercial contract. BG Group argued 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."

Argentina advocated that the D.C. Circuit's decision be affirmed. Argentina contended 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 sought 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.

## SUMMARY OF THE SUPREME COURT'S DECISION

*"[A] treaty is a contract, though between two nations. Its interpretation normally is, like a contract's interpretation, a matter of determining the parties' intent."*

***– Justice Breyer***

Justice Breyer writing for the majority held that U.S. courts, in reviewing arbitration awards rendered under bilateral investment treaties, should apply the same interpretative framework that the Court has developed for arbitration agreements in ordinary commercial contracts. "As we have said," the Court wrote, "the question before applying Article 8's local court litigation provision . . . . In answering the question, we shall initially treat the document before us as if it were an ordinary contract between private parties. Were that so, we conclude, the matter would be for the arbitrators. We then ask whether the fact the document in question is a treaty makes a critical difference. We conclude that it does not." The majority stated that treaties and contracts should be treated alike because "a treaty is a contract, though between two nations. Its interpretation normally is, like a contract's interpretation, a matter of determining the

parties' intent." Accordingly, the Court determined that the regular "presumptions supplied by American law" should apply.

The Court found that the "text and structure of the [local litigation] provision make clear that it operates as a procedural precondition precedent to arbitration . . . . It determines *when* the contractual duty to arbitrate arises, not *whether* there is a contractual duty to arbitrate at all." Moreover, "Article 8 provides that *only* the 'arbitration decision shall be final and binding on both Parties.' Art. 8(4). The litigation provision is consequently a purely procedural requirement—a claims-processing rule that governs when the arbitration may begin, but not whether it may occur or what its substantive outcome will be on the issues in dispute." Applying the *Howsam* framework to the dispute, the majority concluded that the arbitrators presumptively got to decide the meaning and application of the procedural precondition and their determination was entitled to deferential rather than *de novo* review. Consequently, the Court reversed the D.C. Circuit's judgment and reinstated the district court's affirmance of the arbitral award.

*"The Court begins by deciding a different case, 'initially treat[ing] the document before us as if it were an ordinary contract between private parties.' The 'document before us,' of course, is nothing of the sort. It is instead a treaty between two sovereign nations: the United Kingdom and Argentina. No investor is a party to the agreement."*

***– Chief Justice Roberts, dissenting***

Justice Sotomayor wrote an opinion concurring in part. She wrote separately to clarify that the Court was *not* deciding the effect of treaty language "refer[ring] to 'conditions of consent' explicitly." She wrote that "[i]t is far from clear that a treaty's express use of the term 'consent' to describe a precondition to arbitration should not be conclusive in the analysis" of whether courts or arbitrators get primary interpretative authority. However, because such express language was not present in this case, she agreed that the local litigation provision was only "a procedural precondition to arbitration."

Chief Justice Roberts, joined by Justice Kennedy, dissented. "The Court begins," he wrote, "by deciding a different case, 'initially treat[ing] the document before us as if it were an ordinary contract between private parties.' The 'document before us,' of course, is nothing of the sort. It is instead a treaty between two sovereign nations: the United Kingdom and Argentina. No investor is a party to the agreement . . . . It should come as no surprise that, after starting down the wrong road, the majority ends up at the wrong place."

"The treaty by itself," Chief Justice Roberts stated, "cannot constitute an agreement to arbitrate with an investor. How could it? No investor is a party to the Treaty. Something else must happen to *create* an agreement where there was none before. Article 8(2)(a) makes clear what that something is: An investor must submit his dispute to the courts of the host country. After 18 months, or an unsatisfactory decision, the investor may then request arbitration." Chief Justice Roberts accordingly concluded that "[s]ubmitting the dispute to the courts is thus a condition to the formation of an agreement, not simply a matter of performing an existing agreement. Article 8(2) constitutes in effect a unilateral *offer* to arbitrate, which an investor may accept by complying with its terms."

From the Chief Justice's perspective, the majority erred in treating the case as an ordinary contract dispute because "[p]rior to the fulfillment of the local litigation requirement, there was no contract between Argentina *and BG Group* to be performed. The Treaty is not such an agreement, since BG Group is of course not a party to the Treaty." Thus, "[t]he key point, which the majority never addresses, is that there is no completed agreement whatsoever between Argentina and BG Group," which is why *Howsam* and other Supreme Court decisions, in which "there [was] at least a putative arbitration agreement between *the parties to the dispute*," were inapposite.

## IMPLICATIONS OF THE SUPREME COURT'S DECISION

The Supreme Court's decision confirms that the framework for interpreting and applying threshold provisions concerning arbitration in ordinary contracts presumptively applies to similar provisions in bilateral investment treaties. Under this general scheme, a local litigation requirement is a purely procedural requirement for arbitrators primarily to interpret and apply. Furthermore, arbitrators' decisions on such issues are accorded substantial deference.

The opinion turns heavily on the terms of the relevant provision of the United Kingdom-Argentina bilateral investment treaty, including that the Treaty does not state explicitly that the local litigation requirement is a condition of consent to arbitration. The Court leaves for another day the question of interpreting treaties that refer expressly to conditions of consent, meaning that a differently drafted litigation requirement in another bilateral investment treaty (or free trade agreement) may result in a different outcome.

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