

# INTERNATIONAL ARBITRATION LAW REVIEW

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# News Section

## US SUPREME COURT HOLDS THAT AN ARBITRAL TRIBUNAL'S DECISION ON PRECONDITIONS TO ARBITRATION IS ENTITLED TO DEFERENCE

☞ Arbitration awards; International investment disputes; Jurisdiction; Setting aside; United States

On March 5 2014, the US Supreme Court, for the first time, decided a case involving international arbitration under a bilateral investment treaty. The Court ruled that the pre-arbitration requirement provided in the United Kingdom-Argentina Bilateral Investment Treaty (the "UK-Argentina BIT")—that an aggrieved investor must first submit the dispute to local litigation before initiating arbitration—was a procedural matter to be interpreted and decided in the first instance by the arbitral tribunal, whose decision was then entitled to deference by a reviewing court. As a result, in a seven to two decision, the Supreme Court upheld the US \$185 million arbitration award rendered against Argentina in *BG Group PLC v The Republic of Argentina*.<sup>1</sup>

### The Dispute and the Issues

The dispute arose between BG Group PLC ("BG Group"), a UK company that owned a majority of the shares in an Argentine gas distribution company, and Argentina. In 2003, invoking art.8 of the UK-Argentina BIT, BG Group initiated arbitration against Argentina under the UNCITRAL Arbitration Rules. BG Group claimed that emergency measures initiated by Argentina in 2001–2002 in response to the economic crisis afflicting the country, violated protections guaranteed to foreign investors by the UK-Argentina BIT and substantially harmed BG Group's investment.<sup>2</sup>

Argentina contended that the arbitral tribunal lacked jurisdiction, on the ground that BG Group failed to comply with the pre-arbitration requirement in art.8(2) of the UK-Argentina BIT. Article 8(2) of the UK-Argentina BIT provides that an aggrieved investor must first resort to the local courts in the host state, in this instance Argentina. If within 18 months there is no decision by the local court, or the dispute remains unresolved, the investor may then initiate arbitration.

BG Group never resorted to the Argentine courts pursuant to art.8(2) of the applicable BIT, but the arbitral tribunal concluded that it nonetheless had jurisdiction over the dispute. The tribunal found that, by excluding from license renegotiations those who had initiated litigation against the government, and by limiting available remedies to such investors, Argentina had in effect hindered recourse to its courts so that BG Group's obligation to first submit the dispute to local courts was excused as "absurd and unreasonable" in the circumstances.<sup>3</sup>

The US District Court for the District of Columbia affirmed the \$185 million award in favor of BG Group, finding that the tribunal did not exceed its authority by excusing BG Group from complying with the pre-arbitration local litigation requirement.<sup>4</sup> However, the US Court of Appeals disagreed. It held that the interpretation of the local court litigation requirement of art.8(2) was a matter to be decided by the courts, that the district court's deference to the tribunal's determination on this issue was not warranted, and that the tribunal had misinterpreted the 18-month local litigation requirement in the BIT.<sup>5</sup> Accordingly, the Court of Appeals annulled the award in favour of BG Group.

<sup>1</sup> *BG Group Plc v Republic of Argentina*, 134 S. Ct. 1198 (2014).

<sup>2</sup> *BG Group Plc v Republic of Argentina*, UNCITRAL, Final Award (24 December 2007).

<sup>3</sup> *Id.* para.147.

<sup>4</sup> *BG Group Plc v Republic of Argentina*, 134 S. Ct. 1198, 1212-13 (2014).

<sup>5</sup> *Id.* 1205.



## US Supreme Court's Decision and Reasoning

The Supreme Court reversed the Court of Appeals' decision and re-instated the arbitral tribunal's award. The Court held that the tribunal's decision excusing compliance with the 18-month local litigation requirement was a ruling on a gateway procedural issue, which was entitled to substantial deference by the federal court and could not be reviewed *de novo*.

The Supreme Court reasoned that the traditional interpretive framework that applies to private commercial contracts applies to treaties as well, since a "treaty is a contract between nations."<sup>6</sup> Accordingly, in line with the Supreme Court's previous decisions in arbitration cases, absent express language to the contrary, it is presumed that the parties intended for courts to decide questions of "arbitrability" ("*whether* there is a contractual duty to arbitrate") and for arbitrators to decide the questions of procedural preconditions ("*when* the contractual duty to arbitrate arises").<sup>7</sup> The Supreme Court decided that the pre-arbitration local litigation requirement in the UK-Argentina BIT was a purely procedural requirement that governs *when* the arbitration may begin, and does not have a bearing on *whether* the State consented to arbitrate. Therefore, it was the province of the arbitral tribunal to interpret and apply this procedural precondition, which meant, in turn, that a reviewing court had to defer to the tribunal's decision on this issue.<sup>8</sup>

Applying the deferential standard of review, the Supreme Court concluded that the tribunal did not exceed its powers in concluding that it had jurisdiction. While the Court noted that it would not necessarily characterise Argentina's actions as rendering the local court litigation requirement of Article 8(2) "absurd and unreasonable," at the same time, the Court could not say that the tribunal's conclusions were barred by the UK-Argentina BIT.<sup>9</sup> In sum, the Court found that the tribunal did not "stray from interpretation and application of the agreement" or "otherwise effectively dispense" its "own brand of justice."<sup>10</sup> Therefore, the Court upheld the tribunal's award.<sup>11</sup>

Chief Justice Roberts and Justice Kennedy dissented, faulting the majority for not differentiating an investment treaty between two nations from an ordinary commercial contract between private parties. The dissent pointed out that the parties' agreement to arbitrate is formed differently in these two types of instruments.<sup>12</sup> Specifically, a treaty does not contain an agreement to arbitrate between the State and foreign investors. In the UK-Argentina BIT, for example, Argentina's unilateral offer to arbitrate investment disputes with foreign investors was conditioned on satisfaction of the local litigation requirement. Where the BG Group had not fulfilled this requirement, there was, in the view of the dissenting Justices, no proper acceptance of the State's standing offer to arbitrate by the investor and thus no agreement between the parties to arbitrate in the first place.<sup>13</sup> Thus, according to the dissent, the local litigation requirement in art.8(2) was "a substantive condition" to Argentina's consent, and raised a question of "arbitrability," traditionally the province of the courts, not of arbitral tribunals.<sup>14</sup>

## Conclusion

The Supreme Court's decision reaffirms the arbitration-friendly orientation of the United States. It clarifies that a local litigation requirement specified as a precondition to arbitration, which is a common requirement provided in bilateral investment treaties, is a procedural condition for the tribunal to decide. US courts will not interfere with, or second-guess, a tribunal's decision

<sup>6</sup> *BG Group Plc v Republic of Argentina*, para.1202.

<sup>7</sup> *BG Group Plc v Republic of Argentina* para.1207.

<sup>8</sup> *BG Group Plc v Republic of Argentina*.

<sup>9</sup> *BG Group Plc v Republic of Argentina* 1212-1213.

<sup>10</sup> *BG Group Plc v Republic of Argentina*.

<sup>11</sup> *BG Group Plc v Republic of Argentina*.

<sup>12</sup> *BG Group Plc v Republic of Argentina* 1215-1216.

<sup>13</sup> *BG Group Plc v The Republic of Argentina* 1217-1218.

<sup>14</sup> *BG Group Plc v Republic of Argentina* 1211.

in interpreting and applying such pre-arbitration requirements. However, a differently worded treaty, which expressly qualifies a pre-arbitration requirement as a condition of the State's consent to arbitrate, may lead to a different result, although the Court left this question for another day. The Supreme Court's decision also affirmed that the principles governing the interpretation of private arbitration agreements apply to bilateral investment treaties.

While one might question the wisdom of applying, in an investment treaty context, rules that the Court developed in the very different setting of purely private commercial arbitration, the Supreme Court has now spoken clearly and decisively. An arbitral tribunal's decision on procedural preconditions to investment treaty arbitration is entitled to substantial deference, "however good, bad or ugly" that decision may be.<sup>15</sup>

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<sup>15</sup> *Oxford Health Plans v Sutter*, 133 S. Ct. 2064, 2070-71 (2013).