**INTERNATIONAL ARBITRATION UPDATE**

**BG Group PLC v. Republic of Argentina**

In its first case involving international arbitration under a bilateral investment treaty, *BG Group PLC v. Republic of Argentina*, decided March 5, 2014, the U.S. Supreme Court provided guidance on whether a United States court should either defer to or review *de novo* an arbitral tribunal’s interpretation of a treaty’s requirements for initiating arbitration. The Court concluded that the tribunal’s determination was entitled to deference and that the U.S. $185 million award must be enforced.

The case arose out of a dispute between Argentina and BG Group, a U.K. company that had major investments in the Argentine natural gas industry, under the 1990 bilateral investment treaty between Argentina and the United Kingdom. The treaty protects cross-border investment between the two countries. If a state breaches its obligations under the treaty, and thereby damages an investment by an investor of the other state, then the foreign investor is permitted to initiate arbitration and seek monetary damages as provided in the treaty. However, the treaty requires that disputes must first be brought to court in the “host” country before the investor may initiate arbitration. If that court has not made a final decision after 18 months, or if its final decision does not resolve the dispute, the investor may then submit the dispute to international arbitration.


BG Group’s claim had arisen out of certain emergency economic measures Argentina adopted in 2001-2002 that sent natural gas revenues plummeting. At the same time, Argentina hindered recourse to the domestic judiciary by temporarily halting compliance with court judgments related to the economic collapse and excluding companies that sued the government from a renegotiation process for natural gas licenses. BG Group argued that it was senseless to require compliance with the local litigation provision given that a decision could not be rendered by an Argentine court within the specified timeframe.

The arbitration tribunal agreed with BG Group and concluded that BG Group was not required to litigate in domestic courts before initiating arbitration under the treaty. The tribunal then found that Argentina had breached the treaty and awarded BG Group U.S. $185 million. Argentina sought to set aside the award on grounds that the arbitration should not have proceeded because BG Group had not complied with the domestic litigation requirement in the treaty.

The U.S. District Court for the District of Columbia enforced the award. On appeal, the D.C. Circuit reversed, holding that the local litigation requirement could not be excused. The court held that no deference to the tribunal was warranted because the local litigation requirement was a gateway question of arbitrability for the court to decide *de novo*.
The Supreme Court reversed in a decision written by Justice Breyer and joined by five justices and largely joined by a sixth, Justice Sotomayor. The Court concluded that the D.C. Circuit was required to defer to the arbitral tribunal’s decision excusing BG Group’s failure to sue in an Argentine court prior to arbitration.

The decision concluded that U.S. courts must apply domestic arbitration principles in determining who – court or arbitrator – has primary responsibility for resolving an issue in arbitration and that the treaty requirement of local court litigation constitutes a procedural precondition to arbitration that is primarily for the arbitral tribunal to resolve. Therefore, the tribunal’s determination on this issue was entitled to deference and no basis existed to overturn that determination. In dissent, Chief Justice Roberts, joined by Justice Kennedy, embraced the U.S. Solicitor General’s theory that a different analysis should apply to bilateral investment treaties and that no deference to the tribunal’s determination was appropriate here.

The legal framework for the case comes from the Federal Arbitration Act, which gives federal courts authority to vacate or enforce international arbitration awards rendered in the United States. That review is limited, as courts generally must defer to tribunals’ decisions. However, the Supreme Court has held that an exception to this rule of deference exists for threshold questions about whether parties have agreed to arbitrate – what the Court has called “arbitrability.” The issue in this case is whether, in an arbitration seated in the United States, the local litigation requirement in the Argentina-U.K. bilateral investment treaty is a threshold arbitrability question for a court to decide, without deference to the arbitral tribunal, or is a procedural precondition of arbitration, as to which courts will largely defer to a tribunal’s determination.

In reversing the D.C. Circuit, the Court relied on principles developed in domestic arbitration cases. For example, the Court reasoned that an agreement to submit disputes to arbitration is a matter of contract and that the parties are free to decide whether a precondition to arbitration should be decided by a court or an arbitrator. But, if the contract does not directly address the issue, then courts are to follow this general rule: preconditions that are “substantive,” i.e. that speak to whether the parties are bound by the arbitration agreement, are presumptively decided by a court without deference to an arbitral tribunal; preconditions that are “procedural,” such as time limits, waiver, or delay, are presumptively decided by the tribunal and subject only to deferential judicial review. Here, the Court concluded that the local litigation requirement is a purely procedural “claims-processing rule that governs when the arbitration may begin, but not whether it may occur.” As such, the D.C. Circuit should have deferred to the tribunal.

The Solicitor General had argued on behalf of the U.S. Government that the procedural/substantive categories should not apply when an arbitration arises out of a treaty between two sovereigns and the issue is one of consent to arbitration. In the government’s view, a sovereign’s consent to arbitrate should be the key question, and courts should primarily look for treaty language implicating consent. The Court disagreed. A treaty, it said, is a contract between nations. And, like interpreting a contract, interpreting a treaty is “a matter of determining the parties’ intent.” In any event, the Court noted, it need not decide whether express language related to consent would make a difference, because the treaty between Argentina and the U.K. said nothing about consent. The Court thus left open the question of how courts should interpret a treaty that expressly ties a procedural precondition to a sovereign’s consent to arbitrate.

Justice Sotomayor concurred, taking up that open question. She argued that where a treaty expressly bases consent to arbitrate on a procedural precondition, the fulfillment of that condition is a question of arbitrability that must be decided by a court. After all, she argued, “a party plainly cannot be bound by an arbitration clause to which it does not consent.”
In his dissenting opinion, Chief Justice Roberts, joined by Justice Kennedy, largely adopted the Solicitor General’s position. He argued that the investment treaty between Argentina and the U.K. cannot constitute an agreement to arbitrate, because no investor is party to the treaty; it instead represents Argentina’s standing offer to investors that it is willing to arbitrate. That offer is conditioned, however, on the local litigation requirement. Without satisfying that condition, BG could have formed no agreement to arbitrate with Argentina. And this kind of question – whether an agreement to arbitrate has ever been formed – is precisely the sort of arbitrability issue that courts must decide without deferring to the tribunal.

The Supreme Court’s decision highlights the importance of language in drafting international arbitral provisions. U.S. courts will apply domestic arbitration law principles in evaluating dispute resolution provisions and will find that decisions of a tribunal concerning procedural preconditions to an arbitration are entitled to deference absent clear language to the contrary. And for the investment treaty arbitrations that have their legal seat in the United States, and which are reviewable by U.S. courts, a treaty’s language creating preconditions to arbitration will need to be reviewed with care for links between those conditions and the host state’s consent to arbitrate.

The larger impact of the decision remains to be seen, however, as many investor-state arbitrations are conducted under the Convention on the Settlement of Investment Disputes between States and Nationals of Other States (ICSID Convention). Such arbitrations are conducted by the International Centre for Settlement of Investment Disputes (ICSID). While the seat for many ICSID arbitrations is the United States, ICSID arbitration awards are not subject to set aside by domestic courts and are instead subject to potential annulment through the specific procedures set forth in the ICSID Convention.

If you have any questions regarding this update, please contact one of the following Sidley lawyers:

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