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Steven P. Caplow

The US Supreme Court provides its first guidance on arbitrability under bilateral investment treaties in *BG Group Plc v The Republic of Argentina*.[1] Worldwide, there are almost 3,000 bilateral investment treaties currently in effect.[2] These treaties, executed by pairs of sovereign nations, encourage the inflow of foreign capital by establishing legal protections for qualified foreign investments. The matter before the US Supreme Court involved an arbitration commenced by British investors pursuant to a bilateral treaty executed between the UK and the Republic of Argentina. A tribunal of arbitrators sitting in Washington DC issued an award in favour of the British investors. When the British investors sought to confirm the award in the federal district court in Washington DC, Argentina challenged the award's validity on the basis that the British investors had pursued international arbitration without first undertaking to assert the claim in the local courts of Argentina as provided by the treaty. The US Supreme Court's majority deferred to and upheld the tribunal's determination that circumstances excused the British investors from complying with the local court provision of the treaty. However, two members of the US Supreme Court dissented to the majority opinion on the ground that because the British investors failed to satisfy the local court provision of the treaty, the British investors failed to secure Argentina's consent to arbitrate their claim.

1. Argentina Opens the Door to Foreign Private Investment

In 1992, to promote economic development, Argentina enacted legislation to privatise the distribution of natural gas. The law reformed the operation of Argentina's state-owned natural gas utility by transferring its assets to 10 new private companies. Among these new private entities was a company called MetroGAS, which received a 35-year exclusive licence to distribute natural gas in Buenos Aires. BG Group Plc, a British firm, was part of the consortium that tendered the successful bid to purchase a majority interest in MetroGAS. As part of the economic development scheme, Argentina made provision for MetroGAS to earn a reasonable return by the enactment of statutes providing for the calculation of "tariffs" for its distribution of natural gas in US dollars, rather than Argentinian pesos.

This substantial cross-border investment in Argentina by a British company was all the more remarkable because just 10 years earlier the two countries froze billions of dollars of each other's assets during the Falklands crisis.[3] The new favourable conditions for international investment arose in part because the UK and Argentina had recently entered into a bilateral treaty for the promotion and protection of investments (the Treaty) that established a legal framework for dispute resolution by foreign investors.[4]

2. Dispute Resolution under the Bilateral Investment Treaty between the UK and Argentina

Article 8 of the Treaty between the UK and Argentina addresses dispute resolution between a private foreign investor and the sovereign. Article 8(1) authorises either party to submit a dispute to the local court in the territory of the investment. Under this "local court provision", after the elapse of 18 months, if the local court has not issued a final decision,

[1] *BG Group Plc v The Republic of Argentina* 134 S. Ct. 1198 (2014).
[2] See Country-Specific Lists of Bilateral Investment Treaties, United Nations Conference on Trade and Development. The United States is party to about 46, including the North American Free Trade Agreement (NAFTA).
[3] M.S. Daoudi and M.S. Dajani, "Sanctions: The Falklands Episode" (1983) 39(4) *The World Today* 150, 150–160.
[4] Agreement for the Promotion and Protection of Investments, December 11, 1990, 1765 U.N.T.S. 33.

the party may commence international arbitration.[5] But even if the local court issues a final decision, if one of the parties is unhappy with the result, it may commence international arbitration.[6] In either event, the decision of the international arbitration panel determines the final disposition regardless of any decision reached by the local court.[7] Although it did not occur in this particular case, the Treaty also makes provision, if they both agree, for the parties to bypass the local court and proceed directly to international arbitration.[8]

3. Argentina's Economic Crisis Sparks Disputes with Private Investors

The BG Group successfully operated MetroGas for about 10 years. However, in 2001, after a period of exceptional economic growth, Argentina experienced an economic crisis. In response to its predicament, Argentina enacted an emergency law in January 2002 that changed the calculation of the natural gas tariffs from dollars to pesos at artificially low rates. Although the exchange rate at the time was about three pesos to one dollar, the new statute calculated the tariffs at the rate of just one peso to one dollar. In 2002, the President of Argentina also issued a decree staying for 180 days the execution of its courts' final judgments (and injunctions) in lawsuits that claimed harm as a result of the country's austerity measures.

Under these altered financial terms, MetroGAS began to experience substantial losses. In 2003, BG Group invoked art.8 of the Treaty to commence arbitration, without first filing an action in the courts of Argentina as provided by the local court provision. Argentina, while denying the claims and contesting the jurisdiction of the arbitration panel, participated in the appointment of the arbitrators and the selection of the arbitration site in Washington DC. The arbitration panel adjudicated the matter between 2004 and 2006, and issued its final decision in December 2007. The panel determined that the parties' dispute qualified for resolution under the Treaty, and it would have been "absurd and unreasonable" to have required BG Group to submit the matter to the local courts of Argentina for resolution prior to arbitration. Finding BG Group had been denied "fair and equitable treatment", the panel awarded BG Group $185 million in damages.

In March 2008, both sides filed petitions for review in the federal district court. BG sought to confirm the award under the New York Convention[9] and the Federal Arbitration Act,[10] while Argentina sought to vacate the award in part on the ground that the arbitrators lacked jurisdiction.[11] The district court in a series of decisions addressing both the Federal Arbitration Act and the New York Convention ruled in favour of BG Group.[12] In 2012, however, examining the issue of jurisdiction de novo, without any deference to the arbitrators' decision, the Court of Appeals vacated the arbitral award because BG Group had failed to "commence a lawsuit in Argentina's courts and wait eighteen months before filing for arbitration".[13] BG Group successfully petitioned the Supreme Court to decide the issue of whether the arbitrators or a court should determine the arbitrability of the claim.

[5] Agreement for the Promotion and Protection of Investments (1990) art.8(2)(a)(i).
[6] Agreement for the Promotion and Protection of Investments (1990) art.8(2)(a)(ii).
[7] Agreement for the Promotion and Protection of Investments (1990) art.8(4) ("The arbitration decision shall be final and binding on both Parties.").
[8] Agreement for the Promotion and Protection of Investments (1990) art.8(2)(b).
[9] Convention on the Recognition and Enforcement of Foreign Arbitral Awards art.IV, June 10, 1958.
[10] New York Convention 9 U.S.C. §§ 204, 207.
[11] Federal Arbitration Act 9 U.S.C. § 10(a)(4).
[12] *BG Group Plc v The Republic of Argentina* 764 F. Supp. 2d 21 (D.D.C. 2011); 715 F. Supp. 2d 108 (D.D.C. 2010).
[13] *BG Group Plc v The Republic of Argentina* 665 F.3d 1363, 1373 (App. D.C. 2012).

How US courts "Go Back to Yesterday"[14] *to determine the parties' original intent as to arbitrability*

Courts describe the basic question of whether a dispute is subject to arbitration as a "gateway question". But, as occurred in BG Group's case, this threshold issue is seldom resolved until after completion of the arbitration. Accordingly, the standard of review applied by the court reviewing the arbitral award takes on special importance because it determines how stringently the court will scrutinise the tribunal's determination of jurisdiction to arbitrate the claim. The Supreme Court decision in *First Options of Chicago Inc v Kaplan*[15] established the framework for judicial review of arbitral decisions. *First Options* held that the standard of review varies depending on whether the parties agreed to submit the question of arbitrability to the arbitrator. If the court finds the parties agreed to allow the arbitrators to determine jurisdiction, then the court applies the deferential standard of review it applies to any other matter the parties agreed to arbitrate. If, on the other hand, the court finds the parties did not agree to submit the question of arbitrability to the arbitrators, then the court examines the question of arbitrability de novo, independently of how the arbitrators decided the matter. The intent to submit the question of arbitrability to the arbitrators must be established by "clear" and "unmistakable" evidence.[16]

But as this case illustrates, even when the arbitration provision is silent as to who should decide the question of arbitrability, it is not automatic that the court will decide the matter. Instead, courts examine whether the nature of the controversy relates to a procedural or a substantive matter. When the question involves procedural perquisites for the use of arbitration, like time limits, courts defer to the arbitrator's determination.[17] By comparison, when the issue involves substantive matters, like the formation of the arbitration agreement or whether an arbitration clause in a concededly binding contract applies to a particular type of controversy, the court applies its own judgment.[18]

4. The Majority of the Supreme Court Classified the Local Court Provision as a Procedural Claims-Processing Requirement

The majority, applying a US contract law analysis, concluded that the local court requirement was merely a procedural condition precedent. Under US law, a condition precedent sets out what must happen for a specific contractual duty (like the duty to arbitrate) to arise, but does not determine the validity of the contract itself. Focusing on the fact the Treaty allowed arbitration to commence after the elapse of 18 months regardless of the status of the proceedings before the local court, and the arbitrators were vested with the final decision, the majority concluded that the local law provision "determines *when* the contractual duty to arbitrate arises, not *whether* there is a contractual duty to arbitrate at all".[19] The majority then analysed whether the fact that the operative language is contained in an international treaty rather than an ordinary contract made a difference to its analysis. However, as "a treaty is a contract, though between nations",[20] the majority found nothing to change its mind that the local rule provision resembles a claims-process requirement to be evaluated

[14] Lewis Carroll, *Alice's Adventures in Wonderland* (New York: Appleton, 1866), p.99 ("I can't go back to yesterday because I was a different person then.").

[15] *First Options of Chicago Inc v Kaplan* 514 U.S. 938 (1995). The case involved a domestic arbitration governed by the Federal Arbitration Act. However, subsequent decisions apply *First Options* to international arbitral awards where enforcement is sought under the New York Convention. *China Minmetals Materials Import and Export Co v Chi Mei Corp* 334 F.3d 274 (3rd Cir. 2003).

[16] *First Options* 514 U.S. 938 (1995) at 945–946.

[17] *BG Group Plc v The Republic of Argentina* 134 S. Ct. at 1207, 1210 (citing *Howsam v Dean Witter Reynolds, Inc.*, 537 U.S. 79, 85 (2002)).

[18] *BG Group Plc* 134 S. Ct. 1198 (2014) at 1206–1207; 1210.

[19] *BG Group Plc* 134 S. Ct. 1198 (2014) at 1207.

[20] *BG Group Plc* 134 S. Ct. 1198 (2014) at 1208.

by the arbitrators.[21] That being so, consistent with its analysis under US contract law, the majority presumed that "the parties (even if they are sovereigns)" intended for the arbitrators, not the court, to determine the consequence of BG Group's failure to comply with the local court requirement.

Although the majority concluded that the arbitrators had primary authority to evaluate the local law provision, it acknowledged that Argentina was still entitled to review the arbitrators' decision to excuse BG Group's non-compliance with the litigation requirement and take jurisdiction over the dispute.[22] As Argentina did not even dispute that the laws it had enacted "hindered" recourse to the domestic judiciary, it did not fare well under the court's deferential review of the arbitrators' rulings. The majority easily concluded that the arbitrators' jurisdictional determination was lawful.

5. The Dissenting Opinion of the Supreme Court Believed the Local Court Provision Acted to Accept the Sovereign's Standing Offer to Arbitrate

Two members of the court indignantly dissented to the majority's analysis of the local court provision as if it involved an ordinary contract between private parties, rather than a treaty between two sovereign nations. "It should come as no surprise that, after starting down the wrong road, the majority ends up at the wrong place."[23] In particular, the dissent distinguished an ordinary contract from a treaty because investors like BG Group are not signatories to the treaty[24]:

> "The Treaty by itself cannot constitute an agreement to arbitrate with an investor. How could it? No investor is a party to that Treaty. Something else must happen to *create* an agreement where there was none before."[25]

According to the dissent that "something" was the investor's submission of its dispute to the courts of the host country for 18 months. Viewed in this light, submission of the dispute to the local court is a condition to the formation of an agreement, not a matter of performing an existing agreement. In other words, the Treaty "constitutes in effect a unilateral *offer* to arbitrate, which an investor may accept by complying with its terms".[26] The dissent contended that the language of the Treaty further supported its view because it provided that unless the parties otherwise agree, the dispute "shall" be submitted to the local court.[27]

The dissent tried to address the majority's concern that art.8(4), which makes the arbitrators' decision final and binding on the parties, renders the local court provision "toothless".[28] Although acknowledging that the arbitrators "need not defer to an Argentine court's judgment", it expressed doubt that an arbitration tribunal would "give no weight to an Argentine court's authoritative construction of Argentine law".[29] The dissent also observed that the local court provision may help narrow the range of issues or induce settlement. But even the dissent appreciated that the local court provision did not hold up well on the facts of this case. "The foregoing reasons may seem more compelling when viewed apart from the particular episode before us."[30]

[21] *BG Group Plc* 134 S. Ct. 1198 (2014) at 1212.
[22] *BG Group Plc* 134 S. Ct. 1198 (2014) at 1212.
[23] *BG Group Plc* 134 S. Ct. 1198 (2014) at 1215.
[24] The dissent does not address whether an investor would be a third-party beneficiary of the Treaty.
[25] *BG Group Plc* 134 S. Ct. 1198 (2014) at 1216.
[26] *BG Group Plc* 134 S. Ct. 1198 (2014) at 1216.
[27] *BG Group Plc* 134 S. Ct. 1198 (2014) at 1217.
[28] *BG Group Plc* 134 S. Ct. 1198 (2014) at 1220–1221.
[29] *BG Group Plc* 134 S. Ct. 1198 (2014) at 1221.
[30] *BG Group Plc* 134 S. Ct. 1198 (2014) at 1221.

6. Principles of International Law Given Little Weight

International commercial arbitration, operating under the competence-competence doctrine, presumptively authorises an arbitration panel to determine initially its own jurisdiction. The UNCITRAL rules, which applied to the arbitration of this dispute, similarly provide that the "arbitral tribunal shall have the power to rule on objections that it has no jurisdiction".[31] While they do not otherwise agree on the proper analysis of the local court provision, the entire US Supreme Court was in accord that in the US "courts presume that the parties intend courts, not arbitrators, to decide what we have called disputes about 'arbitrability'".[32] While the majority ultimately deferred to the arbitration panel because it determined the provision was procedural rather than substantive, it primarily relied on ordinary principles of US contract law. Just as the US dollar is the preferred benchmark for the tariff of Argentinian natural gas, for now, US law seems to be the model the Court holds out to the world to decide matters of international arbitration.

[31] UNCITRAL Arbitration Rule (1976) art.21(1). The Second and Ninth Circuit have held that art.21(1) constitutes, for the purposes of *First Options*, "clear and unmistakable" evidence of the parties' intent to empower the arbitrators to decide questions of arbitrability. See *Schneider v Kingdom of Thailand* 688 F.3d 68, 73–74 (2d Cir. 2012); *Oracle America Inc v Myriad Group AG* 2013 WL 3839668, at *7 (9th Cir. July 26, 2013).

[32] *BG Group Plc* 134 S. Ct. 1198 (2014) at 1206.