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December 2013

What's So Special About Treaty Arbitration?: U.S. Supreme Court Confronts Its First International Investment Treaty Arbitration Case

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On December 2, 2013, the U.S. Supreme Court heard argument in *BG Group PLC v. Republic of Argentina* (No. 12-138)— its first-ever case involving international investment treaty arbitration. We have previewed this case, and discussed some potential outcomes, in an earlier client alert: http://www.paulhastings.com/Resources/Upload/Publications/U_S_Supreme_Court_to_Hear_an_International_Investment_Treaty_Arbitration_Case.pdf. At issue before the Court is the arbitrators' authority to determine whether arbitration prerequisites have been satisfied and the courts' role in reviewing these decisions. Notably, the Supreme Court may address whether judicial review of awards entered in investor-state arbitrations conducted under an investment treaty should be governed by the same standards as review of domestic arbitral awards. At argument, the justices appeared reluctant to adopt special judicial review standards for international investor-state arbitrations. Rather, they seemed inclined to extend their prior rulings, made in the domestic arbitration context, to international treaty arbitrations, reaffirming the arbitrators' authority to decide issues of procedural arbitrability, such as a party's compliance with preconditions to arbitration.

Background

The case arose out of a long-standing dispute between BG Group, a United Kingdom company, and the Republic of Argentina regarding the impact of several emergency measures taken by Argentina (in the aftermath of its 2001 economic crisis) on the value of BG Group's investment in MetroGas, an Argentine gas distribution company. BG Group initiated arbitration against Argentina under a bilateral investment treaty between the United Kingdom and Argentina. The treaty, which entered into force in 1993, is designed to promote reciprocal private investment between the two countries. According to the treaty, disputes arising thereunder must first be submitted to the national courts of the respondent country; if the national court does not issue a final decision within 18 months, or if the investor still wishes to pursue a claim after the decision, then the dispute may be submitted to international arbitration. BG Group commenced arbitration without first litigating in Argentine courts, and Argentina sought to dismiss the arbitration on that basis.

The Arbitral Tribunal's Award

The arbitral tribunal, convened under the UN Commission on International Trade Law (UNCITRAL) rules, found that the treaty's requirement of litigating first in national courts would constitute an "impediment to arbitration." The tribunal further held that a variety of emergency measures enacted by Argentina in the aftermath of the 2001 crisis "interfere[d] with the normal operation of its courts," hindering recourse to Argentine courts. On that basis, the tribunal concluded that insisting on BG Group's compliance with the litigation requirement would lead to an absurd and unreasonable result, contrary to the accepted international rules of treaty interpretation. The tribunal then awarded BG Group nearly US$185 million, in addition to interest, costs, and attorneys' fees.

Argentina's Challenge of the Arbitration Award

Argentina challenged the award in U.S. federal courts. The U.S. District Court for the District of Columbia confirmed the award, rejecting Argentina's argument that the tribunal exceeded its authority by excusing the litigation requirement. Following an appeal, the U.S. Court of Appeals for the District of Columbia Circuit agreed with Argentina's challenge and vacated the award. The Court of Appeals held that because BG Group had invoked the treaty's arbitration clause without exhausting its remedies in the Argentine courts first, BG Group failed to satisfy the treaty's "gateway" requirement to invoke arbitration. *Republic of Argentina v. BG Group PLC*, 665 F.3d 1363, 1370-71 (D.C. Cir. 2012). As a critical part of its holding, the D.C. Circuit concluded that the parties to the treaty—the United Kingdom and Argentina—would have expected a court, rather than an arbitral tribunal, to determine the effect of an investor's noncompliance with the treaty's litigation requirement. The Court of Appeals then vacated the arbitral tribunal's award on the ground that the tribunal never had jurisdiction to hear the dispute in the first instance.

The U.S. Supreme Court Grants Certiorari and the U.S. Solicitor General Weighs In

BG Group successfully petitioned the U.S. Supreme Court for *certiorari*. In its briefing, BG Group argued that the D.C. Circuit's decision contravened settled precedent on who decides a party's compliance with preconditions to arbitration. Invoking the Supreme Court's precedents of *First Options of Chicago, Inc. v. Kaplan*, 514 U.S. 938 (1995), and *Howsam v. Dean Witter Reynolds, Inc.*, 537 U.S. 79 (2002), BG Group contended that an arbitral tribunal, and not a national court, should determine issues of procedural arbitrability and, specifically, whether conditions precedent to an obligation to arbitrate have been satisfied.

Argentina countered that the U.K.-Argentina treaty's requirement to first litigate an investment dispute in national courts was distinct from the preconditions to arbitration at issue in *Howsam*. Rather, Argentina argued, the litigation requirement was a condition to Argentina's consent to arbitrate a dispute arising under the treaty. Absent compliance with this requirement, there could be no consent to arbitrate on Argentina's part—and the issue of whether consent to arbitrate existed is one for the U.S. courts to decide.

The U.S. Solicitor General, appearing as *amicus curiae*, urged the Supreme Court to adopt a different approach altogether. The Solicitor General argued that the presumptions set forth in *First Options* and *Howsam* as to the arbitrators' and the courts' respective authority should not apply in the context of investor-state arbitrations conducted pursuant to investment treaties. Instead, the Solicitor General distinguished between investment treaty requirements that represent the host state's consent to enter into arbitration with any individual investor and the treaty requirements that do not implicate the question of consent. This determination, the Solicitor General argued, should be made irrespective of

any presumptions used in the non-treaty cases, but solely by interpreting the relevant treaty in accordance with settled principles of treaty interpretation. A U.S. court would then be empowered to review an arbitral tribunal's rulings on consent-based objections without deference, in contrast to the judicial deference normally accorded to an arbitral tribunal's decisions on any other kinds of objections. The Solicitor General, however, declined to state whether the U.K.-Argentina treaty's litigation requirement was a condition to Argentina's consent to arbitrate, urging instead that the case be remanded to the Court of Appeals for that determination.

Supreme Court's Oral Argument

Special Rules for Investment Treaty Arbitration?

At oral argument, the justices appeared reluctant to adopt the Solicitor General's suggestion to exempt international investment treaty arbitration from the presumptions established in *First Options* and *Howsam*. As Justice Scalia pointed out, the same interpretive rules apply when determining whether a party consented to arbitration irrespective of whether a court interprets an arbitration agreement or an investment treaty.[1] Justice Sotomayor similarly observed that in both instances, a court seeks to determine the parties' intent, and therefore it makes sense for a court to "look at all of the factors [courts] normally look at in deciding whether something goes to a substantive or procedural issue."[2]

The justices were skeptical about the distinction drawn by the Solicitor General between investment treaty requirements that represent a consent to arbitration and provisions that did not implicate the question of consent. As Justice Breyer tartly observed, this analytical framework was not derived from "any law," but appeared to have "sprung, full blown, from someone's brain."[3] The justices also struggled to understand how the Government's proposed analytical framework would apply in practice. Justice Ginsburg repeatedly pressed the Assistant to the Solicitor General as to whether the litigation requirement of the U.K.-Argentina treaty was "a condition on the consent to arbitrate a dispute."[4] After the Solicitor General declined to answer that question, Justice Kagan observed that this refusal made her less receptive to the United States' argument because it left her unable to determine "what a consent-based objection is."[5]

Justices Breyer and Kagan expressed concern that the Solicitor General's proposed framework would make the courts' interpretive task much harder, by jettisoning the interpretive presumptions set forth by the Supreme Court's arbitration precedents. As Justice Kagan noted, under the Solicitor General's proposal, "all the techniques that [courts] use in the *Howsam-First Options* line of cases seem to go out the window and not be replaced with anything else."[6] Justice Breyer appeared to agree, observing that the presumption that the Supreme Court established in *Howsam* "seems … easier to work with then this notion of whether a state gave consent or didn't give consent."[7]

By contrast, Justice Alito seemed more receptive to the notion that the principles established by *First Options* and *Howsam* should not apply in the context of an investment treaty. As he noted, while this line of cases sought to delineate the respective competencies of arbitrators and courts when resolving disputes, the purpose of the investment treaties was "to take [investment] disputes out … of the courts of the country against which the claim is asserted, … and put it in an international tribunal."[8]

Conditions of Consent

Turning to the parties' main arguments, the justices were unwilling to view the U.K.-Argentina treaty's litigation requirement as Argentina's condition of consent to arbitrate investment treaty claims. As Justice Ginsburg pointed out, the Argentine courts' decision would not be binding because a party that

disagreed with that decision could still invoke arbitration.[9] To Justice Ginsburg, this fact suggested that "treaty partners agreed that only an arbitration panel can conclusively resolve th[e investment] dispute," and that "under this treaty, the ultimate decision maker is the arbitrator," not the court.[10] Consequently, she inferred, any prior step that a party had to make—such as "to go to the local court" first—was "in the nature of a procedural condition." [11]

Justice Alito was similarly unconvinced that the litigation requirement was "a condition of consent." Because the litigation requirement did not require a judicial decision but could be satisfied by a minimal action that "ke[pt] the case alive in court" for 18 months, Justice Alito did not see "what [the litigation requirement] accomplishes."[12] As he noted, "if some requirement seems to serve virtually no purpose, it's unlikely to be a condition of consent."[13] Chief Justice Roberts disagreed with that assertion, pointing out that mandatory negotiating periods are common to various statutory regimes, reflecting congressional judgment that "it's valuable to give people a period of time to negotiate or discuss" before resorting to litigation.[14] As Justice Scalia observed, however, under the terms of the treaty either party could initiate the proceedings in the Argentine courts, thereby ensuring the court's involvement and satisfying the litigation precondition, and this factor weighed against treating the litigation requirement as a condition of consent.[15]

The justices also questioned Argentina's counsel as to what would happen in a hypothetical case where a judicial strike would prevent the Argentine courts from operating.[16] These questions echoed the arbitral tribunal's excusal of BG Group's noncompliance with the litigation requirement based on a conclusion that Argentina had unilaterally hindered recourse to its courts, and sought to test Argentina's argument that such compliance was a prerequisite to consenting to arbitration. The counsel's response that, in such a situation, "the arbitrators might well find that the [litigation] condition was excused" elicited a sharp rebuke from Justice Kennedy. Noting that this argument gave him "intellectual whiplash," Justice Kennedy urged that this concession was inconsistent with Argentina's central premise that, absent compliance with the litigation requirement, no agreement to arbitrate was formed.[17]

While expressing skepticism about Argentina's position, some of the justices indicated that, as Justice Kennedy put it, "this is a close case." [18] Justice Kennedy observed that "there is substantial merit" to the D.C. Circuit's conclusion as to the scope of the courts' authority upon review of arbitral decisions in the investment treaty context.[19] Chief Justice Roberts similarly indicated that the structure of the U.K.-Argentina treaty presented "a difficulty" for BG's position because it "seem[ed] to suggest" that the litigation requirement "is not part of the arbitration provision," but instead an independent precondition.[20]

Possible Outcomes

The gateway question in *BG Group* is whether the Supreme Court will accept the Solicitor General's recommendation to establish a different framework for the judicial review of arbitral awards rendered under international investment treaties. Most of the justices who spoke during the oral argument appeared to resist this invitation, preferring instead to apply the interpretive presumptions that the Court has developed in the context of private domestic arbitration. These precedents—most notably, the decisions in *First Options* and *Howsam*—set forth a presumption that arbitrators (and not the courts) have the authority to rule on the questions of "procedural arbitrability," such as whether preconditions to arbitration have been satisfied.

The Solicitor General's position likely reflects the executive branch's concern that the United States, as a signatory to numerous treaties (investment and otherwise), could potentially find itself in a position of invoking a particular treaty condition as a defense in investor-state arbitration. Although the justices are traditionally respectful of the United States' sovereign interests, they are also concerned about ensuring the predictability of their interpretive rules and consistency in their application by lower courts.

Here, the justices appeared particularly skeptical about the doctrinal foundation of the Solicitor General's proposed distinction between consent-based treaty conditions and other kinds of conditions, as well as about the courts' ability to apply the distinction. The Solicitor General's refusal to indicate whether the treaty provision at issue—the litigation requirement of the U.K.-Argentina treaty—constituted a consent-based condition, and the inability to articulate any interpretive standards for distinguishing such conditions beyond invoking the general principles of treaty interpretation, did little to quell the justices' discomfort.

The Supreme Court therefore appears likely to hold that the general arbitration presumptions that apply in other commercial cases also apply in the international investment treaty context. Of course, the justices may decide to leave that question open, by concluding that even under the Solicitor General's proposed framework, the litigation requirement of the U.K.-Argentina treaty would not constitute a consent-based condition, and therefore would be presumptively for the arbitrators to determine.

If they apply the *First Options-Howsam* framework, the justices will face the question of whether the litigation requirement of the U.K.-Argentina treaty is just like other preconditions to arbitration, which are normally for the arbitrators to decide, or whether it represents a condition to entering into an arbitration agreement in the first place, and therefore presumptively for the courts to determine. While, as Justice Kennedy observed, this may prove to be a "close case," many of the justices appeared to view the litigation requirement as akin to other procedural preconditions that the Court has previously held are within the arbitrators' sphere of competence. Irrespective of the path the Court takes, its decision will likely clarify the respective roles of U.S. courts and national and/or international arbitral tribunals.

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If you have any questions concerning these developing issues, please do not hesitate to contact any of the following Paul Hastings lawyers:

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[1] Argument Transcript at 33:16-34:2 ("Argument Tr."), *Republic of Argentina v. BG Group PLC*, No. 12-138 (Dec. 2, 2013).

[2] Argument Tr. 4:13-21.

[3] Argument Tr. 28:8-9.

[4] Argument Tr. 32:2-7; *id.* at 32:11-19.

[5] Argument Tr. 32:20-33:5.

[6] Argument Tr. 33:8-10.

[7] Argument Tr. 36:7-18.

[8] Argument Tr. 8:19-9:3.

[9] Argument Tr. 37:13-21.

[10] Argument Tr. 37:24-38:11.

[11] Argument Tr. 41:1-8.

[12] Argument Tr. 45:15-25; *id.* at 46:21-47:2.

[13] Argument Tr. 34:11-13; *see also id.* at 34:19-35:3.

[14] Argument Tr. 11:10-21.

[15] Argument Tr. 39:1-5; *see also id.* at 39:16-20.

[16] Argument Tr. 52:21-24 (Ginsburg, J.); *id.* at 53:4-5 (Kennedy, J.).

[17] Argument Tr. 53:9-54:4.

[18] Argument Tr. 13:4.

[19] Argument Tr. 13:4-7.

[20] Argument Tr. 16:15-17:4.