Expressly acknowledging its “importance … for international commercial arbitration,” on March 5, 2013, the U.S. Supreme Court issued a ruling in BG Group PLC v. Republic of Argentina, the Court’s first-ever case involving international investment treaty arbitration.\(^1\) Justice Breyer delivered the opinion of the Court, holding that, absent express contractual language to the contrary, federal courts must review with deference an arbitrator’s interpretation and application of treaty provisions concerning prerequisites to arbitration, where such provisions do not implicate the arbitration agreement’s validity or scope.\(^2\) Applying the interpretive presumptions developed in the context of private U.S. domestic arbitration to the United Kingdom-Argentina bilateral investment treaty at issue,\(^3\) the Court concluded that the treaty’s local court litigation requirement (demanding litigation in Argentine courts to a final decision or for 18-months, whichever occurred first) was “highly analogous” to procedural provisions reserved for arbitrators, not courts, to interpret and apply.\(^4\) Accordingly, the Supreme Court reversed the Court of Appeals’ decision to vacate BG Group’s US $185 million damages award. The Court’s decision is also notable for the justices’ extensive reliance on international arbitration commentary, including a treatise on investor-state arbitration co-authored by a late Paul Hastings partner, Christopher F. Dugan.\(^5\)

We have previewed this case in previous client alerts, including a discussion of the potential outcomes and approaches that the Supreme Court may adopt.\(^6\) As predicted in our December 2013 alert, the Court reaffirmed the arbitrators’ authority to decide issues of procedural arbitrability, such as a party’s compliance with preconditions to arbitration. The Court also rejected the Solicitor General’s recommendation to establish a new framework for the judicial review of arbitral awards rendered under international investment treaties. Instead, the Court extended its prior precedents, made in the domestic arbitration context, to international investment treaty arbitrations. Under the Court’s analytical framework, judicial review of arbitral awards pursuant to international investment treaties must be similar to the federal courts’ power to review awards rendered in private, commercial arbitration disputes—extremely limited. The Court, however, left open the possibility that a differently-phrased investment treaty could vest the courts with a greater reviewing role by explicitly designating certain arbitration preconditions as the host state’s “conditions of consent” to arbitration.\(^7\)
Background
Summary of Key Facts
As we have written previously, 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 various measures enacted by Argentina in the aftermath of the 2001 crisis, “while not making litigation in Argentina’s courts literally impossible, nonetheless ‘hindered’ recourse ‘to the domestic judiciary’ to the point where the Treaty implicitly excused compliance with the local litigation requirement.” Thus, according to the tribunal, requiring a private party to seek relief in Argentine courts would have led to “absurd and unreasonable result[s],” contrary to the accepted international rules of treaty arbitration. 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. 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. BG filed a petition for certiorari, which was granted by the Court in June 2013.

The Court’s Decision
The Majority
As Justice Breyer’s opinion for the majority explained, the question before the Court was whether a federal court or arbitrator bears primary responsibility for interpreting and applying the U.K.-Argentina treaty’s local court litigation provision. Put another way, should United States federal courts review the arbitral tribunal’s interpretation or application of the provision de novo or with the deference that courts generally accord to arbitral decisions on matters the parties have committed to arbitration?
In considering this issue, the Court first considered the treaty “as if it were an ordinary contract between private parties.”18 In such cases, under the Supreme Court’s arbitration precedents, courts accord great deference to arbitrators to decide whether the preconditions to arbitration have been satisfied.19 These conditions may include claims of waiver or delay (e.g., whether a party filed a notice of arbitration within the specified time limit) or other prerequisites (e.g., whether a party gave the required notice or complied with mandatory pre-arbitration grievance procedures).

The Court similarly viewed the U.K.-Argentina treaty’s local court litigation provision as 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.”20 Because the local court litigation provision did not have a direct impact on the resolution of the parties’ dispute, and because only a decision by the arbitrator was “final and binding,” the majority concluded that such provision did not constitute a substantive condition on consent to arbitrate.21 Rather, the Court reasoned, the local court litigation provision was “highly analogous” to other procedural provisions that are for the arbitrators to interpret and apply.22

Rejecting the Solicitor General’s recommendation, the majority saw no principled reason why the construction of a treaty provision should differ from the interpretation of ordinary, commercial agreements. As the Court explained, “a treaty is a contract, though between nations,” and like any other contract, a court must give effect to the parties’ intent as expressed by the plain language.23 In particular, the Court stressed that the U.K.-Argentina treaty did not contain any clear statement indicating that satisfaction of the local court litigation provision constituted a “condition of consent” to the agreement to arbitrate.24

The Court left open the possibility that a different interpretive approach may apply to a treaty that “refer[s] to ‘conditions of consent’ explicitly” when discussing procedural preconditions to arbitration—such as the United States-Korea Free Trade Agreement or, perhaps more significantly, the North American Free Trade Agreement.25 The majority was openly skeptical, however, that any such language would warrant a departure from the general interpretive presumptions set forth by the Court’s arbitration precedents.26

**Judge Sotomayor’s Concurrence**

Justice Sotomayor, while joining most of the Court’s opinion, wrote separately to distance herself from the majority’s skepticism and to emphasize that this issue remained open. Justice Sotomayor agreed that the local court litigation provision in the U.K.-Argentina treaty constituted a procedural precondition to arbitration to be interpreted by the arbitrator (and deserving of deference by federal courts).27 But she stressed that the parties may contract around the default rule, so that a similar provision expressly denominated as a “condition on consent” in a treaty may lead to a different conclusion with respect to whether the treaty’s signatories intended such requirement to be a gateway provision interpreted by a court and not by an arbitrator.28

**Chief Justice Roberts’s Dissent**

Chief Justice Roberts, joined by Justice Kennedy, dissented. The dissent argued that the majority reached an incorrect holding because it started with an incorrect premise—that an agreement to arbitrate was formed in the first instance.
According to the dissent, the local court litigation provision constituted a substantive condition on Argentina’s consent to arbitration (normally reserved for courts to interpret). The dissent argued that the U.K.–Argentina treaty did not contain a completed agreement to arbitrate between the host country and foreign investors. Rather, the treaty merely contained certain provisions for resolving disputes between them, provided that a valid agreement to arbitration was formed in some way.

Chief Justice Roberts insisted that no agreement to arbitrate was formed in this case. In his view, the local court litigation provision constituted a “unilateral standing offer” to arbitrate a dispute, which an investor could have accepted by litigating the dispute in Argentine courts, either to a final decision or for at least 18 months. Because BG Group failed to avail itself of the local courts, it had not accepted Argentina’s offer to arbitrate, and thus there was “no completed agreement whatsoever between Argentina and BG Group.” Absent such agreement, the dissent urged, the dispute should have been reviewed by a federal court de novo. The dissent would have remanded the case, however, for the Court of Appeals to consider whether the U.K.–Argentina treaty implicitly incorporated a principle that the offeree’s (here, BG Group’s) failure to comply with the offer’s condition can be excused if the failure was due to the offeror’s (here, Argentina’s) own fault.

**Potential Ramifications**

The Supreme Court’s decision in *BG Group* is an important clarification of the respective roles of U.S. courts and international arbitral tribunals. As we predicted, the Supreme Court declined to adopt a different analytical framework for the judicial review of arbitral awards rendered under international investment treaties. Instead, the Court reaffirmed interpretive principles developed in the context of private U.S. domestic arbitration, and held that the same principles apply to international investor-state arbitral awards. These precedents set forth a presumption that arbitrators (and not the courts) have the authority to decide questions of procedural arbitrability, such as whether preconditions to arbitration have been satisfied. In holding that this presumption applies in the international investor-state arbitration context as well, the Supreme Court reaffirmed that decisions rendered by international arbitral tribunals with respect to such procedural preconditions are entitled to a high degree of judicial deference.

This result is important for any international arbitration where the parties select the United States as the seat of the arbitration. Because parties normally select the arbitration seat with the goal of ensuring deference to the arbitrator’s eventual decision in any proceeding to confirm or vacate an award, the Supreme Court’s decision in *BG Group* helps to ensure that the United States remains a popular and reliable seat for international arbitration proceedings.

The Court’s decision demonstrates, however, the relative difficulty in drawing a distinction between the procedural preconditions and the conditions that are essential to the formation of the agreement to arbitrate. While the majority viewed the local court litigation provision in the U.K.–Argentina treaty as a procedural “claims-processing rule,” the dissent argued that it was a prerequisite to Argentina’s consent to arbitrate a dispute with a foreign investor.

The majority’s treatment of the litigation provision accords with the bilateral investment treaties’ objective of fostering and protecting private foreign investors. As Justice Sotomayor stressed in her concurrence, however, a differently phrased treaty could potentially transform the same litigation provision into an express condition of the host state’s consent to arbitrate, altering the traditional presumption of deference. The Court ostensibly left this question for another day, and it remains to be seen whether states will seek to specify explicitly whether the litigation provision (or similar
prerequisites) in an investment protection treaty constitutes a procedural requirement or a condition of consent to arbitrate. Treaty negotiation, however, is a prolonged and difficult process, and for the immediate future, BG Group mandates that the U.S. courts treat such treaty conditions as procedural requirements with respect to which arbitrators’ decisions enjoy a great measure of deference.

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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1 572 U.S. ___ (2014), No. 12-138, slip op. at 5.
2 Id. at 17.
3 Id. at 7-8; see also id. at 10-11.
4 Id. at 9.
5 See id. at 5, 11, 16 (citing C. Dugan, et al., Investor-State Arbitration (Oxford 2008); see also 572 U.S. ___ (2014), No. 12-138, slip op. at 3, 5, 6, 17 (Roberts, C.J., dissenting) (same).
7 Slip op. at 12; see also 572 U.S. ___ (2014), No. 12-138, slip op. at 1 (Sotomayor, J., concurring).
8 Slip op. at 2-3.
9 Id.
10 Id. at 3-5.
11 Id.
12 Id. at 4 (citation omitted).
13 Id. at 4 (citation omitted).
14 Id. at 5.
16 Slip op. at 5.
17 Id. at 6.
18 Id.
The investor-state arbitrations conducted under the Convention on the Settlement of Investment Disputes between States and Nationals of Other States (ICSID Convention), while held mostly in Washington, D.C., are not subject to being set aside by national courts and are exempted from the Federal Arbitration Act requirements. See ICSID Convention, Art. 53(1); 22 U.S.C. § 1650(a). The impact of BG Group on investor-state arbitrations conducted under the ICSID Convention may, therefore, be limited.