

Client Alert

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Supreme Court Begins Setting Rules For Review of Investment Treaty Arbitrations in the United States

On March 5, 2014, the US Supreme Court rendered a 7-2 decision reinstating a \$185 million arbitration award in favor of the BG Group against Argentina under the UK-Argentina bilateral investment treaty (BIT). The Supreme Court held that the Court of Appeals for the DC Circuit erred in deciding *de novo*, and without deference to the tribunal's award, the issue of the arbitrators' jurisdiction. The decision has been anxiously awaited in international arbitration circles because the case reflects the first instance in which the Supreme Court has interpreted a BIT.

Background

The dispute between BG Group and Argentina arose as a result of the economic crisis in Argentina in 2001–2002. Argentina changed its law for calculating gas tariffs from dollars to pesos, setting the currency conversion at one-third of the prevailing market rate. BG Group sought arbitration under the BIT, which contained a somewhat unusual “local litigation clause” requiring disputes be submitted to an Argentine court for a period of 18 months. After 18 months, if the dispute was not resolved, BG Group could file an international arbitration. Contending that local litigation was “futile,” BG Group proceeded immediately to submit its dispute to arbitration in Washington, DC, under the Federal Arbitration Act (FAA) pursuant to UNCITRAL arbitration rules. The tribunal concluded it had jurisdiction, holding that exhaustion of the 18-month local litigation requirement was not required. On the merits, the arbitrators held that Argentina had denied the BG Group fair and equitable treatment under the BIT and awarded \$185 million in damages.

This award was confirmed by the District Court for the District of Columbia under the New York Convention and the FAA. Argentina appealed, and the Court of Appeals for the DC Circuit reversed, finding that the 18-month local litigation requirement demonstrated Argentina intended a court rather than an arbitrator would decide the issue of arbitrability. The DC Circuit therefore proceeded to review the arbitrators' award *de novo*. It concluded the arbitrators had no jurisdiction because the 18-month local litigation requirement was not exhausted, and vacated the \$185 million award.

Decision

For the majority, the question before the Court “is who—court or arbitrator—bears primary responsibility for interpreting and applying Article 8's local court litigation provision.” The answer to that question determined whether the court could review the arbitrators' interpretation of the contract *de novo*, or whether the reviewing court had to show deference to the arbitral award. In answering the question, the Court initially treated the BIT as if it were an ordinary contract between private parties, disregarding arguments by some amicus parties that the Court should look to the Vienna Convention for guidance interpreting the BIT. The majority held that where a federal court is requested to vacate or confirm an award made under the FAA, even one involving an international treaty, “it should normally apply the presumptions supplied by American law.”

Citing almost exclusively to American law, the Supreme Court pointed to the distinction drawn by its prior decisions between substantive questions of arbitrability, i.e., whether the parties had agreed to arbitrate a

particular dispute, which issue was to be decided by courts, and procedural preconditions to arbitration, which were to be decided by arbitrators. Examining the language of the BIT's dispute resolution provision, the Court concluded there was nothing to suggest that the parties had intended to alter the ordinary American presumptions about courts deciding questions of arbitrability and arbitrators deciding procedural questions such as the time for commencing arbitration. Finding the BIT was silent as to "whether the parties intended to give courts or arbitrators primary authority to interpret and apply a threshold provision in an arbitration contract," the Court applied its ordinary presumptions. It then held that "the local litigation requirement is highly analogous to procedural provisions that both this Court and others have found are for arbitrators, not courts, primarily to interpret and to apply."

The Court accordingly found that the DC Circuit had erroneously applied a de novo standard of review in annulling the arbitral award, rather than the more deferential standard required when the issue was left to the arbitrators to decide in the first instance. The Court proceeded to examine whether, under the highly deferential standard that should have been applied, the arbitrators had "exceeded their powers." Finding they had not, the Court concluded the arbitrators' jurisdictional determinations were lawful and reversed the Court of Appeals, reinstating the \$185 million award against Argentina.

Impact

The Supreme Court's decision confirms, for international investment arbitrations conducted under the FAA, that (i) American and not international law should be applied and (ii) substantive issues of arbitrability are resolved by the courts under a de novo standard of review while procedural issues, including procedural preconditions to arbitration, are to be decided by arbitrators, subject to later deferential review by a court on the grounds permitted by the New York Convention and FAA.

The Supreme Court's decision resolves, as a matter of US law, the proper construction of pre-arbitral waiting periods and local litigation requirements similar to the provisions of the UK-Argentina BIT, holding they are procedural in nature and therefore presumptively for arbitrators to construe (and waive). The Court's resolution of this issue may influence whether parties are willing to seat their arbitrations in the US. Parties wishing to assert a defense based on a procedural precondition to arbitration may contend the US is not a "neutral" forum, as the issue has been conclusively decided against that party as a matter of US law, which must be applied in any petition to confirm or annul the award. The Supreme Court's decision also impacts the precise manner in which a jurisdictional defense must be pled, as failure to assert the defense as a challenge to arbitrability of the claim under the rubric of US case law may be fatal to the success of the claim. Any party planning an investment claim that might be seated in the US under the FAA should consult with counsel about the impact of the BG Group decision.

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