
U.S. Supreme Court Holds that Arbitrators, Not Courts, are Entitled to Interpret Local Litigation Requirements in Bilateral Investment Treaties

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On March 5, the U.S. Supreme Court held in *BG Group PLC v. Republic of Argentina*, --- S.Ct. ---, 2014 WL 838424 (March 5, 2014) that local litigation requirements in bilateral investment treaties (BITs) are generally procedural preconditions to arbitration and that arbitrators, rather than courts, should interpret and apply such requirements in the first instance, subject to only very limited judicial review. The decision is [available here](#).

The majority, in an opinion by Justice Breyer, adopted a two-step analysis. It first assessed the local litigation provision as if it were contained in an ordinary commercial contract between private parties, and then it asked whether the provision's inclusion in a BIT rather than a contract altered the result. The Court concluded that, under principles applicable to ordinary contracts under the FAA, the provision's subject would be considered a procedural issue and thus a question for the arbitrator to decide in the first instance. The Court then determined that because a treaty is in many respects akin to a contract, the result was the same for the local litigation requirement in the UK-Argentina BIT. Absent a clause expressly assigning interpretation of local litigation obligations to courts, the Court held, the arbitrator's decision on the matter would be entitled to "highly" deferential review under the FAA; applying this analysis, the Court readily concluded that there were no grounds for setting aside the arbitrators' determination that compliance with the local litigation requirement would be futile and, as a consequence, not required by the BIT. Reversing the D.C. Circuit's decision, the Supreme Court reinstated the \$185 million award against Argentina.

Background

Petitioner BG Group is a British company with a significant stake in MetroGas, a company that distributed natural gas in Buenos Aires. In 2001 and 2002, Argentina changed the rules that its regulators used to calculate gas tariffs, resulting in losses for MetroGas. In 2003, BG Group initiated an arbitration against Argentina under the dispute resolution provisions of the UK-Argentina BIT (under the UNCITRAL Arbitration Rules in an arbitration seated in Washington, D.C.).

Article 8(2)(a) of the BIT required parties to seek resolution of the dispute first in the local courts and wait 18 months prior to initiating arbitration under the BIT. BG Group did not comply with the local

litigation requirement and Argentina argued to the arbitral tribunal that this failure deprived the tribunal of jurisdiction. The tribunal found in favor of BG Group and decided that Argentina's own actions, restricting the possibilities of challenging its actions in local courts, had made it "absurd" and "unreasonable" for BG Group to comply with the terms of Article 8(2)(a). The tribunal subsequently rendered an award in favor of BG Group on the merits of its claim, holding Argentina liable for some \$185 million in damages.

Argentina sought to vacate the award under §10(a)(4) of the Federal Arbitration Act on the ground that the arbitrators lacked jurisdiction. The district court denied Argentina's claims and confirmed the award. The D.C. Circuit reversed. The court of appeals held that interpretation of Article 8(2)(a)'s local litigation requirement was a question for the courts and that BG had failed to comply with the requirement.

Supreme Court Decision

In answering the question whether arbitrators or courts should have primary responsibility for interpreting the local litigation requirement, the majority first analyzed the provision as if it were in an ordinary contract between private parties. Under this analysis, the local litigation requirement would be classified as a procedural precondition to arbitration, rather than a substantive issue of jurisdiction, such as whether the parties have given consent to arbitration or whether a particular type of controversy is subject to arbitration. Under *Howsam v. Dean Witter Reynolds*, 537 U. S. 79, 84-5 (2002), substantive issues are for the courts to decide *de novo*, while procedural issues are for the arbitrator to decide in the first instance, subject only to highly deferential judicial review, unless the parties make clear that they intend otherwise. See also *Granite Rock Co. v. Teamsters*, 561 U.S. 287, 299-300 (2010).

The Court observed that it has previously held procedural issues to include "claims of waiver, delay, or a like defense to arbitrability," as well as "prerequisites such as time limits, notice, laches, estoppel, and other conditions precedent to an obligation to arbitrate." (Slip op. 2). The Court analogized the local litigation requirement to these types of provisions, noting that the function of the local litigation requirement is to "determine[] *when* the contractual duty to arbitrate arises, not *whether* there is a contractual duty to arbitrate at all." (emphasis original). *Id.* The "litigation provision is consequently 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." (Slip op. 2-3).

The Court next held that the *Howsam* analysis does not change when the agreement at issue is a BIT because treaties are similar in many respects to contracts between national governments. The Court thus concluded that "in the absence of language in a treaty demonstrating that the parties intended a different delegation of authority, the ordinary interpretive framework applies." (Slip op. 3). Citing the first edition of Gary Born's *International Commercial Arbitration* 842 (2009), as reflecting the "bulk of international authority," the Court held that the BIT's local litigation requirement "functions as a purely procedural precondition to arbitrate."

The Court left open the treatment of treaties that contain language making clear that certain

provisions are conditions of a country's consent to arbitrate. The Court noted that the UK-Argentina BIT did not state that the local litigation requirement is a "condition of consent" to arbitration, contrary to the U.S. Solicitor General's argument in its amicus brief. While not deciding the issue, however, the Court intimated that even when a BIT uses phrases like "conditions to consent," that would not necessarily be dispositive. In other words, the Court suggested that merely using the label "conditions of consent," and nothing more, may be insufficient to constitute an explicit assignment of interpretative authority to the courts, rather than to the arbitrator.

Justice Sotomayor concurred. She agreed with the majority that the local litigation requirement is a procedural question. However, she wrote to disagree with the Court's dictum that even if the words "consent" were used to describe conditions in a treaty, such labels would not be conclusive in determining whether the parties intended for the condition to be resolved by the courts or by arbitrators.

Chief Justice Roberts, joined by Justice Kennedy, dissented. They argued that the local litigation requirement is part of the host country's unilateral offer to arbitrate, which the investor must accept by complying with its terms. Unlike a provision in an ordinary contract, the arbitration agreement contained in a BIT runs between the signatory countries, rather than between the host country and private investors such as BG Group. In the dissenters' view, prior to the fulfillment of the local litigation requirement, there is no arbitration agreement in place between Argentina and private investors such as BG Group. Because Article 8(2)(a) is a condition to the formation of an arbitration agreement, its meaning is a substantive question for the courts to resolve *de novo*.

The dissent also rejected the argument (not reached by the Court) that the BIT's incorporation of the UNCITRAL Rules delegated the question of compliance with Article 8(2)(a)'s local litigation requirement to the arbitral tribunal. The dissent reasoned that the local litigation requirement was a condition to Argentina's consent and, consequently, that the UNCITRAL Rules had no effect unless that requirement was satisfied: "If the parties have not validly agreed to any arbitration agreement at all, then they also have necessarily not agreed to institutional arbitration rules." (Slip op. at 15) (citing G. Born, *International Commercial Arbitration* 870 (2009)). Thus, in the dissent's view, the question whether Article 8(2)(a)'s local litigation requirement had been satisfied or waived was subject to *de novo* judicial review.

Despite these conclusions, the dissent also suggested fairly clearly that the court of appeals had erred in its *de novo* review of the arbitral tribunal's application of Article 8(2)(a). The dissent observed that the court of appeals "seems to have simply taken it for granted" that the local litigation requirement had to be complied with even if futile. The dissent suggested that this conclusion found no support in principles of either contract law or international investment law.

Implications

The Court's decision provides a measure of welcome clarification regarding the allocation of competence between U.S. courts and arbitral tribunals over jurisdictional disputes. The Court reaffirmed its previous decisions (in *Howsam* and *Granite Rock*) that "procedural" requirements associated with an arbitration agreement are generally matters for the arbitral tribunal to decide,

subject to only very limited judicial review under §10(a) of the FAA. The Court also displayed marked receptivity to international authorities, with both the majority and dissent relying on a range of international commentary and arbitral awards. Its decision should go far in reassuring international businesses (and foreign states) that the United States provides a predictable and reliable seat for international investment and commercial arbitrations.

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