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Argentina v. BG Group and the Question of Arbitrability

By Claudia D. Hartleben — May 23, 2012

On January 17, 2012, the D.C. Circuit Court of Appeals granted Argentina's appeal to vacate a $185-million arbitral award on the principal ground that the arbitral tribunal exceeded its authority by ignoring the terms of the Bilateral Investment Treaty (BIT) between the United Kingdom and the Republic of Argentina. *Republic of Argentina v. BG Group PLC*, 665 F.3d 1363 (D.C. Cir. 2012). Argentina's appeal against the district court's order confirming the award was heard by Chief Judge Sentelle and Circuit Judges Henderson and Rogers.

In an opinion authored by Judge Rogers, the Court examined the investor-state dispute settlement provision in the BIT, which required submitting the dispute to local courts for a period of 18 months before resorting to international arbitration, to conclude that the arbitral tribunal's decision was rendered "without regard to the contracting parties' agreement establishing a precondition to arbitration." *Id.* at 1366. The Court's ruling was consistent with a line of rather complex jurisprudence considering the question of arbitrability, which, in aiming to preserve the integrity of the parties' intent, has proven challenging to interpret and apply.

The Question of Arbitrability in U.S. Jurisprudence

The "question of arbitrability" asks whether the contracting parties agreed to submit a particular dispute to arbitration. *See Howsam v. Dean Witter Reynolds, Inc.*, 573 U.S. 79, 83 (2002) (citing *AT&T Technologies, Inc. v. Communications Workers*, 475 U.S 643, 649 (1986)). Answering this question, however, has proved less straightforward.

It is important to note from the outset that the Supreme Court has distinguished the question of "who (primarily) should decide arbitrability" from "whether a particular merits-related dispute is arbitrable because it is within the scope of a valid arbitration agreement." *First Options of Chicago, Inc. v. Kaplan*, 514 U.S. 938, 944–45 (1995). Thus, the "question of arbitrability" as referred to under this body of law refers to the former question and should not be confused with the latter.

In *AT&T Technologies, Inc.*, the Supreme Court established a presumption that the question of arbitrability is "an issue for judicial determination [u]nless the parties clearly and unmistakably provide otherwise." 475 U.S. at 649. In making this determination, a court must not consider the merits of the underlying claim, *International Union v. Cummins, Inc.*, 434 F.3d 478 (6th Cir. 2006), and, where the parties' agreement contains an arbitration clause, there is a presumption of arbitrability to resolve any doubts in favor of arbitration. *AT&T Technologies*, 475 U.S. at 649.

In *First Options*, the Court decided that a reviewing court should apply a de novo standard of review to an arbitrator's ruling on arbitrability. 514 U.S. at 947–48. It further rejected the suggestion that a party must raise an arbitrability issue in court in advance of an arbitration, *id.* at 946, thereby leaving the door open for parties to challenge an arbitral award after it has been

rendered on the grounds that the parties never agreed to submit that particular dispute to arbitration, in other words, the question of arbitrability.

Most recently in *Howsam*, the Supreme Court reaffirmed the rule that the question of arbitrability is an issue for judicial determination unless the parties have "clearly and unmistakably" provided otherwise. *Howsam v. Dean Witter Reynolds, Inc.*, 537 U.S. 79 (2002). In considering whether the court or an arbitrator should interpret and apply a statute of limitations, the Court delineated what constitutes a question of arbitrability and what should be considered a procedural gateway issue. The Court rejected the view that "any potentially dispositive question" is necessarily a question of arbitrability. Instead, finding that "the phrase 'question of arbitrability'" has a "far more limited scope," the Court outlined the "narrow circumstances" where contracting parties would likely have expected a court to decide a "gateway matter." *Howsam*, 537 U.S. at 83–4. Such circumstances may include questions of the existence and scope of the arbitration agreement. *Id.* at 84. Yet, "procedural questions which grow out of the dispute and bear on its final disposition," however, are for the arbitrator to decide. *Id.* at 84. Thus, the *Howsam* procedural gateway test now assists lower courts' continued efforts in determining the "who" question; that is, whether a court or arbitrator should decide whether the dispute should be arbitrated.

Background of the BG Group: Argentina Dispute

The BIT between the United Kingdom and Argentina was signed on December 11, 1990, and entered into force on February 19, 1993. *Id.* The BIT sought to promote investment between the contracting parties following Argentina's economic reforms to reduce inflation and public debt. As part of the reforms, Argentina privatized the state-owned gas transportation and distribution company, Gas del Estado, and pegged the Argentine peso to the U.S. dollar. *Id.* at 1366–67. BG Group held a controlling interest in a gas-distribution company, MetroGAS, that held a 35-year exclusive license to distribute gas in the city of Buenos Aires and parts of the surrounding metropolitan area. *See id.*

In the wake of a deep financial crisis in late 2001 and into 2002, the government of Argentina enacted Emergency Law 25,561 on January 6, 2002, converting U.S.-dollar-based adjustment clauses in agreements to peso-based adjustment clauses and converted dollar-based tariffs into peso-based tariffs at a rate of one to one, thereby substantially decreasing BG Group's investment. *See id.* at 1367. Disagreement between offered exchange rates and market rates prompted Argentina to enact decrees that established a renegotiation process for public-service contracts, though any licensee who sought judicial redress would be excluded from renegotiation of its license. *Id.*

On April 25, 2003, BG Group filed a notice of arbitration under United Nations Commission on International Trade Law (UNCITRAL) rules claiming that Argentina had breached its duty to accord fair and equitable treatment to its investment and that Argentina had expropriated BG Group's investment in MetroGas. *BG Group Plc v. Argentina*, UNCITRAL, Award, December 24, 2007. Argentina objected to the tribunal's jurisdiction, arguing that BG Group had not

submitted the dispute to local courts and waited the required 18 months before submitting the claim to international arbitration, as the BIT required. *Id.* at ¶ 141. BG Group countered that this requirement was senseless, as there was no chance that a case of this nature could be resolved within the 18-month period and that, under the circumstances, customary international law allowed the requirement of the exhaustion of local remedies to be disregarded. *Id.* at ¶ 142.

The text of the investor-state dispute settlement provision in Article 8(1) and (2) of the BIT provides:

> 1) Disputes with regard to an investment which arise within the terms of this Agreement between an investor of one Contracting Party and the other Contracting Party, which have not been amicably settled shall be submitted, at the request of one of the Parties to the dispute, to the decision of the competent tribunal of the Contracting Party in whose territory the investment was made.
> (2) The aforementioned disputes shall be submitted to international arbitration in the following cases:
>
> > (a) if one of the Parties so requests, in any of the following circumstances:
> >
> > > (i) where, after a period of eighteen months has elapsed from the moment when the dispute was submitted to the competent tribunal of the Contracting Party in whose territory the investment was made, the said tribunal has not given its final decision;
> > > (ii) where the final decision of the aforementioned tribunal has been made but the Parties are still in dispute;
> >
> > (b) where the Contracting Party and the investor of the other Contracting Party have so agreed.

In a Final Award rendered on December 24, 2007, the arbitral tribunal asserted jurisdiction, concluding that "as a matter of treaty law" investors must fulfill the requirement to submit the dispute to local courts. Final Award at ¶ 146. However, it found that "as a matter of treaty interpretation" under the Vienna Convention on the Law of Treaties, the provision "[could] not be construed as an absolute impediment to arbitration." *Id.* at ¶ 147. Because Argentina had temporarily restricted access to its courts through an emergency decree and, as a licensee, BG Group was excluded from the renegotiation of its license, the tribunal considered that a plain textual reading of the BIT requiring recourse to the domestic judiciary would produce an "absurd and unreasonable result proscribed by Article 32 of the Vienna Convention, allowing the State to unilaterally elude arbitration[.]" *Id.* at ¶ 147.

On the merits, the tribunal rejected BG Group's expropriation claim because the decrease in value of BG Group's investment was not permanent. *See id.* at ¶¶ 268–69. The tribunal did conclude, however, that by dismantling the regulatory framework that was put in place at the time the investment was made, "Argentina violated the principles of stability and predictability inherent to the standard of fair and equitable treatment." *Id.* at ¶ 307. After calculating the value

of BG Group's total investment and assessing the damages caused by the Emergency Law, the tribunal rendered an award for BG Group in the amount of US $185,285,485.85.

Argentina petitioned to vacate or modify the final award under the Federal Arbitration Act (FAA) on the grounds that the arbitrators had exceeded their powers. 9 U.S.C. §§ 10(a). BG Group filed a cross-motion for recognition and enforcement of the final award. The district court denied vacatur and granted enforcement of the final award. *Republic of Argentina v. BG Group PLC*, 715 F. Supp. 2d 108 (D.D.C. 2010); *Republic of Argentina v. BG Group PLC*, 764 F.Supp.2d 21 (D.D.C. 2011).

Court of Appeals Considers Gateway Question of Arbitrability

Argentina appealed the district court's rulings pursuant to the FAA, 9 U.S.C. §§ 10(a) & 11, on the basis that the arbitral tribunal exceeded its authority by ignoring the terms of the parties' agreement. Reviewing the district court's findings of fact for clear error and reviewing questions of law de novo, *see First Options of Chicago, Inc. v. Kaplan*, 514 U.S. 938, 947–48 (1995), the Court framed its analysis by considering the "gateway" question of whether the dispute was arbitrable; meaning, when the contracting parties executed the BIT, "did they, as contracting parties, intend that an investor under the Treaty could seek arbitration without first fulfilling Article 8(1)'s requirement that recourse initially be sought in a court of the contracting party where the investment was made?" *BG Group*, 665 F.3d at 1369.

That question raised the antecedent question of whether the contracting parties intended for a court or an arbitrator to provide that answer. *Id.* Invoking the Supreme Court's rule that the intention of the contracting parties controls whether a court or an arbitrator decides whether a matter is arbitrable, *see, e.g.*, *First Options*, 514 U.S. at 943, the Court emphasized that a desire to submit a question of arbitrability before an arbitrator should not be presumed. *See BG Group*, 665 F.3d at 1369. Rather, evidence of agreement to arbitrate the question of arbitrability must be "clea[r] and unmistakabl[e]." *Id.* (citing *First Options*, 514 U.S. at 944).

The Court explained that the arbitration clause should be construed to "give effect to the contractual rights and expectations of the parties." *Id.* (citing *Stolt-Nielsen S.A. v. Animalfeeds Int'l Corp.*, 130 S. Ct. 1758, 1773–74 (2010)). Further, a court, rather than an arbitrator, should decide a question of arbitrability in the "narrow circumstances where the contracting parties would likely have expected a court to have decided the gateway matter . . . and . . . where reference of the gateway dispute to the court avoids the risk of forcing parties to arbitrate a matter that they may well not have agreed to arbitrate." *Id.* at 1370 (citing *Howsam v. Dean Witter*, 537 U.S. 79, 83 (2002)).

Applying these standards, the Court found that the district court erred in viewing Argentina as having conceded that the arbitrator had the power to determine arbitrability. It supported this conclusion with a temporal analysis of the BIT. *Id.* Specifically, only after recourse to local courts for the prescribed period of time failed to resolve the dispute could the parties commence UNCITRAL arbitration. *Id.* at 1371. UNCITRAL Article 21(1) granted the arbitrator power to

determine questions of arbitrability. *Id.* (citing UNCITRAL Arbitration Rules, G.A. Res. 31/98, art. 21, ¶ 1, U.N. Doc. A/RES/31/98 (Dec. 15, 1976), which provides that "[t]he arbitral tribunal shall have the power to rule on objections that it has no jurisdiction.") The Court thus reasoned that the UNCITRAL Rules, and the accompanying grant of authority to the arbitral tribunal to determine whether the matter was arbitrable, were not "triggered until after an investor has first, pursuant to Article 8(1) and (2) of the Treaty, sought recourse, for eighteen months, in a court of the contracting party where the investment was made." *Id.* at 1370–71.

Further, a comparison of the provision in question with the BIT provision for resolution of inter-state disputes that provided for direct recourse to arbitration, including a directive that "[t]he tribunal shall determine its own procedure," reinforced the Court's finding that the parties knew how to grant an arbitrator such authority. *Id.* at 1371. Indeed, the Court reasoned, the absence of similar language in Article 8(1) and (2) was intentional, therefore counseling "against a reading that would render its [local recourse] requirements inoperative." *Id.*

The Court concluded that because the BIT was silent on whether a court or the arbitral tribunal decides arbitrability when an investor disregards the precondition of initial resort to a local court, it is a question of law for the court to independently decide. *Id.* at 1371–72. Thus, it was error for the district court not to determine whether there was clear and unmistakable evidence that the contracting parties intended the arbitrator to decide arbitrability where BG Group had disregarded the requirement to initially seek resolution of its dispute with Argentina in an Argentine court. *See id.*

The Court added that because the dispute-settlement mechanism under the BIT is explicit, the usual "emphatic federal policy in favor of arbitral dispute resolution" could not override the intent of the contracting parties, as the underlying policy in favor of arbitral resolution of international disputes is to give effect to the intent of the parties. *Id.* at 1373 (citing *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 631 (1985)). In holding that BG Group was required to commence a lawsuit in Argentine courts and wait 18 months before resorting to arbitration if the dispute remained, the Court reversed the orders denying the motion to vacate and granting the cross-motion to confirm the final award and vacated the final award against Argentina. *Id.*

International Implications of U.S. Jurisprudence on Arbitrability

The decision in *Argentina v. BG Group* becomes part of a nuanced body of case law on the gateway question of arbitrability. Here, the D.C. Circuit interpreted and applied these principles in the context of the enforcement of an arbitral award rendered pursuant to an investment treaty. Relying on Supreme Court precedent in *AT&T Technologies, Inc. v. Communications Workers*, 475 U.S. 643 (1986) and its progeny, the D.C. Circuit decided that the contracting parties to the U.K.-Argentina BIT did not intend to submit the question of arbitrability—that is, the issue of whether arbitrators or courts have the primary power to decide if the parties agreed to arbitrate the merits of a dispute—before the arbitral panel that rendered the final award.

On these grounds, it vacated an arbitral award in favor of BG Group and sustained Argentina's view that the international investment arbitration should not have commenced at all. Because, at its core, this was an action to enforce a foreign arbitral award, *Argentina v. BG Group* also inevitably becomes a part of U.S. jurisprudence on the enforcement of foreign arbitral awards under the 1958 Convention on the Recognition and Enforcement of Foreign Arbitral Awards. The ruling fosters the importance of enforcing the terms on which the parties agreed in a matter in which they intended the terms of their agreement to be applied. It also serves as a key reminder of the important role of the law of the place where the enforcement of an arbitral award is sought.

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