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BITs as Contracts, and Lurking Consent Issues: BG Group v. Republic of Argentina

Kellen Lavin · Friday, March 21st, 2014

Introduction

In *BG Group v. Republic Argentina*, a divided U.S. Supreme Court (“the Court”) continued to hold that arbitrators are the proper decision makers in gateway questions of arbitrability, not courts. The issue here concerned whether or not the local litigation requirement in the U.K-Argentina BIT was a procedural prerequisite to investor-state arbitration, or a necessary substantive step needed prior to the formation of an agreement to arbitrate. The Court’s decision also left open the possibility that clear language evidencing consent by a State could lead to a different outcome. Justice Sotomayor joined the majority, and wrote a separate concurrence regarding conditions of consent. Chief Justice Roberts and Justice Kennedy dissented, concluding that the failure to first file suit in Argentina meant there was no agreement to arbitrate between BG Group and Argentina.

Background

In the early 1990’s, BG Group, a British company, had invested in an Argentine entity, which was licensed to distribute natural gas. At the time, Argentinian law provided that all tariffs collected on the natural gas distribution was to be denominated in U.S. dollars. After the financial crisis in Argentina, the State made several emergency changes to its laws, including changes to the calculation of tariffs to be denominated in Argentine pesos. This rapidly altered the profitability of BG Group.

BG Group filed a claim for arbitration under the UK-Argentina BIT (“the BIT”) claiming that Argentina had expropriated BG Groups’ investments. Article 8 of the BIT provided a dispute-resolution mechanism for aggrieved investors against a host state, which included a requirement that disputes be filed in local courts prior to any international arbitration.

Argentina argued before the tribunal that BG Group’s failure to first file suit in Argentina’s local court precluded the arbitral tribunal from having jurisdiction. The tribunal disagreed, and proceeded to decide the case, awarding BG Group US\$185 Million U.S. Argentina filed suit in the District Court for the District of Columbia. The District Court denied Argentina’s motion to vacate, and confirmed the Award. Argentina appealed to the Court of Appeals for the D.C. Circuit, which reversed the earlier orders and vacated the Award. BG Group appealed to the Supreme Court.

The Majority Opinion: Treaties as “Ordinary Contracts”

The majority, led by Justice Breyer, found that the arbitrators, not the courts, had the responsibility to examine and apply the local litigation requirement. The question came down to the familiar

dichotomy of procedure or substance. On one hand, if the litigation requirement was a substantive matter dealing with an agreement to arbitrate, then the courts could properly review the arbitrator's decision *de novo*, and the Court of Appeals verdict should be upheld. On the other hand, if the litigation requirement was a procedural matter, then it would be squarely within the duties and powers of an arbitrator, and the Court of Appeals should be reversed.

The Court stated that the local litigation requirement “determines when the contractual duty to arbitrate arises, not *whether* there is a contractual duty to arbitrate at all.” The Court went so far as to label the requirement a “claims-processing rule,” controlling only the timing of when arbitration begins.

The Solicitor General of the United States had argued before the Court that the local litigation requirement “may be a condition on the State's consent to enter into an arbitration agreement.” The Court, however, was not swayed by this argument, concluding that the term consent would not alter their decision-making process.

Justice Sotomayor, agreeing with the majority, wrote separately to clarify her position on the importance and relevance of consent in a treaty, along with its potential effect upon any analysis along the lines of the majority's decision. She felt that were the litigation requirement labeled as a condition to consent, the Court's analysis would have to change.

The majority itself left open the possibility that condition of consent language in a BIT could change the analysis. The argument for party consent attempted to show that by failing to follow the exact procedure for commencing arbitration, the State's consent was not given. Instead, the Court concluded that in this case, where there was no specific language of consent, and therefore no clear language as to the delegation of authority (either arbitrator or court review), a presumption exists in favor of the arbitrators having such authority.

The Dissent: Treaties Should be Viewed Differently

Chief Justice Roberts and Justice Kennedy argued that a different analysis is needed, that Argentina's signing of the BIT merely contained an offer to arbitrate. In order to accept that offer BG Group had to do so on the terms offered in the BIT. In this view, the local litigation requirement was “a condition to the formation of an agreement, not simply a matter of performing an existing agreement.”

To the dissent, the treaty-based nature of this dispute makes a difference. The special nature of sovereigns giving up rights, and the conditions of consent they might place on giving up such rights, results in a different analysis. Concluding that the local litigation requirement is a condition of consent, it follows that a court could properly review an arbitral decision, as the dispute then becomes a substantive matter of formation of an agreement to arbitrate. The dissent is clear to point out that the Supreme Court's holding is limited only to treaties that do not contain clear language concerning conditions of consent, again clearly marking the boundaries of this decision.

Implications

In the final analysis, the Court walks a fine line by looking to the BIT as an ordinary contract, subject to an ordinary presumption analysis. In so doing, the Court held up the ability of arbitrators to decide their own jurisdiction, and in the process relegating the status of treaties to mere ordinary contracts. Given other recent decisions, it appears there is a schism in the Court's logic on treaties.

The Court carved out a potential exception to its ordinary contract rule, by not coming to any

conclusions about explicit party consent language, due to its absence in the BIT. This consent issue is lurking and still up for debate, as Justice Sotomayor's concurrence and the dissent make clear. Given the importance of this language in NAFTA as well as some U.S. BITs, it is unsurprising that the Court left the consent issue alone. Perhaps this decision will provide States with some means of protecting themselves, if their BITs contain such language – if there is no valid agreement to arbitrate between the parties, then a court could conceivably intercede to review and potentially overturn any arbitral Award arising out of such dispute.

For the international arbitral community, this decision maintains the status quo of arbitral decision-making. For arbitrations seated in the U.S., this decision strengthens a tribunal's power to determine arbitrability, by making it less likely a court would overturn jurisdictional decisions by a tribunal, absent clear consent language in a BIT. This decision leaves one big open question: would this case have been decided differently had the BIT contained clear consent language? The dissent answer unequivocally that this hypothetical case could clearly come before a court, and Justice Sotomayor's concurrence hints that she might feel the same.

By consigning the status of treaties to mere ordinary contracts, the majority's decision may have pushed a future court to follow a different analysis. It is difficult to see how a future court could use a contractual analysis, as recommended by the majority, combined with clear conditions for consent in a BIT, to come to any other conclusion than court review. Under a regular contractual analysis, the failure to exactly accept another party's offer means that there is no agreement.

A final two questions, for readers: how much (if at all) does consent matter in international arbitration? Can States claim that they did not consent to an arbitral proceeding, after they have already agreed to such processes in a BIT? With *BG Group v. Argentina*, the Court failed to answer these questions.

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