New York Law Journal
SERVING THE BENCH AND BAR SINCE 1888
WWW.NYLJ.COM
An ALM Publication
VOLUME 251—NO. 02
MONDAY, MAY 5, 2014

ARBITRATION

Expert Analysis

Conditions Precedent And Arbitrability—Who Decides?

By **Samuel Estreicher**

And **Holly H. Weiss**

An arbitration agreement may provide expressly whether a court or an arbitrator should decide the issue of "arbitrability"—i.e., whether an arbitration agreement actually binds the party and applies to the dispute at hand.[1] In the absence of an express allocation of this authority, courts presume that contracting parties intended for the courts to determine arbitrability.[2] Substantive arbitrability questions, however, must be differentiated from conditions precedent to hearing the case—such as certain exhaustion requirements and filing periods. Such procedural questions are presumptively within the domain of the arbitrator.[3]

The Supreme Court has grappled with the distinction between "substantive" and "procedural" gateway questions to arbitrability in domestic cases.[4] This term, in *BG Group Plc v. Republic of Argentina*,[5] the court applied the framework developed in the domestic context to a business investment treaty between the United Kingdom and Argentina. This case is of considerable importance to the field of international arbitration, as well as domestic arbitration.

Background

Argentina and the United Kingdom entered into a treaty on Dec. 11, 1990, stating the conditions under which investment activities between nationals and other businesses in the two nations would occur.[6] Through the treaty, Argentina and the UK each agreed to "encourage and create favourable conditions for investors of the other [nation] to invest capital in its territory, and, subject to its right to exercise powers conferred by its laws, shall admit such capital" and afford investors from each nations "fair and equitable treatment."[7] To that end, the treaty established, among other things, the right of each nation's investors to be treated no less favorably than other investors (including domestic investors of the host country),[8] rules regarding recovery for losses,[9] and a prohibition on expropriation except in limited circumstances.[10] Article 8 of the treaty also set forth procedures for the resolution of disputes between the host nation and investors from the other nation.

Where the disputants in a post-pact dispute did not agree to arbitrate, such disputes would nonetheless be arbitrated "(i) where, after a period of eighteen months has elapsed from the moment when the dispute was submitted to the competent tribunal of the [nation] in whose territory the investment was made, the said tribunal has not given its final decision; [or] (ii) where the final decision of the aforementioned tribunal has been made but the Parties are still in dispute."[11]

In the early 1990s, a consortium that included the British investor BG Group plc obtained a controlling interest in MetroGAS, the exclusive distributor of natural gas within Buenos Aires. Under Argentinian law, natural gas tariffs during this period were calculated based on U.S. currency. These tariffs, by law, "would be set at levels sufficient to assure gas distribution firms, such as MetroGAS, a reasonable return." Approximately one decade later, however, MetroGAS experienced losses when Argentina enacted new laws replacing U.S. dollars with Argentina pesos—which then had an exchange rate with U.S. dollars of three-to-one—on a one-to-one basis as the currency used to determine tariffs on gas. According to BG Group, Argentina violated the treaty by enacting these new laws. In particular, BG Group argued that the treaty's prohibition on expropriation barred Argentina from changing the law in this way and that these changes denied BG Group "fair and equitable treatment."

In 2003, pursuant to Article 8 of the treaty, BG Group presented its claims to a three-person arbitration tribunal sitting in Washington, D.C. Argentina objected to the arbitrators' authority to hear the case on several grounds, including "failure by BG [Group] to bring its grievance to Argentine courts for 18 months" in contravention of Article 8. The tribunal rejected Argentina's arguments. With respect to BG Group's alleged failure to litigate its claims before the Argentina courts, the arbitrators determined that Argentina "'hindered' recourse 'to the domestic judiciary' to the point where the treaty implicitly excused compliance with the local-litigation requirement."[12]

For instance, Argentina's president by decree stayed for nearly a half-year all injunctions and final judgments in court cases relating to the legal changes in the early 2000s. Under these facts,"[r]equiring a private party…to seek relief in Argentina's courts for 18 months, the panel concluded, would lead to 'absurd and unreasonable result[s].'" Although BG Group lost its expropriation claim, the arbitrators agreed that Argentina had not provided "fair and equitable treatment" to BG Group, and entered a $185 million judgment in BG Group's favor.

The Lower Courts' Analysis

The U.S. District Court for the District of Columbia confirmed the arbitral award. On appeal, the U.S. Court of Appeals for the D.C. Circuit reversed. In the appeals court's view, arbitrability was a matter for the courts to decide de novo, without any deference to the arbitral decision. The D.C. Circuit determined that BG Group's failure to submit its dispute to

SAMUEL ESTREICHER *is the Dwight D. Opperman Professor of Law at New York University School of Law and of counsel at Schulte Roth & Zabel.* HOLLY H. WEISS *is a partner at Schulte Roth & Zabel.* FRANK P. SABATINI*, an associate at the firm, assisted in the preparation of this article.*

the Argentina courts for 18 months meant that the arbitral tribunal lacked authority to decide the matter, and required vacatur of its award.

Supreme Court's Analysis

The Supreme Court granted certiorari to decide whether "a court or instead the arbitrator determine[s] whether a precondition to arbitration has been satisfied."[13] The court reversed, holding 7-2 that the courts must defer to the arbitrators' interpretation of the treaty's local-litigation requirement. Writing for the majority, Justice Stephen Breyer divided his analysis into two parts: (1) how the treaty would be interpreted if it were a typical contract rather than a treaty, and (2) whether the treaty should be treated differently from a private contract because it is a treaty.

The court first analyzed the treaty as if it were a normal contract. The court observed that "it is up to the parties to determine whether a particular matter is primarily for arbitrators or for courts to decide." Courts may use certain presumptions to ascertain the intent of the contracting parties in the event that the contract does not explicitly indicate which type of tribunal "is to decide 'threshold' questions about arbitration."

The court distinguished "disputes about 'arbitrability'…such as 'whether the parties are bound by a given arbitration clause,' or 'whether an arbitration clause in a concededly binding contract applies to a particular type of controversy'" from merely procedural hurdles such as delay or waiver or "'prerequisites such as time limits, notice, laches, estoppel, and other conditions precedent to an obligation to arbitrate.'" "Arbitrability" questions are for the courts, but arbitrators may rule on procedural prerequisites to hearing the case.[14]

In the court's view, Argentina had made clear that it was bound under the treaty to arbitrate investor disputes such as BG Group's and that the local-litigation requirement was not a condition to Argentina's consent to arbitrate: The local-litigation requirement "determines when the contractual duty to arbitrate arises, not whether there is a contractual duty to arbitrate at all."[15] The court noted that Article 8 did not dictate that the arbitrator give any substantive force to the local tribunal's decision or otherwise affect an arbitrator's ruling on the merits, further indicating that the provision was "purely procedural."

The court referenced *Howsam v. Dean Witter Reynolds*,[16] which held that the arbitrator, not a court, was to apply an arbitration rule prohibiting a party from commencing an arbitration six or more years after the event from which the dispute arose. Similarly, in *John Wiley & Sons v. Livingston*,[17] it was for the arbitrator, not the courts, to rule on an employer's objection that a union did not hold two mandatory conferences prior to commencing arbitration. The court found the provisions in these cases to be "highly analogous" to the treaty's local-litigation rule.

The court found no reason to interpret the treaty differently from other contracts simply because it was an agreement between foreign states. In response to an argument by the Solicitor General that the local-litigation rule perhaps constituted "a condition on the State's consent to enter into an arbitration agreement," the majority, without deciding the issue, expressed skepticism that even explicitly labeling a certain treaty provision as a "condition" to the state's consent would change the interpretive framework. At any rate, the treaty lacked such express language, so there was no basis for departing from the usual principles of contract interpretation. In particular, no language indicated that the local-litigation requirement was "a substantive condition on the formation of the arbitration contract, or that it [was] a matter of such elevated importance that it [was] to be decided by courts."[18]

> Substantive arbitrability questions must be differentiated from conditions precedent to hearing the case.

Moreover, "[i]nternational arbitrators are likely more familiar than are judges with the expectations of foreign investors and recipient nations regarding the operation of the provision." Finally, arbitration organizations, referenced under Article 8(3), have rules providing that the arbitrators have interpretive authority over "provisions of this kind."

Having decided that the arbitrators' determination in this case was to be reviewed on a highly deferential standard of review, the court upheld the arbitrators' determination. Noting that it "would not necessarily characterize" the Argentinian president's decree or the ban on litigants availing themselves of Argentina's contract renegotiation procedures "as rendering a domestic court-exhaustion requirement 'absurd and unreasonable,'" the court nonetheless held that "[t]he arbitrators did not 'stra[y] from interpretation and application of the agreement' or otherwise 'effectively dispens[e]' their 'own brand of…justice.'"[19]

Justice Sonia Sotomayor concurred in part, stating that explicit "condition of consent" language could change the outcome of the case. Because there was no such language in the treaty, however, she otherwise joined the opinion of the court. Chief Justice John Roberts, joined by Justice Anthony Kennedy, dissented. In his view, treaties should not be treated like ordinary contracts. The submission of a dispute to local courts was not merely a "condition precedent" to arbitration but rather the means by which an investor would form an arbitration agreement with the host nation. In the absence of any such agreement, the arbitrators could not decide the case.

Implications

BG Group reaffirms the court's strong presumption of arbitrability—here extended to the international arbitration context. Rejecting the Solicitor General's suggestion to interpret treaties differently, the court makes clear that only express language conditioning a party's agreement to arbitrate a dispute will suffice to overcome the presumption. Because the local-litigation requirement would not have prevented arbitration in any circumstance, the court was comfortable concluding that the requirement was merely a "procedural" condition precedent as to when rather than whether Argentina had agreed to arbitrate the dispute.

1. See *BG Grp. Plc v. Republic of Arg.*, 134 S. Ct. 1198 (2014); *First Options of Chi. v. Kaplan*, 514 U.S. 938, 943 (1995).
2. *Kaplan*, 514 U.S. at 943.
3. *Howsam v. Dean Witter Reynolds*, 537 U.S. 79, 84 (2002).
4. See, most recently, *Rent-A-Center, West, Inc. v. Jackson*, 561 U.S. 63 (2010); *Granite Rock Co. v. Teamsters*, 561 U.S. 287 (2010).
5. 134 S. Ct. 1198 (2014).
6. Agreement for the Promotion and Protection of Investments, U.K.-Arg., Dec. 11, 1990, 1765 U.N.T.S. 34, available at https://treaties.un.org/doc/publication/unts/volume%201765/volume-1765-i-30682-english.pdf (last accessed April 29, 2014).
7. Id. art. 2.
8. See id. art. 3.
9. See id. art. 4.
10. See id. art. 5.
11. Id. art. 8(2)(a). The treaty also established in Article 8(3) alternative routes for referring the dispute to international arbitration.
12. Id. at 1205.
13. Petition for a Writ of Certiorari, *BG Grp.*, 134 S. Ct. 1198 (No. 12-138), 2012 WL 3091067; see also *BG Grp. Plc v. Republic of Arg.*, 133 S. Ct. 2795 (2013) (granting certiorari).
14. *BG Grp.*, 134 S. Ct. at 1206-07.
15. Id. at 1207.
16. 537 U.S. 79 (2002).
17. 376 U.S. 543 (1964).
18. *BG Grp.*, 134 S. Ct. at 1210.
19. Id. at 1212-13.