CASE COMMENT

Judicial Review of Investor Arbitration Awards: Proposals to Navigate the Twilight Zone between Jurisdiction and Admissibility

By Luis Miguel Velarde Saffer and Jonathan Lim

Background[1]

In March 2014, the highly anticipated case of *BG Group v Argentina* was decided by the US Supreme Court. This was the first time an investor-State arbitration award had come before the Supreme Court for its review. And although the Supreme Court had already considered the question of whether courts or arbitrators have the final say on whether preconditions to arbitration have been satisfied, it had never had occasion to consider this issue in the context of an international arbitration between non-US parties. As a case of many firsts, the *BG Group* case was a welcome opportunity for the US Supreme Court to provide guidance on the scope of judicial review of arbitrators' decisions on whether preconditions to international investment arbitration have been satisfied or may be dispensed with.

The spotlight was on a much-criticised decision of the Circuit Court of Appeals in Washington, DC, which vacated a $185m award in favour of BG Group. The initial dispute arose out of emergency actions taken by the Republic of Argentina in late 2001. BG Group, a UK company, had

1 A previous related piece, written before the US Supreme Court decision was rendered, was published in *Transnational Dispute Management* on 6 January 2014.

a sizable investment in an Argentine gas distribution company. Because the government measures had compromised BG Group's investment, BG Group initiated UNCITRAL arbitration against Argentina pursuant to Article 8 of the Argentina-UK Bilateral Investment Treaty (BIT). Although Articles 8(1) and 8(2) of the BIT provide that an investor must litigate its claim before the courts of the host State for 18 months before bringing a claim in arbitration, BG Group commenced arbitration without first attempting recourse in the Argentinian courts. Nonetheless, the arbitral tribunal held that BG Group's claim was admissible because Argentina had by its own actions unilaterally prevented or hindered recourse to its domestic judiciary. BG Group prevailed at the arbitration, and the arbitral award was subsequently confirmed by the US District Court for the District of Columbia, which held that the arbitrators' decision was entitled to deference.

On appeal, the DC Circuit had ruled for Argentina and vacated the award, holding that (i) it had the authority to decide de novo the 'gateway' question of 'arbitrability'; and accordingly, that (ii) the tribunal lacked jurisdiction since BG Group was required to commence a lawsuit in Argentine courts and wait 18 months before filing arbitration.[2]

The US Supreme Court predictably reversed the DC Circuit judgment, although the manner by which it reached this result was probably less predictable.[3] The majority, led by Justice Breyer, found that the litigation pre-condition was a question of procedural arbitrability, since it was similar to a 'claims-processing rule' which governs *when* a duty to arbitrate arises and not *whether* it exists. On that basis, and also on finding no reason to construe treaties differently from ordinary contracts, the Court applied a deferential standard of judicial review and upheld the award. Justice Sotomayor concurred with the result but expressed disagreement with the majority *dictum* that express stipulation of 'conditions to consent' in a treaty would likely not change the Court's analysis. Even the dissenting opinion did not uphold the Court of Appeals decision, and instead recommended remand of the case to the DC Circuit. In their dissenting opinion, Justices Roberts and Kennedy reasoned that the submission of the dispute to local courts was a condition to the formation of the arbitration agreement, placing emphasis on Argentina's sovereignty and the difference between treaties and ordinary contracts.

2 *Republic of Argentina v BG Group PLC*, 665 F 3d 1363, 1371 (DC Cir 2012).

3 *Republic of Argentina v BG Group PLC*, 572 US _ (2014).

Jurisdiction versus admissibility: the consent argument

The central issue in the appeal was whether, in the context of an investment arbitration case, the US Courts must defer to arbitrators' decisions on preconditions to arbitration, or whether they get to independently decide such issues de novo. In other words, the issue was not merely whether an investor could validly submit a claim to arbitration without first fulfilling the Treaty's local litigation requirement, but whether arbitrators or courts would get the final say on that question. This is a meta-question that concerns the distribution of responsibilities between courts and arbitrators.

How the meta-question is answered fundamentally impacts whether parties get the process they bargained for and, as a corollary, whether the process of investment arbitration will be seen as legitimate and effective.[4] The challenge lies in correctly identifying whether an issue properly raises a question of jurisdiction, which the Courts may review de novo, or whether it raises a mere question of admissibility, on which deference should be given to arbitrators' decisions[5]. While there are clear cases, most commentators agree that there is a 'twilight zone' of hard cases, ie a spectrum of hard cases that resist easy classification. BG Group is interesting precisely because it falls within this zone.

Under existing US arbitration law, the distribution of roles between courts and arbitrators is accomplished using the concept 'arbitrability'.[6] US courts are to ask, in relation to 'questions of arbitrability', whether parties intended to submit such questions to the arbitrators or the courts. To answer this, the *Howsam* line of cases[7] distinguishes between 'substantive arbitrability' (ie jurisdiction) and 'procedural arbitrability' (ie admissibility) issues: Courts can review de novo decisions relating to the former, but must

4 As one commentator explains: '[d]ecisions of tribunals which do not respect jurisdiction may be invalidated by a controlling authority. But if parties have consented to the jurisdiction of a given tribunal, its determinations as to the admissibility of claims should be final. Mistakenly classifying issues of admissibility as jurisdictional may therefore result in an unjustified extension of the scope for challenging awards, and frustrate parties' expectation that their dispute be decided by the chosen neutral tribunal.' See Jan Paulsson, 'Jurisdiction and Admissibility', in Gerald Aksen and others (eds), *Global Reflections on International Law, Commerce and Dispute Resolution: Liber Amicorum in Honour of Robert Briner,* (ICC Publishing 2005), 601.

5 One way of making the distinction conceptually is: jurisdictional objections take aim at arbitrators' power to decide the dispute, while admissibility objections take aim at the claim itself, regardless of who the decision-maker is.

6 This is a confusing usage – meaning threshold issues to be decided by either judges or arbitrators – that is at odds with the international consensus on the meaning of 'arbitrability', which is usually taken to refer to 'subject matter arbitrability', or in other words public policy limits on the types of matters that may be submitted to arbitration. The UNCITRAL Model law reflects this understanding of 'arbitrability'.

7 *Howsam v Dean Witter Reynolds*, Inc 537 US 79 (2002).

give deference to arbitrators' decisions on the latter. Under this dichotomy in US law, the Supreme Court has held that 'conditions precedent to an obligation to arbitrate' are 'procedural' and therefore presumptively for the arbitrators to decide.[8] However, despite this seemingly straightforward categorisation, the arguments exchanged in the BG Group case call into question any blanket assumption that 'conditions precedent' should always be treated by Courts as 'procedural' in nature.

The relevant provisions of the UK-Argentina BIT are Articles 8(1) and 8(2) of the dispute settlement clause, which provide as follows:[9]

'(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 clever reframing of the issues before the Supreme Court, Argentina had characterised the local litigation requirement as a condition of its consent to arbitration. To be clear, this was couched as a condition to the very existence of an arbitration agreement, rather than a precondition to the performance of the obligation to arbitrate (which presumes a valid arbitration agreement). This effectively shifts the terms of the debate, given that the validity or existence of an arbitration agreement is regarded, under existing law, as a 'substantive arbitrability' question. Argentina's characterisation thus called upon the Court to decide whether there is consent to investment arbitration only when preconditions requiring litigation in a different forum are satisfied, or whether States' consent

8 *John Wiley & Sons, Inc v Livingston*, 376 US 543 (1964).

9 Above n 2.

occurs once the Treaty is executed.

Without denying the internal logic to Argentina's argument, there is perhaps a dangerous circularity here. If the Supreme Court accepted Argentina's characterisation, it would have opened the door to respondents making objections based on consent every time a procedural condition is not met, however trivial. Hence the Supreme Court's apparent obsession at oral arguments with how a requirement that something 'be filed on blue paper' would be analysed, and whether that could also be a consent-based objection if documents were filed instead on white paper.[10] While obviously a reductio ad absurdum, it highlights that Argentina's characterisation threatens to jettison the line-drawing established under existing US precedent, without proposing any better alternatives.

Ultimately, Argentina's characterisation simply begs the question of how responsibilities between courts and arbitrators should be distributed. Had Argentina's proposal been accepted, in every case where one party alleges lack of consent, courts will review the objection de novo, and decide whether consent was given or not. If a court decides there was consent to arbitrate, the preconditions would be mere 'procedural arbitrability' issues and deference would be given to arbitrators' decision. On the other hand, if the court decides there was no consent, then arbitrators were wrong in taking jurisdiction and the court would confirm vacatur. In short, a court can reach any outcome it wants through a de novo revision of the matter. But yet, this already presumes the answer to the meta-question the court was asked in the first place, ie whether it should defer to the arbitrators' decision. Argentina's proposal thus loads the dice in favour of de novo review.

What this debate illustrates is how difficult it can be to distinguish between jurisdiction and admissibility in 'twilight zone' cases. Unlike issues that clearly go towards admissibility on one end (such as time limits and estoppel), and those that clearly go towards jurisdiction (such as validity of the arbitration agreement), a 'twilight zone' case defies easy classification. In such cases, the US approach of focusing on who the parties intended to have the ultimate say on particular 'arbitrability' issues becomes unrealistic, as this is usually a matter that parties did not consider. In the absence of expressed party intentions, the line-drawing between jurisdiction and admissibility rests on the uncertain basis of presumed party intentions, thus providing courts with too much leeway to decide a matter de novo, and potentially frustrating the parties' chosen dispute resolution mechanism.

10 See transcript of oral argument, *BG Group PLC v Republic of Argentina*, (US Supreme Court, 2 December 2013), at 21, 31, 51.

Existing guidance on navigating the 'twilight zone'

It should be no surprise that *BG Group* is a 'twilight zone' case, given the profusion of *amicus curiae* briefs in support of both sides. Article 8 of the Argentina-UK BIT is unusual in requiring recourse to local courts, while also stipulating that such court decisions would not be final and that an investor can still proceed to arbitration if it is dissatisfied with the court decision or 18 months have passed. Because of the provision allowing arbitration after a time-lapse, such a clause falls short of being a requirement to exhaust local remedies, which is generally regarded as being jurisdictional in nature.[11] On the other hand, unlike multi-stage dispute resolution clauses mandating prior mediation or settlement attempts, which have been considered under US law as admissibility matters, Article 8 requires prior recourse to the local courts of Argentina, that is, to a very different forum with adjudicative powers.

The case law and academic literature posit several tests for navigating the 'twilight zone', but they are unfortunately indeterminate in the present BG Group case. In *John Wiley*, the Court took into consideration how closely linked the precondition's satisfaction was to the merits of the dispute.[12] The Court held that it 'would be a curious rule which required that intertwined issues of 'substance' and 'procedure' growing out of a single dispute and raising questions on the same facts had to be carved up between two different forums, one deciding after the other'. Applying this in *BG Group*, the same facts which gave rise to the dispute (emergency actions taken by Argentina) are practically inextricable from the facts that the arbitral tribunal relied on to excuse BG Group from compliance with the local litigation requirement. This thus argues in favour of viewing the precondition's satisfaction as an admissibility issue.

Another test, however, arguably points in the other direction. Jan Paulsson has suggested the objection's 'relevance to the nature of the forum' as a promising 'lodestar' for determining whether an issue goes towards jurisdiction or admissibility.[13] In other words, the question is 'whether the success of the objection necessarily negates consent to the forum' (emphasis added).[14] Because the precondition in BG Group is recourse to Argentine courts, Argentina's objection in this case does in

11 See Paulsson, above n 5, at 616. See also *Maffezini v Spain*, Decision on Jurisdiction, 25 January 2000, paras 38 et seq, 40 ILM 1129 (2001). Indeed Article 26 of the Washington Convention explicitly provides that in the case of ICSID arbitrations, States may require exhaustion of local remedies 'as a condition of its consent to arbitration'.

12 *John Wiley*, above n 9, at 556.

13 Paulsson, above n 5, at 616.

14 Ibid.

fact take aim at the appropriate forum for the case. Under this proposed test, therefore, it is at least arguable that the objection is a jurisdictional one. Yet, the opposite result may also be argued for under Paulsson's test. Because Article 8 empowers an investor to bring an arbitration claim if it wishes so after certain time, Argentina's objection does not necessarily negate consent to have an arbitral forum decide the dispute. If this is the case, then arguably the issue is one of admissibility.

The authors' proposals

While the majority reaches the right outcome in *BG Group* by classifying the local litigation pre-condition as a procedural issue of admissibility, the Justices' opinions do not offer much guidance on navigating future 'twilight zone' cases. The majority opinion is formalistic in its application of traditional contract law without nuance, and, in equating such pre-conditions with claims-processing rules, the majority's reasoning fails to engage with the quality and nature of the pre-condition, in particular parties' choice of recourse to a judicial forum at first instance – which is qualitatively different from waiting periods or statutes of limitation. On the other hand, the dissenting opinion gives too much credit to Argentina's consent argument, and is subject to the circularity criticism – giving no guidance as to how to identify true conditions to consent in future cases.

Although this underscores that the line-drawing exercise in relation to 'twilight zone' cases is not easy, clear authoritative guidance is needed for consistent resolution of future hard cases. As such, the authors make two contributions to the possible rationalisation of difficult 'twilight zone' cases, and in particular, how the *BG Group* case should be understood.

First, it is suggested that a narrow resolution of *BG Group* could have been found in the particular shape and structure of the multi-step dispute resolution clause in the Argentina-UK BIT. While the majority's decision adopts a close analysis of Article 8 and its provisions, it relies on the formalistic assertion that condition precedents are concerned with the timing rather than with the existence of a duty. This analysis fails to accord due weight to the *quality* and *nature* of the pre-condition. A proper distinction should have been made between a precondition that requires prior recourse to an adjudicative forum capable of making a final and binding decision, and a precondition that requires recourse to a non-binding or non-adjudicative forum. In the latter, as is the case in BG Group, because 'all roads lead to arbitration' it may be argued that there is consent to have the arbitral tribunal decide the substantive dispute. In contrast, in the former case, the dispute is capable of being resolved conclusively and finally through

adjudication in the first forum, and therefore consent to the arbitral forum may be properly regarded as conditional upon prior recourse. For instance, an Article-8-type pre-condition for local litigation, but without the ability to appeal the local decision (ie there is a possibility local litigation would give binding resolution), would be jurisdictional. Under this analysis, the touchstone for deciding whether the prior recourse requirement is a precondition to the very existence of an arbitration agreement is the shape of the clause: whether it is shaped like a 'pyramid', with all roads leading to arbitration at the apex, or a 'fork', meaning the parties may be subject to potentially more than one forum that can provide binding adjudicative resolution to the conflict.

Secondly and alternatively, a broader resolution of *BG Group* might be better reached through the adoption of a general presumption that parties have consented unconditionally to arbitration, absent express stipulation of conditions to consent. There are strong policy reasons in favour of such a common sense rule, particularly where investment arbitration is concerned. When States enter into a Treaty that provides for arbitration, it is reasonable to believe they intended to have disputes determined by arbitrators with expertise in international law. As the determination of the nature and satisfaction of preconditions to arbitration generally involves interpretation of treaties in accordance with international law, and the sovereign State's consent is a matter of public international law, it would make sense to presume that an arbitral tribunal with international law expertise is the proper body to resolve such disputes. The proposed presumption is also consistent with the Vienna Convention, which governs the arbitration clause in the BIT.[15] In line with the Convention's textualist approach, which requires strict adherence to the treaty text over unexpressed party intentions,[16] the proposed rule would constrain creative interpretations by courts or arbitrators in hard cases.

Both the majority and dissenting opinions seem to overlook this reality. The former, in analysing treaties as ordinary contracts, ignores several good reasons to believe that parties may have intended arbitrators to have the last word in regard to investment treaty interpretation. The dissent makes the same assumption in regard to the comparative expertise of arbitrators. But arbitrators in investment arbitration are often chosen specially for their particular expertise in investment or international law, and it is reasonable to presume that they are better positioned for the interpretation of preconditions contained in the treaty text.

15 Vienna Convention on the Law of Treaties, 23 May 1969, 1155 UNTS 331.

16 See Article 31 of the Vienna Convention.

In addition, the rule proposed by the authors would bring many benefits to the investment arbitration system as a whole. If parties could only make such objections when their consent was expressly conditioned, this would go some way towards creating a more efficient 'one-stop adjudication' process for investment disputes. Such a bright-line rule would also provide greater certainty and predictability. Additionally, this general rule carries a lower risk of decision-error. Because review of arbitral decisions on investment disputes can surface before national courts long after the relevant treaty was executed, very little information may be available to the courts to construe and determine the facts of the dispute. In contrast, an arbitral tribunal is constituted far closer in time to the dispute, and will also have the benefit of having directly heard the primary evidence of the case. Finally, such a general rule would not be costly for States, as they can easily bargain for and include the relevant language in their BITs. On a simple cost-benefit analysis, therefore, the authors favour and advocate drawing the line in favour of a presumption of unconditional consent by a party to arbitration.

Conclusion

Ultimately, the *BG Group v Argentina* decision, while welcome, does not do much to clarify. It leaves unanswered the question of what constitutes a proper condition to consent, and provides scant guidance on how future cases involving differently worded treaty pre-conditions would be analysed.

'Twilight zone' cases like *BG Group* will probably arise again in the future. Indeed, as cross-border investments and transactions continue to proliferate, there is likely to be greater diversity in the shape and structure of arbitration clauses. With little information available to construe the will of the parties, and lawyers becoming more creative and sophisticated in their argumentation, there is a danger that contradictory decisions by various courts and tribunals will be rendered. Parties may be deprived of the dispute process they bargained for. This looming uncertainty about the finality of arbitral awards may put the very legitimacy of the system at risk.

The authors' proposals seek to avoid this unfortunate reality by advocating a clear and principled approach to the distribution of responsibilities between courts and arbitrators. In particular, the proposed presumption of unconditional consent to arbitrate will incentivise parties to adopt clearer arbitration clauses. This accords with common expectations of parties, and is not too costly because parties can easily opt out.