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UNITED STATES: Nixing a final award on jurisdictional grounds

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Timothy Nelson and **Julie Bédard**, partners at Skadden Arps Slate Meagher & Flom in New York, report on three recent US court decisions that consider challenges against international arbitral awards on jurisdictional grounds.

The power of a US court to confirm or vacate an international arbitral award rendered in the US, and the corresponding power of the courts to grant or decline recognition to foreign arbitral awards, has been the subject of renewed interest in the wake of three recent decisions where an international award was challenged on the ground that the arbitrators lacked jurisdiction.

Each decision involved an award rendered against a sovereign state. In two of these decisions, both rendered by the US Court of Appeals for the Second Circuit, a challenge to an UNCITRAL award was rejected, despite vigorous jurisdictional objections by the unsuccessful sovereign party. In the third – the highly controversial case of BG Group v Argentina – the DC Circuit vacated an award in its entirety, based on the investor's failure to meet a threshold "gateway" point that, it held, deprived the UNCITRAL tribunal of any jurisdictional from the outset. This issue has revived debate about the proper role of the courts in reviewing arbitral awards, particularly those rendered under bilateral investment treaties (BITs); a system in which the courts historically have taken a "minimalist" role.

The modern system of BITs, which give private parties the right to seek arbitration of investment claims against host sovereigns, has enabled international tribunals to remedy a wide variety of investment grievances and to award damages against states that expropriate or mistreat foreign investors' assets. In BIT arbitrations, sovereigns often raise jurisdictional objections, for example, that the dispute does not relate to an "investment", that the claimant lacks the required nationality, or that the claimant did not satisfy the prescribed pre-dispute procedures (for example, a period of negotiation with the sovereign). Jurisdictional objections also are not uncommon in contractual disputes between private parties and sovereign states. They are, quite simply, part of the modern arbitration landscape.

With the prevalence of jurisdictional objections grows the importance of dealing with such objections in an efficient and predictable manner. Within the ICSID system, jurisdictional objections are addressed in the first instance by the arbitral tribunal under the principle of Kompetenz-Kompetenz, but may potentially be revisited by an ad hoc annulment committee, which has the power to annul an ICSID award if the arbitral tribunal manifestly exceeded its powers within the meaning of article 51(1)(b) of the ICSID Convention (and, sometimes, based on "failure to give reasons"

under article 51(1)(e)). The annulment committee's ability to vacate awards on such grounds has proven controversial, particularly following the annulment decisions in Sempra v Argentina (2010) and Enron v Argentina (2010). Generally, however, ICSID annulment committees have exercised their powers sparingly and have rejected most jurisdictional challenges to ICSID awards.

Outside of the ICSID Convention system, including in arbitrations governed by the UNCITRAL rules or the ICSID additional facility rules, a jurisdictional challenge to an arbitral award will often be addressed by the tribunal itself, but may also be examined by the courts of the seat of arbitration. Indeed, as the Waste Management v Mexico tribunal memorably observed in 2001, a treaty award rendered outside the ICSID Convention system "is not quarantined from legal supervision under the law of the place of arbitration."

Where the place of arbitration is the US, the "supervision" of an award takes place under the Federal Arbitration Act (FAA), and the ability of US courts to nullify an award on jurisdictional grounds is narrow. Thus, while section 10(a)(4) of the FAA allows an award to be vacated if the arbitrators manifestly exceed their powers, US courts "have consistently accorded the narrowest of readings" to this power, "especially where that language has been invoked in the context of arbitrators' alleged failure to correctly decide a question which all concede to have been properly submitted in the first instance" (Westerbeke v Daihatsu). The US courts have also accepted (to a limited extent) the principle of competence-competence – or, as they prefer to put it, the arbitral "power to decide arbitrability", which power exists only if the parties have conferred it upon the tribunal (see First Options v Kaplan). As a result, after-the-fact jurisdictional challenges to an arbitral award will often receive short shrift in the US courts.

Judicial restraint is perhaps more obvious in those instances where the losing party seeks to have the US courts deny recognition of a foreign arbitral award. While article V(1)(c) of the New York and Panama Conventions allows a court to decline recognition of an award if it "deal[s] with a difference not contemplated by or not falling within the terms of the submission to arbitration, or it contains decisions on matters beyond the scope of the submission to arbitration," this power has been construed narrowly by the US courts. See, for example, the Delaware district court's ruling in SEI v L-3 Fuzing that "[r]eview of the scope of arbitration should favor arbitration 'unless it may be said with positive assurance that the arbitration clause is not susceptible of an interpretation that covers the asserted dispute.'"

***Schneider v Thailand*: BIT challenge denied**

The Second Circuit's recent decision in Schneider v Kingdom of Thailand illustrates the US courts' usual reluctance to entertain jurisdictional challenges to an arbitral award. In that case, a Geneva-based UNCITRAL tribunal awarded €30 million to a German investor after finding that the Thai government had breached the 2002 Germany-Thailand BIT by engaging in the indirect expropriation of a tollway project. The investor sought to have the award recognised and enforced in the US District Court for the Southern District of New York. Resisting this application, Thailand argued that the Geneva tribunal lacked jurisdiction because the investor's enterprise was not an "approved investment" as defined by the BIT. Relying on its earlier deci-

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The international journal of commercial and treaty arbitration
NEWS

sions in Contec Corp v Remote Solutions and Republic of Ecuador v Chevron Corp rejecting similar submissions of alleged lack of arbitral jurisdiction to determine arbitrability issues with finality, both the district court and the US Court of Appeals for the Second Circuit held that the question of whether there was an "approved investment" was reserved to the arbitrators under the BIT, embodying the parties' agreement to arbitrate under the UNCITRAL Rules 1976. Article 21 of the rules states that the arbitral tribunal "shall have the power to rule on objections that it has no jurisdiction, including any objections with respect to the existence or validity of the arbitration clause or of the separate arbitration agreement." The adoption of the UNCITRAL Rules, therefore, constitutes "clear and unmistakable evidence" of the parties' intent to arbitrate questions of arbitrability.

The Second Circuit in Schneider also warned of the adverse policy implications of raising jurisdictional challenges so late in the arbitral process, that there would be an "enormous waste of resources contrary to the purposes of the New York Convention" if the court failed to "give any deference" to the UNCITRAL tribunal's determinations on jurisdiction, especially after 13 days of hearing and years of briefing. In sum, Thailand was "not entitled to an independent judicial re-determination of that same question."

Thai-Lao: contractual disputes with states and _Kompetenz-Kompetenz_

Also in 2012, the Second Circuit denied an appeal from the government of Laos from an UNCITRAL award rendered against it in a contractual case. In that case, Thai-Lao Lignite v Gov't of Lao People's Democratic Republic, arbitration proceedings were commenced against Laos by two claimants, one of which was not a signatory to the contract containing the arbitration agreement. Apparently viewing the arbitral tribunal as having power to determine its own jurisdiction over the non-signatory claimant, the Second Circuit held that an independent judicial review of this determination was "inappropriate". Laos, it held, indisputably was a "signatory to a valid arbitration agreement incorporating the UNCITRAL rules," and this required deference to the arbitral tribunal on its decisions as to arbitrability. Laos has petitioned the US Supreme Court to review the decision.

BG Group v Argentina: jurisdictional challenge to BIT award upheld

The DC Circuit's decision in BG Group v Argentina stands in sharp contrast to Schneider and Thai-Lao Lignite two cases. Like Schneider, it involves a host state's challenge to an award made by an UNCITRAL tribunal under a BIT, but it raised a "gateway" issue concerning the enforcement of a preliminary step to arbitration.

In 2007, a Washington, DC-seated arbitral tribunal awarded US$185 million in damages to BG Group after finding that Argentina's 2001-2002 "pesification" of gas utilities' tariffs violated investment protection guarantees in the UK-Argentina BIT. The basis for the arbitration was article 8 of the BIT, permitting UNCITRAL arbitration of treaty "disputes" against Argentina in certain circumstances, including where the investor had first pursued litigation in the Argentine courts for 18 months.

Rather than challenge the pesification measures in the Argentine courts, however, BG instituted UNCITRAL arbitration in 2003, arguing that the Argentine government

had effectively blocked recourse to the Argentine courts. In its 2007 award (which followed a lengthy series of hearings in DC), the BG Group tribunal held that strict compliance with article 8 was excused, in light of the 2002 emergency "pesification" decree staying "all suits brought by those whose rights were allegedly affected by the emergency measures adopted by the government." This law, it held, "directly interfer[ed] with the normal operation of [Argentina's] courts," thus rendering it unreasonable for Argentina to insist that investors spend 18 months litigating in the Argentine courts before seeking international arbitration under article 8. The tribunal consequently found BG's claims admissible.

Argentina challenged the award in the US District Court for the District of Columbia, arguing (among other things) that the UNCITRAL tribunal lacked jurisdiction because BG had failed to observe the 18-month host-state litigation rule in article 8 of the BIT. In a 2010 opinion, US District Judge Reggie Walton rejected this argument, holding that the tribunal "correctly turned to the text of [article 8] and relevant international law sources in attempting to discern its jurisdiction to hear BG Group's claims, and it relied upon a colorable, if not reasonable, interpretation of these provisions in concluding that the matter was arbitrable." Thus, on the basis that the UNCITRAL tribunal's jurisdictional findings warranted deference, its conclusions concerning the 18-month requirement (including its holdings regarding futility) were not disturbed.

On appeal, however, the DC Circuit reversed this decision and ordered that the UNCITRAL award be vacated. First, it held that, as a "gateway" matter, the parties to the BIT "intended" for the issue of whether an investor could seek arbitration without first fulfilling the requirement that recourse initially be sought in the Argentine courts to be addressed by a court, not the UNCITRAL tribunal. Compliance with the host-state litigation rule was not a matter for the UNCITRAL tribunal to decide, in the DC Circuit's view, because the threshold availability of arbitration depended on the 18-month rule being observed in the first place. The DC Circuit, therefore, followed a "temporal" analysis of the treaty, finding that the UNCITRAL Rules (and the competence-competence rule found in article 21) could not apply until after compliance with the 18-month Argentine litigation provision.

Having decided that the courts should determine this issue, the DC Circuit then proceeded to hold that the 18-month period could not be excused. This was not a case of disregarding "informal resolution steps" but of an "explicit" condition to arbitration. Thus, it held, "there can be only one possible outcome" on the arbitrability question, namely, "that BG was required to commence a lawsuit in Argentina's courts and wait eighteen months before filing for arbitration". The award was vacated in its entirety.

Policy issues with the *BG Group* decision

From both a legal and policy perspective, the BG Group decision raises a host of issues. One is whether the 18-month "host-state litigation" pre-requisite indeed is a "gateway" issue for the courts, as opposed to a procedural matter that falls within the arbitrators' power to determine the scope of the arbitration agreement and their jurisdiction over the dispute. The latter would be consistent, among other things, with the principle of Kompetenz-Kompetenz reflected in article 21 of the UNCITRAL Rules. Another is whether the DC Circuit should have paid more heed to the fact

gar
The international journal of commercial and treaty arbitration
NEWS

that the BIT is governed by international law and exists within a network of BITs in which national courts historically have played a “minimalist” role. Yet another issue is practical: if the DC Circuit’s analysis is correct, it means that the federal courts have an inherent power to review de novo certain “gateway” issues years after the arbitral tribunal was constituted and heard the case – and, in this case, nine years after the case itself was commenced. This is a decidedly uncomfortable possibility for an investor contemplating BIT arbitration against a government.

Moreover, even assuming that the compliance with the “18 month home court litigation” rule was in fact a threshold matter for the courts to adjudicate, the DC Circuit’s rather truncated analysis of the substance of article 8(2) of the BIT is itself concerning. The court held, with virtually no elaboration, that the only possible interpretation of article 8(2) was that a claimant needed to litigate its grievances in the Argentine courts for 18 months as a precondition to validly commencing a BIT arbitration, and that failure to satisfy these procedures would automatically strip an UNCITRAL tribunal of jurisdiction.

But other tribunals that have considered this (or similar) BIT provisions in cases against Argentina have found that there are at least three possibilities:

- that such a clause is mandatory and permits of no derogation based on futility or otherwise (the conclusion reached by the UNCITRAL panel in the ICS Inspection & Control case and ICSID panels in Daimler and Wintershall);
- that compliance is excused where litigation would be futile (the conclusion reached not only by the BG tribunal in its 2007 award but also by the ICSID panels in Ambiente Ufficio, Abaclat and Urbaser; or
- that compliance is excused by reason of the most-favoured nation clause in the BIT (the conclusion reached, based on the same BIT, in National Grid and, based on similar BIT language, in Teinver, Siemens and Impregilo,as well as Maffezini v Spain and several other cases).

Each of the arbitral tribunals that addressed the 18-month litigation ruling engaged in extensive reasoning and analysis (sometimes provoking a spirited dissent); each tribunal appears to have accepted that the issue raised important and complex issues of public international law and treaty interpretation (including, often, an analysis of past International Court of Justice case law). By contrast, the DC Circuit’s conclusion that there was “only one” outcome possible concerning the admissibility of BG’s arbitral claims, which took up little more than a few lines, can only be described as cursory, and its failure to acknowledge, much less address, the alternative ground of jurisdiction presented by BG (the MFN clause) is also troubling.

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It may be possible to distinguish BG Group from Schneider (and Thai-Lao) on the basis that the arbitration clause in BG Group should be viewed as having certain conditions, non-fulfillment of which would destroy jurisdiction based on the terms of the BIT. Indeed, Argentina argued that its submission to arbitration was conditioned upon the claimant following a certain pre-arbitration procedure, that it had failed to do so and that, under First Options, the parties to the relevant arbitration agreement contained in a BIT had chosen to allow the courts to have ultimate power to

review this issue. Schneider, by contrast, concerned an issue that (again based on the terms of the particular BIT) appeared to have been entrusted to the arbitration. Indeed, BG has asked the US Supreme Court for leave to appeal the DC Circuit's ruling, based, in part, on its divergence from previous Circuit and Supreme Court decisions. The Supreme Court announced on 10 June that it will hear the appeal.

The BG Group decision shows that DC may not be optimal as a seat for investor-state disputes from the perspective of investors. In view of the more pro-arbitration approach that the BIT award received in Schneider, the courts of the Second Circuit, and New York in particular, may offer a more attractive venue for UNCITRAL disputes.

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