THE POWER OF ARBITRATORS TO ADAPT CONTRACTS

Juan Pablo Hernández*

As circumstances continue to change around us, doctrines such as hardship and *force majeure* are starting to become indispensable in legal discussions about contracts. Many domestic legal systems\(^1\) and uniform texts\(^2\) state that, when circumstances fundamentally change and performance becomes too difficult, the affected party may be entitled to claim a modification of the contract to ‘adapt’ it to the new circumstances. Whether this threshold is met as a result of the COVID-19 pandemic has been extensively discussed in recent weeks. As arbitration becomes more and more prevalent, discussions on hardship-based adaptation must now address a different question: in contracts providing for arbitration as a dispute resolution mechanism, are the arbitrators able to adapt the terms of the contract based on hardship?

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* Juan Pablo Hernández is the founder and editor-in-chief of *The Treaty Examiner* and a Moot coach at Universidad Francisco Marroquín (Guatemala).


\(^2\) See Article 6.2.3(4)(b) of the UNIDROIT *Principles of International Commercial Contracts*; Article 6:111 of the *Principles of European Contract Law*; Principle VIII:2 of the *Translex Principles*, etc.
I. Arbitration as a Creature of Contract

Unlike courts, which derive their power from the State, arbitral tribunals are created and empowered through consent. By concluding an agreement to arbitrate, the parties consent to submitting existing or future disputes to an arbitrator or a panel of arbitrators that will resolve those disputes in a final and binding award. This consent gives rise to the arbitration and confers on the arbitrators the power to adjudicate, replacing otherwise competent national courts. In that sense, arbitration is a creature of contract. In discerning the existence of a power, the arbitrators must start with interpreting the parties’ arbitration agreement. Only then can they analyze whether the power is granted by the applicable law (if not excluded by party agreement), and how the exercise of that power is supported, restricted or prohibited by those laws.

II. The Power to Adapt

The ordinary task of an arbitrator is to settle a dispute judicially. It is a judge created by contract. To fulfil that task, the arbitrator should normally look into the parties’ contract and determine, through interpretation, what are their rights and obligations.

The task of adapting a contract, however, is fundamentally different. When adapting the contract, the arbitrators do not look at the parties’ existing rights and obligations but rather undertake to change them. Adaptation is a ‘creative’ rather than a ‘judicial’ task. The creative task of regulating future contractual relationships is usually given to the parties themselves, who are in the best position to do so. Through

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3 This is reflected in Article II(3) of the New York Convention, which imposes on State courts the duty to refer the parties to arbitration if an agreement to arbitrate is invoked.
adaptation, the arbitrator imposes a contractual modification based on a legal rule providing for that change.

Arbitration agreements usually grant arbitrators jurisdiction to decide disputes that ‘arise out of’, ‘relate to’, are ‘in connection with’, etc., the contract where the arbitration agreement is contained. An adaptation claim usually does not arise from the original contract but from the adapted contract as determined by the arbitrator. Therefore, it is questionable whether an ordinary arbitration agreement is sufficiently broad to fit an adaptation dispute. The consensus is that adaptation usually requires an express authorization by the parties.\textsuperscript{4}

III. JURISDICTION OR POWER?

Adaptation is, as one would say, a ‘the egg or the chicken’ kind of question. Because the creative power of adaptation entails changing the terms of the contract that created the arbitrators in the first place, it is questionable whether an empowerment to adapt can be derived from the contract absent an express stipulation. The question that comes up is whether adaptation is a matter of jurisdiction or a matter of power.

The distinction may appear hairsplitting, but it is fundamental. While jurisdiction refers to the categories of disputes that the arbitrators can validly decide upon, power refers to the ability of the arbitrators to carry out the tasks within their jurisdiction and validly to compel the parties to abide by the solution to the dispute.\textsuperscript{5} An arbitrator can have jurisdiction over evidentiary issues but lack the power to order document production. In other words, to exercise proper


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authority over a dispute, the arbitrator must have the jurisdiction to hear the dispute and the power to materialize the solution to that dispute once reached. Usually, that is the case.

The distinction is important because a matter that falls within the arbitrator’s jurisdiction cannot be litigated before a court. If the tribunal can hear the dispute but lacks the power to order the remedy requested by the party, then that party will be bound to find an alternative within the arbitration – an arbitrator with jurisdiction but without power is a dull knife for the claimant. In contrast, if the tribunal lacks jurisdiction, the party can claim relief before national courts.

Adaptation, in a way, is a matter of both jurisdiction and power. As a matter of jurisdiction, the arbitrator can hear an adaptation claim (for instance, whether hardship has ensued). As a matter of power, the arbitrator can grant the adaptation claim, issuing an order to that effect. The distinction has practical importance:

In the context of hardship, an arbitrator with jurisdiction to hear a changed circumstances claim but without the authority to adapt is not a chimaera. Not all hardship definitions provide for adaptation as the remedy. The parties can decide that adaptation is off the table and that the remedy to hardship should be termination. In those cases, however, the claim is not for adaptation, but for the parties’ chosen remedy. Therefore, if a party were to raise an adaptation claim based on a contract that does not provide for adaptation, the tribunal would lack jurisdiction over the claim – and, consequently, the power to

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7 See, for example, the 2003 model hardship clause of the International Chamber of Commerce (ICC). Note that a 2020 version of the ICC clause exists giving the parties the opportunity to choose adaptation as the remedy.
adapt. Conversely, a claim of hardship requesting termination would easily fall within the tribunal’s jurisdiction.

A situation where the tribunal lacks adaptation jurisdiction but theoretically has adaptation powers is the case where the lex arbitri empowers the arbitrators to adapt but the parties did not authorize the tribunal. A reverse situation would be when the parties authorized the tribunal to adapt, but a requirement imposed by the lex arbitri is not met – in that case, the tribunal has jurisdiction over the adaptation claim, but lacks the power to adapt. In both cases, the tribunal would not have the authority to issue an award adapting the contract, albeit for different reasons.

IV. WHEN SHOULD ARBITRATORS BE ALLOWED TO ADAPT?

If arbitration is a creature of contract, then the starting point should be finding an authorization by the parties to adapt. This is due to the principle of pacta sunt servanda, mandating that the contract be performed as agreed, and the intangibility of contract, stating that the arbitrators normally lack the power to change the contract of the parties. The authorization may be oral or written and its validity in either case will depend on the law governing the arbitration agreement and lex arbitri.

Once an agreement to adapt is established, the arbitrator must determine whether that power is supported by the lex arbitri. If an adaptation claim is non-arbitrable, the arbitrator is deprived of authority. Likewise, if the lex arbitri imposes additional requirements on adaptation, they should be observed.

Finally, the arbitrator should determine to which extent the remedy of adaptation exists in the contract (for instance, a hardship clause) or the applicable law, and its requirements. If so, the trigger for adaptation would be the criteria for hardship.
recognized by the contract or the law. The existence of an adaptation remedy in the contract or the applicable substantive law is also relevant to determine whether the parties agreed that the tribunal would be empowered to adapt.