The Rule of Law As Created by Arbitrators – An Update on the Discussions At The Recent IBA Arbitration Day in Buenos Aires

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At a time when Argentina is looking to modernize its arbitration culture and attract foreign investment, the IBA Arbitration Day held in Buenos Aires could not have been more opportune. Gathering more than 400 arbitration experts from more than 45 countries, the venue and the event proved to be up to the challenge. While arbitration has been a frequent target of criticism in recent years in Latin America, as highlighted by Eduardo Silva Romero during the conference's opening, one of this year's goals was to recognize arbitrators' many positive contributions to the rule of law. To that end, presentations revolved, *inter alia*, around the principles of *pacta sunt servanda* and *bona fide* and the way in which arbitrators apply the law. Interestingly in this regard, Prof. Kaufmann-Kohler started by analyzing certain statistical data and concluded that in 90% of cases, parties made a choice of law: they chose national law in 97% and transnational rules in only 3% of them. Despite this, due to their diverse backgrounds and frequent lack of familiarity with the applicable national law, arbitrators tend to apply transnational rules in conjunction with national law. Therefore, while applying national law, international arbitrators validate the outcome by reference to rules with wider recognition. In essence, she concluded, arbitrators transnationalize the law.

This post attempts to report on that debate but also to add to it by taking the analysis a step back and assessing whether and to what extent arbitrators have the power to modify contracts, an issue which becomes particularly relevant in the field of cross-border transactions. As highlighted by Philippe Pinsolle during the conference, we see more and more complex long-term relational contracts which include arbitration clauses. Because these contracts are structured to last for many years, sometimes decades, they become more vulnerable to technological, political and/or economic changes which may substantially affect the parties' rights and even disrupt the contract's economic equilibrium. Were that to happen, the possibility to restore that equilibrium through adjudication becomes crucial. Now the question is: are arbitrators entitled to modify contracts? The answer is, as almost any other answer to a legal question, "it depends". Nonetheless, as the IBA debate clearly showed, there exists a steady trend demonstrating that, whether expressly or impliedly, arbitrators often do so.

The Interaction Between Arbitrators' Powers, *Pacta Sunt Servanda* And The *Bona Fide* Principle

It is especially in the context of *lex mercatoria* that *pacta sunts ervanda* is considered an essential

feature. However, just as any other legal principle, *pacta sunt servanda* is not absolute and is therefore subject to certain limits (e.g., *rebus sic stantibus*). Some have argued that there has been a change of paradigm in international contract law which proposes that the sacred principle of *pacta sunt servanda* should not be abused by means of a blind, and sometimes hypocritical, compliance [K. P. Berger, "Power of Arbitrators to Fill Gaps and Revise Contracts to Make Sense", Arbitration International, Ed. Oxford, 17(1): 1-18, p. 17 (2014)]. Notably, good faith and fair dealing have become the central yardstick for the social control of business behavior and of the fairness of business agreements. In this regard, it has been noted that the "all or nothing rule" of the sanctity of contracts is being replaced by a more flexible, pragmatic approach seeking to produce results that are in line with commercial common sense, mutual cooperation, flexibility and an intrinsic willingness of the parties to adjust terms which reduces the rigid use of contract law [K. P. Berger, *op. cit*., p. 16].

It is against this background that the potential clash between the arbitrators' power to modify contracts and *pacta sunt servanda* should be assessed. After explaining how the various elements of the normative framework for interpretation interact with each other, Almeida Prado's presentation at the IBA tried to convey the idea that, in case of conflict, international arbitrators tend to prioritize the contract's wording and its nature; particularly given how the nature of the contract affects its interpretation and constitutes a reliable parameter for the interpretation of specific obligations. Additionally, while he explained that the nature of the contract in itself does not create additional obligations, the contract's nature coupled with the governing law and/or international usages may do so (*bona fide*).

In practice, *pacta sunt servanda's* effects are further diminished by contractual and/or statutory provisions, such as those pertaining to changed circumstances. Common examples are hardship, indexation, re-negotiation or price revision clauses. Their inclusion may indicate that, in certain circumstances, parties are willing to provide arbitrators with the power to adapt their contracts, which they often do.

Legal Basis For Arbitrators' Powers

One has to refer *simultaneously* to three different legal sources: the arbitration agreement and the underlying contract, the law applicable to the arbitration (*lex arbitri*) and the law applicable to the substance of the dispute (*lex causae*) [K. P. Berger, *op. cit*., p. 7 and 8]. Of course, party autonomy plays a decisive role in this assessment. In cases where a contractual authorization is given, *pacta sunt servanda* would not speak against but in favor of arbitrators' competence [K. P. Berger, *op. cit*., p. 5]. Conversely, if no express or implied authorization has been given [for example, an ICC tribunal found that an ICC clause contained in a long-term contract containing a number of provisions that required adjustment over the period of the contract, was an implied authorization (ICC Award No. 5754 cited by Craig, Park and Paulsson, *International Chamber of Commerce Arbitration*, 2nd ed., p. 112 (1990))], then arbitrators must look for legal authority in the applicable rules of law. And here, the issue gets more complicated because, as stated above, there are several laws which might be relevant.

In relation to different *lex arbitris*, only a few arbitration laws contain express provisions dealing with arbitrators' authority to adapt contracts [for example, the 1986 Dutch Arbitrators Act, the 1999 Swedish Arbitration Act, the 1993 Bulgarian Law on International Commercial Arbitration, etc.]. Where arbitration laws remain silent, a useful exercise is to refer to the competence of domestic courts in that particular jurisdiction and assess whether this power is procedurally available [C. H. Brower, "Mind the Gap", BYU Law Review (2016), p. 18].

It can be argued that arbitrators' powers to modify contracts should be placed on equal footing with those of State judges (parties should not be worse off in arbitration). This is known as the principle of synchronized competences [P. Sanders, *International Encyclopedia of Comparative Law*, Vol. XVI, Ch. 12, p. 70]. However, State judges' power to modify contracts is far from being internationally established [L. Beisteiner, "Adjusting Contracts in Arbitration?", available here]. But it has been proposed that, under certain circumstances, arbitrators' power can be wider than judges' power. One of the clearest examples is that, if parties agree, arbitrators are generally allowed to decide cases *ex aequo et bono*—a power which is generally outside of the scope of the competence of State judges. If the domestic procedural law does not provide for a rule applicable to judges, then one must resort to the substantive law of that jurisdiction. Because the assessment of the relevant rules of law is generally done holistically, the case may be that one of the applicable laws may allow the arbitral tribunal to do so while another may not. Then, whether any of the provisions are mandatory will likely affect the outcome of that clash.

Conclusion

In practice, the line between contract interpretation and adaptation is not always clearly distinguishable. However, even if unconsciously or under the disguise of "contract construction", the IBA debate revealed a feeling among practitioners that whether expressly or impliedly, or directly or indirectly, arbitrators frequently adapt contracts to meet the needs and intentions of disputing parties, and by doing so, they contribute to the rule of law. Were the tribunal not to do this, the dispute resolution procedure would not be fully effective. Our comfort level with arbitrators acting in this manner is reflected in the express hardship or re-negotiation clauses which have become a common feature of modern contracts that establish complex and long-term arrangements. As a general matter, the prevailing view seemed to be that we should not be too cautious to grant and/or accept that arbitrators have powers to fill gaps and adapt contracts, but we should demand that arbitrators be extremely cautious while making use of them.