

## Settlement of Investment Disputes in East-West Trade

### Introduction

Before embarking on my principal remarks, I would like to comment on a few points which Mr. Stein has made in his introduction. I am sure that Mr. Stein did not intend to imply that arbitration in Sweden is the first preference of Soviet foreign trade organizations. The Soviet first choice is still arbitration in Moscow, and their second choice is arbitration in the country of the defendant. Most American lawyers and their corporate clients resist those two Soviet preferences and when that occurs Soviet corporations have been agreeing to arbitration in a third country. The third country which Americans and Soviets have most often agreed upon is Sweden. Some recent U.S.-Soviet contracts provide for arbitration in Switzerland, but they are relatively few. A number of American lawyers prefer Sweden to Switzerland because arbitration held in Switzerland is subject to mandatory provisions of Swiss law under which the arbitration award can be appealed to the courts on grounds of alleged error in fact or law, resulting in the possibility of greatly prolonged proceedings.

Mr. Stein also commented on current discussions between the American Arbitration Association (AAA) and the U.S.S.R. Chamber of Commerce and Industry, looking toward the possibility of arriving at a model clause which each side could recommend in its own country. The desirability of a model clause is underscored by the fact that so many clauses which have been written in U.S.-Soviet trade have been incomplete—perhaps, even defective in some cases—and the potentially undesirable consequences have often not been fully understood by the parties. A model clause would attempt to provide guidelines to remedy that situation—as AAA model clauses have long done in domestic trade and in commerce with a number of other countries. Current thinking is that any model clause would be sufficiently flexible to allow parties to reach their own agreements on such key matters as arbitration locale and governing law.

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\*Howard M. Holtzmann is a partner in the law firm of Holtzmann, Wise and Shepard, of New York. Chairman of the International Arbitration Association, past Chairman of the Board of the American Arbitration Association, and Vice-Chairman of the International Council for Commercial Arbitration.

Reference should also be made to ECE and ICC arbitration rules which appear in the U.S.-Polish trade agreement and to the ICC Rules in the recent U.S.-Romanian trade pact. It is always important to remember that these references are not exclusive recommendations and in both cases the agreements provide that the parties may enter into any other arbitration arrangements which better suit their particular needs. Also, one should remember that, to date, there has been a marked disinclination by Soviet parties to agree to ICC arbitration.

In virtually all contracts in East-West trade, the parties on both sides routinely express a strong preference to submit future disputes to final decision by arbitrators rather than resorting to litigation in national courts of law. This is true in commercial contracts generally and is particularly true in investment transactions. Thus, for example, the Yugoslavian law on foreign investments specifically refers to arbitration and provides that parties may include it in their contracts.<sup>1</sup> In the joint statement of the United States and Romania on economic, industrial and technical cooperation the two governments recommend that arbitration clauses be included in all joint ventures.<sup>2</sup> The Bulgarian law also appears to contemplate the use of arbitration.<sup>3</sup> In addition to those provisions specifically relating to the use of arbitration in investment transactions, a broad recommendation for the use of arbitration in all contracts is found in the U.S.-Polish Trade Agreement.<sup>4</sup> As for U.S.-U.S.S.R. trade, arbitration clauses which had been commonly used even before the Trade Agreement of 1972, were recommended in the Trade Agreement.<sup>5</sup> They continue as general practice despite the demise of that agreement.

As a result, U.S. businessmen and lawyers will find that their counterparts in the socialist countries accept the concept of arbitration. They expect to include an arbitration clause in every investment contract, and are quite familiar with

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<sup>1</sup>"Law on Investment of Resources of Foreign Persons in Domestic (Yugoslav) Organizations of Associated Labor," adopted April 13, 1973 (*Official Gazette of the SFRY*, No. 22 (April 19, 1973), at 742).

<sup>2</sup>"The Joint Statement on Economic, Industrial and Technical Cooperation Between the United States of America and the Socialist Republic of Romania, December 5, 1973." *70 U.S. Dept. of State Bulletin*, January 7, 1974, states that "Commercial contracts should include provisions concerning arbitration of disputes. . . ." (par. 12). See also "Decree on Authorization and Working Regulations of Commercial Agencies Set Up By Foreign Trading and Economic Organizations of the Socialist Republic of Romania," Decree No. 15, Jan. 25, 1971. *Official Bulletin of Romania*, No. 10 (January 27, 1971).

<sup>3</sup>"Decree No. 1196 on Economic, Production and Technical Cooperation with Foreign Judicial Entities and Individuals," adopted by the State Council of the People's Republic of Bulgaria, published in *Durzhaven Vestnik*, No. 46 (June 14, 1974).

<sup>4</sup>The U.S.-Polish Agreements on arbitration are set forth in two letters exchanged between the U.S. Secretary of Commerce and the Polish Minister of Foreign Trade, both dated November 8, 1972. Texts appear in "Fact Sheet, Joint American-Polish Trade Commission, November 4-8, 1972," issued by U.S. Dept. of Commerce.

<sup>5</sup>Agreement Between the Government of the U.S.A. and the Government of the U.S.S.R. Regarding Trade (Oct. 18, 1972), Article 7. *67 U.S. Dept of State Bulletin*, No. 1743, at 595-597.

the processes of utilizing arbitration when disputes arise which the parties cannot themselves resolve.

I will not today repeat the now quite familiar information concerning the mechanics of arbitration clauses and procedures in East-West trade. Those matters are well covered in the chapter on "Arbitration of U.S.-U.S.S.R. Trade Disputes" by Charles Norberg and Daniel B. Stein, contained in *Business Transactions with the U.S.S.R.*<sup>6</sup> a copy of which has been given to each participant at this Institute. A somewhat more detailed analysis of the same subject, including references to socialist countries in addition to the U.S.S.R., will be found in my chapter in Robert Starr's volume on *East-West Business Transactions*, which was reprinted in the January, 1975 issue of the *International Lawyer*.<sup>7</sup> Rather than retrace that ground, it may be more helpful to concentrate on two aspects which are particularly relevant to disputes arising out of East-West investment transactions and joint ventures. These are:

- Some of the unique problems involved in resolving the particular kinds of disputes which may arise in investment transactions and joint ventures.
- The practical problems which occur in arbitration proceedings in which one party is a State or a state-controlled body.

These issues received careful analysis at the Fifth International Congress on Arbitration which was held in New Delhi in January, 1975.

### **Unique Aspects of Disputes in Investment Contracts and Joint Ventures**

Contracts which relate to industrial cooperation, investment of joint ventures have certain unique characteristics in common:<sup>8</sup>

**First**, they are all for long periods of time, often ten years or more. Indeed, sometimes the arrangements contain no termination dates.

**Second**, the arrangements are usually not restricted to a single specific transaction, or even a series of specific transactions. Rather, they establish a broad business relationship between the parties in which the collaborators will do much more than merely buy and sell.

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<sup>6</sup>BUSINESS TRANSACTIONS WITH THE U.S.S.R., Robert Starr, ed., Section of International Law, American Bar Association (1975), 175-184. See also in same volume, discussion on arbitration by R. Starr at 14, and by Harold J. Berman and George C. Bustin at 49-53.

<sup>7</sup>*Settlement of Disputes: The Role of Arbitration in East-West Trade*, in EAST-WEST BUSINESS TRANSACTIONS, R. Starr, ed. (Praeger Publishers, 1974) at 540-566. Reprinted under title *Arbitration in East-West Trade* in THE INTERNATIONAL LAWYER, Vol. 9, No. 1 (January, 1975), at 77-100.

<sup>8</sup>The comments in this section are based, in part, on a paper "Arbitration in Long-term Business Transactions," written by the author in coordination with Prof. Georgio V. E. Bernini, presented at the Conference on International Commercial Arbitration, sponsored by the British Institute of International and Comparative Law, London, October 3-6, 1974 [Proceedings to be published by Oceana Press].

**Third**, in all of these transactions there is a pressing need to provide some mechanism to deal with changing future circumstances, some of which may be quite unpredictable.

**Fourth**, the kinds of disputes which may arise go far beyond those with which we were familiar in the past, such as traditional controversies over quantity or the quality of goods delivered, failure to perform on time, or refusal to make proper payment. Disputes under the newer long-term arrangements are more varied and complex, including disagreements over management policies, problems arising from unexpected events and controversies related to dealings between a joint venture and one of the companies which formed it.

**Fifth**, in all of these transactions once the business collaboration begins the parties quickly become "married." "Divorce" would be costly and destructive. To avoid major financial losses, the parties must be able to continue their business together in a friendly way, even after disputes arise.

Given the particular characteristics of these long-term international business arrangements, it is clear that arbitration can make a valuable contribution in connection with the disputes relating to such transactions. Arbitration can normally be invoked more quickly and can be conducted more informally than proceedings in public courts. Arbitration avoids the need to subject one party to the unfamiliar processes of the national courts of the other party. Arbitration will permit the case to be determined by an expert, chosen for his knowledge of the industry involved, rather than by a judge who, although learned in national law, is likely to be less familiar with the technical and commercial factors in controversy. Moreover, in most instances arbitration proceedings can be arranged so that they can be conducted in relative privacy, away from the glare of publicity and the prying eyes of competitors.<sup>9</sup> These qualities of arbitration are recognized as being of value in all types of international commercial disputes, but it seems to me that they are particularly helpful in connection with long-term investment and joint venture transactions.

In addition, there are two unique advantages which arbitration has in long-term investment and joint venture transactions and which are absent in court litigation. These advantages arise from the fact that in customary import-export trading the disputes usually occur after the goods are delivered, or the time for performance is past, whereas in investment and joint venture transactions disputes are likely to arise while contract performance is still going on.

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<sup>9</sup>For example, under the Rules of Conciliation and Arbitration of the International Chamber of Commerce "The hearings shall be private" (Art. 21, par. 4) and the award is given to the parties "but to no one else" (Art. 28, par. 2). To the same effect, see Arbitration Rules of the U.N. Economic Commission for Europe, Art. 29 and Art. 41, E/ECE/625/Rev. 1; U.N. Sales No. E.70.II.E/Mim.14.

The first unique advantage of arbitration for resolving disputes which occur while contract performance is still going on stems from the circumstance that in these long-range business arrangements it is a poor solution, or no solution at all, to rely on courts to resolve the dispute. This is because it is often vitally important that the parties be able to continue to work together in a friendly way, something which is virtually impossible in the abrasive atmosphere which seems to be an inevitable by-product of prolonged court proceedings. Arbitration provides a way to resolve disputes in a relatively amicable setting. As Neil Pearson has written, "International arbitration properly conducted is a softer process than contests in the courts . . . and the human relations between adversaries can be made even friendly during pauses in the battle." Pearson trenchantly observes that arbitration can be more human and neighborly than "any other lawyerlike activity which involves two sides."<sup>10</sup> Another broadly experienced arbitration expert, Professor Pieter Sanders echoes the same view, noting that "The choice of arbitration may favor the maintenance of good relationship."<sup>11</sup>

A second unique, and in my view, indispensable advantage of arbitration in connection with many long-term investment and joint venture transactions is that parties who embark on such arrangements cannot be sure whether or not unpredictable technological, economic or political developments may occur during the long life of the contract which would make it necessary to modify prices, royalty rates or other contractual conditions. It is always difficult, and sometimes quite impossible, to anticipate every possible future change in circumstances and to write a specific contract clause to take care of all possible future contingencies. When situations arise during the performance of a contract which are not specifically covered by the contract, parties typically try to reach mutual agreement on a way to fill the "gap." But what if they cannot reach such agreement? In that event, as the late Professor Eugenio Minoli pointed out, "Arbitration is sometimes the only way of breaking a deadlock."<sup>12</sup> The existence of a clause in a contract providing that arbitration will be used to resolve any deadlock arising over such a gap not only performs an important practical service for the parties, it also fulfills a vital legal function. For, by providing the mechanism of arbitration to fill the gap the parties avoid having their contract become a mere agreement to agree. As Gerald Aksen, General Counsel of the American Arbitration Association, explained in his paper at an

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<sup>10</sup>Neil Pearson, *Letter Across Frontiers*, COMMERCIAL ARBITRATION—ESSAYS IN MEMORIAM EUGENIO MINOLI, (1974), at 37.

<sup>11</sup>Pieter Sanders, *International Commercial Arbitration*, COMMERCIAL ARBITRATION—ESSAYS IN MEMORIAM EUGENIO MINOLI, (1974), at 471.

<sup>12</sup>E. Minoli, *Arbitrage et Cooperation Internationale*, COLLECTION OF THE IV INTERNATIONAL CONGRESS ON ARBITRATION MATERIALS (MOSCOW, 1974).

American Bar Association program on this subject, a contract which states that the parties will attempt to reach agreement in the future on filling a gap and which provides for arbitration if they cannot agree "is not an agreement to agree in the future, it is a complete present agreement."<sup>13</sup>

This advantage of arbitration in long-term transactions has been increasingly recognized in recent years. For example, it has been the subject of extensive discussions at International Arbitration Congresses held in Venice in 1969,<sup>14</sup> in Moscow in 1972<sup>15</sup> and in New Delhi in 1975. It was also the topic of a program presented by the American Bar Association at its 1972 Annual Meeting.<sup>16</sup>

The delegates at the Fourth International Congress on Arbitration, held in Moscow in October 1972, adopted resolutions which recognized the emergence of "new and diverse contractual arrangements" which "often relate to projects which are complex and involve long periods of time to complete."<sup>17</sup> The Congress considered the fundamental question of whether arbitration is as useful in connection with disputes arising under such contracts as it is in the more traditional import-export field. The delegates, although they came from 36 different capitalist, socialist and developing countries, were unanimous in the resolution which they adopted on this point:

The Congress unanimously and strongly affirms the great value of arbitration not only for traditional types of disputes arising in international trade, but also for new types

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<sup>13</sup>G. Aksen, *Legal Considerations in Using Arbitration Clauses to Resolve Future Problems*, *THE BUSINESS LAWYER*, Vol. 28, No. 2 (January, 1973).

<sup>14</sup>See for example, Howard M. Holtzmann, *Long-Term Multinational Disputes: A Challenge to Arbitration*, reprinted in *NEW STRATEGIES FOR PEACEFUL RESOLUTION OF INTERNATIONAL BUSINESS DISPUTES* (1971), at 116-120.

<sup>15</sup>See for example, reports and communications in *COLLECTION OF THE IV INTERNATIONAL CONGRESS ON ARBITRATION MATERIALS*, including Eugenio Minoli, *Arbitrage et Cooperation Internationale*, at 54-88; S. Bratus *Arbitration and International Cooperation Toward Industrial, Scientific and Technical Development*, at 89-112; I. Rucareanu, *Arbitration and Contracts Concerning Projects of Industrial Installations, Supply and Mounting*, at 219-234; S. Stern, *Arbitrating Disputes in Major Construction Projects*, at 235-245; C. Rucellai, *Contractual Arbitration in Agreements of Industrial Co-operation to be Executed at Successive Stages*, at 255-261; N. Pearson, *Role of Arbitrators and Consulting Engineers with Regard to Contracts on Civil Construction Workers*, at 285-323; L. Kopelmanas, *L'arbitrage et Verification Technique de la bonne execution de contrats internationaux dans le domaine de l'industrie*, at 366-372; H. Strobach, *Arbitral Jurisdiction and Contracts on Scientific Technical and Research Work, Including Licensing and Know-How Agreements*, at 409-427; M. Boguslavsky, *Examination of Disputes Arising out of Contracts in the Field of Scientific and Technical Cooperation*, at 472-478; H. M. Holtzmann, *Arbitration and Contracts Concerned with Scientific, Research and Technical Work*, at 479-482.

<sup>16</sup>Three papers on this subject were included in symposium presented at the Annual Meeting of the American Bar Association in San Francisco in 1972 on the topic of Arbitration Clauses—Valuable Methods for Solving Business Problems Arising in Long-Term Business Arrangements. These papers which appear in *THE BUSINESS LAWYER*, Vol. 28, No. 2 (January, 1973) at 585 et seq. are: H. M. Holtzmann, *An Overview*, A. D. Angel, *The Use of Arbitration Clauses as a Means for the Resolution of Impasses Arising in the Negotiation of, and During the Life of, Long-Term Contractual Relationships*, G. Aksen *Legal Considerations in Using Arbitration Clauses to Resolve Future Problems*.

<sup>17</sup>*Congress Resolutions, IV International Congress on Arbitration, Section II*, reprinted in *THE ARBITRATION JOURNAL*, Vol. 27, No. 4, (December, 1972) at 225-226.

of disputes which may arise out of international commercial contracts for industrial, scientific and technical development.<sup>18</sup>

The same view was restated and reemphasized in the Resolutions of the Fifth International Congress on Arbitration in New Delhi.<sup>19</sup>

Lawyers who desire to take advantage of this unique benefit of arbitration, must, however, consider whether, under the law (or laws) applicable to a particular contract, arbitrators have the power to fill gaps which the contract leaves otherwise unfilled.

There may be several different laws which must be considered in answering the question of whether arbitrators have power to fill a particular gap:

**First**, one must consider the substantive contract law governing the interpretation of the contract. Under the governing contract law, does an arbitrator have the power to fill the gap?

**Second**, one must consider the law governing the arbitration proceeding. This is usually the arbitration law of the locale of the arbitration. The arbitration law is often referred to as the procedural law. Under the law governing the conduct of the arbitration, does an arbitrator have the power to fill the gap?

**Third**, assuming that the arbitrator has power to fill the gaps under both the law governing the contract and the law governing the arbitration proceeding, one must consider whether, the courts of the country in which the arbitration award is sought to be enforced will refuse to enforce the award either (i) because filling such a gap is a subject matter not capable of settlement by arbitration under the laws of that country or (ii) because the recognition and enforcement of that award would not be consistent with the public policy of that country. Refusal to enforce an award for such reasons is recognized in international law and is, for example, specifically sanctioned as ground for refusal to enforce in the UN Convention on the Recognition and Enforcement of Foreign Arbitral Awards<sup>20</sup> to which the United States and all of the COMECON countries are signatories.

The law on this subject varies in different legal systems. Until recently, these differences had never been studied on a comparative basis so that parties might have a reliable source of information to guide them as they plan long-term transactions. However, such a study was undertaken by a working party at the New Delhi Congress and its results provide much helpful information for lawyers who must draft contracts in long-term investment transactions and joint

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<sup>18</sup>*Id.*, Section II, subparagraph 1.

<sup>19</sup>*Congress Resolutions, V International Congress on Arbitration, Section VII*, reprinted in *THE ARBITRATION JOURNAL*, Vol. 30, No. 1 (March 1975), at 21-22.

<sup>20</sup>UN Doc. No. E/CONF. 26/9 Rev. 1 6/10 (1958); U.N. Treaty Series, Vol. 330, No. 4739, at 38.

ventures. The paper by the rapporteur of the working group, Prof. Giorgio Bernini, has put the subject in perspective.<sup>21</sup> In New Delhi there were detailed analyses of the laws of several representative common law and civil law countries.<sup>22</sup> These papers will be published in the *Proceedings* of the Congress and, meanwhile, are available at the library of the American Arbitration Association.<sup>23</sup>

It would not be possible today to review in detail the results of the extensive study made in New Delhi, but a brief summary may be helpful. It may not be an overgeneralization to say that the discussion indicated that the law in both common and civil law systems appears to permit parties to agree that gaps may be filled, or deadlocks broken, by the decisions of third persons. Papers presented to the Congress indicate that in common law countries arbitrators may be given broad powers to fill gaps, that courts will not review the merits of awards in such cases and will enforce awards in the same manner as other arbitration awards. Informal discussions which I had with lawyers from the U.S.S.R. and other socialist countries of Eastern Europe, indicate that their laws give similar broad powers to arbitrators to fill gaps. In the civil law countries, while the details of the relevant laws vary from country to country, it would appear, in general, that third persons who are entrusted by contract with the power to fill gaps under civil systems may do so, but they are usually given a name other than "arbitrator," the merits of their decisions may usually be reviewed for reasonableness by courts; and if a party does not comply with the decision it may be judicially enforced by an action for breach of contract, rather than as an arbitration award. The importance in East-West trade of being conscious of these differences between common and civil law countries is that the locale of the arbitration may well be in a civil law country, such as France or Switzerland, and the arbitrators may have civil law backgrounds. Participants in the Congress concluded that despite these differences between common law and civil law concepts and the variations in detail among civil law countries, in *all* systems third persons can effectively perform the valuable function of filling gaps and breaking deadlocks in international transactions. However, it is important that parties who wish to grant such powers have a clear

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<sup>21</sup>G. Bernini (in coordination with H.M. Holtzmann), *Techniques For Resolving Problems in Forming and Performing Long-term Contracts* [to be published in the Proceedings of the Vth Congress on International Arbitration.]

<sup>22</sup>Several papers presented describe the civil and common law on this subject. Belgian and French law is described by Prof. L. Matray in a comprehensive paper. Italian law is summarized by Miss G. D'Amely-Melodia in a paper on "Improving Techniques For Resolving Problems Which May Arise in Forming and Performing Long-term Contracts—Communication on the Hypothetical Case," and also in the report of Prof. Bernini, *supra*, note 21; see also paper of C. Rucellai. Swedish law is described by Prof. L. A. E. Hjarner in "Reply to Hypothetical Case." Common law concepts are summarized by H. M. Holtzmann in "Powers of Arbitrators Under United States Law to Fill Gaps Arising Under Long-term Commercial Contracts." [All to be published in the Proceedings of the Vth Congress on International Arbitration.]

<sup>23</sup>140 West 51st Street, New York, N.Y.

understanding of the particular laws which govern their transaction and draft their contract with technical skill in the light of the applicable law.

The International Council For Commercial Arbitration is continuing the study begun at New Delhi with a view toward preparation of model clauses which might be used in varying legal systems to give arbitrators powers to fill gaps. Meanwhile, there is now sufficient data to guide lawyers writing contracts in East-West investment transactions or joint ventures who wish to use this valuable device.

### **Practices When States or State-controlled Bodies Are Parties to Arbitration**

Lawyers who draft arbitration clauses in investment contracts or joint-ventures in trade with socialist countries realize, of course, that they are dealing either with States or state-owned bodies, and quite often ask if, when a dispute arises, the socialist party will seek to invoke sovereign immunities to avoid arbitration.

As Robert Starr points out in his chapter in *Business Transactions with the U.S.S.R.*, "Past experience suggests there is no serious risk that a Soviet foreign trade organization would claim immunity . . ." <sup>24</sup> This conclusion is supported by both Harold Berman <sup>25</sup> and Christ Statakis <sup>26</sup> in their contributions to the same volume. Similar statements appear to be warranted with respect to foreign trade organizations (FTOs) of other socialist states which are patterned on the Soviet system.

However, investment contracts may be made directly with States, or with state-controlled entities which have characteristics different than the FTOs. What then?

The ultimate answer to that question must rely more on political prognostication than upon legal research. However, a knowledge of past practices may help to dispel the fear of the unknown which inhibits many private companies when they consider long-term transactions with socialist countries. Such knowledge is also valuable because states which are confronted with the need to decide how to react to an arbitration claim by a private enterprise may be influenced if they know how other states have acted in similar situations. Systematic, practical information on this subject was developed at the New Delhi Congress. <sup>27</sup>

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<sup>24</sup>*Supra*, note 6 at 13.

<sup>25</sup>*Id.*, at 33.

<sup>26</sup>*Id.*, at 189.

<sup>27</sup>F. Eisemann, "Report on the Present Situation of International Commercial Arbitration Between States or State Entities and Foreign Private Parties." See also the excellent paper of Prof. K. H. Bockstiegel, "Specific Problems of International Arbitration Between States and Private Enterprises." [Both to be published in the Proceedings of the Vth International Congress on Arbitration.]

A working party at New Delhi reviewed world-wide data, including experience with the socialist countries. The data enabled the Congress to reach the following encouraging conclusions:

- There is "a growing readiness of governments and state-controlled bodies to stipulate [arbitration] in their international business contracts with foreign private parties."
- "States normally carry out arbitral agreements and proceed with arbitration on a basis of equal footing, especially with respect to the selection of independent arbitrators, the international character of the procedure and the law to be applied."
- "In recent times there appears to have been no claim of immunity by any State made with a view to avoiding the institutions of agreed arbitration proceedings."
- "Claims of immunity from enforcement seem to be rare."<sup>28</sup>

While no one can guarantee the future, the data gathered in New Delhi provides an objective basis for optimism that arbitration clauses in East-West investment transactions and joint ventures will be honored.

### **Conclusion**

A perceptive Italian observer once wrote that arbitration "is an ancient institution that is, however, marvelously capable of being adopted to new economic and social needs."<sup>29</sup> The usefulness of arbitration in the newer forms of investment transactions and joint ventures in East-West trade gives renewed meaning and dimension to that statement.

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<sup>28</sup>*Supra*, note 19, at 21.

<sup>29</sup>Franco Mattei, *Arbitration and Contracts of International Industrial Cooperation*, COMMERCIAL ARBITRATION—ESSAYS IN MEMORIAM EUGENIO MINOLI, (1974) at 310.