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New Uses for Arbitration in Soviet-American Contracts for Industrial, Scientific, and Technical Development

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New Uses for Arbitration in Soviet-American Contracts for Industrial, Scientific, and Technical Development

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In recent years trade between the Soviet Union and the United States has become increasingly concerned with new types of business arrangements that are quite different from the relatively simple import-export transactions which have traditionally constituted the major part of international trade. These newer business transactions relate to industrial, scientific, and technical development. They include such activities as the design and construction of large industrial plants; the supply, assembly and installation of machinery; the transfer of technical knowledge and know-how; joint ventures for carrying out scientific research; and consortia for undertaking major industrial or civil engineering projects.

These transactions are reaching major size and appear to be growing rapidly. For example, Soviet-American contracts for industrial plant and equipment totalled \$239 million in 1971 and rose to \$465 million in 1972. These figures do not include a number of billion-dollar projects which are in negotiation including such things as large-scale development of Siberian natural gas, joint ventures for chemical production and joint development of computer facilities. In 1971 and 1972, the Soviet Union's orders to the United States for plant and equipment exceeded orders to France or West Germany, or any other Western nation.¹

These newer transactions involve many more complex legal and engineering aspects than traditional import-export transactions. For example, some of these newer transactions require a contractor to design and build an entire factory on a "turnkey" basis. Other arrangements may require the party which is acquiring the factory to perform part of the work, such as erecting the building in which the factory will be installed, or supplying certain materials and components. A number of the most complex arrangements contemplate even greater cooperation and provide for joint research, and for the exchange of services and know-how between the parties on a continuing long-term basis. As Professor S.N. Bratus, the distinguished

* Chairman, International Arbitration Committee of the American Arbitration Association; Past Chairman of the Board of the American Arbitration Association; Vice Chairman, International Committee for Commercial Arbitration. Author, *Arbitration in East-West Trade*, 9 INT'L LAW. 717 (1975).

1. United States Congress, Joint Economic Committee, as reported by the N.Y. Times, Dec. 12, 1973, at 1, col. 1.

Chairman of the Foreign Trade Arbitration Commission at the U.S.S.R. Chamber of Commerce has pointed out, the contractual arrangements relating to such projects have "outgrown the framework of traditional sales transactions."²

The delegates at the Fourth International Congress on Arbitration held in Moscow in October 1972 adopted resolutions which recognized the emergence of these "new and diverse contractual agreements" which "often relate to projects which are complex and involve long periods of time to complete."³ 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 of disputes which may arise as a result of international commercial contracts for industrial, scientific, and technical development.⁴

In addition to this general observation, the Moscow Congress explored in detail the uses of arbitration which are uniquely applicable to the newer forms of contractual arrangements relating to technological development and which are not generally applicable to traditional forms of sales contracts. For example, the Congress' resolutions noted that, unlike most import-export transactions in which arbitration is generally involved only after goods are delivered or the time for performance is past, in contracts involving industrial, scientific, and technical development, arbitration is valuable at a number of earlier stages.

Thus, for example, in long-term arrangements for technological collaboration, arbitration is a valuable way to resolve disputes which may arise during the performance of the contract due to changes in technological or economic conditions which the parties could not predict when the contract was initially concluded. Also, disputes can arise during the construction of complex industrial plants which, if not resolved quickly, could seriously interrupt the completion of the work.

Recognizing the possibilities of such disputes, the Moscow Con-

2. Bratus, *Report on Arbitration and International Cooperation toward Industrial, Scientific and Technical Development*, 27 *ARB. J.* 230 (1972).

3. *Resolutions of the Fourth International Congress on Arbitration in Moscow, October 3-6, 1972*, 27 *ARB. J.* 225, 226 (1972) [hereinafter cited as *Resolutions*].

4. *Id.* at 225-26, Section II, subpara. 1.

gress included in its resolutions a recommendation that “[t]he value of arbitration is not limited to disputes which may arise after completion of the work under such contracts, but also that arbitration is valuable in connection with disputes which may arise while the performance of such work is in progress.”⁵

Drafting and interpreting arbitration provisions relating to such matters as referred to in the two examples above present new challenges to Soviet and American lawyers who write contracts for long-term industrial development projects. The Moscow Congress recommended that these subjects are “worthy of further thorough study.”⁶

In pursuance of such “further thorough study,” I shall set forth some thoughts which I hope will stimulate discussion on the following two subjects: first, the value of arbitration in resolving disputes which may arise during the life of long-term contracts due to unexpected changes in conditions; and second, the roles of technical experts and arbitrators in resolving disputes under contracts for industrial, scientific, and technical development.

I. THE USE OF ARBITRATION TO RESOLVE DISPUTES WHICH MAY ARISE DURING THE LIFE OF LONG-TERM CONTRACTS DUE TO UNEXPECTED CHANGES IN CONDITIONS

The very essence of many contracts concerned with scientific, technical, and research work is that the two parties to the contract are agreeing to embark together on a journey into the unknown. I am speaking particularly of contracts in which two enterprises agree to cooperate over a long period of years in an area of development or research, to share their scientific knowledge, and to pool their technical skills, with the understanding that they will fairly divide the fruits of their joint efforts. The parties to such contracts have a general idea of what they hope to accomplish, but they cannot be sure how long the task will take, precisely how much it will cost, and exactly what unexpected problems or changes in conditions may occur in the future.

The problem is further complicated by the fact that scientific and technical projects generally require many years of effort and the parties to such contracts must therefore consider not only the uncertainties in their own program but also many types of unpredictable external changes which may occur during the long life of their contract. For example, technical advances made by others may cause the project on which the parties are working to become obsolete even before it is finished. Other unpredictable events which may occur

5. *Id.*

6. *Id.* at 226, Section II, subpara. 3.

during the life of an international scientific, research, or technical agreement include changing economic conditions and shifts in competitive conditions. Such events may require changes in royalty rates or other contractual terms.

One of the major tasks of those who write contracts, particularly lawyers, is to predict the future and, on the basis of that prediction, to draft contract provisions which will regulate the conduct of the parties upon the occurrence of future events. The task of prediction is relatively simple when the contract writers are dealing with normal commercial contracts which involve single purchase-sale transactions intended to be concluded in a short period of time. We must, however, recognize that the difficulties of prediction increase geometrically when we attempt to write contracts intended to define for many years the rights and responsibilities of parties to a scientific or technical agreement. Even the most imaginative lawyer and the most farsighted executive cannot predict all of the things which may happen during the long life of a scientific or technical contract. In such situations, the parties may fear what the future will bring; they may anticipate possible changes in circumstances, but the imponderables are so great that they cannot devise contract provisions to take care of all the possible future contingencies which may arise.

Faced with such difficulties of prediction, there is a danger that the parties may conclude that it is impossible to write a contract and they may therefore abandon their proposed collaboration. It is at this point that a knowledge of the usefulness of arbitration is of vital importance. Arbitration—and only arbitration—can bridge the gap between the precise statement of contractual rights and responsibilities required in a legal contract and the unpredictability which is an inescapable element in scientific and technical development. A properly written arbitration clause can provide that when unpredictable changes arise during the life of a contract, the parties will attempt first to agree on fair ways to solve the problem and, if they are unable to do so, the matter will then be submitted to arbitration.

The late Professor Eugenio Minoli, President of the Italian Arbitration Association, recognized the importance of this use of arbitration when he wrote in his Report to the Moscow Congress that arbitration

may be used to settle in the future certain points in the contract where the information in possession of the parties at a given time is insufficient to make a precise agreement . . . [and] arbitration is sometimes the only way of breaking a deadlock when it is practically impossible to lay down precise and detailed contractual rules.⁷

7. E. MINOLI, *ARBITRATION AND INTERNATIONAL COOPERATION TOWARD INDUSTRIAL, SCIENTIFIC AND TECHNICAL DEVELOPMENT* 8 (1972).

Moreover, the provision for arbitration in a contract is important not only because it supplies an indispensable mechanism for solving possible future deadlock but, just as importantly, because the existence of arbitration is a strong incentive to the parties to avoid deadlock by reaching a mutual agreement when problems arise.

It would be most helpful to discuss whether Soviet and American lawyers share the view that arbitration may appropriately be used to resolve unexpected problems which may arise in the future. Do we agree that special provisions for this use of arbitration should be included in long-term scientific, industrial and technical contracts in Soviet-American trade? And, if such provisions are included in contracts, how should the powers of the arbitrators be defined or limited?

II. THE ROLES OF TECHNICAL EXPERTS AND ARBITRATORS IN RESOLVING DISPUTES UNDER CONTRACTS FOR INDUSTRIAL, SCIENTIFIC, AND TECHNICAL DEVELOPMENT

The disputes which may arise between the parties to contracts for industrial and technical development are most likely to result from engineering or technological difficulties. Typically, such disputes involve the question of whether or not there has been a failure to comply with the technological or engineering requirements of the contract, and, if so, who is to blame for it and what action must be taken to correct it. A highly experienced lawyer and arbitrator, Lazare Kopelmanas, reporting on this subject at the Moscow Congress, observed, "[i]t is probably not an exaggeration to say that the technical aspect predominates in all the differences which can arise between the parties on the subject of the proper performance of the contract."⁸

Clearly, the resolution of such disputes requires answers to technical or engineering questions which can only be given by qualified experts. It is for this reason that the delegates to the Moscow Congress expressly recognized "the increasingly important role of persons possessing specialized scientific and technical experience in connection with problems which may arise at various stages of projects for industrial, scientific, and technical cooperation."⁹

Moreover, when disputes arise under the types of contracts which we have been discussing, there are many advantages in having the technical or engineering questions answered by qualified experts as soon as possible. For example, it may be necessary to resolve a dispute arising out of a preliminary stage of construction before work

8. L. KOPELMANAS, *ARBITRATION AND THE TECHNICAL VERIFICATION OF SATISFACTORY PERFORMANCE OF INTERNATIONAL CONTRACTS IN THE SPHERE OF INDUSTRY 3* (1972) [hereinafter cited as KOPELMANAS].

9. *Resolutions, supra* note 3, at 225-26.

can proceed on later stages of the project.

Another reason for prompt intervention by experts has been pointed out by Dr. Kopelmanas:

The time lag between the moment when the technical difficulties between the parties arise and the experts being in a position to know of them, will often have as a consequence that the experts are in a position where they cannot discover all the elements necessary to the solution of the dispute The plant will have been in operation or brought to a stop for a long lapse of time An inspection of the site, which is an indispensable basis for a complete technical opinion, will put the experts in the presence, not of a plant exactly as it was supplied, but as it may have been affected by the action or inactivity of the party acquiring it.¹⁰

Dr. Kopelmanas points out that an additional reason favoring prompt use of experts is that when "experts intervene at the very moment when a controversy arises . . . they can help the parties in the search for a new technical solution capable of opening the way to a friendly and practical end of the dispute." However, this "conciliatory function of the experts will have difficulty" if it occurs at a time "too far away from the birth of the dispute."¹¹

For those interested in East-West trade, it is significant to note that the opinion that technical experts should intervene early was supported at the Moscow Congress not only by Western observers but also by representatives of socialist countries. For example, Professor I. Rucureanu of Rumania, reporting on experience in the CMEA countries, emphasized that:

. . . practice shows that in the case of disputes which are submitted to arbitration a long time after the technical difficulties appeared, such technical examinations can no longer be performed in the best conditions, and sometimes cannot be performed at all. For removing such obstacles the intervention of technical experts is recommended to be as early as possible after the appearance of the technical difficulty.¹²

For these reasons the provisions of a number of standard forms of contracts for engineering and construction work suggest the early intervention of experts to decide technical disputes while work under the contract is still in progress. For example, the desirability of intervention by technical experts when disputes arise during construction is referred to in the *Cahier des Charges General de l'Office des Nations Unies*¹³ and in the *Guide for Use in Drawing up Contracts Relating to the International Transfer of Know-How in the Engineering Industry* sponsored by the United Nations Economic Commission for

10. KOPELMANAS, *supra* note 8, at 5-6.

11. *Id.*

12. I. RUCUREANU, ARBITRATION AND CONTRACTS CONCERNING PROJECTS OF INDUSTRIAL INSTALLATIONS, SUPPLY AND MOUNTINGS 9 (1972).

13. KOPELMANAS, *supra* note 8, at 8.

Europe.¹⁴ Similarly, provisions for early intervention by technical experts will, for example, be found in the standard forms suggested by the *Federation Internationale des Ingenieurs-Conseils* (F.I.D.I.C.).¹⁵

Expanding on this concept, Dr. Kopelmanas has suggested the establishment of "summary procedures" which

. . . would permit the parties or the interested party to demand, in advance of the treatment of the dispute in the juridical field, the designation of experts charged with the duty of resolving disagreements which are purely of a technical order and of resolving these immediately [as they come to light].¹⁶

The early intervention of technical experts to resolve technical disputes raises a number of important questions for lawyers who write contracts and arbitrators who rule upon them. These questions arise from the fact that international contracts which provide for early intervention of experts to decide technical disputes also typically contain an arbitration clause. In such circumstances, to what extent should arbitrators who deal with a case at a later stage accept the decisions of a technical expert who has previously made decisions in connection with the matter? One of the resolutions adopted at the Moscow Congress posed the question as follows:

What is the proper relationship between the conclusions reached, on the one hand, by engineers and technical consultants while work on a contract is proceeding, and the decisions to be reached, on the other hand, by arbitrators when one of the parties contests a consultant's conclusions?¹⁷

The primary questions which arise in connection with the relationship between technical experts and arbitrators are:

- (1) What disputes should be referred to technical experts and what should be referred only to the arbitrators?
- (2) Are decisions of technical experts final, or are they subject to review and revision by the arbitrators?
- (3) In cases in which arbitrators are called upon to review the decisions of technical experts, to what extent should the arbitrators accept experts' decisions?

As to the first question, lawyers who write contracts for early intervention of technical experts when technological or engineering disputes arise, should define as precisely as possible the disputes in which there is to be recourse to technical experts and the disputes to be referred only to arbitrators. Many contracts now being written

14. U.N. Doc. TD/222/Rev. 1 (1970).

15. N. PEARSON (published as M. PIRSEN), *ROLE OF ARBITRATORS AND CONSULTING ENGINEERS WITH REGARD TO CONTRACTS ON CIVIL ENGINEERING WORK* 20 (1972) [hereinafter cited as PEARSON].

16. KOPELMANAS, *supra* note 8, at 17.

17. *Resolutions*, *supra* note 3, at 226, Section II, subpara. 3(iii).

probably fail to do this adequately. As Dr. Kopelmanas has suggested,

. . . it is necessary that the parties should get into the habit of separating in their contracts disputes which are of a technical kind from those which are not and that they should foresee recourse to expert opinion at the very moment that unresolvable technical difficulties actually arise.¹⁸

As to the second question, whenever parties provide in their contract for intervention by an expert to decide certain technical disputes, the contract should also state whether the decisions of the technical expert are to be final or whether a party who objects to the decision will have the right to appeal to arbitration under the arbitration clause of the contract. A contract provision that the decision of the expert will be final has the advantage of resolving technical disputes most quickly and economically. On the other hand, when very important issues are at stake some parties may prefer to have the right of appeal to arbitration which typically insures greater procedural safeguards and a more juridical approach than are customary in the relatively informal atmosphere in which decisions are made by technical experts. The parties to each contract must weigh these relative advantages and disadvantages and determine the matter in the light of the particular circumstances of their transaction.

From the information available, it appears that most enterprises and lawyers engaged in international trade choose to provide that the decisions of technical experts will be subject to appeal to arbitration. For example, a number of standard form contracts provide that if the technical expert makes a decision which either party does not accept, the aggrieved party may have recourse to arbitration. In such cases, the arbitrators typically have the power to "open up, review and revise" the decision of the technical expert.¹⁹ Although the *Cahier des Charges General de l'Office des Nations Unies* suggests that decisions of technical experts should be final, nevertheless Dr. Kopelmanas indicates that such provisions are so uncommon as to be considered "radical" and he expresses doubt as to whether they would "generally be accepted at the first attempt in international practice."²⁰

Inasmuch as the great majority of international contracts provide that the decisions of technical experts are subject to review by arbitrators, it is important to determine to what extent the arbitrators should accept the prior decision of the technical expert and how much weight the arbitrators should give to such decisions. It appears

18. KOPELMANAS, *supra* note 8, at 7.

19. See F.I.D.I.C. standard form, "Part I—General Conditions," cl. 67; see also R.I.B.A. standard form, cl. 35. For comment on these standard forms see PEARSON, *supra* note 15, at 20-41.

20. KOPELMANAS, *supra* note 8, at 8.

that most contracts, as presently written, give little guidance in answering those questions. It therefore becomes necessary to try to develop an answer which, hopefully, could be broadly adopted by parties and arbitrators.

I will at this point venture some suggestions of my own in an attempt to propose an answer to the question of whether arbitrators who enter a dispute at a later stage should accept the decision of technical experts made at earlier stages of the matter. I welcome the opportunity to expose these thoughts with the hope that they will stimulate discussion and critical comment.

I consider these suggestions to be preliminary and subject to much refinement. I should also emphasize that these are my personal views. While I have had the benefit of discussions on this subject with colleagues at the American Arbitration Association, these suggestions have not been formally acted upon and do not represent the official views of the American Arbitration Association. In the spirit of the Moscow Congress, they are submitted for "further thorough study."

Basic to my suggestion is the concept that in major international matters the expert should be not only technically qualified, but also should be an impartial person, independent of both parties. I suggest that the decision of an impartial technical expert on questions within his field of technical expertise should be entitled to much greater weight and respect by arbitrators than, say, the evidence given by a party.

As a practical matter, if an impartial technical expert has decided a dispute within the area of his expertise, it is quite difficult for an aggrieved party to overturn that decision on appeal to arbitration. Dr. Kopelmanas has described this practical situation as follows:

It would seem difficult for a party who had taken part in a procedure involving expert opinion to defend in the course of a trial, whether judicial or arbitral, a position contrary to the conclusions of the experts, given that all necessary precautions had been taken over the choice of qualified independent expertise. Their conclusions would of necessity be impressive, if not juridically, at least in fact.²¹

It is my contention that the weight which, as a practical matter, is usually given by arbitrators to the decisions of impartial technical experts should be expressed as a legal principle.

The principle which I suggest is: *Arbitrators should not reverse or modify a decision made by an impartial technical expert in determining a question of fact within his field of expertise, provided the expert's decision is supported by substantial evidence.*

21. *Id.* at 8-9.

A key problem in applying the principle is the determination of what constitutes "substantial evidence" in each specific case. "Substantial evidence" may be defined as the amount of evidence which a reasonable mind would accept as adequate to support a conclusion.

In determining that there is substantial evidence, the arbitrators would only have to find that there is evidence on which they could reasonably reach the same decision reached by the technical expert. The arbitrators would not have to go on to analyze the evidence in detail in order to be able to say that, on the basis of the evidence, they reach the same conclusion as the technical expert. It is important to emphasize that this principle, while it limits arbitrators in their review of technical facts, leaves them the judges of all questions of law.

In essence, the principle which I suggest would say to arbitrators, "You should limit the scope of your review of decisions by technical experts. As arbitrators, you should defer to the expertise of the technical experts and not substitute your factual judgment for theirs. However, the 'substantial evidence' principle gives you sufficient flexibility to overrule obvious errors and glaring injustices. Moreover, you have unlimited power on all questions of law."

In arbitration cases in which this suggested principle is followed, the arbitrators would be concerned with only a limited number of questions, such as:

- (1) Was the technical expert impartial?
- (2) Was the expert technically qualified in the field covered by his decision?
- (3) Was there substantial evidence to support the expert's decision?

If each of these questions is answered "yes" by the arbitrators, they could then concentrate on deciding questions of law and non-technical questions of fact, and on the determination of damages or other appropriate remedies.

There are several practical advantages in adopting the principle which I suggest. *First*, the arbitrators would not substitute their judgment for the judgment of the technical experts on technical questions. This makes good sense because, particularly in European practice, the arbitrators are usually lawyers and are less qualified to pass on technical matters than the experts. *Second*, under the "substantial evidence" principle, the arbitrators would only have to find that there was reasonable factual evidence sufficient to support the decision of the technical expert. Because the arbitrators' function would thus be limited, the arbitrators would be much less likely to require extensive testimony from additional experts. This would save time and money for the parties. *Third*, because the question submitted to the arbitrators would be limited, it would be somewhat easier to

predict the outcome of the case than if all the technical questions were entirely open for re-evaluation. Predictability is always a virtue in business affairs and when it exists it is a strong incentive to the friendly settlement of disputes by the parties themselves.

Given the desirability of the principle outlined above, how can it be made effective so that parties can be sure that arbitrators will follow it? The best way to effectuate the principle would be for parties to include it specifically in their contracts. Contract wording similar to the italicized statement above might be appropriate for that purpose.

In my opinion, agreement by the parties to follow the "substantial evidence" principle is enforceable in an arbitration proceeding under United States law. Maitre Ernst Mezger, a distinguished French lawyer, has expressed a similar opinion with respect to the law in most countries in western Europe. He said:

I conclude that according to the law envisaged here—i.e., the law in force in continental Europe and particularly the original EEC countries—it would seem that if the parties have so provided with sufficient clarity and accuracy, not only will the expertise be an element of proof for the judge or arbitrator before whom the case is subsequently brought, but in fact it will even be an element which will bind him more closely than expert testimony ordered during the trial or hearing, since the latter is always subject to his evaluation of it. Thanks to their contractual freedom, the parties have the possibility of incorporating, so to speak, the expertise in their contract, which henceforth has force of law for them and also binds both judge and arbitrator. The authority of the [pre-arbitral] technical expertise does not, however, go any farther than the objects of the expert's examination.²²

Lawyers and businessmen all over the world who are interested in contracts for industrial, scientific, and technical work are increasingly recognizing the vital role which arbitration plays in such agreements. I can think of no better way to conclude than by repeating the words of an American colleague who delivered a paper on this subject at a meeting of the American Bar Association:

I think you will agree that arbitration has more uses than were once envisioned—and that we are merely limited in this field, as in many others, by our power of imagination.²³

22. E. MEZGER, PRE-ARBITRAL TECHNICAL EXPERTISE—ACCEPTABILITY AS EVIDENCE 4-5 (1973).

23. Angel, *The Use of Arbitration Clauses as a Means for the Resolution of Impasses Arising in the Negotiation of, or During the Life of, Long-Term Contractual Relationships*, 28 BUS. LAW. 589 (1973).

