Varia

International Commercial Arbitration and Punitive Damages [*]

Niccolò Pietro CASTAGNO

Summary: I. Introduction. II. Punitive damages for breach of contract. 1. Jurisdictions awarding punitive damages in contract actions. III. Punitive damages in arbitration: parties' agreement and arbitrators' power to grant the exemplary remedy. III. International Arbitration rules and the available remedies. 1. UNCITRAL Arbitration Rules and UNCITRAL Model Law on International Commercial Arbitration. IV. Absent any parties' statement about the applicable law. 1. The application of the *lex loci arbitri* and other indicators. V. Enforcement of arbitral awards: will punitive damages prevent it? 1. Defining Public Policy: the enforcement of foreign arbitral awards. 2. Punitive damages: a ground for enforcement refusal. VI. Conclusion.

I. Introduction

Punitive damages are widely awarded in Common law jurisdictions, particularly with regard to tort law that is the field in which they took their steps and flourished. Since International Commercial Arbitration mainly regards contract liability, this paper will look at exemplary remedies awarded in contract actions. Not every Common law jurisdiction allows punitive damages to be awarded in contract cases, for instance England. Nonetheless, they are very common in the U.S. and recently in Canada. On the contrary, there is little dispute that Civil law countries do not recognize the lawfulness of such remedy: European courts usually refuse to recognize and enforce punitive damages awards.

Arbitration is increasingly becoming one of the major dispute resolution methods, particularly with regard to international business transactions. While domestic arbitration still preserves features strictly linked to the related national legal environment, International Commercial Arbitration entails different issues. First, the parties to an international arbitration are mainly coming from different countries and in several cases they have a different legal background. Second, the award arising from an international arbitral proceeding may be enforced in a country different from the one in which it was rendered, thus concerning the applicability of more than just one body of rules. The outcome of these features has two aspects: an interna-

[*] The subject of my final thesis is: International Commercial Arbitration and Punitive Damages. The latter is written in English and took steps from a study and research experience at the Center for Transnational Legal Studies in London.

tional award is subject to several laws both with regard to the proceedings (the procedural law and the law applicable to the merits) and with regard to its enforceability. Therefore, International Commercial Arbitration is not completely detached from national laws and thus arbitrators may face the challenge of conciliating rules coming from different legal systems in order to not jeopardize the award's effectiveness.

To this extent, punitive damages can constitute a strong bias against the enforcement of an arbitral award, especially when the parties to the underlying dispute come from countries different from those allowing for the exemplary remedy in contract actions.

The paper will first go through a brief overview of what punitive damages are and in which instances and jurisdictions they are awarded. Then, once established that arbitrators may have the power to award punitive damages, the purpose of this paper is to decide whether or not they should do so. The reasoning is based on arguments concerning the nature of punitive damages awarded for breach of contract, the recognition and enforcement of such awards and suggestions arising from transnational legal practice.

II. Punitive damages for breach of contract

A brief analysis of what punitive damages are and in which cases they are awarded in contract actions is necessary in order to better tackle the issue of punitive damages in International Commercial Arbitration.

Punitive damages are: "Damages awarded in addition to actual damages when the defendant acted with recklessness, malice or deceit"[1].

Such damages are often considered a case of overcompensation: they are awarded over and above what is necessary to compensate claimant[2]. The terms "punitive" or "exemplary" entail the idea that they are intended to be more than just a means to compensate the losses suffered by the non–breaching party, rather they are mainly intended as a means to deter and punish conduct that is considered to be particularly outrageous.

The theoretical underpinnings of punitive damages lie in the Punishment and Deterrence Theory, according to which the exemplary remedy is to punish the defendant and to deter such future misbehaviour[3]. A third component is present, which can be considered a corollary of the previous two: denunciation, the community's collective condemnation of the misbehaviour[4]. Al-

[1] *Black's Law Dictionary*, 7th ed.

[2] Wilcox & Koziol, *Punitive Damages: Common Law and Civil Law Perspectives,* in *Tort and Insurance Law*, vol. 25, Morlenbach, Springer–Verlag, 2009 at Ch. 1, §1.

[3] *Vid.* Schmit, Pritchett & Fields, *Punitive Damages: Punishment or Further Compensation?*, in *The Journal of Risk and Insurance*, vol. 55, no. 3 (1988) at 456. *Vid.* also the leading case *Wilkes v. Wood,* 98 Eng. Rep. 489 (1973) at 498–499 where it is stated that: "Damages are designed not only as a satisfaction to the injured person, but likewise as a punishment to the guilty, to deter from any such proceeding for the future and as a proof of the destination of the jury to the action itself".

[4] *Vid. Whiten v. Pilot Co.*, 2002 SCC 18, at summary.

though this theory particularly refers to tort damages, it can be also applied to contract cases.

The issue can be addressed by another point of view, which may be the best way to tackle it: to analyse it from an Economic Analysis of Law perspective.

This theory focuses on the efficiency of the exemplary damages in deterring particular kind of breach of contract. According to this point of view, the request for punitive damages may not be grounded for every breach of contract: the breach must be wilful, that is when the breaching party has the intention to escape from its contractual obligations and does it intentionally. There is a distinction among wilful breaches of contract: efficient breach of contract and opportunistic breach of contract. The latter occurs when the breaching party gains more than she bargained for at the expense of the non–breaching party[5]. The economic analysis of law argument supports the availability of punitive damages in contract actions in order to deter this kind of breach, on the grounds that they are considered inefficient[6].

Notwithstanding the appeal of the latter theory, the operational rule enacted by courts mostly relies on the Punishment and Deterrence theory and it is explanatory of the interference between tort and contract liability, whose differences, according to some opinions, are vanishing overtime, with particular respect to remedies[7].

1. Jurisdictions awarding punitive damages in contract actions

Punitive damages for tort claims are common to the major Common law jurisdictions; the same cannot be said with respect to contractual claims.

In England, there is no argument about the availability of the exemplary remedy for tort actions, although there have been many expansions and backlashes concerning their amounts and the causes of action for which punitive damages can be awarded[8]. So far, there is no contention about the fact that

---

[5] *Vid.* W.S. Dodge, "The Case for Punitive Damages in Contracts", *Duke L.J.*, vol. 48, no. 4, 1999, p. 629. *Vid.* also Judge Posner in *Patton v. Mid–Continent Sys.*, 814 F.2d 742 (1988), at §28 "Not all breaches of contract are involuntary or otherwise efficient. Some are opportunistic; the promisor wants the benefit of the bargain without bearing the agreed–upon cost, and exploits the inadequacies of purely compensatory remedies".

[6] R.A. Posner, *Economic Analysis of Law*, Boston, Little, Brown & Company, 1992, pp. 117–118. Some authors also argue for the availability of punitive damages for efficient breaches of contract, *Vid.* Dodge, *supra* note 5, at 629. In any case, the efficient breach theory has represented the main grounds on which courts refused to award exemplary damages in contract actions.

[7] *Vid.* G. Gilmore, *The Death of Contract*, Ohio State University Press, 1995 where the Author, departing from an analysis of the relationship between contracts and torts, affirms that the second one has become preeminent and that contract has to be lead back to tort. In particular, what disrupts the distinction between the two fields is the *promissory estoppel* according to which a promise is binding even when lacking of consideration, on the ground of promisee's reliance on it, so that a breach would entail damage to him.

[8] The first restriction on the availability of exemplary damages was issued by the House of Lords in the leading case *Rookes v. Barnard* [1964] A.C. 1129, where Lord Delvin, after having remarked the overlapping between criminal and civil law with respect to the goals persued by punitive damages, restricted the cases for which they could be awarded to three: a) oppressive, arbitrary or unconstitu-

they are not available for breach of contract[9]: the first bar can be found in *Addis v. Gramophone Co. Ltd*[10] where almost unanimously the House of Lords held that "exemplary damages ought not to be, and are not according to any true principle of law, recoverable in such an action [a contract action] as the present"[11]. The point has been further addressed in a report submitted by the English Law Commission where it explicitly states that "punitive damages should not, however, be available for breaches of contract"[12]. There has been a recent expansion of the recoverability of punitive damages, namely the cause of action test introduced by *Broome v. Cassell& Co Ltd* is no more applicable, still there are no precedents about exemplary damages for breach of contract so far[13].

United States are much more familiar with punitive damages for breach of contract: two main theories have been developed to this regard. The first one is called the Traditional Rule it is clearly stated into the Restatement Second of Contracts, § 355. According to this provision punitive damages are recoverable every time the conduct that constitutes the breach is also a tort for which punitive damages are granted. Thus, it is a case in which there is an overlapping and a summon of the two types of liability: the contractual and the tort one. This entails that the Court overseeing over the dispute can choose the appropriate rule which best fits the facts that are brought before it between the two fields of law[14]. The Traditional Rule has been applied in several instances, particularly in cases concerning fraud and misrepresentation even arising out of commercial contracts[15] or in cases in which there was a tort of bad faith breach, the most of them with regard to insurance contracts.[16] The tort of bad faith breach has also been applied in cases concerning employment contracts[17] and, in few instances commercial contracts.[18]

---

tional action by the servants of the government; b) the defendant's conduct has been calculated by him to make a profit for himself which may well exceed the compensation payable to the plaintiff and c) when there is a statutory provision. *Vid.* id. at 1226–1227. A further restriction has been made in another precedent, *Broome v. Cassell& Co. Ltd* [1972] A.C. 1027, according to which, and in addition to Lord Delvin's three categories, punitive damages cannot be awarded in tort actions for which they had not previously been awarded. *Vid.* id. at 1130 – 1131.

[9] Beatson, *Anson's Law of Contract*, Oxford University Press, Oxford 2002, p. 592. *Vid.* also McGregor, *McGregor on damages*, Sweet & Maxwell, London 2003, at § 19–002.

[10] *Addis v. Gramophone Co. Ltd* [1909] UKHL 1 [1909].

[11] *Vid.* id. at 5.

[12] English Law Commission, *Aggravated, Exemplary and Restitutionary Damages* [1997] EWLC 247, § 5.42.

[13] *Vid. Kuddus v. Chief Constable of Leicestershire,* [2001] 2 A.C. 122. *Vid.* also McGregor, *supra* note 9, at § 11–016.

[14] Corbin, *Corbin on contracts*, Vol. 5, West Publishing Co., St. Paul 1971, at § 1002.

[15] I.e. *Boise Dodge Inc. v. Robert E. Clark*, 92 Idaho 902 (1969); *Robinson Helicopter Co. v. Dana Corp.*, 22 Cal.Rptr.3d 352 (2003).

[16] I.e. *Comunale v. Traders and General Insurance Co.* 328 P. 2d 198 (1958) (the wrongful refusal of insurer to settle the claim against insured is to be generally treated as a tort); *Crisci v. Security Insurance* 66 Cal.2d 425 (1967) (Breach of the duty to accept reasonable settlements, which is included into the implied covenant of good faith and fair dealing); for other examples *Vid.* M. Penninghton, "Punitive Damages for Breach of Contract: A Core Samples from the Decisions of the Last Ten Years", *Arkansas L. Rev.*, vol. 42, 1989, p. 31.

[17] *Vid. Monge v. Beebe Rubber Co.* 316 A.2d 549 (1974) (A termination by the employer of a contract of employment at will is not in the interest of the economic system or the public good where such

The second theory is the one developed by the so called "Indiana decisions": according to this rule, punitive damages are recoverable for breach of contract "when it appears from the evidence as a whole that a serious wrong, tortious in nature, has been committed, but the wrong does not conveniently fit into the confines of a pre–determined tort"[19]. Therefore, there is no need to prove a specific independent tort, being enough that the conduct presents elements of fraud, malice, gross negligence or oppression[20].

Punitive damages in insurance cases recently found fertile ground in Canada: the Supreme Court adhered to the underpinning of the "Indiana decisions" theory holding that "a breach of the contractual duty of good faith is independent of and in addition to the breach of contractual duty to pay the loss. It constitutes an 'actionable wrong' [...], which does not require an independent tort"[21] thus rendering available punitive damages for breach of contract.

This brief overview, far from being exhaustive, is intended to give an idea of the possible grounds on which punitive damages can be awarded for breach of contract and a basis of the following argument about International Commercial Arbitration.

III. Punitive damages in arbitration: parties' agreement and arbitrators' power to grant the exemplary remedy

Parties choose to solve their disputes by means of arbitration including in the contract an arbitration clause or, if not, they stipulate an arbitration agreement once the dispute arises[22]. A milestone of International Commercial Arbitration is the principle of parties' autonomy and it finds crucial importance when contracting for the arbitration agreement: in the latter parties define which disputes can be solved by arbitration, the applicable law to the merits of those disputes, the applicable law to the arbitral proceedings and even the place of arbitration[23]. The parties' arbitration agreement is the primary source of arbitrators' power and it identifies and outlines the dispute's arbitrability. Thus, the importance of the interpretation of the arbitration agreement is straightforward for it entails whether or not arbitrators can

termination is motivated by bad faith or malice or based on retaliation); *Coffey v. Fayette Tubular Products* 929 S.W.2d 326 (1996) (Plaintiff was awarded USD 500.000,00 in punitive damages because of employer's particularly malicious conduct in wrongfully terminating the employment contract).

[18] The leading case concerning commercial contracts is *Seaman's Direct Buying Service Inc. v. Standard Oil Co.* 206 Cal.Rptr 354 (1984) (punitive damages are available for the case in which the breaching party seeks to shield himself from liability by denying, in bad faith and without probable cause, that the contract exists).

[19] *Vid. Vernon Fire & Cas. Ins. Co. v. Sharp* 349 N.E.2d 173 (1976) at 180.

[20] *Vid. Hibshman Pontiac v. Batchelor* 362 N.E.2d 845 (1977) at 847. Justice DeBruler, however, underlines the vagueness and uncertainty of this rule, stating that it can leave room for awards "motivated by vindictiveness and prejudice."

[21] *Vid. Whiten v. Pilot Insurance Co.* [2002] 1 S.C.R. 595 at § 79.

[22] A. Frignani, *L'arbitrato commerciale internazionale*, vol. 33, in *Trattato di diritto commerciale e diritto pubblico dell'economia*, Padova, Cedam, 2004, p. 49.

[23] G.B. Born, *International Commercial Arbitration in the United States: Commentary & Materials*, Boston, Kluwer Law and Taxation, 1994, p. 118.

award punitive damages. The arbitrability of punitive damages is therefore linked with parties' intent as included in the arbitration agreement and the question whether or not the exemplary remedy can be granted is to be addressed with regard to it[24].

To this extent, there might be the case in which parties expressly agreed on the exclusion of punitive damages as a possible remedy. Here, there seems to be no contention on the interpretation of the arbitration clause as an expression of parties' willingness, but the arbitration agreement may include some other provision. For instance, the choice of law provision. Parties might have chosen Italian law, which does not allow for punitive damages, as applicable to the merits of the dispute: in this occurrence the choice of law is consistent with the "exclusion" clause and arbitrators should have no doubts on which remedies are available[25].

Nonetheless, there might be the case in which there is inconsistency between the express exclusion of punitive damages and the choice of the applicable law when the latter provides for them. Arguably, the parties made two statements about the availability of the exemplary remedy: the first one, the most explicit, is included in the exclusion clause of the agreement; the second one lies in the shadow of the choice of law clause. Such inconsistency can be an issue in deciding the dispute since it introduces ambiguity into the arbitration agreement. Some state that a possible solution to this case can be that the explicit intention of parties to avoid punitive damages is to be considered as a modification of the choice of law clause[26]. But that is possible only as long as the waived rule is not considered to be a mandatory one: mandatory provisions are a constraint to parties' autonomy and they are often conveyed with the idea of public policy[27].

This occurrence is well addressed in the case *Stark v. Sandberg*[28] in which the contracting parties agreed to exclude punitive damages but then chose the Missouri law as applicable law to the dispute, which provides for the availability of such remedy. In the case at hand the Court of Appeals ruled that such waiver could be enforceable only to the extent that the governing law permitted it: that was not the case since parties, in the eye of the Court, were trying to exonerate themselves from future tort liability[29]. Therefore,

---

[24] *Vid.* M.S. Donahey, "Punitive Damages in International Commercial Arbitration", *J. Int'l Arb.*, vol. 10, 1993, p. 72. *Vid.* also J.Y. Gotanda, "Awarding Punitive Damages in International Commercial Arbitration in the *Wake of Mastrobuono v. Shearson Lehman Hutton, Inc.*", *Harvard Int'l L.J.*, vol. 38, 1997 p. 87.

[25] T.H. Oehmke, *Commercial Arbitration*, St. Paul, Thomson Reuters, 2010, at § 121.3: "Unless punitive damages are unambiguously waived, [U.S.] court[s] have confirmed an arbitrator's award of punitive damages".

[26] J.Y. Gotanda, *supra* note 24, at 91. This interpretation is consistent with the ruling in *Mastrobuono*, which is supportive of the proarbitration policy contained in the Federal Arbitration Act as interpreted by U.S. Courts.

[27] *Vid.* Id. at note 166 when explaining the meaning of mandatory rule and note 167, addressing the point of public policy.

[28] *Stark v. Sandberg, Phoenix & von Gontard*, P.C., 381 F.3d 793 (2004).

[29] *Vid.* Id. at 800: "Under Missouri law there is no question that one may never exonerate oneself from future liability for intentional torts or for gross negligence [...] An attempt to procure a waiver of

the governing law provision allowing punitive damages was considered to be mandatory and to this extent not avoidable by parties' express agreement[30]. Notwithstanding this interesting ruling, it has to be born in mind that such judgment was issued according to a very strict idea of public policy and mandatory law applicable to the dispute, an idea that in most cases is not applied by courts sitting to decide the *exequatur* of international awards.

Parties can also provide the possibility for arbitrators to grant punitive damages as a remedy by explicitly stating it into the arbitration agreement. In this occurrence, since parties' intent is clear on the point, there should be no question about the availability of the exemplary remedy[31]. Nonetheless, as seen in the previous paragraph, ambiguity can arise when the arbitration agreement contains several provisions, particularly about the choice of the applicable law. In case of an explicit statement about the availability of punitive damages accompanied by the choice of an applicable law that does not provide for them, arbitrators face again the issue of deciding which of the two parties' statements shall prevail over the other.

The first important precedent in which courts undertook an analysis of arbitrators' power to award punitive damages is *Garrity v. Lyle Stuart, Inc.*[32]. The case was heard before the Court of Appeals of New York and was about the recognition of an arbitral award in which arbitrators awarded punitive damages in the absence of parties' clear statement about them.

After underlining the general principles that portray arbitration and make it a useful means to solve disputes[33], the Court goes further stating that awarding punitive damages is a function reserved to courts and juries, therefore to the State, "as the engine of imposing a social sanction", to the extent that punitive damages are an "exemplary remedy", opposed to a private remedy[34]. This argument continues purporting that imposing such penal sanctions privately would undermine "the rule of law of organized society" which, eventually, requires that the exemplary remedy should be controlled by the State[35]. That is to say, the resort to such remedy is neither a matter subject to

punitive damages is an attempt to exonerate oneself from future liability for intentional torts or gross negligence, because the remedy of punitive damages would otherwise be available for such acts".

[30] *Vid.* T.H. Oehmke, *supra* note 25, at § 121.3.

[31] *Vid. Belko v. AVX Corp.*, 251 Cal.Rptr. 557 (1988). In the case at hand the employer, AVX Corp., wrongfully terminated Belko and the arbitrator granted the employee compensatory damages for breach of contract and punitive damages for wrongful discharge and breach of implied covenant of good faith and fair dealing. The employer questioned the power of the arbitrator to grant the exemplary relief on the ground that he was exceeding the scope of his jurisdiction. The ruling of the Court in enforcing the award was sharp on the issue: commercial exemplary damages may be awarded by arbitrator of commercial dispute when expressly provided for in arbitration agreement. Id at 557. The Court also held that exemplary damages may be awarded pursuant to the "express understanding of parties reflected in their pleadings and litigation conduct which establishes they intended to submit that issue to arbitrator".

[32] *Garrity v. Lyle Stuart, Inc.,* 40 N.Y.2d 354 (1976).

[33] Namely: (a) arbitrators are not generally bound by substantive law principles or rules of evidence and (b) arbitrators are generally free to choose among the appropriate remedies the wrong requires. *Vid.* Id 356–357.

[34] Id at 357.

[35] Id at 359.

the principle of parties' autonomy nor it is appropriate that privately appointed arbitrators could wield a sanctioning power like this one. Moreover, the Court states that whereas actual damages are objectively measurable, exemplary damages "take their shape from the subjective criteria involved in attitudes toward correction and reform, and courts do not accept readily the delegation of that kind of power"[36].

A possible underpinning of this decision can be also found in due process concerns: since arbitration has no strict procedural rules, the Court is concerned that this lack of procedural safeguards and the above mentioned consideration about exemplary damages' subjectiveness may somehow lead to unjust awards favoring the party with the stronger bargaining position[37]. This latter consideration encompasses a second rationale the Court purports to be pre–emptive of punitive damages in arbitration: the danger for the award to be unfair would justify courts' judicial intrusion, thus undermining the usefulness of arbitration. For this reason, the Court argues, arbitration would be unpredictable and uncontrollable[38]. The criticism over *Garrity* has been fierce over the years and in many cases this case law has been distinguished or even overruled, changing overtime the overall opinion about arbitrator's power to award punitive damages.

In most cases, the arbitration agreement does not contain any provision about exemplary damages since, as it often happens, parties may not consider the issue when negotiating the contract[39]. In the U.S., the federal policy in favor of arbitration, which is outlined in the Federal Arbitration Act as interpreted by courts[40], requires courts to interpret arbitration agreements liberally and to order arbitration for any of the disputes arguably covered by the agreements. Applying this policy to broad arbitration agreements led courts to argue for a wide arbitral authority, which is eventually inclusive of issues like punitive damages. As previously underlined, in order to recover punitive damages for breach of contract, in most cases there is the need of proving the existence of an additional tort accompanying the breach (accord-

---

[36] *Vid.* id at 359.

[37] T.J. Stipanowich, "Punitive Damages in Arbitration: Garrity v. Lyle Stuart, Inc. Reconsidered", *Boston University L. Rev.*, vol. 66, 1986, p. 962.

[38] *Vid. Garrity* at 359.

[39] For instance, because they come from legal traditions to which punitive damages are unknown or not applicable. *Vid.* J.Y. Gotanda, *supra* note 24 at 96.

[40] That is, the federal arbitration law that applies to interstate and international commerce transactions. Notwithstanding the early enactment of the FAA, it was only in the 80s that U.S. courts started to use it to enhance arbitration, particularly when the Supreme Court in *Moses H. Cone Memorial Hospital v. Mercury Construction Corp.* 103 S.Ct. 927 (1983) expanded the FAA to apply also in state Courts in 1983: the Court argued that Section 2 of the FAA was "a congressional declaration of a liberal federal policy favoring arbitration agreements" and that this policy was pre–emptive of any federal and state substantive and procedural policies to the contrary. The outcome of these considerations is that: "any doubts concerning the scope of arbitrable issues should be resolved in favour of arbitration, whether the problem at hand is the construction of the contract language itself or an allegation of waiver, delay, or a like defense to arbitrability" *Vid.* id at 941–942. *Vid.* also D.R. Davis, "Overextension of Arbitral Authority: Punitive Damages and Issues of Arbitrability – *Raytheon Co. v. Automated Business System, Inc., 882 F.2d 6 (1st Cir. 1989)*", *Washington L. Rev.*, vol. 65, 1990.

ing to the Traditional Rule). The pattern, as concerns the arbitrability of the exemplary remedy, has been the same: courts first expanded the scope of broad arbitration clauses as to encompass the arbitrability of tort claims as well as contractual ones[41], then came the inclusion of punitive damages. A straightforward challenge to the *Garrity Rule*, which prevented the availability of punitive damages in arbitration, is encompassed in *Willoughby Roofing & Supply Co., Inc. v. Kajima Intern., Inc*[42]. The District Court questioned the holding in *Garrity* arguing on both a formal ground and on a policy one, tackling the issue directly with *Garrity*'s arguments. In the case at bar, the parties agreed on a very broad arbitration clause so that there was little contention on the applicability of the FAA proarbitration policy[43]. The most interesting argument the District Court set forth was about the displacement of social justice from courts to private dispute settlement means, therefore to arbitrators. What is remarkable here is also the argument about arbitrators' capabilities to grant punitive damages, founded both on the observation that in many cases arbitrators are more technically equipped than judges and, particularly, that for the purposes of the enhancement of social justice through the power to sanction, there is no real difference between courts and arbitrators[44]. To this extent, it is to be stressed the fact that a civil sanction like punitive damages, does not entail the same level of judicial review as criminal sanctions would; the goal pursued by punitive damages is the one of deterrence, not just punishment. Thinking of that and believing that deterrence is the ultimate aim of punitive damages – that is the possibility by awarding them to prevent such misbehavior in future – there is really no reason why an arbitrator could not possibly undertake such role.

---

[41] The leading case on the issue is *Prima Paint Corp. v. Flood & Conklin Manufacturing Co.*, 87 S.Ct. 1801 (1967): in the case at bar, the Supreme Court argued that a tort claim is arbitrable, except when parties otherwise intended, "[w]hen no claim is made that fraud was directed to the arbitration clause itself, a broad arbitration clause will be held to encompass arbitration of the claim that the contract itself was induced by fraud". Id at 1805. The implementation and the enhancement of such rationale can be found in *Willis v. Shearson/American Express, Inc.*, 569 F.Supp. 821 (1983): the Court argues that in this case the arbitral clause is "extraordinary broad" and that it is not possible to reasonably confine it to just breach of contract questions since "it covers any controversy arising out of or relating to the account agreement 'or the breach thereof ....' " Id at 823. In the case at hand, the Court also questioned the *Garrity Rule* stating that the *Garrity* case only dealt with the powers of arbitrators under state law, not addressing at all their power under the federal law: this entails that *Garrity*'s holding is circumscribed only to those claims that are about transactions not covered by the FAA, namely domestic transactions. The Court goes further stating that notwithstanding parties' choice of a particular state law, "federal law governs the categories of claims subject to arbitration" and that "If an issue is arbitrable under federal law, it remains so despite contrary state law". Id at 823–824.

[42] *Willoughby Roofing & Supply Co., Inc. v. Kajima Intern., Inc.*, 598 F.Supp. 353 (1984).

[43] The "federal policy does not prohibit the award of punitive damages by arbitrators if the parties' agreement is found to confer upon them the authority to make such an award". Id at 359–360.

[44] "An arbitrator steeped in the practice of a given trade is often better equipped than a judge not only to decide what behavior so transgresses the limits of acceptable commercial practice in that trade as to warrant a punitive award, but also to determine the amount of punitive damages needed to (1) adequately deter others in the trade from engaging in similar misconduct, and (2) punish the particular defendant in accordance with the magnitude of his misdeed". Id at 363.

The question whether "a contractual choice–of–law provision may preclude an arbitral award of punitive damages that otherwise would be proper" is ultimately addressed in a U.S. Supreme Court precedent: *Mastrobuono v. Shearson Lehman Hutton, Inc.*[45]. Determining if the FAA is pre–emptive of the applicable state law (in this case New York state law and therefore the *Garrity* rule) depends on parties' intent as expressed into the contract: the interpretation of the arbitration agreement is the waypoint through which the analysis must go in order to solve the dispute. In order to do that, the Supreme Court split the arbitration agreement in two parts: the choice of law provision and the arbitral clause. In examining the New York choice of law, arguably entailing the *Garrity Rule,* the Supreme Court ruled that the provision "is not, in itself, an unequivocal exclusion of punitive damages claims" to the extent that "the provision might include only New York's substantive rights and obligations, and not the State's allocation of power between alternative tribunals"[46]. While the arbitration clause, recalling the application of NASD[47] rules which grant arbitrators broad remedial power, is not to be considered a clear authorization of punitive damages, it nonetheless "strongly implies that an arbitral award of punitive damages is appropriate"[48]. At very heart of this decision there is the standpoint according to which, whereas parties are generally free to shape their arbitration agreement and whereas ambiguities in it must be resolved in favour of arbitration, in the absence of an explicit prohibition of punitive damages, they are awardable by arbitrators. Moreover, there is a second principle: a choice of law clause only incorporates substantive principles of state law, and not state arbitration law and policy[49]. The underpinning of this last rationale and the basis of the *Garrity* rule is that:"the choice–of–law provision covers the rights and duties of the parties, while the arbitration clause covers arbitration; neither sentence intrudes upon the other"[50].

What is the impact of such decision with regard to International Commercial Arbitration, then? As a matter of facts, the Supreme Court holds no position concerning punitive damages as a remedy; it does not undertake a policy analysis on them, so that in a certain way it leaves freedom of choice to the parties of interstate and international contracts: if they wish to exclude exemplary damages from the available remedies, they should expressly provide for such exclusion[51]. What we can grasp from the analysis of the genesis of the FAA pro–arbitration policy and its recent backlash[52] and expansion is

[45] *Mastrobuono v. Shearson Lehman Hutton, Inc.*, 514 U.S. 52 (1995).

[46] Id at 60.

[47] National Association of Securities Dealers.

[48] Id at 61.

[49] *Vid.* J.Y. Gotanda, *supra* note 24 at 76 – 77.

[50] *Vid. Mastrobuono* at 64.

[51] *Vid.* id at 56–57: "In other words, if the contract says 'no punitive damages,' that is the end of the matter, for courts are bound to interpret contracts in accordance with the expressed intentions of the parties–even if the effect of those intentions is to limit arbitration".

[52] The said backlash was the one contained in *Volt Information Sciences Inc. v. Board of Trustees of the Leland Stanford Junior University*, 109 S.Ct. 1248 (1989) in which the question before the U.S. Supreme Court was whether or not the FAA pre–empted the application of the California Code and

that, generally, in the U.S. arbitrators are considered to be capable to award punitive damages. First, this capability derives from the extent that arbitration, as a highly used alternative forum for dispute resolution, is deemed to pursue the same goals as state courts utilizing the same tools, but in a manner more suitable to international and interstate commerce – it's faster, simpler and to some extent more reliable. Arbitrators can properly achieve punishment and deterrence even if their appointment does not have a statutory nature. Moreover, many courts stressed the fact that in many instances arbitrators are chosen between highly–specialized people of the commercial field, hence there is not a technical preparation gap between them and state judges. Secondly, everything depends on parties' intention. The operational rule arising from all of the cited cases is that in the presence of a broad arbitration clause granting arbitrators wide remedial powers, they have the power to grant punitive damages if the case allows for it. The suggestion that clearly comes from *Mastrobuono* is that parties should better define the scope of the arbitration agreement, particularly when outlining the available remedies.

III. International Arbitration rules and the available remedies

When considering a broader approach to punitive damages other than the U.S. one, help can come from the analysis of the main bodies of international commercial arbitration rules, the ones most widely used by international arbitral institutions. The aim is to see the difference between them and the ones previously analyzed when investigating the U.S. approach to the issue. For instance, the American Arbitration Association rules with regard to remedies arbitrators can grant states that

> "Rule 43 – Scope of award. (a) The arbitrator may grant any remedy or relief that the arbitrator deems just and equitable and within the scope of the agreement of the parties, including, but not limited to, specific performance of a contract"[53].

This is a very broad rule, interpreted as including the possibility to award punitive damages as well. However, international arbitration rules are not as broad a this one.

1. UNCITRAL Arbitration Rules and UNCITRAL Model Law on International Commercial Arbitration

Let's take as an example one of the most widely used set of rules, the UNCITRAL Arbitration Rules. These were rules adopted by the United Nations Commission on International Trade Law on April 28, 1976 and unani-

---

whether or not the order to stay arbitration undermined FAA goals and policies. The Supreme Court held that the California Code provision, which provided for the stay of arbitration when there was a pending court action between one of the arbitration parties and a third party arising out of the same transaction, was applicable. Thus, questioning the effectiveness of the federal pro–arbitration policy not considering it pre–emptive of a state law provision that, substantially, had the effect to impede arbitration to take place.

[53] *Vid.* American Arbitration Association Commercial Arbitration Rules and Mediation, available at http://www.adr.org/

mously approved by resolution of the U.N. General Assembly on December 15, 1976. The aim of the Commission was to create a body of procedural rules that would allow general international acceptance of an arbitral award rendered according to them. In the beginning they were established as a set of rules created for use in ad hoc arbitrations, but eventually they have been adopted as the applicable rules of the Inter–American Commercial Arbitration Commission, the Iran–United States Claims Tribunal, the Centre for Commercial Arbitration at Cairo, the Centre for Arbitration at Kuala Lumpur, the Spanish Court of Arbitration, and others.

Another set of rules drafted by the Commission can be analyzed along with the Arbitration Rules for they are very similar: the UNCITRAL Model Law on International Commercial Arbitration, specifically designed to help states in reforming and modernizing their laws on arbitral procedures with the aim to address considerable disparities in national laws on arbitration.

Both the Model Law and the UNCITRAL Arbitration Rules state nothing about punitive damages, furthermore they do not even have a specific provision about the available remedies. In describing the scope and the form of the arbitral award they just state that the award "shall be made in writing and shall be final and binding on the parties" and that "the arbitral tribunal shall state the reasons upon which the award is based". The only reference these sets of rules make to remedies is when dealing with the statements of claim and defence: the claimant "shall state the facts supporting his claim, the points at issue and the relief or remedy sought"[54]. These provisions talk about remedies in an unspecified way, so that there is not any bar as to include into the statement of claim a request for punitive damages.

In any case, both sets of Rules acknowledge that the arbitration is to be conducted with reference to some national legal system, in particular according to the substantive law applicable to the dispute, and both provide that mandatory provisions of the national legal system will prevail over conflicting provisions of the rules[55]. The issue of punitive damages then, being the rules silent, is devolved to the application of substantive law, which, in this case, seems to be the only source of guidance to argue for the availability of punitive damages.

2. ICC Rules and LCIA Rules

There is not any reference to remedies in the ICC Rules of Arbitration nor do the provisions concerning the award give any guidance on the issue. In relation to the applicable law to the dispute, Art. 17 ICC Rules of Arbitration

---

[54] UNCITRAL Model Law on International Commercial Arbitration, Art. 23 – *Statements of claim and defence. Vid.* also UNCITRAL Arbitration Rules Art. 18.

[55] *Vid.* Model Law Art. 1(5) – *Scope of application*: "This Law shall not affect any other law of this State by virtue of which certain disputes may not be submitted to arbitration or may be submitted to arbitration only according to provisions other than those of this Law." Arbitration Rules Art. 1(2) "These Rules shall govern the arbitration except that where any of these Rules is in conflict with a provision of the law applicable to the arbitration from which the parties cannot derogate, that provision shall prevail."

– Applicable Rules of Law – states that, in the absence of parties' agreement, "the Arbitral Tribunal shall apply the rules of law which it determines to be appropriate" and that "in all cases the Arbitral Tribunal shall take account of the provisions of the contract and the relevant trade usages".

The same could be said about the London Court of International Arbitration rules, whose Art. 26 – The Award – only provides that arbitrators have the power to award interest, and nothing states about any other remedies. With regard to the applicable law, the Rules provide for parties' choice and if there is not, provide that the arbitral tribunal "shall apply the law(s) or rules of law which it considers appropriate"[56].

The provisions according to which arbitrators should also look to trade usage in solving the dispute represent a possible impediment to punitive damages. We can find them in the ICC Rules of Arbitration (Art. 17, see *supra*), in the UNCITRAL Arbitration Rules[57] and into the Model Law[58]. As a matter of fact, this condition stands for an interpretation forbidding the exemplary remedy since the most of the countries of the world do not allow for it.

As seen before, all these sets of international rules – in contrast with U.S. domestic ones – are not concerned with the availability of punitive damages, neither they are with other remedies in general. Including these rules into an arbitration agreement would add nothing to what arbitrators could grasp from interpreting it in the light of the choice of the applicable law to the merits, which in the end constitutes the only account for punitive damages, if providing for them (again, in the absence of parties' statements about them).

IV. Absent any parties' statement about the applicable law

As underlined above[59], parties are often not concerned about the proper selection of available remedies, nor they often are in drafting proper arbitration agreement at all: in drafting international commercial contracts attention is paid to more substantial issues than the arbitration agreement. The result of such disregard is that sometimes parties only agree on the respective obligation to solve the dispute by arbitration, not going any further in specifying the terms of the agreement. In these circumstances arbitrators' interpretation of the arbitral clause is essential when deciding whether or not exemplary damages are available, moreover other factors can be considered apart from the plain choice of law clause.

Many indicators can give arbitrators guidance in interpreting the arbitration agreement: they can be the *lex loci arbitri*, the closest connection rule or the principle of delocalization of international commercial contracts.

---

[56] *Vid.* London Court of International Arbitration (LCIA) Rules, Art. 26.

[57] Art. 33 – "In all cases, the arbitral tribunal shall decide in accordance with the terms of the contract and shall take into account the usages of the trade applicable to the transaction."

[58] Art. 28 – Rules applicable to substance of dispute, the provision is the same as the Arbitration Rules.

[59] *Vid. supra* § 2.

1. The application of the lex loci arbitri *and other indicators*

In many countries, parties' autonomy might be limited by the application of mandatory rules of the law of the place of arbitration, particularly those rules that are considered an expression of state's public policy. This traditional approach can apply both to the application of choice of law rules of the seat of arbitration and the application of the substantive law of the *situs*[60]. For instance, according to this view, arbitrators sitting in the U.S. and deciding an interstate and international dispute will be likely to have the power to award punitive damages, as seen before[61]. The application of the *lex fori* might be useful when arbitrators think that the place of arbitration is the one in which most likely the award will be enforced: to this extent applying either the procedural or the substantive law of the place of arbitration would reduce the risk of the award not to be enforced, granting it a strong basis of effectiveness[62].

However, this traditional rule went through an erosion process towards an almost total abandonment since the rationale of adopting national choice of law rules does not really suit international commercial arbitration[63]. The reason underlying this trend is that international arbitral tribunals cannot be compared with national judicial forums since their powers do not arise from statutory provisions but from the arbitration agreement and they do not exercise public or institutional power in the name of the State. To this extent, detaching the choice of applicable law from circumstances that are not really functional to solving the dispute and instead applying choice of law principles more linked to the dispute or the contract itself would achieve a major level of delocalization, permitting arbitrators to make choices more suitable to the circumstances[64].

In the absence of the choice of law provision, another useful tool can be the Closest Connection Rule: it provides that arbitrators must apply the conflict of laws rules that are most closely connected to the merits of the dispute[65]. In any event, applying national conflict of laws rules means that the

---

[60] One of the countries adopting this view is the United States. According to the *Restatement (Second) Conflict of Laws* parties' choice of the place of arbitration can be considered as implied intention to choose the law of the *situs*. *Vid. Restatement (Second) Conflict of Laws,* § 218, Comment b. "Provision by the parties in a contract that arbitration shall take place in a certain state may provide some evidence of an intention on their part that the local law of this state should govern the contract as a whole." *Vid.* also *Sapphire Int'l Petroleum Ltd. v. National Iranian Oil Co.*, Award of Mar. 15, 1963, 35 I.L.R. 136 (1967) in which the arbitrator referred to a 'general rule' which, according to the arbitrator, provides that in the absence of a choice by the parties, the arbitration is governed by the law of the place where the tribunal has its seat.

[61] *Vid. supra* § 2.

[62] *Vid.* V. Danilowicz, "The Choice of Applicable Law in International Arbitration", *Hastings Int'l Comp. L. Rev.*, vol. 9, 1986, p. 252. An example of the importance of the law of the seat of arbitration is contained in the ICC Case No. 5946, where the Arbitral Tribunal sitting in Geneva, notwithstanding the New York choice of law provision, denied the claim for punitive damages arguing that they were considered contrary to Swiss public policy. ICC Case 5946, *Yearb. Comm. Arb'n*, vol.XVI, p. 118.

[63] G.H. Born, *International Commercial Arbitration*, 3rd, Kluwer Law International, 2009 pp. 2123–2124.

[64] *Vid.* A. Frignani, *supra* note 22.

[65] In the ICC Case No. 1422 *Manufacturer (Italy) v Distributor (Switzerland)*, in *Digest of ICC – International Court of Arbitration*, whereas in the contract there was neither an express choice of law

arbitrator defers state law to choose the applicable law to the dispute, thus applying those national policies that underpin the conflict of laws rules. In International Commercial Arbitration, where arbitrators are chosen by parties who have the power to shape the arbitration agreement as they consider suitable to their interests, there is no real need to apply states' interest as contained in their conflict of laws rules[66].

Eventually, in order to enhance the de–localization of contractual relationships between international parties, many international provisions lay down a more "impartial" principle as to the choice of applicable law: in many cases arbitrators can apply the choice of law rules that they considers "appropriate"[67]. There are authors stating that this method would foster the better result in terms of de–localization of the contract, arguing that this view is also justified by recognition and enforcement international conventions that exclude the judicial review on the merits of the dispute[68]. Others are concerned that this kind of direct application of substantive law would leave parties' substantive rights "to turn on subjective, unarticulated instincts of individual arbitrators"[69] not furthering the fairness and predictability of the arbitration outcome.

This short analysis of choice of law principles is helpful in understanding the responsibility arbitrators have when applying one law rather than another, particularly when considering the substantive effectiveness of the arbitral award that comes into light when questioned with regard to its recognition and enforcement. Choosing the appropriate law carefully means granting the award the posibility to be fully equipped in order to produce its effects between the parties. To this extent, notwithstanding the possibility for arbitrators to grant punitive damages in force of the chosen applicable law, enforceability concerns might prevent their availability.

V. Enforcement of arbitral awards: will punitive damages prevent it?

An arbitration proceeding, once begun, in most cases reaches its conclusion, the award, without difficulty. Moreover, in most cases parties voluntar-

in the contract nor any other indication from which to draw a conclusion, the Arbitral Tribunal, ruling out the place of arbitration law because of its choice being fortuitous (arbitration took place in Paris), held that Italian law was applicable according to the nexus': (1) the contract was signed in Italy, (2) the contract was principally to be executed in Italy, where the goods were to be delivered to the defendant, (3) payment in US dollars was only of secondary importance.

[66] Furthermore, "Selecting the conflicts rules – rather than the substantive law – of the state that is most closely connected to the underlying dispute aggravates the uncertainties of conflict of law analysis by effectively requiring two such analyses [the choice of the mostly connected conflict of laws rules and then the choice of the substantive law in accordance with the latter], while producing no discernible benefits." *Vid.* G.H. Born, *supra* note 63 at 2133.

[67] *Vid.* Article VII of the European Convention on International Arbitration (Geneva 1961): "Failing any indication by the parties as to the applicable law, the arbitrators shall apply the proper law under the rules of conflict that the arbitrators deem applicable." Similar provisions are: Art. 28(2) UNCITRAL Model Law; Article 17(1) of the ICC Rules.

[68] *Vid.* A. Frignani, *supra* note 22 at 132.

[69] *Vid.* G.H. Born, *supra* note 63 at 2137.

ily comply with the award without the need to seek enforcement in national courts[70]. Notwithstanding these statistics, the presence of punitive damages in the award may still constitute a bias against the voluntary execution of the awards, especially when parties come from countries that do not recognize the exemplary remedy or when the award is to be executed in one of them. That is to say, the presence of punitive damages constitutes a Dummy variable that grants significant possibility for the losing party to escape from its obligations under the arbitral award. This chapter will go through the analysis of the application of the main instrument with regard to the recognition and enforcement of arbitral awards, the UN Convention on the Recognition and Enforcement of Foreign Arbitral Awards, particularly in relation to the public policy exception.

1. Defining Public Policy: the enforcement of foreign arbitral awards

The UN Convention on the Recognition and Enforcement of Foreign Arbitral Awards (hereinafter, New York Convention) entails several provisions that allow parties to directly enforce an arbitral award by a judgment of the Court of the place of enforcement. The recognition and enforcement of the award is subject to the review of that court not directly on the merits of the decision, but with regard to general principles of law such as fairness, due process, non–arbitrability and public policy.

Article V is of the most importance because it outlines the "refusal" provisions: the grounds on which national courts can refuse the enforcement of an arbitral award. The article is divided into two paragraphs. The first one sets forth the exceptions the parties must specifically plead for, namely: (a) the incapacity of one of the parties to agree on arbitration under the applicable law to the dispute or under the law of the country it was made; (b) there was no proper notice of the appointment of the arbitrator or arbitration proceedings or the aggrieved party was unable to present its case; (c) the award is given beyond the scope of the arbitration agreement; (d) the composition of the arbitral tribunal is not consistent with the arbitration agreement; (e) the award has not yet become binding on the parties.

Paragraph 2 of Article V deals with those refusal grounds on which judges of the enforcing country can rely on *ex officio*: (a) the non–arbitrability of the dispute and (b) the recognition of the award would be contrary to the public policy of that country.

It must first be underlined that there is a difference between the wording of the New York Convention and the operational rule adopted by national courts when judging on public policy. We saw before that Article V (2)(b)

[70] *Vid.* A. Frignani, *supra* note 22 at 247 note 1. *Vid. Queen Mary / PriceWaterhouseCoppers* 2008 survey "*International Arbitration: Corporate attitudes and practices*" at 8 where it is stated that "84% of respondents indicated that the opposing party had honoured the award in full in more that 76% of cases" mainly for the purpose of preserving a business relationship. *Vid.* also P. Contini, "International Commercial Arbitration: The United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards", *Am. J. Comp. L.*, vol. 8, 1959, p. 309.

prevents the recognition of arbitral awards contrary to the public policy of "that country", namely the country where the enforcement of the award is sought. The simple wording of the Convention purports that national courts have to apply some domestic public policy, the one inherent to the *forum* where the enforcing court seats. This interpretation is consistent with the intentions of the Drafting Committee, to the extent that it wanted the provision to be limited in cases where the recognition and the enforcement would be "distinctly contrary to the basic principles of the legal system of the country where the award is invoked"[71]. To this extent, the Convention does not seem to aim to promote a uniform definition of public policy, leaving national courts free to shape the boundaries of the effectiveness of such exception and enhancing its usefulness as a national policy tool[72].

The operational rule used by courts does not refer to domestic public policy, but to international public policy, not a truly "international" one, though, for it has to be related to the enforcement State's fundamental principles. The definition of its scope is not simple, nor it is simple to summarise it in an exhaustive list of features. Arguably, international public policy: "Refers to an autonomous body of international public policies, derived from international sources and state practice; to those public policies of the forum state that are considered applicable in international contexts; or to those public policies of the forum intended for international settings"[73].

On a closer analysis, the contents of international public policy can be identified in these macro–features: (1) fundamental principles, pertaining to justice or morality that the State wishes to protect even when it is not directly concerned; (2) rules designed to serve the essential political, social or economic interests of the State and (3) the duty of the State to respect its obligations towards other States or International Organizations[74].

In any case, there is no real uniformity in interpretation. For instance, in the U.S. the leading case is *Parsons &Whitemore Overseas Co. v. Societe Generale de l'Industrie du Papier*[75] where the Court of Appeals ruled in favour of a very narrow interpretation of public policy, namely that"Enforcement of foreign arbitral awards may be denied on [public policy] basis only where enforce-

[71] *Vid.* Report of the Committee on the Enforcement of International Arbitral Awards, 28 March 1955, UN Doc. E/AC.42/4/Rev.1 at 49.

[72] Committee on International Commercial Arbitration, *Interim Report on Public Policy as Bar to Enforcement of International Arbitral Awards*, London Conference 2000, International Law Association at 8: "The drafters of the 1958 Convention did not seek overtly to attempt to harmonize public policy or to establish a common International standard".

[73] *Vid.* G.H. Born, *supra* note 63 at 2622. With regard to forum state's legal system the authors contends that "the rationale is that only matters which are essential [...] and considered mandatory even in international or transnational settings, will constitute international public policy".

[74] *Vid.* Mayer & Sheppard, *Final ILA Report on Public Policy as a Bar to Enforcement of International Arbitral Awards*, in *Arbitration International* (2003) at 255. *Vid.* also Committee on International Commercial Arbitration *supra* note 72 at 15.

[75] *Parsons &Whitemore Overseas Co. v. SocieteGenerale de l'Industrie du Papier* (RAKTA), 508 F.2d 969 (1974).

ment would violate the forum state's most basic notions of morality and justice"[76].

The Court then raised an interesting point with regard to the difference between the scope of public policy as a tool for promoting national interests and its scope in relation to the aim of the Convention: such narrow approach is the one really functional to the promotion and enhancement of international commercial arbitration[77]. More recently, in *Mitsubishi Motors Corp. v. Soler Chrysler–Plymouth, Inc.*[78], the Court of Appeals reinstated the policy favoring arbitration enforcing an arbitral award given under U.S. antitrust law arguing on the grounds of the principle of international comity. This case is very straightforward in evidencing the strength of the U.S. narrow approach to international public policy; specifically it shows that such interpretation can overcome worries about the arbitrability and application even of those laws that mostly favor "national policy" such as antitrust law[79]. The FAA itself recalls the application of the New York Convention "in accordance with this chapter"[80] and according to it, public policy must be "well defined and dominant, and is to be ascertained 'by reference to the laws and legal precedents and not from general considerations of supposed public interests'"[81]. Moreover, an award may be refused on the grounds of public policy "if it produces a result that the parties could not lawfully have agreed upon directly"[82].

In France, the Code Civil makes a distinction between national and international public policy in Art. 1502(5): whereas the former is to be applied to domestic arbitral awards, the latter is to be applied to international arbitral awards; this example has been followed by several other countries[83].

Germany, as well, adopted a narrow interpretation of international public policy, that must consist in an "a violation of essential principles of German law" contravening the basic rules of public and commercial life or the "German idea of justice in a fundamental way"[84].

Some commentators also argue for the existence of a "Transnational public policy" that finds application any time an arbitral tribunal applies the principles of *lex mercatoria* as the governing law of the dispute. It is not clear how the application of such public policy is related to the public policy of the place of enforcement nor seems to be possible to ask a national court to "apply fundamental general principles of law without inquiring whether

---

[76] Id. at 974. *Vid.* also Mayer and Sheppard, *supra* note 74 at 252.

[77] *Parsons &Whitemore* at 974: "To read the public policy defense as a parochial device protective of national political interests would seriously undermine the Convention's utility."

[78] *Mitsubishi Motors Corp. v. Soler Chrysler–Plymouth, Inc.*, 473 U.S. 614 (1985).

[79] Id. at 660. *Vid.* also Committee on International Commercial Arbitration, *supra* note 72 at 16.

[80] *Vid.* Federal Arbitration Act, Chapter 2, Section 201.

[81] *Vid. W. R. Grace and Company v. Local Union 759, International Union of the United Rubber, Cork, Linoleum and Plastic Workers of America*, 461 U.S. 757 (1983).

[82] *Vid.* G.H. Born, *supra* note 63 at 2626.

[83] For an exhaustive list of them *Vid.* A. Frignani, *supra* note 22, at 269. *Vid.* also Committee on International Commercial Arbitration, *supra* note 72 at 11.

[84] *Vid. Bundesgerichtshof*, 1990 as cited in Committee on International Commercial Arbitration, *supra* note 72 at 5.

the dispute has any relationship to a particular state" including the enforcing one[85]. As a matter of fact, transnational public policy has been lately defined as to infer from the international nature of the case and the existence of a consensus within the international community with regard to the public policy principle the Court is considering applicable. "When such consensus exists, the term 'transnational public policy' may be used to describe such norms"[86].

2. Punitive damages: a ground for enforcement refusal

Notwithstanding the fact that the public policy defence, even if often invoked, finds little application in most cases[87], it could still represent a strong bias against the enforcement of punitive damages awards.

The feature of international public policy that comes into consideration is the one related to the application of general principles of law of the enforcing country: several Civil law and Common law countries do not recognize punitive damages as a lawful remedy for breach of contract actions. For instance, in Italy there are no grounds on which one can argue for the availability of punitive damages: they clearly are against Italian public policy to the extent that they are not consistent with Italian principles on remedies[88]. The result will be that the enforcement of an arbitral award granting them is likely to be refused by Italian courts. The same could be said with regard to Germany, where compensation is the only purpose of contract and tort law: the German Supreme court held that punitive damages are incompatible with fundamental tort principles and therefore they cannot been forced[89]. As stated

---

[85] K.M. Curtin, "Redefining Public Policy in International Arbitration of Mandatory National Laws", *Defense Counsel Journal*, vol. 64, 1997, p. 282.

[86] *Vid.* Mayer & Sheppard, *supra* note 74 at 259. The extent is that enforcing courts should also take into consideration the practice of other foreign courts.

[87] *Vid.* K.M. Curtin, *supra* note 85 at 282. *Vid.* also F. Bortolotti, *Manuale di Diritto Commerciale Internazionale*, vol. 1, Padova, Cedam, 2009, p. 681, where it is stated that in many cases the loosing party pleads a public policy violation in order to have the merits re–examined by the enforcing courts, which is not possible to do.

[88] The issue of punitive damages has been analyzed by the Italian Supreme Court (Corte di Cassazione) in relation to the recognition and enforcement of a U.S. award of punitive damages according to tort law: the case was *Parrot v. Fimez*, Corte d'Appello di Venezia, 15 ottobre 2001, n. 1539. For an English translation of the case *vid.* L. Ostoni, "Italian Rejection of Punitive Damages in a U.S. Judgement", *Journal of Law and Commerce*, vol. 24, 2005. The core underpinning of Court of Appeals' rejection of punitive damages lies in their similarities with criminal law. The analysis of the Court is very straightforward: the injured party by pleading for punitive damages acts as a public prosecutor, since punitive damages have the peculiar function to deter any subsequent wrongdoer in favour of the community; nonetheless is the injured party who directly benefits of a punitive award. The sanction and the deterring effects of the decision make it very similar to the one rendered in a criminal case. Furthermore, punitive damages are at odds with one core principle of Italian legal system: both in tort and contract actions "[Italian] legal system assumes that compensation to the injured party shall be due based on the damages that the party actually suffered". In affirming the Court of Appeals' rationale, the Italian Supreme Court added that the idea of punishment is at odds with the idea of compensation and, moreover, that tort liability has the only purpose to restore the patrimonial sphere of the injured party with a sum of money as to eliminate the consequences of the injury.

[89] *Vid.* BGH vom 4.6.1992 – IX ZR 149/91, *NJW* 1992, 3096 as analyzed by G. Fischer, "Recognition and Enforcement of American Tort Judgements in Germany", *Saint John's L. Rev.*, vol. 68, 1994, p. 212. *Vid.* also J.Y. Gotanda, *supra* note 24 at 83.

above[90], there also are Common law countries in which, while in tort law punitive damages are allowed, they are not in contract actions: this is the case of England. Furthermore, in case of multiple damages award, the Protection of Trading Interests Act 1980 prevents English courts from enforcing them[91]. A similar provision can be found in Canada, where according to the Foreign Extraterritorial Measures Act the Attorney General, when the recognition or enforcement of a judgment rendered under a foreign trade law in Canada is likely to adversely affect significant Canada's interests, may (a) declare the judgment not enforceable or (b) reduce the amount of money awarded[92].

The only exception is the United States, where arbitral awards of punitive damages are currently enforced and affirmed, as we had the chance to see supra. Nonetheless, absolute certainty is not possible even in the U.S.

The public policy exception has been used to refuse the enforcement of a foreign award that was considered inconsistent with U.S. fundamental principles of law. The case was *Laminoirs–Trefileries–Cableries de Lens, S. A. v. Southwire Co.*[93] and it was about the judgement for the recognition and enforcement of an award made by an international arbitral tribunal between a French manufacturer and a Georgia corporation who entered in a purchase agreement. The arbitral tribunal awarded interest to *Laminoirs*plus 5% p.a. from the date of the award according to the French law. The Georgia Supreme Court argued that the additional interest rate was penal rather than compensatory and "bears no reasonable relation to any damage resulting from delay in recovery of the sums awarded"[94] eventually not enforcing that part of the award. This case, however, may be considered to some extent overruled by the interpretation U.S. courts gave of the FAA policy favouring arbitration, as purported above.

Nonetheless, the underpinning of *Garrity*[95] may still constitute some appeal when arguing on the basis of Article V (2)(b) – namely the argument against the displacement of social justice from courts to arbitrators by granting them the possibility to award punitive damages[96]. This view is mainly supported by the extent that the American jurisprudence on the point is not as clear as it should be, evidencing a disarray on the doctrine on which the argument for the exclusion of punitive damages may still be grounded[97].

---

[90] *Vid. supra* § 1.1.

[91] *Vid.* Protection of Trading Interests Act 1980, Section 5, which defines an award of multiple damages as a "judgment for an amount arrived at by doubling, trebling or otherwise multiplying a sum assessed as compensation for the loss or damage sustained by the person in whose favour the judgment is given."

[92] *Vid.* Foreign Extraterritorial Measures Act §8 (1.1). *Vid.* also J.Y. Gotanda, "Charting Developments Concerning Punitive Damages: Is the Tide Changing?", *Columbia J. Trans'l L.*, vol. 45, 2007, p. 515.

[93] *Laminoirs–Trefileries–Cableries de Lens, S. A. v. Southwire Co.*, 484 F.Supp. 1063, 1980.

[94] Id. at 1069.

[95] *Vid. supra* § 2.

[96] *Vid.* also E.A. Farnsworth, "Punitive Damages in Arbitration", *Stetson L. Rev.*, vol. 20, 1990, pp. 406–407 when recognizing that "One possible answer is that the public policy in question is one against allowing parties to delegate a 'public power' to punish to an essentially private forum."

[97] *Vid.* Id. at 407.

VI. Conclusion

The brief analysis about the underpinnings of the exemplary remedy and its availability in contractual claims leads to some preliminary consideration. Punitive damages for breach of contract, except for some instances, are awarded in cases in which there is a disproportion of bargaining power or a "special relationship" in addition to some policy concern of courts[98]. That is to say that such remedy is usually not awarded with regard to plain commercial relationships: commercial contracts between parties with the same bargaining power (*arms–length business deals*) are to be excluded for they are clearly outside any paternalistic policy consideration.

Efficiency of punitive damages has also been addressed, but the argument is not compelling as well. If it is true that opportunistic breaches of contract are not socially desirable and ought to be deterred, the same could not be said of efficient breaches of contract. The latter,when they do not affect any relevant social policy, effectively pursue efficiency in a market economy and should not be deterred in those cases in which parties act on the same level.

With respect to International Commercial Arbitration, the argument against punitive damages gains strength. The International or Transnational features of such means of dispute settlement suggest that further factors are to be taken into account, first of all the difference between national legal systems with respect to the exemplary remedy. Among the national legal systems analyzed, the only one that extensively allows for punitive damages in contract actions are United States. Whereas the differences between Common law countries may be difficult to evaluate, those between U.S. and Civil law ones are more evident. In Italy, for instance, tort law is completely detached from criminal law; there is no jury because there is the presence of a much more pervading social security system (so that redistributive goals are pursued in ways other than exemplary damages) and litigation costs are awarded to the losing party[99]. England and Canada, from their side, while moving towards a broader recognition of punitive damages in contract actions, in our view they are not ready to permit them coming from non–state authorities and in purely commercial matters.

According to Art. 35 ICC Rules of Arbitration: "the Arbitral Tribunal [...] and shall make every effort to make sure that the Award is enforceable at law"[100].

---

[98] The majority of cases involved insurance companies wilfully disregarding insured rights under the contract and employment relationships affected by a wrongful discharge.

[99] This argument is well presented in G. Ponzanelli, "I danni punitivi", *Nuova Giurisprudenza Civile Commentata*, vol. 2, 2008, p. 27 also evidencing that the Economic Analysis of Law has not been followed by Italian judges. Moreover, he argues that in Italy there is not the proper institutional environment for an effective legal transplant of punitive damages.

[100] *Vid.* also London Court of International Arbitration Rules Art. 32.2 providing that: "In all matters not expressly provided for in these Rules, the LCIA Court, the Arbitral Tribunal and the parties shall act in the spirit of these Rules and shall make every reasonable effort to ensure that an award is legally enforceable."

This is to be considered as a goal to pursue whenever an award is made. Notwithstanding the fact that in most cases parties willingly comply with award, when punitive damages are granted there might be the case for a party to prevent the enforcement of the award and therefore to seek its refusal. First, as pointed out hereinbefore, due regard must be given to parties' intent as set forth in the arbitration agreement: does it provide for punitive damages? If, after a proper interpretation of the choice of law clause when parties are silent on the issue, the answer is yes; the question an international arbitrator has to ask himself is: will a punitive damages award be enforceable in the place of execution? It may be true that in some instances it is difficult to know exactly where the award will be executed or where it is foreseeable it will be enforced: in such cases the wise arbitrator ought to refrain from awarding exemplary damages. As a matter of fact, the public policy exception finds a fertile ground in all those countries that ignore punitive damages as a remedy. Second, from the comparative analysis undertaken and as underlined above, it can be maintained that the only country in which punitive damages arbitral awards are enforced is the United States.

Therefore, and in the light of the above, a punitive damages award should be issued only under these circumstances: when (a) there is an explicit statement of parties or the interpretation of the arbitration agreement provides for exemplary damages and (b) the award is to be surely enforced in a U.S. jurisdiction allowing for punitive damages.

However, it has been suggested that the only way to overcome punitive damages and the *Mastrobuono* interpretation standard is to explicitly exclude their availability in the arbitration agreement[101]. The suggested arbitration clause may state:

> "All claims, disputes and other matters in question between the Parties to this Contract, arising out of or relating to this Contract or the breach thereof, shall be [finally] decided by arbitration under the [rules of arbitration] and according to [substantive law applicable to the dispute]. Each Party shall be liable to the other Party for damages it causes by any breach of Contract. Liability as between the Parties is limited to actual damage suffered. Punitive damages (i.e. damages intended to punish a party for its outrageous conduct) are specifically excluded."[102]
>
> ...then the number of arbitrators and the language and the place of the arbitration.

We often talk about globalization not only with respect to economy, but also with respect to justice and more generally to law. The trend is to think

[101] *Vid.* E.A. Farnsworth, *supra* note 96, at 406–407: "If the arbitration clause plainly states that the arbitrators have no power to award punitive damages, that ends the matter – in every jurisdiction, even where arbitrators would otherwise have that power" and "The lesson for the drafter is obvious. If you would strip the arbitrators of the power to award punitive damages, you should – in so many words – either ban 'punitive' (or 'exemplary') damages or allow only 'compensatory' damages. The drafter who uses plain English can eliminate the risk of an award of punitive damages."

[102] The punitive damages exclusion is taken from the model clause the ICC suggests for the transfer of personal data from EU to Third Countries. *Vid.* also A. Frignani y M. Tosello, *Il contratto internazionale*, in *Trattato di diritto commerciale e di diritto pubblico dell'economia*, vol. XII, Tadova, Cedam, 2010, p. 427 where, recalling the American Arbitration Association' suggestions, the Author invites arbitrators not to grant punitive damages for they could seriously jeopardize the recognition and enforcement of the arbitral award.

that some sort of transnational legal system allows for judicial rules to travel across borders without being affected by national legal systems and their policies. While this can be true with regard to some basic legal rules, particularly in the commercial field – think about the rise and factual recognition of *lex mercatoria* – this is not the case for punitive damages.

International Commercial Arbitration is one of the main and better–implemented tool to promote uniformity among different legal systems and to this extent provides international businessmen with a predictable and reliable means of enforcing their contractual rights; still it is not capable to overcome national judicial austerity with regard to some basic domestic rules. The aforementioned theoretical, practical and policy reasons stand for the argument that punitive damages are not suitable for International Commercial Arbitration and therefore that arbitrators should refrain from awarding them in order not to jeopardize the enforceability of the award.

Resolución extrajudicial de conflictos relacionados con los contratos con consumidores celebrados en los mercados financieros internacionales[*]

Vésela ANDREEVA ANDREEVA

Investigadora Postdoctoral de Derecho internacional privado
Universidad Autónoma de Barcelona

Sumario: I. Introducción. II. Marco normativo. III. Mecanismos alternativos de resolución de conflictos. IV. La red *FIN–NET*. V. Órganos nacionales de resolución extrajudicial de conflictos entre los consumidores y los proveedores de servicios financieros. 1. Francia. 2. Bélgica. 3. Republica Checa. 4. La figura del *Financial Ombudsman* en Reino Unido, Irlanda, Australia, Nueva Zelanda y África de Sur. 5. Alemania. 6. España. VI. Conclusiones.

I. El arbitraje en las transacciones financieras

1. Los procesos de globalización afectan a todos los operadores económicos, tanto los privados como los públicos. En el ámbito financiero los gobiernos se han visto obligados a abrir sus mercados nacionales y liberalizar el acceso a inversiones privadas a los monopolios estatales, lo que ha llevado a un incremento de las inversiones privadas en sectores que antes gozaban de un régimen económico especial. La apertura de dichos sectores es una medi-

[*] Este trabajo se ha realizado en el marco del Proyecto de Investigación DER2009–09039, "Interacción entre la autonomía de la voluntad y la protección de los intereses generales en la regulación de la actividad internacional de las sociedades", cuyo Investigador principal es el Dr. Rafael Arenas García.