

Journal  
of  
International  
Arbitration

Vol. 10 No. 3

September 1993

# Punitive Damages in International Commercial Arbitration

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## I. INTRODUCTION

The use of civil damages to punish and deter is common in the American system. Punitive damages serve a public policy function, and although often criticized as quasi-penal in nature and lacking appropriate procedural protections, the award of punitive damages is entrusted to American civil juries on a daily basis.

Where claims that might give rise to punitive damages are referred to arbitrators sitting on an international commercial arbitration, American jurisdictions are split as to whether the arbitrators are empowered to award punitive damages. Even assuming that an international commercial arbitral tribunal has determined that it has the power to award punitive damages, would the exercise of such power jeopardize the enforceability of the award? Unfortunately, U.S. Federal courts are of two minds on this question, depending upon whether the award is penal under U.S. law or under non-U.S. law. As in most other matters, the international arbitral tribunal should be guided by the applicable laws and the wishes of the parties when faced with the possibility of an award which might include punitive damages.

## II. THE DEVELOPMENT OF THE CONCEPT OF PUNITIVE DAMAGES BY NATIONAL COURTS

### A. *The Function of Punishment and Deterrence*

#### 1. *At English law*

One of the earliest statements of the concept of punitive damages at common law was made by the Court in the case of *Wilkes v. Wood*.<sup>1</sup>

"I still continue of the same mind, that a jury have it in their power to give damages for more than the injury received. 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 detestation of the jury to the action itself."<sup>2</sup>

In this terse comment, the Court enunciated two of the basic justifications for

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The author wishes to acknowledge and express his sincere gratitude to Howard M. Holtzmann for his constructive criticism of this article. The author is also grateful for the assistance of Mary E. O'Byrne and Michelle E. Lentzner. Any errors, statements of opinion, or other misstatements are entirely those of the author.

<sup>1</sup> Lofft 1, 98 Eng. Rep. 489 (C.P. 1763).

<sup>2</sup> Id. at 18-19, 98 Eng. Rep. 498-99.

punitive damages which American courts have cited over the more than two centuries that have followed the Court's opinion.<sup>3</sup> However, punitive damages were never fully accepted at English common law and in 1964 were limited to two categories:

- (1) where there was oppressive, arbitrary, or unconstitutional action by government personnel; and
- (2) where the defendant's conduct was calculated to profit the defendant in excess of the compensation he would owe the plaintiff as a result of the wrong.<sup>4</sup>

## 2. *At American law*

In 1851, the Supreme Court reviewed the state of the development of the common law of punitive damages in the United States, citing punishment as the primary purpose for the doctrine.<sup>5</sup>

"It is a well-established principle of the common law that in actions of trespass and all actions on the case for torts, a jury may inflict what are called exemplary, punitive, or vindictive damages upon a defendant, having in view the enormity of his offence rather than the measure of compensation to the plaintiff. We are aware that the propriety of this doctrine has been questioned by some writers; but if repeated judicial decisions for more than a century are to be received as the best exposition of what the law is, the question will not admit of argument. By the common as well as by statute law, men are often punished for aggravated misconduct inflicted by way of penalty or punishment, given to the party injured. In many civil actions, such as libel, slander, seduction, etc., the wrong done to the plaintiff is incapable of being measured by a money standard; and the damages assessed depend on the circumstances, showing the degree of moral turpitude or atrocity of the defendant's conduct, and may properly be termed exemplary or vindictive rather than compensatory.

In actions of trespass, where the injury has been wanton and malicious, or gross and outrageous, courts permit juries to add to the measured compensation of the plaintiff which he would have been entitled to recover, had the injury been inflicted without design or intention, something farther by way of punishment or example, which has sometimes been called "smart money". This has been always left to the discretion of the jury, as the degree of punishment to be thus inflicted must depend on the peculiar circumstances of each case. It must be evident, also, that as it depends upon the degree of malice, wantonness, oppression, or outrage of the defendant's conduct, the punishment of his delinquency cannot be measured by the expenses of the plaintiff in prosecuting his suit. It is true that damages, assessed by way of example, may thus indirectly compensate the plaintiff for money expended in counsel-fees; but the amount of these fees cannot be taken as the measure of punishment or a necessary element in its infliction."<sup>6</sup>

This focus on punishment and deterrence, first enunciated in *Wilkes v. Wood*, was

<sup>3</sup> A leading commentator recently identified the seven primary purposes of punitive damages as expressed in judicial opinions and commentaries: punishment of the defendant; specific deterrence (to prevent the defendant from repeating the offense); general deterrence (to prevent others from committing similar offenses); preservation of the peace; inducement for private law enforcement; compensation to victims for otherwise uncompensable losses; reimbursement of plaintiff's attorney's fees. Dorsey Ellis, *Fairness and Efficiency in the Law of Punitive Damages*, 56 S. Cal. L. Rev. 1, 3 (1982). And, see, Melvin M. Belli, *Punitive Damages: Their History, Their Use, and Their Worth in Present Day Society*, 49 UMKC L. Rev. 1, 6-7 (1980); Jane Mallor and Barry Roberts, *Punitive Damages: Toward a Principled Approach*, 31 Hastings L. J. 639, 648-49 (1980).

<sup>4</sup> *Rookes v. Barnard*, (1964) 1 All E.R. 367, 410 (Lord Devlin for the House of Lords).

<sup>5</sup> *Day v. Woodworth*, 54 U.S. (15 Wall.) 363 (1851).

<sup>6</sup> *Id.* at 370-71.

more recently iterated by the Supreme Court as the primary justification for the award of punitive damages.<sup>7</sup>

"Punitive damages are awarded in the jury's discretion 'to punish [the defendant] for his outrageous conduct and to deter him and others like him from similar conduct in the future'. Restatement (Second) of Torts Sec. 908(1) (1979). The focus is on the character of the tortfeasor's conduct—whether it is of the sort that calls for deterrence and punishment over and above that provided by compensatory awards. If it is of such a character, then it is appropriate to allow a jury to assess punitive damages; and that assessment does not become less appropriate simply because the plaintiff in the case faces a more demanding standard of actionability. To put it differently, society has an interest in deterring and punishing all intentional or reckless invasions of the rights of others, even though it sometimes chooses not to impose any liability for lesser degrees of fault."<sup>8</sup>

This function of punishment and deterrence can be viewed as quasi-criminal in nature and punitive damages have been criticized as a penal remedy in a proceeding lacking procedural safeguards.<sup>9</sup> However, certain other American courts have looked at the purpose of punitive damages in an entirely different light.

#### B. *The Function of Compensation*

Without regard to the concept of punitive damages, under English law the prevailing party in a litigated dispute is entitled to recover the reasonable attorney's fees incurred in prosecuting or defending the action.<sup>10</sup> This is not the case in the United States, unless the parties have expressly provided for such recovery in their contract or a specific statute provides for such recovery.<sup>11</sup> The rationale for the "American rule" is that the award of attorney's fees would penalize a party merely for bringing or defending a lawsuit or might discourage those less well off from bringing actions to vindicate their rights.<sup>12</sup>

As if in response to the limited ability to recover attorney's fees and litigation costs, certain American courts have begun to measure the quantum of punitive damages a party can recover, once the right to recovery has been established, by the legal costs he has incurred in securing his recovery. Alabama, Connecticut, the District of Columbia, Idaho, Illinois, Iowa, Kansas, Maryland, Mississippi, Ohio and Wyoming have all shifted the focus away from the amount required to punish and deter the defendant from repeating such conduct in the future, to the amount necessary to adequately compensate the plaintiff for having to bring the lawsuit in order to protect its rights.<sup>13</sup> Courts rationalize this shift in focus by denying that there is really any shift at all; by awarding attorney's fees where otherwise no grounds exist for such award, the court argues that it is punishing the wrongful defendant.<sup>14</sup>

<sup>7</sup> *Smith v. Wade*, 461 U.S. 30 (1983).

<sup>8</sup> *Id.* at 54-55.

<sup>9</sup> Mallor and Roberts, footnote 3, *supra*, 644-45.

<sup>10</sup> *Fleischmann Corp. v. Maier Brewing Co.*, 386 U.S. 714, 717 (1967).

<sup>11</sup> *Id.*

<sup>12</sup> *Id.* at 718.

<sup>13</sup> Judith L. White, Note, *Critical Reappraisal of Punitive Damages Encompassing Attorney's Fees: Normative Analysis and Pragmatic Concerns*, 42 *Baylor L. Rev.* 737, 747-49 (1990).

<sup>14</sup> *St. Luke Evangelical Lutheran Church, Inc. v. Smith*, 568 A.2d 35, 39 (Md. 1990).

"It is true that an award of attorney's fees reimburses a plaintiff for his out-of-pocket legal expenses. When viewed solely in this light such fees may seem to be wholly compensatory in function. Yet, when viewed in the context of the long-standing prohibition against awarding attorney's fees, and the fact that when they are awarded, they most often serve as a statutorily imposed punitive measure, the need to include them in compensatory damages diminishes. Under this view, attorney's fees would seem to be an appropriate consideration in measuring an award of punitive damages."<sup>15</sup>

Thus, courts in some American jurisdictions asks juries to examine the attorney's fees which a successful plaintiff has incurred in assessing the amount of punitive damages that they should award.<sup>16</sup> While courts may rationalize this approach as being consistent with the purposes of punishment and deterrence, the focus clearly has shifted from these purposes, since the amount incurred by the plaintiff in bringing the action may bear no meaningful relationship to an amount that would serve to punish a specific defendant or to deter it from such conduct in the future.

### III. INTERNATIONAL ARBITRATION AND THE AWARD OF PUNITIVE DAMAGES

In international commercial arbitrations, the request for an award of punitive damages is likely to arise in one of two situations:

- (1) where the arbitration is being held within the jurisdiction of the United States of America; and
- (2) irrespective of the *situs* of the arbitration, where the contract which contains the arbitration provision also contains a "governing-law" clause which calls for the application of the laws of the United States or the laws of one of its constituent states or of the District of Columbia.<sup>17</sup>

When such a request is made of an arbitral tribunal, two questions immediately arise: (a) does an arbitral tribunal have the power to award punitive damages? and (b) assuming the answer to the first question to be in the affirmative, should a tribunal exercise such power and make such an award, even where such an award would be justified under the application of the correct law to the facts as determined? Neither question gives rise to a ready answer, and the tribunal should carefully examine the applicable law and the factual situation with which it is confronted before proceeding further.

#### A. *Can the Arbitrators Award Punitive Damages?*

In examining the contract and the applicable law, a check-list of questions immediately comes to mind:

- (1) Do the parties in their arbitration agreement, or by other agreement (such as at the establishment of the terms of reference or at the preliminary hearing conference) *expressly* authorize the arbitrators to award punitive damages?

<sup>15</sup> *Id.* at 41.

<sup>16</sup> White, footnote 13, *supra*, at 749.

<sup>17</sup> The question of punitive damages in contract actions is unlikely to arise in other jurisdictions or under other national laws. E. Allan Farnsworth, *Punitive Damages in Arbitration*, Vol. 7, No. 1, *Arbitration International* 11 (1991).

- (2) Do the parties expressly prohibit the arbitrators from making such an award?
- (3) Do the parties by their agreement *impliedly* either sanction or prohibit such an award?
- (4) Does the applicable law permit the parties to agree to do that which they have professedly agreed to do in this regard?
- (5) Assuming that the law which will be applied to these questions will be that of the United States of America or of one of its constituent states or of the District of Columbia (either by reason of the law selected by the arbitrators applying appropriate choice of law principles, because it is the law of the *situs* of the arbitration, or as the law selected by the parties), what factors must be considered in the proper resolution of the foregoing questions?

1. *Where the parties have expressly agreed that the arbitrators can award punitive damages*

Generally, the principle of party autonomy would be thought to apply where the parties have, by their agreement, expressly empowered the arbitral tribunal to award punitive damages. Such an express clause would provide, e.g. "The arbitrators are empowered to award punitive damages where the law and the facts would justify such an award." Several jurisdictions applying various state laws have held that arbitrators have the authority to award punitive damages where the parties' agreement so provides.<sup>18</sup>

However, certain other jurisdictions applying their own state laws have held that even where the parties by their agreement have empowered the arbitrators to award punitive damages, the arbitrators cannot legally make such an award.<sup>19</sup> The rationale for this position is one of public policy, best enunciated in the leading case of *Garrity v. Lyle Stuart, Inc.*<sup>20</sup>

"Punitive damages is a sanction reserved to the State, a public policy of such magnitude as to call for judicial intrusion to prevent its contravention. Since enforcement of an award of punitive damages as a purely private remedy would violate strong public policy, an arbitrator's award which imposes punitive damages should be vacated."<sup>21</sup>

Later Federal cases have called into question the continuing efficacy of this decision. The U.S. Supreme Court has expressly held that the "parties are generally free to structure their arbitration agreements as they see fit".<sup>22</sup> Although *Volt*

<sup>18</sup> *Ex parte Costa and Head (Atrium) Ltd.*, 486 So.2d 1272 (Ala. 1986); *Belko v. AVX Corp.*, 204 Cal. App.3d 870, 251 Cal. Rptr. 557 (1988); *Regina Construction Corp. v. Envirmech Contracting Corp.*, 565 A.2d 693 (Md. 1989); *Rodgers Builders, Inc. v. McQueen*, 331 S.E.2d 726 (N.C. 1985); *USX Corp. v. West*, 781 S.W.2d 453 (Tex. 1989).

<sup>19</sup> Colo. Rev. Stat. Sec. 13-21-102 (5); *Garrity v. Lyle Stuart, Inc.*, 353 N.E.2d 793 (N.Y. 1976); *Anderson v. Nichols*, 359 S.E.2d 117 (W.Va. 1987); *Shaw v. Kuhnel & Associates, Inc.*, 698 P.2d 880 (N.M. 1985); *School City of East Chicago, Indiana v. East Chicago Federation of Teachers*, 422 N.E.2d 656 (Ind. App. 1981). In numerous other jurisdictions, this question has yet to be addressed.

<sup>20</sup> 40 N.Y.2d 354, 386 N.Y.S.2d 831, 353 N.E.2d 793 (1976).

<sup>21</sup> 40 N.Y.2d at 356, 386 N.Y.S.2d at 832, 353 N.E.2d at 794.

<sup>22</sup> *Volt Information Sciences, Inc. v. Board of Trustees of the Leland Stanford Junior University*, 489 U.S. 468, 478-79, 109 S.Ct. 1248, 1255, 103 L.Ed.2d 488 (1989).

*Information Sciences* did not involve the question of punitive damages in arbitration, it did involve the question of party autonomy and that concept's potential pre-emption by Federal law. As noted above, the Supreme Court came down generally on the side of party autonomy. Moreover, the Court of Appeals for the Second Circuit has expressly questioned the continued viability of the *Garrity* rule where the parties have made an express agreement which empowers the arbitrators to award punitive damages.<sup>23</sup>

2. *Where the parties have impliedly agreed that the arbitrators can award punitive damages*

There are arguably at least four ways in which the parties can impliedly agree to empower the arbitrators to award punitive damages. First, the parties can grant the arbitrators broad powers in their arbitration provision. For example, the parties might include in their contract an arbitration clause that reads in part as follows: "Any and all disputes arising under or concerning this contract, including the formation and performance thereof, shall be finally settled by binding arbitration, and the arbitrators shall have all powers required to finally and completely resolve the disputes submitted to them." It may be argued that such a broad grant of powers includes the power to award punitive damages. Second, the parties can select a particular system of arbitral rules that bestow on the arbitrators broad powers in the remedies which they might provide. Third, the parties might select a governing law which permits the award of punitive damages in an arbitration proceeding. Fourth, the parties might agree to hold their arbitration in a jurisdiction which permits the arbitrators to award punitive damages.

Courts have recognized that a very broad arbitration provision in and of itself can empower an arbitrator to award punitive damages where the application of the appropriate law to the facts as determined would justify such an award.<sup>24</sup> This is especially true when a broad clause designates a system of arbitration rules which provides very broad powers to the arbitrators to fashion relief.<sup>25</sup>

<sup>23</sup> *Fahnestock & Co. v. Waltman*, 935 F.2d 512, 518 (2d Cir. 1991).

<sup>24</sup> *Goss Golden West Sheet Metal, Inc. v. Sheet Metal Workers International Union Local 104*, 933 F.2d 759, 764 (9th Cir. 1991); *Kerr-McGee Refining Corp. v. M/T Triumph*, 924 F.2d 467, 468, 471 (2d Cir. 1991); *Ex parte Costa and Head (Atrium), Ltd.*, 486 S.2d 1272, 1273, 1276 (Ala. Sup. Ct. 1986).

<sup>25</sup> Various systems of arbitration rules of the American Arbitration Association (A.A.A.) contain a rule having identical language: "The arbitrators 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." The above-quoted language is not contained in any of the most commonly used systems of international commercial arbitration rules, even including the A.A.A. International Arbitration Rules. Courts have cited the above-quoted rule as authorizing the award of punitive damages by the arbitrator in appropriate circumstances. *Bonar v. Dean Witter Reynolds, Inc.*, 835 F.2d 1378, 1386-88 (11th Cir. 1988) (relying on Rule 42 of the A.A.A. Commercial Arbitration Rules as authorizing the award of punitive damages, even in the face of a choice-of-law clause calling for the application of New York substantive law); *Ehrlich v. A. G. Edwards & Sons Inc.*, 675 F.Supp. 559, 563-564 (D.C.S.D., W.D. 1987) (relying on Rule 43 of the A.A.A. Securities Arbitration Rules as authorizing the award of punitive damages in conjunction with a broad arbitration clause); *Willoughby Roofing & Supply Co. v. Kajima International, Inc.*, 598 F.Supp. 353 (N.D. Ala. 1984) aff'd 776 F.2d 269 (11th Cir. 1985) (relying on Rule 43 of the A.A.A. Construction Arbitration Rules as authorizing the award of punitive damages); *Todd Shipyards Corporation v. Cunard Line, Ltd.*, 943 F.2d 1056, 1062-63 (9th Cir. 1991) (relying on Rule 43 of the A.A.A. Commercial Arbitration Rules as authorizing the award of punitive damages in conjunction with a broad arbitration clause).

The issue of the governing law affecting the power of the tribunal to award punitive damages usually arises in the context of the parties having agreed to apply New York state law to the substance of their dispute. New York's highest court decided in the *Garrity* case that arbitrators had no power to award punitive damages, even where the parties have expressly agreed that the arbitrators shall have such power.<sup>26</sup> Where parties have called for the application of New York law in a choice-of-law clause, some courts have found that the parties have agreed that the arbitrators have no power to award punitive damages.<sup>27</sup> In such cases, the courts have rejected the argument that the *Garrity* rule which prohibits arbitrators from awarding punitive damages is a matter of arbitration (procedural) law unaffected by a choice-of-law provision, and instead have held that the prohibition is a part of state substantive law, which the parties, by their choice-of-law provision, have agreed to apply.<sup>28</sup>

However, certain courts have held that a choice-of-law provision calling for the application of New York law calls only for the application of New York substantive law to the question of what conduct would justify the award the punitive damages, and does not affect the power of an arbitral tribunal to award punitive damages, at least where a broad arbitration provision and the American Arbitration Association (A.A.A.) arbitration rules apply.<sup>29</sup> In short, the courts in these cases have reasoned that a governing-law clause does not encompass state arbitration (procedural) law, and that the power of an arbitrator to award punitive damages is a matter of arbitration law, rather than substantive law.<sup>30</sup>

These latter decisions seem consistent with the international commercial arbitration doctrine of *lex arbitri*, pursuant to which an arbitral tribunal must follow the arbitral law of the *situs* of the arbitration, which law "sets an external standard for the conduct of an arbitration".<sup>31</sup> However, rather than applying the arbitration law of the state in which the tribunal was sitting, the courts in each instance applied the Federal arbitration law which permits arbitrators to award punitive damages.<sup>32</sup> Thus, when the parties to an international arbitration elect to hold their arbitration within the United States, the question arises whether *lex arbitri* mandates that the arbitration law of the particular state in which the tribunal is situated governs, or whether the Federal law of arbitration is applicable. Those Federal decisions which allow the arbitrators to award punitive damages suggest that the latter is the correct answer.

Finally, some courts have held that arbitrators have inherent powers to award punitive damages absent the parties having agreed to the contrary.<sup>33</sup> Thus, arbitrators

<sup>26</sup> Footnote 20 *supra*.

<sup>27</sup> *Barhier v. Shearson Lehman Huston, Inc.*, 948 F.2d 117, 122 (2d Cir. 1991); *Fahnestock & Co., Inc. v. Wallman*, 935 F.2d 512, 518 (2d Cir. 1991).

<sup>28</sup> *Id.*

<sup>29</sup> *Bonar v. Dean Witter Reynolds, Inc.*, 835 F.2d 1378, 1387 (11th Cir. 1988); *Pyle v. Securities U.S.A., Inc.*, 758 Fed. Supp. 638, 639 (D. Colo. 1991); *Todd Shipyards Corp. v. Cunard Lines, Ltd.*, 943 F.2d 1056, 1061-62 (9th Cir. 1991).

<sup>30</sup> *Bonar*, 835 F.2d at 1387; *Pyle*, 758 F. Supp. at 639; *Todd*, 943 F.2d at 1061-62, *see id.*

<sup>31</sup> Allan Redfern and Martin Hunter, *International Commercial Arbitration*, 54, and *see, generally*, 53-55 (1st edition, 1986).

<sup>32</sup> Footnote 29 *supra*.

<sup>33</sup> *Raytheon Co. v. Automated Business Systems, Inc.*, 882 F.2d 6, 12 (1st Cir. 1989); *H.L. Fuller Construction Co., Inc. v. Industrial Development Board of the Town of Vincent*, 590 S.2d 218, 222 (Ala. Sup. Ct. 1991).

in such jurisdictions may award punitive damages absent an exclusion agreement by the parties.

B. *Should the Arbitrators Award Punitive Damages?*

Assuming that arbitrators have the power to award punitive damages, should they exercise that power? This is more than an ethical question. It goes both to the basic purpose of international commercial arbitration and to the enforceability of the award.

Arbitration is a consensual process by which parties refer their dispute to private individuals for resolution.<sup>34</sup> Because it is not directly controlled by the state, nations, particularly civil law nations, historically have been hostile to the process.<sup>35</sup> Recently, the trend has been for governments to recognize the arbitrability of disputes heretofore thought to be the exclusive province of the state judicial system, especially in the United States.<sup>36</sup> Now claims under Federal statutes such as the Sherman Antitrust Act, the Racketeer Influenced and Corrupt Organizations Act, the Securities Acts, and other statutes which carry with them possible punitive damages, are claims which the courts have recognized as arbitrable.<sup>37</sup>

Where punitive damages are measured by the reasonable attorney's fees incurred by the plaintiff, they may be viewed as compensatory in nature. This situation proves far less troublesome than where the damages are to be trebled or to be assessed in an amount sufficient to punish or deter the defendant. Moreover, in most international arbitrations, the arbitrators will not require any "punitive" reason for the award of attorney's fees, since virtually all systems of international commercial arbitration rules provide that the arbitrators may award costs, including reasonable attorney's fees, to the prevailing party.<sup>38</sup>

Where punitive damages are assessed for purposes of punishment or deterrence, a dilemma is created. Normally penal sanctions are instruments of the State and reflect a national public policy. The arbitrator is not a functionary of the State, but a private party who is determining a private commercial dispute by reason of the agreement of the parties to the dispute. Given the arbitrator's purely private position and given the fact that the parties to an international commercial arbitration are almost always from two or more different legal systems (one of which may not recognize the concept of punitive damages, let alone its application in a certain set of circumstances), should an arbitrator award punitive damages even where under the governing law he or she is authorized to do so?

<sup>34</sup> *Domke on Commercial Arbitration*, Sec. 1.01, 1, Gabriel M. Willner (ed.), rev. edition, 1992.

<sup>35</sup> Redfern and Hunter, footnote 31, *supra*, at 2.

<sup>36</sup> Thomas J. Stipanowich, *Punitive Damages in Arbitration: Garrity v. Lyle Stuart, Inc. Reconsidered*, 66 Boston U.L.Rev. No. 3 953, 953-955 (November 1986); and see, generally, Michael F. Hoellering, *Arbitrability*, Commercial Arbitration for the 1990's 1 (1991).

<sup>37</sup> Hoellering, *id.*, 3-10.

<sup>38</sup> See, e.g. A.A.A. International Arbitration Rules, Article 32(d); International Chamber of Commerce Rules of Arbitration, Article 20, para. 2; London Court of International Arbitration Rules, Article 18.3; Singapore International Arbitration Rules, Rule 29.1(e); United Nations Commission on International Trade Law Arbitration Rules, Article 38(e).

To the extent that such damages are regarded as punitive and as deterrents, there is American authority that suggests that an award of punitive damages would be unenforceable, at least that portion of the award.<sup>39</sup> In the *Laminoirs* case, a Georgia state corporation opposed a motion to confirm an arbitral award brought by a French company.<sup>40</sup> The award included a provision for interest pursuant to a French statute.<sup>41</sup> The applicable annual rate of interest awarded was 10.5 and 9.5 per cent, depending on the date of maturity of the underlying invoices, increasing to 15.5 and 14.5 per cent after two months from the date of the notification of the award.<sup>42</sup> The court analyzed the statutory interest award thusly:

"An award of interest is made so that a person wrongfully deprived of the use of his money should be made whole for his loss. A penalty, on the other hand, is a sum of money which the law enacts by way of punishment for doing something that is prohibited or omitting to do something that is required to be done. The law does not lightly impose penalties. A foreign law will not be enforced if it is penal only and relates to the punishing of public wrongs as contradistinguished from the redressing of private injuries."<sup>43</sup>

The Court concluded that the additional five per cent interest was penal rather than compensatory in nature, and refused to enforce that portion of the award citing Article V, para. 2(b) of the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards.<sup>44</sup> Later Federal court decisions have implicitly recognized that to the extent an award is penal in nature it will not be enforced since it violates American public policy under Article V, para. 2(b) of the New York Convention.<sup>45</sup>

However, if the parties contemplate that any award may be enforced in the United States, international commercial arbitrators are faced with a more difficult dilemma should they decline to award punitive damages where they are empowered to do so by the laws of the United States. One such law, the Clayton Antitrust Act, contains provisions which are penal in nature, since it permits the trebling of damages.<sup>46</sup> In *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth* the U.S. Supreme Court was confronted with the challenge to an arbitration going forward before the Japan Commercial Arbitration Association on the grounds that the American party to the arbitration had claims under the American antitrust laws.<sup>47</sup> After a short summary of the remedy of treble damages available to a private litigant under the American antitrust laws, the Supreme Court opined that an international arbitral tribunal would enforce those antitrust laws fully, where appropriate:

<sup>39</sup> *Laminoirs—Trefileries—Câbleries de Lens, S.A. v. Southwire Co.*, 484 F.Supp. 1063 (N.D. Ga. 1980).

<sup>40</sup> *Id.*, at 1065.

<sup>41</sup> *Id.*, at 1067 and 1069. "In the case of a judgment, the rate of legal interest shall be increased by five points upon the expiration of a period of two months from the day on which the court decision has become enforceable, even if only provisionally." French Law No. 75-619, 11 July 1975. *Id.*, at 1069.

<sup>42</sup> *Id.*, at 1068.

<sup>43</sup> *Id.*, at 1069 (citations omitted).

<sup>44</sup> *Id.*

<sup>45</sup> *International Standard Electric Corp. v. Bidas Sociedad Anónima Petrolera Industrial Y Comercial*, 745 F.Supp. 172, 182 (S.D.N.Y. 1990); *Brandeis Intsel Ltd. v. Calabrian Chemicals Corp.*, 656 F.Supp. 160, 170 (S.D.N.Y. 1987).

<sup>46</sup> 15 U.S.C.A. Sec. 15 (West 1993).

<sup>47</sup> *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth*, 473 U.S. 614, 87 L.Ed.2d 444, 105 S.Ct. 3346 (1985).

"There is no reason to assume at the outset of the dispute that international arbitration will not provide an adequate mechanism. To be sure, the international arbitral tribunal owes no prior allegiance to the legal norms of particular states; hence, it has no direct obligation to vindicate their statutory dictates. The tribunal, however, is bound to effectuate the intentions of the parties. Where the parties have agreed that the arbitral body is to decide a defined set of claims which includes, as in these cases, those arising from the application of American antitrust law, the tribunal therefore should be bound to decide that dispute in accord with the national law giving rise to the claim."<sup>48</sup>

In a footnote the Court acknowledged that the governing law in the contract called for the application of Swiss law and noted that "in the event that the choice-of-forum and choice-of-law clauses operated in tandem as a prospective waiver of a party's right to pursue statutory remedies for antitrust violations, we would have little hesitation in condemning the agreement as against public policy."<sup>49</sup> This view seems extremely paternalistic, since it suggests that American international traders require the protection of the Supreme Court, lest they unintentionally waive rights when entering into international arbitration agreements.

Moreover, the Supreme Court went on to suggest that as a matter of public policy, U.S. courts might refuse to enforce foreign awards, pursuant to Article V, para. 2(b) of the New York Convention, to the extent that such awards refuse to enforce American antitrust laws.<sup>50</sup> This indicates that American courts might refuse to enforce foreign awards where the awards are penal under foreign law, at the same time that they refuse to enforce foreign awards where the arbitrators have declined to make awards which are penal under U.S. law. Such a position is patently untenable.

The real dilemma in the *Mitsubishi* case appears to be that if a party is precluded from raising its claim for punitive damages in arbitration, that party may not be able to raise it at all. Punitive damages do not constitute a claim, but rather a remedy. If the claim which underlies the remedy of punitive damages proceeds to arbitration, but the arbitrators cannot, or decline to award punitive damages, the claimant may be barred from seeking punitive damages in another action by the doctrine of *res judicata*.<sup>51</sup> But just as with most other questions in arbitration, this can be handled by party agreement. Either the parties can expressly agree that the arbitrators are empowered to award punitive damages on the claim, or the parties can except the antitrust (or other statutory claim which might be construed as penal in nature) from their arbitration.

Where the parties agree that the arbitrators are empowered to award punitive damages, this does not eliminate the possibility that national courts might raise public policy objections to the enforcement of an award which includes punitive damages, just as American courts have refused to enforce what they regard as penal damages under non-American law. Where the parties have agreed that the arbitrators can award punitive damages, international commercial arbitrators should make sure that

<sup>48</sup> *Id.*, 105 S.Ct. at 3359.

<sup>49</sup> *Id.*, footnote 19 (citations omitted).

<sup>50</sup> 105 S.Ct. at 3359-60.

<sup>51</sup> *Waltman v. Fahnstock & Co., Inc.*, 792 F.Supp. 31, 32-33 (E.D. Pa. 1992).

all parties are aware of the enforcement risks should punitive damages be actually awarded in the matter. Should the parties nevertheless elect to submit the matter to the arbitrators as per their agreement, the arbitrators should proceed as they would otherwise, being guided by the agreement of the parties.

#### IV. CONCLUSION

Punitive damages as an element of national public policy seem at odds with the private character of international commercial arbitration. However, arbitrators must generally follow applicable national laws in the conduct of the arbitration.<sup>32</sup> Arbitrators would be wise to inform the parties of the potential risks of enforcement where awards contain penal remedies, such as punitive damages, but where, in the face of such knowledge, the parties have agreed that the arbitrators are empowered to award punitive damages on certain of the claims before the tribunal, the arbitrators should consider the evidence and award such damages if the application of the law to the facts dictates such an award.

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<sup>32</sup> The one possible exception to this is the "delocalized" arbitration, a theory under which the parties can agree to "detach" their arbitration from any system of national law. See, generally, Redfern and Hunter, footnote 31, *supra*, at 55-61.