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Punitive Damages in International Commercial Arbitration: Much Ado about Nothing?

by MARKUS A. PETSCHÉ*

ABSTRACT

This article constitutes an attempt to assess the practical significance of punitive damages in the context of international commercial arbitration. It shows that, although punitive damages are regularly awarded in domestic arbitrations in the US, such awards are quasi-inexistent in the international arena. As this article explains, this limited practical relevance of punitive damages is due to two factors. It results, first of all, from the limited availability of punitive relief, i.e. the fact that punitive damages are only recognized under a small minority of domestic (substantive and arbitration) laws, especially as far as contract claims are concerned. Second, the limited practical significance of punitive damages also stems from the difficulties to enforce such awards abroad and the resulting reluctance of arbitral tribunals to grant punitive relief even where it may be available and appropriate under the applicable law. While this article is primarily concerned with providing an explanation of the current status quo, it also discusses legal developments that may lead to punitive damages playing a more significant role in the future.

I. INTRODUCTION

In recent years, the issue of punitive damages awards in international commercial arbitration has received increasing attention from legal scholars and practitioners.¹ This growing interest stems, at least in part, from the progressive acceptance of arbitral punitive damages awards in the ‘homeland’ of punitive damages, the United States. In fact, as early as 1985 and 1987, the US Supreme Court affirmed

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¹ See, e.g., M. Scott Donahey, *Punitive Damages in International Commercial Arbitration*, 10 J. Intl. Arb. 67 (1993); John Y. Gotanda, *Awarding Punitive Damages in International Commercial Arbitrations in the Wake of Mastrobuono v. Shearson Lehman Hutton, Inc.*, 38 Harv. Intl. L. J. 59 (1997); Darlene S. Wood, *International Arbitration and Punitive Damages: Delocalization and Mandatory Rules*, 71 Def. Counsel J. 402 (2004); Kyriaki Noussia, *Punitive Damages in Arbitration: Panacea or Curse?* 27 J. Intl. Arb. 277 (2010); Niccolo Pietro Castagno, *International Commercial Arbitration and Punitive Damages*, 4 Revista de Arbitraje Comercial y de Inversiones 729 (2011).

the arbitrability of antitrust² and RICO claims³ and, by the same token, the ability of arbitral tribunals to award treble damages.⁴ In 1995, in *Mastrobuono*, the Supreme Court generally affirmed the ability of arbitrators to grant punitive relief,⁵ a right which had historically been considered as incompatible with public policy.⁶

These decisions of the US Supreme Court have raised, and continue to raise, various questions. First of all, they have generated renewed interest in the classical issue of whether American punitive damages awards can be enforced in third countries. The Court's decision in *Mastrobuono*, which was rendered in relation to a domestic dispute, raises the question of whether, and under what circumstances, arbitral tribunals hearing international business disputes should apply the liberal test formulated by the Court.⁷ Lastly, the Court's case law raises the general question of the role that punitive damages play, or should play, in the area of international commercial arbitration.

Although punitive damages in international commercial arbitration are a hotly – and controversially – debated topic, the available empirical data suggests that such awards are, at best, very exceptional.⁸ Significantly, there is no reported International Chamber of Commerce case in which such damages have been awarded.⁹ Similarly, although this may not be directly relevant for the purposes of this study, punitive damages awards are virtually inexistent in investment disputes.¹⁰ Punitive damages are sometimes awarded in maritime arbitration cases,¹¹ but it is not always clear whether those cases are domestic (US) or

² *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614 (1985) (holding that an arbitral tribunal sitting in Japan may hear a claim for treble damages under US antitrust laws).

³ *Shearson/American Express, Inc. v. MacMahon*, 482 U.S. 420 (1987).

⁴ When a court or tribunal awards treble damages, it awards damages in an amount equal to three times the actual loss suffered. In other words, treble damages are one-third compensatory and two-third punitive.

⁵ *Mastrobuono v. Shearson Lehman Hutton, Inc.*, 115 S. Ct. 1212 (1995).

⁶ *Garrity v. Lyle Stuart, Inc.*, 353 N.E.2d 793, 797–798 (N.Y. 1976) (holding that punitive arbitration awards violate public policy, *inter alia* because such sanctions are 'reserved to the State' and because 'the power to punish' constitutes a 'monopoly of the State').

⁷ For a detailed discussion of this question, see Gotanda, *supra* n. 1.

⁸ See Karen J. Tolson, *Conflicts presented by Arbitral Awards of Punitive Damages*, 4 Arb. Intl. 255, 256 (1988), (observing that 'no record of any international arbitral award of punitive damages exists . . .'). Although this statement is somewhat dated, it has lost little of its accuracy.

⁹ To this author's knowledge, the only (limited) exception would be ICC case no. 7453 where the sole arbitrator granted statutory damages under a Michigan statute which comprise punitive elements. However, the sole arbitrator qualified those damages as 'primarily compensatory', thus avoiding the question of the availability of punitive relief. See *Agent v. (1) Principal and others, Final award in case no. 7453 of 1994* in 22 Y.B. Comm. Arb. 107 (Albert Jan van den Berg ed., 1997).

¹⁰ For recent cases, see, e.g. *Ionnasis Kardassopoulos & others v. The Republic of Georgia*, ICSID Cases No. ARB/05/18 and ARB/07/15, Final award of Mar. 3, 2010, § 508 (referring to the Amoco Tribunal's holding that the unlawfulness of an expropriation does not justify the award of punitive damages and that the actual damage sustained is the measure of the reparation); *Joseph Charles Lamire & others v. Ukraine*, ICSID Case No. ARB/06/18, Final award of Mar. 28, 2011, § 332 (referring to an earlier case where the tribunal held that punitive damages were 'generally not available except in extreme cases of egregious behavior').

¹¹ See, e.g., *Society of Maritime Arbitrators, Triumph Tankers Ltd. (Owner) v. Defendant: Kerr McGee Refining Corp. (Charterer), Final award no. 2642 of 28 March 1990* in 18 Yearbook Commercial Arbitration 112 (Albert Jan van den Berg ed., 1993) (awarding treble damages under RICO on the basis of cargo conversion); *Society of Maritime Arbitrators, Trade & Transport, Inc. as Owners of "M/T LAUBERHORN" (ex TRADE ENDEAVOR) (Owners) v.*

international ones.¹² Overall, it appears that punitive damages awards in arbitration are essentially an American phenomenon.

This article analyses the reasons for the limited practical relevance of punitive damages in the context of international commercial arbitration. It does not, however, elaborate on the exceptional nature of the punitive damages remedy as such, i.e. on the threshold applying to the ‘gravity’ of the defendant’s conduct. While the basic empirical observation underlying this study is that punitive damages awards are quasi-inexistent in international commercial arbitration, this article nevertheless acknowledges that a more widespread recourse to this remedy may be possible in the future.

Part One of this article explains that in international commercial arbitration, punitive damages awards are rare because they are only available in those cases in which this remedy is recognized under the applicable domestic and/or procedural law. As will be shown, only very few laws authorize the award of punitive damages, especially as far as contract claims are concerned. Part Two highlights that punitive damages awards are exceptional because, even where they are available under the applicable law(s), they are, in most countries, considered to be in violation of public policy. As a result, there is a serious risk of annulment or refusal to enforce such awards, which, in turn, prompts arbitral tribunals to refrain from awarding punitive relief.

II. THE LIMITED AVAILABILITY OF PUNITIVE DAMAGES IN INTERNATIONAL COMMERCIAL ARBITRATION

(a) Law(s) determining the availability of punitive damages

The issue of the availability of punitive damages in international commercial arbitration raises complex conflict of laws questions. Although it is impossible to discuss those questions in detail in the context of this study, it is important to highlight that both the applicable substantive law and the procedural law of the arbitral seat may be relevant. As a result, punitive damages may not be available if either of these two laws fail to provide for, or prohibit, such relief.

Valero Refining Company, Inc. (Charterer), Final award no. 2699 of 23 August 1990 in 18 Yearbook Commercial Arbitration 124 (Albert Jan van den Berg ed.), (awarding treble damages under RICO on the basis of cargo conversion). See also Donald E. Zubrod, Punitive and RICO Damages in American Maritime Arbitration, 8 J. Intl. Arb.17 (1991).

¹² See Society of Maritime Arbitrators Final awards no. 2642 and 2699, *supra* n. 11. These cases involve carriage of goods across borders, but it is not clear whether the relevant contracts can adequately be characterized as ‘international’ ones considering that it is not clear whether the parties to these agreements were established or domiciled in different countries.

(i) *Applicability of the lex contractus*

The availability of punitive damages affects the substance of the rights and obligations of the parties. This question should, therefore, be governed by the applicable substantive law or *lex causae* (*lex loci delicti* in tort cases; *lex contractus* in contract cases). In most countries, private international law principles acknowledge that the *lex causae* governs the ‘matters in respect of which damages may be recovered’.¹³ As far as the scope of the *lex contractus* is concerned, the Rome I Regulation (which is applicable in all Member States of the EU) expressly provides that this law governs ‘the consequences of a total or partial breach of obligations, including the assessment of damages’.¹⁴

As far as the availability of punitive damages more specifically is concerned, a number of commentators take the view that the *lex contractus* plays a (decisive) role. Redfern and Hunter, for example, observe that arbitrators ‘should examine the question of whether or not such damages may be awarded under the law applicable to the substance of the dispute’.¹⁵ Noussia similarly accepts the idea that ‘it is necessary to look at the law applicable to the substance of the dispute’ in order to determine whether punitive relief may be granted.¹⁶ Farnsworth also seems to imply that the applicable substantive law governs the availability of punitive damages.¹⁷

Although the case law on this issue is limited, this author is aware of at least two ‘international’ awards in which the arbitrators recognized the applicability of the *lex contractus* to the question of the availability of punitive relief. In ICC Case no. 5946, the sole arbitrator implicitly recognized the relevance of the applicable substantive law, the law of the state of New York.¹⁸ However, he did not examine whether this law allowed punitive damages awards since he found that such an award would in any event be contrary to the public policy of the arbitral seat. In ICC Case no. 8445, the arbitral tribunal rejected a claim for punitive damages, *inter alia* on the grounds that such damages were not generally available under the applicable (substantive) Indian law.¹⁹

¹³ See, as far as English conflict of laws principles are concerned, Adrian Briggs, *The Conflict of Laws* 39 (2008, Oxford University Press, 2nd edition).

¹⁴ Regulation (EC) No. 593/2008 of the European Parliament and of the Council of 17 June 2008 on the law applicable to contractual obligations (Rome I), Art. 12(1)(c).

¹⁵ Nigel Blackaby, Constantine Partasides et al., *Redfern and Hunter on International Arbitration* 531 (2009, Thomson Sweet & Maxwell, 4th edition).

¹⁶ Noussia, *supra* n. 1, at 283.

¹⁷ E. Allan Farnsworth, *Punitive Damages in Arbitration*, 20 *Stetson L. Rev.* 395, 398 (1990–1991) (observing that in a case where California law is the applicable substantive law, the appropriateness of awarding punitive damages must be determined under that law).

¹⁸ *Seller v. Buyer*, *Final award in case no. 5946 of 1990* in 16 *Yearbook Commercial Arbitration* 97 113 (Albert Jan van den Berg ed., 1991), (stating that ‘even if an award of punitive damages were not found to be inconsistent with Swiss public policy [i.e. the public policy of the arbitral seat], respondent has not proven that under New York law [the applicable substantive law] a claim for such punitive or exemplary damages would lie’).

¹⁹ *Final award of 1996 in Case No. 8445* in 26 *Yearbook Commercial Arbitration* 167 178 (Albert Jan van den Berg ed., 2001).

(ii) Relevance of the procedural law of the arbitral seat

While the applicability of the *lex contractus* is widely acknowledged, most commentators also recognize the relevance of the procedural law of the place of arbitration. Redfern and Hunter, for instance, note that ‘the question of whether an arbitral tribunal has the power to impose penal sanctions depends on . . . the law of the place of arbitration (*lex arbitri*)’.²⁰ Noussia, who accepts the applicability of the *lex contractus*, explains that the question of the availability of punitive damages is sometimes viewed as a procedural issue, especially in the United States.²¹

It is, in fact, not impossible to consider that the availability of punitive relief is a procedural issue – although one may wonder how a single issue may constitute both a substantive and a procedural question. Under this approach, the possibility for arbitrators to award punitive damages is governed by the procedural law of the place of arbitration. In the context of international commercial arbitration, this procedural law refers to the ‘arbitration law’ in force at the arbitral seat.²² As a general rule, as will be shown, arbitration laws are silent with regard to the issue of remedies and, therefore, with regard to the availability of punitive damages.²³ Still, US courts have interpreted this silence (specifically the silence of the Federal Arbitration Act) to constitute an implicit authorization of arbitral punitive damages awards.²⁴

Under a slightly different (and arguably more convincing approach), the procedural law of the arbitral seat does not govern the issue of the ‘availability’ of punitive relief, but rather the distinct question of whether arbitral tribunals at all have the ‘power’ to award such damages. This approach is based on the idea that arbitrators do not necessarily have the exact same powers as courts and that domestic legislators may wish to restrict the ability to grant specific categories of relief to their courts. Several commentators draw such a distinction between ‘power’ and ‘availability’.²⁵

(iii) Irrelevance of the substantive law of the arbitral seat

The substantive law of the arbitral seat is, as a matter of principle, irrelevant for the purposes of determining the availability of punitive relief. Indeed, it governs neither the substance of the parties’ agreement, nor the procedural aspects of the arbitration (including the question of the arbitrators’ ‘power’ to award punitive damages). However, even if the substantive law of the seat does not determine the

²⁰ Redfern and Hunter, *supra* n.14, at 530.

²¹ Noussia, *supra* n.1, at 281.

²² *Ibid.* (expressly equating procedural law with arbitration law).

²³ See *infra* at I.C.1.

²⁴ See *Mastrobuono v. Shearson Lehman Hutton, Inc.* 115 S. Ct. 1212 (1995) (holding that the Federal Arbitration Act ensures that private agreements to arbitrate are enforced according to their terms and that in the absence of contractual intent to the contrary, arbitrators may award punitive damages even where such awards are prohibited under the relevant state (arbitration) law).

²⁵ See, e.g., Redfern and Hunter, *supra* n. 14, at 530 (stating that the question of whether arbitrators may impose penal sanctions depends on the law of the place of arbitration); Farnsworth, *supra* n. 17, at 397.

availability of punitive damages as such, it may nevertheless have an impact on the decision of the arbitrators. In fact, as shall be explained, a punitive arbitral award may contravene the (substantive) public policy of the seat and may thus be annulled by the courts of that seat. As a result, arbitral tribunals may refuse to award punitive relief even though it is otherwise available under the *lex contractus*.²⁶

(b) *Limited recognition of punitive damages in domestic (substantive) laws*

(i) *Limited recognition of punitive damages in general*

Subject to a limited number of exceptions, punitive damages are only recognized in common law countries. They are notably awarded by the courts of the UK, the US, Canada, Australia, and New Zealand.²⁷ However, as some comparative law scholars have rightly pointed out, the circumstances in which punitive relief is available and the magnitude of punitive damages awards vary greatly from one jurisdiction to another.²⁸ In the United States, the availability of punitive relief is a question of state law, with a significant majority of states authorizing punitive damages awards.²⁹

In civil law jurisdictions, punitive damages are generally not available.³⁰ Hence, under French and German law, for example, courts do not grant punitive relief. While some authors have suggested that this traditional hostility vis-à-vis punitive damages may be progressively eroding,³¹ to date, no significant changes have taken place. There are, however, a few limited exceptions to the unavailability of punitive relief in civil law countries. Those notably include Norway, Poland, Brazil, Israel, and the Philippines.³²

(ii) *Exceptional recognition of punitive damages for breach of contract*

As a general rule, international commercial arbitration involves disputes based on contracts.³³ In fact, in the vast majority of cases, the referral of an international commercial dispute to arbitration is based on a contractual clause providing for arbitration of disputes arising in connection with the parties' transaction. Hence, the availability of punitive damages in international commercial arbitration depends on whether, under the applicable law(s), such damages are available for breach of contract cases.

²⁶ See ICC Case no. 8445, *supra* n. 19.

²⁷ See John Y. Gotanda, *Punitive Damages: A Comparative Analysis*, 42 Colum. J. Transnatl. L. 391 (2003).

²⁸ *Ibid.* at 443 (concluding that 'we have not witnessed . . . the harmonization of the laws and practices concerning punitive damages . . .').

²⁹ *Ibid.* at 421.

³⁰ Gotanda, *supra* n. 1, at 66.

³¹ See, as far as German law is concerned, Volker Behr, *Punitive Damages in American and German Law – Tendencies Towards Approximation of Apparently Irreconcilable Concepts*, 78 Chi.-Kent L. Rev. 105 (2003).

³² Gotanda, *supra* n. 1, at 109.

³³ Castagno, *supra* n. 1, at 729 (observing that international commercial arbitration 'mainly regards contract liability').

In most countries that recognize punitive relief, such relief may only be granted in tort claims involving ‘exceptionally objectionable conduct’ on the part of the defendant.³⁴ In those countries, punitive damages may not be awarded in contract claims. In the UK, for example, the unavailability of punitive damages in breach of contract actions has been affirmed by the House of Lords as early as 1909³⁵ and was recently reiterated in a report of the English Law Commission.³⁶ The courts in Australia and New Zealand have followed the English example.³⁷

It is generally acknowledged that punitive damages in breach of contract cases are only available in the United States and Canada. In the United States, the Restatement Second of Contracts expressly provides for the availability of punitive damages when the breach of contract also constitutes an ‘independent’ tort.³⁸ In addition, under the so-called Indiana decisions, punitive relief may also be awarded where the breach in question does not amount to an independent tort, but was fraudulent, malicious, grossly negligent or oppressive.³⁹ Punitive damages for breach of contract are also awarded in Canada, though apparently to a more limited extent.⁴⁰

(c) *Limited recognition of punitive damages in arbitration laws and rules*

(i) *Silence of most arbitration laws and rules on the availability of punitive damages*

Arbitration laws do not generally address the question of whether arbitrators may award punitive relief. As a general rule, they do not even deal with the more general question of the available remedies.⁴¹ Thus, arbitration laws do not, for example, contain any provisions regarding the arbitrators’ ability to order specific performance. Most arbitration laws do, however, include one or several provisions regarding the rendering of the final award.⁴² Yet, under most laws, those provisions merely set forth the requirements that the award shall be in writing, reasoned, and signed.⁴³

The silence of arbitration laws regarding the possibility for arbitrators to award punitive relief is hardly surprising. First of all, it reflects the idea that the question of the available remedies (including the availability of punitive relief) is most

³⁴ Gotanda, *supra* n. 27, at 440.

³⁵ *Addis v. Gramophone Co. Ltd.* [1909] UKHL 1 (holding that ‘exemplary damages ought not to be . . . recoverable in such an action [a contract action] as the present’).

³⁶ English Law Commission, *Aggravated, Exemplary and Restitutory Damages* [1997] EWLC 247, § 5.42.

³⁷ Gotanda, *supra* n. 27, at 407–420.

³⁸ *Restatement (Second) on Contract*, § 355 provides: ‘Punitive damages are not recoverable for a breach of contract unless the conduct constituting the breach is also a tort for which punitive damages are recoverable.’

³⁹ Castagno, *supra* n. 1, at 733.

⁴⁰ *Ibid.*

⁴¹ No section on remedies is contained, for example, in the UNCITRAL Model Law, the French Code de Procédure Civile, the US Federal Arbitration Act, the German Arbitration Act, and the Swiss Private International Law Statute (PILS).

⁴² See Art. 31(1) and (2) of the UNCITRAL Model Law, Arts 1480 to 1482 of the French Code de Procédure Civile (relating to domestic arbitration), ss 1054(1) and 2 of the German ZPO, Art. 189(2) of the Swiss PILS.

⁴³ *Ibid.*

appropriately regarded as a substantive issue which, by implication, falls outside of the scope of arbitration laws. Under such an approach, arbitration laws are 'procedural' laws which provide a normative framework for the various stages of the arbitral procedure (e.g. arbitration agreement, arbitral proceedings, award, enforcement and means of recourse). Accordingly, substantive questions such as the validity of the underlying contract or the consequences of a breach of contract are not addressed in arbitration laws.

Second, assuming that the availability of punitive damages may be considered as a procedural issue governed by the applicable arbitration law, it must be remembered that arbitration laws generally do not establish a detailed regulatory framework, but merely lay down basic guidelines. In fact, arbitration laws are essentially based on the principles of party autonomy and arbitral discretion. Also, in the specific context of international arbitration, it would hardly make sense to expressly provide for the availability of a remedy that is unheard of in the vast majority of countries. Conversely, for the reasons mentioned above, it is neither necessary nor appropriate expressly to exclude punitive damages awards.

Like arbitration laws, institutional arbitration rules are generally silent with regard to available remedies and, more specifically, with regard to the availability of punitive damages. Section 4 of the UNCITRAL Rules (entitled 'The award'), for example, contains no provision pertaining to remedies. Article 31 of the ICC Arbitration Rules, which relates to the 'making of the award', similarly fails to address this issue. Article 26 of the LCIA Rules also remains silent on the question of remedies, even though it specifies that the tribunal 'may order simple or compound interest...at such rates as the Arbitral Tribunal determines appropriate'.⁴⁴

The absence of provisions concerning the availability of punitive damages in institutional arbitration rules is unsurprising. First of all, given that arbitration rules are of a procedural nature, it is not, in principle, their function to define the types of remedies that may be granted by arbitrators. Second, since institutional rules, like arbitration laws, are based on the idea of party autonomy, a rule authorizing or proscribing the award of punitive relief would be either an undue interference with such autonomy or unnecessary.

(ii) Express prohibition of punitive damages in selected instruments

In those rare instances where arbitration laws or rules discuss the availability of punitive relief, this possibility is usually precluded. Admittedly, Section 21(a) of the United States Uniform Arbitration Act recognizes the right of arbitrators to award punitive damages.⁴⁵ However, in reality, this provision only implies that arbitrators are not prevented from granting such relief, provided it is available under the

⁴⁴ LCIA Arbitration Rules, Art. 26(6).

⁴⁵ Uniform Arbitration Act, Section 21(a) provides: 'An arbitrator may award punitive damages or other exemplary relief if such an award is authorized by law in a civil action involving the same claim and the evidence produced at the hearing justifies the award under the legal standards otherwise applicable to the claim.'

applicable substantive or procedural law. Hence, it would be erroneous to say that the Uniform Arbitration Act ‘empowers’ arbitrators to grant punitive damages. Also, and very significantly, the Uniform Arbitration Act constitutes a piece of legislation on domestic arbitration and is thus not directly relevant for the purposes of international commercial arbitration.

The International Mediation and Arbitration Rules of the AAA expressly exclude punitive relief. Article 28(5) of those Rules provides that, ‘[u]nless the parties agree otherwise, the parties expressly waive and forego any right to punitive, exemplary or similar damages...’ In other words, the parties may expressly authorize punitive damages awards but if they fail to do so, such awards will be excluded under the Rules.

Punitive damages awards are also expressly excluded under a number of public international law instruments. Under the Draft Model Agreement on International Investment prepared by the International Institute for a Sustainable Development, arbitral tribunals hearing investor–state disputes ‘may not award punitive damages’.⁴⁶ Likewise, arbitral tribunals constituted under the Dominican Republic–Central America Free Trade Agreement are ‘not authorized to award punitive damages’.⁴⁷ In a similar vein, Section 1606 of the US Foreign Sovereign Immunities Act 1976 provides that ‘a foreign state... shall not be liable for punitive damages’. While these provisions are not directly relevant for the purposes of international commercial arbitration, they nevertheless suggest that punitive damages awards are generally perceived as inappropriate in an international context.

III. THE LIMITED ENFORCEABILITY OF PUNITIVE DAMAGES AWARDS IN INTERNATIONAL COMMERCIAL ARBITRATION – INCOMPATIBILITY OF PUNITIVE DAMAGES WITH THE PUBLIC POLICY OF MOST JURISDICTIONS

(a) Reasons for this incompatibility

(i) Incompatibility of punitive damages with the basic distinction between private and criminal law

In most legal systems, punitive damages are considered incompatible with the basic distinction between private and criminal law. According to this distinction, private law governs the relationships between (private) legal subjects and involves exclusively private interests. Criminal law, however, involves matters of ‘general’ or ‘public’ interest pertaining, *inter alia*, to the punishment and deterrence of criminal

⁴⁶ International Institute for a Sustainable Development, Draft Model Agreement on International Investment, Annex A. Investor–State Dispute Settlement, Art. 13(3).

⁴⁷ Dominican Republic–Central America Free Trade Agreement, Ch. 10, Sec. A: Investment, Art. 10.26(3).

behaviour. Therefore, the objectives of punishment and deterrence are, or should be, absent from the sphere of private law. In continental European countries, this strict distinction between the respective objects and purposes of private and criminal law is viewed as ‘an achievement of modern legal culture’.⁴⁸

The confinement of punishment and deterrence to the field of criminal law is based on the idea that penalties should only be imposed if the legal subjects concerned are afforded specific fundamental protections. The most basic of these protections consists of the principle of the ‘legality’ of sanctions according to which sanctions must be provided for by law (*nullum crimen, nulla poena sine lege*).⁴⁹ In addition, the legal subjects must also benefit from procedural guarantees such as, for example, the double jeopardy principle and the ‘beyond reasonable doubt’ standard of proof.

Even in the United States, courts and commentators accept the idea that punitive damages awards may, in certain cases, be unconstitutional. In *BMW of North America, Inc. v. Gore*,⁵⁰ the US Supreme Court acknowledged that ‘grossly excessive’ punitive damages awards ‘transcend the constitutional limit’ established by the Due Process Clause of the Fourteenth Amendment.⁵¹ A few years later, in *State Farm Mutual Automobile Insurance Co. v. Campbell*,⁵² the Court clarified under what circumstances punitive damages awards may be regarded as ‘grossly excessive’ when it observed that ‘few awards exceeding a single digit ratio between punitive and compensatory damages, to a significant degree, will satisfy due process...’⁵³ Some commentators question the constitutionality of punitive damages more generally.⁵⁴

In most civil law jurisdictions, however, the sole purpose of damages (whether for tort or breach of contract) is compensation. In Germany, for example, the statutory provisions on damages contained in the Civil Code, while addressing restitution and compensation, are silent with regard to the availability of punitive damages. More importantly, Article 40, Section 3 of the EGBGB (Einführungsgesetz zum Bürgerlichen Gesetzbuch, Introductory Act to the Civil Code) provides that ‘[c]laims governed by the law of another country cannot be raised insofar as they . . . go substantially beyond what is necessary for an adequate compensation of the injured party’.

Like its German counterpart, the French Civil Code provides that damages for tort and breach of contract are exclusively compensatory in nature.⁵⁵ French law of obligations adheres to the principle of full compensation whereby the actual loss

⁴⁸ Helmut Koziol, Punitive Damages – A European Perspective, 68 *La. L. Rev.* 741, 755–756 (2008).

⁴⁹ *Ibid.* at 756.

⁵⁰ 517 U.S. 559 (1996).

⁵¹ *Ibid.* at 586.

⁵² 123 S. Ct. 1513 (2003).

⁵³ *Ibid.* at 1524.

⁵⁴ Thomas B. Colby, *Beyond the Multiple Punishment Problem: Punitive Damages as Punishment for Individual, Private Wrongs*, 87 *Minn. L. Rev.* 583, 650 (2003) (stating that ‘a number of commentators (along with two Justices) have noted that punitive damages . . . clearly appear to meet the test for requiring criminal procedure protections’).

⁵⁵ See Arts 1382 (relating to tort liability) and 1149 (relating to contract liability) of the Civil Code.

suffered is the sole measure for the damages to be awarded. Damages must compensate for ‘all the damage’ and ‘nothing but the damage’. The reprehensibility of the conduct of the tortfeasor or breaching party (e.g. his gross negligence, maliciousness etc.) is irrelevant. In a decision rendered on 3 July 2006, the Court of Appeal of Paris confirmed the principle that the gravity of the tortfeasor’s fault does not affect the amount of damages to be awarded to the victim.⁵⁶

Considering that in civil law countries, the award of punitive damages is incompatible with the basic function assigned to the law of obligations, it is hardly surprising that such damages should be regarded as contrary to public policy. Although the relevant case law is limited, the highest courts of at least two countries have expressly held that foreign punitive damages awards are contrary to domestic public policy and, therefore, unenforceable. In a 1992 landmark decision, the German Supreme Court refused enforcement of the punitive damages portion of a California judgment on the grounds that such damages were contrary to German public policy.⁵⁷ More recently, on 19 January 2007, the Italian Supreme Court handed down a similar decision.⁵⁸

As far as other civil law jurisdictions are concerned, there are, with one exception, no reported cases in relation to the enforcement of foreign punitive damages awards. However, in light of the fact that such damages are contrary to the prevailing perceptions of the basic function of private law, it is reasonable to assume that the courts of those countries would follow the German and Italian examples. To this author’s knowledge, the only exception to this general rule consists of the position taken by the Spanish Supreme Court in a decision rendered on 13 November 2001 in which the Court held that punitive damages awards are not as such contrary to Spanish public policy.⁵⁹

Some authors have pointed out that the incompatibility of punitive damages awards with continental European public policy may be exaggerated, if not erroneous. Behr, for example, has shown that despite the formal exclusion of punitive damages under German law, German courts increasingly award non-compensatory damages in cases involving pain and suffering⁶⁰ and infringement of intellectual property rights.⁶¹ In addition, recent developments indicate that civil law attitudes towards punitive damages may be evolving. In France, for example, a recent proposal to reform the French Civil Code suggests introducing punitive damages into French tort law.⁶² Regardless of whether such a proposal will ultimately be adopted, it is in itself a reflection of a changing mindset.

⁵⁶ Court of Appeal of Paris, decision of 3 July 2006 reported by Thomas Rouhette, *The Availability of Punitive Damages in Europe: Growing Trend or Nonexistent Concept?* 74 Def. Counsel J. 320, 323 (2007).

⁵⁷ Bundesgerichtshof [BGH] [Federal Court of Justice] June 4, 1992, 118 Entscheidungen des Bundesgerichtshofes in Zivilsachen [BGHZ] 312 (F.R.G.).

⁵⁸ Italian Supreme Court, decision of Jan. 19, 2007, No. 1183/2007 reported by Rouhette, *supra* n. 56, at 331.

⁵⁹ *Ibid.* at 332.

⁶⁰ Behr, *supra* n. 31, at 130–136.

⁶¹ *Ibid.* at 137–139.

⁶² Proposal to reform the law of obligations and the law of prescriptions, 22 Sep. 2005, Art. 1371: ‘One whose fault is manifestly premeditated, particularly a fault whose purpose is monetary gain, may be ordered to pay punitive damages in addition to compensatory damages . . .’

(ii) Unjust enrichment and unequal treatment of plaintiffs

Punitive damages are not only contrary to basic views on the object and purpose of private law, but they also pose two additional problems. First, the award of punitive damages leads to situations that can be characterized as ‘unjust enrichment’. In fact, punitive damages do not take the form of a fine that the defendant is ordered to pay to the state;⁶³ rather, they are awarded to the plaintiff. As a result, the plaintiff is ‘compensated’ beyond the actual damage sustained, i.e. he is enriched. In most countries, such enrichment would be considered as ‘unjust’.

Second, punitive damages also lead to unequal treatment of plaintiffs who are essentially in the same situation. In fact, two plaintiffs who have suffered the same damage will be ‘compensated’ differently, depending on whether the defendant’s behaviour justifies the award of punitive relief. In many countries, this may be considered as contrary to the basic principle of equal treatment before the law or similar notions having constitutional or quasi-constitutional status.

*(b) Consequences of this incompatibility**(i) Annulment of, and refusal to enforce, arbitral punitive damages awards*

The incompatibility of punitive damages with domestic public policy requirements may have a twofold impact on the enforceability of arbitral punitive damages awards. First of all, it may lead to such awards being annulled (set aside) by the courts of the place of arbitration. Under virtually all arbitration laws, as is well known, arbitral awards may be the subject of setting aside proceedings in those courts.⁶⁴ One of the grounds upon which an award may be set aside is the award’s incompatibility with the forum’s public policy.⁶⁵ Therefore, if the courts of the arbitral seat consider that punitive damages violate public policy, they may annul punitive arbitral awards.

Second, incompatibility with public policy is also a ground upon which courts may refuse to enforce foreign arbitral awards. Under the New York Convention, for example, ‘[r]ecognition and enforcement of an award may . . . be refused if the competent authority in the country where recognition and enforcement is sought finds that . . . recognition or enforcement of the award would be contrary to the public policy of that country.’⁶⁶ The UNCITRAL Model Law contains a similar provision regarding the enforcement of foreign arbitral awards.⁶⁷

To this author’s knowledge, there are no reported cases in which courts have either enforced, or refused to enforce, foreign punitive damages awards under the New York Convention or domestic legislation based on the UNCITRAL Model

⁶³ In this respect, it is interesting to note that under the French reform proposal, judges awarding punitive relief ‘may direct a part of such damages to the public treasury’. See Art. 1371, *supra* n. 62.

⁶⁴ See, e.g., Arts 1(2) and 34 of the UNCITRAL Model Law.

⁶⁵ See, e.g., Art. 34(2)(b)(ii) of the UNCITRAL Model Law.

⁶⁶ Article V(2)(b) New York Convention.

⁶⁷ Article 36(1)(b)(ii) of the UNCITRAL Model Law.

Law. Back in 1987, Karen Tolson attributed this lack of relevant case law to the fact that ‘no record of any international arbitral award of punitive damages exist[ed]’.⁶⁸ As has been pointed out, to a large extent, this observation remains accurate today.

Despite the absence of relevant empirical data, most commentators agree that arbitral punitive damages awards are generally not enforceable in jurisdictions that do not recognize this remedy. Castagno, for example, observes that in those countries, ‘the public policy defence . . . could . . . represent a strong bias against the enforcement of punitive damages awards’.⁶⁹ As a result, he argues, it is unlikely that such awards would be enforced in Italy or Germany, for example.⁷⁰ He also takes the view that the enforcement of punitive arbitral awards is highly improbable in the UK, considering that under English law, such relief is not available in contract cases.⁷¹ A number of other writers have acknowledged that the enforcement of punitive arbitral awards may be problematic.⁷²

Other scholars, however, take a different view.⁷³ They rely primarily on the idea that under the New York Convention’s public policy exception (or similar domestic provisions), an award will only be refused recognition or enforcement if it violates ‘international’, rather than ‘domestic’ public policy.⁷⁴ They consider, in other words, that the public policy exception applying to arbitration awards is more restrictive than the one pertaining to foreign court judgments. Thus, the fact that a court of country ‘A’ refuses to enforce a foreign punitive damages *judgment* would not necessarily imply that another court of country ‘A’ would deny enforcement of a punitive *arbitral award*.

Arbitration laws and court decisions confirm the relevance of ‘international’, rather than ‘domestic’ public policy standards for the purposes of assessing the enforceability of foreign arbitral awards. Although express legislative references to the concept of international public policy are rare, one such reference can be found in Article 1520(5) of the French Code of Civil Procedure.⁷⁵ In other countries, the courts have reached similar results by relying on the idea that the New York Convention’s public policy exception must be interpreted restrictively. In the United States, for example, courts generally consider that ‘the Convention’s

⁶⁸ Tolson, *supra* n. 8, at 256.

⁶⁹ Castagno, *supra* n.1, at 747.

⁷⁰ *Ibid.*

⁷¹ *Ibid.* at 748.

⁷² See, e.g., Redfern and Hunter, *supra* n. 15, at 530–531 (referring to ‘[p]roblems of enforcement of [punitive damages awards]’ and arguing that it is likely that such awards would be denied enforcement in Germany); Gotanda, *supra* n. 1, at 101 (acknowledging that ‘arbitral awards of punitive damages [may] be against the public policy of countries that do not allow for such relief domestically’).

⁷³ See, e.g., Farnsworth, *supra* n. 17.

⁷⁴ *Ibid.* at 407 (pointing out the anecdotal fact that his ‘[c]olleagues from civil law systems seem to think that an award of punitive damages would not be against their *international* public policy’) (emphasis added). See also Albert Jan van den Berg, *The New York Arbitration Convention of 1958* (1981, Kluwer Law and Taxation), at 360.

⁷⁵ French Code of Civil Procedure, Art. 1520(5) provides: ‘An award may only be set aside where . . . recognition or enforcement of the award is contrary to international public policy.’

public policy defense should be construed narrowly⁷⁶ and that its application requires ‘supranational emphasis’, rather than reliance on ‘national political interests’.⁷⁷

(ii) *Refusal to award punitive damages in light of their incompatibility with the public policy of the place of arbitration*

As has been explained, punitive arbitral awards may be annulled by the courts of the arbitral seat if they contravene the applicable public policy requirements. This prospect inevitably influences the arbitral tribunal’s decision. In fact, arbitral tribunals may be reluctant to grant punitive relief if it is probable, or at least possible, that such an award would be set aside by the courts of the place of arbitration. Two factors play a role in this respect.

First, arbitrators have an understandable interest in issuing an enforceable award. Since the arbitral process is ultimately ineffective if it does not lead to the rendition of such an enforceable award, arbitrators generally consider enforceability as a duty owed to the parties. While it may not constitute a ‘legal’ duty in the strict sense, some arbitration rules expressly refer to the award’s enforceability as an objective of the arbitral process. Under the ICC Rules, for example, arbitral tribunals ‘shall make every effort to make sure the Award is enforceable at law’.⁷⁸

Second, the reluctance of arbitrators to issue an award that is likely to be annulled by the courts of the seat is reinforced by the fact that the legal consequences of an annulment are particularly ‘drastic’. In fact, as a general rule, an award that has been set aside at the place of arbitration can no longer be enforced in a third country. Under the New York Convention, for instance, an award may be refused recognition or enforcement if it ‘has been set aside or suspended by a competent authority of the country in which . . . that award was made’.⁷⁹ While it is true that the courts of a few countries have occasionally enforced annulled awards,⁸⁰ those decisions remain exceptional.

Although, as has been mentioned, the relevant case law is limited, one ICC award provides a useful illustration. In ICC case no. 5946,⁸¹ the respondent claimed punitive damages on the basis of the claimant’s alleged unilateral and unprovoked termination of the parties’ agreement. The sole arbitrator denied the respondent’s claim on the grounds that punitive damages were ‘considered contrary to Swiss public policy, which must be respected by an arbitral tribunal

⁷⁶ *Parsons & Whittemore Overseas Co. v. Société Générale de l’Industrie du Papier*, 508 F.2d 969, 975 (2d Cir. 1974).

⁷⁷ *Ibid.*

⁷⁸ ICC Rules of Arbitration, Art. 35.

⁷⁹ New York Convention, Art. V(1)(e).

⁸⁰ For a recent discussion of such decisions, see Emmanuel Gaillard, *Legal Theory of International Arbitration* 135–143 (2010, Martinus Nijhoff Publishers).

⁸¹ *Seller v. Buyer*, Final award in case no. 5946 of 1990, *supra* n. 18.

sitting in Switzerland even if the arbitral tribunal must decide a dispute according to a law that may allow punitive or exemplary damages as such⁸²

(iii) Refusal to award punitive damages in light of their incompatibility with the public policy of probable enforcement jurisdictions

The concern of arbitral tribunals with the enforceability of their award may prompt those tribunals to deny a request for punitive relief if it is unlikely that a punitive award can be enforced in the relevant foreign jurisdictions. An arbitral tribunal sitting in New York, for example, may be reluctant to award punitive damages in a case brought by an American claimant against a German respondent, considering that it would most probably be impossible to enforce such an award in the respondent's home jurisdiction. To this author's knowledge, there are no reported cases where arbitral tribunals have expressly adopted this line of reasoning, but their natural interest in the award's enforceability suggests that it is likely that arbitral tribunals should take those considerations into account.

Two practical questions arise in this respect. The first one pertains to the determination of the relevant enforcement jurisdiction(s). When deciding whether to grant a party's request for punitive damages, arbitral tribunals will seek to determine whether and, if so, in which jurisdiction(s), such an award could be enforced. This analysis should take into account both legal factors (such as the applicable legal framework governing enforcement of foreign arbitral awards) and matters of fact (notably the localization of the relevant party's assets). Arbitral tribunals may not necessarily be in possession of all the relevant information and it is debatable to what extent they should proactively investigate these issues.

The second question relates to the possibility to enforce the non-punitive portion of an arbitral award. If such a partial enforcement of an arbitral award is possible, then the incentive for arbitrators to refrain from awarding punitive damages would be more limited. While this article is not the proper forum for a detailed comparative study of the possibility of partial enforcement of arbitral awards, no specific objections to such a possibility come to mind. As a practical matter, it is thus vital for arbitral tribunals clearly to distinguish between the amounts of compensatory and punitive damages awarded.

VI. CONCLUSION

To a large extent, punitive damages in international commercial arbitration remain a theoretical, as opposed to practical, issue. Depending on the way in which one defines the 'internationality' of international commercial arbitration, punitive arbitral awards are either inexistent or extremely rare. Doctrinal contributions focus on punitive arbitral awards in domestic US arbitration; where they address the availability of this remedy in an international context, they are largely speculative.

⁸² *Ibid.* at 113.

As has been shown, the reasons for the limited relevance of punitive damages for the practice of international commercial arbitration are essentially twofold. First, such damages are only recognized in, and available under the laws of, a very limited number of countries. Second, in most countries, punitive relief is not only unavailable, but also considered contrary to public policy. Thus, both the availability and the enforceability of punitive damages awards in international commercial arbitration are severely restricted.

However, the current status quo should not be viewed as excluding the possibility for punitive damages to play a more significant role in the future. Evolutions could take place at two levels. First, as far as the legal status of punitive damages in civil law countries is concerned, the traditional hostility vis-à-vis this remedy may be progressively declining. Second, as a matter of arbitration law, the pro-enforcement bias of the New York Convention and restrictive interpretation of the public policy exception suggest that domestic courts may, on future occasions, view punitive arbitral awards more favourably than punitive judgments.

Yet, even if those changes take place, it is undeniable that punitive damages will necessarily remain an exceptional remedy in the context of international commercial arbitration. In fact, punitive damages are an inherently extraordinary remedy requiring conduct of exceptional gravity on the part of the defendant. Moreover, punitive damages for breach of contract – which is almost always the type of claim involved in international commercial arbitration – are only recognized in the US and Canada, and only in limited circumstances.